The internationalization of commercial real estate markets in France and Germany

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journals.sagepub.com/home/cch **Gertjan Wijburg and Manuel B Aalbers**

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Abstract

This paper investigates the internationalization of the commercial real estate markets of France and Germany, markets typically ignored in comparative political economy. Although both markets are embedded in Continental European capitalism, their trajectories of internationalization are variegated. After exploring how processes of internationalization are processed within each country, we show how these processes have played out in the commercial real estate markets of France and Germany. The French state played a key role in guiding processes of internationalization: the introduction of new tax regimes allowed French property companies to raise capital at the stock exchange. The case of Germany demonstrates the continued importance of the banking sector for real estate investment markets. Although the typical characteristics of the French and German political economies are strengthened in this process, agents also feel the need to respond to the interests of international investors by creating Real Estate Investment Trust-like systems to absorb domestic and foreign capital.

Keywords

Internationalization, financialization, liberalization, commercial real estate, coordinated market economies, France, Germany

Introduction

The Continental European model of capitalism has long been perceived as the counterexample of the Anglo-Saxon model of capitalism (Albert, 1991; Crouch and Streeck, 1997; Shonfield, 1965). Over the past few decades, however, the literature has documented how Continental European economies such as France and Germany have liberalized and

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internationalized their modes of economic organization (Amable, 2003; O'Sullivan, 2007; Streeck, 2009). As a consequence, it could be argued that the coordinated market economies (CMEs) of Continental Europe have become more similar to Anglophone liberal market economies (LMEs) (Hardie and Howarth, 2009; Lapavistas and Powell, 2013; Streeck, 2013).

Although the literature has emphasized how processes of internationalization and financialization have deeply transformed major domains of Continental European economies, a crucial sector often remains understudied: commercial real estate. This is a missed opportunity since the emergence of deep and liquid real estate investment markets in Continental Europe largely coincides with major reforms in financial systems and corporate governance regimes. In recent decades, real estate markets have radically adjusted to international capital flows and increasingly are integrated in international financial markets (see, e.g. Gotham, 2012; Leitner, 1994; Lizieri, 2009). While European integration as well as financial and technological innovations has reduced barriers to foreign ownership (Coakley, 1994; Pryke, 1994), cross-border investment flows in European real estate markets have increased dramatically (Baum, 2001; Lizieri et al., 2003). At the height of the most recent investment cycle, between 2003 and 2007, global investment funds and other foreign investors pushed the office rents to unprecedented levels (Savills Research, 2014).

Based on the comparative political economy literature we can expect that both the degree and effects of the liberalization of real estate markets differ between countries. Simply put, one would expect more open, international markets in LMEs and more closed, less international markets in CMEs (Hall and Soskice, 2001). Yet, since the property boom of the 1980s, the real estate investment markets of CMEs have become integrated in and through international financial markets and largely suited to the needs of international institutional investors (Fernandez and Aalbers, 2016; Lizieri, 2009; Nappi-Choulet, 2012). The literature shows how key agents in Continental Europe have attempted to strengthen their domestic market position in response to the challenges of internationalization, either through the adaptation of Anglo-American investment practices (Just, 2010; Theurillat et al., 2008; Van Loon and Aalbers, 2017) or by reforming domestic markets (Bastard, 2011; Berry et al., 1999; Boisnier, 2011). Indeed, internationalization has not merely increased the role of international investors; it has also forced domestic agents to compete with foreigners and to consolidate their national interests (Crouch, 2005; Deeg and Jackson, 2007; Theurillat et al., 2014).

To understand how internationalization has forced domestic financial agents to consolidate their national market interests, this paper seeks to understand major changes in the real estate investment markets of two key Continental European capitalist economies: France and Germany. Although traditionally considered illiquid markets, the real estate investment markets of Germany and France are now the second and third largest within the European Union (CBRE Research, 2011; FSIF, 2010; Savills Research, 2014) – and once the Brexit has been carried out, they will be the largest two. Global investment funds have played a key role in transforming the investment markets of France and Germany. But rather than diminishing the activities of domestic financial agents, these agents, supported by the state, were able to consolidate their domestic market position. In France, the state introduced a new tax regime that contributed to the emergence of a listed real estate sector, which allowed French property companies to become more competitive by raising foreign capital at the stock exchange (Boisnier, 2011; FSIF, 2010; Nappi-Choulet, 2012). In Germany, the traditionally dominant non-listed and bank-related real estate sector could respond more autonomously

to the challenges of internationalization (Just, 2010; Pfnür, 2013; Rohmert, 2013). We contribute not only to the comparative political economy literature but also to the real estate literature by demonstrating how domestic financial actors respond to the internationalization of commercial real estate markets.

This paper derives its findings from studying primary and secondary sources, including 20 semi-structured interviews with real estate and finance professionals in Frankfurt am Main (Germany) and Paris (France) in 2014 and 2015. These professionals include CEOs, managing directors, fund managers and senior analysts of various real estate funds and companies. In addition, we have also analysed the commercial real estate transaction databases of BNP Paribas Real Estate and CBRE Research. By calculating the net investment turnover (acquisitions minus sales) of major investment groups in the property markets of Germany and France, we are able to differentiate between the investment flows of different types of investors before and after the global financial crisis (GFC). Rather than presenting the absolute levels of investments in commercial real estate, we focus on the net turnover in order to centre on which types of agents are expanding in or retracting from the investment market.

The outline of this paper is as follows. The next section discusses the model of Continental European capitalism and shows how processes of internationalization have been processed within the wider political economies of France and Germany. We then discuss the internationalization of the commercial real estate investment markets, demonstrating the rise of a listed real estate sector in France and the continued importance of banks in the German commercial real estate market. We conclude that the commercial real estate markets of CMEs have opened up to international flows on finance, but that this has not necessarily resulted in a diminished role of domestic agents. Indeed, the state has facilitated these actors, but it is important to note that the role of the state in CMEs is internally variegated as France and Germany have followed different paths to open up their markets while protecting key domestic agents.

Internationalization of the Continental European model

In the comparative political economy literature, France and Germany traditionally have been known as the key examples of Continental European capitalism (Albert, 1991; Amable, 2003; Shonfield, 1965; Zysman, 1983). Continental European capitalism, like other CMEs, is typified as a non-liberal form of economic organization (Amable, 2003; Höpner, 2007), whereby patterns of shareholding and crossholdings between large banks, firms and (local) states limit the autonomy of 'free' markets (Jackson and Deeg, 2012; Streeck and Thelen, 2005). Unlike LMEs, the social organization of Continental European countries is 'premised on a logic of high commitments, patience, and stability and are underlaid by a Fordist coalition of workers and managers that prefers to see some key institutional aspects of society under democratic and bureaucratic control' (Engelen et al., 2010: 57). The importance of banks in funding private enterprises, combined with relatively small and undeveloped capital markets, has largely protected firms against hostile takeovers (Höpner and Jackson, 2006; Jackson and Deeg, 2012; Johal and Leaver, 2007). Instead, a major feature of Continental European capitalism is its supposedly stable and inward-looking corporate governance model that revolves around associational networks of organized private enterprise, often guided by the state or large banking groups (Amable, 2003; Jackson and Deeg, 2012).

There is of course not one single form of Continental European capitalism: whereas France is known as a more centrally guided political economy, characterized by *dirigiste* state intervention, Germany is regarded as the prototype of an insider-controlled, stakeholder-oriented political economy in which banks play a central role and in which a dense network of firms, banks and insurance companies forms the institutional foundation for organized private enterprise (Fichtner, 2015; Howarth, 2013; O'Sullivan, 2007; Streeck, 2009). However, the end of post-war prosperity, the crisis of Fordism and high inflation undermined the structural foundations of the political economies of France and Germany (Albert, 1991; Amable, 2003; Streeck, 2013). The pressures to reposition the model of Continental European capitalism on a global scale increased (Hardie and Howarth, 2009). As a consequence, CMEs have not only become more similar to LMEs (Hardie and Howarth, 2009; Lapavistas and Powell, 2013; Streeck, 2013), but have also opened up their insider-controlled corporate governance model to international institutional investors (Höpner and Jackson, 2006; Johal and Leaver, 2007).

The internationalization of the French domestic economy started in the early 1980s. Initially, the French government sought to protect its economy by nationalizing major French banks and firms (Boyer, 1997; Clift, 2012; Howell, 2009). Mounting debt levels, however, encouraged the French government to privatize its public banks and firms (O'Sullivan, 2007; Schmidt, 2003). By the mid-1980s, the French state opted for a network economy, whereby public corporations were gradually privatized by selling them to 'friendly' cross-shareholders of French nationality (Hancké, 1999; Johal and Leaver, 2007). In the 1990s, European integration and the globalization of financial markets undermined the French network economy (Morin, 2000): international institutional investors were able to acquire shares of French corporations and started introducing new regimes of accountability and profitability. Some feared that French corporations now would be subject to Anglo-Saxon forms of management (Morin, 2000).

Similarly, the West German government initially sought to protect its model of Continental European capitalism by upholding the interests of organized private enterprise and by allowing public debt levels to increase (Amable, 2003; Höpner and Krempel, 2004). However, the shock of German reunification exhausted the capacity of the German federal government to do so (Streeck, 1997). During the 1990s, the German government stimulated the disintegration of the network of cross-shareholdings in Germany by encouraging large German firms and commercial banks to sell their stocks and to raise liquidity in and through international financial markets (Nölke and Vliegthart, 2009; Streeck, 2009). The 'KonTraG' law, which abolished the tax on the sale of block-holdings of corporations in other firms, reinforced the liberalization of Germany's company network and facilitated the arrival of international institutional investors and hedge funds that were keen on buying German stocks (Fichtner, 2015; Höpner and Jackson, 2006). Like their counterparts in France, these new financial agents immediately started demanding shareholder value and changing the corporate governance model of German corporations (Lütz, 2000; Vitols, 2004).

Despite the dissolution of insider-dominated regimes of corporate governance in France and Germany (Culpepper, 2005; Hall and Soskice, 2001), internationalization has not undermined the Continental European model per se (Amable, 2003; Hay, 2004). Responding to the challenges of internationalization, the French government has not fully liberalized the autonomy of 'free' markets, but has sought to regulate and modify the outcomes of internationalization by giving a dense corporate network of French CEOs a large degree of local

autonomy and managerial competence (O'Sullivan, 2007; Schmidt, 2003). Although the French government has shaken off its post-war *dirigisme* (Clift, 2012; Howell, 2009) by privatizing public companies and banks, it continues to guide and modify economic relations and transformations of the French economy. The *post-dirigiste* strategy of the French government is characterized by a paradoxical 'retreat from interventionism in the economy, and the increasing exposure of the institutions of the French economy to international market forces' (Howarth, 2013: 388). Hence, joint-stock companies and commercial banks are encouraged to attract foreign capital and to expand abroad, but also to consolidate domestic market operations, using foreign capital as a lever (see, e.g. Dixon, 2010; Johal and Leaver, 2007).

Rather than resulting in the complete dismantling of its Continental European features, the internationalization of the German political economy has provided a window of opportunity for German commercial banks and large firms to escape the strongholds of German corporatism by expanding their activities in international financial markets (Mertens, 2017; Nölke and Vliegthart, 2009). The literature has widely documented how the largest German firms and commercial banks listed on the stock exchange – Deutsche Bank being a typical example (Hardie and Howarth, 2009) – have disintegrated from the associational network that once formed the corporate governance model of the German economy (Fichtner, 2014; Höpner, 2007). However, beyond this select group of firms, the corporate governance model of Germany has remained fairly in place (Jackson and Deeg, 2012; Streeck, 2009). For instance, public and cooperative banks still operate within a relatively strict regulatory framework (Lehrer and Celo, 2016; but see Hendrikse, 2015: chapter 3).

In sum, the Continental European economies of France and Germany have opened up their insider-controlled corporate governance models to foreign investors. However, the degree of internationalization has been different in both countries and has not resulted in the rise of 'free', liberal markets. In France, under supervision of the state, domestic actors and joint-stock companies started attracting foreign capital to consolidate their domestic market activities and to expand abroad. In Germany, only the largest listed companies and commercial banks expanded abroad and became subject to Anglo-Saxon forms of management. At least until recently, a large part of the German economy still revolves around associational networks wherein German banks play a key role.

The internationalization of commercial real estate in France and Germany

The previous section has explained why the internationalization of CMEs has not resulted in convergence along the lines of LMEs. Rather, internationalization has been processed differently in the political economies of France and Germany. In France, the state has sought to guide the directions of internationalization. In Germany, the banking sector has done so. These patterns have also shaped the trajectories of internationalization of the commercial real estate markets of both countries. During the post-war era, commercial real estate investment in Germany and France largely responded to the need to boost national industries and to accompany post-war spaces of production (Albert, 1991; Shonfield, 1965). Both markets were locally organized, financed by local banks or families and real estate properties were often held on the balance sheets of firms and corporations (Pfnür, 2013).

However, following European integration, financial liberalization and economic globalization in the 1980s and 1990s, international institutional investors have entered the property

markets of France and Germany. Against this background, the internationalization of Continental European investment markets is often operationalized as the acceleration of cross-border investment flows (Just, 2010; Nappi-Choulet, 2013). Although we do acknowledge the role of international institutional investors in France and Germany, our focus is on how domestic financial agents, supported by the state, have sought to strengthen their market position in their domestic investment markets. In France, the rise of a listed real estate sector exemplifies how the state has sought to protect domestic market interests by allowing the French property sector to raise foreign capital at the French stock exchange. In Germany, where foreign competitors appeared relatively late in the mid-2000s, the insider-controlled, non-listed real estate sector, traditionally owned by the German banks, blocked the transition towards a more international, transparent and liquid investment market. The liquidity crisis of German open-ended funds, however, has raised questions concerning the regulatory framework of the German property sector.

This section is informed by various primary and secondary sources, including 20 interviews with real estate and finance professionals in France and Germany. We have adopted a methodology of ‘process tracing’, whereby we have used the interviews to identify key decision points and movements to draw out the internationalization of both markets in time and space (for a similar research strategy, see Hendrikse and Sidaway, 2014). We have first conducted 14 semi-structured, in-depth interviews in Frankfurt am Main between October and December 2014, which also included various exploratory interviews to learn more about commercial real estate markets in general. Subsequently, we have conducted six interviews in Paris between October and December 2015.

The interviews have informed our research in three ways. First, the interviews have helped us to refine and to nuance some ‘popular’ claims on internationalization that we had found in newspaper articles and business magazines. Second, the interviews were indispensable for gathering some market-specific information on property investment in both countries. In some cases, interviewees have also provided internal documents and real estate data. Third, the interviews made us aware that we should not only focus on the GFC and its aftermath, but also take into account the 1980’s property boom and the 1990’s property crisis as events that put institutional change in motion.

Drawing on our interviews, we have reconstructed a historical narrative for both markets, while focusing on a sequence of events: the reconstruction of the post-war markets, the 1980’s property boom, the 1990’s property crisis, the GFC and its aftermath. Specifically, we have focused on how the domestic markets have responded to the 1990’s property crisis and to foreign competition. While doing so, it was also useful to study the house price dynamics in both countries. Although housing markets typically are less volatile they have followed a similar pattern as the commercial markets, especially between 2003 and 2007 in France and from 2009 onwards in Germany (Wijburg, 2017; Wijburg and Aalbers, 2017). However, while both markets are fundamentally different, we have not fully elaborated on the similarities and differences.¹

The rise of a listed real estate sector in France

In the decades after World War II, the commercial investment market in France emerged in the so-called Golden Triangle of inner Paris. The Golden Triangle, which is mainly located in the Eight Arrondissement, including the Arc de Triomphe, the Place de La Concorde and the Boulevard Haussmann, was already the city’s financial hub during the 19th century

(Nappi-Choulet, 1998). Although the post-war French state was primarily concerned with managing industrial relations to launch French national industry (Boyer, 1997), it also provided the legal framework for a moderate investment market during the 1960s. The tax regime of *Société Civile de Placement Immobilier* (SCPI) allowed French commercial banks to develop public funds (open ended and closed end) that could invest in real estate on behalf of French households (Bastard, 2011). The tax regime of *Sociétés Immobilières pour le Commerce et l'Industrie* (SICOMI) provided an archetypical structure for commercial leasing and property finance.

Financial reforms in the 1980s and the 1990s resulted in the lifting of post-war credit restrictions to mortgage lending and property development (Nappi-Choulet, 1998). As a result, French commercial banks and real estate developers increasingly turned towards property construction and launched an unprecedented property boom in Paris (Nappi-Choulet, 2013). While the city of Paris was becoming a global city, the property boom of the 1980s was underpinned by the expectation that Paris required an almost infinite supply of new 'glitzy office space' (Ball, 1994; Pryke, 1994). The French state also played a key role here: in an attempt to rival with London as a 'national champion', it orchestrated the construction of a new business district, La Défense (Crouch and Le Galès, 2012).

The 1980's property boom was largely triggered by excessive credit availability and came to a sudden halt when the global economy moved into a deep recession in the 1990s (Lizieri, 2009; Wissoker et al., 2014) in which the SCPIs and SICOMIs suffered terrible losses (Nappi-Choulet, 1998). The property crisis of the 1990s, which also resulted in a severe banking crisis, marked the arrival of international institutional investors in the investment market of France (Halbert, 2013). Buying cheap and selling high, American private equity and hedge funds profited from the fall in property prices (Nappi-Choulet, 2013). It was expected that the property sector of France (largely located in the Greater Paris region) would soon recover (Crouch and Le Galès, 2012), American hedge funds and other foreign institutional investors speculated on future property prices (Nappi-Choulet, 1998). Figure 1, which illustrates an historical account of the transaction volume in the Greater Paris region, shows the increased importance of foreign investors in the French investment market in the 1990s.

The arrival of international institutional investors was seen as an undesirable development that undermined the long-term stability of the French property market. Introducing new modes of accountability and profitability, American hedge funds took full advantage of the French property crisis and neglected corporate real estate management (Nappi-Choulet, 2013). The French government perceived the arrival of international institutional investors as a threat to domestic interests and wished to protect the market better (Boisnier, 2011). Against the background of various capital market reforms in the mid-1990s, the post-dirigiste French state therefore introduced a new tax regime named *Société d'Investissement Immobilier Cotée* (SIIC) in 2003 (AMF, 2003). SIICs allowed French property companies to trade commercial real estate on the French stock exchange (Nappi-Choulet, 2013). As such, the property market would become less dependent on bank loans and could refinance itself through the capital market (KPMG, 2013). Like their American counterpart, real estate investment trusts (REITs), the SIICs are fiscally transparent investment vehicles that focus on investments in income-producing real estate assets (Boisnier, 2011; FSIF, 2010).

The introduction of a fiscally transparent listed real estate sector can be seen as a strategy of the French post-dirigiste government to modify the internationalization of the French

Figure 1. Investment volume in the Greater Paris region in billions of Euros (1990–2012, nominal).
Source: Adapted from Nappi-Choulet (2013).

investment market (Boisnier, 2011). On the one hand, the SIIC regime enabled real estate companies to increase their liquidity by raising capital on the stock exchange (KPMG, 2013). On the other hand, the introduction of SIICs also responded to the demand from large French corporations to divest their commercial real estate assets in order to raise shareholder value and to focus on ‘core activities’ (FSIF, 2010; Guironnet et al., 2015). Hence, the SIIC tax regime allowed large French firms to sell their corporate real estate assets without paying corporate taxes and by leasing them back from joint-stock real estate companies (KPMG, 2013).

Between 2003 and 2007, the French listed real estate market would develop into the largest of Europe (Boisnier, 2011; FSIF, 2010). Through mergers and acquisitions a few listed real estate companies in France could develop into Europe’s largest in terms of portfolio size and market capitalization (FSIF, 2010). As Figure 2 shows, the net investment turnover (total acquisitions minus total sales) of SIICs amounted to EUR5 billion in 2007; in contrast, the net turnover of non-French REITs was only two billion. In other words, the French property sector had accomplished to take control over the domestic market; tapping from the pool of foreign capital provided a viable answer to the 1990’s property and banking crisis (Boisnier, 2011; FSIF, 2010).

Although the SIICs generally had performed better than other French joint-stock companies during the GFC (IEIF, 2014), a decline in share prices overshadowed their pre-crisis performance (Boisnier, 2011). The SIICs had to sell some of their assets and relocated their post-crisis investment activities to other countries until the French market recovered (Boisnier, 2011). The retreat of the SIICs also can be related to a change in monetary politics from the European Central Bank. During the pre-crisis investment cycle, the SIICs thrived on financial leverage and securitized loans (FSIF, 2010). These options exhausted in the wake of the GFC, since the sovereign debt crisis in the faltering Eurozone triggered the

Figure 2. Commercial real estate transactions in France in billions of Euros (2000–2015, nominal). Source: CBRE Research (2016) and author's own calculations.

European Central Bank to implement stress tests and to introduce new capital requirements for European banks (Hardie and Howarth, 2009; Howarth and Quaglia, 2013a).

Nonetheless, the retreat of the SIICs did not imply that the French market of listed real estate stopped growing. In 2007 the French government introduced the new tax regime of *Organisme de Placement en Immobilier* (OPCI). The introduction of OPCIs was meant to gradually replace the SCPIs and to make French investment funds more competitive, flexible and transparent, thereby also attracting investments of French households (De Vignet de Vendeuil et al., 2007). Unlike SCPIs, OPCIs are equipped with the additional capability to invest in listed real estate companies (De Vignet de Vendeuil et al., 2007). Furthermore, OPCIs can be established as either public funds or special purpose funds for institutional investors (Bastard, 2011). Strategically positioned between non-listed and listed real estate investment, OPCIs mark another stage in the evolution of the French investment market (Bastard, 2011). As Figure 2 shows, the OPCIs reached a net investment of EUR2 billion in 2013. French pension funds, that had taken big hits in the 1990's property crisis, became important investors in OPCIs.

The introduction of OPCIs has not resulted in the progressive withdrawal from SCPIs as expected at their introduction. After Mario Draghi's famous proclamation in 2012 to do 'whatever it takes' to rescue the Euro, the European Central Bank under his presidency lowered interests rate to an all-time low, officially to stimulate investments in the Eurozone (Howarth and Quaglia, 2013b). The low interest rate environment was an incentive for French investment funds to borrow cheap capital and to reinvest it in real estate. In addition, the low interest rates on savings accounts pushed French households towards SCPIs (Bastard, 2011). Against the odds, the SCPIs became major buyers during the post-crisis investment cycle (net turnover of EUR3 billion). This example shows that the non-listed real estate sector in France has not become obsolete: while SCPIs only invest directly in real estate, they are able to realize higher profits than OPCIs, as long as the capital costs remain

low (Bastard, 2011). Nonetheless, the rise of the SIICs and the OPCIs indicates that the French property sector has increasingly turned towards listed real estate, a development that is likely to continue in the future.

The continued importance of banks in Germany

During the post-war era, West Germany did not have a prime city like Paris for France. Berlin was divided by allied troops and instead, a polycentric structure emerged with Berlin, Düsseldorf, Frankfurt, Hamburg, Munich, Cologne (often together with Bonn) and Stuttgart – the so-called Big Seven – as the major cities of commercial interest (Rohmert, 2013). The post-war German investment market largely co-evolved with Germany's banking sector (Voigtländer, 2010). From the 1960s onwards, German banks (both public and commercial) started collecting capital from German households to invest it on their behalf in commercial real estate assets. Open-ended funds allowed German households to invest small amounts of their savings in real estate with the possibility to redeem their shares at any time (Just, 2010; Pfnür, 2013). Closed-end funds, which mainly invest on behalf of private investors, did not have this redemption option (Rohmert, 2013).

During the 1980s, the lifting of credit restrictions fuelled a property boom in West Germany, in particular in Frankfurt, West Germany's major financial centre (Ploeger, 2004; Rohmert, 2013). Upon German reunification, West German banks and real estate developers also started constructing and investing in East Germany (Mertens, 2014). To facilitate the inclusion in Reunified Germany, it was expected that a wide range of commercial real estate buildings had to be built in East Germany. The property boom was also largely encouraged by the Kohl administration that provided tax breaks to stimulate investments in the East and to prevent that too many (economic) migrants from the East would come to the West (Mertens, 2014; Rohmert, 2013). Hence, the post-unification construction boom was seen as a window of opportunity by German investment funds, commercial banks and real estate developers.

However, the property boom in Reunified Germany was underpinned by the belief that East Germany would 'catch up' with the economy of West Germany (Uffer, 2011). In reality, 36 years of socialism had left the built environment and the labour market in many East German cities in an idle state (Michelsen and Weiß, 2010). Many East German cities did not develop immediately into 'mature' capitalist markets that could position themselves in the global economy (Glock and Häußermann, 2004). The new capital of Berlin only developed into a commercial hub that matches the demands of commercial real estate investors in the early 21st century (Uffer, 2011). Institutional investors continued to perceive the German market as somewhat backward and illiquid. Figure 3 shows how during the mid-1990s commercial real estate investment in Germany was still predominantly domestic in nature.

Substantial reforms in the property sector of Germany were not implemented during the early 2000s (Berry et al., 1999). Instead, the German government focused on strengthening the expansion of banking models and trade balances overseas and neglected the domestic property sector (Fichtner, 2015; Höpner, 2007). The non-listed real estate sector with its close ties to the German banks absorbed most of the market pressures related to European integration and the internationalization of finance (Rohmert, 2013). Unlike in France, the German government did not push for the provision of a radically new institutional framework for listed real estate vehicles (Amable, 2003; Berry et al., 1999). This can also be explained by the fact that international institutional investors had not yet entered the

Figure 3. Investment volume in the 'Big Seven' of Germany in billions of Euros (1990–2012, nominal). Source: Bulwiengesa AG (2016) and author's own calculations.

German investment market, which allowed the status quo to be maintained (Kofner, 2012; Wijburg and Aalbers, 2017). Simultaneously, German open-ended funds started buying foreign real estate properties, in particular in the Greater Paris region and Eastern Europe (Bitterer and Heeg, 2012; Nappi-Choulet, 2013).

Yet, during the early 2000s cheap credit and new financial instruments triggered a new investment boom in European property markets (Fernandez and Aalbers, 2016; Lizieri, 2009). The financial expansion of global investment funds initially focused on the property markets of the United Kingdom and Southern Europe (Lizieri, 2009). As these markets saturated, international institutional investors discovered that German real estate prices in 2003 were at the lowest point in decades (Rohmert, 2013). American private equity and hedge funds started buying commercial real estate assets with the intention to resell at higher prices in the near future. As Figure 4 shows, in 2007 private equity funds had a net investment turnover of EUR10 billion and listed funds of EUR5 billion.

Most global investment funds had focused on highly leveraged investments in the top segment of the German market, typically buying portfolios priced over EUR200 million (Heeg and Dörry, 2009). The high net turnover of private equity and listed funds conceals that German investment funds had also sought to profit from the global investment boom (Rohmert, 2013); the *Spezialfonds* (special purpose funds) and open-ended funds stand out. *Spezialfonds* are public funds for institutional investors that have existed since 1968 and are mostly managed by public and commercial banks. Historically, effective demand from institutional investors for *Spezialfonds* has been low (Pfnür, 2013). Yet, *Spezialfonds* gained popularity in the late 1990s when institutional investors discovered that commercial real estate provided relatively stable and moderate cash flows (Berry et al., 1999). In 2007, the *Spezialfonds* displayed an investment net turnover of EUR2 billion.

The activity of open-ended funds is even more striking (net turnover of minus EUR6 billion in 2006). Selling a majority of their real estate assets to private equity funds, German open-ended funds had taken full advantage of the increased liquidity in the market and the demand of foreign investors for German real estate (Just, 2010).

Figure 4. Commercial real estate transactions in Germany in billions of Euros (2000–2013, nominal). Source: BNP Paribas Real Estate (2016) and author's own calculations.

However, open-ended funds had also leveraged their funds with investment capital from institutional investors. By design, open-ended funds allow investors to redeem their investments anytime they want (Berry et al., 1999). Between 2005 and 2007, international institutional investors started redeeming their invested capital as they expected that the investment boom was turning into a bubble (Rohmert, 2013). This created the equivalent of a bank run on German open-ended funds and many funds were forced to sell large parts of their portfolios (Lizieri, 2009). Consequently, this resulted in a liquidity crisis whereby many open-ended funds plunged into underperformance and bankruptcy (Just, 2010).

The post-GFC investment market was temporally disrupted by the banking crisis and the retreat of international institutional investors. The liquidity crisis of German open-ended funds also sparked some new developments. On the one hand, the Spezialfonds initiated a rescue pact of several illiquid open-ended funds that struggled with selling their properties (Scharmanski, 2012). This manifestation is represented by a net turnover of EUR2 billion in 2011. On the other hand, the German state recognized that serious reforms were needed to solve the liquidity crisis. The implementation of the German Capital Investment Code in 2013 was necessary to increase the transparency of the funds and to restore investor confidence (Rohmert, 2013). An important part of the new Investment Code is that the option of daily share redemption from investors in open-ended funds was significantly reduced. At the same time, fund managers of open-ended funds were obliged to become more transparent in their investment practices and strategies (Himbert, 2014).

In another attempt to regulate the post-GFC investment market, the German state implemented a new tax regime in 2007: the G-REIT. Much like the American REITs or the French SIIC, the G-REIT allowed the German property sector to attract foreign capital at the German stock exchange and to increase the liquidity from investment funds. The

G-REIT was implemented to make the market more professional and to increase fiscal transparency (Voigtländer, 2010). However, its introduction coincided with the GFC: due to bad timing the expected public offerings of new listed real estate companies have remained limited (Rohmert, 2013). To a large extent, this can be explained by the fact that the non-listed real estate sector in Germany is traditionally dominant and still has several advantages compared to the new tax regime of the G-REIT (Pfnür, 2013; Voigtländer, 2010). For now, the incentive for German banks and investment funds to transfer their real estate portfolio into a capital market structure is not strong enough.

The recent developments in the German property sector have reinforced the debate whether more serious reforms are necessary. For instance, German pension funds traditionally guarantee fixed returns on investments (*Garantiezins*), which is difficult in the current low-interest environment. As returns on stocks and bonds have declined during and after the GFC, pension funds expanded their investments in real estate in the post-GFC years (Scharmanski, 2012). As this interviewee proclaimed: ‘today, when we invest in bonds or in stocks, the level of the yield is too low. Our clients are now asking us to buy real estate, to generate yields of 4% or 5% that cannot be generated in the capital market’ (Interview with a CEO of a pension fund, November 2014, NRW). This development is reflected in a net turnover of EUR2 billion in 2012 and indicates that commercial real estate has become an important outlet for institutional investors in Germany (Heeg and Dörry, 2009). However, the expansion of a listed real estate sector could offer these financial agents more possibilities to optimize their investment flows: investing directly or in a German Spezialfond or G-REIT.

Discussion and conclusion

Ever since the property boom of the 1990s, international investors have entered the property markets of Continental European countries. This has resulted in the idea that a global hegemony of foreign investment funds has taken a majority control over the property markets of Continental Europe, including France and Germany. This paper has gone beyond the key role of global investment funds and has highlighted how domestic financial agents in France and Germany have responded to the challenges of internationalization by consolidating their domestic interests. We have mobilized CPE to come to a better understanding of the continued variegation in commercial real estate markets in CMEs but have also enriched CPE with an analysis of a market to which it had hitherto paid little attention. Commercial real estate markets are of particular interest because they are heavily tied to both national and international finance, but also because of the tension between location and liquidity. Real estate is by definition spatially fixed, but during the last decades it has been remade into an increasingly liquid asset class (Van Loon and Aalbers, 2017). As we have demonstrated in this paper, the creation of liquidity out of spatial fixity (Gotham, 2012) is highly variegated within the two major CMEs of Continental Europe.

Where the property crisis in France already began in the mid-1990s, foreign investors entered the Parisian market during the mid-1990s and sought to profit from the falling property prices. American private equity and hedge funds introduced new modes of profitability but also undermined long-term stability. The French state perceived the arrival of foreign investors as a potential threat to the French property companies and implemented a new tax regime that allowed these companies to launch publicly listed real estate vehicles known as SIICs. As such, the French property sector could attract foreign capital and increase

liquidity, while enjoying new tax advantages. The rise of the SIICs was a major driver of the French investment boom of 2003–2007. In 2007, another major reform followed: the new tax regime of OPCI would gradually replace the old one of SCPI and transform French investment funds into ‘hybrids’ that could invest both in listed and non-listed real estate, with investments from not only institutional investors but also the general public. These vehicles have contributed to the rise of the listed real estate sector in France. Yet, the OPCIs have not fully replaced the SCPIs. In the contemporary low-interest environment, the SCPIs still have a comparative advantage: because they invest only directly in real estate, the SCPIs are able to realize higher profits, as long as the capital costs remain low. Rather than seeing the French commercial real estate market being swallowed up by a globally active investment funds, international capital has been absorbed by French listed real estate funds.

Due to the shocks of German reunification, the momentum for internationalization arrived relatively late. During the 1990s, international investors considered the federally organized German property sector as somewhat backward and illiquid that still had to ‘catch up’ with international trends. Major reforms in the German property sector were not implemented in the 2000s. Rather, the German state encouraged German firms and banks to expand abroad and to use positive balances of trade for capital accumulation in emerging economies. Between 2003 and 2007, American private equity and hedge funds entered the market and invested unprecedented amounts of capital in the German property sector. However, the traditionally dominant non-listed investment funds in Germany also responded. The German *Spezialfonds* were able to invest above their historical average because they collected capital from pension funds and insurance companies. Open-ended funds absorbed international capital flows and sought to provide high returns, something that resulted in a liquidity crisis when investors started redeeming their investment capital in 2007–2008. Some of these funds have recently been bailed out by German *Spezialfonds*, but the crisis of German open-ended funds has not been solved yet. In the aftermath of the GFC, the German state has introduced a new Investment Code to make the non-listed real estate sector stronger. This sector continues to rely heavily on the liquidity of banks: raising capital at the stock exchange is not possible. Contrary to France, the introduction of the G-REIT in 2007 has so far made little difference; the German preference for non-listed real estate remains strong.

Although the commercial real estate markets of France and Germany have opened up to global capital, they have not converged to a LME model. Despite the inflow of foreign capital these markets remain firmly embedded in their respective CME models. In France, we see the development of a post-dirigisme that extends to investment markets and facilitates foreign and domestic investment in French listed and mixed real estate funds that are similar to REITs yet typically French in their structure. In Germany we see a delayed entry of foreign capital: private equity and hedge funds massively buy up real estate portfolios (both commercial and residential) but we also see a strengthening of the existing bonds between banking and real estate. As private equity funds partly retreat from German real estate in the post-GFC years, it is the typically German *Spezialfonds*, among others, that expand their market share. Although the French and German political economies keep – and even strengthen – some of their typical characteristics, agents in both countries also feel the need to respond to the interest of international investors by creating REIT-like systems to absorb domestic and foreign capital.

Changes to real estate investment markets are crucial to the political economies of France and Germany. Not only is real estate a key arena to study the existing variegation within

Continental Capitalism, real estate investment has also become increasingly important to the economies of both countries. The listed real estate market of Germany and France is now the biggest of Continental Europe. Furthermore, real estate investment has become a standard investment class for households in both countries and wealth management by French and German institutional investors increasingly relies on investments in commercial real estate. The controlled opening up to internationalization in France squares with wider trends in the French political economy. Similarly, the continued importance of banks indicates that Germany's dominant banking sector also takes an important share in the real estate business. Finally, in both countries we see how the state facilitates this process while simultaneously creating favourable conditions for select domestic investors (cf. Nölke et al., 2013; Stockhammer, 2008).

Although this paper has applied a comparative political economy lens, it is noted that the critical connections between political economy, commercial real estate and European property markets could be made more explicit by follow-up studies. For instance, the wider connections between the consolidation of Germany's non-listed real estate sector and Germany's bank-dominated financial system are only touched upon here (for a deeper analysis, see Berry et al., 1999; Pfnür, 2013). The same goes for the intricate relationships between France's post-dirigiste financial system and the push for a listed real estate sector by the French Financial Authority (AMF, 2003; Hardie and Howarth, 2009). However, future market changes in European property markets will also be associated with wider dynamics in the *global* political economy. In this regard, a more fine-grained analysis is needed to denote the linkages between commercial real estate investors, offshore finance and the shadow banking system (Fernandez and Aalbers, 2016; cf. Garcia-Bernardo et al., 2017; Haberly and Wójcik, 2015). If, as some studies have suggested (e.g. Boisnier, 2011; Kofner, 2012; Lizieri, 2009), European investment funds use offshore centres to invest in their home markets, another complex layer needs to be added to the fundamental interplay between domestic and non-domestic investment flows.

Another open question regards the connections between commercial real estate investors, global finance and *urban* political economy. During European investment booms, some investment funds strategically move away from prime markets like Paris and Frankfurt, and start investing in the urban periphery or in mid-sized cities (see, e.g. Savini and Aalbers, 2016). It has been well documented that European cities are becoming a reserve currency for domestic and non-domestic investment funds (Fernandez et al., 2016; Guironnet et al., 2015). French SIICs are known to be deeply involved in major urban redevelopment projects in the Greater Paris region (Boisnier, 2011; Enright, 2012). By contrast, the few listed real estate companies in Germany are mainly involved in the residential sector, where the market potential is considered higher (Wijburg and Aalbers, 2017). The wider involvement of commercial real estate investors in urban redevelopment projects may provide more evidence that domestic investors have a home advantage over their foreign competitors.

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Note

1. Institutional investors in France still hold residential portfolios but tend to invest in commercial real estate through REITs. The state encourages private investors to invest in private rental housing. In Germany, by contrast, large housing portfolios increasingly are owned by listed real estate companies. However, institutional investors prefer to invest in commercial real estate through non-listed investment funds.

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