The last three years have been particularly difficult for the German open end funds industry. Even more so than in the past, where investments in German open end funds (GOEF) were regarded as extremely prudent, this situation has changed dramatically since the beginning of the recent financial turmoil.

Investors withdrew a large proportion of their capital from retail funds, forcing some of these funds to close to prevent firesales in which the remaining investors would inevitably lose money. Meanwhile, some funds liquidated their assets completely and vanished from the market. Against this backdrop, the government decided to reform the investment legislation concerning GOEFs. One focal point of the new legislation (AnsFuG), which is due to take effect in January 2013, is the introduction of a 24-month lock-up period and a redemption notice period of 12 months. In addition, the debt ratio is to be capped at 30%. These rules apply to the traditional retail funds and retail funds for institutional investors but not to the Spezialfonds, as illustrated in figure one.

Institutional investors shift their capital from German Open End Retail Funds to Spezialfonds due to new legislation

- Reform of German open end funds is welcomed by institutional investors and fund managers
- Retail fund sector will downsize but Spezialfonds will flourish
- An effect of the new legislation on prices and transaction in the European real estate markets is unlikely

FIGURE 1: TYPOLOGY OF GOEF

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The interviews conducted with fund managers and institutional investors made it clear that GOEFs remain an important asset class in the German property market. This is the case for long-term investors who prefer less volatile cash-flows, particularly as they do not consider any other German domiciled products as alternatives. Consequently, most investors and fund managers welcome the reform and conclude that the product will become healthier and even more attractive.

A downsizing in the retail fund sector, nevertheless, is inevitable. With liquidations on-going and institutional and private investors shifting capital, the net asset value of the sector will decrease from €85 billion to roughly €65 billion. Especially the net asset values of institutional retail funds, which are specifically designed for smaller institutional investors, are expected to halve their values to €5 billion. The exit of institutional investors will have a significant impact on the providers of retail funds and local banks will become an increasingly important distribution channel. As a consequence, a market concentration is expected. In the end, it is not implausible to assume that, of a current 14 providers, only half will still be active in the medium-term. Given this, mergers of retail GOEFs are a distinct possibility.

In contrast to retail funds, allocation to Spezialfonds are likely to grow. The net asset values are expected to increase by more than 20% to a value of roughly €38 billion. Most investors agree on shifting capital from retail funds to Spezialfonds. For 64.3% of institutional investors Spezialfonds are the preferred future investment vehicle as shown in figure two.

REITs, direct investments or Luxembourg funds, do not fit into the investment strategies of typical institutional retail GOEFs. Therefore, it can be concluded that the Spezialfonds sector, although dampened by other reforms, such as Solvency II, will be given an extra boost by the AnsfuG reform.

On the other hand, some smaller institutional investors which are typical for the German market, such as insurance or pension funds, face minimum investment amounts of €5 million for Spezialfonds which might be too high. Thus, the industry should look for solutions for these smaller investors, like pooling investment amounts of smaller investors for Spezialfonds.

Spezialfonds are thus the winners of the reform and will gain more and more in importance.

Since most capital is shifted within the GOEF sector and not to other real estate investments, 59% of respondents do not think there will be an impact of the reform on prices and transactions across the German and European real estate market.

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**OTHER KEY HIGHLIGHTS**

- Cap on leverage ratios held responsible for diminishing the possibility of hedging currency risks.
- Decrease of debt ratio assumed by 80% of fund managers.
- Uncertainty of the effects on returns.
- Minimum effect on country allocation and liquidity management.