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Interview with Dr. Reinhard Kutscher, DIFA



Places & spaces – DIFA's real estate magazine - spoke with DIFA board member Reinhard Kutscher about portfolio restructuring in DIFA's funds, and the opportunities offered by emerging markets (Date of publication of places & spaces will be 17 october 2006)

Mr. Kutscher, DIFA is currently taking advantage of the strong demand from foreign investors to restructure its portfolio. What strategy are you using for your open-ended real estate funds?

Our strategy is to keep the funds within a certain range which depends on their different profiles, and which is defined over the long term. For every fund there is a target range for the amount of investment in Germany. At present, DIFA-Fonds Nr.1 and DIFA-GRUND are at the upper end of this range, meaning that it's time for a restructuring. We also want to use the strong investor demand to cut back cluster risks in the fund. With other products such as DIFA-Global and DIFA Immo-Invest, on the other hand, we are not only investing abroad, but also continuing to use opportunities in this country.

Where exactly are the opportunities for DIFA in Germany?

The German office property market has reached the bottom end of its downwards trend. At the same time, this once more means there's potential for rent increases. Foreign investors have also noticed this development and many have come to realise that comparatively interesting initial returns can be made in Germany. This explains why property portfolios are sometimes sold at a relatively high price. We also want to use this trend in demand for further sales. On the other hand, there are interesting individual properties where an increase would pay off for

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DIFA, so it is quite possible that there will be buying and selling in the same market.

Is DIFA also planning other products in the property asset class in future?

That is indeed an important topic that we're actively working on in view of the keen interest in property investment among institutional investors. Two years ago, we launched the DIFA Immo-Invest fund, which is aimed at institutional investors, with sums starting at 1 million euros. This fund has had an excellent reception, and we are preparing other new investment vehicles.

Beside the sales in Germany, you're currently investing in new markets – which ones?

Property markets, especially outside the eurozone, are characterised by different cycles. International diversification brings with it the chance to use the right moment for entry. Outside the established core markets, there are regions which have not yet been discovered by international investors, so the initial returns we find there are at a different level to those in Europe or the USA. We make the most of it. But return is also always a function of risk, which is why we need to get involved in these emerging markets, develop contacts and know-how, carefully check investment opportunities, then make the plunge and buy them. That's what we did in Mexico, for example, and we're the only open-ended real estate fund to have done so yet.

What is the attraction for you to enter these emerging markets now?

If you enter a market early on, you profit from rising prices afterwards, but far more important are basic factors such as the financial background, political security and, of course, any risks. Another fundamental criterion is the stability and volume of the market, which also needs to be large enough to provide an exit. Chances and risks need to be balanced. In the end you're left with a few investment locations where the opportunities clearly prevail.

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And how are things in Mexico?

In Mexico we still have initial returns of 8 percent, whereas in the USA they are between 5 and 6 percent. Mexico has the potential to continue developing stably, so it fulfils our requirements. Of course, investing does not just run on its own. You have to be involved locally, above all with local partners, When you buy your first property, suddenly people in that country also want to talk to you, and that generates new potential. After we became involved in the Torre Mayor in Mexico City – probably the best office building in all Central and South America – other new paths opened up immediately. Since then, we have developed a small portfolio of six properties in Mexico, which pays off for our investors.

You are also currently buying in Asia. Can you tell us specifically where and why the continent is so interesting?

Asia is a region which basically fulfils all the requirements for property investment. However, you soon realise that in the region, there is a lot of money looking for a place to invest, so there aren't a lot of investment opportunities. There are huge markets there, but rarely any suitable properties. The office market in Tokyo, for example, is the biggest in the world, with 80 million square metres of floor space, yet the transaction volume is relatively low. The most interesting properties generally go to Japanese REITs. Foreign investors need patience and good contacts. It's similar in Korea – we've only just been able to make our first purchase in Seoul after a long preparation period.

Can your investment model for Mexico also be transferred onto Asia?

At present we're actively looking again in Seoul and in China, particularly Shanghai. We're also interested in Singapore. In Hong Kong, the time is not right for buying at the moment, as the market there has already gone through strong rent increases. In general, we're interested in office and retail property, and in principle also in hotel investment with rental contracts. We're also acquiring properties in the capitals of Malaysia and

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Thailand, and of course, India is an important future market. When we go out to acquire properties, in the back of our mind there is always the desire to develop small to medium-sized portfolios in the target markets, step by step.

DIFA is among the German investors who've invested in Turkey. What makes the country so interesting?

The first property that we bought was a shopping centre development in Mersin. Completed properties in Turkey are hard to find or do not live up to our demand for quality, which leads us along the path of taking part in third parties' project developments. The way purchasing power has developed in Turkey means that the demand for shopping centres is rising markedly. Turks absolutely love shopping and have a taste for consumerism, and increasingly have the financial opportunities for it. Today, there is growing affluence among the middle classes.

Yet you are continuing to invest in the core markets of France, Germany and Britain. Are you pressing on with project development there?

Yes, within limits. We are not buying properties and then developing them ourselves as speculators, but instead buying projects from third parties, such as in Mersin, but also in Paris, London and southern Spain. The advantage of this is that we are buying a new product, and at the same time we get higher initial returns due to the risk we are taking on. This is limited, however, as we do not take on the risks of the whole project and construction – the project developer has to cover that side, although we do share the rental risks. We see this model as a good way of getting decent returns for our fund in what is otherwise a very aggressive pricing environment.

Reinhard Kutscher has been a DIFA board member since 1999. Among other things, his areas of responsibility include international asset management.

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