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Real Estate

Austria

Trends & Developments

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Trends and Developments

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Real Estate Investments

After several years of growth climaxing in a record-breaking year 2019, the Austrian institutional real estate investment market saw new challenges arising from the COVID-19 pandemic and the ensuing crisis (COVID-19).

While one might assume that the overall economic downturn as well as the general decrease in investment volume would affect all asset classes in the same negative way, a closer look reveals that the impact of COVID-19 actually varies widely. This article will examine the development of the various asset classes over the past year and give an outlook on what might be expected from the market in 2021.

Hotels

Unsurprisingly, the hotel sector was (or rather is) hit disproportionately hard by COVID-19, suffering from the government-ordered lockdown for roughly 4.5 months in 2020 (and ongoing until at least Easter 2021) and from the massive and continuing worldwide travel restrictions. The number of transactions and the investment volume declined significantly in the past year, and the market has almost come to a halt.

On the one hand, the governmental aid programmes and measures as well as standstill agreements with financing banks have prevented impending fire sales and/or insolvencies. On the other hand, potential investors bailed out of hotel development projects, which therefore had to be postponed or converted into residential and/or long-stay concepts.

The recovery of the market will likely gain momentum once the lockdowns end, as travelling will once again be possible based on sufficient immunisation rates and/or rigorous testing, and hotels will be allowed to reopen. Meanwhile, several investors are on the lookout for fire sales, which are expected to occur once governmental aid runs out and/or financing banks call in loans over the course of 2021.

The speed of recovery in the market is projected to vary within the sector. While the demand for travel for leisure purposes is expected to skyrocket after the lockdowns (which also significantly fosters the realisation of leisure buy-to-let concepts in Austria), business travel might recover at a slower pace as businesses have to cut expenses and COVID-19 has proven that video conferences can be a viable substitute, at least to some extent.

Residential

In comparison, the residential real estate sector in Austria has proven to be highly resilient. Despite a short halt in construction at the beginning of the first lockdown in March 2020 and some difficulties with cross-border traffic relating to foreign construction workers, developers quickly adapted and implemented the required measures. The number of completed residential units peaked in 2020, encountering a high demand from institutional as well as private investors, which led to a further increase in purchase prices.

More than ever, residential real estate is considered to be a very secure and stable investment, as institutional (as well as private) investors need to place their funds and financing is available at low cost. While the completion of new projects is expected to decrease slightly in 2021, the broad investor base and the high overall demand will likely lead to a further increase in purchase prices.

Institutional

In 2020 the institutional investment volume in Austria amounted to around EUR3.3 billion in total, with the office sector holding a share of about 33%, proving that office space is a crisis-resistant asset class. About 121,000 sq m of office space were completed in Vienna in 2020, about 75% of which had already been pre-let. Rents for office buildings in Vienna have also not been heavily affected by the COVID-19 crisis so far. The low completion output in the office asset class, however, will hinder a strong investment increase in 2021.

Retail

Like hotels, the lockdown measures enacted in Austria resulted in heavy collapse in turnover in the retail sector, with the exceptions of food and online retail. The clothing sector was hit especially hard. As a result of the situation, comparatively little new space was rented out in 2020. Due to the capping of state aid payments and the expiry of other tenant supporting measures, a wave of insolvencies is expected for 2021.

The completion level of around 48,000 sq m of new retail space in shopping centres and retail parks was similar to 2019. The largest opening in 2020 was the 21,000 sq m Pado Gallerien in Parndorf, Burgenland. Insolvencies, declining rents and higher vacancy rates are expected to lead to lower property values for retail properties.

Logistics

With an investment volume of about EUR450 million, industrial and logistics were the third strongest asset classes in 2020, with German investors taking the major share. For example, DEKA acquired two further construction phases of the Industrial Campus Vienna East.

From an investor's perspective, the legal ramifications of the governmental measures to combat COVID-19 (business closures, restrictions on entering, etc) on already concluded lease agreements are of particular importance. The Austrian Civil Code already includes provisions governing precisely these situations, granting the tenant the right to withhold rent payments (including service charges) if the leased object cannot be used for the agreed purpose at all, or (in most instances) the right to reduce rent payments proportionally in case of partial unfitness for the agreed purpose. If this condition lasts for an extended period of time, the tenant is even entitled to terminate the lease agreement for cause. Despite these provisions being more than 100 years old and of a dispositive nature, they received little to no attention before March 2020.

Real Estate Finance

Due to COVID-19, real estate financing varied significantly between asset classes in 2020. While residential real estate performed strongly, new financings of other asset classes, such as retail, hotels and offices, were hit hard. The prices for residential real estate, especially single family houses, continued to rise, with an increase of 9.5% in the 3rd quarter of 2020, which can be attributed partially to the home office trend (Austrian National Bank Real Estate Report Q4). Similarly, the boom in housing loans to private households has not slowed down, but rather showed an increase of 6% in the 3rd quarter of 2020 compared to 2019.

The banks have somewhat tightened their lending requirements for housing loans, yet the average interest rate was 1.28% in September 2020, marking a decrease of 29 basis points compared to 2019. In other asset classes, new finance transactions have slowed down or postponed due to COVID-19, and the origination market almost came to a halt.

Existing debt

For existing projects, especially hotel and retail assets, 2020 was marked by COVID-19-related standstill agreements, covenant resets and state financial support in the form of guarantees, grants and repayable advances. For private debt and loans to micro-enterprises, a statutory moratorium was introduced by the 4th COVID-19 Act and the 2nd COVID-19 Justice-Accompanying Act on repayment of loan agreements concluded before 15 March 2020.

From a legal point of view, the extraordinary termination rights in respect of loan agreements (Article 987 of the Austrian Civil Code) if maintaining the credit relationship becomes unbearable for important cause (*aus wichtigen Gründen unzumutbar*) for a party came into focus for the first time. This relatively new law was introduced as a consequence of the last financial crisis, and has been relatively untested to date.

Moreover, not only "LMA style" debt documentation but also Austrian "in-house" loan agreements and the general terms and conditions (GTCs) of Austrian banks typically contain material adverse condition (MAC) provisions that entitle a lender to terminate an agreement and cancel commitments. The GTCs also often foresee the right to unilaterally adjust margins or to request the granting of additional collateral in the material deterioration of the financial condition of a borrower or its assets or a significant decrease of the value of the collateral granted (eg, substantial deterioration of stocks held by a borrower). However, the lender's rights under such MAC provisions and GTCs are limited by law, and such provisions could be invalid if not objectively justified. In particular, careful legal assessment is recommended if a MAC event would be based on the occurrence of a crisis event only and thus would not have immediate (threatening) effect on the financial condition or the business of a borrower, its assets or the granted collateral itself.

It remains to be seen whether lenders would base a termination of a loan solely on this provision, but given that mandatory closures of assets due to COVID-19 are no longer expected to be the norm, it is believed that discussions around this issue will cease.

On the other hand, no specific statutory "force majeure" provisions exist under Austrian law that would entitle a borrower to prevent a MAC termination by a lender in the case of a crisis.

New debt/debt origination

Article 991 of the Austrian Civil Code entitles a lender to refuse payouts if, after the conclusion of a loan agreement, circumstances arise that result in a deterioration of the financial condition of a borrower or respective collateral, provided that such event endangers the repayment of the loan or the payment of interest (also taking potential enforcement proceeds from collateral into consideration). Article 991 was also passed in the context of the last financial crisis, and has been relatively untested thus far. It is recommendable to contractually address, specify or exclude the application of Article 991 (which is not mandatory law) when entering into a new financing or amending existing financing as a consequence of a crisis.

2021 is expected to be marked by large restructuring processes for asset classes that have been heavily affected by COVID-19. Standstill agreements and state support measures will run out and financing will need to be adjusted to new profitability and business plans. On the originator side, there is willingness and ability to invest. Interest rates are expected to remain low, with the trend moving towards fixed interest rates.

However, loan documentation is becoming more lender-friendly, with covenants becoming tighter, especially with respect to the senior debt capability (eg, LTV based financing), and transferability in respect for lenders loosening up. It is likely that this will also cause mezzanine financing to emerge for several asset classes in Austria to fill in the new gap from senior debt. From a legal point of view, this will likely increase the complexity of real estate finance deals, as mezzanine structures and intercreditor relationships with senior lenders are still a relatively new product so no general market standard exists, unlike in many other neighbouring countries (Germany in particular). Moreover, significant ad valorem registration costs for mortgages (1.2% of the amount to be secured) require careful deal structuring when handling several creditor classes for a real estate financing.

Green finance

Apart from COVID-19, green finance for assets is on the rise and is definitely here to stay. The Taxonomy Regulation (EU 2020/852) came into force in July 2020 and tasked the European Commission with establishing an actual list of environmentally sustainable activities by defining technical screening criteria for each environmental objective through delegated acts, which is set to be implemented by 2022.

Green finance is already strong on the debt capital markets and bonded loan (*Schuldschein*) side, but is not yet widespread for real estate project finance. Currently, "green" real estate loans are predominantly linked to the mere green certification of the asset (following completion) without real covenant or pricing effect for the financing, and thus are treated rather as a marketing tool. This will change soon though, as the European Green Deal is putting pressure on the industry to reduce CO2 emissions and to channel funds into sustainable investments.

Real Estate Construction – Going, Going and Going

COVID-19 and the consequent economic crisis do not seem to have affected the construction industry in Austria. Contractors' order books are as full as they were in previous years, and construction projects keep coming. This is particularly true for residential developments.

In Lower Austria, for example, more apartments were built than ever before in 2020, with 7,900 units completed; Vienna also reached a peak of 18,500 completed units. COVID-19 and the 2020 lockdowns have not significantly delayed the industry's schedules, even though leading Austrian construction firms deliberately let thousands of employees go in March and April 2020 (to only re-employ them shortly after).

However, the future seems bright, given that more than 40,000 additional residential units are currently in the approval process or have already been approved in Vienna alone, keeping the construction companies busy until mid-2022. Furthermore, the EU's Green Deal and the shift to renewables are providing the Austrian construction industry with new and additional opportunities.

The most significant projects currently under way or planned are as follows.

- Vienna Twentytwo – currently one of the largest residential projects in Vienna. By 2024/25, a mixed-use tower 155 m high and a residential high-rise of 110 m will be built on an area of around 15,000 sq m in the 22nd district in Vienna. The total net floor area will be approximately 80,000 sq m, containing around 600 new apartments and also a hotel and commercial space. The project is being carried out by a joint venture consisting of SIGNA and ARE - Austrian Real Estate.

- TrIIIple – three towers with a height of around 100 m each will be completed by 2021 directly at the Danube Canal in Vienna's 3rd district. These three towers will contain approximately 500 residential units and 670 apartments for students and young professionals, with a net floor area of around 70,000 sq m. The EUR300 million-plus project is being developed by a co-operation between SORAVIA and ARE - Austrian Real Estate.
- Althan Quartier – a broad mix of offices, co-working spaces, restaurants/bars, shops and apartments is being created, with a total net area of 130,000 sq m, on the site of the former Franz-Josef railway station. The newly created offices are expected to create around 2,500 jobs in the district. The developer is the Austrian company 6B47. Completion of the entire project is scheduled for 2023.
- Wohngarten – Viennese real estate developer INVESTER United-Benefits is currently developing 682 apartments with a total usable area of 35,000 sq m. Completion is scheduled for the end of 2021. The project has already been sold to ZBI Zentral Boden Immobiliengruppe and their open investment fund AIF "Unilimmo: Wohnen ZBI".
- S1 Viennese Outer-ring highway Schwechat–Suessenbrunn – with a total investment volume of around EUR1.9 billion, a new highway will be built between Schwechat and Suessenbrunn from 2021 onwards. This route will likely relieve the busy southeast highway (A 23) and close the ring of motorways and expressways around Vienna. The new highway will be approximately 19 km long, containing more than 8 km of tunnels.
- Wildgarten – 1,100 residential units on approximately 11 hectares at Rosenhügel in Vienna's 12th district are currently under construction. The entire project has a total floor space of around 82,000 sq m, and will be completed by 2023. Interestingly, this project does not contain any high-rises but will consist of three buildings, each having up to eight floors. 46,000 sq m of the project site will be a green recreational area.
- Brennerbasistunnel – one of Europe's main infrastructure projects is finally under construction after years of planning. The tunnel will be approximately 55 km long and will establish a new and direct connection between Innsbruck and Franzenfeste through the core of the Alps. When completed, it will be one of the world's longest train tunnels. Completion is currently scheduled for 2028.

Summary

The Austrian real estate industry proved to be crisis-resistant, and one of the stabilising factors of the Austrian economy. Of course, developments vary from asset class to asset class, and some recently hyped asset classes will go through heavy restructurings in the near future. However, this will create new opportunities. If all this is combined with "green" standards, it might even be a chance for the future of the environment.

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