Factors Influencing
German Private Equity Investment in US Real Estate

by

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B.Sc. Architecture
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Submitted to the Department of Urban Studies and Planning
in partial fulfillment of the requirements for the degree of

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ABSTRACT

This thesis identifies and ranks in order of importance the key factors influencing high
net-worth German investors’ decisions about US real estate private equity investments. Through research and in-depth interviews with key clients and investment advisors of Taurus Investment Holdings, LLC, each factor is examined based on available data and is ranked in a significance hierarchy according to client responses. Interview results indicate that “Higher Expected Returns in US Real Estate,” “Trust in the Investment Advisor/Company,” and “Diversification” are the three most influential factors for investor decisions about US real estate investment. Investors reported that exogenous factors such as German and US tax laws, US economic/political climate, and currency exchange rates are not as important. However, these exogenous factors are intimately linked to the more personal factors: both rational (Higher expected returns in US real estate, Diversification benefits) and emotional ones (Trust in the Investment Advisor). Furthermore, investors’ decisions to invest in US real estate is crucially dependent on their trust in the investment advisor, regardless of high promised returns or diversification benefits. In a global recession where the sagging US economy and the weakening US dollar have eroded the returns for German investors with US real estate investments, the element of trust is more important than ever. A carefully chosen US investment advisor / partner plays a critical role in accomplishing investment objectives and achieving optimal results for German investors.

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Factors influencing
German Private Equity Investment in US Real Estate

1 Introduction

Foreign investment in US real estate is a vital component of the US economy. German investors have been major players in the US real estate market for many years. Which factors weigh most heavily on German investors’ decision to invest in US real estate, given the recent changes in the global economy? How will these recent changes influence investor decisions?

This study identifies, examines, and ranks the factors influencing German investor decisions:

- Diversification
- Currency Exchange Rate
- Taxation
  - German tax laws
  - US tax laws
- US economic climate
- US political climate
- Higher expected returns in US real estate than returns in German real estate
- Perceived safety or low risk of returns in US real estate
- Strategic reasons
- Trust in Investment Advisor/Company

On a micro-level, understanding Germans’ investment decision-making enables US real estate advisors to compete effectively in the marketplace -- by implementing strategies and offering products and services that satisfy client demands. On a macro-level, it sheds light on the historic patterns of German investment in US real estate, and offers an investment outlook given recent changes in the global market.
2 Literature Review and Synthesis

2.1 Significance of Foreign Investment in US Real Estate

Foreign investment in US real estate plays an important role in the US economy. It not only provides capital to support the US real estate industry, but also influences domestic interest rates and job growth. In return, US real estate provides foreign investors with many benefits such as diversification, favorable tax treatment, and solid returns.

"Foreign investment in US real estate increased to $44 billion in 2001, up from $38 billion in 1997." This increase of nearly 16 percent during the five-year period was due to a variety of factors: “the globalization of the real estate industry and the broader inflow of foreign investment caused by favorable macroeconomic conditions in the US and weak conditions abroad.”

Despite the recent recession and the Iraq War, an AFIRE (Association of Foreign Investors in Real Estate) survey indicates that foreign investors maintain strong

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Figure 2-1: Foreign Investment in US Office Properties

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confidence in US real estate. The US ranked first among other regions for “offering the most stable and secure real estate investments; the best opportunity for capital appreciation; and the best risk-adjusted potential return.”

Future foreign capital influx to US markets depends on how well foreign investors can achieve their investment objectives given the growth prospects for the US economy and real estate market, relative to those of foreign economies.

2.2 German Foreign Investment: Recent History
German investors have not been major investors in US real estate until the mid-1990s. “From 1994 through 1995, the amount of total reported foreign direct investment in US real estate decreased from $28.5 billion to $26.5 billion, according to the Commerce Department. Only Germany and some East Asian countries bucked the trend. German investment crept up 3.9 percent, from $1.22 billion to $1.26 billion.”

In the mid-1990s, German real estate investment pools and wealthy individuals were very active in the US real estate market. “In retreat from often disastrous real estate spending in eastern Germany, leery of rising prices in Europe and skeptical of the euro, Europe's proposed single currency, German investors have spent $1 billion-plus on U.S. property [in 1996], more than double what they spent in 1995, estimates Jim Reid, who directs international investment for CB Commercial.”

Since then, Germans have become one of the leading sources of new foreign direct investment in US real estate: “They relish property ‘because two times in this century they lost their currency,’ notes Albert Behler, chief executive officer of Paramount

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Group, which invests in U.S. real estate for the Otto family, mail order titans from Hamburg.”

In 1996, German investors (with $1.6 billion invested) ranked seventh among sources of foreign investment in American property. In 1998, German investments totaled $3.5 billion, and Germany ranked fourth behind the Netherlands, Canada and Japan. According to AFIRE, Germans accounted for 40% of all new US property investment in 1998, up from 22% in 1997.

After more than a year of curtailed investment activity triggered by the weak euro, German investors returned to the US real estate market in summer of 2001, reviving languishing markets such as Washington DC, Boston and Los Angeles.

According to a March 3, 2003 Financial Times article, “Old Europe” is still pouring money into the US: “Germans bought at least $3.9bn worth of US commercial property in 2002 – half of the approximately $7.9bn of properties acquired by foreign investors last year . . . That is nearly double the $1.5bn acquired the year before.”

Ten years ago, German investors won the bidding for blue-chip New York City trophies as Lever House and the Seagram Building. Today, Germans are active investors in office buildings, apartments, and regional malls. And, they are still purchasing landmark sites, such as 1 Times Square in Manhattan.

The recent slowdown in the US economy led to shrinking returns to German investors, due to falling rents and high vacancy rates. Moreover, the relations between the US and

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10 Ibid.
Germany have soured over military action in Iraq.\textsuperscript{15} In addition, some investors are concerned about the uncertainty of the weakening US dollar, the lack of good opportunities in the recession, and the increased competition from pension funds, REITs and other domestic buyers.\textsuperscript{16}

Will these changes reduce the inflow of German capital into the US property market? For now, there appears to be no slowdown in the transatlantic flow of capital. Joachim Seeler, managing director of HGA Capital, said, “There is still a lot of confidence in the US economy.”\textsuperscript{17} For the most part, recent research and this study’s investor interviews confirm his view.

\subsection*{2.2.1 Why Germans Invest in US Real Estate}
Traditionally, US real estate has been an attractive investment alternative to European real estate because it provides “portfolio diversification, favorable tax treatment and the potential for higher yields without sacrificing stability.”\textsuperscript{18} Furthermore, the increased flow of German capital into US real estate may be attributed to “stable currency exchange rates, weakness in world equity markets and low interest rates that contribute to low returns from savings accounts and other forms of debt investing in Germany.”\textsuperscript{19}

Below are the oft-cited reasons for German investment in US real estate, which are explored later in the paper:

- Diversification Benefits\textsuperscript{20,21}
- Stable Currency Exchange Rate\textsuperscript{22}

\textsuperscript{21} Brown, Steve. \textit{Non-US investors tap into Dallas real estate.} The Dallas Morning News. 01/10/2003.
• Favorable Tax Treatment\textsuperscript{23}
• US Economic / Political Stability\textsuperscript{24}
• Higher returns than European real estate\textsuperscript{25,26}
• Perceived safety or low risk of returns in US real estate\textsuperscript{27}
• Weak German economy\textsuperscript{28}

A recent AFIRE annual survey indicates that the primary reason for US investments is “favorable risk-adjusted return” (45 percent of respondents), “US market fundamentals” (36.5%), “stability” (23.5%), diversification (20%), and US economy (10%). One respondent stated, “Real estate in the US benefits from political and economic stability, population and job growth, and a transparency of information and data. US real estate has low risk and a strong legal system to protect investment. It is still the most stable market in the world.”\textsuperscript{29}

2.2.2 Investment Preferences

A Jones Lang LaSalle survey in 2000 revealed the following investor preferences.\textsuperscript{30}

• **Product Type** – “Historically, most German investors have concentrated on fully leased, class A office properties. Although this sector is still the preferred choice, a wider product range is now being considered. A large number of investors have expressed interest in retail properties (64

http://www.realtor.org/IntUpdt.nsf/0/67011a3b5977245786256b7c00730136?OpenDocument
percent) but still have only minimal interest in hotels (18 percent), industrial property (14 percent), development scenarios (14 percent), [and] residential property (5 percent).”

- **Tenancy Profile** – “The majority of investors are interested in multi-tenant property, with only 18 percent focusing solely on single tenant properties. However, they continue to specify income security as one of the highest priorities, as well as long lease terms.”

- **Geographic Diversity** -- “The survey indicated no clear preference among investors with regard to CBD versus suburban locations; 64 percent confirmed that they would consider both.” The top seven preferred locations are Atlanta, Boston, Washington DC, New York City, Dallas, Chicago and Florida.

- **Structure** – “Investors continue to seek 100 percent acquisition opportunities but have also begun to consider opportunities where they take a smaller equity position. Surprisingly, 59 percent of all respondents stated that they would consider joint venture arrangements. Almost one quarter (23 percent) expressed a definite interest in indirect investments such as investments in private operating companies and REITs. A further 23 percent stated that they would not rule out indirect investment.”

- **Leverage** – “The majority of respondents (82 percent) ideally seek to leverage acquisitions with a conservative amount of mortgage financing. Loan to value ratio preferences range from 40 percent to 80 percent. In general, the average ratio is a relatively conservative 50 percent. . . Based on financing preferences, the survey inquired about targeted return from both leveraged and unleveraged scenarios. Of all respondents, 64 percent target an initial unleveraged return of 8 percent to 10 percent; 27 percent will accept a lower initial return range of 6 percent to 8 percent; and 5 percent seek return in the 10 percent to 12 percent range. Due to fluctuations in the euro/dollar exchange rate and increased interest rates in the United States, most respondents were not prepared to commit to a specified target range for a leveraged investment.”
• **Holding Period and Exit Strategy** -- “The exit strategy planned by individual investors spans a broad range, but the most favored holding period is between five and 10 years.”

2.2.3 **Major Categories of German Investors**

- Open-ended funds
  i.e. BfG ImmoInvest, DESPA and WestInvest.
- Close-ended funds
  i.e. Jamestown, Bayernfonds, and KanAm.
- Insurance Companies
  i.e. Allianz, Ergo and Gothaer
- Pension funds
  i.e. BVV, Siemens, Bayer, and BASF
- Spezialfonds
  i.e. Oppenheim and MEAG
- Property Companies
  i.e. IVG, Stodieck, BauVerein
- Private investors
  i.e. high net worth individuals or families
- Banks
  i.e. Rheinhyp.

2.3 **Private Equity Investment Vehicles for Germans**

This paper focuses on “Private Investors” investing via US Real Estate Investment Advisory Companies. However, US REITs and Open- and Close-ended German Funds are briefly discussed here as other investment vehicles.

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2.3.1 US REITs (Brief Overview)

"AFIRE members cite the public REIT sector as the second most attractive US real estate opportunity for their firm, after direct equity investment. Respondents indicated dividend yield (38%), liquidity (24%), and diversification (19%) as the primary reasons for investing in US public REITs." 32

2.3.2 Open- and Close-ended German Funds (Brief Overview)

German funds have been placing capital in US real estate for 20 years. The capital flow slowed during the 1990s, first as investors turned to real estate opportunities in the former East Germany after reunification and then as they turned to the stocks of technology companies." 33 After the stock market crashed, investors are again shifting their capital towards US real estate.

“For many investors, private indirect vehicles are an important and growing part of their overall real estate investment strategies. These vehicles are not publicly quoted on stock markets. German private indirect vehicles that target private individuals have a combined value of over €217 billion." 34 “Investors that are seeking to invest in overseas real estate are attracted to private indirect vehicles mainly because they offer: access to product, access to local management, access to specific sectors/countries, access to geared returns." 35

The July 2002 changes to German investment laws allowed operators of open-end funds and spezialfonds to invest more capital outside Europe and to have more flexibility through joint ventures deals. 36 "The influx of equity and credit into the US real estate market that is expected to result . . . may help keep mortgage rates low and push up

35 Ibid.
prices for some commercial projects.”37 Although flush with capital to invest in US real estate, German funds have difficulties in finding opportunities that offer high enough yields [above 8%] to satisfy their investors.38

2.3.3 US Real Estate Investment Advisory Companies (Main Focus of Paper)

According to Raymond C. Mikulich, a managing director with Lehman Brothers Inc., New York, since the early 1990s, there have been many wealthy, European private investors or families looking at US property markets.39 These investors usually invest in small lot sizes (up to €10 million per property), seeking “to build personal assets, to pursue tax advantages or to seek long-term increases in value.” 40 Some high net worth families (such as the Mann and Quandt families) and individuals have invested hundreds of millions of dollars in the US, either directly or through asset management organizations.41

Taurus Investment Holdings, LLC, is an example of a US Real Estate Investment Advisory Company. “Founded in 1976 as a leading real estate advisor to wealthy European families and several prominent German and Swiss institutions, Taurus is one of the premier owner-operators of both directly managed and joint venture commercial real estate throughout the eastern United States and Canada. Since its inception, Taurus has purchased and sold over 10 million square feet of office, industrial, retail, residential and hotel assets. Taurus is widely recognized as a strategic real estate owner-operator specializing in value creation through a mix of development, redevelopment, lease-up and intensive professional management of each individual investment. Through the combination of its US regional office platform and extensive European resources, Taurus

41 Ibid.
successfully brings together a unique blend of local entrepreneurship with global financial strength.\(^{42}\)

Taurus differs from Open- and Close-ended Funds in the following ways\(^ {43}\):

- Taurus does not offer funds, but shares in Limited Partnerships, with Taurus as the General Partner and the Investor as the Limited Partner. Taurus only earns money after the investors receive their share.
- Taurus Limited Partnerships usually hold only one building, which makes the risk/return ratio very clear and transparent.
- The number of investors per deal is significantly lower than in most funds.
- The holdings periods of Taurus deals are usually five years -- shorter than with closed funds.
- In comparison to open funds, Taurus investments are rather illiquid, though there is a unregulated secondary market for LP shares.
- Most Taurus Investments are entrepreneurial – focusing on the capital gain at the end of an investment (while protecting the principal against any losses); whereas, open-ended funds usually focus on distributions.
- Taurus’ upfront fees are significantly lower than those of most funds, allowing Taurus to have minimal overhead.
- Taurus does not invest in "trophy" buildings that only look good in a brochure but do not satisfy return ambitions.
- Taurus' clients consist of high net worth individuals that are experienced investors, family offices, investment advisors, and private banks. The investment amount of $100,000 is a general minimum for participation.

It is clear that German investors interested in US real estate can privately invest through a variety of vehicles: US REITs, German funds, and US real estate investment advisory companies. Investors’ reasons for preferring one vehicle to another are varied and

\(^{42}\) Comparison provided by Johannes Goderbauer of Taurus Investment Holdings, LLC.

\(^{43}\) Comparison provided by Johannes Goderbauer of Taurus Investment Holdings, LLC.
idiosyncratic. This study focuses on private German investors investing through US real estate investment advisory companies. The next section examines the factors that impact these investors’ decisions.

2.4 Discussion of the factors influencing German investment decisions

2.4.1 Diversification

German investors invest in US real estate in order to diversify their portfolios to reduce risks and increase the likelihood of higher returns.

*Increasing Risk-Adjusted Returns*

"Because the benefits of international portfolio diversification are mainly due to low co-movements between different national asset-markets, adding real estate into an international portfolio of stocks and bonds should improve the benefits from international portfolio diversification substantially." 44

A 2002 study examined the “diversification potential of integrating US real estate investments in international investment portfolios.” 45 Analyses were conducted with data from 1985 to 2001, in the perspectives a German investor vs. a US investor. “In order to study the influence of the currency risk for international investments, the analyses have been undertaken with and without hedging the currency risk.” 46 “In the ex post perspective, significant diversification benefits appeared for both investors through the consideration of real estate companies . . . The source of these diversification gains was risk-reduction. The additional application of the optimal currency hedging also brought significant gains.” 47

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45 Ibid.
46 Ibid.
47 Ibid.
Currency Diversification

Investing in US real estate allows Germans to diversify into dollar-denominated assets. “United States real estate offers foreign investors diversification of their investment portfolios so that their assets are not fully tied to the health of their domestic economy.”

Asset Class Diversification

“After the crash of the Neuer Markt, the stock market for small, mostly technology-related companies, investors who had lost money on equity investments were scared away from the stock market.” Edmund Craston, head of European real estate at UBS Warburg said, “Investors looking for higher yields and more stable investments are putting more money into property.”

Geographic Diversification

Germans usually invest in major US cities for certain reasons. Germans are active in Washington DC and Boston because they seem to be insulated from the high-tech crash. Likewise, Germans invest in Chicago due to “the equity markets’ lackluster performance, concerns about corporate scandals at many publicly traded companies, the drop in interest rates and Chicago’s relatively diverse economic base.”

2.4.2 Currency Exchange Rate

Volatility of Currency Exchange

In June 2000, “the strong dollar, rising US interest rates and the lure of the stock market [dampened] individual German investors’ enthusiasm for US real estate.”

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49 Ratner, Juliana. (2003) “Germans get high-spirited: The country’s open-ended funds are buying more grade A quality real estate than ever before as they try to invest the record amounts of cash that investors are giving them.” The Financial Times (London). May 16, 2003.
50 Ibid.
During 2002-3, the dollar weakened relative to the euro. Real estate financier Sam Zell suggested, “The increasing strength of the euro has help boost German investment here.”\(^{54}\) However, although the dollar’s decline added 10% buying power in the US for euro-based investors, many offshore investors are waiting for the currency to stabilize.\(^{55}\) “Foreign investors, concerned about the U.S. economy, weak commercial-real-estate markets and the dollar's rapid decline, have scaled back their acquisitions of U.S. office properties.”\(^{56}\) Foreign investors accounted for 36.4% of total office acquisitions during the second quarter of 2002; but only 12.2% during second quarter of 2003.\(^{57}\)

Christoph Kahl, the 45-year-old president of German-owned syndicator Jamestown US-Immobilien GmbH, said, “It’s not the dollar’s level but its volatility that makes investors hesitate.”\(^{58}\)

**Uncertainty about the Euro**

Distrust of the euro is spurred overseas investment. “The creation of the euro has been widely viewed with suspicion by a lot of German investors who are fearful that the European central bank will not have the discipline and strength the German central bank has had to protect the currency,” says James Braithwaite, the U.S. partner in KanAm U.S.\(^{59}\)

**Impact of Currency Exchange on Returns in Marks**

A study that simulates the impact of exchange rate changes on the IRR of foreign investors indicates that “a strengthening of [German investors’] national currency (relative to US Dollar) diminishes their returns.”\(^{60}\) The author of the study acknowledges a caveat of the study: “For some foreign investors, there will never be a foreign currency exchange . . . The investor may convert from his own national currency to dollars to

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\(^{56}\) Ibid.

\(^{57}\) Ibid.


make the initial investment, but never convert the proceeds back to his own national currency . . . When this is the case, it’s irrelevant . . . to measure the returns in a foreign currency into which they will never be converted.”

2.4.3 Taxation

Tax Efficiencies

“The US and German tax systems . . . influence the rate of German investment in US real estate. Tax results can vary, but with significant planning and depending on a transaction’s structure, German investors have recognized that efficiencies can be created with respect to investments in US real estate.”

High German Taxation

“The German income tax rate is as high as 60%” and the US offers “lower capital gains tax rates than Germany.”

Holding Period Tax Penalty

There is a German tax penalty for holding German real estate for less than ten years.

Termination of East Germany Tax Incentives

Germans turned their attention to US real estate when German tax incentives for investment in eastern German real estate expired in the late 1990s.

US-German Avoidance of Double Taxation Treaty

Under the tax treaty, the profit from a US real estate investment is taxed in the U.S. if its investment income in the U.S. is its only income: “a German doctor may be earning the equivalent of $500,000 a year in Germany. But if she is making only $20,000 off a U.S.
investment, she is taxed by the U.S. at the same rate as someone in a low tax bracket whose entire income is $20,000.  Thus, the tax consequence of US real estate investments is particularly advantageous to Germans earning high incomes.

2.4.4 US economic climate

Current Economy

![US Economic Indicators](https://www.ny.frb.org/rmaghome/dirchrts/i-uspage.pdf)

In general, “the better the [economic] conditions are, the better the returns on investment for both domestic and foreign investors.” GDP growth, unemployment rate, stock market indices, currency exchange rate, and vacancy rate are indicators of the US economy.

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Real gross domestic product (GDP) -- the output of goods and services produced by labor and property located in the United States -- increased 1.4 percent (annually) in the first quarter of 2003.\(^70\) Unemployment rate is high (6.4% in Jun 2003).\(^71\) Inflation, change in consumer price index (CPI), was +0.2% in Jun 2003.\(^72\) The S&P 500 Index, indicative of the health of equity markets, is trending up in July 2003, after plummeting in 2001 and 2002.

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\(^72\) Ibid.


23
The charts above compare the Dow, NASDAQ, and S&P 500 indices. It appears that investors are regaining confidence in equities.

74 http://finance.yahoo.com
75 Ibid.
76 Ibid.
For the past year, the US Dollar has been losing strength relative to the Euro.

National office vacancy rates have been steadily increasing since the end of 2000. The economy certainly is not as robust as recent years but it is on the road to recovery.

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US Real Estate Foreign Investment Outlook

"A number of foreign investors attributed their slowed activity to lack of good opportunities, rather than lack of interest. The properties foreign investors typically go after, well-located and leased office buildings, have become a dwindling -- and therefore pricey -- commodity amid record-high national vacancy rates, falling rents and increased competition from private U.S. buyers."79

German investors have more staying power in a soft US real estate market than Japanese investors did in the 1980s. Germans are typically involved in US deals that have much lower loan-to-value financing than the US deals that the Japanese participated in two decades ago.80 In general, German investors remain confident in the recovery of the US economy.

2.4.5 US political climate

"The appetite of various players – particularly the Germans – does not seem to have been weakened much by the war in Iraq, terrorism fears or ongoing weakness in the US economy."81 “Investors say they are undeterred by the uncertainty caused by the terrorist attack.”82

2.4.6 Higher expected returns in US real estate than in German real estate

Germany’s tepid recovery from last year's recession makes the US recovery look robust and US real estate returns particularly enticing. “European investors are accustomed to 4% to 5% yields on European real estate, while returns in the U.S. average between 6% to 8%.”83

2.4.7 Perceived safety or low risk of returns in US real estate

"The political stability in the United States, its stable currency, relatively low cost of funds, well-defined and developed markets, and the diversification of the major US cities... lower the risks associated with real estate investments here. Helaba’s Hans-Christian Ritter asserted: ‘The US market has higher transparency, liquidity, and availability of market information. It is much easier to find properties in this market and get good supporting information, and better returns here by and large.'" 84

Investors consider the US as “one of the world’s largest and most sophisticated financial markets.” 85 “Although the U.S. real estate arena may be weaker than it used to be, it still provides more stability and predictable gains than other markets around the world.” 86 Hence, “for international investors looking for a stable investment with good earning potential, US real estate and financial markets both remain the global standard.” 87

2.4.8 Strategic reasons

“Strategic investment policies define broad, overall allocations and long-run directions and objectives... An analytic tool widely used at the strategic level is modern portfolio theory (MPT).” 88 Some investors are current-income-driven; others are capital-appreciation-driven. Investors apply different strategies on their portfolios depending on their investment objectives. The strategies are not discussed here because they vary from investor to investor.

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2.4.9 Trust in Investment Advisor/Company

Foreign investors have three choices when investing in US real estate: (1) employ US-based personnel; (2) hire domestic consultants to advise them; or (3) look for US partners to work with. Many foreign investors prefer to co-invest with US partners who are familiar with the US local markets. They “prefer their US partner to contribute significant equity . . . to assure proper alignment of investment objectives amongst all partners.”

Desirable traits of a domestic investment partners are listed below:

- **Structural Flexibility** – “Utilizing the right investment structures often increase the overall yield to the foreign investor.”
- **Effective and Efficient Operations** – A domestic co-investor that provides operational services on a national scale (property management, acquisition, new development, capital improvements) can produce enhanced investment yields.
- **Local Market Knowledge** – This positions the partnership to “take advantage of the most expedient times to buy and sell; again, enhancing overall returns to the investors.”
- **Diversification in Risk Mitigation** – Participants can “spread their capital over assets and markets, helping to better diversify the portfolio.”
- **Value Creation Through Repositioning** – A “hands-on” co-investor with the ability to look creatively for other opportunities (such as build-to-suits, development possibilities, repositioning buildings) can produce higher returns.
- **Technology** -- It is critical that the co-investor is able to quickly communicate results, make decisions, respond to problems, complete market evaluations, and take opportunistic action.

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90 Ibid.
- **Exit Strategies** – “A partnership that establishes a number of viable options with which to exit an investment gives the investor flexibility to maximize returns.”
  
  Such exit options include:
  - Selling individual assets one by one.
  - Selling assets within a classification group.
  - Selling part of all of a portfolio to a public or private REIT for shares.
  - Taking the vehicle public.
  - Merging part or all of a portfolio with another private equity.

- **Partnership Decisions** – Major decisions that impact investment goals and returns should be made jointly and unanimously by all major partners. “Equal involvement in significant decisions fosters a level of trust among the partners that can both profit and sustain the relationship.”

- **Long-Term Objectives** – Foreign investors seek a long-term association with a co-investor. “Success and long-term partnerships are based on trust and fair play . . . Long-term objectives can be achieved only if a strong and very positive relationship exists.”

Selecting a trustworthy US investment advisory company is very important, given the recent bankruptcy troubles of Rosche, a German close-ended fund which invested in US real estate, and the arrest of its chief executives, Michael Vogelbacher (in December 2001) and Gabriele Rosche (in February 2002), for fraud.92,93,94

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3 Research Question

Which factors weigh most heavily on German investors’ decision to invest in US real estate, given the recent changes in the global economy? How will these recent changes influence investor decisions?

Foreign investment in US real estate is a vital component of the US economy. German investors have been major players in the US real estate market for many years. This study identifies, examines, and ranks the factors influencing German investor decisions, according to investor interview responses. On a micro-level, understanding Germans’ investment decision-making enables US real estate investment advisory companies to compete effectively in the marketplace -- by implementing strategies and offering products and services that satisfy client demands. On a macro-level, it sheds light on the historic patterns of German investment in US real estate, and offers an investment outlook given recent changes in the global market.
4 Description of Methodology

4.1 Source of Data

Taurus Investment Holdings, LLC, provided access to clients and investment advisors for interviews. Besides sponsoring the phone interviews, Taurus also supplied client investment profiles, a previous questionnaire survey, and relevant information for the research.

4.2 In-depth investor interviews

A structured interview survey was conducted by telephone with ten key Taurus investors. The qualitative interviews were not intended as an exhaustive survey.

4.2.1 Interview Question List

Below are the questions that each of the ten interviewees responded to.

Client profile questions:

1. How long have you been an active investor?
2. How long have you invested in US real estate?
3. Do you have real estate investments in other parts of the world? If so, where?
4. How long have you invested with Taurus?
5. How many Taurus deals have you participated in?
6. Are they development or acquisition deals?
7. Are they retail, office, industrial, residential, or land deals?
8. About what percentage of your overall portfolio is in real estate?
9. About what percentage of your real estate allocation is US real estate?

General investment questions:
1. Please give a few reasons for why you chose to invest in real estate in the US as opposed to in other countries?

2. Does the geographic region of an US investment matter to you? If so, which areas do you prefer? (Northeast, Washington DC, Southeast, Southwest, West Coast)

3. How do your real estate investments differ from your other foreign private equity investments? (in terms of risk and return)


5. Apart from currency effects, how do you expect initial yields (cash payout) in US real estate to be higher or lower than those in Germany? in Western Europe in general?

6. Apart from currency effects, do you expect total lifetime real estate investment returns (IRRs) in US real estate to be higher or lower than those in Germany? in Western Europe in general?

7. What is your preferred expected holding period when investing in US real estate? (Most of Taurus’ deals are assuming a 5-year hold, which is shorter than usual, especially for European investors.)

8. Is your preferred holding period for US real estate higher or lower than your preferred expected holding period for real estate investments in Germany?

9. Is your preferred holding period for US real estate higher or lower than your preferred expected holding period for other private equity investments in your portfolio?

10. Are the following factors important to your decisions regarding US real estate investment?
    • Diversification
    • Currency exchange rate
    • German Tax Laws
    • US Tax Laws
    • US economic climate
- US political climate
- Higher expected returns in US real estate
- Perceived safety or low risk of returns in US real estate
- Strategic reasons (real estate as a hedge against inflation; other roles of real estate in portfolio)
- Trust in investment advisory company (such as Taurus)
- Other factors

11. In regards to the factors in question 10, what changes have taken place in past years – in the US or in Germany – that influenced your US real estate investment decisions?

12. Looking forward, for US real estate investment, what is your perspective on each of these factors?

13. Do you anticipate increasing or decreasing your percentage allocation to US real estate over the coming one or two years? Why?

14. In what ways can investment advisory companies, such as Taurus, help mitigate the risks going forward?

Specific/Deal level questions:

15. What part of the deal do you consider important?
   - Geography
   - Exit strategy/Holding period
   - Financing
   - Return
     - Current Income
     - Capital Appreciation
   - Deal structure
   - Others – please describe

16. What do you do with the Quarterly Distribution (current income) from the deal?
   Keep it in the US or bring it back to Germany? Is the money reinvested?
17. What do you do with the Final Distribution in the event of a sale? Keep it in the US or bring it back to Germany? Is the money reinvested?

18. Are tax considerations important? (since distributions are taxed as dividends and sale proceeds are taxed as capital gain)

4.3 Analysis of responses

Interviewees were asked to rank the different factors in order of importance. The collective factor-ranking was generated based on interview responses. The top ranking factors were further scrutinized for their validity. Please see Appendix and Chapter 6.
5 Description of Data

5.1 Investor Info

5.1.1 General Info About Taurus Investors

Taurus Investment Holdings, LLC, currently has ~251 active investors:

<table>
<thead>
<tr>
<th>Region</th>
<th>Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>German</td>
<td>150</td>
</tr>
<tr>
<td>Other European (Italian, Swiss, etc.)</td>
<td>15</td>
</tr>
<tr>
<td>US</td>
<td>85</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1</td>
</tr>
<tr>
<td>TOTAL</td>
<td>251</td>
</tr>
</tbody>
</table>

Table 5-1: Number of Investors Regionally (as of July 2003)

The ten investors interviewed comprise ~4% of the total number of active Taurus investors. These ten investors include --

- Two long-time Taurus investors.
- Two investment-advisors representing a larger number of Taurus investors.
- Three investors who are below age 35.
- Three investors have US corporations as their investment vehicles.
- One has no current Taurus investment.
- Six PhD's, four have law degrees, one woman.

<table>
<thead>
<tr>
<th>Investors</th>
<th>These Investors’ Current Invested Capital as a Percentage of the Total Capital Currently Invested by All Taurus Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ten Investors Interviewed</td>
<td>~10.5%</td>
</tr>
<tr>
<td>Investors Counseled by the Two Advisor-Interviewees</td>
<td>~33.6%</td>
</tr>
<tr>
<td>Total Investors Represented by Interviewees</td>
<td>~44.1%</td>
</tr>
</tbody>
</table>

Figure 5-1: Current Amount of Capital Invested with Taurus (as of July 2003)
5.1.2 Investor Profiles

Please see Appendix.

5.2 Interview data

5.2.1 Interviewee Responses to Questions

*Question 10: Are the following factors important to your decisions regarding US real estate investment?*

- **Diversification**

All investors interviewed except Investor 10 consider Diversification an important factor.

**YES**

"It's the number one factor." (Investor 1)

"Real estate diversifies and stabilizes the portfolio." (Investor 2)

"The US is probably the only country in the world that's worth looking into for diversifying for the very wealthy. There is no other country that offers as many advantages in diversifying and investing money and still achieving fairly high yields and fairly high security. Investors are looking to diversify – making sure that part of their money is in a safe haven even when things get really bad." (Advisor 4)

**NO**

"Diversification in US real estate was a significant factor in the 1980s (when we were cautious about Eastern Europe). However, it is not an important for investments now and in the future." (Investor 10)

- **Currency Exchange Rate**

All investors interviewed except Investor 6 stated that Currency Exchange Rate is not an important factor.
YES

"Exchange rate is important in terms of diversification in currency." (Investor 6)

NO

“I keep dollars in the US and euros in Europe. I don’t care if the dollar goes up or down.” (Investor 2)

“We explain to our investors before they invest (and they agree) that it’s not worth calculating in different currencies because what they invest will remain in US currency. Obviously, they always try to buy dollar very cheap. But they also realize that it doesn’t make sense to consider investments from a currency-rate point of view. Their investments last for several years. Sometimes the dollar will be cheaper, sometimes more expensive. They look at it as an investment of part of their wealth that will go into the dollar and will remain in the dollar.” (Advisor 4)

- Taxation

Most of the interviewees agreed that taxation, in general, is important in their decisions.

YES

“I think the tax advantage is the most important factor.” (Investor 3)

“Taxes are linked to the overall return. I look at investments after tax. I don’t care whether the high returns are from tax saving or from high yields.” (Investor 5)

NO

“There are no tax reasons for investing in US real estate.” (Investor 1)

German tax laws
Eight out of ten investors consider German tax laws an important factor in their decisions about whether to invest in Germany vs. in the US.

YES

"German tax rates are very high. The US has a lower rate for capital gains. In Germany, we pay the full income tax on capital gains. The highest income tax rate is 51%. The quarterly distribution tax rate – the rate that we pay on all income – is the same high rate of income tax."

(Tax Advisor 7)

"German investors often prefer to invest through corporations rather in their private names. First, this reduces the obligations in a limited company. (German companies such as the GmbH - Gesellschaft mit beschraenkter Haftung are set up such that there is no personal liability, only corporate liability.) Second, there is also a tax advantage. If the investor has a corporation, he pays corporate tax, the rate is lower than the income tax rate. If dividends are paid out from the corporation, there is income tax. There is less tax as a corporation when the money is left in the company. Only corporate tax is paid. If the money is reinvested, then there's an advantage, but it's not a large difference. Third, corporations cannot die. If the investor dies and he invested in his private name, there is inheritance tax.”

(Tax Advisor 7)

NO

"We don’t pay taxes in Germany for US real estate. Therefore, it’s not a concern for me."

(Investor 6)

US tax laws
Six out of ten investors consider US tax laws an important factor in their decisions.

YES

"US tax structure is very advantageous for the German investor. Investors often invest through legal entities. Sometimes, they invest in their personal name or take their wife's name or children's name to start a new tax book."

(Advisor 4)

"The advantage of the double taxation treaty between Germany and the US is that if German investors have no other income from the US except for income from their US real estate
investments, we only pay taxes in the US and we do not pay taxes in Germany. So, we pay taxes at a lower rate in the States. There is no tax difference between investing in funds such as Jamestown and limited partnerships such as Taurus.” (Tax Advisor 7)

NO

“There is the withholding of tax but we get it back in one to two years. It’s not lost. I’m comfortable with the tax laws.” (Investor 2)

“I don’t care at the moment but one of the reasons I will not invest in the US in the future is due to the tax complication [and my retirement].” (Investor 3)

• US economic climate

Seven out of ten investors consider the US economy an important factor.

YES

“The US economy is always a factor. I’m positive on the US economy for the long term.” (Investor 2)

“It is very important. I think it has deteriorated and I expect further decrease of attractiveness of real estate investments in the US. The recession is not over in the States.” (Investor 3)

“In general, there is trust and confidence in the US.” (Advisor 4)

“I’m not in a position to know whether the economy is getting better or worse. I invest a constant amount no matter where we are in the economic cycle.” (Investor 5)

NO

“The US economy is worse than Europe’s but we’ll get through it.” (Investor 6)

• US political climate

Four of ten investors consider the US political climate an important factor.
"The US political climate has changed but I haven’t done US investment in the last 2 ½ years. I invested six years ago. Economic policy of free trade and capital movement didn’t play a role then. Now they may play a role but I haven’t decided on that because my investments are done.” (Investor 1)

"The US is more stable than most other regions. That’s a plus in my opinion, despite the Iraq War.”

"Sometimes investors are concerned about US policies. However, the Iraq War and other events last such a short period that it doesn’t concern people.” (Advisor 4)

"I don’t care if it’s Republican or Democrat, as long as it’s stable politically.” (Investor 5)

- Higher expected returns in US real estate than returns in German real estate
All ten investors agreed that this factor is very important.

"I invest in US real estate for diversification purposes. Higher returns in US real estate ties to the diversification and risk/rate of return assessment.” (Investor 1)

"It is a primary factor, but the difference in yield [US real estate vs German real estate] has declined.” (Investor 3)

"We hope to have returns of 10% or more. 5-10% is also okay because we can’t earn that rate in Germany.” (Advisor 7)

"US returns are much higher but may go down. The IRR of my last investment was 15% over 3-4 years.” (Investor 10)

- Perceived safety or low risk of returns in US real estate
Four of ten investors consider the perceived lower risk of US real estate returns an important factor. Some of the investors do not see US real estate returns as having lower risk.

**YES**

"US returns have lower risk because it is much more transparent and calculable. The US has an evaluation methodology and has much more information. For foreigners, it's a big advantage since there is a higher probability of not being cheated. In Germany, you can find a good price in real estate if you move fast because prices are not as researched and can vary quite a bit." (Investor 3)

**NO**

"There is no perceived lower risk. It depends on the deal. You cannot judge generally." (Investor 1)

"I don’t think investors perceive returns in US as having lower risks. Our wealthy investors are not dependent on the income from investment. Our typical investors are IRR-driven, meaning that they can wait the entire holding period but really want to cash in once we sell it. That’s why they don’t want to wait 10-15 years, as you will find with most of the big close-ended funds. Big German institutions investing through close-ended funds will have holding periods of a minimum of 10 to 15 years. Taurus investors want VC-type investments - meaning that returns are much higher with a much shorter holding period, such as five years." (Advisor 4)

"Risks are higher in the US. Germany has 25-year tenant contracts. The shorter contracts in the US increase rental rates/returns but there is also a risk that the rental rate goes down. In Germany, it takes longer for rental rates to be affected." (Advisor 7)

"Risks are project- and time-specific. Risk is a function of market timing. Some investments in Germany are more risky at a certain point in time than investments in the US, and vice versa. It's not geographic." (Investor 8)

"The US has higher risk because I’m far away." (Investor 9)

"US real estate has the same risks as German real estate. I am concerned about the same issues: the number of tenants, lease expirations, etc." (Investor 10)
• Strategic reasons

Three of ten investors stated that strategic reasons are important in their decisions.

YES

"I'm trying to be globally invested. I'm trying to diversify in different asset classes. My bias for German real estate was so high at the time that I decided on investments in US and in other parts of Europe." (Investor 1)

"I'm interested in risk variety. I keep funds in different places and industries." (Investor 2)

NO

"I look for investments regardless of the percentage [allocation in the portfolio]. I don't care whether I'm 80% or 50% invested in a certain asset class. I'm basing decisions more on the individual opportunistic expectation of a big return." (Investor 3)

"We had strategic reasons 20 years ago. We were threatened by the Russians, not now." (Investor 9)

• Trust in Investment Advisor/Company

All ten investors believe that trust is an important factor in their decision.

YES

"If I didn't trust Taurus, I wouldn't invest in US real estate. I think real estate is an efficient market so it doesn't make any sense to buy REITs. Real estate is privately driven by opportunity so I wouldn't use the public market as an investment vehicle. The private market depends on the people I'm working with." (Investor 1)

"Trust is very important. The qualification and professionalism of companies in charge are very important. I think Taurus is doing a good job." (Investor 2)

"Personal connection and a good reporting system that gives an overview of what's happening in the US are important." (Investor 3)
"The type of investment we do is all based on trust and confidence. There is no investor who would invest without having any knowledge of the procedures, the advisory boards, etc. Most likely, he will know one or two investors who have invested over past years.” (Advisor 4)

“Having partners with local expertise is important.” (Investor 5)

“I invest in people. I’ve known [someone in Taurus management] since my student days. Information, fast response to my emails, regular reports and meetings are important. Taurus is professional and reliable in this regard.” (Investor 10).

**Question 11: In regards to the factors in question 10, what changes have taken place in past years – in the US or in Germany – that influenced your US real estate investment decisions?**

- **Changes In Germany**

"There are no significant changes in the US. However, there are changes in Germany. It seems that Germany is getting socialistic. Many Germans are losing trust in the government and are investing money outside the country.” (Investor 2)

"There are not many changes in past years. My allocations stayed the same. There is disillusion from German deals. We lost money from investments in East Germany – which was not driven by economic factors but by tax savings. In the end, real estate investments driven by tax or public subsidies can't work in long run. They work only if they were driven by economics. We are happy with our past US investments. The US recession didn't affect my investment decisions. I try not to be pro- or anti-cyclic. I like to ride out the cycle.” (Investor 5)

- **Changes In Other Parts Of Europe**

"We started US real estate investments in 80s because of the dangers from Eastern part of Europe. Now it's very different. We invest much less in the US now.” (Investor 10)

- **German Taxation**

"In Germany, the taxation laws are changing for the worse. In the US, there is a decline of the returns after tax.” (Investor 3)
"The German tax system remained the same in the past few years, only the tax rates changed a little bit." (Tax Advisor 7)

- Weak Us Economy

"There aren't any big changes. We would have liked to sell some deals in last few years. At the same time, the investors agreed not to sell due to the weak economy. This may also hold back future investments until we see a recovery in the economy. It's always about weighing the pros and cons. In last 3 ½ years, we had such a decline in stocks and bonds. In 2001 and up to the first months of 2003, there was minus performance (in the two digits) per year in stocks and bonds. This made people invest in other areas, especially in US real estate. How and when will we recover? It's uncertain. The first strong investment will be back in the US as soon as we see more light at the horizon." (Advisor 4)

"We always look at the US economic/political situation. There aren't significant changes in the last 5 years that influenced our investments too much. At the moment, we won't invest in the US, we are cautious and will wait." (Advisor 7)

- Personal Circumstances

"After I retired, I wanted to stay much more liquid. Enjoy the wealth and not be invested in real estate which I would have to keep for a long period of time." (Investor 3)

- Forward-Looking Decisions

"My decisions are not influenced by the market development of past years. I'm not rate-of-return driven, but rather, I'm risk-and-return driven. I assess whether the rate of return in the US real estate market through Taurus, today, would fit in my portfolio." (Investor 1)

*Question 12: Looking forward, for US real estate investment, what is your perspective on each of these factors?*

- Us Political Climate
"There is a potential that the Republican policy (the current administration) can change my assessment about investing in US real estate. I haven't come to that point yet. The change in security and foreign policy between Europe and America can change my investing activities. It could tilt it toward solely in US or solely in Europe or stay as it is. I haven't gathered enough information to give a precise answer to that." (Investor 1)

"As long as the US has a stable political system, it doesn't matter if the administration is Republican or Democrat." (Investor 5)

- Economy & Returns

"Lease rates are going down. Vacancy is up to 25-30%. Investments are less safe perhaps for the next two to three years. As long as we don't lose our tenants, investments will be okay. We can't buy real estate much cheaper than three years ago but returns are lower for the next few years. This doesn't affect my capital allocations." (Investor 2)

"As long as the economy is somewhat sound, I will continue my investments." (Investor 5)

"The US economy will be better in the next few years." (Advisor 7)

- Personal Circumstances

"There is still high attractiveness in US real estate, in general, for German investors. For me personally, it's different. I'm getting out of real estate in total. I'm trying to sell all of my real estate in the next two to five years. I want to be more liquid and invest in more opportunities with a shorter time horizon, such as stocks and guaranteed/hedge funds." (Investor 3)

- Trust

"The track record of the company, like Taurus, is very important. Companies have to prove that they are able to perform, to deliver, to sell." (Advisor 4)

- Combination Of Factors

"High returns, tax laws and trust are important for future investments." (Investor 10)
**Question 14:** In what ways can investment advisory companies, such as Taurus, help mitigate the risks going forward?

- **Trust**

  “Transparency is an issue. For me as investor, I can't only look at objective risk factors but also subjective risk factors. I'm far away from America. I expect Taurus to fulfill the investment plan. Trust is important. Trust is easily lost and hard to win.” (Investor 1)

  “In last 12 months, Taurus has been extremely cautious with new investments – making sure that we can exit, can perform, can deliver. Even while we are ‘sitting’ on quite a lot of dollars that need investment, it was a very wise decision not to produce deals just to satisfy people who want to invest, because if we do that, there will be little profit. We strive to have mutual interest as the initiator and as the investor. We want quite a strong profit participation which we will only get once we sell the product.” (Advisor 4)

- **Tax Considerations**

  “For Germans, Taurus has to think more about vehicles to reduce tax burdens. Every investor has to think of his own taxation position. To attract other investors, investment companies have to think more about the consequences of taxation. In the end - the selection of a good real estate opportunity is the central job of Taurus. They have demonstrated that they have good capability to select good real estate. I would recommend German investors who are interested in US real estate to invest with Taurus.” (Investor 3)

- **Tenant Relationships**

  “I need to know that Taurus really care about the real estate, that they talk to the tenants. They know if anyone not happy in the building. We can't be surprised that an important tenant wants to leave the building. Contact with the tenant can minimize risk. Even if we have to bring down the rent to keep the tenant, it’s better for the building to be full with tenants. It’s important to manage the building well.” (Investor 10)
• Other Comments

“Taurus is a good company. It makes good choices about real property. We think Taurus is better than many others. There is good management, good ideas. Risks are smaller with Taurus than the risks with other companies.” (Advisor 7)

“I’m happy with what Taurus experts are doing.” (Investor 9)
6 Results

6.1 Analysis of Data

6.1.1 Factor-Ranking Summary

Please see Appendix for detailed ranking table.

<table>
<thead>
<tr>
<th>Factor Importance Ranking</th>
<th>Factor</th>
<th>Average Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Higher expected returns in US real estate than returns in German real estate</td>
<td>1.9</td>
</tr>
<tr>
<td>2</td>
<td>Trust in Investment Advisor / Company</td>
<td>2.1</td>
</tr>
<tr>
<td>3</td>
<td>Diversification</td>
<td>2.3</td>
</tr>
<tr>
<td>4</td>
<td>German tax laws</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>US tax laws</td>
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<tr>
<td>6</td>
<td>US economic climate</td>
<td>4.1</td>
</tr>
<tr>
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<td>Perceived safety or low risk of returns in US real estate</td>
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</tr>
<tr>
<td>8</td>
<td>Strategic reasons</td>
<td>4.7</td>
</tr>
<tr>
<td>9</td>
<td>US political climate</td>
<td>5</td>
</tr>
<tr>
<td>10</td>
<td>Currency Exchange Rate</td>
<td>5.5</td>
</tr>
</tbody>
</table>

Table 6-1: Factor-Ranking Based on Investor Responses

Note: Higher expected returns in US real estate and Trust in the Investment Advisor / Company are important factors for all ten investors.

The results indicate that rational factors (such as Higher returns in US real estate and Diversification) must be complemented by emotional factors such as Trust in the Investment Advisor/Company. Without trust, most investors have stated that they would not invest despite high returns and diversification benefits.
6.1.2 Validating the Higher Returns Factor: Analysis of German real estate returns vs. US real estate returns

**Impact of Currency Exchange Rate Fluctuations on German vs. US Real Estate Returns**

<table>
<thead>
<tr>
<th>Year</th>
<th>US Real Estate Returns (NCREIF) in USD</th>
<th>US Real Estate Returns (NCREIF) in Marks</th>
<th>German Real Estate Returns (DIX) in Marks</th>
<th>German Bond Returns in Marks</th>
<th>German Cash Returns in Marks</th>
<th>German Equities Returns in Marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-96</td>
<td>10.30%</td>
<td>15.73%</td>
<td>3.50%</td>
<td>7.50%</td>
<td>3.40%</td>
<td>28.20%</td>
</tr>
<tr>
<td>Dec-97</td>
<td>13.91%</td>
<td>30.89%</td>
<td>3.70%</td>
<td>6.60%</td>
<td>3.30%</td>
<td>47.80%</td>
</tr>
<tr>
<td>Dec-98</td>
<td>16.25%</td>
<td>17.49%</td>
<td>4.80%</td>
<td>11.20%</td>
<td>3.60%</td>
<td>17.20%</td>
</tr>
<tr>
<td>Dec-99</td>
<td>11.36%</td>
<td>16.03%</td>
<td>5%</td>
<td>-1.90%</td>
<td>3%</td>
<td>39.10%</td>
</tr>
<tr>
<td>Dec-00</td>
<td>12.25%</td>
<td>29.62%</td>
<td>5.60%</td>
<td>6.90%</td>
<td>4.30%</td>
<td>-7.50%</td>
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<tr>
<td>Dec-01</td>
<td>7.28%</td>
<td>10.47%</td>
<td>5.90%</td>
<td>5.60%</td>
<td>4.50%</td>
<td>-19.80%</td>
</tr>
<tr>
<td>Dec-02</td>
<td>6.75%</td>
<td>1.46%</td>
<td>4.20%</td>
<td>9%</td>
<td>3.40%</td>
<td>-43.90%</td>
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<tr>
<td>Average</td>
<td>11.16%</td>
<td>17.39%</td>
<td>4.67%</td>
<td>6.41%</td>
<td>3.64%</td>
<td>8.73%</td>
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<tr>
<td>Stdev</td>
<td>0.0341</td>
<td>0.1031</td>
<td>0.0092</td>
<td>0.0410</td>
<td>0.0055</td>
<td>0.3353</td>
</tr>
</tbody>
</table>

Table 6-2: German Investments and US Real Estate Returns Comparison

Please see Appendix for Conversion of US Real Estate Returns into Marks.

![German and US Real Estate Returns Comparison](image-url)

Figure 6-1: German and US Real Estate Returns Comparison

*German DIX Returns data started in year 1996. Hence, the short time horizon.*
Investment Property Databank (IPD)’s DIX German Property Index measures “unleveraged returns on direct investment in properties held through the year” since 1996. Properties are valued annually in accordance with the Ertragswertverfahren. NPI (NCREIF Property Index) is unlevered and is based on appraised values of directly-held large commercial properties.

In local currency, US NPI real estate returns (in US Dollars) have been higher than German DIX real estate returns (in Marks) from 1996 through 2002. However, taking currency exchange rate fluctuations into consideration, US NPI returns (in Marks) exhibit much more volatility and they are lower than German DIX returns (in Marks) in 2002.

*German Investments Returns vs. US Real Estate Returns*

An IPD report stated that in Germany, total returns on German real estate was 4.2% in 2002 (down from 5.9% in 2001). Bonds, the best performing asset, had a 9% return. Real estate was second at 4.2%. Cash was third at 3.4%. Equities finished last, at -43.9%.

“Over the last seven years, bonds are the top performing asset, with returns of 6.4%.

---

96 Ibid.
They are followed by property shares and direct property, with returns of 5.5% and 4.7% per year respectively. Equities and cash have both returned 3.6% per year since 1995 and equity returns have been highly volatile. 97

The above chart shows that US real estate returns (measured in Marks) were higher than German real estate returns (in Marks) from 1996 through 2001. In 2002, US real estate returns (1.46%) were below those of German real estate (4.2%).

Possible Reasons for the Decline in US Real Estate Returns in 2002

The decline in US real estate returns (in Marks) can be explained, first, by the low US real estate returns (in US Dollars) in 2002 (6.75%, down from 12.25% in 2000). Second, the German Mark started to gain strength against the US Dollar in 2002, after the introduction of the Euro. The strengthening of the German domestic currency diminishes foreign US real estate investment returns for German investors investing in the US.

US Real Estate Can Still Be Attractive

Despite falling US real estate returns in 2002, US real estate can still be more attractive than German real estate.

First, the decline of US real estate returns due to the rising mark is only an issue if the money is repatriated. For many investors, the money stays in the US as dollars. In this case, investors are not affected by the unfavorable currency exchange rate.

Second, advantageous financing improves returns. The record-low interest rate environment in the US allows investors to refinance to enhance profits even in the recession. Non-recourse financing in the US (which is not available in Germany) also reduces risks in real estate investment.

Third, it is important to compare after-tax returns for real estate in the US vs. in Germany. Investors have idiosyncratic tax situations. A more general example that applies to German investors across the board involves the German tax penalty for holding

97 Ibid.
German real estate for less than ten years. The after-tax return on German real estate held for five years may be lower than the after-tax return on US real estate held for the same numbers of years, even if the before-tax US return is lower than the before-tax German return.

6.1.3 Validating the Diversification Factor: Correlation Analysis of German real estate returns vs. US investment returns

Correlation Matrix

<table>
<thead>
<tr>
<th>All Returns Measured in MARKS</th>
<th>Correlation with US Real Estate (NPI)</th>
<th>Correlation with German Bonds</th>
<th>Correlation with German Cash</th>
<th>Correlation with German Equities</th>
<th>Correlation with German Real Estate (DIX)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Real Estate</td>
<td>1</td>
<td>-0.0675</td>
<td>0.0769</td>
<td>0.6227</td>
<td>-0.0218</td>
</tr>
<tr>
<td>German Bonds</td>
<td>-0.0675</td>
<td>1</td>
<td>0.2812</td>
<td>-0.369</td>
<td>-0.2369</td>
</tr>
<tr>
<td>German Cash</td>
<td>0.0769</td>
<td>0.2812</td>
<td>1</td>
<td>-0.545</td>
<td>0.7203</td>
</tr>
<tr>
<td>German Equities</td>
<td>0.6227</td>
<td>-0.369</td>
<td>-0.545</td>
<td>1</td>
<td>-0.407</td>
</tr>
<tr>
<td>German Real Estate (DIX)</td>
<td>-0.0218</td>
<td>-0.2369</td>
<td>0.7203</td>
<td>-0.407</td>
<td>1</td>
</tr>
</tbody>
</table>

Figure 6-3: Correlation Matrix of Investment Returns (measured in Marks)

The Correlation Matrix above indicates that the returns on US real estate are negatively correlated with those on German real estate returns and German Bonds returns; while positively correlated with those on German Equities and German Cash.

US real estate not only offers diversification in terms of two different real estate markets but also in terms of two currencies. The negative correlation suggests that US real estate returns tend to be low when German real estate and German Bonds returns are high and vice versa. Hence, US real estate can indeed help reduce the volatility of German investors' portfolio. Thus, German investors should take into account not only US real
estate returns’ standard deviation over time but also the co-movement of the returns with those of other assets in the portfolio.\textsuperscript{98}

\textit{Sharpe-Maximizing Portfolios – With and Without US Real Estate}\textsuperscript{99}

To quantitatively analyze the diversification benefits of US real estate for German portfolios, the Maximum Sharpe Ratios were compared between two portfolios. The first one contains US Real Estate along with German Bonds, Cash, Equities, and Real Estate; the other contains only German Bonds, Cash, Equities, and Real Estate – there is no allocation to US Real Estate. The historical average German Cash return (3.6\%) was used as the risk-free rate since the returns are in Marks. Portfolio analyses are on the following pages.


\textsuperscript{99} Portfolio Analyses generated from Ibbotson EnCorr software.
Table 6-3: Sharpe-Maximizing Portfolio WITH US Real Estate

<table>
<thead>
<tr>
<th>Asset Classes</th>
<th>% of Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Real Estate (NCREIF) in Marks</td>
<td>3.16%</td>
</tr>
<tr>
<td>German Bonds</td>
<td>14.55%</td>
</tr>
<tr>
<td>German Cash</td>
<td>0%</td>
</tr>
<tr>
<td>German Equities</td>
<td>1.13%</td>
</tr>
<tr>
<td>German Real Estate (DIX)</td>
<td>81.16%</td>
</tr>
<tr>
<td>Expected Return</td>
<td>5.37%</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>0.82%</td>
</tr>
<tr>
<td>Sharpe Ratio</td>
<td>2.17</td>
</tr>
</tbody>
</table>

Figure 6-5: Portfolio WITH US Real Estate
Figure 6-6: Efficient Frontier WITHOUT US Real Estate (Max Sharpe Ratio 2.09)

<table>
<thead>
<tr>
<th>Asset Classes</th>
<th>% of Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>German Bonds</td>
<td>15.08%</td>
</tr>
<tr>
<td>German Cash</td>
<td>0%</td>
</tr>
<tr>
<td>German Equities</td>
<td>1.75%</td>
</tr>
<tr>
<td>German Real Estate (DIX)</td>
<td>83.17%</td>
</tr>
<tr>
<td>Expected Return</td>
<td>5.01%</td>
</tr>
<tr>
<td>Standard Deviation</td>
<td>0.67%</td>
</tr>
<tr>
<td>Sharpe Ratio</td>
<td>2.09</td>
</tr>
</tbody>
</table>

Table 6-4: Sharpe-Maximizing Portfolio WITHOUT US Real Estate

Figure 6-7: Portfolio WITHOUT US Real Estate
The portfolio with US Real Estate has a higher expected return of 5.37% and a higher Sharpe Ratio of 2.17. The portfolio without US Real Estate has lower expected return (5.01%) and lower Sharpe Ratio (2.09). This portfolio analysis confirms that the inclusion of US real estate along with German investments offers diversification benefits that enable German investors to have higher risk-adjusted returns.

6.1.4 Investment Outlook Based on Interviews

Investor responses suggest that the US recession, the weak US dollar, and the decline in after-tax returns may have caused some investors to hold back and be more cautious about investments in the short run. However, investors are optimistic about the recovery of the US economy. Given the higher expected returns and diversification benefits in US real estate, investors will continue to invest in US real estate in the long run.

Trust, transparency of information, careful asset selection and management, and deals that allows for tax efficiencies will mitigate some of the risks that investors face going-forward.
7 Conclusions

7.1 Identification of key factors influencing investment decisions

The ten investors agreed that the ten factors identified below are the main factors influencing their US real estate investment decisions. They did not have other factors to add to the list.

- Diversification
- Currency Exchange Rate
- Taxation
  - German tax laws
  - US tax laws
- US economic climate
- US political climate
- Higher expected returns in US real estate than returns in German real estate
- Perceived safety or low risk of returns in US real estate
- Strategic reasons
- Trust in Investment Advisor/Company

7.2 Hierarchy of factors

The factors are ranked in order of importance:

1. Higher expected returns in US real estate than returns in German real estate
2. Trust in Investment Advisor/Company
3. Diversification
4. German tax laws
5. US tax laws
6. US economic climate
7. Perceived safety or low risk of returns in US real estate
8. Strategic reasons
9. US political climate
10. Currency Exchange Rate
Note 1: Higher expected returns in US real estate and Trust in the Investment Advisor / Company are important factors for all ten investors.

Note 2: The ten investors interviewed comprise ~4% of the total number of active Taurus investors and represent ~10.50% of the capital currently invested with Taurus. The hierarchy is based on investor opinions, which may or may not be consistent with the collective opinion of most German investors.

7.3 Implications of results

7.3.1 Importance Of Factors

The results indicate that exogenous factors – German/US tax laws, the US economic/political climate, and currency exchange rate – are not as important to investors as more personal factors: higher returns in US real estate, trust in the advisory company, and diversification benefits.

Within the set of personal factors, rational factors (Higher returns in US real estate and Diversification) must be complemented by emotional factors, i.e. Trust in the Investment Advisor/Company. Without trust in the first place, investors would not invest in opportunities promising high returns and providing diversification benefits to their portfolio.

However, exogenous factors do play a role. Though these factors are lower in the hierarchy, they influence the personal factors at higher positions in the hierarchy. Exogenous factors are linked to personal factors: the health of the US economy is linked to US real estate returns; tax laws are linked to the investors’ after-tax returns. If changes in the exogenous factors affect the personal factors, then the exogenous factors are given more consideration; for example:

- if the decline of the US economy erodes the higher returns in US real estate;
- if German/US tax laws change to render the after-tax returns of US real estate much lower;
- if German currency gains strength relative to the US dollar and US real estate returns diminishes when measured in Marks. (i.e. money is repatriated.)

![Investor Decision Flowchart](image-url)

**Figure 7-1: Investor Decision Flowchart**

### 7.3.2 Validating The Factors

To validate investors’ perception of higher returns and diversification potential of US real estate, comparative analyses were performed on returns (adjusted for currency fluctuations).

Analyses show that US real estate returns have been much higher than German real estate returns from 1996 to 2001. The decline in US real estate returns (measured in Marks in order to compare with German investment returns) in 2002 can be explained: first, by the low US real estate returns (in US Dollars) in 2002 (6.75%, down from 12.25% in 2000). Second, the German Mark was for the first time gaining strength against the US Dollar in
2002, after the introduction of the Euro. The strengthening of the German domestic currency diminishes foreign US real estate investment before-tax returns for German investors investing in the US. However, US real estate can still be attractive if money is not repatriated (i.e. insulated from currency fluctuations), if the US offers favorable financing terms, and if after-tax returns are compared.

US real estate not only offers diversification in terms of two different real estate markets but also in terms of two currencies. The negative correlation between US real estate and German real estate and German bonds indicates the low co-movement among these asset classes, which reduces portfolio volatility. Furthermore, Sharpe-maximizing portfolio analysis demonstrates that a portfolio with containing US real estate and German investments offer a higher expected return and Sharpe Ratio than one that contains the same asset classes but lacking US real estate. Indeed, US real estate can help enhance risk-adjusted returns for German investors.

7.3.3 Ex Ante Recommendations

Historically, US real estate returns were higher than those of German real estate. The compounded effect of exogenous factors such as the US economy and currency exchange rate fluctuations in recent years have caused US real estate returns to drop below German real estate returns.

The underperformance of US real estate in 2002 leaves German investors uncertain about whether US real estate returns will continue to decline or will instead recover in coming years. Investors have to reconsider the benefits of higher returns and diversification of their US real estate investments in their portfolios.

In a global recession where the US economy and the weakening US dollar have eroded the returns for German investors with US real estate investments, German investors’ selection of US investment partners is now more important than ever. It is imperative to keep in mind that the data of real estate returns reflects the average performance of the properties in the indices. A well-chosen US partner / investment advisor can deliver
well-above-average returns. In 2002, while the overall average performance of US properties was 6.75% (US dollar measure), some investment companies had achieved significantly higher-than-average returns.

*Rational* and *emotional* factors are inextricable: the choice of a competent US investment advisory company is critical in enhancing the returns and diversification benefits for a German investor investing in US real estate. In light of the shifting global economy of recent years, it is vital that foreign investors partner with carefully-chosen US investment advisors in order to accomplish investment objectives and to achieve optimal results.
## 8 Appendices

### 8.1 Investor Profiles

Investor identities are disguised.

<table>
<thead>
<tr>
<th>Investor Number</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor or Investor-Advisor</td>
<td>Investor</td>
<td>Investor</td>
<td>Investor</td>
<td>Advisor</td>
<td>Investor</td>
</tr>
<tr>
<td><strong>Additional Characteristics</strong></td>
<td>Age under 40</td>
<td>Age above 40; Long-time investor; Liquidating real estate holdings due to retirement</td>
<td>Age above 40; Responds on behalf of ~60 German Taurus investors; He advises</td>
<td>Age under 40; Manages family's money.</td>
<td></td>
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<tr>
<td>Years of active investment</td>
<td>7-8 years</td>
<td>~15 years</td>
<td>40 years</td>
<td>n/a</td>
<td>14 years</td>
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<tr>
<td>Years of US real estate investment</td>
<td>6 years</td>
<td>11 years</td>
<td>5 years</td>
<td>17 years of advising for US real estate investments</td>
<td>14 years</td>
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<tr>
<td>Real estate investment location</td>
<td>Germany</td>
<td>UK, Switzerland</td>
<td></td>
<td></td>
<td>Canada</td>
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<tr>
<td>Years of investing with Taurus</td>
<td>5 years</td>
<td>11 years</td>
<td>6 years</td>
<td>7 years of advising Taurus clients</td>
<td>5 years</td>
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<tr>
<td>Total number of Taurus deals (sold and currently invested)</td>
<td>4</td>
<td>10</td>
<td>3</td>
<td>66 (deals advised)</td>
<td>4</td>
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<td>Total current investment with Taurus</td>
<td>Investment vehicle: Private person Corp/ Limited Partnership Current Amount of Capital of Investors Advised</td>
<td>0.23%</td>
<td>0.94%</td>
<td>no personal investment</td>
<td>0.44%</td>
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<td>2.19%</td>
<td>4.38%</td>
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<td>Investor Number</td>
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<td>Land</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
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<td>Does location of investment matter?</td>
<td>Yes</td>
<td>Depending on Taurus expertise</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>Trust Taurus' recommendation</td>
<td>No</td>
<td>As long as there is good profit</td>
<td>No, but geographic diversification important</td>
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<td>Regions invested</td>
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<td>•</td>
<td>•</td>
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<td></td>
<td>Washington DC Area</td>
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<td>Southeast (Florida)</td>
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<td>South</td>
<td>•</td>
<td>•</td>
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<td>•</td>
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<td>Percentage of real estate investments in overall portfolio</td>
<td>40-45%</td>
<td>33-40%</td>
<td>80%</td>
<td>n/a</td>
<td>50%</td>
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<td>Percentage of US real estate investments in overall portfolio</td>
<td>10-15%</td>
<td>24-28%</td>
<td>5%</td>
<td>n/a</td>
<td>20-30%</td>
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<td>Expects initial yields and IRRs in US real estate vs. German real estate (after tax)</td>
<td>Higher in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td></td>
<td>Same</td>
<td>•</td>
<td>•</td>
<td>•</td>
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</tr>
<tr>
<td></td>
<td>Lower in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
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<tr>
<td>Preferred holding period in US real estate</td>
<td>4-5 years</td>
<td>3 years</td>
<td>5 years</td>
<td>5 years</td>
<td>4 years</td>
</tr>
<tr>
<td>Preferred holding period in US real estate than in German real estate</td>
<td>Shorter holding in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
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<tr>
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<td>Same</td>
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<td></td>
<td>Longer holding in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td>Preferred holding period in US real estate than in other private equity investments in portfolio</td>
<td>Shorter holding in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td></td>
<td>Same</td>
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<td>•</td>
<td>•</td>
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<tr>
<td></td>
<td>Longer holding in the US</td>
<td>•</td>
<td>•</td>
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</tr>
<tr>
<td></td>
<td>Cannot compare</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
</tbody>
</table>

stocks = 5 years; venture = 3-5 years
<table>
<thead>
<tr>
<th>Investor's anticipated percentage allocation to US real estate over the coming 2 years</th>
<th>Increasing the percentage</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holding percentage the same</td>
<td>Decreasing the percentage</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Distributions (Current Income) from deal</th>
<th>Keep in the US and Reinvested Bring back to Germany Depends</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Final Distribution (from sale)</th>
<th>Keep in the US and Reinvested Bring back to Germany Depends</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Are tax considerations important in above 2 decisions?</th>
<th>Yes</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investor Number</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>-----------------</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>----</td>
<td></td>
</tr>
<tr>
<td>Investor or Investor-Advisor</td>
<td>Investor</td>
<td>Advisor; (Tax advisor)</td>
<td>Investor</td>
<td>Investor</td>
<td>Investor</td>
<td></td>
</tr>
<tr>
<td>Additional Characteristics</td>
<td>Age under 40; Manages family's investments; Interview focused on his personal investments</td>
<td>Age above 40; Responds on behalf of the 15 German Taurus investors he advises</td>
<td>Age above 40; start-up VC</td>
<td>Age above 40; Has $0 40; interested in future investment</td>
<td>Woman</td>
<td></td>
</tr>
<tr>
<td>Years of active investment</td>
<td>2 years, personally; (family 12-14 years)</td>
<td>40 years</td>
<td>15 years</td>
<td>40 years</td>
<td>20 years</td>
<td></td>
</tr>
<tr>
<td>Years of US real estate investment</td>
<td>2 years, personally; (family 12-14 years)</td>
<td>6 years</td>
<td>6 years</td>
<td>20 years</td>
<td>17 years</td>
<td></td>
</tr>
<tr>
<td>Real estate investment location</td>
<td>Germany</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td></td>
<td>US</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Others</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Canada</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Netherlands</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Netherlands</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td></td>
</tr>
<tr>
<td>Years of investing with Taurus</td>
<td>2 years, personally; (family 8 years)</td>
<td>5 years</td>
<td>4 years</td>
<td>5 years</td>
<td>5 years</td>
<td></td>
</tr>
<tr>
<td>Total number of Taurus deals (sold and currently invested)</td>
<td>2. (6 - family)</td>
<td>60+</td>
<td>4</td>
<td>2</td>
<td>2 (personal); 1 (corporation); 1 sold</td>
<td></td>
</tr>
<tr>
<td>Total current investment with Taurus</td>
<td>Investment vehicle:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Private person Corp/ Limited Partnership</td>
<td>1.01%</td>
<td>0.19%</td>
<td>0.47%</td>
<td>0%</td>
<td>0.25%</td>
</tr>
<tr>
<td></td>
<td>Current Amount of Capital of Investors Advised</td>
<td>2.34%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deal type</td>
<td>Development Acquisition</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Investor Number</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>-----------------</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td></td>
</tr>
<tr>
<td><strong>Building type</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Industrial</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>•</td>
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<tr>
<td>Residential</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Hotel</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Does location of investment matter?</strong></td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Regions invested:</strong></td>
<td>Northeast</td>
<td>Washington</td>
<td>DC Area</td>
<td>Southeast (Florida)</td>
<td>South</td>
<td>Southwest (New Mexico)</td>
</tr>
<tr>
<td></td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td><strong>Percentage of real estate investments in overall portfolio</strong></td>
<td>30-40%</td>
<td>n/a</td>
<td>15-20%</td>
<td>5%</td>
<td>30% (personal); 90% (corporation)</td>
<td></td>
</tr>
<tr>
<td><strong>Percentage of US real estate investments in overall portfolio</strong></td>
<td>80%</td>
<td>n/a</td>
<td>5-7%</td>
<td>3%</td>
<td>9% (personal); 4.5% (corporation)</td>
<td></td>
</tr>
<tr>
<td><strong>Expects initial yields and IRRs in US real estate vs. German real estate (after tax):</strong></td>
<td>Higher in the US</td>
<td>Same</td>
<td>Lower in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td><strong>Preferred holding period in US real estate</strong></td>
<td>5 years</td>
<td>5-7 years</td>
<td>5 years</td>
<td>5 years</td>
<td>3-5 years</td>
<td></td>
</tr>
<tr>
<td><strong>Preferred holding period in US real estate than in German real estate:</strong></td>
<td>Shorter holding in the US</td>
<td>Same</td>
<td>Longer holding in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td><strong>Preferred holding period in US real estate than in other private equity investments in portfolio:</strong></td>
<td>Shorter holding in the US</td>
<td>Same</td>
<td>Longer holding in the US</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td>Stocks</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>VC investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IPOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Shares</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Stock = shares</td>
<td>5 - 3 years</td>
<td>20 - 30 years</td>
<td>•</td>
<td>•</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td>Cannot compare</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investor Number</td>
<td>Investor's anticipated percentage allocation to US real estate over the coming 2 years</td>
<td>Increasing the percentage</td>
<td>Holding percentage the same</td>
<td>Decreasing the percentage</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>-----------------</td>
<td>-----------------------------------------------</td>
<td>---------------------------</td>
<td>-----------------------------</td>
<td>--------------------------</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Distributions (Current Income) from deal</td>
<td>Keep in the US and Reinvested Bring back to Germany Depends</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Final Distribution (from sale)</td>
<td>Keep in the US and Reinvested Bring back to Germany Depends</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>Are tax considerations important in above 2 decisions?</td>
<td>Yes</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>No</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
</tbody>
</table>
8.2 Ranking Analysis

8.2.1 Individual Investor Rankings

Investors provided the following factor ranking during their interviews. Investor 9 indicated that he cannot rank the factors due to their interdependencies.

<table>
<thead>
<tr>
<th>Factor Rank</th>
<th>Investor 1</th>
<th>Investor 2</th>
<th>Investor 3</th>
<th>Investor 4</th>
<th>Investor 5</th>
<th>Investor 6</th>
<th>Investor 7</th>
<th>Investor 8</th>
<th>Investor 9</th>
<th>Investor 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Diversif</td>
<td>Trust</td>
<td>Higher</td>
<td>Trust</td>
<td>Diversif</td>
<td>Diversif</td>
<td>N/A</td>
<td>Higher</td>
<td>Returns</td>
<td>Trust</td>
</tr>
<tr>
<td>2</td>
<td>Trust</td>
<td>Strategy</td>
<td>Currency</td>
<td>Exchange</td>
<td>Rate</td>
<td>Trust</td>
<td>Higher</td>
<td>Returns</td>
<td>Tax</td>
<td>Trust</td>
</tr>
<tr>
<td>3</td>
<td>Higher</td>
<td>Returns</td>
<td>Strategy</td>
<td>Risk</td>
<td>Higher</td>
<td>Returns</td>
<td>Trust</td>
<td>Higher</td>
<td>Returns</td>
<td>Trust</td>
</tr>
<tr>
<td>4</td>
<td>US Politics</td>
<td>Higher</td>
<td>Returns</td>
<td>Risk</td>
<td>Diversif</td>
<td>Higher</td>
<td>Trust</td>
<td>Higher</td>
<td>Returns</td>
<td>Trust</td>
</tr>
<tr>
<td>5</td>
<td>Tax</td>
<td>Trust</td>
<td>US Economy</td>
<td>Trust</td>
<td>US Economy</td>
<td>Higher</td>
<td>Returns</td>
<td>Trust</td>
<td>Trust</td>
<td>Diversif</td>
</tr>
<tr>
<td>6</td>
<td>US Economy</td>
<td>Diversif</td>
<td>US Economy</td>
<td>Higher</td>
<td>Returns</td>
<td>Trust</td>
<td>Trust</td>
<td>Trust</td>
<td>Trust</td>
<td>US Economy</td>
</tr>
</tbody>
</table>

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### 8.2.2 Collective Hierarchy

Individual investor rankings were consolidated into one collective factor hierarchy. A factor with a rank of "1" indicates that this factor is most important for the investor's decision to invest in US real estate. A rank of "2" indicates that the factor is second most important. A rank of "6" indicates that the factor is not at all important in the investor's decisions.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Investor Number</th>
<th>Total Score</th>
<th>Avg Rank</th>
<th>Numeric Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diversification</td>
<td>1 3 4 2 1 1 3 6</td>
<td>23</td>
<td>2.3</td>
<td>3</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>6 6 6 6 1 6 6 6</td>
<td>65</td>
<td>5.5</td>
<td>10</td>
</tr>
<tr>
<td>German tax laws</td>
<td>6 5 1 2 6 2 3 1</td>
<td>30</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>US tax laws</td>
<td>6 6 6 2 6 2 3 1</td>
<td>36</td>
<td>3.6</td>
<td>5</td>
</tr>
<tr>
<td>US economy</td>
<td>6 4 5 2 3 4 3 6</td>
<td>41</td>
<td>4.1</td>
<td>6</td>
</tr>
<tr>
<td>US politics</td>
<td>2 6 5 6 6 4 6 3</td>
<td>50</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>Higher returns</td>
<td>1 2 1 2 3 2 3 1</td>
<td>19</td>
<td>1.9</td>
<td>1</td>
</tr>
<tr>
<td>Lower risk of US RE</td>
<td>6 2 2 6 3 6 6 6</td>
<td>45</td>
<td>4.5</td>
<td>7</td>
</tr>
<tr>
<td>Strategic reasons</td>
<td>1 3 6 6 1 6 6 6</td>
<td>47</td>
<td>4.7</td>
<td>8</td>
</tr>
<tr>
<td>Trust</td>
<td>1 1 3 1 2 3 3 2</td>
<td>21</td>
<td>2.1</td>
<td>2</td>
</tr>
<tr>
<td>Others</td>
<td>6 6 6 6 6 6 6 6</td>
<td>60</td>
<td>6</td>
<td>11</td>
</tr>
</tbody>
</table>
8.3 Converting US NPI Returns in terms of Marks

8.3.1 Yearly Average D. Mark/US Dollar Exchange Rate (1995-2002)\(^99\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Yearly average D. Mark/US Dollar Exchange Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>1.4331</td>
</tr>
<tr>
<td>1996</td>
<td>1.5048</td>
</tr>
<tr>
<td>1997</td>
<td>1.7339</td>
</tr>
<tr>
<td>1998</td>
<td>1.7593</td>
</tr>
<tr>
<td>1999</td>
<td>1.8359</td>
</tr>
<tr>
<td>2000</td>
<td>2.1240</td>
</tr>
<tr>
<td>2001</td>
<td>2.1855</td>
</tr>
<tr>
<td>2002</td>
<td>2.0755</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Yearly average Euro/US Dollar Exchange Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1.0579</td>
</tr>
</tbody>
</table>

8.3.2 Conversion Formula Derivation

Definitions:

\[ R_M = \text{German investors’ returns in Marks, for US real estate investments} \]

\[ R_D = \text{US real estate returns in US dollars} \]

\[ r_0 = \text{Exchange rate } \frac{\text{Marks}}{\text{USDollars}} \text{ at } t_0 \]

\[ r_1 = \text{Exchange rate } \frac{\text{Marks}}{\text{USDollars}} \text{ at } t_1 \]

\[ CF_t = \text{Cashflow of Property at } t, \text{ US dollars} \]

\[ V_0 = \text{Value of Property at } t_0, \text{ US dollars} \]

\[ V_1 = \text{Value of Property at } t_1, \text{ US dollars} \]

\[ y_1 = \text{Income return } = \frac{CF_t}{V_0} \]

\[ g_1 = \text{Appreciation return } = \frac{V_1 - V_0}{V_0} \]

\[ e = \text{Growth rate of foreign exchange rate} \]

Formula Derivation:

\[ r_1 = r_0 * (1 + e) \]

\[ r_t = r_0 + r_0 e \hspace{1cm} (1) \]

\[ e = \frac{r_1 - r_0}{r_0} \]

For German investors:

Value of US property in Marks \[ = r_1 V_1 \hspace{1cm} (2) \]

CF of US property in Marks \[ = r_1 CF_t \hspace{1cm} (3) \]
\[ g_1 = \frac{V_1 - V_0}{V_0} \]
\[ g_1 = \frac{V_1}{V_0} - 1 \]
\[ \frac{V_1}{V_0} = g_1 + 1 \quad (4) \]

Start with this basic equation:
\[ R_D = \frac{CF_1}{V_0} + \frac{V_1 - V_0}{V_0} = y + g \]

Substitute with equations (2) and (3) to get:
\[ R_{M_1} = \frac{r_0 CF_1 + r_0 V_1 - r_0 V_0}{r_0 V_0} \]

Substitute with equation (1) to get:
\[ R_{M_1} = \frac{(r_0 + r_0 e) * CF_1}{r_0 V_0} + \frac{[(r_0 + r_0 e) * V_1] - r_0 V_0}{r_0 V_0} \]
\[ R_{M_1} = \frac{r_0 CF_1 + r_0 e CF_1 + r_0 V_1 + r_0 e V_1 - r_0 V_0}{r_0 V_0} \]
\[ R_{M_1} = \frac{CF_1 + e CF_1}{V_0} + \frac{V_1 + eV_1 - V_0}{V_0} \]
\[ R_{M_1} = \frac{CF_1 (1+e)}{V_0} + \frac{eV_1 + V_1 - V_0}{V_0} \]
\[ R_{M_1} = \left[ \frac{CF_1}{V_0} \right] (1+e) + \frac{eV_1 + V_1 - V_0}{V_0} \]

Substitute in \( y \) and \( g \) to get:
\[ R_{M_1} = y_1 (1+e) + \frac{eV_1}{V_0} + g_1 \]

Substitute in (4) to get:
\[ R_{M_i} = (1 + e)y_i + e(g_i + 1) + g_i \]

This formula is used to convert US NPI returns (US Dollars) into Marks, in order to compare US NPI returns with German investment returns in Marks.
### 8.3.3 US NPI Returns (US Dollars) Converted to Marks Using Formula from 8.3.2

<table>
<thead>
<tr>
<th>Year</th>
<th>US NPI Returns (in US dollars)</th>
<th>Income Returns (in US dollars)</th>
<th>Capital Returns (in US dollars)</th>
<th>Exchange Rate D. Mark/US Dollar, yearly average</th>
<th>Change in Exchange Rate the change in yearly exchange rate to year (in Marks)</th>
<th>US NPI Returns (in Marks)</th>
<th>German DIX Returns (in Marks)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>1.4331</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>n/a</td>
</tr>
<tr>
<td>1996*</td>
<td>1.5048</td>
<td>1.5048</td>
<td>1.5048</td>
<td>15.73%</td>
<td>3.50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>1.7339</td>
<td>1.7339</td>
<td>1.7339</td>
<td>15.22%</td>
<td>3.70%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>1.46%</td>
<td>1.46%</td>
<td>1.46%</td>
<td>17.49%</td>
<td>4.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>1.8359</td>
<td>1.8359</td>
<td>1.8359</td>
<td>16.03%</td>
<td>5.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>2.1240</td>
<td>2.1240</td>
<td>2.1240</td>
<td>29.62%</td>
<td>5.70%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>2.1855</td>
<td>2.1855</td>
<td>2.1855</td>
<td>10.47%</td>
<td>5.90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
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<td>2.0755</td>
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<tr>
<td>Avg</td>
<td>17.39%</td>
<td>17.39%</td>
<td>17.39%</td>
<td>17.39%</td>
<td>4.65%</td>
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<tr>
<td>Stdev</td>
<td>0.0341</td>
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<td>0.1031</td>
<td>0.0093</td>
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Ratner, Juliana. (2003) “Germans get high-spirited: The country’s open-ended funds are buying more grade A quality real estate than ever before as they try to invest the record amounts of cash that investors are giving them.” The Financial Times (London). May 16, 2003.


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