FMA Information about Real Estate Bonds

What is a real estate bond?

The designation "Immobilienanleihe" (real estate bond) does not have any legal significance. A real estate bond usually is offered in the form of a corporate bond in an undertaking whose core business is related to the construction, acquisition, development and/or management of real estate. However such undertakings are not actually legally obliged to invest the funds raised by the bond issue in real estate in any form.

An undertaking issuing a bond with precisely determined conditions collects money from investors and normally makes interest payments in return. The amount of the interest is primarily based on the credit quality of the undertaking that issues the bond and should correspond with the risk that is inherent to the bond. Generally speaking it applies that a higher rate of return is always associated with a higher risk.

By buying a real estate bond the bondholders therefore neither directly participate directly in a property, nor are they entered as owners in the land register, nor do they gain a right of pledge in the land register - unless the collateralisation and/or a relevant use are explicitly defined in a contract.

What should investors look out for when buying a real estate bond, and what risks exist?

- **Buyers of real estate bonds potentially share in the risks of the undertaking:** Purchasing a property is not automatically profitable. The risk exists from the continuing low interest rate that some properties are overvalued and undertakings have increasing difficulties in finding suitable properties. This leads to undertakings instead investing in more high-risk properties or in properties that are currently still under construction or are only in the planning stage. The success of many real estate development projects only becomes apparent after several years.
  The risks of the undertaking therefore include for example all risks that emanate from a purchase at a higher price than normal, or the planning, construction and completion of a property. Depending on the business model that is pursued, some risks may also even remain after completion for the undertaking, such as due to wrong investments and lost rent.

- **Losses or defaults may occur against the investment or the returns that are hoped for:**
  Real estate bonds are not secured as a rule, meaning that in the event of the insolvency of the undertaking collaterals will not be available to bondholders, with the risk of loss or even a dead loss therefore being highest for such creditors. In the case of an insolvency, creditors, to whom securities were granted, as well as creditors of senior bonds will be serviced first.

- **Funding risk:**
  In many cases real estate bonds have high returns despite relatively short terms. This has proven to be particularly risk, since the repayment of the bond must be refinanced by a new bond issuance, and it may lead to a default during such a process.

  It should also be noted that some bonds may be redeemed early. The expected term and return may change as a result.

- **The bond may become less attract once purchased, and is subject to fluctuations in value:**
  As a result of changes in market interest rates, the bond may lose value: in the case of increasing market interest rates, the market value of bonds with a lower rate of interest falls accordingly. The market value also falls in the event of a deterioration of the credit quality of the issuer.
  Furthermore risks of exchange rate fluctuations also exist in the case that the bond is not repaid in Euro. If the currency in which the bond is denominated falls against the Euro, then investors sustain currency losses.
  In the case of bonds that are less actively traded on small markets, the risk also exists that their ability to be traded is restricted. The buyer of the bond may possibly not be able to sell the bond at any time or quickly without having to sustain large markdowns in price.

It generally applies that relevant information about the risks and the undertaking itself must be honest and unambiguous and shall not be allowed to be misleading. Information should be easily accessible for investors, in particular by the undertaking also regularly publishing a balance sheet or an annual report.

An investor should also inform him/herself about certain characteristics of the bond that determine payments. The payment may be dependent on specific conditions, or might be associated with subordination. Rules in this regard can be found in the conditions of the bond.

Market Study on Austrian Real Estate Bonds

The FMA conducted a market analysis about real estate bonds.[1] As of April 2018, the time of the analysis being conducted, some 189 bonds had been issued by 82 issuers and with a total outstanding planned issue volume of EUR 6,496.5 million.

The undertakings that issue real estate bonds, are very varied, both in terms of their business models as well as their size. The terms of the majority of bonds are between 3 and 10 years. Some undertakings offer interest payments of up to 12% p.a. This value is higher by far than the typical average market returns for corporate bonds. Generally speaking it again applies that **a greater return is always associated with a higher risk.**

[1] Undertakings that issue real estate bonds, are not as a rule subject to supervision by the FMA. The FMA therefore does not have specific and complete data reporting available. The market study therefore made use in part of publically available data and partially data from other institutions.

Some undertakings issue quite a lot of bonds and therefore are able to take on a relatively high amount of debt. **– This could be an indication of the undertaking's financial situation being somewhat strained. It is noted that the FMA as a rule does not perform any solvency supervision over undertakings that issue real estate bonds.**

The FMA's analysis has revealed that the **majority of real estate bonds do not have any form or collateralisation or a capital guarantee**. It was also determined that **undertakings offering high interest payments increasingly have very low equity capital**. However, often only very little information is provided about the financial situation of the undertaking. It is therefore made very difficult for the purchaser of the bond to gain an adequate picture of the situation of the undertaking. Only just under a third of the real estate bonds offered had a securities prospectus due to a legal obligation to produce one, which thereby made it easier for the investor to inform him/herself about the risks and rights associated with the bond as well as the assets and earnings situation or the future prospects of the undertaking.