

said negotiations are now taking place that could lead to an agreement by August. "There are two possibilities - the first is to divide up Bami's assets, the second is to sell. But this is not the right moment (to sell) because the assets have declined in value by around 35% since the stake was acquired," he said. ■ *pie* (Full story first published in *PIE* 167 on 24 May)

PIE COMMENT: We remain highly sceptical since Rivero's credibility is extremely low. This is a clear at-

tempt to persuade existing major shareholders to buy him out at a good price. Politics is at play between France and Spain over this issue that could, if the otherwise very rigorous French real estate community allows, get in the way of a complete solution to the scandal at Gecina. Merely the fact the Bami investment, according to his own reckoning, has lost Gecina shareholders around €37m over 12 months – and saved Rivero and Soler the same amount – should unfurl a very large red flag for French authorities.



GUEST COLUMN

GSW IPO failure maybe correct response from well-functioning capital markets

by Ramón Sotelo, University of Weimar

The international community has identified good reasons for the failure of the initial public offering of Berlin-based housing company GSW: the high volatility of the capital market amid the euro crisis sparked by Greek debt worries, large loans from GSW maturing next year, and the fact that the major part of the funds raised would go to the owners and not for reinvestment. The failed IPO was interpreted as a market failure as it was already planned with a significant discount to net asset value. However, told that way, the story does not consider the modern theory of finance, but remains within the neoclassical thinking where each asset has a pricing independent from the usage of financial vehicles. Within this universe of the professors Modigliani and Miller - who, together with Harry Markowitz, are the fathers of neoclassical financial theory - the financial vehicle does not matter. The capital cost depends on the latitude presented by the financier. The latitude of a financial vehicle is defined, in other words, by the possibility of action the financier opens to the recipient.

To understand this idea, imagine an hotelier who needs employees to fulfil duties such as housekeeping and accountancy. Employees executing the latter tasks, for example, need access to the bank account and this will imply a larger latitude than those charged with the former. If

one also gave access to the bank account to housekeeping employees the risk of fraud for the principal would be larger - without the employees being enabled to do a better job on assigned tasks. Thus in a financing, the rising latitude of action offered by the principal brings with it higher risk - and in a financial relationship, this is linked with higher cost of capital. Different financial vehicles offer different latitudes of action for agents. The financier can be seen as the principal, and the recipient of the money as the agent. In the case of a listed corporation, the shareholder is the principal, the management of the company the agent. The more latitude of action the principal gives to the agent, the higher the risk the principal takes on, and therefore the higher his capital cost. This is the main reason why the capital cost of a covered bond is lower than for a closed- or open-ended fund or a REIT. And the capital cost of a listed ordinary corporation is much higher, while private equity, given a very large latitude of action, is the most expensive form of financing. Therefore capital costs primarily hinge on the offered latitude. Putting the key knowledge of investment banking into a nutshell: choose the financial vehicle with the appropriate latitude to allow the business to function, but no more.

Looking at the planned IPO from GSW that way, its failure looks obvious. Trying to finance a conservative business model - the pure renting

of housing accommodation - through a vehicle with a rather high latitude and therefore with a high capital cost means the discount to NAV requested by the market becomes too wide for the agents to accept. So the cancelled GSW IPO was not a failure of markets but their correct response. I would say that post-crisis, enough principals have seen investments lose value and realised at least some of this teaching: capital markets under current conditions are seeking a much more relevant pricing model. The right vehicle for GSW might have been a REIT, but in Germany REITs may not finance existing housing stock. In these terms, one peculiar, additional aspect of the story is that the city of Berlin, governed by the very political party - Social Democrats - which opposed the introduction of residential G-REITs, obtained a payment of €30m for permitting the IPO to proceed outside previously contracted arrangements. On the positive side, this modern approach at the same time identifies a possible solution for GSW owners in the sales process now developing along other lines. They either wait until housing stock is permitted for German REITs and then float in an IPO, or find strategic investors such as insurance companies or pension funds for whom the principal-agent relationship is appropriate. ■ **rs**

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