Germany Opportunities and barriers to inbound construction

G20 rankings & data

<table>
<thead>
<tr>
<th>G20 heatmap rankings</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction industry health</td>
<td>Construction industry value</td>
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<td>Construction industry, real growth</td>
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<tr>
<td></td>
<td>Announced spend on construction in next 3 years</td>
</tr>
<tr>
<td>Country financial health</td>
<td>Budget balance</td>
</tr>
<tr>
<td></td>
<td>Overall announced fiscal stimulus</td>
</tr>
<tr>
<td></td>
<td>GDP/Head</td>
</tr>
<tr>
<td></td>
<td>Credit ratings rank</td>
</tr>
<tr>
<td>Ease of doing business</td>
<td>Doing business overall rank</td>
</tr>
<tr>
<td></td>
<td>Dealing with construction permits rank</td>
</tr>
<tr>
<td></td>
<td>Business transparency rank</td>
</tr>
<tr>
<td>Tax regime</td>
<td>BDO overall tax rank</td>
</tr>
<tr>
<td></td>
<td>World bank – paying taxes rank</td>
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Financial metrics

- Total fiscal stimulus announced: £58.4bn
- Announced spend on construction in the next 3 years including fiscal stimulus to construction: £15.1bn
- Construction industry value – 2009: £86bn
- Main corporate tax rate: c29%

Construction sector metrics

<table>
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<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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<tr>
<td>Construction industry value, £bn</td>
<td>83</td>
<td>86</td>
<td>86</td>
<td>88</td>
<td>91</td>
<td>94</td>
<td>98</td>
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<tr>
<td>Construction industry, real growth, per cent y-o-y</td>
<td>3.9</td>
<td>1.5</td>
<td>-2.0</td>
<td>2.0</td>
<td>1.5</td>
<td>2.0</td>
<td>1.2</td>
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<tr>
<td>Construction industry, per cent of GDP</td>
<td>3.7</td>
<td>3.7</td>
<td>3.7</td>
<td>3.8</td>
<td>3.8</td>
<td>3.7</td>
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BDO review of tax

- Amongst the lowest national tax rates and still relatively competitive effective rate including variable state taxes
- Thin capitalisation rules are particularly restrictive as they apply to bank and other unconnected finance as well as shareholder debt
- Relatively generous system of tax depreciation
- Useful but relatively limited sector specific tax breaks

Overall scoring 5/10

12= out of the G20

BDO ease of doing business

There are some significant barriers for inbound construction activity however it is possible to get round these

<table>
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<tbody>
<tr>
<td></td>
<td>Very easy</td>
<td>Quite easy</td>
<td>Average</td>
<td>Quite difficult</td>
<td>Very difficult</td>
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Top construction firms

- Bilfinger & Berger
- Hochtief AG (£17.8bn)
- Kemna bau andreae gmbh & co. KG
- Eurovia Verkehrsbau Union GMBH
- Eurovia Teerbau GMBH
- Bien-Zenker AG

This dominance does not form a barrier for inbound construction companies – over recent years companies from neighbouring countries (such as Strabag, Alpine) have enjoyed successful growth in Germany.
“Germany has one of the largest construction sectors in Europe and with its stable economy and low public debt, has few barriers to inbound construction activity. Demand is tempered by highly developed existing infrastructure and a slowing private and commercial sector. Furthermore the fallout from the downturn is predicted to continue and impact on the sector into 2010.”

Richard Kelly
Partner, Head of Construction

“Following a recent overhaul of its corporate tax system, Germany’s tax rates are now reasonably favourable but care needs to be taken with thin capitalisation rules that, unusually, can restrict tax relief for bank interest as well as shareholder debt interest.”

Stephen Herring
Tax Partner, Real Estate and Construction

Opportunities and barriers

13th overall in our G20 heat map, Germany offers relatively low barriers to entry, however the size of the opportunity is lower than others due to some construction saturation and a slowing private sector only offset by government driven activity.

In 2007 Germany accounted for around 15 per cent of European construction activity, worth an estimated €86bn. Germany has an extensive rail and road network in which it invests heavily. With 48,215km of railways, it has the world’s fifth-largest network. Its road network stretches for 231,000km and motorways are used to carry 69 per cent of total freight in the country, and as such are vital for the economy.

Growth in non-residential investment in Germany slowed over the period 2005-2008, from 10.1 per cent in 2006 to 4.4 per cent in 2008. The slow down is attributed to mature public infrastructure and sluggish activity in key private sectors. The global financial downturn has resulted in a further slowing of the construction industry. Activity in the commercial construction sector, one of the areas that had performed reasonably well in recent years, dropped off significantly in the second half of 2008.

The short term outlook for non-residential investment in Germany is weak, with many commentators expecting it to stagnate or contract in 2009. In January 2009 growth forecasts for the construction and infrastructure industry were revised downwards from 1.3 per cent growth to a 2 per cent contraction. ZDB, a German construction industry association, reports slightly more optimistic figures, forecasting nominal construction sales growth to slow to 1.3 per cent. HDB, the other major German construction industry association, expects nominal construction sales to stagnate this year.

In January the Bundesbank reported a fall in German construction orders in December; extending falls reported in November:

One area of relative strength is expected to be civil construction, as the Government increases spending to compensate for waning private sector investment. In November 2008 the German government unveiled a €58.4bn stimulus programme in which public infrastructure was made a spending priority.

Spending under the package will focus on new public investments in infrastructure and transportation. Investments announced include:

- £1.9bn – federal roads, railways and rivers.
- £1.9bn – federal government buildings, equipment and research conducted by the government.
- £6.0bn – education, ie the construction or renovation of day-care facilities for children, schools, universities and research institutes on the state or local level.
- £3.3bn – infrastructure on a local level such as hospitals, local roads and urban or rural development.

Utilities are likely to offer a good opportunity over the longer term driven by increasingly stringent self-imposed carbon-dioxide emissions limits. £37bn is likely to be invested in the expansion of renewable energy resources. In addition, an estimated £28bn will be directed towards the construction of power plants and related infrastructure by 2012, much of which will most likely be clean coal based.

Germany signed 87 PPP deals between 2001 and 2007 worth a total value of around €3bn. In 2007 35 new projects were signed, worth about €1.5bn. The majority of the projects came from municipalities (64 out of 87). Projects concerning schools, day-care centres and educational establishments are the main areas of focus, closely followed by the recreation, culture, event and sport sector with 25 projects and administrative buildings with 13 projects.

Barriers/challenges to construction activity

- Complex labour laws including legislation on subcontracting
- Relatively complex process for building permission (Germany ranked 14th out of the G20 for Dealing with Construction Permits)
- Falling private and commercial demand for construction projects.

BDO viewpoint and advice

Pitfalls to avoid when doing business in Germany

- To underestimate legal barriers (labour and tax law).
- To underestimate local networks and their role in dealing with regulatory and, in some cases, also arranging finance.

Practical advice for inbound construction activity

- Forming a strategic alliance with local companies to aid understanding of local laws and regulations as well as incentives to take advantage of.
- Make use of not only international law firms but also local law firms with a good reputation to get the best advice when forming alliances and tendering for projects.
- When tendering for PPP, the following criteria apply:
  - The project must be of obvious relevance to development policy. It must be in accordance with the priority areas of development cooperation as agreed during government negotiations between Germany and the partner country.
  - Public and private contributions must complement each other in such a way that both parties can achieve their targets better, more cost-effectively and more quickly on account of the cooperation.
  - Public funding may only be provided if the private partner would otherwise not carry out the project.
  - The private partner must not gain any competitive advantages on account of the public funding provided.
  - The private partner must provide a substantial amount of funding to the PPP measure, generally at least 50 per cent of the overall volume.

Useful tax and other incentives for inbound construction activity

Main depreciation rates:

- Buildings – Straight line tax depreciation generally mandatory based upon useful economic life. Declining balance may also be available in certain circumstances.
- Tangible fixed assets (except for land) – tax depreciation is available at rates specified by the Federal Ministry of Finance.

Enhanced tax depreciation rates apply on costs of renovation and modernising buildings in specified redevelopment areas (at rates up to nine per cent) and on construction costs for flats to be let to lower earners (at rates up to 10 per cent).


