

Analysis of the investment in Karolinenviertel in Hamburg

Marc Meyer, 2011-03-30

Introduction

Property

The Property was bought in May 2007, consisting of 220 apartments, 5 commercial units and 13 parking lots. It was built between 1898 and 1900. The entire property consists of four street sections: Augustenpassage, Sternstraße, Beckstraße and Neuer Pferdemarkt. It has a size of 12,684 square meters in apartments and another 680 square meters in commercials. It amounts to the total size of 13.364 square meters. The gross rental income per year is around 1.576 T€ The property is located in an A-location. Hamburg-Sternschanze is, especially for younger people, one of the most requested districts in Hamburg, providing a wide variety of bars, galleries and small shops. Two public parks are close to the object. A bus and a metro station are reachable within short walking distance. The ingoing average residential rent level 2010 was 9.5 €per square meter. During 2009 we had reached a new lease level of 12.5 € for 2010 we were planning to reach 12.7 € The current potential is consequently 34 percent.

Maintenance

There has been a lot of deferred maintenance, which we wanted to get rid off. All the roofs needed to be refurbished as well as the facades. The staircases were refurbished and painted. The total maintenance costs were 3.55 T€

Tenants

In this property the tenants were not very careful with the building. Doors were damaged on purpose. The floors were covered with graffiti. The apartments were not very well-kept. There was garbage laying in the yard. Some tenants use blankets to prevent pedestrians from taking a look into the inside.

There are a few older tenants that love the area and have stayed there for several years. They were careful with the property. They mostly have low rent.

Situation before Investment

Property

The handover was on the 11.05.2007. The documentation of the property was very poor. We needed to investigate everything for ourselves to find out about the houses and the tenants. We had to change our property management to get better results and more information. We had to assign an engineer to survey the object and to draw new plans.

Tenants

The tenants living in the property were on the one hand older people, that had lived there all their lives and on the other hand young people. Those were the majority. They did not really care about the condition of this property. This is kind of typical of people living in this district.

Rents

The new lease level in 2009 had been around 12.0 €per square meter. Those flats were completely refurbished including the change of the heating system from night storage heater to district heating.

Wanted Situation after Investment

Property

The property should be in good condition, seen from a technical as well as optical point of view. The running maintenance should stay within the budget. No further complaints about mildew.

Tenants

The tenant structure must be changed from “antisocial” to “normal” people. A mix of older and younger people in this property would be perfect, i.e. students, employed people and senior citizens.

Rents

We want higher rents in this property. The new lease level after the investment should be more than 13.0 €per square meter

(completely refurbished apartment). Even consisting contracts could be raised.

Investment Specifications

Preface

The following measurements were all part of the budget of 2010. Everything started in April 2010 and was supposed to be completed by the end of 2010. But due to bad weather they finished at the end of February 2011.

We did not expect any risk in the assumed rent level and only a low risk from a technical point of view. The risk that the auditors would not approve that all costs could be activated was not seen by our accounting apartment. The total project costs of 4.700 T€ will be capitalized.

Key Facts

Type of Investment: façade, roof and staircase modernization

Maintenance Costs: 3.550 T€

- roofs Augustenpassage.....500 T€

- roofs Beckstraße.....1.000 T€

- roofs Neuer Pferdemarkt200 T€

- staircases Augustenpassage300 T€

- Augustenpassage, Beckstraße (front façade)1.000 T€

- façade Neuer Pferdemarkt (including balconies).....550 T€

Investment Costs: 1.150 T€

- Augustenpassage, Beckstraße (rear façade EIFS).....1.000 T€

- windows exchange (fluctuated apartments).....150 T€

Total Project Costs:..... 4.700 T€

Approximated Yield [on Total Project Costs]:1.6 %

Description

The property had been in bad shape. This has caused problems with mildew, high running maintenance costs and rent abatements. During 2009 the running maintenance costs were 20 €/per square meter and during 2010 already under 10 €/per square meter. To get rid of the these problems and to secure the substance of the property we had to renew the roofs completely, renew the facades, partly with insulation, refurbish balconies, change windows and refurbish staircases. The front facades were not insulated, since it is a listed building and heritage protected.

Economics

The greatest portion of the investment measure is remediating deferred maintenance – roofs, staircases and part of the facades. These costs are not able to be passed on to the tenants, hence will not give any return. They are however included in the current market valuation, which means that the market value will increase by an equal amount after finishing the project. However, parts of the costs, for the façade insulation, are able to be passed on to the tenants; a yearly gross rental income effect of 66 T€ yearly. We are also assuming a higher new lease level, due to the higher standard of the object after the project; a yearly gross rental income effect of 8 T€ All in all the project will raise the yearly gross rental income by 74 T€, which implies a yield of 1.6 percent on total project costs. As already mentioned above, the running maintenance costs due to the bad condition of the property are very high. During the year 2009 the running maintenance costs amounted to 20 €/per square meter, or 15 € per square meter more than what we expect after the project. This means 200 T€ lower running maintenance costs per year, raising the project yield to 5.8 percent.

Analysis

In General

The Karolinenviertel is one of the most requested districts in Hamburg, besides Eimsbüttel, Eppendorf, Altona, Ottensen and Barmbek. The increase of the new lease level with apartments that are not refurbished had already shown us that to invest in such an area or property and raising the rents even more or having the possibility to do so, would pay off. People asked us before we had invested, why we had not painted the walls or refurbished the roof. They wanted a house in a good shape. We wanted that, too.

Gross Rental Income

The gross rental income, when the project was started was around 1.576 T€ This will be increased in two ways. The first way is to pass on the modernization costs to the tenants. About 600 T€ out of 1.000 T€ total costs of the external façade insulation systems (EIFS) are able to be passed on the tenants. All tenants are affected by the measure. The pass on rate is 11 percent, which means that the derived gross rental income increase is 66 T€

	Costs possible to Pass On, T€		Share of Tenants		Pass on Rate		Gross Rental Income p.a., T€
EIFS (rear facades)	600	x	100%	x	11%	=	66
Total:	600	x	100%	x	11%	=	66

The second way is to reach a higher new lease level. We have expected at the beginning of 2010 to reach a new lease level of about 13.0 €per square meter after finishing the project, therefore 0.3 €per square meter higher than the calculated new lease level of 12.7 €per square meter. Therefore, the gross rental income increases by 8 T€ due to the assumed fluctuation of 17 percent.

	No. of sqm		Higher Lease Level		Expected Fluctuation		Gross Rental Income p.a., T€
standard increase	13.364	x	0,30	x	17%	=	8
Total:							8

People that were interested in our apartments saw that Akelius was investing a lot of money to raise the technical and visual standard and did not hesitate to pay even 13.50 €per square meter, which is even 0.8 €per square meter higher than the calculated new lease level of 12.7 €per square meter. Therefore, the gross rental income increases by 22 T€ due to the same assumed fluctuation of 17 percent.

	No. of sqm		Higher Lease Level		Expected Fluctuation		Gross Rental Income p.a., T€
standard increase	13.364	x	0,80	x	17%	=	22
Total:							22

The gross rental income of the entire project will be 88 T€ (instead of 74 T€). This is an increase by 19 percent. The yield on total project cost would climb up to 1.9 percent (1.6 percent).

	Gross Rental Income p.a., T€
Pass of modernization costs:	66
Higher rentals:	22
Total	88

Running Maintenance

The running maintenance cost in 2009 were about 20 €per square meter. In 2010, while the measures were going on, the running maintenance costs dropped to under 10 €per square meter. The new budget for 2011 shows running maintenance costs of 5 €per square meter. The outgoing number at the end of 2011 should stay within the budget.

Average Rent Level

The average rent level was increased from 9.56 €per square meter in April 2010 up to 9.96 €per square meter in March 2011. The average rent level increase is 4.2 percent.

Image

The Karolinenviertel is located in the inner city. Just near the Reeperbahn (red light district) and the Dom (annual fair) and a great park. The Alster is not far away and neither is the city centre with its shops. Those reasons make it one of the most requested districts in Hamburg. It is the lifestyle of the ordinary people but also is the extravagance of the “upper-class”. This is the change the district goes through. Today it has both faces. And our property should be special and make the tenants feel that way.

Conclusion

The Karolinenviertel is well-located. An investment that has positive aspects, such as the increase of the gross rental income and the reduction of deferred maintenance as well as the increase of the average rent level should be calculated very precisely

The figures lead to the conclusion that this project should be carried out, although the yield is not high. It is more a long-term investment considering the increase of the average rent level by 3.0 €per square meter within the entire property.