Acquisition Analysis – Angemünder Straße in Berlin

Pär Hakeman, 2011-03-30

Introduction

One of the first acquisitions in 2010 was the property Angemünder Straße in Berlin. The property contains 14 residential units with all in all 700 square meter residential area. The location, a calm side street in Berlin Mitte, is excellent. The average rent at signing was 7.32 € per month per square meter and we estimated the market rent to 10.50 € – after standard raising measurements. Five apartments were empty. The seller worked on two parallel transaction structures; a sale of the property to a long term investor such as Akelius or to sell the apartments to the tenants (or investors) as condominiums. In the latter case would it be positive for the purchase price if the apartments were empty.

The property fitted the category of small and beautiful; furthermore, the location was very good and the rent potential high.

Indicative Offer and Due Diligence Process

The initial contact with the seller, a Norweigian private investor was established by a real estate broker. In connection with the first contact we received some basic information like gross rental income, number of apartments, number of square meters and expected purchase price. After having analysed this information we inspected the property together with a technical consultant.

After the inspection we were in a position to make an indicative offer, meaning that we had analysed and clarified several of the key facts and figures needed for the purchase calculation, in particular required yield, market rent and vacancy risk. Furthermore, we were able to estimate the costs for standard raising measures. We estimated the location to an A location with a required yield of 4.4 percent, the market rent was estimated to 10.50 € per square meter, the fluctuation to 15%, the costs for standard raising measures to 110.000 €, including the renovation of the five empty apartments and the average costs for future renovation of apartments to 5.900 €.

Based on these figures we sent our indicative offer amounting to 1.000.000 € on the 10 of March 2010. As neither the technical, the business nor the legal due diligence were completed the indicative offer needed to be subject to due diligence and of course a Board approval.

The technical report was finalised on 25th March 2010. It did not contain any big surprises, neither regarding repair measures nor costs. As we had made fair and conservative estimations we only needed to specify the measures and make minor adjustments in the calculation.
All figures handed over to us, for example the tenant list, were verified in the due diligence.
Now we were able to finalise the Board application, which was approved on 6th April 2010. .

Negotiations, Signing and Closing

Based on the due diligence, in particular the technical due diligence, we obtained some good arguments for a minor adjustment of the purchase price, some 10.000-20.000€. These arguments were based on the seller's claims regarding the standard of the property, in this case regarding the windows. As the windows were in somewhat worse shape than claimed we were able to agree on a price reduction of 10.000 €, meaning 990.000 €.
The legal due diligence was uncomplicated. It was an asset deal and the seller was a German GmbH. There were neither any issues regarding the real estate register nor service agreements or other potential risks.
As we had five empty apartments we wanted to refurbish them directly after closing the deal, it was important for us to regulate that we would have free access to the building and the apartments before closing in order to prepare the refurbishment work. For example, visit the building with potential construction companies in order to negotiate the price and time table for the refurbishment measures. This was achieved.
The purchase agreement was signed on the 9th of April 2010 and the take over took place on 1st of July.

Take over and post closing measures

In this rather small transaction the major issue was to refurbish and rent out the five vacant apartments as soon as possible. We started this work even before closing by preparing and negotiating the agreements for refurbishment of the apartments. The work started in July and all apartments were ready in August and September.

The average costs per apartment were 25.000 €. The standard raising measures in general areas has not started yet, but are planned to start in Q2 or Q3 2011. For the time being we do not plan for any measures not identified in connection with the acquisition. The new lease level of 10.50 € has been reached, in fact we have rented out the five refurbished apartments to an average lease of 10.58 €. However, this took somewhat longer time than estimated. The first apartment was rented in mid September and the last in mid November. The longer vacancy period shall been seen in the light of the market rent system and the influence of the market rent on the value of the property. One has to find a balance between new lease level and vacancy.

Analysis of the business plan in figures

The acquisition business plan contains all relevant information for the valuation of the property and thus the purchase price. The main facts and assumptions are: average lease level compared to estimated new lease level, location/required yield, vacancy, costs for deferred maintenance, costs for refurbishment of apartments and the fluctuation.
The acquisition calculation is based on a ten year cash flow, including all cash in and cash out from the property in the first ten years. The estimated exit value of the property is considered as cash in, in this calculation. The cash flow, net operating income and yield for the first five years are set out in the projected cash flow sheet, which is part of the Board application. Below you will find the projected cash flow set out in the Board application and the assessed market value as of 31.12.2011.

Region:	East
City:	Berlin
Property:	Angermünder Straße 9-10
Date:	30.03.2010

PROJECTED CASH FLOW

	€/sqm	Y1	Y2	Y3	Y4	Y5	Average Growth Rate
Gross Rental Income:	**90,7**	**64**	**69**	**73**	**76**	**81**	**5,8%**
Vacancy:	*-0,9*	*-1*	*-1*	*-1*	*-1*	*-1*	
Vacancy Ratio:	*-1,0%*	*-1,0%*	*-1,0%*	*-1,0%*	*-1,0%*	*-1,0%*	
Net Rental Income:	**89,7**	**64**	**69**	**72**	**75**	**80**	**5,8%**
Maintenance:	-10,0	-7	-7	-7	-7	-7	
Costs for Unrented Areas:	-0,2	0	0	0	0	0	
Management:	-5,4	-4	-4	-4	-4	-4	
Other Costs:	-1,0	-1	-1	-1	-1	-1	
Administration:	-3,0	-2	-2	-2	-2	-2	
Costs:	**-19,7**	**-14**	**-14**	**-15**	**-15**	**-15**	**1,6%**
Net Operating Income:	**70,1**	**50**	**54**	**58**	**61**	**65**	**6,9%**
Yield:		**4,0%**	**4,4%**	**4,6%**	**4,9%**	**5,2%**	
Akelius Standard Refurbishments:	-124,2	-88	-6	-12	-12	-12	
Refurbishment Apartments:	-17,3	-12	-12	-11	-11	-10	
Cash Flow before Financing:	**-71,5**	**-51**	**37**	**35**	**39**	**43**	**-4,0%**

Market Valuation 2010.12.31		
	WE	
	T€	€/qm
Gross Rental Income:	**72**	**99,9**
Vacancy:	*0*	*0,0*
Vacancy Ratio:	*0,0%*	
Net Rental Income:	**72**	**99,9**
Maintenance:	-7,2	-10,0
Administration, External:	-3,8	-5,2
Administration, Internal:	-2,2	-3,0
Costs:	**-13**	**-18,2**
Net Operating Income:	**59**	**81,6**
Value before Adjustment:	**1.311**	**1.814**
Required Yield:	**4,50%**	

Adjustments:		
Deferred Maintenance:	-29	-40
Invest Apartments:	-19	-26
NPV Investments:	0	0
Vacancy:	-16	-22
Rent Potential:	59	82
Market Adjustment:	0	0
Total Adjustments:	**-5**	**-7**

Value after Adjustment:	**1.306**	**1.807**
Yield:	**4,52%**	

The main difference between the projected cash flow and the cash flow at year end is the rental income, which has increased significantly faster than estimated. The yearly rental income at year end was 72.000 € compared to 64.000 € in the business plan. When comparing the costs in business plan and the market valuation one shall keep in mind that the costs in the market valuation are based on standard assumptions, meaning that the costs are not the actual costs but costs that normally would occur for residential properties of the relevant standard.
The market value of 1.306.000 € is significantly higher than the current total investment costs of 1.162.000 €, which corresponds to a 12 percent increase. The current total investment cost consists of the purchase price 990.000 €, the acquisitions cost of 97.000 € and the investment costs of 75.000 €.

Conclusions

This case shows how the business developer identified the potential of the property and already in the purchase process focused on a speedy execution of the business plan. The asset manager managed to fulfil the expectations regarding new lease level and succeeded in keeping the costs for renovation of the five empty apartments.

The development in market value is extremely strong, in particular when looking at the relevant time period of six months. Normally it takes longer time to build up value, meaning increasing the net operating income.