

Operational Costs

Jordan Milewicz,

Introduction

Operational Costs in Germany

In Germany, basically all costs of a property have to be met by the owner of the property.

The owner has the possibility of allocating some of their costs to the tenants by an arrangement with the tenants. It is not necessary, but advisable to make a written arrangement by setting it in the lease contract, for example.

As a result of this arrangement, the owner of a property is obliged to invoice the tenants for the operational costs, annually. This is the reason why many private property owners avoid this arrangement, despite the fact that operational costs are becoming an increasing relevant factor.

The operational costs in Germany are legally regulated. From the 1st January 2004, the decree of operational costs – Betriebskostenverordnung (BetrKV) came into force. This decree defines what operational costs are, what kind of costs can be allocated, and what kinds of costs are not permitted to be allocated to the tenants.

Operational costs in accord with the BetrKV are standing costs to the owner resulting from the use of a property. Costs of capital, administration costs, and costs for maintenance are not apportionable operational costs.

The decree specifies the operational costs that can be allocated in seventeen cost items:

1. Running public charges – Property Tax
2. Costs for water supply
3. Costs for drainage
4. Costs for the heating system
5. Costs for the warm water supply system
6. Costs for combined heating and warm water supply systems
7. Costs for the elevator
8. Costs for street cleaning and waste disposal

9. Costs for property cleaning and pest removal
10. Costs for Garden upkeep
11. Costs for lighting
12. Costs for chimney sweeping
13. Costs for indemnity and property insurance
14. Costs for property caretaker
15. Costs for cable-TV or an antenna
16. Costs for a collective laundry
17. Other operational costs

Other operational costs are the costs that are not included in the numbers from one to 16, these are also standing costs, **and** the allocation is arranged with the tenant.

If the owner of the property arranged the allocation of the operational costs, they have to invoice the operational costs with the tenant annually. The scale of allocation must be equal for each tenant. The scale can be arranged with the tenant. If there is no arrangement, the owner can choose the allocation scale by himself. The mostly commonly used scale is the proportion of the area of the flats. The freedom of choosing the scale does not apply to the costs of heating.

The scale how to allocate the costs for heating is set in the decree of operational costs – Heizkostenverordnung (HeizKV). This decree is mandatory and applies to all properties with two or more flats. It is independent of whether or not there is an arrangement about the operational costs. This decree prescribes that the costs for heating have to be allocated in the proportion of 50% to 70% of the consumption of heating, and 50% to 30% of the square meter floor space of the flat.

It is recommended that the owner of the property arrange that the tenant pay a monthly payment in advance for the operational costs. This advance payment should be based on the expected costs, to avoid bigger settlements or back payments with the tenants.

As described it is necessary that the owner invoice the operational costs with the tenants. This takes place via a utilities statement – in German *Nebenkostenabrechnung*. This statement must include four necessary points:

1. Total costs with the structure and direct expenses to each cost item
2. Scale of allocation
3. Calculation of the share for the tenant
4. Deduction of the advance payments

Operational Costs in Akelius GmbH in Germany

Forecast costs for 2009

The forecasted operational costs for Akelius GmbH for 2009 will be 14,557,000 €. Because of a vacancy ratio we expect that we can allocate 98% of these costs to the tenants, this equals 14,280,000 €.

Deriving from approximately 495,000 sqm in 2009, each tenant will pay 28.9 €/sqm for operational costs. We have an average size of 63 sqm per flat. This means that an average tenant will pay approximately 1,830 € for operational costs annually.

From the figures above, we can see that our tenants have to pay on average in addition to their monthly rent, an amount of approximately 150 €. For us this amount is only a transit item. However, we can see that the tenants are willing to pay this “extra fee”. As the tenants are only interested in knowing their total rent, our target should be to lower the operational costs. Through this, it would be possible to raise the cold rent without raising the total rent.

Lowering the operational costs

To lower the operational costs, we have to firstly analyse our operational costs, to achieve this we need to return to our list derived from the legislation. Here we have to decide which cost items qualify for a switch. Some of these costs are bigger and some are smaller, some are not able to be affected.

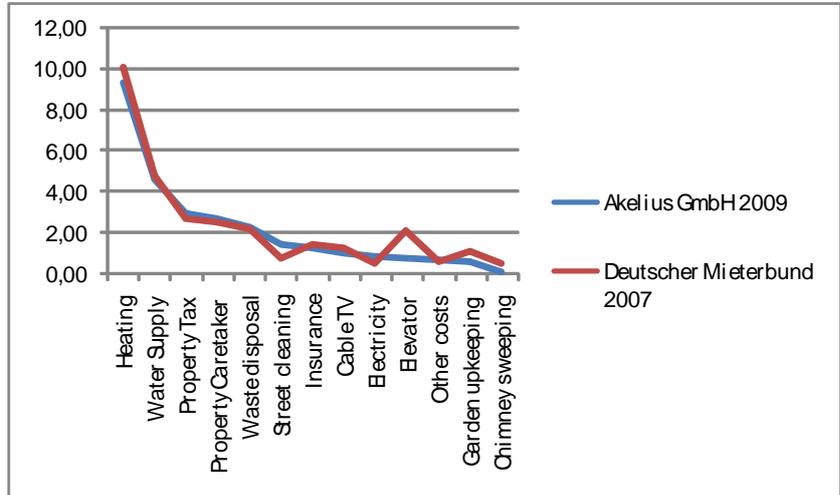
The second step should be the drawing up a comparison between our operational costs and reference values to see where we have opportunities to lower the operational costs.

The following chart shows a comparison of the expected operational costs of Akelius GmbH in 2009, and the average operational costs per square meter in Germany in 2007. The figures originate from the German Renter Organisation (Deutscher Mieterbund (DMS)).

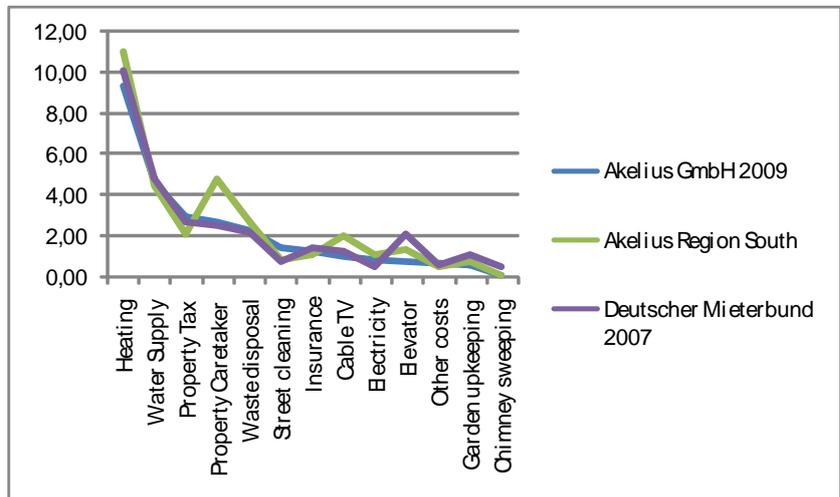
We can see that the most of the operational costs at Akelius GmbH are within the scope. Only the costs for street cleaning are higher than the German average, this is because the locations

of our properties are mostly in bigger cities where we have to pay for street cleaning.

It is hard to find the items where we have the potential to lower the operational costs.



We can also compare the operational costs from each region to the figures from DMS. In the next chart you can see the operational costs from Akelius GmbH Region South, where we have the highest operational costs of Akelius in Germany, compared with the figures of DMS.



In the chart above we can clearly see that we have potential to lower the operational costs in the items for heating, property caretaking and cable TV.

Now we know our potential and we can try to switch these costs.

Heating

The cost item “heating” is an important point and it will increase in relevance in the future. Heating-costs are usually the highest operational cost item, and because of the aging technology in old buildings there is potential for significant savings. Unfortunately, almost all measures for lowering the heating costs involve a great deal of initial expense; though in the long run it is more profitable to lower these particular costs.

There are countless measures available to achieve a reduction in the heating costs. A few of them are presented here.

One of the best options for lowering the heating costs is the installation of heat cost allocators. This results in the tenants knowing how frequently they use the heating, and thus they can save a lot of energy. A consequence of the decree of operational costs – Heizkostenverordnung (HeizKV), is that every building must have heat cost allocators installed.

Because most properties have heat cost allocators, we have to look at other options for reducing the heating costs. The majority of the heat disappears through the windows, the facade, the roof, and the basement. To save energy and lower the costs, we have the possibility of installing heat insulation in these places and of installing new windows when the old ones are inefficient. The advantage of these measures is that we can allocate a part of the installation costs to the current tenants, beside the cost saving through immediately increasing the cold rent. The new tenants will also be willing to pay a higher cold rent because of the reduced heating costs.

Another option for lowering the heating costs is the installation of a new heater. Older buildings often still have oil-based heating. Besides the higher costs of oil, there are more disadvantages: You need extra insurance for oil heaters, the old heating requires more service; the performance is not as high as modern heating.

In many places, especially in towns, we have the possibility of installing district heating. Through the installation of this you will receive modern heating, where you effectively do not need any service, insurance etc. Another advantage is that district heating does not require a large space, so you will get a extra space, if a boiler is removed. Also, in places where we do not have the possibility of installing district heating, or the costs are too high, the current heating can be provided by solar cells on the roof.

There is another possibility of switching the source of heating – by installing a heat source that is powered by terrestrial heat.

Because of the extreme effort that is involved in the installation of such heating, it is only worth fitting in new buildings.

Property Caretaker

The property caretaker is often the second highest cost item. It is worth inspecting this cost item because there is often high potential for lowering this cost item, as we can see in our chart above.

We do not have as many options for lowering the costs for the property caretaker as we had in the heating costs item.

Firstly, it is necessary to study the contract with the company responsible for caretaking. In many cases there are items in the contracts that contain administration tasks. It is necessary to eliminate the unnecessary job positions from the contract and put in positions for that we normally have to pay an extra fee for, such as the cleaning of windows. Finally, the contract has to include an account of the work that is unique for that specific property. We can then ask the property caretaker and of course other caretakers for new prices.

We can also look for companies that are represented in places where we have our properties. The mere process of allocating a new caretaking assignment for more properties, usually created room for a better offer and a better price.

One problem in changing the property caretaker to a cheaper one is that the quality is not always better. Because a property caretaker is the first contact point of the property, thereby the first impression; consideration should be given as to whether a switch of companies should be done or not.

Cable TV

There are not many options regarding lowering the costs for cable TV. One of the possibilities is to cancel the contract so that the tenants can receive TV by antenna or *Digital Video Broadcasting Terrestrial*. It is the cheapest way, but we will soon recognise that this is not the best way to manage these costs. Many tenants will legally or illegally install Satellite dishes which will make that the building will look like an asylum house.

A better way of saving the costs for cable TV is the installation of a collective satellite dish on the roof. Besides the fact that all tenants will have the possibility of seeing TV for free, the satellite dishes that are currently installed on the facade will disappear.

The installation of a collective satellite dish is not always easy and this can result in it often being very expensive.

Another possibility for reducing the costs for cable TV is to take advantage of the number of properties we have and make new contracts that include the cost of cable TV.

The contracts usually include a scale. So that the cost of the cable per apartment will be cheaper the more flats that are included in the contract.

Unfortunately in Germany, we only have one company that provides the whole of Germany with cable TV besides some regional companies. This, results in reduced competitive ability and the prices are high.

The best method is to install the collective satellite dish if it is possible.

Other costs

Of course there are even more numerous possibilities for lowering the operational costs.

Each property must be treated individually to recognize the potential in lowering the operational costs, because every property has the potential.

The target must be the lowering of operational costs and keeping them as low as possible.

Irrespective of what we do, and in which way we lower the operational costs, we should not lose the sight of the quality of the properties.