

# Property Development

Marko Hartmann, 2011-01-17

## Case: Lindenstr.13, Hamburg

### Introduction

#### Property

The four-storey-building is a part of a row and displays the typical solid brick facade of 1957, the year of construction. There are eight residential units in storey's one to four and two commercial units on the ground floor and a third one in a decrepit workshop building in the backyard, used as a storage place and garage.

The main building with a total size of 670 square meters was, at the date of handover, of an average condition; the backyard shed with a size of 120 square meters was in a very poor condition. The price for the object was 940 T€ which corresponds to 1,164 € per square meter. The property has an average rent level of 6.31 € per square meter. We are expecting to reach 9.80 € per square meter when we have taken over the property, because of the development of the area and the refurbishment measurements we are planning, we do believe we can manage the property better than the current owner.

#### Location and Surrounding

Lindenstraße 13 is an A-location, only 2.6 kilometers from downtown Hamburg. The location of the property is one of the most preferred in St.Georg, there are two subway stations in close vicinity and Hamburg Central Station is just 10 minutes by foot.

Founded in the past, St.-Georg does not have the best reputation: A multicultural population, pimps and prostitutes, drugs and violence was dominant, mainly in the region around and about the central station. By the late 90's, there was a change in the population structure and St.Georg became more and more "hip". Prostitution was banished into other districts, a big artist scene was up and coming and a part of the university moved to St.Georg. Thus, lots of young people and students wanted to live there.

St.Georg is a rising, inner-city suburb with almost no vacancies and enjoyed a great new popularity.

## Tenants

Due to the increase in popularity of St.Georg and the university in close vicinity to Lindenstrasse, there are mainly young, higher earner tenants, and often students in the property.

The apartments are well-kept but old, and there was no damage in the staircase or other public areas. During every change of tenant we decided to carry out a refurbishment of the flat to attract more of the young, higher earner tenants who are bent on paying a higher rent in return for a modern apartment with a high level of standard.

## Property Development

### Step 1 – Akelius- Office moved to Lindenstrasse

In the spring of 2009, the Akelius Office had to leave the rented office in the Mundsburg-Towers. We looked into several Akelius properties for the new office and sought out Lindenstrasse due to the fact of the inner-city location and the development potential of St.Georg.

One of the commercial units was vacant and we terminated the contract with the other commercial unit on the basis of home requirement and consolidated the two units to the new Akelius Office within a complete refurbishment of the ground floor.

- We had to submit a building application because of the change of use. Due to the fact, that the building land-use plan only allowed office-use in the service sector, we used a simple trick: We hanged a logo in the shop window displaying "*Vermietungsladen*" ("*Renting shop*")
- We renovated the staircase and gave the building a modern and open look by installing new shop-windows and entrance doors which was inviting for everybody to come in and ask for vacant apartments.

However, there was still the unsatisfying situation in the backyard (During the weekend, lots of drunken people used the backyard as a "public toilet") and the vacant storage place in the ramshackle backyard shed.

### Step 2 – The Backyard Shed

Due to the bad building stock we proposed a second building application to break up the backyard shed and create parking

spaces for hire. In St.Georg there is an increasing requirement for parking space due to the central location.

- ➔ In this case, the building land-use plan did not allow parking spaces above ground and we were forced to build an underground car park.  
Of course we do not - the NPV of this investment would be deeply in a negative range.

We had to find alternatives: If we were not allowed to demolish it, we would have to upgrade the ramshackle backyard shed to an apartment house. Due to the bad condition of the building, the refurbishment would be expensive and fraught with risks; we had to ask ourselves, who would be willing to pay an extravagant rent for the new apartment?

- ➔ We decided to fill a market niche in St.Georg by upgrading the ramshackle backyard shed into a modern and fancy loft-apartment house in a friendly backyard which would look like a green oasis in the centre of the city. Our investigation reflected that there is a demand especially in St.Georg for unusual living space.

Further, our investigation found that there was even financial benefit from the WK-Kreditanstalt for changing commercial units into residential ones.

### **Step 3 – Investment Application and Building Construction**

The asset manager was confident to be able to let an extravagant loft-apartment in St.Georg for not less than 11 €/per square metre.

With a life expectancy of 43 years and an expected rate of return of 7.5 % we determined a maximum budget of 200,000 € That sounds like a great amount of money, but in consideration of the poor quality of the building there was the risk of increased building costs during the period of construction. In this case, we were in danger of ending up with a negative NPV of this investment.

#### **Investment Application**

Region:.....North

Property: .....Lindenstraße 13

Object Number:.....7138

#### **Investment Key Facts**

Type of Investment:.....New residential Unit

Investment Cost:.....	200 T€
Net Present Value of Investment.....	1 T€
Discount Rate:.....	7,5 %
Assumed Growth Rate of Cash Flow Advantage of Investment:....	1,5 %
Life Expectancy of Investment:.....	43 Years
Initial Yield:.....	6,9 %
Internal Rate of Return:.....	7,5 %

### **Project Description**

Conversion of the backyard building. It would become a residential unit with approx. 120 sqm. It would have loft character with an open kitchen and a great living room with a terrace. The whole building would get thermal insulation. The new lease will be 11 € per sqm.

### **Budget/Prognosis**

This measure was not a part of the budget for 2009.

### **Time-plan**

The measures would be done during the summer.

### **Decision Proposal**

The Managing Director would be given the task of activating the costs.

## **Risk reduction by risk transmission**

To reduce the risks we decided to transfer the risk to the contractor:

- Functional submission
- General Contractor (GU)
- Lump-sum turnkey contract (LSTK)

In this case, the GU is responsible for determining the perimeter of redevelopment by themselves. We defined solely the Akelius-standard by laying down a fitting-out-list.

Of course, every general contractor calculates with a so called GU-premium; however, we get the highest guarantee of construction costs.

However, there were parties who became interested in leasing this building after production, though this included demands for a refurbished cellar, generating additional costs while the potential rent of these offered, 16.5 €per square meter, this was a lot higher than our first expectations, 11.0 € Therefore, we decided to refurbish the cellar as well. The cost increase amounted to 30 T€and therefore the assumed costs for the total project amounted to 230 T€

## Investment Application (Cost Increase)

City:.....Hamburg  
Property:.....Lindenstraße 13  
Object Number:.....7138

### Investment Key Facts

Type of investment:.....New Production  
- New residential unit (granted).....200 T€  
- New residential unit (cost increase):.....30 T€  
Total project Costs.....230 T€  
Yield (on Total Project Costs):.....9,3 %  
Net Present Value (on Total Project Costs):.....189 T€  
Discount Rate:.....6,0 %  
Internal Rate of Return (on Total Project Costs):.....11,0 %

## Current situation = Wanted situation

The redevelopment of the backyard shed, now a fancy loft apartment house, was finished in September of 2010 and is rented out with an expected rent of 16.50 €/per square meter.

We decided to complement the renovation of the backyard shed with some measures in the main building and a complete change of the backyard conditions:

- Laundry room and bicycle storage in the basement of the main building
- Reshaping of the garbage area
- Outdoor terrace with banquirai
- New illumination of the backyard
- New paving of the backyard

## Summary

- Always think in alternatives, there is often a loop-hole in the planning and building laws that you can take advantage of.
- Determine possible financial benefits like energy-saving programs or the benefits of changing commercial units into residential ones.
- Calculate the NPV of each alternative and choose the one with the highest return
- In the case of risky developments (sometimes there is no alternative) try to reduce the risk of rising construction costs by appropriate agreements (like a *lump sum turnkey contract*)

# Property Development

## Group work

Marko Hartmann, 2011-01-17

### Tasks

#### Case study

Your company is buying a property with a vacant commercial unit in the backyard. The backyard shed has been vacant for years due to the ruinous condition of the building.

You are the asset manager and responsible for the increase in value of this property. In this case, there are three options of investments to determine:

- a.) Demolish the backyard shed and create parking spaces for hire.

#### Option A

Parking space	8
Rent (€/unit/month)	50
Net Rental Income (€/year)	4800
Maintenance(€/year)	0
Administration(€/year)	0
Net Operating Income (€/year)	4800
Investment Costs (€)	-40.000
Demolishment Costs (€)	-12.000
Total Project Costs(€)	52.000

Yield .....

Life expectancy (years)	20
Discount rate	6,0%
Inflation	2,0%

- b.) Complete refurbishment of the building, change from commercial to residential unit with a benefit from the government (*WK-Förderkredit, 150 €/m<sup>2</sup>*)

#### Option B

Sqm	120
Rent (€/sqm/month)	12,5
Net Rental Income (€/year)	18.000

Maintenance (€/year)	-1.000
Administration (€/year)	-1.000
Net Operating Income (€/year)	16.000
Investment Costs (€)	-150.000
Yield	.....

Life expectancy (years)	25
Discount rate	7,5%
Inflation	2,0%
WK-Subvention (150 €/sqm) Year 1	18.000

c.) Partial refurbishment (remedial maintenance) and sub-let as a commercial unit.

### **Option C**

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Sqm	120
Rent (€/sqm/month)	8,0
Net Rental Income (€/year)	12.000
Maintenance (€/year)	-750
Administration (€/year)	-750
Net Operating Income (€/year)	10.250
Investment Costs (€)	-100.000
Yield	.....

Life expectancy (years)	25
Discount rate	7,5%
Inflation	2,0%

*Question 1:* Calculate NPV of each option, based on the cash-flow forecasts above.

*Question 2:* What is the initial yield of each option?

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## Group work

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### Solutions

#### Case study

Your company is buying a property with a vacant commercial unit in the backyard. The backyard shed has been vacant for years due to the ruinous condition of the building.

You are the asset manager and responsible for the increase in value of this property. In this case, there are three options of investments to determine:

*Question 1:* Calculate NPV of each option, based on the cash-flow forecasts above.

*NPV Option A (in 1.000 €) = 12*

*NPV Option B (in 1.000 €) = 78*

*NPV Option C (in 1.000 €) = 50*

*Question 2:* What is the initial yield of each option?

*Initial Yield Option A = 9,16%*

*Initial Yield Option B = 11,99%*

*Initial Yield Option C = 12,09%*