

Refurbishment of apartments – the Berlin way

Martin Schroeder, 2011-01-1009

Introduction

The total portfolio of the German region "East" actually consists of about 4,500 apartments. Due to a fluctuation of 11% approximately 500 flats are given back to Akelius each year. In every case a decision has to be made: do we refurbish the apartment or not. Furthermore, how much should we invest to get a good rent? In 35% of cases a complete refurbishment has to be undertaken.

Due to the high amounts we spend on refurbishment and the opportunities to make good investments there are determining processes with the following aims:

- make good investment decisions
- reduce costs (and the duration) of the measures
- guarantee quality in the work and materials
- reduce the time effort of the asset manager

So let us have a look at the processes an asset manager in Berlin actually has to deal with concerning the refurbishment of apartments.

Part 1:

The decision-making process

Deciding to refurbish an apartment means to make an investment. Therefore, we must first decide whether it is a good investment or not.

We rate an investment by calculating the net present value.

To simplify the calculation, an Excel sheet was designed. We have to enter a few basic facts and assumptions in the table and get the net present value of the investment (see Appendix A).

Some of the basic facts and assumptions needed for the calculation:

- The discount rate for investments in Germany is normally set at 7.5%.
- Costs of the *minimum* refurbishment that has to be done to allow the letting of the apartment once again and the rent that could be achieved in that condition.
- Costs of *additional* refurbishment to improve the apartment's equipment to a certain level in order to achieve a higher rent in this improved condition.
- The lifetime of the investments, for example an investment in paintwork has a significantly shorter lifetime than the investment in the replacement of the entire electrical installation of the apartment.

Excel makes the calculation itself pretty simple. Therefore, the focus is on making good assumptions in order to make the right decisions.

Part 2:

The process of the refurbishment

For a complete refurbishment of an apartment normally five different types of craftsmen are needed: electricians, plumbers, carpenters, floorers and painters. Two years ago we had to ask for five quotations and negotiate five contracts. Then we (respectively the asset manager) had to coordinate and to supervise the execution.

With this procedure of placing individual orders the complete refurbishment of an apartment took between five and six weeks.

Actually there are about 4,500 apartments in the German region "East" and there is a fluctuation of about 11%. It is necessary to completely refurbish about 35% of these apartments, this results in approximately 170 complete refurbishments every year. Given these figures, it seemed necessary to optimize the process.

Sometimes about 15 apartments are in the process of being refurbished completely and in 10 cases smaller refurbishments are in progress at the same time. Think of up to five craftsmen in every case. The resulting coordination effort can not be covered by the asset manager.

As a result we decided to work together with some general contractors. These general contractors assume the whole coordination effort and they guarantee that the flat can be let again within four weeks after the initiation of the work. This refers to the normal case of an average apartment of up to 85 sqm.



Berlin, Arosen Allee, Bathroom before refurbishment.



Berlin, Arosen Allee, Bathroom after refurbishment.

With each general contractor a pricelist has been negotiated, which includes the usual work which has to be done, so there is a price for a square meter of wallpapering or the installation of a square meter of laminate. Of course in some cases the quality level and in other cases a special product is agreed on to be used. Therefore, in the case of a standard refurbishment it is not necessary to do any price negotiations.

The following table shows the scheduling of the refurbishment of apartments in seven phases:

Refurbishment of apartments in Berlin - scheduling						
Step	Process	Period	Activity	Location	Documentation	Responsible
1	Coordination of the objectives of Akelius	earliest as possible	Coordination between Akelius and the contractor regarding the aim of the measure, the maximum time frame and the maximum budget	if possible in the apartment	verbally	AM
2	Preparing a firm offer	24hrs	Preparing an offer with the necessary measures to reach the aim of the measure.	office	e-Mail to AM	GC
3	Award of contract	24hrs	Informal award by E-Mail after clarification of any questions. Formal awarding by construction contract within three working days.	office	e-Mail / phone / fax	AM
4	Construction phase	1 Month	Refurbishment of usual apartments up to 85 sqm within four weeks. Any shift of the completion has to be notified immediately.	apartment	e-Mail	GC
5	Acceptance	3 working days before handover to the tenant	Filling out the certificate of acceptance.	apartment	certificate	GC / AM
6	Correction of deficiencies	3 working days	Correction of deficiencies	apartment	completion notice by E-Mail	GC
7	Final inspection	Handover to the tenant	Inspection, if the deficiencies have been corrected in order to the completion notice.	apartment	e-Mail to AM	LA

That is the actual way of refurbishing apartments in Berlin. Of course, these processes are always under development, because “stagnation means regression”.

Appendix A

Investment Application for Apartment Modernization Modell



Region:	East	Basic assumptions		
Sub Region:	Northberlin		Discount Rate	7,5%
City:	Berlin		Inflation	2,0%
Property:	Pflugstraße		annual growth rate 1-5 years	0,0%
Location within the building:	Pflugstr. 19, EG links		annual growth rate after 5 years	2,0%
Tenant number	7088.0073.02			
Balkony / Terrace:	nein			
Apartment size (m ²):	93,96			
Number of rooms	2,0			
Start of refurbishment:	01.12.2010			
End of refurbishment:	01.01.2011			
Asset Manager:	Martin Schroeder			

Measures

Measures	Gross Costs in €			Life Expectancy	
	Total	Simplest Renovation	Invest	Assumption	Standard
Paintwork	5.703		5.703	5	5
Plumber	5.334	800	4.534	20	20
Floor	4.039		4.039	15	15
Kitchen			0	15	15
Electric Install.	3.126	500	2.626	35	35
Others	5.406		5.406	20	20
Total cost	23.608	1.300	22.308	17	17

Comments in case of deviating life expectancy:

Economic Assumptions

Standard Cash-Flow-Advantage Calculation

	net rent	€/ m ²
old monthly rent	281,88	3,00
new rent without investment	375,84	4,00
new rent with investment	681,21	7,25
Increase by modernizing	305,37	3,25
Net rent according to budget	681,21	7,25

Years rental income advantage	3.664
Adjustments	161
Initial Cash-Flow Advantage	3.825

Advanced consecutive annual advantages / disadvantages

	m ²	Gesamt
Maintenance cost reduction	2,10	198
expected vacancy*	1,0%	-37
Total	1,71	161

*Value from actual market valuation

Result

Net Present Value:	16.272,75 €
Annual growth rate:	1,5%
IRR:	16,6%
Initial Yield:	20,30%

Calculations

	Σ	per m ²
Total cost	23.608,00 €	251,26 €
Maintenance	1.300,00 €	13,84 €
Investment costs	22.308,00 €	237,42 €
Life expectancy		17

Group work

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Investment decisions

Calculate the net present values of the following three investments with Excel and decide what to do.

Property:	Pflugstr.	Arosen Allee	Spenerstr. 16-17
Location within the building:	Pflugstr. 17, 1st fl left	Romanshomer Weg 32, ground fl left	Spenerstr. 17, 5th fl right
Apartment size (m ²):	46,78	43,64	93,96
<i>Investment:</i>			
Paintwork	2.651	3.264	5.703
Plumber	1.020	4.363	5.334
Floor	1.325	2.405	4.039
Kitchen			
Electric Install.	2.879	2.915	3.126
Others	2.056	3.689	5.406
<i>Simplest Renovation:</i>			
Paintwork	500	1.600	
Plumber	300	500	800
Floor			
Kitchen			
Electric Install.		2.915	500
Others	300	300	
old monthly rent	6,20	4,88	4,57
new rent without investment	7,60	4,00	4,00
new rent with investment	8,75	6,50	7,25
Net rent according to budget	8,75	6,20	7,25