Optimum Asset Management: Berlin - An Unparalleled Real Estate Investment Opportunity

Berlin’s unconventional profile is helping bring back investors as they are struggling more than ever to find investments with optimal or even adequate risk/return profiles in the current post-financial crisis era.

Due to a low interest rate environment (caused to a great extent by central bank’s quantative easing), a particularly depressed performance of emerging market equities, the recent crisis of gold and stagnant prices of other commodities, is today a true challenge when aiming to achieve appropriate diversification and risk taking, with consistent positive returns over the medium and long term.

In this context, real estate is quickly recovering its central role in investor portfolios due to its main benefits: real estate status, hedged against inflation, stable and positive yields, as well as low correlation to other asset classes. The most attractive investment opportunities in European real estate are found on Berlin’s commercial and residential property markets.

A GREAT OPPORTUNITY TO EXPLOIT
It was the end of 2005 when I happened to be in Berlin and discovered its unconventional real estate market offering exceptional returns and an attractive outlook and plenty of opportunities. In almost twenty years of investment origination, I had never found an investment opportunity offering similar yields, strong upside potential and limited downside risk.

I decided to create Optimum Asset Management as I saw the great opportunity international investors could exploit with a company that could consistently deliver an excellent level of service, comparable to the one offered by well-established asset managers and banks, but with the added benefit of flexibility and customised solutions typical of a small and client-oriented firm.

Since then, the Berlin real estate market has increased by 60 per cent and Optimum was able to successfully invest more than half a billion euros, spread over two funds. The firm is currently managing the fundraising phase of a third fund aimed at acquiring residential and commercial properties in the German market with a special focus on Berlin.

The reasons behind the current exceptional situation on the Berlin real estate market are both historical and structural.

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UNIFICATION BRINGS CHANGE
From 1990 to 2005, Berlin faced the problematic issue of reunification – in the context of a stagnating economy with a 20 per cent unemployment rate and GDP growth close to zero. Public deficits, combined with an enormous stock of property inherited from the former German Democratic Republic in East Berlin, resulted in a constant flow of properties onto the market through both government and Public Housing Corporation auctions.

By that time, oversupply was matched by a weak demand – a direct result of the poorly performing economy – which placed housing prices under enormous pressure, bringing them down to a level without comparison in the whole of Europe and other developed countries. Furthermore, before 1990, Berlin real estate was managed through a vast number of state subsidies that included the residential rental market, creating a legacy of low rental costs. This encouraged people to rent as opposed to buy and led to one of the lowest homeownership rates in the EU.

However, Berlin is the capital of Germany – the largest economy in Europe and the fourth largest in the world by GDP. Important reforms introduced by the German government led to the development of fast-growing sectors such as tourism, life sciences, mobility and services with an emphasis on information and communication technologies. Indeed, since 2005, the situation has significantly improved. From 2005 to 2013, the city’s economy has grown continuously at rates well above the German average. Its GDP growth rate over the last year was 1.2 per cent versus 0.4 per cent nationally and just 0.1 per cent across the entire EU.

Thanks to the strong role played by business services providers and the construction industry, job opportunities have increased and the unemployment rate fell to 11.0 per cent, which represents a year-on-year reduction of 0.6 percentage points. Moreover, Berlin is benefiting more than other German cities from the economic recovery because of its low cost of living, excellent educational system, as well as the city’s strategic position in the country and its technological hub – it is the leading German city in terms of network infrastructure.

Structurally, the extremely low prices of Berlin properties – about EUR 1,472/m² for whole buildings according to GSW-CBRE 2014 Berlin Housing Market Report – have created a one-of-a-kind situation in its real estate market. The prices of existing properties are, in fact, still below the cost of new construction and, therefore, little new residential building activity has taken place over the past ten years.

This situation, coupled with the unabated high levels of population growth over the last few years – currently, around 3.4 million people live in the city and, in 2013 only, the population increased by roughly 50,000 – led to an excessive demand on the real estate market. The small but significant increase in new-build completions still falls well short of meeting demand. As a consequence, the vacancy rate has sharply decreased and now stands below 2 per cent for residential properties.

With a significant difference between institutional (whole buildings) and retail (single units) property prices – EUR 1,472/m² vs. EUR 2,770/m² – and due to constantly rising rental-yields for institutional investors – stable at an average of 6.5 per cent with peaks reaching 8.0 per cent - the market offers exceptional opportunities.
BERLINERS PURCHASING POWER

Even after growing for almost a decade, Berlin’s prices are still substantially cheaper than others’ comparable German cities, including Munich and Frankfurt and other major European metropolises, including London, Rome, Paris, Madrid and even Budapest and Athens. New key developments are changing the city’s property market and experts foresee the homeownership rate to increase. Currently at around 15.6 per cent versus a German 45.7 per cent, it is expected to be positively influenced also by the misbalance in the purchasing power of Berlin residents who, compared to other German residents, have a salary-to-property ratio significantly higher (see table) and can thus benefit from the positive incentive of low rate mortgages coupled with increasing property value.

This is leading to the establishment and strengthening of a retail market characterised by positive price dynamics, providing an exceptional exit strategy to institutional investors like Optimum that can buy entire buildings and then split them to be sold on a single unit basis at the much higher retail prices mentioned earlier.

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This profitable situation of the Berlin real estate market is already clear to both national and international investors. According to the latest data released by Jones Lang LaSalle, in 2013 the city’s market registered the highest liquidity within Germany, showing a continuously upward trend with a fourfold increase in the number of transactions as compared to 2012. With a record transaction volume of around EUR 6.7 billion and a strong participation of both national and international investors, the residential market of the German capital is by far the most sought-after in Germany.

OPTIMUM’S DISTINGUISHED APPROACH TO THE REAL ESTATE MARKET

In a growing, competitive and unique environment like the Berlin market, investment in real estate can follow two opposite approaches.

There are large traded portfolios, usually made up of more than 3,000 units, built over many years and cyclically transferred among significant institutional investors. These portfolios can be bought at a significant discount in different ways - either through a direct acquisition or via a takeover of the owning entity — and their significant size can provide relevant diversification and large-scale benefits in day-to-day management. However, I believe this approach might be considered as the equivalent of index investments in equity markets: their return is often mostly linked to the overall relevant market sentiment.

The opposite approach is to build a portfolio from scratch, as Optimum does, through the careful selection and cherry-picking of properties deemed to be undervalued and, therefore, with significant upside potential. I believe this approach represents the best way to exploit the potential of a still growing and non-homogeneous market like the one in Berlin, where specific and notable opportunities can be found.

On the other hand, it requires a specific structure and expertise to reduce due diligence and execution time to the lowest possible: indeed, the best properties often stay on the market for as little as one or two weeks. Furthermore, besides a deep knowledge of the market and acquisition expertise, during the optimisation phase an active approach is needed in order to fully realise the upside potential of the portfolio, through property management and careful investments in renovation of the properties.

Either way, for the next years Berlin’s real estate market will continue to attract a growing number of investors, both retail and institutional, looking to benefit from the dynamic and unparalleled opportunities it presents. As of today, the market still has a lot of potential, but the catching up process with its German and European peers has begun.

ABOUT THE AUTHOR

Mr Alberto Matta is the founder and CEO of Optimum Asset Management and Futura Investment Management.