A spotlight on the Dutch and German rented residential sectors

Marcus Cieleback, PATRIZIA Immobilien AG

Michiel Dubois, Bouwfonds REIM

At the IPF seminar on 'Residential Investment in Continental Europe', held in London in November 2012, Marcus Cieleback, PATRIZIA Immobilien AG and Michiel Dubois of Bouwfonds REIM talked about their first-hand experience of the markets in Germany and the Netherlands.

Subsequently, they spoke to Sue Forster about the general size and structure of the rented residential sector in the respective jurisdictions covered by their organisations. This discussion is outlined below.

Sue Forster (SF): How large is the rented residential sector in your respective domestic markets and how much of this is held by institutional investors?

Marcus Cieleback (MC): In Germany, rented property accounts for 55% of the overall stock, of which only 25-30% is in institutional hands.

For the last 20-25 years, the rental sector has been dominated by private investors. Prior to that, the insurance companies had a large proportion of their holdings in residential but they sold a lot in the 1960s and 1970s, due to a combination of increasing political interest in the sector and property management being far more intensive than that required for commercial property.

There is no one dominant player in the German market, particularly as organisations tend to specialise in particular certain regions or sub-markets. Investors with large residential holdings include GAGFAH, Deutsche Wohnen, GSW Immobilien and PATRIZIA Immobilien.

Michiel Dubois (MD): 40% of the total housing stock in the Netherlands is rented. Of this, the housing associations account for 82%, private investors 13% and institutional investors only 5% (equivalent to 132,000 dwellings).

Institutions used to hold nearer 10% but they have been selling them to private individuals, who have been benefitting from fairly-relaxed mortgage regulation and low interest rates. The main driver for these sales was the large differential in price achievable for property with vacant possession compared with rented. This sell-off is unlikely to continue to any significant extent as potential purchasers have been hit by the recent introduction of tighter mortgage regulation and falling house prices, due in part to loss of consumer confidence.

There has been a considerable number of mergers in the housing association sector in order to take advantage of economies of scale – in the past, there were around 800 but this has now halved and is likely to decrease even further. Coupled with this, the associations are also reducing their holdings, triggered by a less favourable funding and taxation regime. They are selling to institutional investors, who see residential as one of the few sectors to offer growth prospects currently – the demand for housing is still growing because of more and more one-person households.

SF: How much do your organisations have invested in the rented residential sector and what do you consider to be the attractions of the sector as an investment?

MC: PATRIZIA has €7.5bn under management, of which 40-45% is in residential and 90% of this is in Germany.

The main investment attractions of the sector are security and stable cash flow. Risk of loss of cash flow is very low due to high granularity and, as housing is a basic need, rents move smoothly and are less cyclical. With a good asset manager, you can get generate a similar income return to that of commercial property.

MD: Bouwfonds REIM has approximately €5.5bn under management, with €1.3bn (25%) in residential. This is invested predominantly in Germany and the Netherlands, followed by France and the Nordics.

As regards the attractions of residential property as an investment, I agree with MC's opinion and would add that residential offers the best diversification in real estate – retail and office investments are often affected by market cycles at the same time, while residential markets differ from city to city.

SF: So are there particular cities/towns where your organisation's holdings are concentrated?

MC: All cities that offer potential growth in rental values and demand. We look very closely at the demand and supply of accommodation in each market.

MD: I agree with MC. Our approach is research driven; rental growth is fuelled by demographic/household growth or economic growth. We focus on large cities and regional 'champions'.

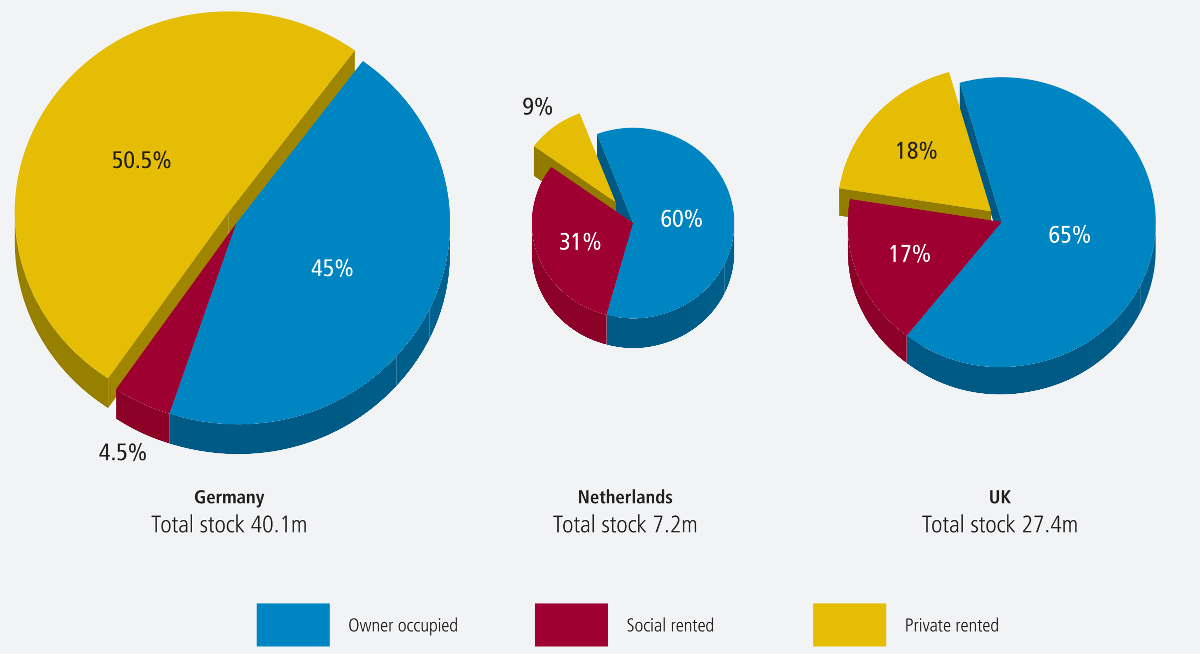
Timing and pricing is also very important – we used to buy a lot in Germany but with prices falling in the Netherlands, we have now shifted our strategy to take advantage of this.

SF: How do you hold your residential investments?

MC: We have joint ventures and operate funds – some are on our balance sheet and the rest we manage for others.

MD: We don't have any joint ventures but operate through non-listed funds, and separate accounts – co-investing where requested.

Figure 1: Comparison of the ownership structure in the Dutch, German and UK housing markets



Sources: Housing Statistics in the European Union, CECODHAS; ABF Research, Syswov 2012; DCLG Live Table 101

SF: What about residential investment outside your home market, now and in the future?

MC: We are looking to increase our current holdings in Sweden, Denmark and Finland. We are also looking at Ireland, Norway, France and the Netherlands – the last is of interest because of recent legal changes.

The UK is interesting and we are thinking about involvement but are not sure whether the investors will be there. UK investors sold out when the regulatory environment got too difficult and it is hard at present for outsiders to get a handle on the market and determine how to gain economics of scale.

Generally we are looking to increase our holdings in attractive locations, as outlined earlier, where there is strong investor interest.

MD: Our approach is to view Europe as being the domestic market so investment is not about countries but rather regions within them.

We are not active in the UK yet but it is a large and transparent market and so is on our radar. Also other regions are on our radar, like Dublin and Warchau.

SF: What impact does regulation of the residential rented sectors in different jurisdictions have on your investment decisions?

MC: We take account of the local regulations in our investment modelling, e.g. Finland has a less regulated market than Sweden so rental growth has been much higher but this is reflected into the price.

MD: Regulation and politics are important to consider in any market. It's all about stability of returns and predictability – rent control is not an issue providing that it has been priced in at the time of purchase.

SF: Are there any proposals to change the regulatory environment for residential property in your domestic market?

MC: As from late 2013, rental increases in Germany will be limited to a maximum of 15% over three years, compared with the current limit of 20%. This is politically-motivated – in an election year, it plays well to voters in metropolitan areas.

There is also little political support for new housing construction so there will be a reduction in future supply.

MD: There are many proposed changes, driven by the government's need to generate or save money. The two principal initiatives at present are to: (a) reduce the tax relief on mortgage interest – this will be done gradually as house prices are currently falling; and (b) to encourage richer tenants to vacate rent-controlled housing by increasing their rents more rapidly, thereby releasing units for those in need.

SF: Is land zoned in German and/or Dutch city plans for rented housing or just for residential generally and do your organisations build-to-let?

MC: City planning allows for residential use and then the building permit determines the type of housing you build, e.g. you may have to include low-cost housing.

We build some housing to rent – it is market and location dependent. We also build to sell.

MD: In the Netherlands, plans are quite detailed. Municipalities like mixed developments – social rental housing with owner occupation for example. However, they do take into account the harsh realities of the current market. Developers required to provide social housing may also do a trade with a housing association.

We generally buy existing buildings that are already tenanted but we do have development roots through our sister company and we also buy empty properties from developers.

SF: If, and when, you sell any residential investments, do you sell with vacant possession or with the tenants in place?

MC: It depends on the individual building and market. Sometimes we sell with vacant possession and sometimes there are investors who will pay more than the vacant possession value for a tenanted building.

MD: It depends on the market. We used to achieve large premiums for selling with vacant possession but, with prices in the owner occupier market falling, there is less difference at present.

SF: On what basis do you value residential property in your investment portfolio?

MC: They are valued on a DCF basis using market rents and making deductions for untenanted units.

MD: Our external appraisers also value the cash flow using DCF – discounting for vacant units. We only consider vacant possession value if the property is to be sold in the very near future.

SF: Looking at the landlord and tenant relationship in more detail:

a) What rights do tenants have to security of tenure?

MC: In Germany, the lease is unlimited as long as the tenant pays the rent and the owner does not seek vacant possession through the prescribed legal means.

MD: Tenants are well protected in the Netherlands so landlords are generally unable to terminate the lease. For investors, the key is to have a large portfolio as based on historical data most houses change hands on average every 10 years.

b) What rent regulation is there?

MC: In Germany there are maximum rents permissible, determined by the rent table, and restrictions on rental increases, as mentioned previously.

MD: In the private rental sector, property is assessed using the dwelling valuation system (WWS), which accords points to a dwelling on the basis of the quality of the housing and the housing environment. All property with less than 140 WWS points (92% of the sector) is subject to a maximum rent, graduated by the actual number of points. The maximum annual rent increase is also set every year by the central government. Properties assessed at 140 WWS points or more are not subject to rent control.

c) What is the usual basis upon which units are let?

MC: It is usual to let unfurnished in Germany. Depending on the particular market, one may need to put in a kitchen but where there is high demand this is not necessary. Carpets and wooden floors are standard but no other furnishings are required.

MD: This depends on the market and what will generate the highest rent. Fitted bathrooms and kitchens (without appliances) are standard in the Netherlands.

d) How intensive is property management?

MC: Tenants expect good building services, e.g. regular cleaning of shared staircases.

MD: Property management is intensive – a professional property manager is important. We hold regular meetings with our property managers – some every two weeks.

e) What is the difference between the gross rent received and the net operating income?

MC: Rent collection and management costs equate to around 10-15% of the gross rent. Service charge is paid separately by tenants.

MD: It is down largely to the type of property – town houses have lower maintenance costs and the tenant may do some works. High rise flats require more maintenance, e.g. the lifts but these are likely to be covered by service charges. Depending on how we account for larger amounts of expenditure, the difference between gross and net is 15-30%.