MICROAPARTMENTS – THE NEXT BIG THING IN PROPERTY

CUSHMAN & WAKEFIELD

EDITORIAL

Dear readers,

They may be small, but they've got a big future ahead of them: microapartments are a mega-trend in terms of urban living. Whether as stylish student flats, as affordable mini-apartments for trainees and young professionals, or, if built to be accessible, as manageable spaces for senior citizens, microapartments are here to stay. For some analysts, they're an **alternative asset class**, for others an **established investment with low exposure to the economic cycle** which also offer an answer to the **shortage of residential space** in booming city markets.

Small is beautiful – and the news has spread. As such, there is no shortage of new developments in this up-and-coming segment of the market, described by a plethora of terms from micro-living and mini-flats through to business apartments, serviced residential space, and short-term living, The profusion of synonyms can be bewildering.

So in order to offer an overview of the market from both a real-estate and legal point of view, in this report, we will be classifying various kinds of microapartments and gauging their importance in the German property market; we will also be offering analysis of the opportunities and risks inherent in the micro-living trend.

We hope our report is of interest to you and offers you a new perspective on this market.

Andreas Polter

Simon Jeschioro

MICROAPARTMENTS IN THE PROPERTY MARKET

In today's property industry, no topic is as controversial as (affordable) residential property, and calls for alternative forms of living can be heard from across as the board, especially in heavily populated urban areas, as the number of single-person households continues to grow. In this context, microapartments as temporary residential spaces have an increasingly important role to play; due to the operational concept behind them, however, they have to be considered separately from the rest of the market – and there is a distinction to be made between residential and commercial use.

THE TAXONOMY OF THE GERMAN PROPERTY MARKET

LEGEND

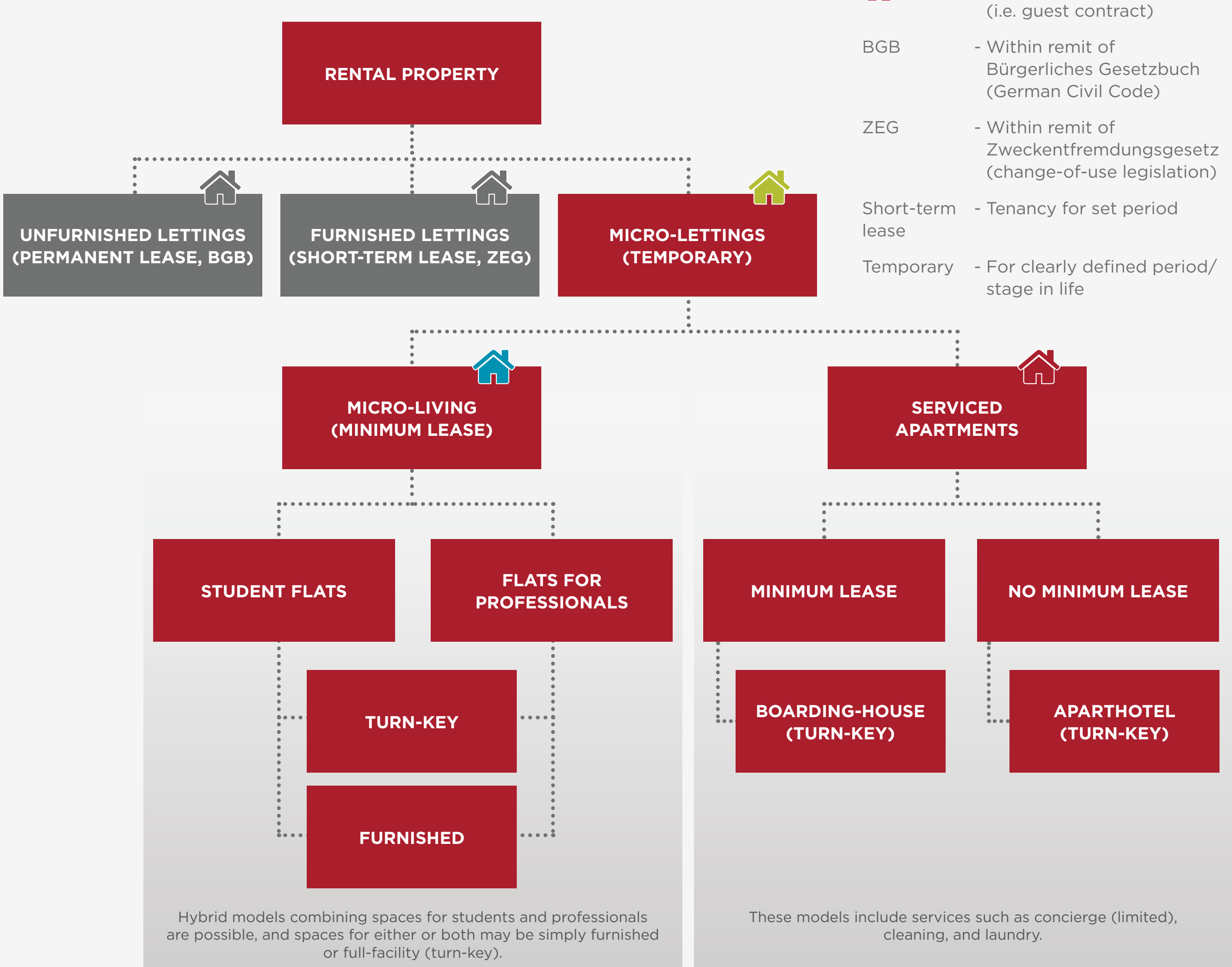
- No operational concept
- With operational concept
- Focus on residential (i.e. rental contract)
- Focus on hospitality (i.e. guest contract)

BGB - Within remit of Bürgerliches Gesetzbuch (German Civil Code)

ZEG - Within remit of Zweckentfremdungsgesetz (change-of-use legislation)

Short-term lease - Tenancy for set period

Temporary - For clearly defined period/ stage in life



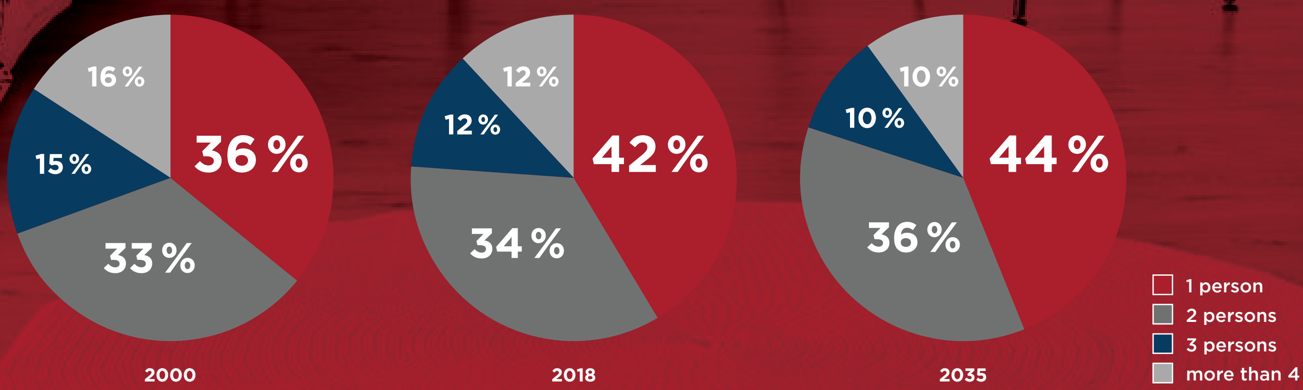
Source: C&W Research

WHAT IS BEHIND THIS TREND?

Ways of working – and of living – have changed markedly in recent years. Younger people especially prioritise living in vibrant urban areas, seek avoiding long commutes, and are willing to trade space in return.

The market for microapartments has grown out of classic forms of short-term accommodation such as furnished rooms and student halls of residence. One development driving this trend is the number of single-person households, which has been continuously increasing for several years now; this has led to a shortage of bedsits and one-bedroom flats in major cities, which in turn has the effect of making it more difficult for new arrivals looking for short-term or temporary lets. The financial expense of moving and furnishing a flat, as well as the time flat-hunters have to spend going to viewings (with no guarantee of success), are additional factors.

SIZE OF HOUSEHOLDS IN GERMANY



Source: C&W, Statista

MOVE IN AND START LIVING

Microapartments are often offered as turn-key full-facility accommodation and run by companies with a clear operational concept.

The primary target groups for this kind of apartment are students and young professionals, but business-people and long-distance commuters of all ages who don't want to live in hotels are also a key segment. Senior citizens, too, who are looking to downsize, are also an increasingly important target group.

Microapartments are mainly found in the central districts of metropolitan areas or in university towns and generally have good public transport connections. Most microapartments have around 20-25m^2 of space (including bathroom and kitchenette), with larger types extending to 35m^2 and attracting a price premium which limits their potential tenants almost entirely to working-age professionals.

Another characteristic of microapartments is an all-in monthly rental including all bills (e.g. electricity) and costs for furnishing and facilities (everything from bedclothes to broadband). The overall concept is that residents should be able to move in with a suitcase and start living in the space immediately.

REPLACING GARAGES WITH CHICKEN COOPS

Born between 1980 and 1995, millennials (also referred to as digital natives) are the largest target group for microapartments, and have very different criteria for residential property to those applied by preceding age cohorts; microliving providers have adapted their concepts accordingly.

Currently, the overwhelming majority – around 80 percent – of the microapartments in planning in Germany are being built in the private sector; the other 20 percent will be run by public bodies (i.e. providers of student accommodation).

As urban living becomes standard and car-sharing replaces car-ownership, issues such as sustainability and community gain in importance. Rather than have a living room or home office, residents of microapartments use shared spaces in exchange for a more central location: providers such as i Live include learning lounges and event kitchens in their concepts, and residents in their Berlin facility can even watch a beekeeper at work harvesting honey from the roof-top hives; in Cologne, meanwhile, residents can even adopt one of the building's chickens, which are kept on-site, using an app to reserve an ultra-fresh breakfast egg. Other providers have entered into cooperation with car-sharing services, making car-ownership redundant for residents – and eliminating the need for reserved parking spaces or subterranean garages.

This community approach also makes it easy for residents to meet like-minded people after a day in lectures or at work, with the challenge for operators shaping up as how to make sure that the communal spaces in their concepts get filled with life. Indeed, those who don't succeed in creating genuine community spirit are likely to disappear from the market, as Dirk Lembke, Managing Director of Upartments Real Estate, explains in the following interview.

MICROAPARTMENT PROVIDERS

Micro-Living		Serviced Apartments		Facilities
Students	**Professionals**	**Boardinghouse** (Minimum stay)	**Aparthotel** (No minimum stay)	
• SMARTments student (GBI)	• Berlinovo Apartment • Linked Living (Corestate)	• SMARTments business (GBI) • Joyn (Corestate)	• Adagio • DERAG Livinghotels	Turn-key[1]
• SMARTments student (GBI) • The FIZZ (IC) • I live • Staytoo (MPC)	• The FIZZ (IC) • I live • Staytoo (MPC)			Furnished

Source: C&W Research

[1] Turn-key and full-facility are terms used to describe lettings in which tenants can move in with nothing more than a suitcase, e.g. cutlery and crockery are provided.

EXPERT INTERWIEW WITH DIRK LEMBKE

Managing Director of Upartments Real Esate GmbH (Corestate Capital Group)

Following nine years in charge of investment and auditing at CORESTATE Asset Management GmbH, Dirk Lembke became a director of UPARTMENTS Real Estate GmbH in August 2018. With 20 years' experience in project management and controlling in the property industry, Lembke has extensive knowledge of due diligence processes, property management, and maintenance. At UPARTMENTS, he is responsible for expanding the YOUNIQ brand. Dirk Lembke took a degree in commercial engineering at HTWK Leipzig and holds a Master of Business Administration in Real Estate Management from the Berlin-Brandenburger Akademie der Wohnungswirtschaft, an institution specialising in property teaching and research.

In your view, what role with micro-apartments play in the future of the German property market?

Microapartments are becoming increasingly important as the demographic shift takes place and the number of single-person households continues to increase. This means that there will be a growing – and lasting – need for residential units in urban areas offering good value for money.

Where does it make sense to invest?

As a corporate group, we at Corestate are focussing on A locations, i.e. larger university towns and other cities with permanent generators of increased demand.

When buying sites, what do you look for especially?

The most important things are a good, central location or proximity to universities; the minimum size is 150+ units. Other criteria are good connections (above all to public transport) and local infrastructure for residents, i.e. shops, cafés, bars, restaurants, doctors' practices; another thing which has become decisive is communal space for co-working, gym studios, or laundry facilities.

Is the potential for other uses, e.g. the potential for easy-access conversions into units for senior citizens, an issue at present?

Not yet, no; if barrier-free is part of the building concept, obviously that is a plus-point, but it's by no means a must. What is clear is the refitting lots of small units later would be costly.

What features need to be included now and in future in order to meet potential tenants' standards?

In terms of furniture, fittings, and fabrics, the flats need to be top-of-the-range; the look needs to be contemporary, especially in bathrooms. Internet access is a basic requirement. In terms of added value in the future, we think the overall concept will be key: that might include things like concierge service to sign for parcels during the day, or communal spaces offering interaction with other members of the community.

What will tomorrow's microflat buildings look like and how will they influence the look and feel of their surroundings? We're thinking of co-farming, cooperation with sharing providers, drone landing spots, solar-panel exteriors...

There are clear megatrends towards sustainability and security, and these are integrated in the planning and construction phases. When it comes to the design of the apartments themselves, the move towards increasing customisation comes into conflict with the pressures of urbanisation, meaning that we see the future focus on community areas, both for new working concepts and for recreational use.

GERMANY, LAND OF STUDENTS

With around 2.9 million people enrolled, Germany is Europe's biggest student market – and one of its fastest growing, too. The average student in Germany needs around 7.9 semesters to complete a first degree.

Regardless of these time requirements, many providers of student rooms have maximum occupancy limits: residents of Berliner Studentenwerk, for instance, have to move out after 10 semesters, and many private student landlords have contractual limitations, too (in many cases, two years at most).

In contrast to the bulk of microapartments currently in planning, around 80 percent of existing student flats are owned by public bodies, with Studentenwerk (student services) as the biggest provider.

While only 12 percent of all students stay living with their parents through their degree, there is, due to the limited income of this demographic, little readiness to pay high rents: only around 41 percent of students surveyed would be happy to pay above €400 monthly for somewhere to live. The group's key requirements are a short distance to the university and practical furnishings, with prices per square meter higher for furnished lettings.

With an expansive target group and plenty of unmet demand, the future prospects for student living as a market segment are excellent.

MORE POTENTIAL IN SERVICED CONCEPTS

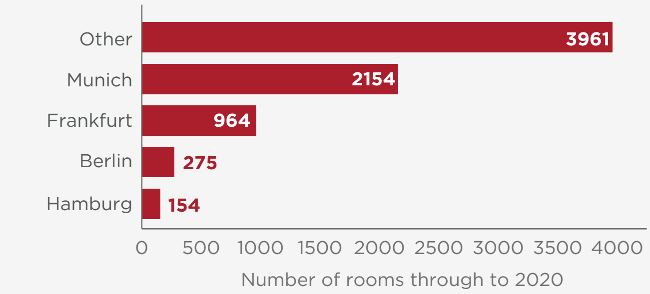
As against standard student flats, serviced apartments offer additional benefits – and cost more correspondingly. As such, the target group is generally people in employment looking for furnished lodgings at short notice.

Serviced apartments are a sub-segment which have developed out of the hospitality industry and can be located at the intersection between hotels and the residential property market. In general, they are considered hotels/hostels, with legal forms closer to commercial firms than to property companies. The concept is originally from the USA, where it is primarily used by workers, but also services tourists and new arrivals.

Like microapartments, serviced apartments are usually fully furnished and have an equipped kitchenette, allowing guests to live there for anything from a few days up to several months.

Taken over a longer period of time, serviced apartments are generally cheaper as hotels and prices do not tend to tick upwards over holidays are when trade shows are in town; with prices at around €1,500 monthly, however, they cost considerably more than standard residential flats of the same size.

SERVICED APARTMENTS (PLANNED)



Source: RCA, TD, C&W Research

As a sub-segment, serviced apartments can be further subdivided into boarding houses and aparthotels. While the former tend to be more orientated towards living and can only be booked by the month, the latter generally have a more extensive range of services, e.g. daily breakfast, cleaning service.

As a general rule, serviced apartments are planned for stays of up to 12 months; in view of the ever-decreasing void rate in Germany's major cities, they contribute flexibility to the residential property market despite their commercial nature. Working-age professionals who frequently switch location and need flexible lodgings fast have learned to appreciate them.

In view of this, the serviced apartments sector is ideally placed to meet the requirements of tomorrow's labour and property markets, an insight confirmed by the high number of serviced apartments currently in planning.

CO-LIVING – FLATSHARING FOR PROFESSIONALS

Co-living concepts are essentially shared flats with different furnished rooms, measuring 10-15m^2 on average which are then let to individuals; each flat has a shared kitchen, bathroom, and living space. Also aimed at professionals, this living concept is conceived for both short and long-term stays, which makes it difficult to categorise.

The effect of this concept is that residents communicate directly and, frequently, work and personal space are linked.

Depending on the location and the standard of the building, a co-living room can be let from €55 per night/€500 per month. Community feel is of great importance in this concept, meaning that regular events such as communal breakfasts and after-work drinks are key; some providers such as rent24 offer a fitness space or, if required, a cleaning and laundry service.

CATEGORISING SERVICED APARTMENTS

Orientation	Shortstay (up to 14 nights)		Longstay (from 14 nights)
Type	**hotel**	**serviced apartments**	**residential**
Furnishings	full	full	none/partial
Reception	24/7	limited	none
Service	comprehensive	limited	usually none
Cooking	room service, kitchenette	fully equipped kitchen/ kitchenette	usually fitted kitchen

THE RIGHT MIX

According to forecasts, by 2030, there will be around one million fewer younger people in Europe than there are today; by contrast, urban centres such as Berlin (+9%), Hamburg (+5.6%), and Munich (+18.3%) will continue to see rises in this demographic.

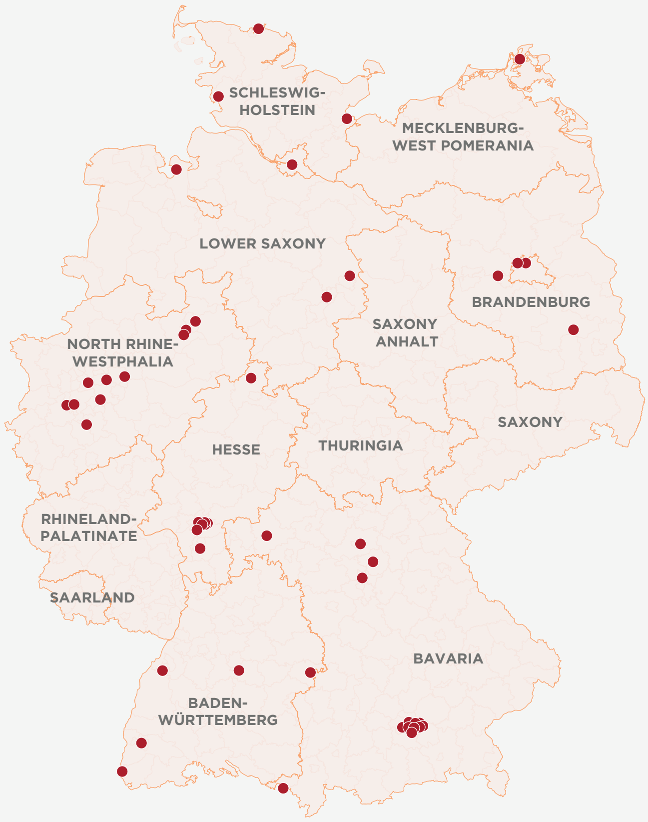
In fact, the overall downward trend in younger age cohorts can be stopped in Germany due to the country's attractive range of degree courses, the low cost of studying there, and the increase in the number of international students. Moreover, as companies in innovative future industries set-up there, young, highly-mobile professionals will stream into Germany's metropolitan areas.

Notwithstanding, an ageing population can present an opportunity on the microapartment market, too. If issues such as step-free access are taken into account from the start of the planning stage, it is easy to convert microliving spaces to suit other age groups at a later point in time.

It is important, however, to avoid neglecting demand for residential property in the lower price ranges of the market. Berlin alone, according to the city's development office, is lacking 77,000 flats, and the demand for affordable space is high across Germany's urban areas. To date, however, not one single microapartment concept has attempted to serve the lower end of the price range.

> There is a clear correlation between microapartment buildings under construction and urban areas in which demand for residential property is highest.

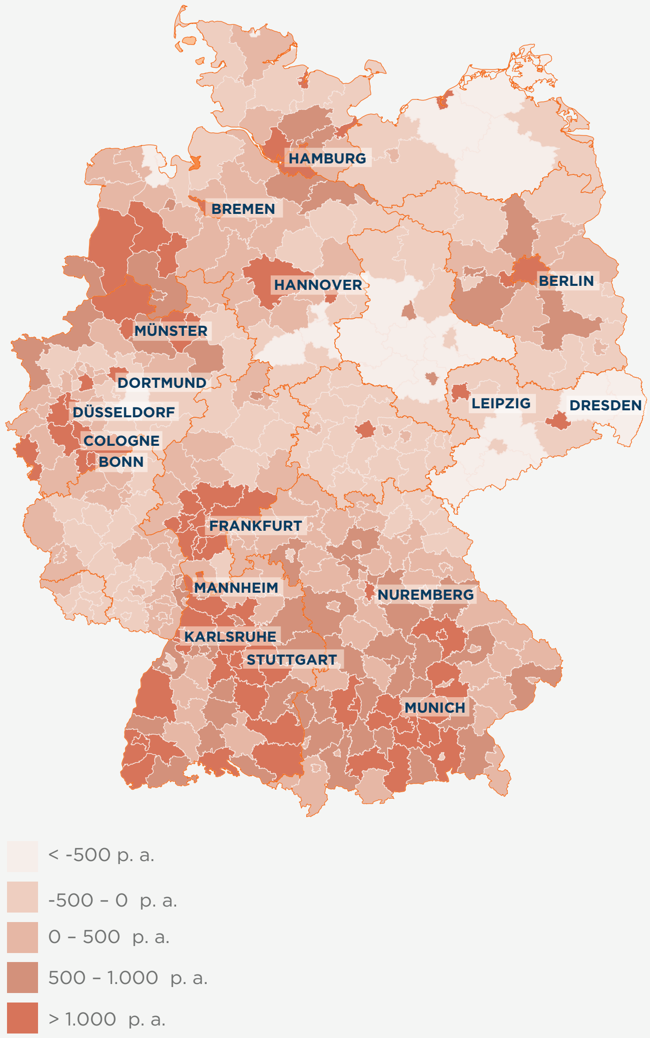
SERVICED APARTMENTS DUE FOR COMPLETION BY 2025



● Serviced apartments under construction

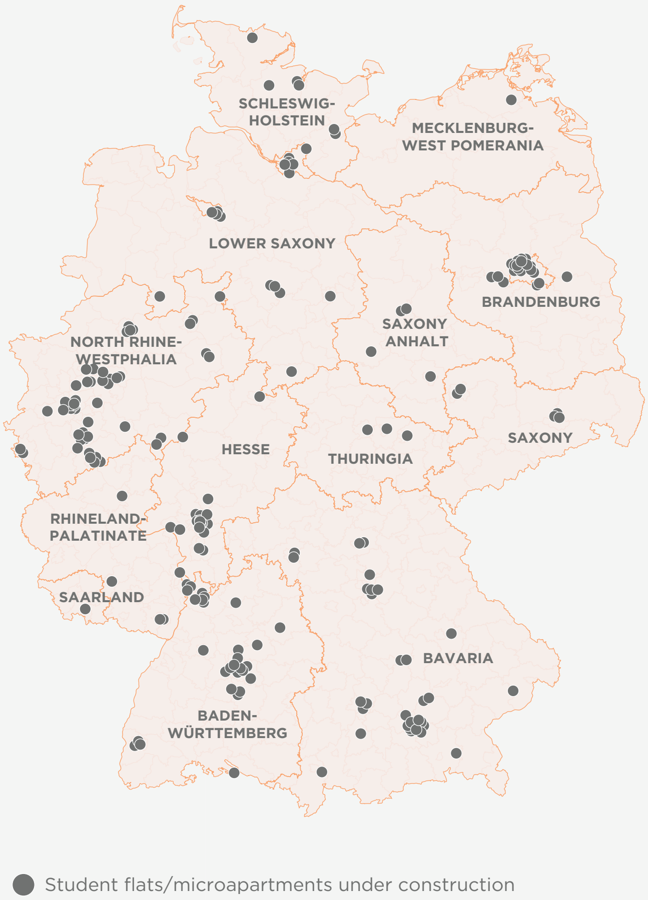
Source: Cushman & Wakefield, Thomas Daily

DEMAND FOR RESIDENTIAL PROPERTY THROUGH TO 2035



Source: Cushman & Wakefield, RIWIS

STUDENT FLATS DUE FOR COMPLETION BY 2025



Quelle: Cushman & Wakefield, Thomas Daily

THE LEGAL PERSPECTIVE FROM GSK STOCKMANN

Kristina Marx is a lawyer at GSK Stockmann

Offering legal counsel to investors from both inside and outside of Germany, Kristina Marx specialises in planning regulations and construction legislation pertaining to property development projects. She has experience of residential and mixed-use developments, retail and logistics projects, and care homes.

In terms of planning regulations, the precise definition of the microliving concept – "temporary lettings", "co-living", "aparthotel", "boarding house", "business apartments" – is actually irrelevant, as the profusion of terminology is not reflected in the key legislation, the Federal Land Utilisation Ordinance (Baunutzungsverordnung, abbreviated to BauNVO); moreover, this legislation does not differentiate solely on the basis of whether a property is let furnished, unfurnished, nor simply according to whether the letting is a short-term or longer-lasting contract.

According to BauNVO, microapartments are either 'dwellings' or they are 'hospitality premises'.

The law distinguishes between dwellings on the one hand, whose purpose is to allow for the independent running of a household and provide physical space for the personal sphere for a certain period of time, and hospitality premises on the other, conceived to provide a continuously changing set of guests a temporary space in which to spend the night, but without the option of setting up an independent household.

Permission for a specific type of use is set out in the planning regulations applying to a particular plot of land. In areas marked as solely residential (§3 BauNVO) or primarily residential (§4 BauNVO), planning permission may only be granted for hospitality use as an exception: the reason for this is that lawmakers assume that hospitality premises will exert a negative effect on residential areas, particularly in terms of noise. As such, it is very difficult to obtain planning permission for concepts which are based on providing accommodation to continuously changing guests staying for short periods of time in residential areas.

The planning issue is thrown into sharp relief on trading estates (§8 BauNVO), on which no residential property may be built or let; the reasoning behind this is that residential use may impede on commercial operations – the very grounds on which areas are declared as trading estates. Hospitality, however, can often be considered permissible.

Of course not every case is easy to define as either 'dwellings' or 'hospitality premises'; quite to the contrary, as some concepts contain elements of residential property with hotel-style use. Serviced apartments, for instance, can be very similar to dwellings if they are comparatively spacious and fully equipped; due to these characteristics, they are often let for several months or even more than a year, but, just as often, guests may change every few weeks. This kind of use is hard to categorise in the inflexible 'either housing or hospitality' schematic of BauNVO – a frequent point of criticism with regard to this ordinance.

Nevertheless, BauNVO remains the yardstick with which planning authorities have to work, and they generally begin with a detailed case-by-case assessment of the development concept behind apartments or serviced flats with a view to determining whether their purpose is to enable the setting up of a household; key criteria here are the size and facilities of each unit, the length of lettings, and services provided (either on an all-inclusive or billed basis).

As such, depending on whether the land in question is solely residential or located on a trading estate, concepts often have to be modified more clearly towards housing or hospitality in order to be eligible for planning permission.

The assessment process is similar in cases regarding change of use. Most larger cities in Germany now have change-of-use legislation preventing the use of existing residential space for commercial operations without prior permission. This kind of legal instrument can only be applied in cases in which developers aim to renovate residential buildings and then re-let them as part of a commercial accommodation concept; new-builds for commercial lettings are not affected.

Specific elements of the concept can have an effect on the regulations applying to rentals, not least on pricing.

When it comes to setting or raising rents, landlords are not able to act entirely as they see fit – especially in areas affected by what is referred to as 'rent brake' legislation, a tool which has been introduced by most city councils in Germany's urban areas facing high demand for residential property and a lack of supply. This rent control instrument can be applied to prevent landlords from setting rent at more than 10% over the local reference rent as per §556d Abs. 1 BGB); there are special exemptions if the property in question has been improved in the three years preceding the conclusion of the rental agreement.

The 'rent brake' does not apply to:

- new-builds after October 2014;
- temporary rentals;
- rentals in student and youth halls or residence.

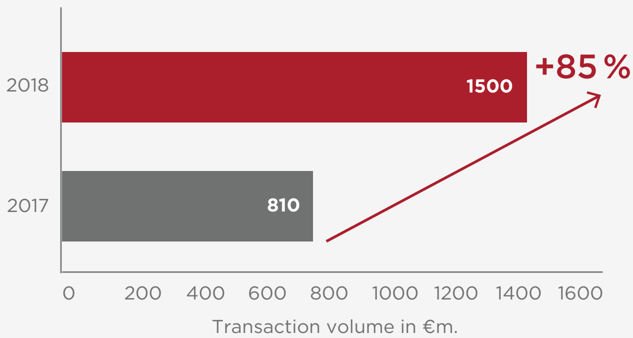
Lettings for temporary use can be agreed regardless of whether the dwelling is furnished or not as the decisive point is whether there is a time-limited purpose for the rental contract (e.g. trade fairs, building work, work experience); of course furnished flats are better suited to this kind of temporary occupancy, and this is what has led to a jump in the number of flats being let with furnishings since the introduction of the rent control structure in 2015. According to figures by Emprica, in Munich alone, 60% of flats listed are now being let furnished, a development also driven by the fact that rents can be set higher for furnishings – up to 80% higher depending on the part of Germany in question.

As a rule of thumb, it is safe to assume that concepts which are considered to be hospitality trades pursuant to BauNVO – i.e. which do not focus on providing space for the setting-up of a household – are generally also temporary use concepts (e.g. hotels, aparthotels); for serviced apartments, the specifics of the concept are key. The longer the duration of the rental contract, the more important it becomes to document the purpose for its temporary nature.

THE INVESTMENT MARKET IN GERMANY AND CONTINENTAL EUROPE

Due to the lack of available options in the segment, the role of the (comparatively new) sub-segment microapartments, including student flats, serviced apartments, boarding houses, and aparthotels, has grown considerably in recent years.

TRANSACTION VOLUME: MICROAPARTMENTS IN GERMANY



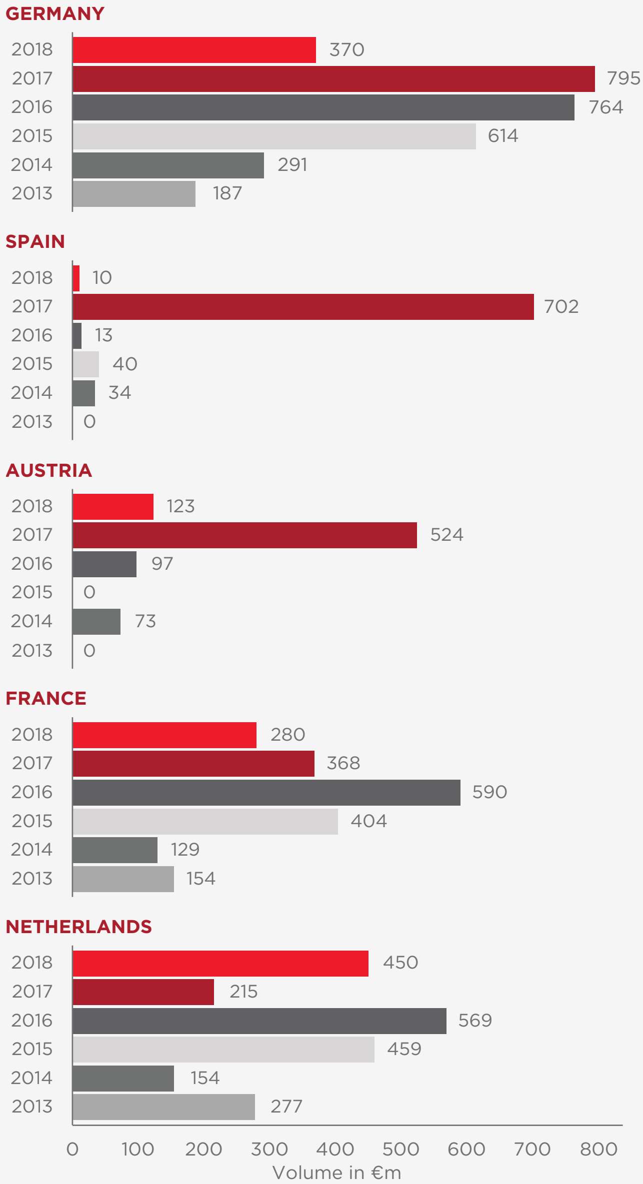
Source: RCA, TD, C&W Research

In 2018 alone, the total transaction volume in all of these various sub-segments in Germany totalled approximately €1.5 billion, representing a rise of almost 100% compared to the previous year.

Viewed on their own, it becomes clear that student apartments are still a niche product: between 2013 and 2018, the total volume in the student flats sub-segment was around €3 billion, i.e. roughly €500 million annually. Nevertheless, this kind of clear distinction between different concepts is becoming increasingly difficult as an increasing number of mixed concepts come into play and ever more specific types of accommodation are defined.

Compared with other European markets, only the United Kingdom had a higher transaction volume in the sub-segment of student accommodation; nevertheless, other markets are seeing increases here, too.

TRANSACTION VOLUME: STUDENT ACCOMMODATION



Source: RCA, TD, C&W Research

With their record-breaking transaction figures in 2017, Spain and Austria jump out of the statistics; in Spain, this exceptional year was due to the purchase of a large portfolio belong to a joint venture between AXA, Greystar, and Nationale Nederlanden.

Cushman & Wakefield Spain provided consultancy on this deal; in Austria, three major projects changed hands in 2017.

The main focus of these transactions was on Vienna, which has the largest number of students of any German-speaking city.

In Germany, it has, to date, primarily been domestic investors driving demand for student accommodation, at 60%, with a further 28% coming from other European countries and 12% from elsewhere.

Most in demand were three key metropolitan areas: Berlin-Brandenburg (€483m), Hamburg (€362m), and Frankfurt-Rhine/ Main (€294m).

In 2018, the net initial yield from investments in full-occupancy properties in one of Germany's top-five locations was between 3.75% and 4%.

TOP BUYERS
(LAST 24 MONTHS)

1. COMMERZ REAL
2. (JV) GSA GROUP+GIC
3. UNIVERSAL-INVESTMENT
4. CATELLA
5. CORESTATE CAPITAL

TOP SELLERS
(LAST 24 MONTHS)

1. MPC (PORTFOLIO DEAL)
2.CUBE REAL ESTATE
3. BONAVA (PORTFOLIO DEAL)
4. GBI AG
5. HOMEPOINT

Top 5 Deals (last 24 months)

Volume	City	Property	Buyer	Seller
€70m	Munich	Reserl	Corestate Capital	Strabag
€65m	Berlin	Neon Wood Berlin	GSA Group	Cresco Capital Group
€50m	Hamburg	Uninest Navale	GSA Group	Garbe Industrial
€50m	Hamburg	Woodie	Corestate Capital	PRIMUS developments
€45m	Essen	Jägerstraße 23-25	Commerz Real	i Live Holding GmbH

Source: RCA, C&W Research

CONCLUSION

Next to the United Kingdom, France, and the Netherlands, the German market for microapartments is one of the most important destinations for investments in Europe.

Re-urbanisation is a global megatrend which will continue to leave its mark on German conurbations and university towns, too. The combination of increasing populations in core cities, the increasing number of single-person households, and the explosion in costs for buying last and building are presenting the property industry with a range of new challenges when it comes to supplying large segments of the population with affordable housing.

At present, the focus of developments in microapartments lies on long-distance commuters and high-earning urban singles; but demand for affordable, optimised space is growing, especially in urban areas. As such, upping the supply of microapartments is a necessity of the highest order.

Moreover, the increasing profusion of community and sharing approaches will, in future, play an important role in the development of new kinds of property: for upcoming projects, there is no other option than to work with providers of micro-mobility services, car-sharing networks, or washing and laundry. Cooperating with partners from outside of the property industry will become increasingly crucial to success.

The task facing the property industry will be to develop intelligent solutions for new project which allow for lower-cost construction. This might mean modular buildings, for instance, and a willingness to work without classic cost-drivers such as basement garages.

Politicians, too, will have a role to play in creating planning regulations which allow for the development of suitable housing to satisfy demand.

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