Corporate Real Estate: Earnings Figures and Benchmarks by Category

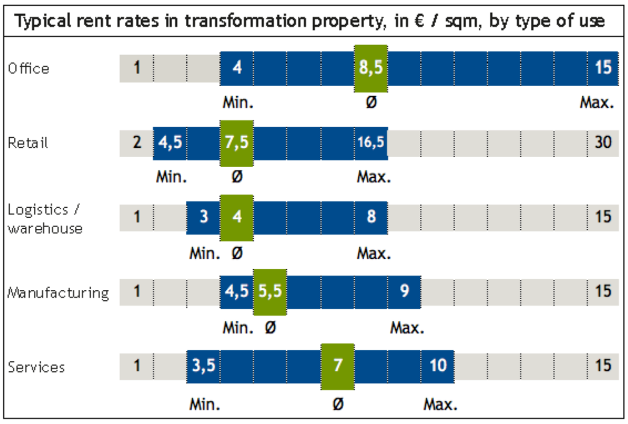
INTRODUCTION

BEOS Survey is an analytic series that reports quarterly on the latest research findings in the corporate real estate segment. The previous issue looked at the average performance ratios and benchmarks of corporate real estate across categories, and put them in relation to other asset classes. This issue before you will seek to deepen the understanding of corporate real estate along the same lines.

It will take a closer look at the four basic categories into which corporate real estate divides. Differences in dimensions, floor space mix, typical lease terms, achievable rent rates and ultimately the average yields and investment risks will be studied below for each type and compared among the types.

TRANSFORMATION PROPERTY

Transformation properties are highly versatile in their use options because of their very heterogeneous and comparatively large structures. Transformation property thus qualifies for nearly any classic type of use. Depending on what sort of redevelopment is undertaken, transformation property may continue to serve business purposes for another 50 years on average, assuming sound use concepts. Their frequently central urban locations justify elevated rent levels that match or indeed exceed the local reference rent, especially whenever properties of this type are redeveloped into office or retail accommodation. Accordingly, leases tend to be signed for longer average terms, with ten-year leases not uncommon. General purpose accommodation take exception, as they are mainly let for terms for 3 to 6 years.



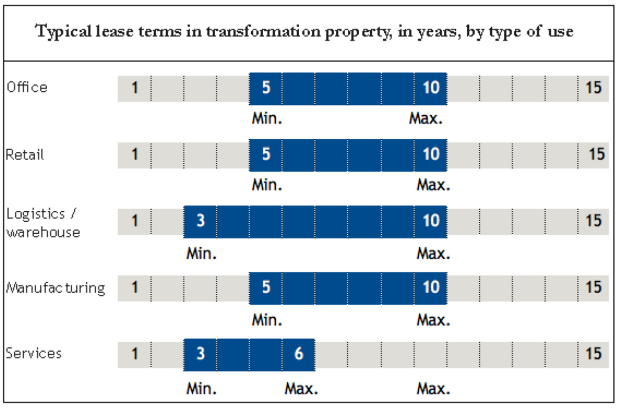


Fig. 2: Rent rates and lease terms for transformation property, by use type[1] (source: bulwiengesa)

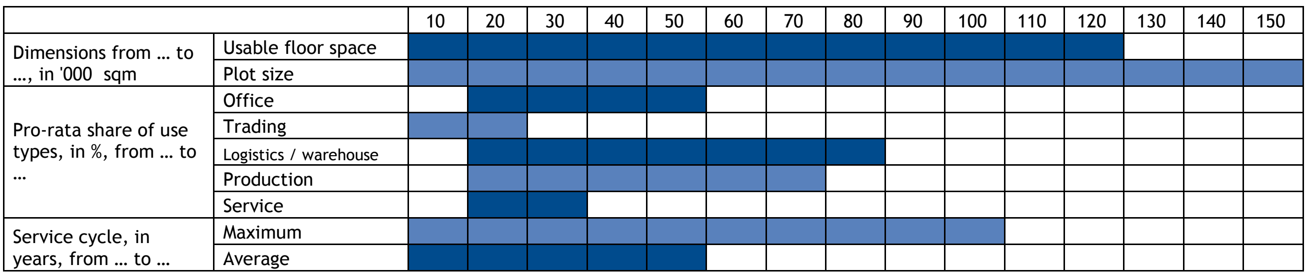


Fig. 1: Basic data on dimensions, service cycle, and use types of transformation property, 2013[1] (source: bulwiengesa)

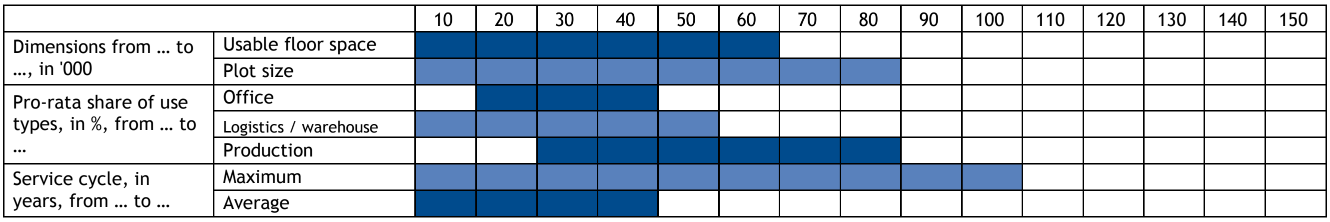


Fig. 3: Basic data on dimensions, service cycle, and use types of light manufacturing property, 2013[1]
(source: bulwiengesa)

LIGHT MANUFACTURING

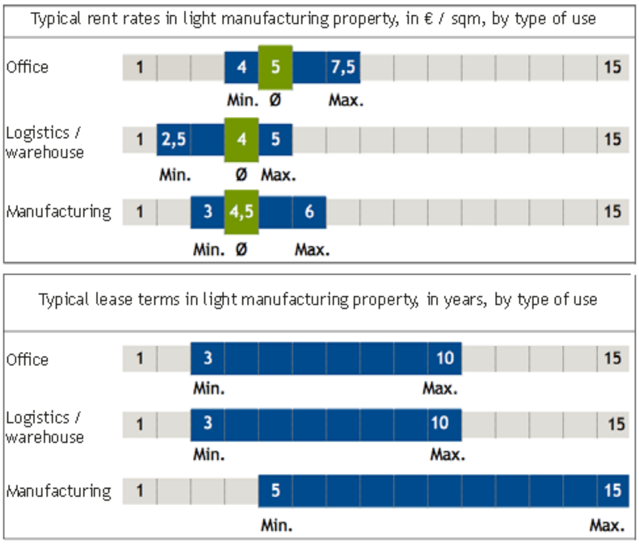


Fig. 4: Rent rates and lease terms for light manufacturing property, by use type[1] *(source: bulwiengesa)*

Light manufacturing real estate is located in trading estates or industrial areas close to cities. Due to the relatively high degree of specialisation and customisation for specific manufacturing processes, lease terms signed by economically established businesses often exceed the ten-year mark, which would otherwise be a rather atypical length of time for corporate real estate. It is explained, inter alia, by the substantial proprietary investments that occupiers tend to make.

Above all, though, the cost effectiveness of light manufacturing properties benefits from above-average lease terms. Rent revenues, by contrast, tend to be in the medium range. Realistic market rents for classic light manufacturing areas in German averages around 4.50 euros / sqm. The reason for this is in many cases the relatively simple building standard that could alternatively be use for warehouse, service, and logistics purposes. Modern light manufacturing schemes are often designed for a flexible adaptation of these floor area types from the start because of the close synchronisation of production and logistics processes within the framework of the supply chain management. This can change as soon as a light manufacturing property is customised to serve the purposes of a certain occupier.

LOGISTICS

The profitability of logistics properties hinges essentially on their age. Modern facilities raised in the 21st century are often standardised, and manifest a high alternative use potential. The flexibility achieved corresponds to the current requirements in the logistics industry, and simultaneously makes these assets so attractive for investors. The best scenario for vintage stock properties is to be located in a region subject to great logistics demand.

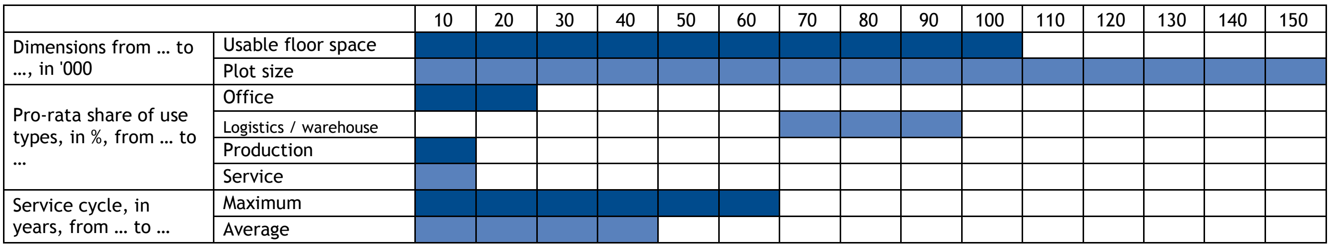


Fig. 5: Basic data on dimensions, service cycles, and use types of logistics property, 2013[1]
(source: bulwiengesa)

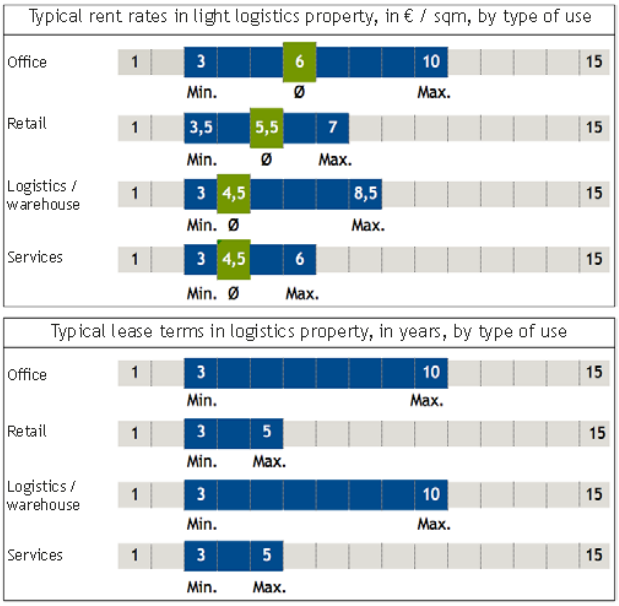


Fig. 6: Rent rates and lease terms for logistics property, by use type[1] (source: bulwiengesa)

Driving factors such as globalisation and segmentation of manufacturing processes have greatly boosted the logistics industry in Germany, not least because of the country's advantageous location in Europe. The momentum is further and sustainably accelerated by the ascendency of e-commerce, and has lately generated strong demand among occupiers and investors. Among the corporate real estate types, it is the asset class with fastest-growing footprint in Germany. The combination of keen demand with limited floor space supply makes it reasonable to expect rental growth upside here. The prospect is actually reflected in the ongoing yield compression.

BUSINESS PARKS

Business parks are designed from the start as multi-tenant properties. Over time, however, the concept of business parks has been repeatedly adjusted to the needs of the economy by changing the pro-rata floor space contingents. This has led to the creation of a wide variety of different business park types.

The latest trend favours a constellation that includes less office accommodation (40 % maximum) while having larger commercial and warehouse sections. At the same time, there is a trend to move new schemes close to town centres again. Both trends enhance the marketability of modern assets.

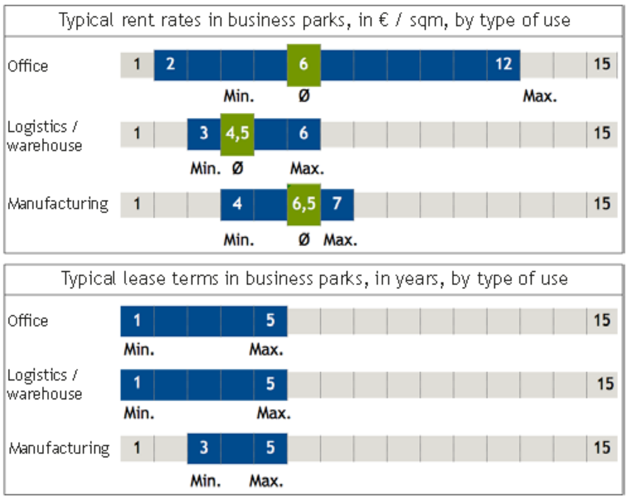


Fig. 8: Rent rates and lease terms for business parks, by use type, 2013[1] (source: bulwiengesa)

Rent rates in business parks are comparatively high for corporate real estate, though much depends on location. The elevated rent level is primarily explained by the higher office share. The central location also comes into play, because it justifies higher square-metre prices. Warehouse space, which often has a multifunctional layout, generates an average of 4.50 euros / sqm, which is by all means a respectable result for this type of floor area. The multi-purpose nature of interconnected complexes turns modern properties into safe and profitable vehicles. Older existing schemes with a high office share and located in peripheral sites, however, need to factor discounts into office rents. The spread of achievable rents in business parks is therefore comparatively high for office space.

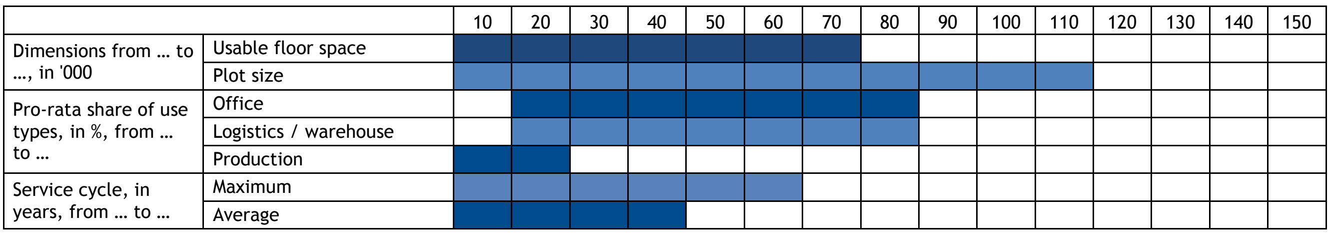


Fig. 7: Basic data on dimensions, service cycles, and use types of business parks, 2013[1] (source: bulwiengesa)

COMPARING CORPORATE REAL ESTATE TYPES

The characteristics in terms of occupier structure and location criteria, which can differ considerably, also impact the lifetime of lease contracts as well as the rental income and yield returned by them. Given the generally heterogeneous nature of the national market, any case study should therefore include the regional and property level in its analysis. That being said, it still makes sense to group the various corporate properties into specific types despite their differences concerning quality of location, fit-out, and building age. All four categories have characteristic features that are mirrored in return requirements and the associable risk.

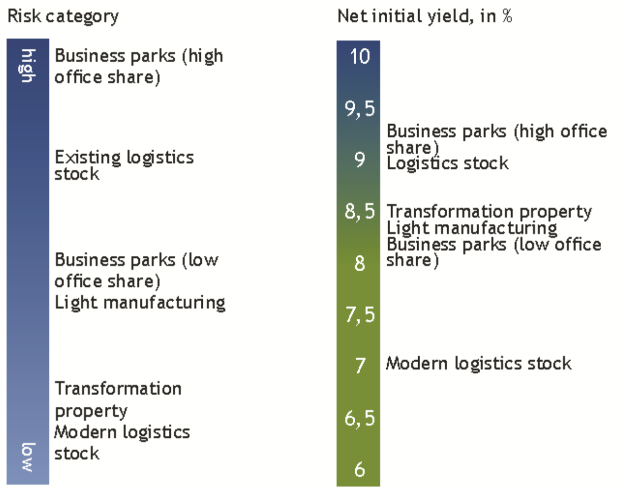


Fig. 9: Yield rates and risks by corporate real estate category[1] (source: bulwiengesa)

Modern logistics properties are subject to the lowest risk among the four categories, and are therefore subject to the lowest return requirements, too. This is explained by the currently very high demand for accommodation in this category and dwindling supply, but also by the high quality of the properties, many of which were raised in recent years. Older logistics properties come with a greater exposure, and thus with a substantially higher net initial yield as their risk premium.

The return requirements for light manufacturing and transformation property are more or less comparable, while their respective exposure differs starkly. It may not be a big problem to sell light manufacturing properties with secure tenant covenants, and to increase their value. Yet finding a follow-up use for them can be tough, and may prove costlier than it would with established transformation properties.

The high risk associated with business parks results from the many different structures and concept that evolved over the years. While some of them work just fine, others are plagued by structural issues. Things are not made any easier by the high management effort that is occasioned by the multi-tenant nature of the building, even if the latter effectively diversifies the risk of vacancy.

CONCLUSION

Corporate real estate offers versatile possibilities for yield-oriented and long-term investments. Rather than being intrinsic to the corporate real estate categories as such, they also arise from a plethora of variations within these categories. Basic knowledge of the respective strengths and weaknesses is therefore of the essence for successful investments.

Investors need to create the necessary awareness in line with their allocation strategy and asset management competency, which may then serve as basis for acquiring suitable corporate real estate to match their investment strategy. As suggested above, corporate properties may involve very different requirements to achieve certain targets. Modern logistics real estate, for instance, lend themselves mainly to passive direct investments in the core segment, whereas investments in dated business parks or existing logistics properties with appreciation potential presuppose active asset management and the concomitant expertise.

OUTLOOK

Survey No. 05 will discuss corporate real estate in the context of the evolving industry 4.0, and investigate the changes it will bring for industrial and commercial real estate. It will be published in February 2014.

1) BulwienGesa AG et al., 2010 Gewerbe- und Industrieimmobilien in Deutschland, bos.net/sites/beos.net/html/media/pdfs/downloads/BulwienGesa_Gewerbe_Industrie-immobilien_2010-06-08.pdf -: - Values adjusted to the 2013 status

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