The value investment approach to real estate development
A case study from Berlin, Germany

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Abstract
The standard development approach all over the world is to “build new” on vacant sites. However, the refurbishment or redevelopment of existing buildings is becoming increasingly important, and not only for ecological and sustainability reasons. Buildings have to be adapted at a faster pace to changing uses and tenant needs for flexibility. With the “internet of things” and the growing digitalization of so many processes, our work environment has to adapt rapidly and without large capital expenditures. By presenting a case study from Germany, this chapter highlights an investment story from redeveloping former industrial buildings into modern uses for the growing tech and internet industry in the urban center of Berlin. In doing so, the chapter deals with the fundamentals of value investment in real estate. Based on the model that Dodd and Graham (1934) developed for analyzing securities in the 1930s, the authors apply the same principles to analyzing and investing in real estate. They compare the value investment approach to the prime/core investment approach of institutional investors and conceive it as a contrarian strategy for developers, independent of location and cycle.

Introduction
It is obvious that buildings are very different from cars. Yet both are durable goods, so we can draw some meaningful parallels. Just like a new premium-class car straight off the production line, from a technical perspective, buildings can also have a very long useful life if properly maintained and cared for. In terms of holding their price, however, the situation is completely different. As we all know, the value of a car declines continually, even if it is not being driven. Indeed, cars currently lose their value at an even faster pace, as vehicle manufacturers accelerate the rate at which they launch new models with enhanced features, and buyers perceive them as an improvement on previous models. Furthermore, only very few car owners hold on to their vehicles long enough for them to acquire a value among enthusiasts as vintage models, at which point, their value will slowly increase. A similar pattern can be observed for core real estate, that is, newly built or completely redeveloped and well-rented office and retail premises in prime city locations. Although car owners are presumably all aware that new vehicles in
The value investment approach

In particular, lose much of their value in the first few years, real estate investors appear to assume, when buying core properties, that they are economically sustainable, in the sense that they will retain their premium investment status and continue to generate premium rents or returns on sale. In fact, however, just like cars, these properties also age and lose their utility value. Signs of wear and tear become apparent, and in many cases, both the fixtures and technical features of a building very soon fail to conform to the latest standards and the requirements of tenants with constantly changing preferences.

Project developers bring new properties onto the market in regular cycles, in the form of buildings that more effectively meet the needs of tenants than their older counterparts. These trends in tenant expectations manifest themselves in terms of comfort (e.g. air conditioning, lighting), IT equipment (e.g. centralized/decentralized and integrated/external server rooms, wiring systems), workplace design (from cell offices to business club), and sustainability.

As an alternative to building new real estate, developers also take over empty, ex-core properties from investors with no development expertise. Such properties are then renovated with the aim of letting them and offering them again as premium or core properties, with a low-risk return strategy and predictable cash flows. The rather florid term occasionally used within the industry to describe this scenario is “broken core.” This strategy follows a process of the original owner first suffering a heavy loss on what was a premium-ranking property, and then selling it on cheaply to a developer, who may subsequently make a substantial capital gain.

One of the main reasons for this widespread belief in the ever-appreciating value of prime real estate is a market-based approach that works to some degree as a method of interpreting the market. However, it is then often applied by inexperienced investors without proper consideration of the specifics of the real estate market and its various segments. They expect the value of their property to move in line with the market as a whole, but buildings are not a homogeneous commodity. No single building can “track the market” permanently. Even if an investor has a large portfolio in a particular location, that investor’s property holdings will not correspond exactly to the market. He may be able to influence the market to some degree with his pricing policy, but he cannot monopolize or replicate the market.

To put it another way, if a new building or a completely refurbished one can be described as “core,” it can only be classed reliably as such at the time it first occupies. Over time, it is no longer representative of the market, but merely of its own specific rental situation. Using the example of a ten-year rental contract with an index clause, the cash flow generated will usually grow along with inflation, whether rents in the broader market are rising or falling. It is not until the landlord needs to find another tenant that he has to deal with the market again. An example of how this can work in practice is presented below.

Core investing in real estate

Movements in the value of core real estate can be demonstrated by reference to the well-known case of “Taunusanlage 11,” a prime office tower in Frankfurt, Germany. In the early 1990s, an institutional investor purchased an office building in Frankfurt am Main, regarded as a “landmark property” in a prime location in the city’s banking district. At the time, the tenant of the building (built in 1972) had already moved out, and the property was completely refurbished. Subsequently, it was the first property in Germany to achieve a monthly rent (for two floors of the building) of more than €50 per square meter. The property could probably have been valued thereafter at around 20 times the annual rent – €9,600 per square meter, assuming a sustainable consistent rent of say €40 per square meter. These figures are based on the assumption that the rent can be increased repeatedly, at least keeping pace with inflation.
On this basis, after 20 years, the rent would have risen from €40 to €56 per square meter (based on average inflation of 1.75 percent). Today's value would be around €13,580 per square meter, if the building were valued at the same initial return of five percent.

However, the situation evolved very differently. The new principal tenants moved out as early as 2007, and the property then remained permanently empty. Over the last 20 years, the return is likely to have been well below five percent, especially if we factor in non-apportionable ancillary costs such as maintenance. Thus, less than 20 years after its construction and again after its later refurbishment, the property was no longer competitive. It was then sold a number of times and completely refurbished once again by a developer, between 2012 and 2013 (hp developments, 2014; Wiederhold, 2011). According to Jones Lang Lasalle (2016) the premium rent for offices of this kind in Frankfurt is now roughly €36.5 per square meter, with the cap rate at around 4.4 percent. From today's perspective, the property's theoretical selling price is likely to be approximately €8,800 per square meter. However, this would only apply, if it were to be let at a premium rent in a completely refurbished state and could be sold at the core cap rate. Our example demonstrates that this property had core status when it was built, and again when it was refurbished in 1993 and again in 2013, but (after the first two of these occasions) it subsequently declined to the official reference land value, plus shell construction costs, within less than 20 years (see Thomas Daily, 2016).

Many other real-life examples could also be cited to illustrate the point that in economic terms, the residual useful life of tenanted office premises in the premium segment, and even of those occupied and used by the owner, is subject to constant decline. Consequently, the refurbishment costs that owners need to factor in every five to ten years, increase considerably. Yet, it seems likely that very few investors actually do factor in this expense – which can, from evidence, be as much as several years' rental income. Otherwise, they would not be satisfied with an initial return of 4.4 percent. Instead, investors assume that it will always be possible to let such office premises, simply because the location itself is outstanding. That is, it cannot be duplicated, and the premises are tailored to the tenants' current requirements. When calculating the purchase price, most investors do not appear to give sufficient thought to the fact that the premises will age, that tenant needs and preferences will change, that technology will progress and that the site itself will evolve for better or for worse.

Incidentally, this case study from Frankfurt is not an isolated example. The same pattern recurs not only for this building, but also for many others, whether in the office or retail segments, city-center shopping malls or luxury hotels. Figure 17.1 shows uniformly low cap rates for core property in the retail, office, and residential segments in Germany's top seven cities. Since 1996, there has been no observable increase in values as a result of higher purchase prices. As long as nearly all institutional investors such as pension funds or insurance companies focus exclusively on core real estate investments as outlined by Metzler Real Estate (2016), this situation is unlikely to change. For office premises, even the rise in premium rents has not produced any growth in capital values – in fact, the opposite is true. In real terms, we have seen a significant decline in the value of new buildings, although, as we shall now see, this decline is much less pronounced in the case of existing real estate than it is for new properties.

**Intense competition driven by new buildings in core segments**

From a management perspective, all premises undergo their own product life cycle, and in some cases, this may diverge considerably from the broader market cycle. Even if, for example, the premium market rent remains constant or increases, the level of rent is not always achievable for a specific building that was regarded as a core property perhaps ten years before. A series of
filter processes tend to lead to a situation in which the original premium rent gradually declines to an average level over several rental cycles. The set of tenants also changes over time. The market itself filters demand for premises, with the most sought-after tenants moving to newer properties and being replaced by less demanding tenants. Good asset management and high levels of investment can slow down this process, but cannot terminate it.

Alongside the ongoing competition their properties face from new buildings, the situation for owners and investors is made more difficult by the fact that, while the core segment tenants they wish to attract are few in number, they are nevertheless highly mobile. What motivates such tenants is relatively clear; any new premises must be either cheaper or better than their current one. Whether a lawyer works in one location or in another 50 meters away is irrelevant, as far as his or her work is concerned. The marked readiness of such tenants to switch location gives them a strong negotiating position. In most stages of the market cycle, tenants can dictate the terms of any follow-on lease contract. Usually, the landlord takes the view that the risk and damage incurred if the tenant moves out would be higher and that he would therefore rather accept a lower rent. At this point, the difficulties associated with classic core investments become obvious (see also Figure 17.2).

**Value investing in real estate**

There are ways around the problem mentioned in the previous section. Most companies in Germany work on the basis that the higher the rent, the less attractive the premises. That is particularly the case for the German “Mittelstand,” the small and medium-sized enterprises (SMEs) that make up 99.6 percent of all German businesses and account for 59.4 percent of all employees (Institut für Mittelstandsfororschung, 2016). This group of tenants rarely looks for the kind of properties that most institutional investors currently regard as attractive. Apart from low rents, what matters most for such tenants are the productivity and flexibility of the leased property. For SMEs, business premises have a functional character, and status is less important.
To date, institutional real estate investors have tended to focus almost exclusively on prime sites with a high level of market transparency in terms of open and accessible data. Moreover, they have avoided low-rent properties in second-tier locations (not second-tier cities). Nevertheless, such “class B” sites can present an attractive long-term investment, if they can be acquired at low cost, following a thorough analysis of the competition and with good asset management. The key lies in adopting a value-based approach that is referred to in the industry as value investing. It is important not to confuse “value investments” with those in the “value added” risk category, which involve buying slightly higher-risk properties (some vacant units, less desirable locations, tenant credit ratings, refurbishment potential).

The value approach to real estate investing is based on long-term fundamentals, such as the available supply of premises, and growth in employment. The primary focus is on the user’s perception of the supply situation, such as whether there is an over or an undersupply. It is the user’s search profile that defines the relevant market in which landlords compete against each other. Value investors concentrate on a property’s immediate competitive environment and intrinsic value. For example, they will examine, from the tenant’s perspective, whether other landlords are in a position to offer better or cheaper premises. The value approach to real estate investing therefore presupposes a detailed assessment of the micro-location, based on a primary analysis of comparable factors such as rents, purchase prices, and refurbishment costs.

Value investing takes us logically into second-tier locations, often existing buildings that have already experienced a number of rental cycles, as can be seen from Figure 17.2. This approach

![Figure 17.2 Value-based competition strategies generate benefits for their users and allow values to rise](Source: Authors)

**Figure 17.2** Value-based competition strategies generate benefits for their users and allow values to rise

Source: Authors
can be applied to any segment of the real estate sector, be it offices, retail, hotels, or logistics/industry. The fundamental aspects of this approach are outlined below by reference to mixed-use commercial properties, which are also referred to as corporate or industrial real estate. These are mainly buildings used as offices or for services, storage, production, and distribution. For the most part, the tenants in question are SMEs, so that the use of and demand for such industrial real estate is correspondingly diverse. Investing in mixed-use commercial buildings in second-tier locations enables investors to adopt a strategy of cost leadership, as this segment does not necessarily depend on volatile premium or average rents, since the rents are at a low, but constant level. The reason is that this segment is, in comparison to the two other segments that cover the majority of the properties, dominated by large numbers of less mobile tenants. Their commitment to a particular area places the landlord in a comparatively strong negotiating position. Furthermore, the segment attracts only a small number of institutional investors. A lack of market transparency, along with the need for active and specialized asset management, make it possible to acquire such properties more cheaply – assuming the investor has a good knowledge of the market. This price discount, when the purchase price ranges below the property’s intrinsic value, is considered as a margin of safety, as popularized by Dodd and Graham (1934). This margin substantially reduces the overall downside risk of the investment.

Another point in favor of this market segment, in addition to stable rents and purchase-price factors, is a reduced dependency on the capital market. This is particularly clear in the risk–return ratio for different asset classes, as shown in Figure 17.3. The “German Property Index” published by BulwienGesa shows far less pronounced fluctuations in total returns for

![Figure 17.3](image)

**Figure 17.3** The changing pattern of total returns for individual asset classes suggests a convergence between different cycles in Germany

*Source: BulwienGesa, 2015*
industrial real estate than for retail or office. Even new residential properties follow a more cyclical pattern. The only asset class to record consistently positive total returns over the last 20 years is industrial real estate, which underpins its suitability for value investing.

If the risk of declining property values is lower for industrial real estate than for other asset classes, investors should increase their weighting of this sector on account of the potential higher returns. As Figure 17.4 shows, since 1991, investors in the industrial segment not only have experienced much less pronounced volatility in capital real estate values, but also have achieved gross rental yields roughly 200 base points higher.

The apparent contradiction that higher returns can be achieved despite lower volatility, is explained by the fact that the market for industrial real estate is relatively transparent in terms of available data and service provided covering the sector. Furthermore, industrial real estate is dominated by owner-occupiers who focus on cost and specific needs.

**Industrial properties**

In order to provide more detailed insight into our understanding of the abovementioned multi-use and multi-let commercial properties, the four distinct types of industrial properties according the “Initiative Unternehmensimmobilie” (BulwienGesa, 2016) are explained below, which have proven to be an excellent asset class for a value-based approach, namely: converted properties, logistics properties, business parks, and light manufacturing properties.

Converted properties are often former manufacturing sites with a building structure that evolved historically in line with changing business needs. Some of them have a campus

![Figure 17.4](image-url)  
**Figure 17.4** Individual asset classes vary considerably in terms of average gross annual rental yields in Germany  
*Source: BulwienGesa, 2015*
Character and are found in comparatively central locations in urban areas. During the conversion process, the existing rental income facilitates alteration, supplementary, and redevelopment measures aimed at turning a single-occupier homogeneous-use property into a multi-tenant property characterized by a variety of uses. The historic nature of period buildings adds a unique charm to the premises. Young service providers especially identify with the historical “Made in Germany” image of industrial brownfield sites.

Converted properties are highly versatile in their use options, because of their very heterogeneous and comparatively large and adaptable structures. Accordingly, they qualify for almost all classic types of use. Depending on the type of redevelopment undertaken, converted properties may continue to serve business purposes for another 50 years on average, assuming sound use concepts. Their often central urban locations justify elevated rent levels that match or even exceed the local reference rent, especially when properties of this type are redeveloped into office or retail accommodation. Accordingly, leases tend to be signed for extended average terms, with ten-year leases not uncommon for the major tenants.

Against the background of supply chain management, modern logistics properties serve purposes beyond the business of storing, trans-shipping, and order-picking goods and commodities. Existing infrastructure and technology (for instance, annexed offices and social areas, warehouses, conveyor technology, IT, service areas, shops) facilitate rapid adjustment to new requirements, while also lending themselves to mixed use by several occupiers and having a modular structure. Logistics properties constructed after 2000 generally display these characteristics. Most of them are operated by logistics firms on the basis of service contracts (contract logistics), and are frequently located near transport hubs. Their standardization and high alternative-use potential make properties of this type extremely flexible.

The best-case scenario for vintage stock properties is to be located in a region subject to great logistics demand, such as near a major center or port. A serious shortage of floor area, combined with a high level of demand, boosts their attractiveness as investment property. Due to their architectonic structure, dated legacy properties are rarely suitable for multi-tenant use, because they were often custom-developed for their former primary user. Accordingly, these vintage properties do not qualify as typical value investments in the sense explained above.

Factors such as globalization and the segmentation of manufacturing processes have greatly favored the logistics industry in Germany, not least because of the country’s advantageous location in the heart of Europe. The momentum is further accelerated by the rise of e-commerce, and has recently generated strong demand among occupiers and investors. Among the industrial real estate types, it is the asset class with the fastest-growing footprint in Germany. The combination of high demand with a supply of limited floor space also makes it reasonable to expect considerable upward rent potential.

By their very nature, business parks are intended for multiple occupancy. A combination of office, service, storage, and clearance spaces is let in a building cluster, together with professional management. Distinguishing features of modern schemes include central locations and smaller dimensions, whereas older business parks were often located in suburban sites characterized by convenient transportation access.

The history of business parks can be divided into several generations. The first generations were defined by a very low share of office accommodation. Over time, office spaces became increasingly dominant, in some cases accounting for a share of up to 80 percent. More recently, the trend has shifted again in favor of other types of floor space.

While business parks are inherently designed as multi-tenant properties, the concept of business parks has repeatedly been 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. Depending on the location, rents in business parks are comparatively high. This rent level can be explained primarily by the higher office share. Another factor that comes into play is their fairly central locations, because they justify higher square meter prices. The multipurpose nature of interconnected complexes means that these properties are safe and profitable vehicles. Older schemes with a high office share and located in peripheral sites, however, need to factor discounts into their office rents. The spread of achievable rents in business parks is therefore comparatively high for office space.

The fourth type of industrial properties are light manufacturing properties that represent buildings used for light, non-nuisance (low-pollution) manufacturing purposes. Present-day light manufacturing properties tend to be found in location clusters with excellent access to their constituent cities. They frequently combine several floor area types, such as manufacturing, laboratories, logistics, and warehouse space, along with a modest share of office units.

Light manufacturing real estate is located in commercial or industrial areas, either within or close to cities. Due to the relatively high degree of specialization and customization for specific manufacturing processes, lease terms signed by established businesses often exceed the ten-year mark. This is explained, inter alia, by the substantial proprietary investments that occupiers tend to make, and that presuppose long periods of occupation to allow for amortization. Another factor encouraging strong ties to a given location is the local commitment of some companies.

From an investor perspective, the above-average lease terms for light manufacturing properties are attractive. Then again, rent revenues rarely exceed the mid-range. The reason for this is in many cases, the relatively simple building standard that could alternatively be used for warehouse, service, and logistics purposes. Modern light manufacturing schemes are often designed for a flexible adaptation of these property types from the start, because of the close synchronization of production and logistics processes within the framework of supply chain management. This can be changed as soon as light manufacturing property is customized to serve the purposes of a certain occupier. Rental rates are therefore much higher for high-tech installations, for instance, whereas their alternative use potential is compromised.

In summary, it can be stated that the industrial real estate segment certainly provides a good example of the potential of value investing. However, the same approach could reasonably be adopted in other segments and niches within the real estate market. This would allow investors to implement a cost-leadership strategy, even in specialized markets such as budget hotels, retirement homes and student accommodation, provided they are able to acquire inexpensive property in the right location, manage it effectively and develop a close relationship with customers.

**Asset management requirements**

Asset management is generally a key factor for any type of asset. In the case of industrial real estate, asset manager qualifications are even more significant than would be the case with other single-use property types, because of their multi-use character and their frequent letting activities involving a larger number of occupiers. Industrial real estate is often associated with a high churn rate, but this association is rarely based on hard evidence. The prerequisite for tenant loyalty is first-hand asset manager knowledge of tenant requirements, and the capacity to meet changing floor-space needs. After all, the demand for space can fluctuate considerably over time. Depending on the order book balance, company premises may have to be expanded or reduced at short notice. The tenants of a landlord who demonstrates flexibility in this regard are more likely to remain long term. Yet, the flexibility comes with increased administrative costs, which are needed to ensure full occupancy of the floor areas.
Asset managers should communicate openly with their tenants, and place them squarely at the center of their activities. Of key importance here is direct communication on the ground, including regular visits of the asset manager to the occupiers or to the decision-makers of the various companies. This means one-to-one meetings, preferably at periodic intervals, such as quarterly. Between these on-site dates, the asset manager should tap other sources to remain up to date and be able to respond quickly. Other asset management tasks in this context include the periodic reappraisal of a tenant’s creditworthiness and the monthly monitoring of rent payments. If a tenant falls into arrears, the asset manager is well advised not to respond immediately with a written reminder. Rather, the sensible thing to do is to engage the tenant in an informal dialogue and to hold back on tougher measures, such as legal threats, until an amicable approach has clearly failed.

It is essential that an asset manager understand the nature of the tenant’s core business. This is in fact the only way to adapt the lease as much as possible to the respective occupier’s needs. Familiarity with the tenants also enables an asset manager to respond to changing floor-space requirements. Equally important is that the tenants know who to contact if strategic issues arise concerning the premises.

**Case study of value investing: Zeughof, Berlin**

The following case study shows by way of example, how the proposed value investing approach can be successfully adapted individually in real estate development. The project was initiated and developed by BEOS AG, an independent developer and asset manager headquartered in Berlin. Founded in 1997, BEOS employs interdisciplinary teams in Munich, Hamburg, Frankfurt, Cologne, and Berlin to manage and develop properties throughout Germany. The main investment focus is on multi-use commercial properties that offer office, production, service and logistics space to cater for the needs of their heterogeneous tenants. Through personal conviction and as a contribution to sustainability, BEOS invests primarily in existing buildings and attempts to create new usage concepts by pursuing creative and economically prudent solutions.

**Project summary**

The Zeughof is a former single-tenant property in the vibrant Berlin-Kreuzberg area that has been restored, adapted, and transformed into a multi-tenant and multi-use business campus. The project area comprises 11 buildings and features high quality production, storage and office space, attracting emergent and aspiring companies within the technology, media and telecommunications sectors. The project was initiated and developed by BEOS, with the objective of revitalizing a large part of the existing space, developing a campus brand, and participating in the dynamic trend of Berlin’s growing economy in general and the start-up scene in particular. With a total leasable area of about 51,000 square meters, a high occupancy rate, as well as an attractive tenant mix, the project can be considered highly successful, both operationally and financially.

**Development background and the site**

In the nineteenth century, the area surrounding the Zeughofstrasse was incorporated into the city boundaries of Berlin, following the industrialization and economic upturn in the German capital. Shortly after the turn of the century, the property was purchased by a German producer
of telephone equipment and served as its headquarters. The existing buildings date back to the years between 1958 and 1982, and originally comprised office and production space for its single user (Figure 17.5 shows the main building in the year 1972). The project is located on a 30,269 square meter, half-block site along the Zeughofstrasse, Köpenicker Strasse, and Wrangelstrasse in Berlin-Kreuzberg, on the south side of Berlin, close to the Spree river (see Figure 17.6). It includes 31,254 square meters of office space, 12,605 of service and warehouse space, 4,112 of retail space and 2,546 of production space, amounting to a total leasable area of about 51,000 square meters. In 2013, when the property was purchased, the economic situation in Berlin had already improved extensively over the preceding few years, reflecting a decline in unemployment and a GDP increase. Even though Kreuzberg can arguably be considered as a relatively economically weak district, it is characterized by a very young population living predominantly in single households. However, the economy of Kreuzberg has steadily been changing from the historical “industrial-image” with factory workers, to a focus on creativity and culture with clubs, restaurants, and start-up fashion labels. In recent years, the Spree banks surrounding Friedrichshain-Kreuzberg have also undergone a shift towards media services with the establishment of MTV Europe and Universal Music. This has also been underpinned by a couple of ambitious development projects in the surrounding area, with the aim of attracting telecommunication and media companies. The “Zeughof” compellingly illustrates this very shift in appearance of the district, which is surely one of the key factors leading to the success

Figure 17.5 Zeughof: Main building, 1972

Source: BEOS AG
of the project. In summarizing the key points in the historical background and site characteristics, it appears that many proposed value investing requirements are met. First, in terms of city location, the Zeughof can historically clearly be classified as class B, even though the attractiveness has risen constantly since 2010. Second, the property offers a broad range of usage types allowing a multi-use structure. Third, due to its historic multi-use, single-occupier, but flexible structure, the property qualifies for a multi-use, multi-tenant structure. In terms of industrial property classification as presented above, the Zeughof can clearly be classified as a converted property.

The idea and the concept

When the property was taken over by BEOS, the producer of telephone equipment vacated a large part of their former space, and various tenants from distinct sectors occupied the buildings with no uniform or efficient concept. In addition, there was a substantial vacancy rate amounting to 8,523 square meters. Most buildings faced deferred maintenance and the overall condition of the property was poor. Due to the partly resulting outdated and obsolete space, important anchor tenants intended to vacate the buildings after their lease contracts ended shortly. These circumstances created an opportunity to acquire the project at a modest price, well below replacement cost. Moreover, the project featured some of the abovementioned important aspects regarding value investing. Specifically, the property comprised various usage

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*Figure 17.6* Zeughof: Overview of buildings

*Source: BEOS AG*
types and a flexible and functional layout. While the property is located in a typical class B location within a class A city, the area is characterized by economic growth and prevailing moderate rents.

Simply expressed, the basic idea was to gradually invest in the buildings in order to create a modern and open work environment for existing and future tenants. Further effort was put into establishing a property brand, identifying and attracting discerning companies from the TMT sectors and German Mittelstand, some of which had already located in the surrounding area. This entire process was intended to increase the very low rent level within the property that had prevailed up to that point, while still participating in the ongoing cash flow generated from the existing leases.

Development and management

As a first step, right after the purchase, all existing tenants were approached and involved in discussions about the future development of the “Zeughof,” in order to demonstrate the genuine interest of the landlord in the needs and requirements of his tenants. One important point emerging from the discussions, and also from the expectations of typical investors, was the visual appearance of the Zeughof that had suffered over the years. The buildings were not considered as a harmonious entity and the age of the buildings was clearly visible on the facades and the entire courtyard. This circumstance shows one of the typical challenges that have to be faced when converting a property. Thus, a large part of the facades was cleaned (sandblasted) and painted, in order to harmonize the overall image. The courtyard was completely redesigned, by providing an open space with benches, as well as bike racks. By planting trees and shrubs, a green and recreational space was created that now emanates a welcoming, relaxed, and open atmosphere. In the course of redesigning the courtyard, the accessibility of the buildings was further improved.

In order to implement the architectural concepts in the buildings, several tenant units underwent major structural improvements aimed at providing a more open architecture. This included the construction of two additional floors, the reconstruction of the original entrance on the Wrangelstrasse, a new staircase, entrance, and lift serving existing and new floors, and the transformation of basement storage space into office and parking space. In addition to architectural improvements, considerable effort was put into important reconstruction measures, such as modernizing the central heating and the structural fire protection of the buildings.

Since the image of the buildings featured an industrial and aged character, marketing played a crucial role in repositioning the property. Apart from the new architectural concept, an overall brand concept was designed, focusing on the name “Zeughof,” which was inspired by the street name and the history of the area. This marketing strategy entailed a new exterior and interior guidance system with markings for main axes, parking spots, and loading area. In conjunction with the overall redevelopment of the buildings and after completing the improvements, the “Zeughof” finally constituted a homogeneous and uniform property. As a consequence, the property has evolved from a single tenant one into a functioning and visually united multi-tenant property. The efforts made in order to take advantage of the property’s value investing potential show the superior role of active and good asset management with regard to both the building and the tenants. Figure 17.7 gives an impression of the aforementioned key measures, for example, the new architectural concept and the brand concept.

Another important issue that often has to be handled when developing or managing industrial sites is that of the environment. Even the inner-city located Zeughof is, or has been,
subject to some environmental problems primarily relating to contamination. As a consequence, the property is listed in the register of contaminated sites, which generally discourages institutional investors in particular. Therefore, sound historical research and ongoing drilling had to be conducted in order to resolve this issue and bring about a delisting of the site from the register. This whole process requires long-term commitment and ongoing investigation, but is likely to be rewarded by increased investor interest in the property, subsequently leading to higher pricing.

**Conclusion**

Convinced by the overall concept and willingness of the landlord to create a functioning and flexible working space, most anchor tenants extended their long-term leases. However, many new tenants also occupied the vacant or vacated space, which significantly increased the rent level. Through the entire transition, the property has not only become an outstanding location for tenants to produce, develop, distribute or offer their services, but also an attractive investment for those with an appetite for efficiently functioning and well diversified assets that are ready to face future challenges. In addition, even though the development yields a stabilized cash flow and already constitutes a viable investment, further opportunities are being provided, for example, by continuing to transform existing storage or production space into office space. The project shows clearly and convincingly, how the principles of value investing can be implemented successfully in the real estate market and offer a profitable alternative for real estate developers and investors who aim to be independent of location and cycle.
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