

# Briefing Note

July 2011

## Student Apartments Market in Germany

### Potential for investors

Student accommodation established itself as a niche in the investment market in recent years. This is little wonder when one considers that the number of students in Germany has increased over the last 10 years by some 18% to more than 2.1 million. In view of the suspension of national service and civilian service and two age groups of students leaving the upper secondary schools in certain federal states, the coming years are expected to show a further increase in student numbers. There are currently some 181,000 places in publicly funded sector halls of residence available to students - leaving almost two million students as potential tenants on the open apartment market. Here, however, there are shortages in certain cities. While building additional student halls, as the student unions are demanding, would certainly relieve the pressure on student accommodation, this is evidently not in line with the wishes of those concerned: According to research by Germany's higher education information system (HIS), only 10% of all students cite student halls as a first choice with 81% preferring a rented apartment. However, the fact that

only 67% of those surveyed actually live in a rented apartment underlines the latent potential for private investors.

Against this background, student apartments are an attractive market segment for investors. While they are more management intensive compared with "normal" residential property owing to the higher tenant turnover, the income stream is constant and the yields achievable for the investor are likely to be higher on account of the currently relatively low competition. In addition, the target group can be clearly located: There are 180 university locations in Germany in total with only 51 cities accommodating more than 10,000 students. These 51 locations are examined in this analysis in terms of their attractiveness as an investment location for student apartments. It is immediately apparent that the conditions in these locations show a very wide variation. Consequently, each macro-location analysed has been given a specific risk profile with the corresponding yield prospects. To date, the data available in this respect has been limited and greater transparency is certainly desirable from the investor's perspective.

### Key findings

- Over the last 10 years, the number of students in Germany has increased by some 18% to reach a current figure of approx. 2.1 million. A rented apartment is the first choice for more than 80% of students, yet only two thirds have realised this ambition.
- Against this background, it seems appealing for private investors to consider investing in student apartments, particularly since comparatively high yields can be achieved with manageable risks.
- Those 51 cities in which at least 10,000 students live would appear most suitable for investors. These cities have been examined and scored in terms of their macro-locational investment risks.
- The investment risk in the locations considered varies significantly. Darmstadt, Munich and Hamburg show the lowest risk. Halle (Saale), Braunschweig and Magdeburg are regarded as the cities with the highest risk.
- Both the high-risk and low-risk locations include markets that are over-valued or under-valued by trend. The most promising investments would appear to be in those markets showing low price levels combined with favourable development prospects. These include Saarbrücken, for example.
- Overall, a number of parameters suggest that student apartments will receive greater attention from certain investors going forward. However, with the market size limited by the number of students, they will remain a niche investment.

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### Benchmarking analysis

In order to evaluate and compare the 51 student cities in terms of their attractiveness, a benchmarking analysis was applied. Nine indicators were selected to reflect the supply and demand in the market for student accommodation (Fig. 1). Four of these indicators relate to the status quo of a location while the other five reflect the market dynamics. In other words, the scoring model reflects the current attractiveness of the locations analysed as well as evaluating their development prospects. The data available was a limiting factor in the scoring. In case the desired data was not available related values were applied. The indicators or values have therefore been collated in such a way in order to compensate for any disadvantages in individual cases. The nine indicators and data used to measure these are described in brief in Box 1.

Based upon the values calculated for the four status quo and five market dynamic indicators, a status quo and dynamic score between 1 and 10 has been calculated for each city analysed. Low values denote a high investment risk while high scores indicate that the conditions for investment in student apartments in the city suggest a low risk compared with the other cities analysed. As this is merely a comparative analysis of the 51 cities, it is not possible to make inferences as to the absolute investment risk.

### Status quo results

With regard to the status quo, the best performers are Frankfurt am Main with a score of 9.0, Darmstadt (8.9)

and Munich (8.5) (Fig. 2). Frankfurt is primarily attractive on the account of its very high income burden - in no other location analysed do students have to spend a larger proportion of their income on rent. In addition, there is a shortage of places in publicly-funded student halls. There are only places available in student halls for a little over 7.0% of all students - the fourth lowest figure of all 51 cities. These two factors, combined with the high student numbers (approx. 48,000 - 5th place) and a low vacancy rate in the apartment market (approx. 2.2% - 16th place) make Frankfurt the lowest-risk macro-location in terms of the current situation in all cities analysed.

At the other end of the rankings are Siegen (2.1), Braunschweig and Kaiserslautern (both 2.6). In the case of Siegen the result is principally attributable to the comparatively low student numbers (approx. 13,200 - 49th place) as well as the very low income burden (0.74 - 51st place). This is exacerbated by a relatively high vacancy rate (5.4% - 47th place) and a favourable supply of places in student halls (approx. 14% - 36th place).

### Market dynamics results

In the market dynamics scoring, Karlsruhe (8.1), Hamburg (7.9) and Munich (7.8) achieve the highest rankings (Fig. 3). Karlsruhe's strong performance is principally attributable to the clear increase in student numbers in recent years (approx. +32% - 5th place). Apartment rents have also grown noticeably between 2004 and 2010 (approx. + 1.8% p.a. - 7th place).

Fig. 1: Scoring "Market attractiveness student accommodation" - indicators and measurements

Status quo	Dynamics
Market size / level of demand <i>Number of students in 2010</i>	Market attractiveness <i>Variation in average apartment rents from 2004 - 2010 in %</i>
Supply of student halls places <i>Number of places in publicly-funded student halls per 10 students in 2010</i>	Demand trend <i>Variation in student numbers from 2004 - 2010 in %</i>
Apartment vacancy rate <i>Number of vacant apartments in the apartment stock 2009 in %</i>	Demand projection <i>Variation in the number of 18-25-year-olds from 2010 - 2020 in %</i>
Income burden <i>Ratio of average rents to average income per capita in 2010</i>	Population projection <i>Variation in population numbers from 2010 - 2020 in %</i>
	Economic prosperity <i>Variation in gross domestic product from 2010 - 2020 in %</i>

Data sources: BBSR, BulwienGesa, Deutsches Studentenwerk, Empirica, Oxford Economics, Statistisches Bundesamt

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### Box 1: Explanation of the indicators and measurements

**Market size / level of demand:** From the investor's perspective, the attractiveness of a market does not ultimately depend on its size but on the level of demand. In terms of student accommodation, this means: The more students live in a city, the more attractive the city is for potential investors. Figures are based upon the number of students enrolled at universities in the winter semester 2009/10.

**Supply of student halls places:** This indicator measures the availability of student-only accommodation to students. The better this is, the lower the requirement for apartments on the open rented apartment market. Consequently, those cities with a below-average supply are comparatively attractive to private investors. Figures are based upon the number of places in publicly-funded student halls per 100 students in 2010.

**Apartment vacancy rate:** The vacancy rate in the apartment segment provides information on the relationship between supply and demand in the rented apartment market. A very low vacancy rate indicates a general shortage of apartments in the city meaning that apartments suitable for students should also be in short supply. A high apartment vacancy rate, on the other hand, means that students should find a rented apartment with relative ease. The reference year for this indicator is 2009.

**Income burden:** This indicator also reflects the level of pressure on the apartment market. However, it does not reflect the pure availability of accommodation: The income burden provides information on whether the apartments available on the respective markets for rented apartments are in line with income levels of the population. The indicator shows the rent as a proportion of a person's income. Owing to the lack of student-specific data, the average rent for the city has been used along with the average local household income per person. Consequently, the value obtained is likely to considerably under-estimate the actual income burden of students. However, it can be assumed that the values also adequately reflect the differences in burdens in the cities analysed from a student perspective. Since the absolute value has no significance for students, however, this has been standardised at 1. For the scoring, this means that values above 1 reflect above-average market attractiveness for investors as students will find comparatively few apartments there that they can afford in relation to their income. Conversely, values below 1 indicate that apartment rents are below average in relation to income and there is therefore no real requirement for low-priced accommodation. The reference year is 2010.

**Market attractiveness:** To capture the dynamics of the relationship between supply and demand of apartments and, therefore, the general attractiveness of an apartment market from the investor's perspective, trends in average rents from 2004 to 2010 have been used. Owing to a lack of specific data, it was necessary to imply that the general rental trends in a city correlate closely with the rental trends of student apartments. However, it can be assumed that this inference is realistic.

**Demand trend:** To reflect the dynamics of demand, the percentage variation in the number of students between 2004 and 2010 was used. Increasing student numbers have a positive influence on the market size and, thus, make a location more attractive to the investor.

**Demand projection:** This indicator should be viewed in conjunction with "demand trend": Since there are currently no projections for student numbers available, the projection of 18-25-year-olds has been used in the scoring. The majority of students belong to this age group which makes it possible to use these figures as a reference for future student numbers. Thus, the weakness of one indicator is compensated by the strength of the other. The "demand trend" indicator reflects precise trends in student numbers, but with regard to the past. The "demand projection" indicator, in turn, does not reflect direct trends in student numbers but relates to future trends, which is decisive from the investor's perspective. Figures are based upon the period from 2010 to 2020.

**Population projection:** Since students compete with other population groups in the rental market, general population trends are also of interest. The larger the projected population growth between 2010 and 2020, the more additional accommodation will be required in the future. Consequently, locations with high growth rates are more attractive from the investor's perspective than those with low growth rates or declining population numbers.

**Economic prosperity:** The economic prosperity of a city allows the investor to draw conclusions about the local income levels. This, in turn, is an important determining factor for the achievable rents in the respective location. Consequently, the projected growth rate of the gross domestic product (GDP) between 2010 and 2020 used here provides information regarding the rental growth potential of the cities. Furthermore, cities with growing economies are more attractive as they offer students better career prospects. Locations with high GDP growth are therefore more attractive to investors than locations with low growth.

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The three cities with the least favourable development are Halle (Saale) with a score of 2.4, Magdeburg (2.9) and Kassel (3.5). Kassel shows a negative trend in average rents in recent years (approx. -0.2% p.a. - 49th place), and demand for apartments will barely increase in the future given the low population growth projections to 2020 (+5.9% - 42nd place). The north Hessen city also shows a below-average score in terms of projected economic growth for the coming year (approx. +9.2% - 43rd place). Kassel is in 27th place in terms of both indicators relating to trends in student numbers. In the last six years, the number of students has increased by some 6.5% and by 2020, the relevant age group is projected to shrink slightly by -3%.

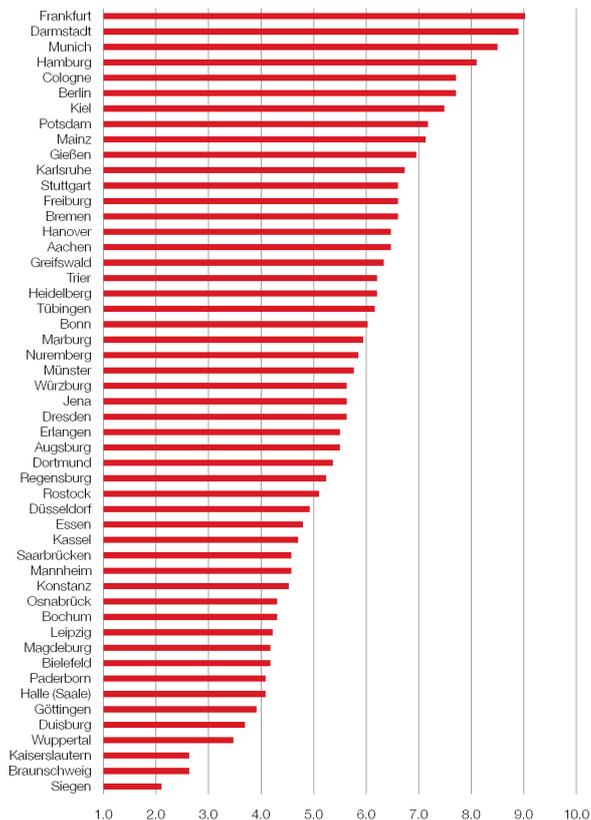
### Total results

The average of the status quo and dynamics score for each city analysed produces an overall score (Fig. 4). Darmstadt (8.2) achieved the highest score in terms of its current locational qualities and its future development and therefore shows the lowest macro-locational investment risk of all 51 locations analysed. Shortly behind in second and third places are Munich (8.2) and Hamburg (8.0). The lowest overall scores were recorded by Halle (Saale) (3.3), Braunschweig (3.4) and Magdeburg (3.6). The performances of the top 3 and bottom 3 are described in brief below.

Darmstadt offers investors in student accommodation the most favourable conditions in terms of low investment risk compared with the other cities analysed. Both the currently prevailing locational conditions (status quo score 8.9 - 2nd place) and the future development of the location are promising (dynamics score 7.6 - 4th place). The availability of places in student halls is currently highly unfavourable for students (availability rate 7.4% - 3rd place) while the vacancy rate in the apartment market of just 1.6% reflects the high levels of pressure on demand (5th place). This is also reflected in the clear positive rental growth averaging +2.1% p. a. between 2004 and 2010 (5th place). Going forward, student demand for suitable apartments is expected to remain high: Student numbers, which have shown dynamic growth in recent years (+12.7% between 2004 and 2010 - 17th place), are projected to remain largely stable going forward (-1.8% from 2010 to 2020 - 15th place).

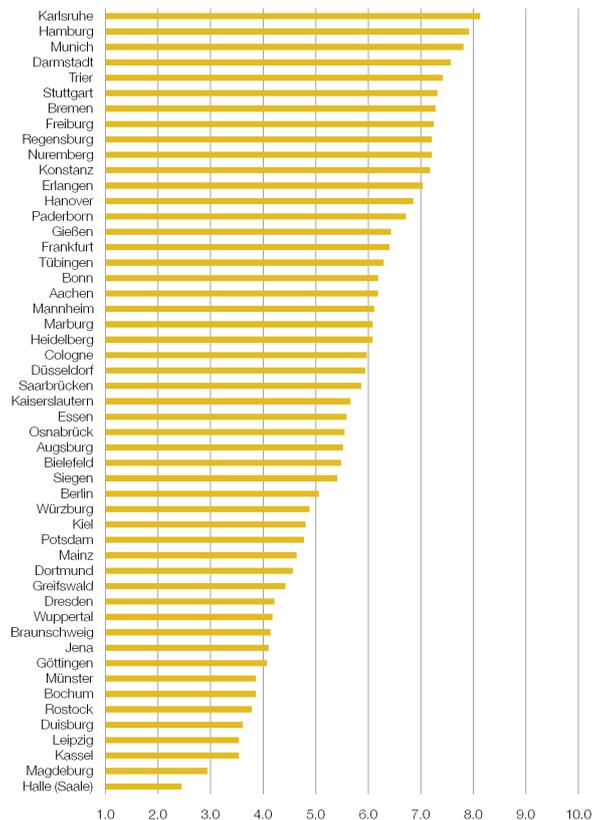
Munich achieved third place for both the status quo and market dynamics in the standings of the cities analysed. Demand in the city is very high (approx. 96,000 students - 2nd place) and has shown extremely positive growth over the last six years (+30% - 6th place). At the same time, the income burden is extraordinarily high (1.3 - 2nd place), while the open rental apartment market already offers little scope with a vacancy rate of just 1.6% (5th place). The favourable economic development (GDP

Fig. 2: Scoring results "Status quo"



Source: Savills Research

Fig. 3: Scoring-results "Market dynamics"

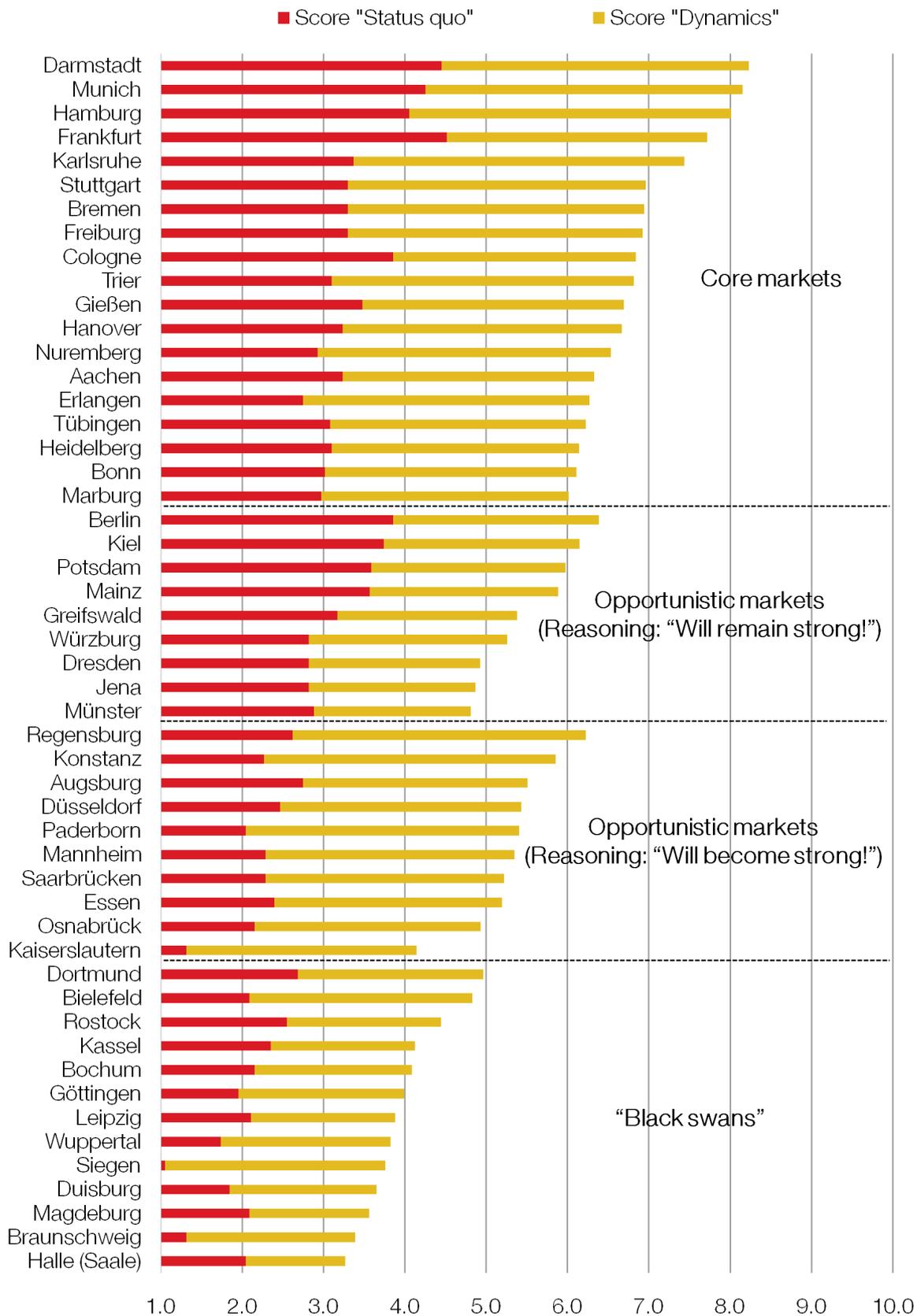


Source: Savills Research

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Fig. 4: Scoring results



Source: Savills Research

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projection to 2020 +29% - 3rd place) and stable population trends (+/-0% to 2020 - 15th place) should result in further pressure on prices and demand going forward. Although Munich already has a relatively good supply of places in student halls (availability rate of 12.2% - 29th place), the conditions indicate a clear requirement for additional student-specific accommodation. The investment risks in this macro-location are consequently low.

Hamburg also shows extremely favourable conditions for investment in student apartments (status quo score 8.1 - 4th place, dynamics score 7.9 - 2nd place). Similarly to Munich, the market size (approx. 75,500 students - 3rd place), low vacancy rate (1.4% - 3rd place) and favourable economic prospects (GDP growth of 32.5% to 2020 - 1st place) underline a requirement for additional student accommodation. In addition, the average rent has already increased by 1.7% p. a. over the last six years (9th place) and this trend is expected to continue on account of the slightly positive population growth to 2020 (+0.6% - 12th place). Overall, the conditions are very positive despite the projected decline in the number of 18-25-year-olds to 2020 (-1.6% - 14th place).

Magdeburg, the capital of Saxony-Anhalt, was just 48th in the overall ranking owing to the unfavourable current conditions (status quo score 4.2 - 41st place) and the even less favourable development prospects (dynamics score 2.9 - 50th place). The vacancy rate in the apartment market is above average at 7.7% (49th place) and rents have shown a slight decrease over the last six years (-0.4% p. a. - 50th place). With both the population and GDP projections showing negative trends (-8% and -0.5% to 2020 - 48th and 50th place respectively), the oversupply should also persist in the future.

In Braunschweig, the two partial scores show a reverse picture: With a status quo score of just 2.6, the city in Lower Saxony is placed second to last while the

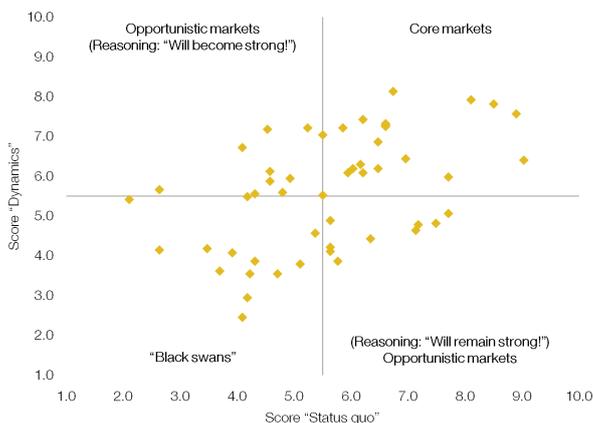
dynamics score of 4.1 ranks the city in 41st place. The stagnating rents in recent years (+0.2% p. a. - 45th place), above-average vacancy rate (3.6% - 38th place) and good supply of places in student halls (availability rate 14.8% - 39th place) indicate no real additional requirement for student-specific accommodation. At the same time, the already low number of students (approx. 15,400 - 45th place) as well as the population are projected to show an overall decline (-3.0% and -1.5% to 2020 - both 28th place), suggesting that potential demand should not increase in future years.

Compared to the other cities analysed, Halle shows by far the lowest dynamics score (2.4) and, despite a status quo score of 4.1 (45th place), occupies last place. Not least because of the population decrease in recent years, the city in south Saxony-Anhalt shows a particularly high vacancy rate in the apartment market of 10.5% (51st place). The continuing decline in population over the next 10 years (-9.2% - 49th place) as well as the negative GDP projection over the same period (-9.5% - 51st place) inhibit an improvement in conditions also in the future. Against a background of the general oversupply in the apartment market, the comparatively poor supply of Halle students with student halls places (availability rate 9% - 14th place) carries little weight.

### Four different risk clusters

Overall, it can be noted that apart from the powerful economic centres of Munich, Hamburg and Frankfurt, smaller cities such as Darmstadt and Karlsruhe also present attractive conditions for investments in student apartments. However, the locations with low scores may also provide lucrative investment opportunities for investors. The higher investment risk means higher yield prospects that should above all appeal to opportunistic investors. This will be particularly true where such investors have local market knowledge. The analysis of the locations with regard to the status quo and dynamics enables the locations to be divided into four different risk groups (Fig. 5). Cities showing above-average scores for both the status quo and dynamics (in each case > 5.5) are the classic core markets with low macro-locational risk. Those locations where one of the two scores is above average (> 5.5) and the other is below average (< 5.5), will be of interest to opportunistic investors. With a high status quo and low dynamics score, the investor's reasoning is likely to be that the dynamics of the location are sufficiently high to suggest that conditions will also be comparatively attractive going forward. The objective in such cases will be to identify a property that will be unaffected or only affected to a limited extent by the relatively unfavourable development of the macro-location. In the reverse cases, i.e. with a low status quo and high dynamics score, the objective will be to invest in a property which benefits to the greatest possible extent from the above-average development of the location. As a rule, when conditions in the macro-location are unfavourable, the

Fig. 5: Risk quadrants



Source: Savills Research

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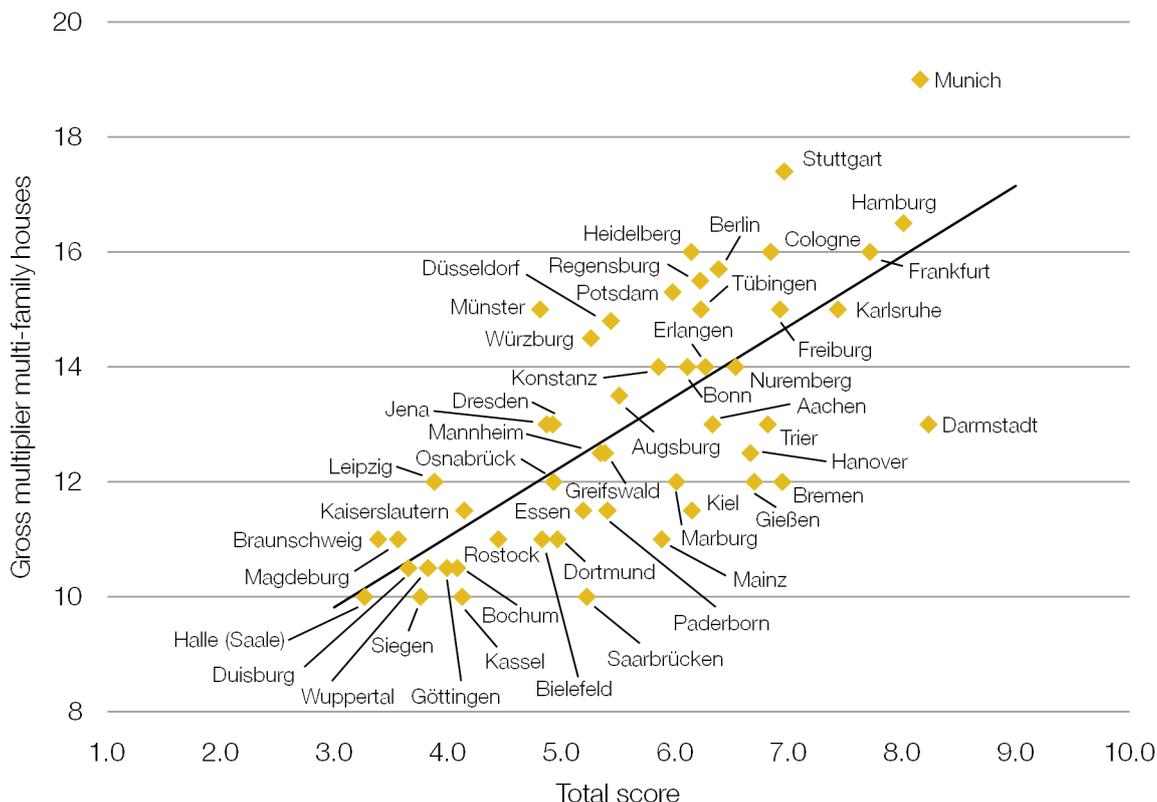
selection of the micro-location and the property will be of greater significance. The markets in the fourth risk category, the lower left quadrant in Fig. 5, show below-average status quo as well as market dynamics scores (< 5.5). These locations could be characterised as 'black swans': The probability that an investment in such markets will result in a favourable exit scenario is, in view of current conditions and foreseeable developments, markedly low. If this does occur, however, the potential returns are in turn very high.

investments in Saarbrücken and Darmstadt, for example, appear to be very high. Such cities merit a closer look, particularly with regard to their dynamics. Saarbrücken, for example, ranks in the bottom third in terms of status quo score but shows a high score for dynamics. This indicates potential for future rental and price growth.

### Low-priced locations with high dynamics score of particular interest

In this context it is important not only to consider investment risks but price levels in a particular market as well. Locations with either a low or high investment risk could be over-valued or under-valued. Fig. 5 underlines this issue: The scores for the 51 locations analysed have been compared with the relevant average multiplier for multiple dwellings. Although the results should be interpreted with caution, as the multipliers for multiple dwellings (used in the absence of more suitable data) are not identical to those for student accommodation, these still give an indication of the risk/return ratio of a location. Munich, Münster and Stuttgart are examples of cities where the price level is above average compared with the risk of the macro-location. In contrast, the prospects of relatively low-price

Fig. 6: Yield-to-risk profiles



Source: BulwienGesa, Savills Research

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### Conclusion and outlook

The comparative evaluation of the selected macro-locations reveals that the 51 locations analysed show different yield-to-risk profiles. Consequently, the student apartment market should offer investment opportunities for both opportunistic and more risk-averse investors. However, the student apartment is certainly not a 'core' product for the majority of investors due to its specific nature. This is exacerbated by the small size of the market segment and consequently its low liquidity. Assuming that every student in Germany living in a rented apartment occupies on average 25 square metres, this produces a total student apartment stock of some 35 million square metres. This equates to approximately one tenth of the office stock in Germany. On the other hand, the investment volume in student apartments is comparatively low, which, in turn, improves resale prospects. For investors taking a long-term view with the appropriate know-how, the stable cash flow is definitely a selling point.

The increasing attractiveness of the segment is reflected by the announcements of several market players in recent months expressing their intention to enter the segment for the first time or to become more active. Until now, only a small number of investors in Germany have focused on this sector. The increasing interest from private investors is undoubtedly also attributable to the fact that, owing to funding shortages, the state is unlikely to be able to build new halls of

residence in order to significantly relieve the increasing shortage of student accommodation in many cities. As this situation is unlikely to change significantly in the coming years, the involvement of private investors is possible to be looked upon favourably by the cities concerned.

Finally, it should be noted that student apartments have numerous benefits as an asset class: The target group and, therefore, the relevant locations can be clearly identified and it can be assumed that the target locations will remain the same in the short term since the German university landscape only changes over a very long timeframe. Also the always high importance of education in the German political agenda has a favourable effect on existing conditions. The properties themselves are relatively uncomplicated with regard to construction and maintenance and a suitable micro-location is relatively easy to identify based upon the location of the relevant university. The risk of non-payment of rent is also manageable as rental payments are normally insured by parental guarantee. In view of the above, it would be little surprise if additional investors discovered this market niche going forward.



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