PHILLIPS & SOUTHERN

ERFURT

PROPERTY REPORT

August 2019

Why Erfurt?

Until two years ago none of us had heard of Erfurt.

Over the last 12 years we have been buying and selling properties in Berlin, during that time we have established a strong network of agents, lawyers, accountants and bankers. As, over time, the market in Berlin has strengthened and yields have compressed a lot of these professionals have started looking to diversify their own portfolios to locations away from the capital.

A lot has been made of cities like Leipzig, Hamburg, Munich and Frankfurt, but the name that stood out as a safe, long term investment city was that of Erfurt. In one afternoon we discovered that the partners of the law firm we use in Berlin have been buying buildings there regularly for their own account and that the bank we most commonly use for financing for our clients is opening a branch in the city.

For about a year now we have been looking into the city, we know it to be the capital of Thuringia, it is bigger and more prosperous than its more famous neighbours Weimar and Jena. Farming has a strong tradition in Erfurt and it is still important to the area, and because of its almost completely intact medieval old town it is a magnet for tourism. More recently, however, it has become known for a flourishing microelectronics industry and as a distribution hub for Germany and Europe as a whole.

Erfurt had the oldest university in what eventually became Germany. Martin Luther studied there for eight years and while the university was closed in the 19th century it was reopened as a modern campus in 1994 and is a prestigious and sought after centre of learning, attracting students from all over Germany.

Erfurt is described as an 'oberzentrum'. This is a super centre in the Federal governments regional planning. These centres are always hubs of the service sector and public services such as hospitals, because of its status as capital of Thuringia the city is home to numerous state ministries, institutions and administration as well as being home to some national authorities.

In the years after reunification many of the old factories were closed either as a result of being too inefficient to compete with the West German factories or by West German owners to reduce competition. However, the early 1990's saw the federal government start to spend a great deal of money and effort on modernising the city and the economy has flourished. The population (274, 000) has returned to its former level with a raft of new secure jobs being created.

The increase in federal spending and growing population has meant there is a shortage of good housing stock and rents have risen and continue to do so. Prices of buildings are beginning to rise too as not only the inhabitants but canny investors see the benefits of owing property in the city as yields are still higher than those of Berlin, Munich or Frankfurt.

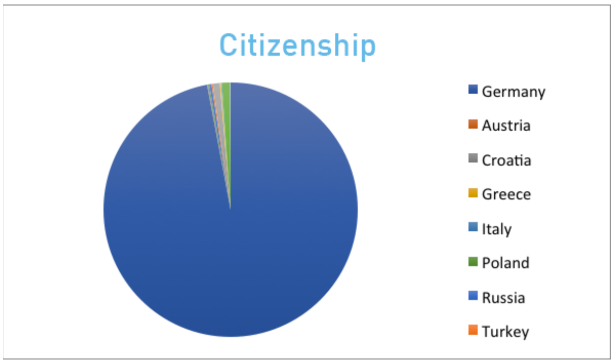
Our contention in that Erfurt is flourishing and that while there has been some price inflation already, the city is poised over the next few years, to see a substantial growth and a healthy expanding property market is a natural corollary to such a scenario.

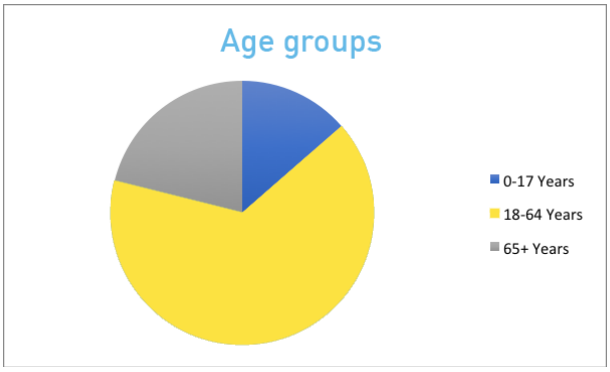
Erfurt is connected to the rest of Germany via a network of roads and rail. It is at the very centre of the ICE rail network (Inter City Express). Travel time from Berlin via ICE is 1 ½ hours, and Leipzig is only 45 minutes away. In 2017 the ICE network was extended to include Munich putting the two cities within 2 hours of each other.

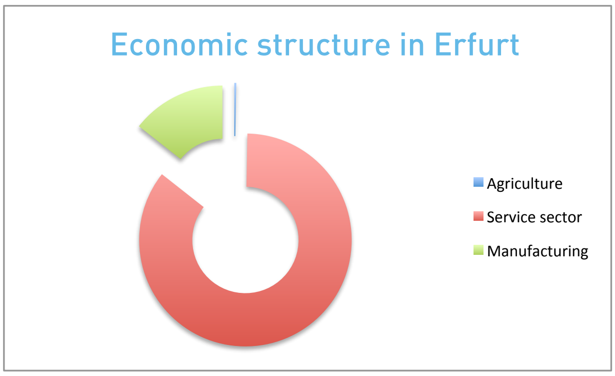
Erfurt at a glance

Population: Approximately 274, 000

Size: 270 km²







Tax

Taxes on purchase:

The buyer of the property must pay the Land Tax (the equivalent of SDLT in UK). This is 6.5 per cent of the purchase price in Thuringia. All fees (legal, notarial and agency) are subject to VAT at the rate of 19 per cent currently.

Income

The interest expenses are tax deductible if the property is rented out (intention of letting is sufficient in the beginning).

Purchase price and all side costs (Legal fees, notary, real estate transfer tax etc.) will be summed up and depreciated over 40 or 50 years for residential units (33 years for commercial buildings). The rate of 2.0% p.a. applies for buildings built after 1.1.1924. Otherwise 2.5% p.a. applies. The value of the building is depreciable. The value of the land will remain the same. The purchase price will be split into value of land and value of building based on official standard ground value tables of this area. The yearly depreciation will decrease the taxable income.

Normal improvements (also insulation), repairs can be fully deducted. If the improvements exceed 15% of the purchase price during the first 3 years the costs have to be capitalized. This will increase the purchase price and depreciated over 40 or 50 years. If there are major improvements which enlarges the utilisation of the building the costs need to be capitalized as well. This is just an overview because there are many specific rules for different circumst ances.

In the event of a sale the taxable income will be calculated as follows:
Taxable income = Sales price – Book value of the property (Purchase price including side cos ts reduced by yearly amortisation).

Capital gains

If the property is bought in the name of an individual and held for at least ten years before resale there will be no tax due on the profit made by a capital gain.

If the property is bought in the name of a SPV (KG) and held for at least ten years the tax on the profit will be 15.85 per cent of the capital gain.
If the shareholder is a company (Ltd) not based in Germany. If the (limited) shareholder of the GmbH & Co. KG is an individual it will be tax free as well. The taxation in the case of the KG is determined by the nature of the shareholder.

If four or more of the units in the portfolio are sold within ten years then the following taxes apply to the profit on the rest of the property (or properties) 15.85 per cent plus a further 15 per cent called a trade tax.

This is based on the KG model. A GmbH & Co.KG is considered a trading partnership (by law). Therefore it is subject to trade tax. If the purpose of the partnership is only administration of own property (not trading) there is a possibility to avoid trade tax. The GmbH (unlimited p artner) will be exempted from the management of the partnership. The KG will then not be considered as trading partnership. Therefore no trade tax will apply.

If the trade tax applies it will be about 15% p.a. The rate depends on the location of the property. In Berlin it is 14.35%, in Erfurt it is 16.45%.

As mentioned before the income tax rate depends on the nature of the shareholder: 15.825% for a Ltd./GmbH, the individual income tax rate for an individual (progressive income tax rate 15% - 45%).

Fees

Acquisitions

Phillips and Southern will charge 3% of the purchase price paid.

Management

Management in Germany is more complicated that it is in England. We will appoint a managing agent and will oversee their performance. We will levy a charge, to be agreed before acquisition.

Sale

Phillips and Southern will charge 3% of the sale price.

All fees are subject to VAT at the prevailing rate.