Research Spotlight:

PUBLIC PRIVATE PARTNERSHIPS USHER IN A NEW DECADE FOR INVESTORS EMBRACING SOCIAL INFRASTRUCTURE IN GERMANY

JUNE 2025

By Britta Roden, Head of Research, KGAL

Infrastructure investment is undergoing a profound transformation. While traditional infrastructure assets such as roads, bridges, and energy networks have long been the focus of institutional capital, a less obvious but rapidly emerging category is social infrastructure: schools, daycare centres, and administrative buildings. These asset types present a compelling opportunity for investors seeking stable, inflation-hedged cash flows, low default risk, and alignment with stringent ESG criteria.

Germany is currently particularly attractive for investment in social infrastructure for several reasons. Decades of underinvestment have left the country's social infrastructure under severe strain, necessitating substantial capital inflows to modernise, expand and maintain essential public services. At the same time, Europe's biggest economy is investing billions in its armed forces following the full-scale invasion of Ukraine in February 2022 - a seismic moment for the continent. Given these fiscal priorities, there is now a greater political consensus than ever before to involve institutional investors in revamping Germany's social infrastructure. Alongside this shift in attitude among German politicians, institutional investors are willing to increase their allocations, as social infrastructure is an appealing asset class and a means of meaningfully contributing to social and economic resilience in an ever-changing world.

THE INVESTMENT IMPERATIVE: MASSIVE INFRASTRUCTURE GAPS IN GERMANY

The sheer scale of Germany's infrastructure deficit is truly staggering. According to the annual municipal panel published by Germany's promotional bank, KfW, German municipalities are facing an infrastructure investment shortfall of over 186 billion euros in 2024 alone. Of this, around 90 billion euros are specifically required for schools, childcare centres and administrative buildings — collectively known as socialinfrastructure. While substantial, the German federal government's 500 billion euros infrastructure special fund will not come close to closing this cumulative gap of an estimated 1.5 trillion euros over the next decade.

This underinvestment manifests tangibly in dilapidated school buildings, closed community pools, outdated or shuttered sports facilities, insufficient daycare capacity, and deteriorating administrative offices are all everyday realities for citizens. The public sector's fiscal constraints mean that traditional budgetary allocations are inadequate, requiring innovative financing solutions and a broader mobilization of private capital.

PUBLIC-PRIVATE PARTNERSHIPS: A FRAMEWORK FOR SUSTAINABLE INFRASTRUCTURE DELIVERY

Public-Private Partnerships (PPPs) have emerged internationally as a robust mechanism for closing infrastructure gaps without overburdening public budgets. In PPP arrangements, private investors provide upfront capital and assume construction and operational risks, while public authorities commit to long-term lease or availability payments. This framework enables municipalities to benefit from accelerated project delivery, risk transfer, and budget predictability.

The UK has been a pioneer in this field, with PPPs operational since 1992. One notable example is the St Bartholomew's and Royal London Hospitals project, valued at approximately £1.1 billion. This project involved comprehensive redevelopment and refurbishment of two major central London hospital sites, home to one of the largest children's hospitals in the UK and London's Air Ambulance, managed by a consortium including Innisfree (UK), Skanska (Sweden), and the Dutch Infrastructure Fund (Netherlands). Completed in 2016, this project illustrates the scale and complexity that PPPs can effectively manage.

In Norway, the Sotra Connection project represents the largest PPP road infrastructure undertaking in the country's history. The project contributes to improved accessibility and traffic safety as an integrated part of a functional Bergen region. It strengthens the links between Norway's second-largest city of Bergen and the adjacent island of Sotra. The road is scheduled to open to traffic in 2027. With a total value approaching 2 billion euros, the project includes a 1 km suspension bridge, 22 smaller bridges, and a four-lane motorway with multiple tunnels. A 21-year concession was awarded to a consortium led by Macquarie Capital, with private investors from Australia, South Korea, and Italy. Germany participates indirectly via financing from KfW-IPEX, demonstrating cross-border collaboration in infrastructure finance.

The Nordic region also showcases the potential of PPPs in social infrastructure. The New Karolinska Solna Hospital in Stockholm, a 900 euros million facility partially financed by the Nordic Investment Bank, stands as one of the world's largest PPP hospital projects. Finland's Espoo Schools Project, which entails building five schools and three daycare centres, funded through a mix of European Investment Bank loans and private investment, exemplifies PPP application in education. Managed by Finnish investor YIT and French developer Meridiam, this project operates under a 22-year design-build-maintain contract.

GERMANY'S SOCIAL INFRASTRUCTURE INVESTMENT LANDSCAPE: SCHOOLS

Within Germany, schools constitute a particularly secure and scalable investment segment. Approximately 88% of schools are publicly owned, with only about 3,800 privately operated schools compared to nearly 29,000 public schools. This creates a robust tenant base with strong credit quality, mitigating credit risk for investors.

School construction costs are on par with office buildings of similar scale, often ranging from 50 million to 200 million euros, depending on size and location. Rental levels reflect this, with net initial yields ranging between 4.5% and 5.5% and IRRs between 6% and 9%. Long-term leases, generally exceeding 20 years, often include full or partial triple-net arrangements, where operating costs are passed through to the municipality.

From the municipal perspective, PPPs facilitate quicker occupancy since they avoid lengthy public procurement processes. Land ownership typically remains with the municipality, secured through land leases, thus reducing political risk and capital lock-up for local governments.

Demographic risks such as declining student numbers are localized and manageable. While some rural areas face enrollment declines, urban centres and economically vibrant regions benefit from stable or rising student populations driven by domestic and international migration. This demographic stability is key to mitigating risk for investors.

DAYCARE CENTRES: ADDRESSING A CRITICAL SOCIETAL NEED WITH STRATEGIC INVESTMENT POTENTIAL

Daycare centres present an equally attractive, though somewhat more complex, opportunity. There is an acute shortage of daycare places in Germany—roughly 385,900 shortfalls in western federal states and 44,700 in eastern states. Nationwide, only 37% of children under three are in formal care, a figure that stands in stark contrast to the 55% rate in the new federal states. The under-provision of daycare forces many parents to take extended career breaks, with profound economic consequences.

Macro-economically, boosting labour participation rates—particularly among young parents—is essential to counter demographic decline and sustain economic growth. Thus, investments in daycare infrastructure are not only socially imperative but strategically significant. Daycare investments typically feature lease terms exceeding 15 years, legal safeguards under the Child Promotion Act (KiföG), and stable rental income streams. Yields align with those of schools, between 4.5% and 5.5%, with IRRs commonly ranging from 6% to 8%. Unlike schools, daycare tenants include a diverse mix of public and private operators, requiring rigorous due diligence on provider creditworthiness. Innovative project structures cluster multiple childcare services on educational campuses, integrating daycare, kindergarten, after-school care, and often staff housing. These holistic developments mitigate operational risks, reduce staff shortages, and enhance tenant stability, thereby lowering overall investment risk.

ADMINISTRATIVE BUILDINGS: THE "SUPER-CORE" ASSET CLASS

Administrative buildings, often overlooked by investors, form a "super-core" category. Their risk-return profile closely resembles that of inflation-indexed sovereign bonds rather than traditional office real estate. Lease durations range from 15 to 30 years, with full rent indexation and tenants exhibiting very high creditworthiness. Net initial yields vary broadly from 3.8% to 6.5%, with IRRs that can reach up to 10%. These assets play a pivotal role in institutional portfolios targeting income stability, low volatility, and ESG compliance. The "S" (social) component of ESG is particularly strong in these assets, as many public administration buildings provide essential civic services. Modern sustainable construction techniques, including timber-hybrid systems, are increasingly being applied to these properties. For example, the wood-hybrid administrative building in Wiesbaden which is home to Hesse's development agency (HA Hessen Agentur) demonstrates how innovative construction methods can marry sustainability with long-term asset durability.

ESG INTEGRATION AND IMPACT INVESTING: ALIGNING CAPITAL WITH SOCIAL OUTCOMES

The integration of Environmental, Social, and Governance (ESG) criteria is now a core requirement for institutional investors globally. Social infrastructure assets stand out as a rare intersection of financial robustness and positive social impact. Public sector tenants substantially reduce default risk, while the very purpose of these buildings—education, care, public service—directly contributes to social cohesion and economic development. The rising emphasis on social infrastructure by policymakers and capital markets alike indicates a maturing asset class poised for growth. Social infrastructure is becoming a critical component of responsible investment strategies, offering transparency, impact measurement, and resilience.

LOOKING AHEAD: POSITIONING FOR LONG-TERM SUCCESS IN GERMANY'S INFRASTRUCTURE MARKET

The German social infrastructure sector is entering a phase of rapid evolution. Investor awareness is rising, political frameworks are solidifying, and transaction volumes are expected to grow. Institutional investors can capitalize on attractive yield profiles, low risk, and ESG alignment while contributing to addressing one of Germany's most pressing public policy challenges.

Public-private partnerships offer a proven vehicle to leverage private capital in delivering social infrastructure at scale. For investors, this means stable, indexed cash flows from highly creditworthy tenants and the security of assets underpinned by critical public services. To capture these opportunities, investors should prioritize partnerships with experienced operators, thorough due diligence on provider creditworthiness (especially in mixed-tenure daycare assets), and a long-term view aligned with public sector planning horizons.

SUMMARY TABLE OF KEY METRICS

ASSET TYPE	NET INITIAL YIELD	INTERNAL RATE OF RETURN (IRR)	TYPICAL LEASE LENGTH
Schools	4.5% – 5.5%	6% – 9%	> 20 years
Daycare Centres	4.5% – 5.5%	6% – 8%	> 15 years
Administrative Buildings	3.8% – 6.5%	4% – 10%	15 – 30 years

Source: KGAL

KEY CONTACTS

BRITTA RODEN

Head of Research, MRICS
britta.roden@kgal.de
Tel. +49 89 64143 083

DR. JAN MUCKENHAUPT

Research Analyst
jan.muckenhaupt@kgal.de
Tel. +49 89 64143 380

DISCLAIMER