EDISON

Phoenix Spree Deutschland

Business update

Delivering on reversion strategy

Real estate

With rent restrictions (the 'Mietendeckel') repealed, the Berlin residential property market has remained robust, with free market rents and condominium prices increasing further amid a continuing housing shortage. FY21 performance for Phoenix Spree Deutschland (PSD) mirrors these trends and its extensive refurbishment programme targets further release of the strong rent reversion potential of its portfolio.

Year end	PBT* (€m)	EPS (c)	NAV**/ share (€)	DPS (c)	P/E (x)	P/NAV (x)	Yield (%)
12/19	28.6	22	4.92	7.5	21.1	0.93	1.6
12/20	37.9	30	5.28	7.5	15.5	0.87	1.6
12/21e	41.4	35	5.65	7.5	12.9	0.81	1.6
12/22e	44.2	40	6.04	7.5	11.5	0.76	1.6

Note: *As reported including realised and unrealised gains. **Measured as EPRA net tangible assets per share.

Portfolio valuation indicates FY21 total return of c 8%

At 31 December 2021 (end-FY21) PSD's property portfolio was externally valued at €801.5m, an increase of 4.3% versus end-FY20. Net of acquisitions and disposals the movement included a 6.3% like-for-like valuation increase (of which 3.7% in H221). Valuation uplifts reflect rent growth, improvements in particular locations and further progress with splitting certain assets into condominiums that may be individually sold where appropriate. Notarisations for sale increased 4.1% to a record level of €15.2m (of which €10.9m in H221) at an average 19.1% premium to book value. Based on the portfolio valuation and supported by accretive share repurchases, PSD expects EPRA NTA to fall within a range of €5.60–€5.66 (FY20: €5.28), in line with our forecast (€5.65). Including DPS paid this would represent an FY21 EPRA NTA total return of 7.5–8.6%. During the year PSD acquired c 4.5m shares (c 4.5% of the total) at an average 16% discount to end-FY21e NAV.

Significant embedded value

There is significant value embedded in PSD's portfolio, not reflected in current income or net asset value. PSD estimates market rents are c 30% above average portfolio rents, representing a substantial income reversion potential. While 75% of the Berlin portfolio has been legally split into condominiums, less than 5% is valued as such, and condominium values are typically 30–35% higher than the rental-based valuations applied to most of the portfolio. New legislation makes splitting more difficult and may increase the scarcity and price of condominiums available for sale in the market. Following Mietendeckel repeal, the rent premium achieved on new lettings has re-emerged. New leases signed during December 2021 were at an average 28.2% premium to passing rents, enabling PSD to resume its comprehensive programme of vacant apartment renovations and modernisations.

Valuation: Not capturing value potential

The wide discount to NAV that emerged with the Mietendeckel has narrowed since June as PSD has stepped up share repurchases, but remains at c 20% based on FY21e EPRA NTA per share. With a continuing premium being achieved on condominium sales, we estimate that the discount may be c 25% on a 'condominium valuation' basis.

11 February 2022

Price	**389p**
Market cap	**£361m**
	€1.18/£
Net debt (€m) at 30 June 2021	261.8
Net LTV as at 30 June 2021	33.7%
Shares in issue	92.7m
Free float	100%
Code	PSDL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.3)	(3.2)	16.1
Rel (local)	(2.1)	(5.7)	(0.6)
52-week high/low		413p	320p

Business description

Phoenix Spree Deutschland is a long-term investor in mid-market residential property in Berlin, targeting reliable income and capital growth. Its core strategy is to acquire unmodernised apartment blocks that may be improved to the benefit of tenants, generating attractive returns for shareholders based on improved rents and capital values.

Next events

FY21 results	Expected late March 2022

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Edison profile page

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Further details on the portfolio development and performance

The 31 December 2021 (end-FY21) portfolio valuation of €801.5m comprises investment properties and properties held for sale (which includes properties where sales have been notarised or where there is a clear intention to sell). The valuation reflects a gross fully occupied yield of 2.8%, higher than the end-FY20 yield of 2.4%, which reflected the negative impact of the Mietendeckel on rents[1] prior to repeal in April 2021, and in line with H121. Prior to repeal, PSD had structured rental agreements to allow for back-payment of the higher rents that again became due and has now collected more than 95% of the €2.1m due. Meanwhile, COVID-19 has continued to have a limited impact on rent collection, with more than 97% of all residential and commercial rents collected by PSD during FY21 and collection rates stable through early 2022.

Included within the portfolio valuation are eight properties that are valued as condominiums[2] with an aggregate valuation of €38.8m (end-FY20: nine properties with an aggregate value of €52.4m). The reduction in the value of held for sale assets during the year primarily reflects completed disposals. Notarisations for sale increased materially in H221 compared with H121, amounting to 23 condominium units with an aggregate value of €10.9m (H121: 13 residential units with an aggregate value of €4.3m). Condominium pricing remained strong during FY21 supported by demand from residential buyers and investors, particularly following the repeal of the Mietendeckel and completion of the German federal elections. On its FY21 notarisations, PSD achieved an average €5,031 per square metre or a 19.1% premium to end-FY20 book value.

High proportion of condominium designated assets is a strategic benefit

The German Federal Elections, held at the end of September 2021, have not led to significant changes to housing policy, not least because the tightness of the result suggests the necessity of seeking consensus and common ground, making radical policy shifts less likely. There is a consensus across parties for the need to reduce CO_2 emissions, of which housing will need to be a significant contributor. With private landlords representing around two-thirds of the total, their ability to support this goal will be of importance. Another area of the residential property market where the federal government has acted is the granting of legal powers to state authorities to ban the conversion of rental apartments into condominiums. With 75% of its portfolio already legally designated as condominiums, PSD is well placed for any change. It is also hopeful that existing applications covering a further 10% of the portfolio, more than half of which in the late stages, may also still proceed. PSD expects the new measures to increase the scarcity of condominiums available for sale across the market, further exacerbating the supply-demand imbalance that currently exists, with a likely positive valuation impact on its condominium assets.

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[1] Reflecting concern at the pace of rent growth over recent years and a desire by local authorities to maintain Berlin as a city of affordable rented accommodation, the Berlin state authority introduced the 'Mietendeckel', significantly limiting rental growth and in some cases imposing rent reductions, in stages during 2020, becoming fully effective in November 2020. It was repealed in April 2021 having been ruled unconstitutional. Prior to repeal, PSD published end-FY20 annualised contracted rents of €20.3m but this was reduced to €16.4m on a 'collected basis' by the Mietendeckel until April 2021.

[2] Created by the splitting of apartment blocks into individual units.

Planned investments to unlock value

PSD's core strategy for organic growth strategy is based on reversionary re-letting, the preparation and sale of condominiums, and the construction of new rentable attic living space. While the division and subsequent resale of selected apartment blocks as condominiums at market-level valuations, significantly above their value as apartments and carried book value, has generated strong returns, it is supplementary to this core strategy.

Although the Mietendeckel has been repealed, the ability to increase rents on existing tenancies remains significantly restricted in Berlin. Refurbishment and subsequent re-letting of vacated units at a premium to existing rents, and closer to market rent levels, is the key driver of reversionary capture. The Mietendeckel led to a temporary deferral of refurbishment projects on economic grounds and PSD expects a significant increase as deferred projects are reinstated, supported by the continuing premium of market rents to passing rents.

In addition to refurbishment, PSD's asset management strategy includes exploiting underutilised space within the footprint of the existing portfolio. It currently plans two new construction projects, for which planning approval has been granted.

In addition to its organic growth strategy, PSD continues to consider opportunities for asset acquisitions.

Share buybacks and financing growth

Reflecting its renewed confidence in the outlook following the Mietendeckel repeal, and disappointed with the continuing discount to EPRA net tangible assets (NTA), in June 2021 PSD adopted a significantly more proactive share buyback strategy. Up until the end of FY21 it had bought back c 4.5m shares, representing 4.5% of the shares outstanding, for an aggregate consideration of £17.7m. The average price paid represents a c 16% discount to the end-FY21e EPRA NTA per share.

The capital allocation to share buybacks has not compromised the organic growth of the company and has been funded by a combination of existing cash balances, refinancing, and condominium sales. In late January 2022 PSD completed a new €60m loan facility with Natixis Pfandbriefbank and a further refinancing of existing debt with Berliner Sparkasse that provides an additional c €15m of debt capital resources. Both are existing lenders to the company. The Natixis facility comprises two components: a €45m acquisition facility providing additional flexibility for PSD to pursue potential future acquisitions; and a €15m capex facility to provide additional support for PSD's comprehensive programme of vacant apartment renovations and modernisations. The Berliner Sparkasse refinancing of c €50m of existing debt provides an additional c €15m of funding for reinvestment.

Forecasts and valuation

We have made no changes to our forecasts set out in detail in our October 2021 update and will review these with the publication of the FY21 results, which we expect may be released in late March. Our forecast end-FY21 EPRA NTA of €5.65[3] is near the top of the range (€5.60–5.66) expected by PSD.

[3] Our last published EPRA NTA per share forecast was €5.64 but this has been enhanced by continuing accretive share repurchases.

With so much of the reversionary income potential within the portfolio yet to be realised, the primary driver of valuation is capital growth rather than immediate dividend income. Our forecast of an unchanged FY21 aggregate DPS of 7.5 cents represents a yield of 1.6% and with the shares trading at a c 20% discount to FY21e EPRA NTA per share, there is potential for investors to benefit from both NTA growth and a re-rating of the shares.

Exhibit 1: Price to EPRA NAV/NTA history

Source: Refinitiv data as at 8 February 2022.

Larger discount on a 'condominium basis' valuation

We estimate that the P/NTA would be lower still if the NTA were adjusted to include all condominium-designated assets at market values. Exhibit 2 shows the historical data for notarisations. The average notarised values per square metre are specific to the mix of assets (different locations, floor space, etc) sold in that period and estimating the value of the portfolio on a full condominium basis is difficult.

Exhibit 2: Condominium notarisations

	FY17	FY18	FY19	FY20	FY21
Sales value of notarisations (€m)	9.1	9.9	8.8	14.6	15.2
Average notarised value per sqm (€)	4,352	4,566	4,711	4,320	5,031
Portfolio average value per sqm at beginning of year (€)	1,965	2,854	3,527	3,741	3,977
Premium to portfolio average	121.5%	60.0%	33.6%	15.5%	26.5%

Source: Phoenix Spree data

The average notarised value over the past three years has been c €4,600 per square metre. We estimate that applying a value of c €4,500 per square metre (as we have done previously) to the c 75% of the portfolio that is designated as condominiums (and which may increase further) and excluding those assets that are already valued on a condominium basis, would lift the reported EPRA NTA per share by c 8%, implying an underlying discount to NTA of c 25%.

Exhibit 3: Net asset sensitivity to condominium valuation*

Average condominium value (€ per sqm)	4,000	4,250	4,500	4,750	5,000
Premium to FY21e portfolio average value (€ per sqm)	-5%	1%	7%	13%	19%
Implied uplift to FY21e NTA	-5%	1%	8%	14%	20%
Implied P/NTA based on current price (x)	0.84	0.79	0.75	0.70	0.67

Source: Edison Investment Research. Note: Based on Edison end-FY21 forecasts.

Exhibit 4: Financial summary

Year ending 31 December, €m unless stated otherwise	2015	2016	2017	2018	2019	2020	2021e	2022e
INCOME STATEMENT								
Revenue	12.1	15.9	23.7	22.7	22.6	23.9	25.9	27.5
Total property expenses	(6.0)	(7.0)	(12.6)	(15.8)	(14.2)	(16.4)	(15.5)	(16.8)
Gross profit	6.1	8.9	11.1	6.9	8.4	7.5	10.3	10.7
Administrative expenses	(2.1)	(3.0)	(3.0)	(3.2)	(3.1)	(3.3)	(3.0)	(3.0)
Gain on disposal of investment property	0.7	0.8	5.3	1.0	0.9	2.2	1.9	1.3
Fair value movement on investment property	18.1	55.2	157.4	66.1	41.5	41.5	36.6	42.7
Property advisor performance fee	(1.3)	(6.4)	(26.3)	(4.0)	(2.8)	0.4	(0.6)	(0.1)
Separately disclosed items	(6.7)	0.0	0.0	(1.0)	(0.3)	0.0	0.0	0.0
Operating profit	14.7	55.6	144.5	65.9	44.6	48.3	45.1	51.6
Net finance charge	(3.2)	(6.8)	(6.0)	(9.5)	(16.0)	(10.4)	(3.8)	(7.4)
Gain on financial asset	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	13.0	48.9	138.5	56.4	28.6	37.9	41.4	44.2
Tax	(2.6)	(10.9)	(26.2)	(11.1)	(5.8)	(7.6)	(7.4)	(6.7)
Profit after tax	10.3	38.0	112.3	45.4	22.7	30.3	33.9	37.4
Non-controlling interest	(0.6)	(1.0)	(0.8)	(0.3)	(0.5)	(0.5)	(0.3)	(0.6)
Attributable profit after tax	9.7	37.0	111.5	45.1	22.3	29.8	33.6	36.9
Closing basic number of shares (m)	69.9	92.5	92.5	100.8	97.8	96.1	92.9	92.8
Average diluted number of shares (m)	70.5	91.5	100.2	99.0	102.1	98.9	95.0	92.8
IFRS EPS, diluted (c)	14	40	111	46	22	30	35	40
DPS declared (c)	5.7	6.2	6.9	7.5	7.5	7.5	7.5	7.5
DPS declared (sterling pence equivalent)	4.2	5.3	6.4	6.7	6.5	6.8	6.4	6.4
EPRA NTA total return	11.8%	22.2%	52.6%	13.1%	9.3%	8.8%	8.4%	8.3%
BALANCE SHEET								
Investment properties	283.6	395.8	502.4	632.9	719.5	749.0	783.0	834.5
Properties under construction			0.0	0.0	0.0	0.0	2.0	0.0
Other non-current assets	1.7	3.1	2.9	3.4	3.5	3.8	5.3	3.3
Total non-current assets	285.3	398.9	505.3	636.4	723.0	752.8	788.3	837.8
Investment properties held for sale	0.0	28.0	106.9	12.7	10.6	19.3	8.7	8.7
Cash & equivalents	12.8	18.5	27.2	26.9	42.4	37.0	22.2	10.5
Other current assets	2.3	7.5	14.4	7.5	9.5	8.4	9.3	10.1
Total current assets	15.0	53.9	148.5	47.1	62.6	64.7	40.3	29.3
Borrowings	(11.5)	(9.2)	(2.6)	(3.6)	(17.8)	(1.0)	0.0	0.0
Other current liabilities	(2.7)	(1.7)	(9.4)	(13.2)	(15.6)	(9.6)	(10.3)	(11.2)
Total current liabilities	(14.2)	(10.9)	(12.1)	(16.8)	(33.4)	(10.6)	(10.3)	(11.2)
Borrowings	(122.3)	(176.4)	(219.6)	(191.6)	(258.5)	(286.5)	(287.0)	(287.7)
Other non-current liabilities	(12.7)	(30.2)	(54.1)	(65.2)	(76.8)	(86.5)	(89.7)	(96.4)
Total non-current liabilities	(134.9)	(206.6)	(273.8)	(256.9)	(335.3)	(373.0)	(376.7)	(384.1)
Net assets	151.2	235.3	367.9	409.8	416.9	434.0	441.6	471.8
Non-controlling interest	(2.6)	(0.9)	(1.7)	(2.0)	(3.0)	(3.5)	(3.8)	(4.4)
Net attributable assets	148.5	234.3	366.2	407.9	413.9	430.4	437.7	467.4
Adjust for:								
Deferred tax assets & liabilities	10.5	21.4	44.6	52.5	58.3	65.4	72.8	79.6
Derivative financial instruments	1.9	4.9	3.3	6.0	16.0	18.2	14.6	14.6
Other EPRA adjustments	(1.3)	(7.6)	(34.0)	(5.4)	(6.8)	(6.4)	(0.6)	(0.7)
EPRA net tangible assets (NTA)	159.6	253.0	380.2	461.0	481.4	507.6	524.5	560.8
IFRS NAV per share (€)	2.13	2.53	3.96	4.05	4.23	4.48	4.71	5.04
EPRA NTA per share (€)	2.28	2.73	4.11	4.58	4.92	5.28	5.65	6.04
CASH-FLOW								
Cash flow from operating activity	4.7	0.8	5.9	13.2	1.5	8.1	7.2	7.7
Income tax paid	0.0	0.0	(0.1)	(4.7)	(0.0)	(1.3)	(0.0)	0.0
Net cash flow from operating activity	4.7	0.8	5.8	8.5	1.4	6.7	7.2	7.7
Property additions	(17.4)	(72.8)	(76.5)	(47.3)	(32.2)	0.0	(2.0)	(9.8)
Proceeds from disposal of investment property	5.5	4.3	60.4	86.0	13.5	7.2	21.5	11.3
Capital expenditure on investment property	(3.9)	(4.2)	(6.7)	(7.9)	(6.5)	(4.2)	(6.2)	(7.0)
Other cash flow from investing activity	(0.2)	(0.7)	0.0	0.0	0.1	(5.9)	0.0	0.0
Cash flow from investing activity	(16.1)	(73.4)	(22.7)	30.8	(25.1)	(2.9)	13.3	(5.5)
Interest paid	(4.0)	(3.2)	(5.1)	(5.1)	(6.2)	(7.5)	(7.0)	(6.7)
Bank debt drawn/(repaid)	26.3	39.4	36.7	(27.0)	64.6	11.2	(1.3)	0.0
Share issuance/repurchase	0.0	47.5	0.0	0.0	(11.5)	(6.0)	(19.4)	(0.2)
Dividends paid	(1.2)	(5.0)	(6.0)	(7.5)	(7.7)	(7.0)	(7.5)	(7.1)
Other cash flow from financing activity	(0.6)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash flow from financing activity	20.5	78.6	25.6	(39.6)	39.2	(9.3)	(35.2)	(14.0)
Change in cash	9.2	6.0	8.7	(0.3)	15.5	(5.4)	(14.7)	(11.8)
FX	0.0	(0.3)	(0.0)	(0.0)	(0.0)	(0.0)	0.0	0.0
Opening cash	3.6	12.8	18.5	27.2	26.9	42.4	37.0	22.3
Closing cash	12.8	18.5	27.2	26.9	42.4	37.0	22.3	10.5
Closing debt	(133.8)	(185.6)	(222.3)	(195.3)	(280.2)	(291.4)	(290.2)	(290.2)
Closing net debt	(121.0)	(167.1)	(195.1)	(168.4)	(237.8)	(254.4)	(267.9)	(279.7)
LTV	42.7%	39.4%	32.0%	26.1%	32.6%	33.1%	33.9%	33.7%

Source: Phoenix Spree historical data, Edison Investment Research forecasts

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