Phoenix Spree Deutschland

FY22 results

Stress-testing the challenges

Real estate

Phoenix Spree Deutschland's (PSD's) core rental business continues to perform well as the demand-supply balance for Berlin rented residential accommodation remains tight. However, the challenging economic backdrop has negatively affected property values, NAV and condominium sales. While DPS has been paused to maintain cash flow for value-creating portfolio investment, PSD remains conservatively financed, with 83% of debt costs fixed/hedged and no debt maturities until 2026.

Year end	PBT* (€m)	EPS* (c)	NAV**/ share (€)	DPS (c)	P/E (x)	P/NAV (x)	Yield (%)
12/21	45.3	39	5.65	7.5	5.6	0.42	3.2
12/22	(17.5)	(17)	5.10	2.4	N/A	0.46	1.0
12/23e***	(59.1)	(54)	4.37	0.0	N/A	0.54	0.0
12/24e***	0.8	1	4.38	0.0	229.5	0.54	0.0

Note: *As reported on an IFRS basis including realised and unrealised gains. **Measured as EPRA net tangible assets per share. ***IFRS forecasts are highly sensitive to portfolio valuations, which remain highly uncertain, and for which we provide a sensitivity analysis.

Rental growth but weaker valuations and asset sales

The end-FY22 portfolio value was €775.9m (vs €801.5m at end-FY21), reflecting a gross fully occupied yield of 3.0% (FY21: 2.8%) and including a like-for-like negative valuation movement of 3.1%. Like-for-like rents increased by 3.9% with EPRA vacancy remaining at a low 2.4%. Although condominium sales volumes weakened, positively, the premium to book value (22.4%) continued. EPRA NTA per share was 10% lower at €5.10. We expect continued growth from low volatility core rental activities, but our earnings forecasts are highly sensitive to property valuation movements (we assume -7.5%), and cash to disposal proceeds (we assume €5m pa of condominium sales, similar to FY22). Our sensitivity analysis indicates that the balance sheet would remain robust under a range of more challenging assumptions and that rental growth will substantially offset the higher borrowing costs implied by market interest rate expectations from 2026 onwards.

Focus on accretive portfolio investment

Given the significant excess demand for rental accommodation in Berlin, we expect PSD's reversion strategy will continue to generate rental income growth, even if growth in free market rents were to stall, given the large premium of market rents to in-place rents in the highly regulated German market. Splitting apartments into selected individual condominiums for sale has made a significant contribution to PSD's property valuations in recent years and, partly crystalised by selected sales, cash flows. While condominium sales remain subdued, PSD intends to focus its resources on investment in the portfolio, continuing to unlock rent reversion, and reinstating dividends a sustainable basis. So long as a share price discount to NAV persists, surplus cash will be used for share buy-backs rather than acquisitions.

Valuation: Discounting a worst case?

Share price performance across quoted German real estate has been weak over the past year, with an average decline of c 50%. PSD's performance is slightly stronger over one year and noticeably so over three years. As a result, PSD shares trade at a P/NAV of 0.46x compared with the average for German listed peers of 0.30x.

31 May 2023

Price	**203p**
Market cap	**£186m**
	€1.16/£
Net debt (€m) at 31 December 2022	303.3
Net LTV as at 31 December 2022	39.1%
Shares in issue	91.8m
Free float	100%
Code	PSDL
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.5	(20.7)	(42.7)
Rel (local)	4.9	(16.8)	(41.3)
52-week high/low		352p	186p

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

H123 period end	30 June 2023

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Edison profile page

Phoenix Spree Deutschland is a research client of Edison Investment Research Limited

Stress testing the challenges

In this note we review the FY22 results and business trends as well as stress-testing our forecasts for a range of assumptions on property valuation and asset disposal proceeds. The market appears to be discounting significant challenges to the market environment and business model from the end of the 'zero interest rate world'. However, despite the near-term headwinds, there are a number of positive indicators that appear not to be recognised in the current valuation. In particular, we highlight:

- While real estate valuations remain uncertain, the fundamental demand-supply balance in the Berlin market continues to support rental values. The Berlin housing shortage has been built over many years by demographic trends, including net migration and insufficient new development. If anything, these drivers have recently strengthened, with more than a million Ukrainian refugees entering Germany and higher construction prices, disrupted supply chains and materials shortages adding to the existing drag on development from strict planning laws.
- So far in FY23, the economic outlook for Germany has been improving. Inflation is declining at a faster rate than had been expected, driven by a sharp reduction in energy prices, while GDP has been supported by the government's fiscal support package. The European Commission now expects the German economy to show slight growth in 2022, of 0.2%, compared with its autumn forecast of a negative 0.6%.
- We expect the core rental operations to remain stable and forecast continuing rental growth. The c 30% re-letting premium is a key driver of this growth, while highlighting the embedded value within the portfolio.
- It is too early to predict a recovery in buyer sentiment in the condominium market accurately, although FY23 has started positively. Higher medium-term interest rates continue to present a challenge to the property market, and we expect further weakness in valuations.
- The cost of all borrowing is 83% fixed/hedged, with no loans maturing until 2026, and we forecast sufficient liquidity to continue accretive investment in the portfolio to unlock rent reversion. We expect rent growth up to 2026 to substantially offset the increase in borrowing costs implied by existing money market expectations as existing debt matures, although if a negative margin between asset yields and funding costs persists we would expect PSD to seek to accelerate the embedded value in the portfolio, reflected in the current re-letting premium and the condominium sales' premium to book value.
- Our forecasts are based on a 7.5% decline in portfolio valuation in FY23 and stable in FY24, with the loan to value (LTV) ratio remaining below 45% and well below PSD's medium-term target of 50%. Our sensitivity analysis shows that even with a 12% valuation decline, LTV remains below 50%. Each 1% movement in valuation versus our forecast is equivalent to a little under 2% change in EPRA net tangible assets/NAV.
- After funding all outstanding capital commitments, our forecast shows only a minimal requirement (€5m out of an available €39m) for PSD to fund ongoing refurbishment capex of €7m pa. This is based on €5m pa proceeds from condominium disposals. The implications for a reinstatement of dividends are positive.

Continuing positive demand-supply supports rent growth and reversionary capture

Berlin rents have risen strongly in recent years, but federal laws significantly restrict the pace at which market rental growth can be passed through to tenancies already in place. This has built up reversionary potential within the portfolio such that even if free market rents were to weaken, rental income should continue to increase. Refurbishment and subsequent re-letting of vacated units at a premium to existing rents, and closer to market rent levels, will remain the key driver of reversionary capture.

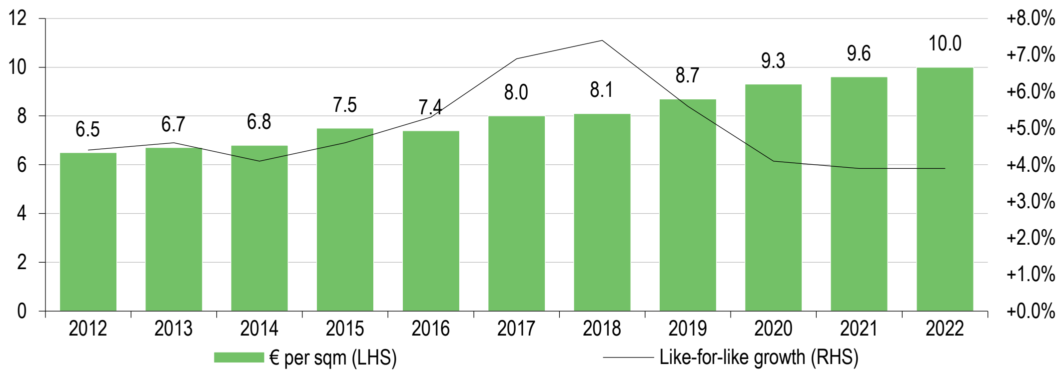
Exhibit 1: Portfolio summary

	Valuation (€m)	Valuation (%)	Value per sqm (€)	Annualised fully occupied cold rent (€m)	Net contracted rent per sqm (€)	Fully occupied net yield (%)	Vacancy by area (%)	EPRA vacancy (%)
Berlin rental	684.3	88	4,194	18.9	10.1	2.9	4.8	2.3
Brandenburg	56.3	7	3,079	1.8	9.7	4	17.3	3.2
Berlin Cond.	30.1	4	4,093	0.7	9.1	2.8	9.3	
Property under development	5.3	1						N/A
Total	**775.9**	**100.0**	**4,082**	**21.4**	**10.0**	**3.0**	**6.2**	**2.4**

Source: Phoenix Spree Deutschland as at 31 December 2022

Across the portfolio, average gross in-place rents were €10.0 per square metre per month at end-FY22, up 3.9% versus end-FY21. Despite the cost-of-living pressure on tenants, PSD says that rent collections have remained broadly stable, a function of conservative rent to income levels for new tenants and German federal support initiatives. While the income statement impairment charge increased from €0.4m to €0.8m, this reflected write-off of provisions while gross outstanding receivables were only modestly higher at €0.9m versus €0.8m.

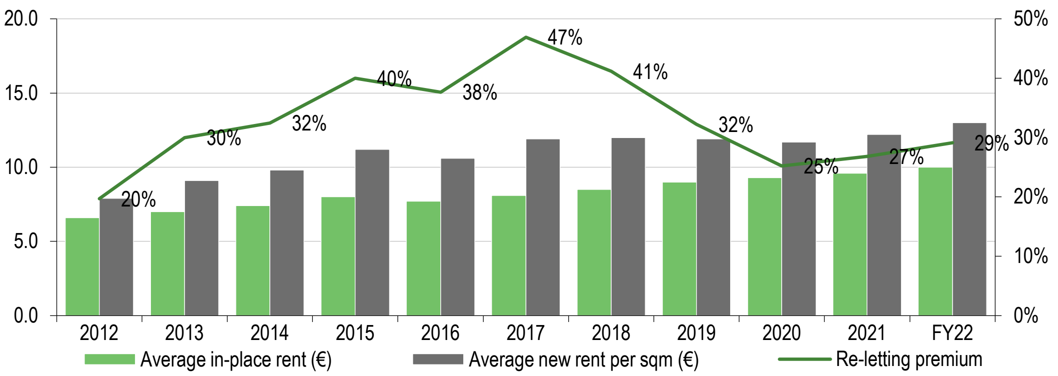
Exhibit 2: Trend in whole portfolio rent levels and like-for-like growth



Source: Phoenix Spree Deutschland data

During 2022, new leases were signed on c 13% of all occupied units, achieving an average rent of €13.0 per square metre, 6.6% above the previous year, and an average 29.1% premium to passing rent. Excluding assets in Brandenburg acquired in 2019, where rents are lower than those achieved in central Berlin, the reversionary premium to previous passing rents was 32.3% (FY21: 33.7%). The premium to previous passing rents varies from period to period, mainly determined by mix, but the average re-letting premium for the whole portfolio in the three years to end-FY21 was c 27%.

Exhibit 3: Re-letting premium



Source: Phoenix Spree data

During FY22, PSD invested €16.4m in property refurbishment and in bringing new residential condominium projects to market,[1] an increase from €9.5m in FY21. The increase included a step-up in the refurbishment of vacant assets for re-letting following the repeal of the Mietendeckel rent cap in April 2021,[2] increased renovation expenditure on the Brandenberg asset acquired in 2019,[3] and further work on bringing assets into a position to be sold as condominiums. PSD expects a positive return on these investments in 2023 and beyond from condominium sales and rental uplifts. FY23 investment is expected to be materially lower as condominium projects complete and we forecast €7.6m in each of FY23 and FY24.

Exhibit 4: Capex

€m	FY22	FY21
Like for like capex (renovation of apartments for re-letting)	7.4	4.7
Development capex (preparing condominiums for sale)	8.5	4.4
Other	0.5	0.4
Total capex	**16.4**	**9.5**

Source: Phoenix Spree data

Condominium sales have slowed with inflation, rising interest rates and economic uncertainty

Condominium market prices are typically 30–35% higher than rental-based valuations The division and subsequent resale of selected apartment blocks as private units (condominiums), with vacant possession, at market valuations, provides cash flow to support the core refurbishment and re-letting rent reversion strategy and accelerates the release of significant value embedded within the portfolio.

Condominium sales during 2022 were heavily affected by a significant deterioration in buyer sentiment as a result of cost-of-living pressures, higher borrowing costs and uncertainty surrounding the macro-economic environment caused by the crisis in Ukraine. During the year, 13 condominium units were notarised for sale for an aggregate value of €4.7m (2021: €15.2m). More positively, the average achieved notarised value per square metre for the residential units was €5,502, representing a gross premium of 22.4% to carrying value and a 34.8% premium to PSD's average Berlin residential portfolio value as at 31 December 2022. The sales premium in any period is specific to the mix of assets (different locations, floor space, etc) but the 22% premium achieved in FY22 was slightly above the three-year average of 20%, albeit on significantly reduced volume.

Exhibit 5: Condominium notarisations

	FY17	FY18	FY19	FY20	FY21	FY22
Sales value of notarisations (€m)	9.1	9.9	8.8	14.6	15.2	4.7
Average notarised value per sqm (€)	4,352	4,566	4,068	4,320	4,988	5,502
Average book value of notarised properties per sqm (€)	3,515	3,676	3,459	3,624	4,216	4,495
Premium to book value	23.8%	24.2%	17.6%	19.2%	18.3%	22.4%
Portfolio average value per sqm at year end (€)	2,854	3,527	3,741	3,977	4,225	4,082
Premium to portfolio average	52.5%	29.5%	8.8%	8.6%	18.1%	34.8%

Source: Phoenix Spree data

At the time of reporting FY22 results in late March, a further three condominiums had been notarised for a total consideration of €0.8m, at a 62% premium to carrying value, and a further three

[1] An additional €1.5m was spent on maintaining portfolio assets and expensed through the income statement (FY21: €1.7m).

[2] While in place, the Mietendeckel had significantly reduced the economic viability of vacant apartment refurbishment for re-letting.

[3] The property is a former army barracks, which offered significant asset management potential from the completion of refurbishment and development, leasing and reversion.

units had been reserved, with the combined value of €0.6m reflecting an average 80% premium to carrying value. PSD cautions that these condominiums are smaller than the average across the portfolio and that the premium achieved should not be viewed as representative of future condominium valuations. The company says that buyer confidence in the condominium market remains very fragile, particularly for occupied units and as a result it is focusing on plans to bring additional unoccupied condominium properties to market. Bulk condominium sales are under active consideration, potentially taking advantage of the high (77%) share of Berlin units that are legally designated as condominiums,[4] a differentiating feature of PSD versus listed German peers.

This strategic advantage is highlighted by recent federal government legislation, which has placed significant restrictions on the ability of landlords to split their properties into condominiums in the future. The measures will inevitably increase the scarcity of condominiums available for sale, further exacerbating the demand-supply imbalance.

Within the portfolio valuation, only six properties, with an aggregate value of €30.1m, are fully valued as condominiums and sales values are typically well ahead of this.

Other net investment

Alongside the condominium disposal programme, during FY22, PSD committed €29.7m to acquisitions and agreed an aggregate €12.1m of disposals. The company plans no further acquisitions for 2023, pending an improvement in market conditions, the resumption of dividend payments and a significant narrowing of the discount to NAV. A number of additional properties are being marketed, although market conditions remain challenging for disposals and offers have been at levels significantly below carrying value, and at prices that would release limited cash after repayment of associated debt.

The single largest acquisition commitment was the March 2022 acquisition by way of a forward funding agreement of a portfolio of 17 environmentally efficient, new-build, semi-detached residential properties (34 houses), well situated in Erkner, in Brandenburg, for a purchase price of €18.5m. PSD has acquired the land site, is funding the costs of construction and will acquire the property at the agreed price on completion, expected in H224. The projected fully occupied rental income is €0.7m pa (3.1% of end-FY22 gross in-place rents), which reflects a prospective gross yield of 3.5%. At end-FY22, €5.5m of the purchase price had been invested.

In May 2022, PSD announced the acquisition of four multi-family houses, located in Hoppegarten Neuenhagen, consisting of 24 residential units for €6.3m.

In September 2022 it exchanged contracts to acquire a multi-family house with 22 residential units and three commercial units in Berlin-Neukölln for €4.9m. Completion is expected in Q223.

In August and September 2022, PSD exchanged contracts to sell two non-core properties for an aggregate consideration of €8.6m. The sale of the property at Margareten Strasse (€4.9m) completed before the end of FY22 and that of the property at Argentinische Strasse completed in January 2023. The aggregate sale price was for the properties was slightly below the end-FY21 carrying value of €9.0m but well ahead of the aggregate acquisition prices of €3.9m in 2008 and 2017.

In December 2022, contracts were exchanged on another non-core property (Putlitz Strasse) for €3.5m, with the sale completing in Q123 The agreed sale price was again a little below the end-FY21 carrying value of €3.9m but well ahead of the 2008 acquisition price. The sale completed in February 2023.

[4] Although 77% of the Berlin residential portfolio is designated as condominiums, within the portfolio valuation of €776m, only six properties, with an aggregate value of €30.1m, are fully valued as condominiums.

Borrowings in place and cost mostly fixed until 2026

PSD has borrowing facilities with Natixis Pfandbrief ('Natixis') and Berliner Sparkasse ('Berliner'), amounting to €365m.

The main facility with Natixis is a €240m seven-year non-amortising interest-only facility that matures in September 2026. It comprises two tranches, a €190m refinancing facility and a €50m acquisition facility, both fully drawn. Also with Natixis, PSD has a €60m non-amortising facility comprising a €45m acquisition facility and a €15m capital expenditure facility. This matures alongside the existing Natixis facility in September 2026. The majority (81%) of the floating rate interest cost for the Natixis facilities has been hedged to give a blended effective rate of 2.4% at end FY22.

With Berliner, PSD has an amortising facility that matures in October 2017. The facility has been fully drawn and after loan amortisation, €61.2m remained outstanding at end-FY22. Just over 70% has been fixed at rates in the range of 1–3%, and most of the balance has been hedged, to give a blended cost of 1.8% at end-FY22.

At end-FY22 PSD had gross borrowings (nominal value, including unamortised loan arrangement fees) of €315.8m, and including cash of €12.5m, net debt was €303.3m. The net LTV ratio of 39.1% (FY21: 34.7%) remained well below the long-term target of 50% (with a 60% maximum).

Exhibit 6: Summary of borrowings

	Facility (€m)	Drawn amount (€m)	Maturity date	Years to maturity	Effective interest rate
Natixis Pfandbrief	240.0		Sep-26	3.8	
Natixis Pfandbrief acquisition & capex facility	60.0		Sep-26	3.8	
Total Natixis	**300.0**	**254.6**			**2.4%**
Berliner Sparkasse	61.2	61.2	Oct-27	4.8	1.8%
Total/average	361.2	315.8		0.9	2.2%
Unamortised loan arrangement fees		(3.7)			
Balance sheet value		312.1			

Source: Phoenix Spree data, Edison Investment Research

At end-FY22, the interest cost on 83% of drawn debt costs were fixed or hedged with swap and the blended effective rate of all drawn debt was 2.2%. The end-FY22 average remaining debt duration was around four years, closely matched by the swaps.[5]

Exhibit 7: Hedging

€m	Fixed	Floating	Total borrowing	Swaps	Fixed/swapped
Natixis Pfandbrief	nil	250.9	250.9	203.0	80.9%
Berliner Sparkasse	44.2	17.0	61.2	11.9	91.6%
Total	**44.2**	**267.9**	**312.1**	**214.9**	**83.0%**

Source: Phoenix Spree data, Edison Investment Research

Financial covenants relating to the Natixis loans include a projected interest cover of at least 150%, minimum debt yield of 4.3% and a maximum LTV of 67.5%. There are no financial covenants relating to the Berliner loans.

[5] The interest rate swaps are expected to mature between September 2026 and February 2027.

Forecasting scenarios

Rental income is relatively predictable and should continue to grow

While rental income is relatively predictable and should continue to grow, property valuations and disposal proceeds are uncertain. For this reason, alongside our base case/central scenario we show the impact of alternative assumptions for property revaluation movements and the scale of condominium sales. Revaluation movements primarily affect the income statement and LTV ratio but have no impact on cash flow. Condominium sales have a relatively modest direct impact on the income statement but drive the cash flow available for investment and determine borrowing requirements.

Base case assumptions and forecast

Compared with our last published FY23 forecast, the change to 'recurring' profit before tax and property valuation movements is a modest €0.7m or 2.5% of revenues, driven by increases in administrative expenses and the net finance charge. Our unchanged forecast 4% pa like-for-like rental growth is slightly offset by recent disposals.

We have assumed a 7.5% like-for-like decline in property valuation (taking the full occupancy gross yield to 3.2% vs 3.0% at end-FY22). The negative pre-tax valuation movement is partly offset by a positive deferred tax movement. Property disposals are assumed to amount to €8.5m, comprising completion of the €3.5m non-core sale exchanged in H222 (see below) and €5.0m of condominiums. The realised gain on condominium sales is more than offset by disposal costs on the total disposals.

At €4.4, FY23e EPRA NTA per share is c 10% lower than previously forecast and c 12% lower than reported in FY22. Net LTV increases to 44% versus 39% in FY22. For FY24 we forecast no change in valuation with a flat EPRA NTA per share and LTV stable.

Exhibit 8: Summary of forecast changes

	Current forecast		Previous forecast		Change
€m unless stated otherwise	**2023e**	**2024e**	**2023e**	**2024e**	**2023e**
Revenue	27.7	28.8	28.2	N/A	(0.5)
Property expenses	(16.1)	(16.4)	(16.5)	N/A	0.5
Gross profit	**11.6**	**12.4**	**11.6**	**N/A**	**(0.0)**
Administrative expenses	(3.2)	(3.2)	(3.0)	N/A	(0.2)
Net finance charge	(8.2)	(8.3)	(7.7)	N/A	(0.5)
Profit before tax and valuation movements	**0.2**	**0.9**	**0.9**	**N/A**	**(0.7)**
Gain on disposal of investment property	(1.1)	(0.1)	0.6	N/A	(1.6)
Fair value movement on investment property	(58.2)	0.0	0.0	N/A	(58.2)
Profit before tax	**(59.1)**	**0.8**	**1.4**	**N/A**	**(60.5)**
Tax	9.2	0.0	0.0	N/A	
Profit after tax	(49.9)	0.8	1.4	N/A	(51.3)
Non-controlling interest	0.2	(0.0)	(0.0)	N/A	
Attributable profit after tax	(49.6)	0.8	1.4	N/A	(51.1)
EPS (c)	(54)	1	2	N/A	(56)
DPS (c)	0.0	0.0	7.5	N/A	(7.5)
EPRA NTA per share (€)	**4.4**	**4.4**	**5.0**	**N/A**	**(0.7)**
Net debt	(319.3)	(325.5)	(304.1)	N/A	
Net LTV	44.0%	44.4%	40.2%	N/A	

Source: Edison Investment Research

Reflecting the current low running income yield on the portfolio, EPRA has historically been negative and returns have been driven by capital growth, including the positive valuation impacts of reversionary rent capture and PSD's condominium strategy. Although the spike in inflation had a negative impact on FY22 EPRA earnings, we forecast a positive trend, driven by continuing rent growth.

Exhibit 9: Reported and forecast EPRA earnings

€m	2019	2020	2021	2022	2023e	2024e
Rental income	17.9	19.1	20.6	20.3	21.9	22.8
Service charge income	4.7	4.8	5.2	5.6	5.7	5.9
Revenue	**22.6**	**23.9**	**25.8**	**25.9**	**27.7**	**28.8**
Property expenses	(14.2)	(16.4)	(16.1)	(17.1)	(16.1)	(16.4)
Admin expenses	(3.4)	(3.3)	(3.4)	(3.3)	(3.2)	(3.2)
Net finance expense	(6.0)	(8.2)	(7.5)	(7.9)	(8.2)	(8.3)
Current tax	(0.0)	(0.5)	0.2	(0.8)	0.0	0.0
Minority	(0.2)	(0.0)	0.2	0.4	(0.3)	(0.0)
EPRA earnings	**(1.3)**	**(4.5)**	**(0.8)**	**(2.8)**	**(0.1)**	**0.9**

Source: Phoenix Spree historical data, Edison Investment Research forecasts

Condominium disposal proceeds have thus been a key source of cash flow to fund portfolio investment and dividends. While dividends have been put on hold until market conditions become clearer, we expect PSD to continue to invest in the portfolio, to support rental growth and selected condominium disposals, as well as its development assets in Brandenberg. In the following section we illustrate to sensitivity of PSD's borrowing requirements and LTV to a range of outcomes for property revaluation and asset disposals. Before that, we discuss our expectations for capex, acquisitions and disposals in detail.

Capex, acquisitions, and disposals

Our forecasts allow for the completion of previously disclosed acquisitions and disposals, future condominium sales, and development capex for the Brandenberg forward funding development.

On this basis, the net cash outflow from investment is €8.6m in FY23 and €8.4m in FY24, which we have assumed is funded by a mix of cash resources and, in FY24, from further debt drawings. If it chooses, PSD has the flexibility to draw additional funds from its capex and investment borrowing facilities (see below). On this basis LTV remains well below the company's long-term target of 50%.

Exhibit 10: Summary of forecast investment activity and cash flow/funding

€m	FY23e	FY24e	
Completion of acquisitions	(4.9)		Berlin-Neukölln exchange
Completion of non-core disposals	7.3		Argentinische Strasse, Putlitz Strasse
Development capex	(7.4)	(5.8)	Erkner development
Disposal gains net of costs	(1.0)	(0.0)	
Assumed refurbishment capex	(7.6)	(7.6)	
Assumed condominium sales	5.0	5.0	
Net cash flow from investment activity	**(8.6)**	**(8.4)**	
Other cash flow before movements in borrowings	0.2	2.1	
Borrowings drawn	0.0	5.0	
Net change in cash	**(8.5)**	**(1.3)**	
Opening cash	12.5	4.0	
Closing cash	4.0	2.8	
Closing debt (inc unamortised arrangement fees)	**(323.3)**	**(328.3)**	
Net LTV	44.0%	44.4%	

Source: Edison Investment Research

Our central assumption of a 7.5% decline in valuations in FY23 (and flat in FY24) generates an LTV of 44.0% (FY22: 39.1%). In Exhibit 11 we show the sensitivity of LTV to what we consider to be a reasonable range of alternative assumptions for property revaluation movements. The actual outcome may of course fall outside this range.

Exhibit 11: LTV sensitivity to portfolio valuation movements					
Valuation movement	0.0%	-5.0%	**-7.5%**	-10.0%	-12.0%
LTV	40.7%	42.9%	44.0%	45.2%	46.2%

Source: Edison Investment Research

With most of our forecast investment already committed, it is the assumption regarding condominium sales that drives a change in funding requirements (cash or debt drawdown). As we show in Exhibit 10 above, based on €5m of sales in FY23, the funding requirement is €8.5m, which we assume will be provided by cash drawdown. With sales of €2m, the funding requirement increases to €11.4m, well within our forecast cash balance and undrawn debt resources (€39m at end FY22). The condominium sales assumption has no material impact on LTV as it reduces both net debt and portfolio value.

Exhibit 12: Sensitivity of funding requirement to condominium sales					
Condominium sales (€m)	**2.0**	**4.0**	**5.0**	**6.0**	**8.0**
Funding requirement (€m)	**-11.4**	**-9.44**	**-8.5**	**-7.5**	**-5.5**

Source: Edison Investment Research

Additional sensitivity to future debt refinancing

Market expectations, reflected in the Euribor forward curve, are that policy rates will increase to around 3.6% by the end of this year before falling to c 2.5% in 2026, when PSD's debt facilities mature. Exhibit 13 shows our existing rental income and interest cost forecasts for FY23 and FY24, including like-for-like growth in rents per square metre of 4% and a slight increase in occupancy. As an illustration, assuming rental income growth accelerates to 4.5% pa through FY25–26, the change in rental income from that reported in FY22 to FY26 would be c €4.4m. Assuming a full refinancing of debt in FY26, on annualised basis, at a 1.5% margin and 2.5% Euribor rate, FY26 cash interest cost would be €5.7m higher. The net negative impact would be €1.3m, which we believe would be manageable, especially if condominium sales recover as interest rates decline. However, without a decline in interest rates there would be a persistent negative spread between the gross asset yield and funding costs, before taking account of corporate expenses. Including corporate expenses, the operating margin (before valuation movements) was 27% (of gross rental income) in FY22 (five-year average: 26%). In such circumstances we would expect PSD to consider an accelerated unlocking of the value that is embedded in the portfolio, currently reflected in the new letting premium and condominium sales at a premium to book value.

Exhibit 13: Illustrative impact of increased funding costs

€m unless stated otherwise	Actual	Forecast		Illustration		
	FY22	FY23	FY24	FY25	FY26	Increase FY22–26
Annualised rental income	22.7	23.6	24.8	26.0	27.1	4.4
Annualised rental income growth		4.2%	5.0%	5.0%	4.5%	
Net finance expense	8.3	8.2				
Less amortisation of loan arrangement fees and other non-interest charges	(1.1)	(1.1)				
Cash interest costs	7.2	7.1	6.8	6.8	12.9	5.7
Average borrowing	303.6	321.4	323.3	323.3	323.3	
Average cash borrowing cost	2.4%	2.2%	2.1%	2.1%	4.0%	

Source: Phoenix Spree Deutschland FY22 data, Edison Investment Research

The valuation is discounting material market pressures

Share price performance across the quoted German real estate companies has been weak over the past year, with our selected peer group down by an unweighted average of almost 50%. PSD shares have modestly outperformed peers over this period and have been noticeably more resilient over the past three years. As a result, PSD shares trade at a P/NAV of 0.46x compared with the average for German listed peers of 0.30x.

The discounts imply that investors continue to anticipate material further market pressures to an extent that none of the companies operating in the sector, including PSD, expects to be the case given the fundamental imbalance of demand and supply in the residential market. The key sector risks and concerns reflected in valuations across the sector primarily include the impact of higher interest rates on financing costs versus asset yields, asset values, compliance with existing debt covenants and refinancing risks at debt maturity.

Exhibit 14: P/NAV history

Source: Refinitiv data as at 30 May 2023

Exhibit 15: Peer valuation and price performance comparison

	Price (local)	Market cap (€m)	P/NTA (x)	Share price performance			
				One month	Three months	One year	Three years
Grand City Properties	6.9	172	0.23	-8.7	-28.6	-58.4	-66.1
LEG Immobilien	47.93	74	0.31	-15.0	-30.3	-50.0	-57.2
Vonovia	17.335	1,592	0.32	-11.7	-27.3	-51.1	-64.3
Phoenix Spree Deutschland	**203**	**92**	**0.46**	**0.5**	**-20.7**	**-42.0**	**-28.8**
Average			**0.33**	**-8.7**	**-26.7**	**-50.4**	**-54.1**

Source: Company data, Refinitiv. Note: Prices as at 30 May 2023.

FY22 results in detail

The investment property valuation update that was published in early February had provided details of the portfolio valuation performance, condominium sales and estimated NAV. Among the detailed information contained in the FY22 results that were published in late April was confirmation of the positive performance of the core recurring income activities but also the announced pause in dividend distributions.

Exhibit 16: Summary of FY22 financial performance

€m unless stated otherwise	FY22	FY21	FY22/FY21
Rental income	20.3	20.6	-1.6%
Service charge income	5.6	5.2	9.3%
Revenue	**25.9**	**25.8**	**0.6%**
Total property expenses	(17.1)	(16.1)	6.4%
Gross profit	**8.8**	**9.7**	**-9.2%**
Administrative expenses	(3.3)	(3.4)	-5.3%
Gain on disposal of investment property	(0.2)	1.5	
Fair value movement on investment property	(42.2)	38.0	
Property advisor performance fee	0.3	(0.3)	
Operating profit	**(36.5)**	**45.4**	
Net finance charge	(7.9)	(7.5)	6.1%
Change in fair value of interest rate derivatives	26.9	7.3	
Profit/(loss) before tax	**(17.5)**	**45.3**	**-138.8%**
Tax	1.7	(7.9)	
Profit after tax	**(15.8)**	**37.4**	**-142.3%**
Non-controlling interest	0.4	(0.1)	
Attributable profit after tax	(15.4)	37.3	-141.4%
EPS (€c)	(17)	39	-142.7%
DPS (€c)	2.4	7.5	-68.7%
EPRA NTA per share (€)	5.10	5.65	-9.7%
NAV total return	-8.4%	8.4%	
Gross debt at nominal value	(315.8)	(288.4)	
Cash	12.5	10.4	
Net debt	(303.3)	(278.0)	
Net LTV	39.1%	34.7%	

Source: Phoenix Spree data, Edison Investment Research forecasts

Key features of the FY22 results were:

- Revenues of €25.9m were at a similar level to the prior year, with service charge income increasing, driven by utility cost, and rental income slightly lower. Adjusted for disposals and the FY21 recovery of back-dated rents in respect of the temporary imposition of rent controls during 2020[6] (we estimate c €1m), rental income would have increased.
- Total property expenses increased by €1.0m or 6% to £17.1m, also reflecting inflationary impacts as well as an increase in the rent receivable impairment charge.
- The gross profit of €8.8m (FY21: €9.7m) reflected a margin of 34.0%, in line with the five-year average but below 37.5% in FY21, and administrative expenses were well-controlled at €3.3m.
- The net loss before tax of €17.5m (FY21: €45.3m profit) reflected the non-cash property revaluation loss of €42.2m, partly offset by a gain on interest rate derivatives of €26.9m. The IFRS EPS loss was 17c versus a profit of 39c in FY21. During the year, PSD repurchased 975k shares (1.0% of share capital) at an average 21% discount to end-FY22 NTA per share.
- EPRA net tangible assets (NTA) of €468.1 were 12% lower versus FY21 and, with a slight positive impact from share repurchases in the earlier part of the year, NTA per share reduced by 10% to €5.1.
- An H122 DPS of 2.35 cents was paid, unchanged year-on-year, but no H222 DPS was paid (H221: 5.15 cents).

6 The H220 back rents were not accounted for as income in FY20 as the Mietendeckel remained in place. Back rents in respect of H121 are included in income following Mietendeckel repeal.

Exhibit 17: Financial summary

Year ending 31 December, €m unless stated otherwise	2018	2019	2020	2021	2022	2023e	2024e
INCOME STATEMENT							
Revenue	22.7	22.6	23.9	25.8	25.9	27.7	28.8
Total property expenses	(15.8)	(14.2)	(16.4)	(16.1)	(17.1)	(16.1)	(16.4)
Gross profit	6.9	8.4	7.5	9.7	8.8	11.6	12.4
Administrative expenses	(3.2)	(3.1)	(3.3)	(3.4)	(3.3)	(3.2)	(3.2)
Gain on disposal of investment property	1.0	0.9	2.2	1.5	(0.2)	(1.1)	(0.1)
Fair value movement on investment property	66.1	41.5	41.5	38.0	(42.2)	(58.2)	0.0
Property advisor performance fee	(4.0)	(2.8)	0.4	(0.3)	0.3	0.0	0.0
Separately disclosed items	(1.0)	(0.3)	0.0	0.0	0.0	0.0	0.0
Operating profit	65.9	44.6	48.3	45.4	(36.5)	(50.9)	9.1
Net finance charge	(9.5)	(16.0)	(8.2)	(7.5)	(7.9)	(8.2)	(8.3)
Gain on financial asset	0.0	0.0	(2.2)	7.3	26.9	0.0	0.0
Profit before tax	56.4	28.6	37.9	45.3	(17.5)	(59.1)	0.8
Tax	(11.1)	(5.8)	(7.6)	(7.9)	1.7	9.2	0.0
Profit after tax	45.4	22.7	30.3	37.4	(15.8)	(49.9)	0.8
Non-controlling interest	(0.3)	(0.5)	(0.5)	(0.1)	0.4	0.2	(0.0)
Attributable profit after tax	45.1	22.3	29.8	37.3	(15.4)	(49.6)	0.8
Closing basic number of shares (m)	100.8	97.8	96.1	92.8	91.8	91.9	91.9
Average diluted number of shares (m)	99.0	102.1	98.9	95.0	92.2	91.8	91.9
IFRS EPS, diluted (c)	46	22	30	39	(17)	(54)	1
DPS declared (c)	7.5	7.5	7.5	7.5	2.4	0.0	0.0
EPRA NTA total return	13.1%	9.3%	8.8%	8.4%	-8.5%	-14.2%	0.2%
BALANCE SHEET							
Investment properties	632.9	719.5	749.0	759.8	761.4	718.0	726.4
Other non-current assets	3.4	3.5	3.8	2.7	16.9	16.9	16.9
Total non-current assets	636.4	723.0	752.8	762.5	778.3	734.9	743.3
Investment properties held for sale	12.7	10.6	19.3	41.6	14.5	7.2	7.2
Cash & equivalents	26.9	42.4	37.0	10.4	12.5	4.0	2.8
Other current assets	7.5	9.5	8.4	11.7	10.1	10.1	10.4
Total current assets	47.1	62.6	64.7	63.8	37.1	21.3	20.4
Borrowings	(3.6)	(17.8)	(1.0)	(0.9)	(0.8)	0.0	0.0
Other current liabilities	(13.2)	(15.6)	(9.6)	(12.4)	(15.9)	(14.8)	(15.3)
Total current liabilities	(16.8)	(33.4)	(10.6)	(13.3)	(16.8)	(14.8)	(15.3)
Borrowings	(191.6)	(258.5)	(286.5)	(283.2)	(311.3)	(320.7)	(326.8)
Other non-current liabilities	(65.2)	(76.8)	(86.5)	(86.1)	(70.9)	(61.7)	(61.7)
Total non-current liabilities	(256.9)	(335.3)	(373.0)	(369.3)	(382.2)	(382.4)	(388.5)
Net assets	409.8	416.9	434.0	443.6	416.4	359.1	359.9
Non-controlling interest	(2.0)	(3.0)	(3.5)	(3.6)	(3.2)	(3.0)	(3.0)
Net attributable assets	407.9	413.9	430.4	440.0	413.2	356.1	356.9
Adjust for:							
Deferred tax assets & liabilities	52.5	58.3	65.4	73.5	70.9	61.7	61.7
Derivative financial instruments	6.0	16.0	18.2	10.9	(16.0)	(16.0)	(16.0)
Other EPRA adjustments	(5.4)	(6.8)	(6.4)	(0.3)	0.0	0.0	0.0
EPRA net tangible assets (NTA)	461.0	481.4	507.6	524.1	468.1	401.8	402.6
IFRS NAV per share (€)	4.05	4.23	4.48	4.74	4.50	3.88	3.88
EPRA NTA per share (€)	4.58	4.92	5.28	5.65	5.10	4.37	4.38
CASH-FLOW							
Cash flow from operating activity	13.2	1.5	8.1	7.8	2.2	7.3	9.3
Income tax paid	(4.7)	(0.0)	(1.3)	0.2	(0.5)	0.0	0.0
Net cash flow from operating activity	8.5	1.4	6.7	8.0	1.7	7.3	9.3
Property additions	(47.3)	(32.2)	0.0	0.0	(13.2)	(4.9)	0.0
Proceeds from disposal of investment property	86.0	13.5	7.2	13.8	21.0	11.2	4.9
Capital expenditure on investment property	(7.9)	(6.5)	(4.2)	(9.5)	(16.4)	(15.0)	(13.3)
Other cash flow from investing activity	0.0	0.1	(5.9)	0.0	0.5	0.0	0.0
Cash flow from investing activity	30.8	(25.1)	(2.9)	4.3	(8.2)	(8.6)	(8.4)
Interest paid	(5.1)	(6.2)	(7.5)	(6.7)	(7.3)	(7.1)	(7.2)
Bank debt drawn/(repaid)	(27.0)	64.6	11.2	(3.2)	27.4	0.0	5.0
Share issuance/repurchase	0.0	(11.5)	(6.0)	(20.5)	(4.2)	0.0	0.0
Dividends paid	(7.5)	(7.7)	(7.0)	(7.4)	(6.9)	0.0	0.0
Other cash flow from financing activity	0.0	0.0	0.0	(1.0)	(0.5)	0.0	0.0
Cash flow from financing activity	(39.6)	39.2	(9.3)	(38.8)	8.5	(7.1)	(2.2)
Change in cash	(0.3)	15.5	(5.4)	(26.6)	2.0	(8.5)	(1.3)
FX	(0.0)	(0.0)	(0.0)	0.0	0.0	0.0	0.0
Opening cash	27.2	26.9	42.4	37.0	10.4	12.5	4.0
Closing cash	26.9	42.4	37.0	10.4	12.5	4.0	2.8
Closing debt	(195.3)	(280.2)	(291.4)	(288.4)	(315.8)	(323.3)	(328.3)
Closing net debt	(168.4)	(237.8)	(254.4)	(278.0)	(303.3)	(319.3)	(325.5)
LTV	26.1%	32.6%	33.1%	34.7%	39.1%	44.0%	44.4%

Source: Phoenix Spree historical data, Edison Investment Research forecasts

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