

Phoenix Spree Deutschland

Trading update

Continuing to realise embedded value

H220 condominium sales increased strongly at a healthy c 20% average premium to book value and disposal proceeds have supported continuing share repurchases at a c 30% discount to net asset value (NAV), enhancing value creation. As discussed in detail in our [December initiation note](#), pending a resolution of the rent cap legal challenge, so far Phoenix Spree Deutschland (PSD) has sought to mitigate the effects while maintaining strategic flexibility; a resolution, which PSD expects mid-year, will determine the strategy for extracting the value embedded in its portfolio.

Year end	Gross profit***(€m)	EPS (c)	EPRA NAV/share (€)	DPS (c)	P/E (x)	P/NAV (x)	Yield (%)
12/19	8.4	22	4.9	7.5	16.2	0.77	2.1
12/20e*	8.8	19	5.1	7.5	18.4	0.72	2.1
12/21s**	9.9	33	5.5	7.5	10.6	0.69	2.1

Note: *FY20 forecast unchanged. **12/21s is our 'no Mietendeckel' scenario. This note also includes a 'continuing Mietendeckel' scenario. ***Revenues less total property expenses (including property management expenses, repairs and maintenance, direct property costs and investment adviser fees).

Outcome will determine strategy for realising value

Resolution of the legal challenge to the Berlin rent-cap law (the Mietendeckel) will determine PSD's strategy for extracting the value embedded in its portfolio. Until resolved, accurate forecasting is not possible and our [initiation note](#) provides scenario analysis based on the potential outcomes. PSD and its advisers firmly believe the cap is unconstitutional and will ultimately be repealed. In this case, we expect a return to focusing on capturing reversionary rent potential to drive income and capital growth (reflected in the FY21 scenario above). If not repealed, we expect a significant reduction in recurring income and a focus on accelerated condominium sales and increased disposal gains to realise embedded value. Positively, by limiting investment, the cap may aggravate the housing shortage and support growth in free market rents and capital values.

Condominium market remains strong

A total of 70% of the Berlin portfolio is now legally split into condominiums and 17% is in application. H220 notarised sales of condominiums increased to 30 units with a value €10.5m (H120: eight units/€3m) at an average €4,276 per sqm or 20.2% above book value (H120: 15.7%). Including guaranteed sales under the Accentro agreement the full-year notarised sale total is €14.6m, 62% up on FY19. Condominium pricing has remained strong and we expect a slight increase in the end-year portfolio valuation to be published in early February. The company has now repurchased c 4.7m shares for €15.2m (4.7% of the total) at an average 30% discount to H120 EPRA NAV per share.

Valuation: Well above average P/NAV discount

A c 30% discount to FY20e EPRA NAV per share compares with a five-year average of 8% since IPO. The discount is c 40% to our estimated 'condominium' valuation that we expect to be in focus if the rent cap is not repealed.

Real estate

7 January 2021

Price **318p**
Market cap **£305m**

€1.11/€

Net debt (€m) at 30 June 2020 246.3

Net LTV at 30 June 2020 33.0%

Shares in issue 100.8m

Free float 100%

Code PSDL

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (0.6) (3.6) (0.6)

Rel (local) (1.9) (14.5) 12.3

52-week high/low 332p 212p

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

FY20 valuation report Early February 2020

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Berlin residential property

PSD is a Jersey-based closed-ended investment company, listed on the Main Market of the London Stock Exchange. It targets an attractive total return from investment in residential property in Berlin, the most populous city in Germany, and represents the largest rental housing market in the country. It is externally managed by QSix (formerly PMM Residential), an independent and owner-managed alternative asset manager with an experienced team of property and investment professionals and established track record in the German residential property market.

With strong demand for housing in Berlin driven by net migration and a relative lack of supply, rents and capital values have steadily increased. Against this background, PSD has built a strong track record of creating value by acquiring under-rented apartment blocks at low valuations and actively managing them to capture reversionary rent potential and drive income and capital growth, supplemented by the division and subsequent resale of selected apartment blocks as private units (condominiums) at market valuations. The average annualised EPRA NAV total return over the five years to end-FY19 of 20.4% per year was well ahead of the 8–10% per year target. PSD estimates the average free-market value of rents for the portfolio at €12–12.5 per sqm per month, well ahead of the H120 average contracted level of €9.1, and local demand for accommodation significantly outstrips supply.

Mietendeckel outcome will determine strategy for value capture

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 rent cap (Mietendeckel) was introduced in stages during 2020, becoming fully effective in November. PSD and its legal advisers firmly believe the Mietendeckel legislation will ultimately be ruled unconstitutional and overturned; the timing of this remains uncertain but PSD expects a resolution by mid-2021. As things stand, the rent cap and rent reductions introduced in November will have a material financial effect in FY21, but while legal challenges to the cap are in process, the company has sought to mitigate its effects while maintaining strategic flexibility. If not repealed, the rent cap seems likely to limit investment in the sector, aggravate the housing shortage, support further growth in free market rents and capital values, but will require a change in PSD's strategy to realise this value.

Anticipating the strategic response

Although we incline to agree with the company's view that eventual repeal is the most likely outcome, the uncertainty around this, particularly in terms of timing, renders an accurate prediction for the next 12 months impossible. For that reason, in [our initiation note](#) we embedded the potential strategic responses and financial effects into two scenarios, intended to illustrate the alternative strategic paths that the company may take and the financial implications of these on an annualised basis. We would strongly encourage readers that have not seen the initiation note to examine the details of these scenarios. The first scenario (illustrated at the start of this report) assumes the Mietendeckel is repealed, that strategy returns to its normal focus on reversionary rent capture, and that this is fully effective throughout FY21. If a repeal comes in FY21, it is likely to be back dated but it is also possible the terms of any repeal may not be effective until FY22. An alternative scenario assumes no repeal and captures the likely strategic response and financial implications of accelerated condominium sales to realise value embedded in the portfolio. It also assumes this is effective throughout FY21, but because management is unlikely to commit to a full strategic shift until the rent cap challenge is settled, it may also be FY22 before the full effect is actually seen.

Assuming a rent cap repeal and return to the traditional strategy based on reversionary rent capture, the FY21 scenario indicates an EPRA NAV total return of 8.1%, within the company's long-

term 8–10% return target range. Relative to the low rates of return prevailing in market, taking account of the historically low volatility displayed by residential assets and considering the near 30% discount to FY20e EPRA NAV, we believe this is attractive.

If there is no repeal, we expect investors to focus on the significant value embedded in the portfolio, to be realised on an accelerated basis through significantly increased condominium sales. Almost 90% of the Berlin portfolio may soon be legally split into condominiums and our analysis indicates the discount to underlying NAV, adjusting asset values to reflect market-level condominium pricing, the discount to NAV is likely to be c 40%.

Exhibit 1: Financial summary

Year ending 31 December, €m unless stated otherwise	2017	2018	2019	2020e	'Mietendeckel repealed' scenario* 2021
INCOME STATEMENT					
Revenue	23.7	22.7	22.6	24.1	24.8
Total property expenses	(12.6)	(15.8)	(14.2)	(15.3)	(14.8)
Gross profit	11.1	6.9	8.4	8.8	9.9
Administrative expenses	(3.0)	(3.2)	(3.1)	(3.7)	(3.3)
Gain on disposal of investment property	5.3	1.0	0.9	2.0	1.9
Fair value movement on investment property	157.4	66.1	41.5	24.4	39.1
Property advisor performance fee	(26.3)	(4.0)	(2.8)	1.9	(0.2)
Separately disclosed items	0.0	(1.0)	(0.3)	0.0	0.0
Operating profit	144.5	65.9	44.6	33.4	47.4
Net finance charge	(6.0)	(9.5)	(16.0)	(9.7)	(6.8)
Gain on financial asset	0.0	0.0	0.0	0.0	0.0
Profit before tax	138.5	56.4	28.6	23.7	40.7
Tax	(26.2)	(11.1)	(5.8)	(4.4)	(7.8)
Profit after tax	112.3	45.4	22.7	19.2	32.8
Non-controlling interest	(0.8)	(0.3)	(0.5)	(0.3)	(0.5)
Attributable profit after tax	111.5	45.1	22.3	18.9	32.3
Closing basic number of shares (m)	92.5	100.8	97.8	96.1	96.1
Average diluted number of shares (m)	100.2	99.0	102.1	98.7	97.3
IFRS EPS, diluted (c)	111.35	45.57	21.83	19.18	33.25
DPS declared (c)	6.9	7.5	7.5	7.5	7.5
DPS declared (Sterling pence equivalent)	6.4	6.7	6.5	6.8	6.8
EPRA NAV total return	52.6%	13.1%	9.3%	5.9%	8.1%
BALANCE SHEET					
Investment properties	502.4	632.9	719.5	738.9	771.1
Other non-current assets	2.9	3.4	3.5	3.9	3.9
Total non-current assets	505.3	636.4	723.0	742.8	775.0
Investment properties held for sale	106.9	12.7	10.6	7.5	7.5
Cash & equivalents	27.2	26.9	42.4	33.4	35.0
Other current assets	14.4	7.5	9.5	9.6	10.1
Total current assets	148.5	47.1	62.6	50.5	52.6
Borrowings	(2.6)	(3.6)	(17.8)	0.0	0.0
Other current liabilities	(9.4)	(13.2)	(15.6)	(8.4)	(8.8)
Total current liabilities	(12.1)	(16.8)	(33.4)	(8.4)	(8.8)
Borrowings	(219.6)	(191.6)	(258.5)	(279.9)	(280.4)
Other non-current liabilities	(54.1)	(65.2)	(76.8)	(83.9)	(91.8)
Total non-current liabilities	(273.8)	(256.9)	(335.3)	(363.9)	(372.2)
Net assets	367.9	409.8	416.9	421.0	446.5
Non-controlling interest	(1.7)	(2.0)	(3.0)	(3.3)	(3.8)
Net attributable assets	366.2	407.9	413.9	417.7	442.7
Adjust for:					
Deferred tax assets & liabilities	44.6	52.5	58.3	62.8	70.6
Derivative financial instruments	3.3	6.0	16.0	18.3	18.3
Other EPRA adjustments	(34.0)	(5.4)	(6.8)	(4.9)	(5.1)
EPRA net assets	380.2	461.0	481.4	493.8	526.5
IFRS NAV per share (€)	3.96	4.05	4.23	4.35	4.61
EPRA NAV per share (€)	4.11	4.58	4.92	5.14	5.48
CASH-FLOW					
Cash flow from operating activity	5.9	13.2	1.5	6.0	6.6
Income tax paid	(0.1)	(4.7)	(0.0)	(1.4)	0.0
Net cash flow from operating activity	5.8	8.5	1.4	4.7	6.6
Property additions	(76.5)	(47.3)	(32.2)	0.0	0.0
Proceeds from disposal of investment property	60.4	86.0	13.5	13.2	15.9
Capital expenditure on investment property	(6.7)	(7.9)	(6.5)	(4.5)	(7.0)
Other cash flow from investing activity	0.0	0.0	0.1	(5.8)	0.0
Cash flow from investing activity	(22.7)	30.8	(25.1)	2.9	8.9
Interest paid	(5.1)	(5.1)	(6.2)	(6.8)	(6.4)
Bank debt drawn/(repaid)	36.7	(27.0)	64.6	3.4	0.0
Share issuance/repurchase	0.0	0.0	(11.5)	(6.1)	(0.3)
Dividends paid	(6.0)	(7.5)	(7.7)	(7.2)	(7.2)
Cash flow from financing activity	25.6	(39.6)	39.2	(16.6)	(13.8)
Change in cash	8.7	(0.3)	15.5	(9.0)	1.6
FX	(0.0)	(0.0)	(0.0)	(0.0)	0.0
Opening cash	18.5	27.2	26.9	42.4	33.4
Closing cash	27.2	26.9	42.4	33.4	35.0
Closing debt	(222.3)	(195.3)	(280.2)	(283.6)	(283.6)
Closing net debt	(195.1)	(168.4)	(237.8)	(250.2)	(248.6)
LTV	32.0%	26.1%	32.6%	33.5%	31.9%

Source: Phoenix Spree historical data, Edison Investment Research forecasts. Note: *As described within this report.

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