

# German Housing Companies Invest Heavily in Existing Portfolios

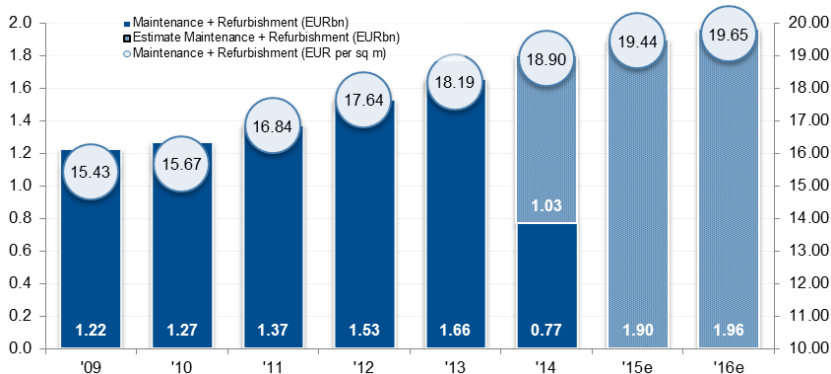
*In the last five years spending on maintenance and refurbishment climbed significantly among the 20 largest German housing companies. The reason: investing in existing portfolios currently offers better returns than buying new holdings.*

## Investment in maintenance and refurbishment rises by 22%

In 2009 the 20 largest German housing companies invested an average of EUR15.43 per square metre (sq m) for maintenance and refurbishment. In 2014 it was EUR18.90 per sq m – a rise of 22% in five years. In the next two years Scope Ratings expects a further increase to just under EUR20 per sq m (Figure 1).

In absolute terms growth will be even higher. In 2009 the 20 companies invested around EUR1.2bn in existing holdings compared to EUR1.8bn in 2014, an increase of 50%. The higher absolute percentage growth compared to investment per sq m is due to an overall increase in the size of the holdings: In 2009 the 20 companies owned 1.27 million housing units by 2014 it had risen to 1.55 million.

**Figure 1: Spending on maintenance and refurbishment of the top 20 German housing companies**



Sources: Annual financial reports of monitored companies, Scope Ratings

## Investment offers better yields than acquisition

How to explain the increased investment on existing holdings per sq m? One major driver of this trend has been the ECB's monetary policy and the consequent low interest rates, pushing investors into alternative asset classes like real estate. The stability in the German housing market makes it especially attractive.

The strong demand for German residential properties has resulted in increased sale prices and falling prime yields. In 2009 prime yields in the German housing market were 5.1%. Five years later it is still just 4.3% on average.

Yields from investment in existing holdings are different. Among the top 20 German housing companies, yields in 2009 were 3.7% on average, in 2014 it was 5.3% – 100bp above the average initial yields for portfolio acquisitions (Figure 2).

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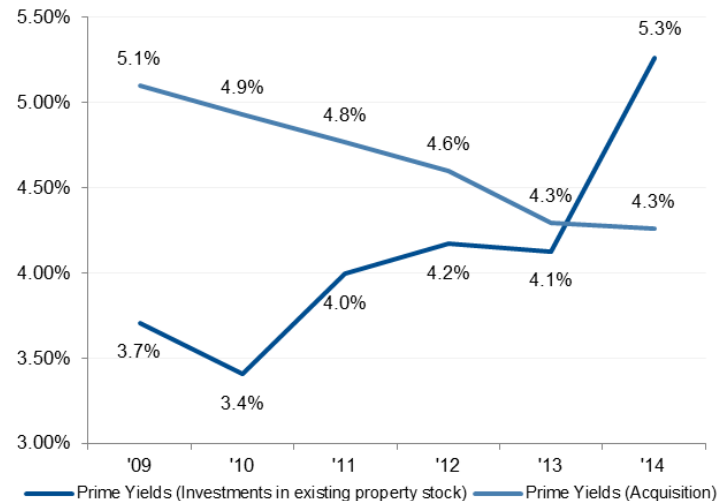
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**Figure 2: Prime initial yields: acquisition vs. investment in property**  
(Assumption: Refurbishment spending/total spending TOP 20)



Sources: CBRE, German Bundesbank, Patrizia, annual financial reports of monitored companies, Scope Ratings

## Refurbishment driving yields

The significant climb in yields for investment in existing holdings is due above all to a rising share of spending on refurbishment as opposed to maintenance. Of investment on existing portfolios among the top 20 German housing companies in 2009, two-thirds were on maintenance and one-third on refurbishment. In 2014 it was 55% for maintenance and 45% for refurbishment.

## 11% of refurbishment costs can be passed on to annual rent

Background: housing owners in Germany can pass 11% of refurbishment costs onto the annual rent, and there are no caps on rent increases resulting from refurbishments. Refurbishment thereby improves the long-term profitability of housing companies.

However this does not apply to maintenance spending. The property owner must carry the costs and cannot pass it to the tenant. As a result, the more spent on refurbishment than on maintenance, the higher the yield from investments in existing portfolios.

In contrast to maintenance work, refurbishment is work that improves a property's long-term utility value and overall living quality, for example by installing a lift or structural insulation.

## Private vs. public housing companies

Of the top 20 German housing companies, nine are privately owned and eleven by public or municipal owners. There are notable differences between the two when it comes to investing in existing properties.

## Public housing companies invest the most in existing properties

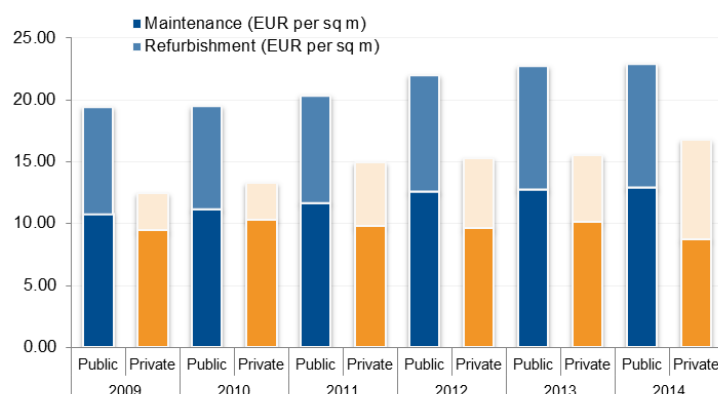
Public housing companies are investing increasingly in existing properties – roughly EUR22 per sq m in the last few years, compared to only EUR16 per sq m by privately owned companies. The difference is explained by the relatively high expenditure of public portfolio holders on maintenance work (Figure 3).

Private housing companies are nevertheless catching up: in the five years monitored by Scope, refurbishment and maintenance spending per sq m increased by 35%, considerably higher than the figure for publicly/municipally held companies at only 16% (Figure 4).

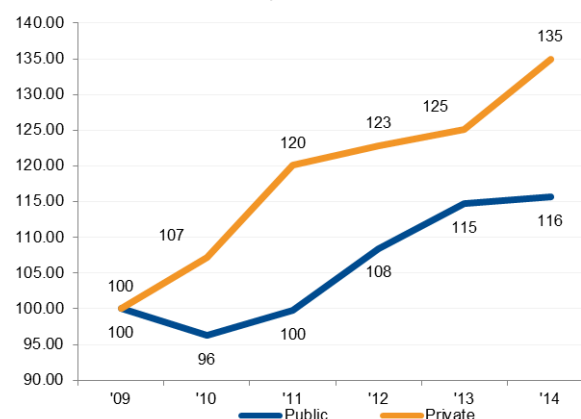
## Private housing companies focus more on refurbishment

The strong growth among privately companies is driven mainly by the three-fold rise in refurbishment spending – from EUR2.96 per sq m in 2009 to EUR8.01 per sq m in 2014. Private housing companies, more so than public/municipal holders, have taken advantage of the potential to increase rental income by refurbishing their properties (Figure 3).

**Figure 3: Maintenance & refurbishment TOP 20 by ownership structure**



**Figure 4: Index Maintenance & refurbishment TOP 20 by ownership structure**



Sources: Annual financial reports of monitored companies, Scope Ratings

## Rating implications

### Refurbishment and maintenance spending reflects positively on company's business risk profile

As a rule, spending on refurbishment and maintenance has a positive effect on a housing company's business risk profile because: i) it strengthens asset quality and ii) increases profitability. Nevertheless tangible effects on the company's creditworthiness will depend primarily on how this spending is financed.

## Outlook

### Further growth expected until 2016

Scope Ratings expects investment on existing holdings to continue growing to just under EUR20.00 per sq m until 2016, a total of EUR2.0bn. Growth is driven by, i) the increasing pressure on initial yields and ii) the "rental brake" introduced in an amendment to German rental law (*Mietrechtsnovellierungsgesetz – 'MietNovG'*).

As competition and purchase prices increase, so investing in existing properties becomes more attractive to housing companies. For the time being, an end to the low interest rate policy and large demand for residential property investment is not yet in sight.

### "Rental brake" makes refurbishment more attractive

Scope expects the "rental brake" to further increase the share of refurbishment investment as total investment. The reason: the rental brake does only partially affect rent increases from refurbishment – making it more attractive to housing companies.

## Outlook: top 20 German housing companies

Scope Ratings analysed maintenance and refurbishment spending for top 20 German housing companies since 2009. These companies manage portfolios of around 1.55m housing units in total.

### TOP 20 German housing companies by housing unit

	Name	HU	Head office	Ownership
1	Deutsche Annington S.E. + Gagfah S.A.	347,000	Bochum	Private
2	Deutsche Wohnen AG	147,000	Frankfurt a.M.	Private
3	SAGA GWG	129,000	Hamburg	Public
4	Vivawest Wohnen GmbH	122,000	Gelsenkirchen	Private
5	LEG Immobilien AG	107,000	Düsseldorf	Private
6	TAG Immobilien AG	73,000	Hamburg	Private
7	degewo AG	63,000	Berlin	Public
8	Gewobag	58,000	Berlin	Public
9	Howoge GmbH	57,000	Berlin	Public
10	ABG Frankfurt Holding GmbH	50,000	Frankfurt a.M.	Public
11	Adler Real Estate AG + Westgrund AG	48,000	Frankfurt a.M.	Private
12	Grand City Properties S.A.	43,000	Luxemburg	Private
13	GAG Immobilien AG	42,000	Köln	Private
14	GWH Immobilien Holding GmbH	42,000	Frankfurt a.M.	Public
15	Stadt und Land Wohnungsbauten-Gesellschaft mbH	42,000	Berlin	Public
16	GEWOBA AG	42,000	Bremen	Public
17	WIRO Wohnungsgesellschaft mbH	36,000	Rostock	Public
18	LWB mbH	35,000	Leipzig	Public
19	GEWOFAG Holding GmbH	32,000	München	Public
20	GWB AG	32,000	München	Private

Sources: Annual financial reports of monitored companies, Scope Ratings



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