Transcription

FY 2016 Results Analyst & Investor Call

March 7, 2017

Rene Hoffmann

Thank you, Vera, and welcome everybody to the conference call on Vonovia's earnings for the full year 2016. I suppose you've all had a chance to look at the material that we've published this morning, including the comprehensive presentation for this call. Your hosts today are CEO, Rolf Buch, and CFO, Stefan Kirsten. They will lead through this presentation first and then open up for your questions.

And with that, I'd like to hand over to Rolf Buch.

Rolf Buch (CEO)

Hi. Welcome from my side also and thank you very much for participating in this call. Of course, this is a year-end call; that's why we will provide you with a big set of figures for the year-end 2016. But we will focus on the highlights and later on the presentation actually on two topics. One is FFO growth, not only in the past, but also what it can be in the future, and the second is the NAV. FFO is, of course, 100% in our control; NAV is partly in our control, because a part is reflected by market valuations and developments, which is very difficult for us to predict.

We have chosen these two topics as main topics, because we think by looking on the projections of some markets, especially long-term, probably it's our obligation to give more educations. So, highlights on FFO growth:

2016 FFO per share is up by 25%. We will see roughly 10% organic growth in 2017 excluding conwert; it will be much more meaningful up including conwert and there is no reason why the growth potential of FFO will stop after

2017 and we will show you in detail why we think that the dynamic of the business is intact and why there is an inbuilt organic growth for the future.

For net asset value, as I said, it is partly in our control, partly in the market. It's a fact that the NAV per share has grown by 27.1%, driven by performance, by investment and, of course, yield compression from exposure to different regional markets. I think it will be very interesting for you to see that yield compression in our detailed figures is not the same all over Germany and we will show you in detail as promised.

We also see further substantial value growth potential which will be unlocked in 2017 and beyond. As again, assuming a part of this potential, we cannot guide because this is market development, not 100% in our control. You will see that all KPIs during the presentation show in the right direction; you will get the compelling guidance for 2017, include, we give you a guidance for Vonovia standalone and we give you a guidance which you have to add to have a view on the total, and then we have several housekeeping topics.

I think page 3, is the start of our so-called FFO section. Here you can see the first time in our short history that we only have grown by 3.6%. In reality, the number of units, we manage in the end of 2016 is lower than we started the year. But on average, we have 3.6% more units, which as you can see, translates to 8.7% of rental income. So more than 50% of the top-line growth is not coming by more units but just by operational excellence in the top-line growth management, which is mainly rental management.

In absolute figures, the top line is €123.5 million above previous year. What you see is that we handle, that we pass this additional top line more than 100% through to EBITDA of operations. For two reasons, because our EBITDA margin is increasing, this is a translation of efficiency effects, and secondly, of course as we always have talked about, the extension business is gaining momentum. So, we are actually passing through more than 100% of the top line through to the EBITDA.

In the year 2016, you also can see that we even add more because we saved interest cost in comparison to previous year. So, out of €123 million of more top line, we ended up with €152 million in more FFO. Some of you might argue yes, but this is because of shrinking interest rates, but in the long run, interest rate will go up. That's why on the left side, you see a simulation that even if interest rates went up immediately today, about 200 basis points, which I think is also the way of a stress test of the Central European Bank, we will get positive FFO contribution from interest rate development until 2019, respectively 2020. So, this slide overall shows that there is no assumptions that the FFO growth of this company will be reduced.

Now we are going through the details.

Dr. A. Stefan Kirsten (CFO)

Yes. Thank you. This is Stefan. A warm welcome from me, too. Rolf and I will ping-pong through the presentation here today. And Rolf has presented the key ingredients of the FFO definition, so let me focus on rental growth now.

Our in-place rent like-for-like in 2016 is for the first time above €6. Why, because we were able to have a like-for-like rent increase of 3.3%. How does that split up? And this is now important to see because this will be the split which we're intending to present to you on a quarterly basis. So the split is more detailed, and it will be quarterly in future, so that you can better track our efforts here. The market-driven rent growth of 1.5% versus 1.7% in the last year was influenced last year by 0.1% subsidized rent, that's in the footnote. You see the effect of modernization volume and keep in mind, the rent increases of 2016 are dependent on the modernization volume of 2015, I can't repeat that often enough. So in 2017, we will bear the fruit of €472 million of modernization in 2016.

So that is the subtotal for the like-for-like rental growth. You know that we are developing ambitious targets with regard to space creation, and space creation, ladies and gentlemen, is not a new balcony, okay. Space creation is, if we add new flats, if we build new buildings and re-densification, so you will see in future that these percentages will jump up, we just are showing you the new structure which we are working on.

And then we have portfolio management effects, which do not include major acquisitions like the GAGFAHs or Südewos of the world, which lead to the respective total rental growth.

It is important to understand that the market-driven rental growth is in any case hovering around these marks. Our modernization spent and our investment program is relatively clear, space creation will come on top and portfolio management, Rolf will later come to that, will be a little bit reduced because we will sell less items in the future because we don't have too much core left. So, all-in-all, going forward, you will see a stable to increasing top line.

Let me draw your attention to page 5, that's maintenance and modernization. And I would like to repeat myself again, the difference is maintenance; it's passive, it's an operating expense or a capital expense, which is reactive, it is protecting our EBITDA.

Modernization is active, proactive by us, and it is increasing our EBITDA. So one is for making the P&L work, and the other one is for spending cash, which you generate to enhance your top line.

We were stable in our maintenance expenses with a total of €320 million, this is €10 million less than the previous year, between us not meaningful. But it shows also that the modernization levels we have reached on a per-square-meter basis, which is approximately €15, is absolutely sufficient to run our business. And we will have more and more maintained units, which are proper there. I misspelt something I just said modernization, I mean maintenance here. So we're on €15 flat out expensed as well as capitalized.

The capitalized maintenance went a little bit down versus previous year. This was the effect that we took more, bigger projects with the GAGFAH portfolio on-board last year. Again not meaningful, we have not changed or altered at all our capitalization policies. Below the dotted line, you see the investments. These are the modernization investments, the new initiatives and space creation. We gave you a guidance of €470 million to €500 million. This guidance had a range because of seasonal weather influx as well as approval levels, which you need for some of the projects. In principle we've hit the guidance and we are proud about it because this €472 million will of course deliver a growing amount of rent.

Rolf Buch (CEO)

So, next question. If you look on the sustainability of FFO growth, of course it's a question, are we able to deliver our investment program which will rise rent in the future?

As you know and as we have told you in the last quarter, we are going to invest €1 billion in our buildings and new construction for the long-term. It will be €700 million to €730 million this year, but after 2018, it will be €1 billion. This will lead to rental increase of around €70 million every year.

The question is of course, when we will run dry of portfolio? And I can tell you that at least it will be not earlier than 10 years from now assuming that we do not see any re-sorting of the portfolio. Keep in mind, in the past, we have moved more and more buildings from Operate to Upgrade Buildings, Operate Apartments, due to technical improvement and efficiency gains. And this also means that there will be no technical development happening in the next 10 years. For example, digitalization, which will give us further investment potential. But, again, without these assumptions – so no technical development, no re-sorting – we will have enough for the next 10 years to invest in our portfolio because we have 214,000 units, which are in the Upgrade Buildings and Optimize Apartments and an additional 75,000 units, which are in the Upgrade Buildings are also suitable for Optimize Apartments.

So, this is enough for the next 10 years and that's why you should not be worried to assume that the €1 billion investment program is for the long run. And also, again, it doesn't make sense to build up an infrastructure, which is able to deliver €1 billion of investment for short-term. So we are very sure that this is for the next 10 years at least.

Now the next question is, if you are looking about sustainable FFO growth, you might ask the question: is it sustainable that the extension business will not even stay stable but will deliver additional cost? I think you have seen the slide on page 7 before, we guide that in 2017 the extension contribution will increase by 75%. Keep in mind that we only have 75% of our apartments already included in our television program.

We have only 30% of 30,000 of our apartments included in our metering program. We have a lot of new projects in the pipeline. So, overall, the €100 million, which you are seeing in 2017 is probably more the beginning then the end of a very long-term increase.

Now, you can assume if you - you can doubt that EBITDA margin will stay stable or decrease. As you can see on page 8, we have seen EBITDA margin's improvements, partly through scale, but also partly through efficiency gains. In 2016, the gain of around 2 percentage points was mainly driven by operational efficiency, because there was nearly no increase in portfolio. And I can tell you – you know I have worked 22 years for efficiency of processes – I can tell you that Vonovia has still a lot of potential left to improve efficiency. So, the assumption that the EBITDA margin operation will not increase is an assumption which I do not share.

Dr. A. Stefan Kirsten (CFO)

That brings us to financing, another driver of the FFO. This chart shows our maturity profile and it also shows the average financing cost for the respective years. So that you can see what we have ahead of us. A, the last GAGFAH CMBS Taurus has been early redeemed in February. So, best to my knowledge, in Continental Europe, there is no residential CMBS anymore left. And it allows us, and you will hear later from us during the housekeeping, to restructure in our GAGFAH according to our legal and tax needs. B, there is no more than 10% of our debt due in any given year 2020, 2021 is a bit of an exception, we'll come to that in a second. And you see opportunities in refinancing in 2019 and 2021, this is of course driven by the hybrids, which were instruments, we were especially structuring around acquisitions.

In 2023, the slightly higher diamond is relatively simply a 10-year bond, which we issued in the U.S. market at that time to open that market also for us in the year of our IPO. The obvious is an interest rate hike will not affect us at full blast, it will affect us over a very balanced structured yearly program. Many worry about these hikes; we don't forget that we are still at very low levels. I mean everybody who believes that interest rates should be negative, should put its hand up now, but we are still at record low levels with regard to interest rates.

Currently, we are able to finance unsecured re-offer yields of seven to eight years in around 1.3% to 1.4%, as we have proven to you in early January.

On page 10, you'll see that we are very proud of our diversified funding mix. It gets a bit dominant with the bonds at the moment, but as long as the European Central Bank via the Bundesbank acquires in its CSPB's bonds they are positively mispriced for us and we are not paid for letting money lie on the table.

Our financing costs went down from 2.6% to 2.1%. Again, the incremental refinancing costs even with extending the maturity is at 1.4%. So you will see that downward trend continuing.

One of the points of bother also due to our history and the acquisitory background, which we had was always the unencumbrance ratio, that unencumbrance ratio is after the last CMBS redemption, healthily above the 50% mark. And therefore, we are keeping well within the structures of Standard & Poors.

Many people focus on loan to value, and we will talk about that in a minute. I would like to take the subjectivity of the value number a little bit out and focus on a metric which I've seen a lot in the U.S., which is debt to EBITDA as a multiple. We are at 10.5 times and are therefore well-positioned also in our own competitive space. All the other covenants are not meaningful at the moment because we're simply beating them.

On page 11, you can see that we are an established player in the debt capital markets, you have, I think, on page 47, all our bonds out there. We have 18 products in the market, which allows the debt capital owners to have a very efficient base for deciding the right pricing and margin. And I must actually say if you look back over the last three to four years, we've continuously improved our financing structure, our funding diversity, our funding cost and the KPIs that go with it. It's no value in itself to be a top 15 bond issuer in Europe, but at least it opened these markets on a permanent basis.

Page 12, let's put some beef onto the metal, let's talk about loan to value. We promised you 42%, we delivered 41.6%. So, 41.6% is the notional loan-to-value, I will very clearly state that the perpetual/equity hybrid of €1 billion is not included in that number.

You know that we executed the conwert transaction nearly all for cash. We still come out below the Q3 number of 2016, which was 47.1%. If this stays and we will be in the range around 45%, so everything is as promised. We have given you a comfort range of low 40s and I can tell you we are comfortable post-conwert.

So, here also when we have discussions in the markets "Oh my god, aren’t you going for equity about conwert?” No, the conwert transaction should not fuel any ideas about an equity issuance and we will talk later about that, if we go to semi-annual valuations, the next yield compression is just around the corner. So from that point of view, there is absolutely no need for us to go further into these matters.

Now let's move on page 13 to some more detailed numbers about the FFO. You always would like to see the FFO 1 per share, AFFOs per share on end of period and average NOSH. In this year, they are, for once, the same, but that's the first for us and you also see that our FFO, which is attributable to our shareholders, to hybrid capital owners, and to non-controlling interests. The non-controlling interest collapsed a bit because last year we still handed out a GAGFAH dividend.

You know that our dividend policy is 70% of FFO 1. We used the remaining 30%, which is now a rather big number, to pay for the hybrids, minorities, one-offs and some historic pension obligations. We also passed the litmus test, which is very close to my heart, as the CFO, that the dividends being covered by the AFFO without any problems.

Rolf Buch (CEO)

So before I jump to the NAV section, well let me summarize. So you have seen that we have an inbuilt FFO growth because the top-line record Q2 rental increase and modernization effects. You can assume that we have an increasing EBITDA margin. It is definitely clear that the extension will contribute more. So we will handle more than 100% of the top line and pass down to the operating EBITDA. And then you have seen that in the next two or three years, we will even see more FFO contribution effects from interest rates. And again, you'll see that the interest rate in comparison to the other cost driver only make one third. So, overall, I think we have passed you the message that the FFO will not only grow you will see in the guidance for 2017, but will significant grow after 2017 because it's an in-built FFO growth system.

Before I jump to the NAV, just for our bookkeeping reasons, I also want to give you an information of our privatization and disposal program. You know that we have promised and we have talked about this, in the whole year 2016 that we will have a significant disposal because we think it is the right timing for selling properties. We have sold close to 24,000 non-strategic and non-core apartments and we have sold 2,700 apartments in the privatization program.

Here you get also first indication that even in the non-core, non-strategic, which is more or less a more problematic portfolio, we were able to assume 5.4% uplift on fair market values, and we have assumed in Vonovia's highest percentage points in the Vonovia's history, 36.2% privatization uplift. So also these figures signal you that there is probably some value uplift in the fair market values, which you have seen then later in the year. For completeness, we have done an EBITDA sales, which is of course not part of FFO 1 of €92.5 million.

Now, I open the NAV section. And again, I want to make sure that I am well understood. We know that a part of the NAV section cannot be influenced by us, but is pure market assumption. So if we are talking about market assumption, we would like to give you some hints. But it is, in the end, your decision and your best guess how you assume the market effects, because we don't feel comfortable enough to fix this.

The chart on page 15 illustrates the potential fair value growth of the current portfolio, which we expect to come from three drivers. The first two, we can influence, the third one is beyond our direct influence. The first driver is modernization investment, what we have done is a simple math. We have looked at the modernization potential of our strategic portfolio, so all of the units of Upgrade Buildings and Optimize Apartments, and we have assumed a 30% rental growth after the modernization, as well as a 30% valuation uplift on the properties in Upgrade Buildings.

We also have assumed a 10% rental growth for the units in the Operate Cluster. All these assumptions fit exactly with our past history. The completion of the modernization investments under these assumptions would translate into about €8.4 billion of additional value potential. The second driver is space creation. We have taken a conservative view of building an additional 26,000 apartments and assumed a rent of €10 per square meter, which is relatively low, because the new apartments we will construct are not in the hot cities. And on average at a multiplier of 25, which is a 4% gross yield and we know from a lot of developers that this is the price of the market of today. The completion of the space creation program under these assumptions will translate into about €5.1 billion of additional value potential. And finally, we have made a rough assumption for an additional multiple expansion of two times. Again, it's more your judgment and your knowledge than ours, which would lead to a €4.2 billion additional value potential. This assumption for multiple expansion is actually a quite bit lower than what we see in the market today. And when we look to the spread between our values and actual transaction multiples.

To be clear, we feel comfortable with the assumptions for the first two drivers, and they are largely under our control. For the third driver, it is our assumption, but of course you may, and also our peers may, have different views.

This illustration shows you our view on the overall potential of the current portfolio once we have implemented the modernization and space creation potential, we have identified at this point. If you ask me for a time frame, I would say half in the next 5 years and the other half in the next 10 years.

Dr. A. Stefan Kirsten (CFO)

Let me drill deeper now onto the NAV numbers, and I can't spare you a tour into goodwills. And it will get a little bit technical. So, please bear with me on page 16. Our EPRA NAV per share is up 22%, our adjusted NAV per share is up 27% to €30.75.

The difference of the goodwill, we'll talk about that. You'll see here for your models, the respective reconciliations. The increase in our NAV per share is obviously driven by operating performance, investments and yield compression. And, by the way, when you look into the P&L, you will of course see a lower number for the valuation uplift, because everything that you modernize goes straight into the balance sheet and therefore a difference of €0.5 billion should not surprise anybody.

Let's go on page 17, which is rather illustrative. And the questions I'd like to answer is where's the yield compression coming from? And I'd like to start with geography. Geography is relatively simple, it's Berlin, Berlin and Berlin again, with 28% in Berlin alone. But, never forget, it's Munich, its Freiburg, Stuttgart a touch left, because there were not too many transactions out there.

You also see that our former initial heartland, which is North Rhine-Westphalia, is more moderate in its value increase and what surprised us very positively is that we got confirmed in Kiel and in Bremen. Bear in mind that we were not really sure after the IPO whether or not these were the smartest cities to invest in with Vitus. We believed conservatively in the cities and we have now been clearly proven wrong and the cities are significantly better than our initial assumptions. So the portfolio management has paid off, we have bought in the right locations, we have withdrawn from the right locations and we are choosing the right locations for our investments.

You can see that on page 18. So, same question: where is the yield compression coming from now, thinking in strategic clusters? The 10.9% on strategic, you find on the page 17 as the footer. You can see that in Upgrade Buildings and Optimize Apartments is the highest potential and also the highest level of yield compression. The lowest levels are in non-strategic and non-core and, between us, that's exactly why they are there where they are. So the next question is for us, internally: what happened with acquisitions? You know that it is an opportunistic strategy, which we were very acquisitory. So, we are on page 19, and now, for the first time, goodwill comes into the game. The value growth since acquisition of €2.9 billion is exceeding the goodwill, which was created with these acquisitions of €2.7 billion. What do these two have in common? And I would really appreciate that, even the ones who say we look through goodwill, listen to me for a moment to ask because, deep in my heart being an accountant, I try to give you a couple of indicators where goodwill can help.

So how does goodwill and goodwill testing in an IFRS environment work? We take our five-year plans, we have some terminal value assumptions and we take the cash flows from these five-year plans and divide them by the WACC. The WACC is a market WACC which is completely audited by KPMG, it’s at the moment at 3.10% versus 3.14% in the year before. This gives the whole impairment test enterprise value, and in this enterprise value, you have three value blocks. The first one is the value of your assets, the second one is the goodwill and the third one is the residual amount which is the headroom.

So when you have a value appreciation of €3.5 billion, €3.7 billion, like we did, you can usually assume that this pushes the value number up, and your headroom should shrink. If your headroom, as in our case, and this is on page 20, still increases, and your WACC is nearly constant, it simply means that the €3.5 billion value increase is justified by expected performance increases and these five-year plans have always been beaten. So you have only three factors which influence the whole goodwill accounting. One is your performance, and God forbid, we are not going down with that one. The other one is WACC, which is market WACC, which is far less influenceable; by the way the highest reaction time is to 30-year Bunds. And the third component is value. And if value grows very fast and you're running out of headroom, you're of course replacing goodwill with value. And so far, this has not been a necessity for us.

So on page 20, we are showing you that our headroom, A, increased. By the way, we don't mention the number, it's a little bit like these cars where you ask about the horsepower and people tell you it's efficient. So it's more than €13 billion.

But let me water down the wine a little bit. Under IFRS, you're splitting these goodwills into cash-generating units, in our case eight CGUs. And we have one cash-generating unit, which is predominantly Berlin which is the East, where the headroom went down by 27% and the fair value went up by 26%. So obviously under a constant WACC, we have a situation that the performance did not increase. And this is for the first time that we see that the valuations with which we come up, and CBRE comes up with, are not underpinned by corresponding performance improvements.

That's a warning sign. It's not a stopping sign, but it's a warning sign coming from an accountant, which is a bit of a rarity. So, I know this is very technical, but this was a very intense discussion we also had yesterday in our own audit committee, what this means for valuation regions, the way how you structure goodwill. The highest sensitivities, by the way, to WACC changes, so I can imagine situations in which we have to write-down goodwill in some of our CGUs.

Rolf Buch (CEO)

So from book-keeping back to engineering, so the engineers likes more to talk about modular construction. I think you have all heard about our modular project in Bochum with 14 residential units. We have built it with a total cost of production excluding land, but all others is included, for €1,800 per square meter. On-site assembly was only five days, which is very important for the tenants living around, because we only generate noise for five days. The construction is completed in mid-December 2016, and the building is fully let by mid-January 2017.

The building was, for obvious reasons, not built in the hottest place, but close to our headquarter in Bochum, so we were able to in-place rent of slightly above €9 per square meter. This compares to €7.20 for Vonovia property in immediate vicinity, and we assume that we will complete construction of around 1,000 of these units, of course, then, in hotter cities, in 2017.

So, we think we also, on the next slide on page 22, I have to give you a little bit more in education. I think during our IPO in 2013, a lot of you have done a detailed analysis of our portfolio, and you have formed an opinion of the quality of our portfolio. This slide is to illustrate that, probably, the portfolio today has not too much in common of what we had in 2013 when we IPOed. We have invested more than €1 billion in our portfolio, we have sold 42,000, and we have bought at the same time 220,000.

And you have heard from Stefan, that the acquisition paid off very nicely, cities like Bremen, Kiel, but also Stuttgart and Munich from DeWAG, for example are paying off. So what you see is actually on the lower part of the page, that we have increased the number of the strategic cluster significantly, and we have decreased the non-core non-strategic. You probably all remember my famous matrix, and I think this was the way how we structured our portfolio, how we took our portfolio decision.

I think, as you have seen Stefan's figures, and if you see these figures, obviously the mathematic model of this matrix was and is working.

On the next page, of course, there is a lot of detailed data. And, here the first time, we gave you also an estimate in the last column on what we see today in reality if we rent out modernized apartments in comparison to the rental price we had before. You can see that there are some cities, which deliver above 30% rental uplift potential, but you also see that there is a lot of cities which are predicted by CBRE of rental growth of above or close to 3%, of course, with the exception of Munich, which is traditionally much higher.

But you also can see that, for example, if you compare the Rhine Main Area, there's a factor of 19 – multiple of 19 and a growth potential of 3.3, with Bremen of a factor of 17.1 and growth potential of 3.1, or Berlin, factor 26 and a growth potential of 3.1. This picture and this slide on page 23, deliver you, a very nice overview on what is the multipliers in comparison to the future rental growth in every respective significant city in Germany.

So, before we are coming to the guidance, let me summarize as well. In the NAV, we see a lot of components, where we think we can influence at least a fair market value growth, and there are some components, where we think, that we have chosen the right portfolio mix to participate significant on the future value growth because, keep in mind, and this is also shown on page 23, value growth is not the same all over Germany. We have to focus on the big cities, which are called the "Schwarmstädte".

Dr. A. Stefan Kirsten (CFO)

So let me talk about the guidance now, and this is a no-surprises chart. We have delivered the guidance to you in November, and we are confirming this wholeheartedly after two months of actuals under the belt. And we can also say that we are confident to be close to the upper end of that guidance. On May 24th, when we report Q1 – that's just three weeks later than normal or two weeks later than normal – because of the conwert integration, we will have the 2017 guidance updated and including conwert. So this is Vonovia standalone ex-conwert. You might wonder about the things which are not on this chart anymore, mainly per-share numbers and NAV. The per-share numbers is very simple. We have a number of outstanding – the number of outstanding shares will be subject to three events. The second offer period of conwert, which I will later address. If we turn to a cross-border merger of the residual GAGFAH shareholders, and a scrip dividend. You will hear later in the housekeeping issues about that.

We will also stop guiding NAV. Why do we stop guiding NAV? We have seen that this is too easy to misinterpret, because we cannot guide the yield compression. So, we have seen also that there is a standard building itself out, to go onto semiannual valuations, and we will do this, at least, for the important part of our portfolio, also more about that later.

Conwert, on page 25. I want you to distinguish pages 24 and 25 very sharply. 24 is a hard-nosed guidance, run through with our full controls department, knowing our business concept. On conwert, we took control, and always keep in mind you cannot take control even a single day earlier, when the last hindrances have fallen on the 10th of January, and we are now, at the moment, aligning our numbers system, our definitions, terminology, their budgeting process, our budgeting process and we are in the middle of the integration already.

So, we don't even have a year-end number, yeah? So we don't have a fully fledged same hardened guidance for conwert as we have for Vonovia. We do have an initial assumption, which is based on the conwert guidance of this year, of 2016, with €80 million as a starting point, and our first conservative assessment gives us approximately €60 million of FFO1 contribution. By the way, this is based on a €130 million to €140 million rental income from conwert. It's a conservative indication, which we will try to harden, and we will, of course, tell you significantly better numbers on the 24th of May, because then we will be harmonized in our thinking. That in itself would result in a combined FFO of €890 million and €910 million.

And now we'll come to a chart which is a little bit new. Because, when listening to the market, we are often seen as a bond proxy or a bet against the Bund, with a negative correlation between 0.8 and 1.0.

On the upper side of the chart, you see the German inflation rate, and you see the rent growth in the German market. And you see that that rent growth has a high degree of stability. The green line is starting from the start of our IPO, the rental growth which Vonovia could deliver. And you know that this is, to a high degree, fueled by our successful modernization program.

You see our EBITDA extension CAGR, you see our adjusted EBITDA operations CAGR. You see our FFO1 per share CAGR and you see that this is a bond proxy with a 17% CAGR of growth in the dividend. Between us, that's a very luxurious bond. So, from my point of view, we should understand, and we hope that during this presentation we could present that to you, that this is a company which has a strong growth momentum in its dividend, integrated in its business systems, and, therefore, should be maybe a bit more than a correlation of nearly minus 1 to the German Bund.

Let me conclude my part with six housekeeping topics. And I can make it relatively brief.

Conwert, page 28. The transaction is fully on track; we have now 71-point-something percent of the share. There will be a second period in which conwert shares can be transformed into cash or into Vonovia shares which ends on the 23rd. We'll come later to that.

Even if the deal looked different with our share price decline from September onwards, the strategic fit is still there. It is absolutely FFO per share accretive, NAV per share accretive, and has, under all circumstances, been rating neutral.

So, we are not suffering, we're benefiting from acquiring a company, that has delivered to us with €0.01 above the unaffected closing price, and, by the way, below the expected NAV.

We will struggle a bit with the financial synergies due to two effects: they had successful non-core sales and therefore have cash on hand. It's not a synergy if they could repay their higher debt by themselves. And, of course, the interest rates have increased since then.

Good news is that we remain confident that our initial estimate of €7 million of operational synergies is conservative. We're looking forward to update you with the Q1 numbers as I just mentioned before. If we look at the timeline on page 29, there is no change in times, there is no change in values. We own, at the moment, 71.54% as a current acceptance ratio, and I think since the last acceptance period, another 300 shares came in against shares, so the capital increase is a must-have for us and we would have the full machine behind it. The integration process has started. Rolf, as the Chairman of the Administrative Board of conwert – it's a monoistic SE – I'm its deputy, we occupy four out of six seats in the Administrative Board, and there is quite some nitty gritty work to be done still, but we have no indication of major obstacles; from our point of view, the integration will be closed in July 27, and you will have the full fruit of synergies from 2018 onwards.

Housekeeping II, scrip dividend. Around the 3rd of April, we will invite for our Annual General Meeting. We have been asked by various shareholders whether or not we can't offer, in parallel to our cash dividend, a scrip dividend. It's well-established in international markets – it's a bit less popular in Germany – but it's increasing popularity.

We quickly found out when we looked at E.ON, Deutsche Telekom and Lufthansa why this is the case, because it's bloody complicated, but it's doable, and it's more and more accepted.

What's the process? The Supervisory Board, which yesterday approved the scrip dividend in principle, will define the structure and price in a very timely fashion close to the AGM. The AGM will approve the total dividend amount, shareholders will then choose cash or shares until early June – keep in mind our AGM is in mid of May – and the payout date will be mid-June. So we will pay out our dividend a touch later than normal, but we offer shareholders now the choice whether or not to choose cash or shares.

Next topic, page 31. NAV guidance versus semi-annual valuation. Fair value is the most relevant line item on our asset side, with, I think, 83% of the balance sheet. NAV remains an important proxy for the share price and our guidance on NAV has, as I mentioned before, always been without yield compression. And, we need to shorten the valuation cycle to reflect the numbers better, because we have seen that our guidance was simply not leading to better investment decisions. So we will do now a valuation as per end of June. It's a similar methodology, but not the entire portfolio, we are trying to capture approximately two-thirds of the value of the company, for simply practical reasons.

The valuation sample will be meaningful. We used not to include the yield compression, as you know, and therefore you will get a reflection of yield compression, now with the Q2 numbers in early August. With that being said, I believe we are serving the market even if our valuation department has to put a lot more effort in, and we have prepared this for quite a while and are happy to announce it now.

Gagfah cross-border merger, page 33. We are holding 93.8% of all Gagfah shares. There is no CMBS in the way anymore that we cannot restructure the company, so what we are doing is we are restructuring the company to make it leaner, from a legal and tax point of view. It is useful, then, to prepare for a cross-border merger. You know that Gagfah is still a stock-listed company; it's de-listed, but it's still a stock company with shares outstanding. We are preparing a mandatory exchange offer; I can't give you the exact timing because I hope to be able to execute it during the course of this year. But there is a lot of legal work to be done. We nevertheless believe that this is true housekeeping to take this one on.

We have presented to you, at announcement, €84 million of synergies with Gagfah. We have realized, and this is our final view, €137 million, and we will stop reporting synergies separately for Gagfah because it becomes more and more difficult to identify them because Gagfah is so fully ingrained and integrated into Vonovia.

Page 33, Vonovia's stake in Deutsche Wohnen. Just an update, the accounting treatment has not changed.

We purchased the Deutsche Wohnen stake at €405.5 million. We are now, after the last Wohnen capital increase, at 4.74% of the outstanding shares. As of last Friday, we had unrealized gains of €127 million plus a dividend which got paid. The accounting treatment is straightforward. We see no need to sell, no intention to sell, and treat this as a strategic stake, which is also working well for us.

Last but not least, Housekeeping VI. Four smiling board members. Why are we smiling? Our CEO got extended by another five years until 2023, and that ensures continuity in leadership. And with that, I go back to him.

Rolf Buch (CEO)

Thank you, Stefan. Also thank you for the smiley. My goal is now only to summarize. I think what you have seen is two big messages which we want to pass to you. First is, we have a built-in sustainable organic FFO1 growth. And this is also for the mid-term future. We will grow FFO organically, as rental income EBITDA growth continue to accelerate. Broadly stable interest rates will lead to additional contribution of FFO1 growth, but even if the interest rate is very negatively impacted, we will see FFO growth in the next years.

Fair value growth, we have talked about elements which we can influence and which we will influence. This is modernization investment, space creation, and selecting the right cities. And then, it's up to you and up to the market to predict the future multiple expansion from exposure to growth markets.

So, we are very confident that not only 2017 will be a good year for Vonovia, but this is an inbuilt process of a longer-term journey. This is, I'm very happy of course to serve for this company for the next years, because I now can prove that what I said today will be true in the next years.

QUESTION AND ANSWER SECTION

Operator

Thank you. We will now begin our question-and-answer session. If you have a question for our speakers, please dial 01 on your telephone keypad now to enter the queue. Once your name has been announced, you can ask a question. If you find your question is answered before it is your turn to speak, you can dial 02 to cancel your question.

The first question is from Remco Simon, Kempen.

Remco Simon

Good afternoon, gentlemen. I just have a few questions. First of all, on slide 15, you highlighted the value growth potential in the portfolio. Could you indicate how much you have to invest in either space creation or modernizations to get to the overall value growth or fair value of about €44 billion that you point to?

Rolf Buch (CEO)

Yes. For the modernization, it will be an investment of around €5.4 billion. For the space creation: €3.4 billion to €3.5 billion.

Remco Simon

Okay. Thank you. And then my second question is on LTV. On slide 12, you indicated that you used the valuation uplift by conwert in an all-cash transaction, and then that is leading to an even slightly lower LTV than, than what it was before the annual revaluation. And also you indicated that you see the next yield compression around the corner. Could you tell us a little bit more about how you feel about adding more debt to the business on more yield compression? How much more you're willing to use the synthetic equity that revaluation gains create to invest in a business or invest in acquisitions?

Dr. A. Stefan Kirsten (CFO)

Yeah. The short answer is, we didn't want to buy conwert with cash. We wanted to buy conwert with shares. But our currency devalued unfortunately and therefore it was a bit difficult, but we always had the cash alternative planned in a way that it was rating-neutral. So this is more an effect than a deliberate action from our side. It is true that we were replacing valuation gains with real assets, valuation gains from my point of view under the methodologies which I've done out there, I would not call synthetic. But in principle, this is not a strategy of the company to move forward like that. If you would have a bigger acquisition, let's say, think about a billion or two billion, we will normally tap the market to ensure a 50-50 equity to debt ratio.

Nevertheless, we are of course happy that with the acceptance of the cash offer and the high FFO per share increase we are kind of generating that, which is in itself another 8%. We are still in our comfort zone on the LTV. Does that answer your question, Remco?

Remco Simon

Yes. That's very helpful. And just to understand it correctly, you mentioned in the case of larger acquisitions, you could tap the market. But given the substantial Capex investments in your own portfolio running at a billion a year as of next year, you, would you feel comfortable doing that on say the current balance sheet, or the current equity base?

Dr. A. Stefan Kirsten (CFO)

We ran the calculation through. We will, of course, need the valuation uplift. No yield compression, but the valuation uplift of our new construction and we believe that we can maintain the loan-to-value numbers for the foreseeable future, even at the run rates, which Rolf has mentioned.

Remco Simon

Okay. Thank you very much.

Operator

Thank you. The next question is from David Prescott, Barclays

David Prescott

Good afternoon, guys. Just a couple of questions from me. You mentioned a lot in the presentation about your £1 billion per annum investment program and you highlight on slide 6 a return on that investment of 7%.I would imagine that you would take advantage of the best return opportunities first. Will that be the case and should we expect that 7% to come down over time over the next 10-year horizon? And also is there a difference between the return you get on modernizations and your space creation?

Rolf Buch (CEO)

So, actually the 7% is a cost-plus calculation. So, and is given by the article 559 of the German Civil Code. So, actually the model is the following: what we invest in reality, we can pass on 7% of the investment on top of the rent. So that's why the question do we have more attractive or less attractive is not really suitable. It also depends, for example for the Optimize Apartment, more about the question if the apartment gets empty or not. So we do not have the free choice to choose between different opportunities. The 7% and also the whole profitability is actually assuming that we have no technical improvement in the future. If a technical improvement in the future will happen, we can add additional apartments out of our operating portfolio. Does that answer your question?

David Prescott

Yeah, I think so. And maybe to the second one: I think in your discussion on goodwill, you kind of alluded to the idea that Berlin is looking a little bit more expensive these days – I think you’ve also been quoted in the press as saying it's a bit of a hot market. Should we read into that that any enthusiasm you had for moving into that market in a big way, has waned over recent times?

Rolf Buch (CEO)

I think that, if you are talking about our peer Deutsche Wohnen, I think the message is very clear. We have learnt the way that an hostile takeover is not possible in the German market. I think we have excluded explicitly several times. In general, of course, we have the opinion that it would make sense on the long run, but we see no indication that anybody in Berlin is going this way further. So we are very clearly waiting and we assume for all our planning that this year in the moment is not happening again, and I think we have shown you today that without any acquisition, this company has a lot of growth potential in the next years. So we don't need to do acquisitions, we don't need to have the Deutsche Wohnen to fulfill the growth target. But of course again, we are looking on all portfolios in Germany, and I repeat that since 2013, and if we find a price that is suitable for us to acquire, we will try to acquire for this price. In 2016 also, we have not seen – we have looks at a lot of portfolios and we have nearly not seen any, which were a suitable in the pricing which fits to our criteria. Is this answering your question?

David Prescott

Great. Thanks.

Rolf Buch (CEO)

So if price is, to be very clear, if prices are going down, then we can acquire. If prices stay the same way, acquisition will be very difficult for us.

David Prescott

Very clear.

Dr. A. Stefan Kirsten (CFO)

They won't meet our acquisition criteria. Okay.

Operator

Thank you. So the next question is from Bianca Riemer, Morgan Stanley.

Bianca Riemer

Yes. Good morning, I have a question about the upcoming elections and any risks that you see for your construction activity depending on which parties do end up eventually in the government. Some parties have already made some comments about potentially subsidizing construction in one shape or the other or on the other hand potentially making construction more expensive by raising energy efficiency regulation. And what risk and opportunities do you see for your business in particular?

Rolf Buch (CEO)

So we as Vonovia, I think, politically well advised not to support one or another party. So that's why it takes my remark also under this understanding. Of course, for the whole real estate industry, and this is a view of all of us, left- left-Green Party will be more challenging for us as an industry, than for example Christian-liberal-green party, which I think are the both only possibilities which we can see today in Germany.

Anyhow, the problem in the big cities is that we do not have enough affordable apartments available. So any government which will come to power has to accept this fact and either they are changing the regulation to the worse for us and then subsidizing us higher or they're doing exactly the opposite. So our business is actually not driven only by politicians, but the regulation itself has to respect the fact that we need more buildings in the big cities, in these 30 “Schwarmstädte”. So, we can now have a lot of pros and contras and all those things, I do not see any fundamental change in the political environment for us, if these two combinations will happen. So I'm not concerned about it, because there's also legal binding agreements between Germany and Europe, for example, to do the CO2 emissions. I cannot have the fantasy that the government which has a Green Party in the government will accept any reduction of the CO2 emission targets, which would be necessary to assume the lower rents will happen.

Bianca Riemer

Thank you for that. Just one follow-up question. The new energy efficiency regulation order is coming into force at the beginning of 2018, which the GdW has said will most likely increase construction costs by 5%. Is your €1,800 per square meter construction cost already including the provision for that, or in other words, is your - is what you are building will be compliant with the new CO2 regulation from 2018 or will you have to change what you're doing? And is that potentially going to make your construction more expensive?

Rolf Buch (CEO)

No, we are compliant with the existing regulation which is 2016. The 2018 is actually still under discussion. Of course, this would lead to higher costs in our construction as well, like for anybody else, assuming that we have no efficiency gains in our production today. We are building out factories now, and normally if you start a factory process, it's not as efficient as it is one or two years along the road. So I think this must be balanced, but I think at the moment, we are on the assumption that we have the EnEV 2016, which is the EnEV which we have to respect at the moment.

Bianca Riemer

Okay. Thank you very much.

Operator

Thank you. The next question is from Thomas Rothaeusler, Jefferies.

Thomas Rothäusler

Hi. I have a question on page 4, rental growth split, you provided there, basically. Could you give us some indication for 2017, especially looking into modernization-driven rental growth and the space creation?

Dr. A. Stefan Kirsten (CFO)

Sure. Thomas, thanks for the question. What we can tell you is that the market driven number will be more or less constant, and due to the fact that we have not fully disclosed what the space creation for the year will be, because in May we will know the approvals which we have. I can't split that up, but in 2017, the modernization bit is of course still the predominant bit. So, apologies that I can't give you more. I have to ask you to ask the question again on the 24th of May.

Thomas Rothäusler

Okay. I will do. Just a follow-up on the goodwill topic you explained quite well. Assuming a meaningful interest rate hike, that would require a goodwill write-down, so where is the threshold, I mean, is there some sensitivity analysis you did on interest rate changes in respect of potential goodwill write-down?

Dr. A. Stefan Kirsten (CFO)

Yes. So you have to see one thing, and we used the CAPM model for the WACC. What you normally have is a correlation to interest rate movements because the so-called risk-free rate is in both sides at equity as well as on debt. The 3.1% based on a risk-free rate, which is the three months rolling of the 30-year Bund. If the total WACC moves from more than 50 basis points upward, we will dig for the first time or we will run out of headroom in the first CGU, which will be in Berlin. This is not really a point of concern, but it's something just to bear in mind when you look at these numbers. So of course we run the sensitivities, I wouldn't survive an audit committee without that sheet.

Thomas Rothäusler

Okay. And then last one on the conwert deal: the impact from the full cash offer on transaction cost. Is there any change to the previous guidance? I mean you needed basically the bridge loan. And also in respect of conwert deal, can you give us a guidance for the goodwill?

Dr. A. Stefan Kirsten (CFO)

Yes. Let's start with the goodwill. Based on the 75% assumption, which is unrealistic, but the best we can have at the moment, the goodwill will be in the range of the deferred taxes, so approximately €170 million, €180 million, €190 million. Now let's assume that our share price increases and people will move into shares and until these shares are settled with increases further, this is pure fuel for the goodwill as we have seen with GAGFAH. So that's one of the reason, why I didn't give a goodwill guidance now.

But based on the existing numbers you can assume let's say €170 million of goodwill very roughly. And this is the deferred tax position, because we de-facto bought at a slight discount to the 31st of December NAV, which will come out at the end of this month.

Your first question about transaction cost. No, we did not need a bridge loan. We had a bridge facility in place when we made the offer, this is a legal obligation. We tend to, let's say, backload our facility so that we pay just the signing fee in the beginning and it may get a bit more expensive if we really have to use it. But, you might recall, that in early December, we brought in €1 billion of EMTN Bonds, this €1 billion we used up for conwert.

You can say that the - let's say, the 1.38% re-offer yield is the conwert financing, the rest came from a working capital facility which was lying around. And then, in January, we would have used these amounts in any case to redeem Taurus, the CMBS in February, and then in January, we entered again the market and took Taurus off. So, from that point of view we have relatively low transaction cost. The current transactions costs for the whole business are close to €10 million only, but we will give you an update on the 24th of May when we have the transaction concluded. So there will be some more costs coming on top but nothing too penalizing.

Thomas Rothäusler

Okay. Thank you very much.

Operator

Thank you. The next question is from Bernd Janssen, Victoria Partners.

Bernd Janssen

Yeah. Good afternoon. Three questions, if I may. One is on the extension business, the other one is on the leverage, and the third one is on organic FFO growth. I might ask them one by one. First question, would it be possible to give us a very rough guidance of how much within EBITDA expansion, what's coming from craftsmen and how much from other activities? Is it fair to assume that, still something like 80% or 90% came from craftsmen?

Dr. A. Stefan Kirsten (CFO)

No, 80% to 90% would be too high a number. The craftsmen organization has proven such a success that it's still the dominant figure. But our other initiatives are eating nicely into it. So, sorry we normally don't split that up.

Let's think about it whether we want to have some serious numbers to explain to you during the next calls, but the craftsmen effect is lowering at the moment, because the rest just simply speeds up faster.

Bernd Janssen

Okay. With respect to actually that effect, really only to kick in mainly from 2017, therefore it was pointing to a relatively high number in 2016. But yes, it would be helpful, if it was possible to give us some rough breakdown at some stage in the future. Second point ...

Dr. A. Stefan Kirsten (CFO)

We'll think that through. Okay?

Bernd Janssen

Okay. Perfect. Stefan, thank you. You highlighted actually to the LTV, and I've a similar view that, with obviously increasing phenomenon – for good reasons – to positive revaluations in German residential, one should obviously have to reconsider LTV targets. So you highlighted the debt to EBITDA, or call it ratio, or multiple. Would you be willing to give us any indication of what you regard on that metric, as a good one, as a conservative or right one, going forward?

Dr. A. Stefan Kirsten (CFO)

We're at the moment, at 10.5 times.

Bernd Janssen

Yeah. That's what you mentioned.

Dr. A. Stefan Kirsten (CFO)

Yeah. I was able to issue the Yankee bonds at 12 times. It was an uphill battle in the U.S., but 12 times didn't hinder people to rate me. And, at that time, I was at BBB flat at that - yeah, to rate me very well in investment grade space. So, a multiple, let's say, better than 11 is very sufficient in the stability of our business model.

If you start changing your business model, if you get more B2B in, for instance, or more dependency from bigger customers, then you need lower multiples. So, I can tell you in the U.S., at 12 times, I nearly get kicked out sometimes until we were able to explain the stability of our cash flow.

Bernd Janssen

Okay. So, up to 11, I guess would be relatively...

Dr. A. Stefan Kirsten (CFO)

Yes.

Bernd Janssen

...a good figure for the time being. Last one, probably a complicated one, organic FFO and FFO growth that you concentrated on a lot in this presentation. As you may know, we are not the biggest fans of FFO, because we would argue that you can partly buy or could buy FFO growth by Capex measures and normally you could at least use the AFFO metric of capturing that Capex as you rightly or wrongly exclude modernization from AFFO calculation. Then, FFO grows nicely, obviously the more you spent in modernization. So the question is here, how should those that are a bit skeptical of not kind of including modernization numbers should look at your – what you call organic growth, which I guess in factual terms it's correct, because you're not acquiring, you're investing into your stock. But would you have some kind of, I don't know, cost targets excluding that modernization that we should focus on or EBITDA margins? And should we otherwise only focus on the return on modernization to make our judgment whether that modernization investments are justified?

Rolf Buch (CEO)

So, you know that we do not agree completely, because we think that if we do an investment, for example, in a new balcony, we generate additional space for rent and it generates additional rent due to the modernization paragraph, we assume that this is similar than to have a new building site, which you, I think accept, that this is an investment. So I think we as modernization, we think that this is investment which has the same return than a building which is these famous 7% unlevered yield.

And also keep in mind that in the €1 billion, there is a significant part of new space creation, so new construction, which will also lead to higher rents and also the respective yield. So having said this, we also have a portion, I think which clearly show it in the slide, which is Capex for maintenance.

Bernd Janssen

Yeah.

Rolf Buch (CEO)

And this is a difference between maintenance and modernization. The Capex for maintenance does not increase rent. And that's why we think Opex and Capex for maintenance is more or less the same but treated different in the bookkeeping for very good reasons. So this is money, this is where we're more talking about maintenance and modernization, and not Opex and Capex, because this will be simply spent for maintenance actually has an impact on the maintains of the building and of course the Opex part of the maintenance has an impact on the FFO, but to assume here in my calculation, we have not changed any assumption about some mixture of Opex and Capex. What we have seen in the 2016 figure is that we are lacking behind a little bit in Capex or Opex. And for the Capex maintenance, Opex maintenance we were not just in line with this expectation. So you see there that we are not fooling around because then we would have done it different.

Dr. A. Stefan Kirsten (CFO)

There's one other aspect then and this has a little bit also to do with rating and assumption of our debt. It is very important to understand that our modernization can be de-facto switched off at an instant. We have, for the first time now, bigger projects, which take let's say a year, but in principle, you can say if this company is very active, but if we come into let's say financial crisis times, as we have seen them eight years ago, we can de-facto switch these things off. You can't switch off maintenance. You can't keep the toilet broken. And so from that point we defined very clearly what is reactive, which is maintenance and what is proactive, which is modernization.

And it was a key argument for the rating agency when we discussed with them these type of programs that they know is granular enough, so we can switch things off, we can easily cocoon the company to its normal organic growth. So from all these points of view, it shows a clear distinction then, therefore, I would refrain from putting the modernization number into the AFFO. I believe our AFFO definition is the unavoidable burden on the FFO through maintenance, through capitalized maintenance, and the litmus test for us is do we cover our dividends, because if this number would be lower than our dividend payout, and there I don't care whether or not it's scrip or cash or anything like that. Then I would dig into the substance of the company and that cannot be the intention of the management.

Rolf Buch (CEO)

To be also very clear, if we have potential to acquire for a 10% unlevered yield, we will rethink that we will use this capital which we are spending today for modernization for acquisitions.

Bernd Janssen

Yeah.

Rolf Buch (CEO)

But, unfortunately I do not find portfolios with the same growth potential afterwards there is a 10% unlevered yield.

Dr. A. Stefan Kirsten (CFO)

So those have smartened up. Okay, I hope that answers your questions, yeah?

Bernd Janssen

Yeah. I think that's a conceptual discussion which we should probably continue at a different stage. Thank you.

Operator

Thank you. The next question is from Marc Mozzi, Société Générale.

Marc Mozzi

Thank you very much. Good afternoon, gentlemen. After all those questions, can you share with us what is your funding strategy, because doing very basic math of your CapEx program, modernization program, dividend in scrip, not in scrip, disposal program, and so on, I end up that no way you're going to deleverage company over the next 10 years. And that's why I find the investment case difficult, because the only way you're going to - the leverage will go down in all that is Germany LTV term is going to be a thanks to asset growth. So I would like you to give us a bit of the sense what is your philosophy around your funding strategy? If you want the big numbers over the next five years at €6.5 billion of FFO, €6.3 billion of modernization CapEx, investment CapEx, €2.6 billion of dividend per scrip and €2.1 billion of disposal, meaning you will fund your dividend with disposal, if any?

Dr. A. Stefan Kirsten (CFO)

Mark, it's a bit too much for me to follow these numbers now here on the phone and talk them live through. We don't have a 10-year horizon, we have a five-year horizon in our planning modulation. Keep one thing in mind, we are building a certain square meter on existing land at €1,800. This square meter will immediately be revalued to whatever, €2,500, €3,000, €3,500, €4,000 because we will not build in the weakest areas, of course. So from that point of view, you are getting an asset valuation in through the new space creation, which in itself is de-levering your company. We will of course use leverage, we will use KFW leverage, we will use a big part of the 30%, plus the small disposals we have and always keep in mind, we are selling 2,500 apartments in privatization.

This is freeing cash of approximately €170 million to €200 million at the current uplift. So, I would like to take this offline or make the presentation in this, when we do the next quarter, how this thing will work, but in the end what we see is that the company will, with its current funding strategies, just hum through and may have a slight increase

of 30, 40 basis points over five years on its loan-to-value ratio. By the way, this is more driven by the equity hybrid becoming due than by the modernization program.

Rolf Buch (CEO)

But Mark, I'll give you a very simpler, I've just made the figures. You have seen as assumption that we are renting out the new construction for €10 per square meter. It's a very conservative consumption because in the big cities, the rent for new apartments is much higher. We also have agreed that 25 times is a multiple paid today by the market for new construction. So this leads us to an immediate market value of this apartment of €3,000 per square meter and above. We are building for Upgrade Buildings on top of €1,600 and for €1,800. In both, say the margin of TGS included which is shown in our extension. So just this example shows that over 50% of the equity actually we generate ourself by using this efficient program. Is this helpful?

Marc Mozzi

Yeah. Definitely, it's exactly what I'm thinking that you're going to on the LTV ratio point of view, reduce it thanks to the value creation, the equity creation from your investment program that's not on a cash on goal, but that's - yeah.

Rolf Buch (CEO)

No, but you know right. You know what we are doing here in Germany, if you are a private house builder, you'll normally get a loan for what you have to buy. And then you build your house partly yourself and this is called the equity portion, and exactly in translation we are doing exactly the same.

Marc Mozzi

Perfectly clear to me. Thank you.

Operator

Thank you. The next question is from Thomas Neuhold, Kepler Cheuvreux.

Thomas Neuhold

Yes. Good afternoon. Two questions from my side too. Firstly, on the space creation business, you mentioned that you're currently producing at €1,800 per square meter and if I remember correctly in the past you mentioned that you do efficiency gains, you target construction cost of €1,500 in the long run. Can you maybe give an update on that figure and also regarding the space creation business, I know it depends on when you receive building permits et cetera. But can you give us a brief or broad indication about the ramp-up of the space creation business. How many units can we expect in 2017, 2018 and 2019?

And the second topic, I want to discuss is the impact of rising inflation on your business. We have seen recently a pick-up inflation in Germany, construction activity has picked up, construction costs have gone up. So maybe can you give us an indication how that the rising inflation could impact your Opex and also how rising construction costs impact your business going forward?

Rolf Buch (CEO)

So, we are talking here about two amounts. One was €1,800 which I used today, which was for the building. So this is a clue, completely building on land we own. So the second amount, which we always mention was €1,600, which is more on upgrading of existing buildings. So putting one additional floor on existing buildings. I think the 1,500 is coming from a target which we have never published, but coming from a target to reduce a €1,600 to €1,500 and even further.

To go immediately from the €1,800 to €1,500 is probably a bigger jump, which we will see later. I cannot tell you, because I don't know it exactly how, where we will end up in the end. I only know that in every process of the world which you start, you end up more efficient after time period. So I think you will get efficiency gains.

Coming to your inflation. Of course, we have a big protection against inflation, because we are more dependent on labor cost development and not so much on construction price increase. In the moment we see the inflation element on the construction price increase, but because of our own craftsmen, we see much less impact on the labor cost increase.

Our assumption is that at least by efficiency gains in the next years, we will compensate labor cost increases.

Keep in mind that we have built up last year 1,000 craftsmen, and this year we will build an additional 1,000 craftsmen. It is obvious for everybody who is doing this kind of operations, that an operation like this is not as efficient as it can be. So, we have again a lot of efficiency potential which we will uplift in the future.

Thomas Neuhold

Okay, thank you, and regarding the ramp-up in the space creation business, I think you target 1,000 units in 2017. How many units can we expect in 2018 and 2019 broadly speaking?

Rolf Buch (CEO)

So the 1,000 units in 2017 are more or less ordered. So, but this is also necessary because we're already in March. And it depends a little bit on the construction permissions, that's why I am a little bit hesitant to give you figures for 2018. I have only learned one important figure. I have talked to the biggest developer in Germany, which is a privately owned company, and this developer is producing 1,500 apartments per year. So with our 1,000, we are on top of this list, of course we are not a developer. To make this also very clear, we are building on existing land, which is, as we have discussed, very different. But I think the 1,000 is a magnitude which is important and it will definitely be bigger in the future.

Thomas Neuhold

Thank you.

Operator

Thank you. The next question is from Sander Bunck, BMO Global Asset Management.

Sander Bunck

Hi. Good afternoon, guys. I have two questions. First one, actually going back on page 15. First question on that is, if you do modernization spend, the impact of the rent is merely reflected in the year thereafter. How was that looking for the valuation increase? Is that regarded also in the valuation the year thereafter or in the same year, as you spend the modernization cost?

Dr. A. Stefan Kirsten (CFO)

This is Stefan. That's multi-fold. On one side of course, let's say it's a property in Dortmund, because there we have moderate yield compression, yeah? The uplift from the normal valuation gains enters in the same year. We built in year zero, we realized the rent increases in year one, and I would say there is part of the valuation uplift in year one, not on space creation, I'm on modernization here, in year one and in year two.

On space creation, it's relatively simple. You build it, you finish it, you rent it out, your value explodes because this stuff is new in your books and therefore you have to value it for the first time.

Sander Bunck

Okay, perfect. And of these €470 million of modernization spend this year, how much of a valuation uplift did you realize this year?

Dr. A. Stefan Kirsten (CFO)

That's the number we haven't disclosed. What we have done is we have these numbers. I think, we have put approximately €520 million into the balance sheet under modernization, but this includes CapEx maintenance. So I have to come back to you about that question.

Sander Bunck

Okay, cool. And, I think the previous question was about the amount that needs to be spent in order to get your modernization investment uplift and your space creation; I think that amount was roughly €9 billion, and I think that is to get to €13.5 billion of value creation. You said you were able to achieve that over the next 10 years, is that my understanding correctly?

Rolf Buch (CEO)

This is really something we will say this is an estimate, this is not a guidance please.

Sander Bunck

Okay, that's fine. But it also means that you're going to spend €9 billion on modernization over the next 10 years?

Dr. A. Stefan Kirsten (CFO)

Sounds reasonable.

Sander Bunck

Okay, so that's quite a step up then.

Dr. A. Stefan Kirsten (CFO)

Yeah.

Sander Bunck

Okay, cool and thank you. And then, one other question relating to the GAGFAH cross-border transaction you're planning on doing. I don't quite understand what's happening here; I was obviously under the assumption that you were able to increase your stake in GAGFAH only up to 95% – is that changing?

Dr. A. Stefan Kirsten (CFO)

Once the CMBS are gone and we will restructure GAGFAH accordingly and make it more efficient from the legal structure, we will have no problems to exceed the 95% threshold.

Sander Bunck

And that will also not trigger any transfer taxes?

Dr. A. Stefan Kirsten (CFO)

No.

Sander Bunck

Okay. So that means issuance of new shares, but also additional income?

Dr. A. Stefan Kirsten (CFO)

It means at least our issuance of new shares definitely, and not more income but less minorities.

Sander Bunck

Okay. But the minorities were quite small anyway, right?

Dr. A. Stefan Kirsten (CFO)

Yeah.

Sander Bunck

Okay, so that's a slight dilutive impact overall most likely...?

Dr. A. Stefan Kirsten (CFO)

Partially dilutive, absolutely.

Sander Bunck

Okay, perfect. That's very useful. Thank you very much.

Dr. A. Stefan Kirsten (CFO)

Thank you.

Operator

Thank you. There are no further questions. I hand back to the speakers.

Rolf Buch (CEO)

So, thank you very much for your very active participation. I think some of you we will see now on our roadshow, so I wish you all a nice afternoon and thank you very much again for your participation and for your trust in our company the last years.

Dr. A. Stefan Kirsten (CFO)

Thank you.