Transcription
9M 2018 Earnings Call
December 6, 2018

Rene Hoffmann

Welcome everybody to our earnings call for the first nine months 2018. Your hosts today are CEO, Rolf Buch and CFO, Helene von Roeder. They will lead through the results presentation first and then be happy to take your questions. I assume you have all had a chance to download the presentation, but just to be sure, the earnings call presentation for today is available on our IR website in the section "Latest Publications".

So, without further delay, let's kick it off and I hand you over to Rolf Buch.

Rolf Buch

Thank you, Rene. So welcome to every one of you to our earnings call for the first nine months of 2018. On page 2, you'll see the agenda for today. Helene and I will first lead you through our nine months results, including of course the final guidance for 2018. We then have a few housekeeping items like you are used to before we will introduce our new performance KPIs including the initial guidance for 2019. Of course always in the end, there will be room for questions.

If you go to page 3, you see the highlights for the first nine months. In operations, organic rent growth is up 4.1% on a year-to-year basis and we have reduced operating expenses by 9.4%, which is actually the synergy coming from Conwert which you remember we have bought more than one-year ago, so you see synergies are always coming. And in consequence of this the EBITDA operations margin excluding maintenance is on all-time high of 91.3% which is 230 bps better than on a year-on-year basis.

FFO 1 is close to 780, which is close to 12.7% better on a year-on-year basis. The FFO on end-of-period NOSH is €1.50, up by 5.6%. We know that some of you are looking on weighted average NOSH, which is €1.55, which is 6.4% on a year-to-year basis increase. We have not made a valuation in the third quarter of the year as we normally do, but we will give you a guidance for the full year result. The overall value increase for the year 2018 will be 13%, and this will lead to an adjusted NAV guidance of around €45 per share.

Guidance 2018: we are very happy to confirm the guidance for 2018, and we will propose to the annual shareholder meeting a dividend per share of €1.44. As you know and as we have discussed previously, Vonovia does not only generate earnings from rental business but also from Value-add Business, recurring sales and development, and we will manage our business by Adjusted EBITDA for each segment plus the total EBITDA and Group FFO, and we will come to this later. Earnings distribution capacity is estimated to grow by approximately €100 million from 2018 to 2019. I continue with page four, which is as you know one of my most favorite pages, it is very simple and it has a strong message as you see on the page, we have a slightly smaller portfolio due to disposals of non-core assets. Due to the significant rental income, our top line is even despite a smaller portfolio higher by €38 million, because we were able to reduce our operating expenses and due to our value-add business in the end, the EBITDA operations is more than 100% increase of top line growth and then thanks to the better refinancing, we actually got out of €38 million top line growth, €87 million FFO 1 growth, which I think this is a strong message and with this I hand over to Helene.

Helene von Roeder

Good afternoon, rent growth as of September 30 for the last twelve months was 4.1%, of which 1.5% were market driven, 2.5% from investments into our portfolio and 0.1% from space creation. On one of the later slides, Rolf will walk you through the regulatory changes that have been approved by the German government and explain what that means for us, but let me say at this point that we remain confident to be able to grow rents at a run rate of about 4.5 % going forward. We will see a shift in our investments, where we expect to do more optimize apartment and fewer upgrade building modernizations. On top of that also come substantially more investments for new constructions so that all-in we expect to be investing between 1.3 and 1.6 billion in 2019.

If we look at the margin expansion: by way of a disclaimer, please bear in mind that slide 6 and 7 are including Victoria Park but are excluding BUWOG. BUWOG will be fully included in all of our KPIs for the full year 2018 but for this 9 months reporting we have again taken the pragmatic approach of reporting BUWOG as a separate line in the IFRS P&L and not breaking it down across our management KPIs. While we’re in the process of integrating the German operating business of BUWOG and look to finish that by year end, we believe that this is a sensible thing to do.

You will have the usual integrated reporting starting with the full year 2018 numbers in March next year. So the numbers on this page and the next page are nine months Vonovia and three months Victoria Park.

Our EBITDA Operations Margin is 75.7% including maintenance and 91.3% excluding maintenance, so quite a healthy growth compared to year end 2017. We show our cost per unit only for the full year but it is indeed safe to assume that the cost per unit for the German portfolio will be below 500 for the year 2018.

Moving on to FFO1, on slide 7 you see our traditional FFO bridge, including the breakout for the perpetual hybrid investors and minorities because I know that some of you adjust our reported numbers for these two line items. So in absolute numbers, FFO is up 12.7% year-on-year, which equals 5.6% per share if you look at it with end-of-period shares and 6.4% with weighted average shares.

Net Asset Value growth. The Adjusted NAV has increased by 12.3% year-to-date in absolute terms and by 5.1% on a per share basis. To be sure, this now includes BUWOG and Victoria Park. We have talked about this in the past but allow me to reiterate our view on NAV and to what extent it is the right metric to use as a proxy for the share price or value of the company.

To remind everybody, by definition, the Adjusted NAV reflects the brick and mortar value of the buildings and it basically applies market terms and assumes the properties are owned by “anyone”, any third party. This approach totally ignores the Value-add Business, the cost advantage and operating platform of a professional owner, the development business profit and the cash flow from any privatization profit.

Which brings me to the outlook of the 2018's full year valuation. Today is December 6, so we have a reasonable view as to the H2 valuation but by no means a final result. This is why we’re showing you ranges for the H2 and the full year. If you compare our expectation for 2018 with what we saw in 2017, you will see that the overall growth is very similar if you ignore the contribution from BUWOG and Victoria Park. Performance and yield compression are still expected to be meaningful with somewhere between 3.25 and 3.55 billion for 2018 and thus broadly in line with 2017. The contribution from investments in 2018 will end up above 2017 levels, which should not come as a surprise to you.

If we separate performance and yield compression from the overall growth, we expect an uplift of 10-11% for 2018, which is below the 11.9% in 2017 but obviously the basis of assets was higher this year.

Back to you Rolf

Rolf Buch

Thank you Helene, and now coming to page 10. This is my most loved business, the value-add business. Value-add is a long-term business, in which we do see steady progress, but things do not change materially from one quarter to the next. That's why we don't have any new surprises. We estimate 120 million of adjusted EBITDA from this business in 2018.

Comparing the value-add business today with five years ago it becomes very clear that the overall volume has grown but also that the program has a more diversified nature today.

And as almost all contributors are directly related or linked to the rental contract, as you can see in this slide, the stability and risk profile of these 120 million Euros are basically the same as the stability and risk profile of our rental cash flows.

Referring back to NAV, if you would to apply the test WACC for the 2019's adjusted EBITDA Value-add Business, the value would be €5.80 per share on top of 9 months adjusted NAV. So this would bring the NAV of the company to more than 50. If you look at the potential, you see that for almost all areas of value-add, we still have a quite a way to go and even in maintenance there will be more growth in the future. So we are not worried about the ongoing momentum also in this part of the business.

Coming to sales, sales continue to go strong, which is obviously a reflection of the positive underlying market. In recurring sales (or privatization), we saw similar volumes as last year and the years before, with almost 1700 units sold and a margin of 30% in spite of the value uplifts we have been seeing. So this part of the sales business continues to be a very reliable part of our overall business.

The non-core sales we achieved a fair value step-up of more than 16%, which is good news, because our own target is at 0. This is a reflection of the healthy demand even for this part of our portfolio and the positive market environment in general. Of course, keep in mind the non-core disposal will come to an end next year because we have now a key portfolio we don't need significant non-core disposals in the future.

And with this, back to Helene.

Helene von Roeder

So page 12, Loan to Value. Our LTV as of Sep 30 was 45.1%, so slightly above the upper end of our range. Given our visibility on the portfolio valuation at year-end we are pretty relaxed about this level.

Obviously, different market participants have different LTV comfort zones, but we would continue to argue that even after the yield compression we have seen, the in-place values of our portfolio remain conservative and we really do not see a scenario in which these values would come under material pressure. So we believe our target range of 40-45% gives investors enough of a security buffer while at the same time not putting an undue burden on our equity yields.

Looking at our internal projections for year-end we should be below 44%. This is on a pro forma basis, already adjusting for the BUWOG squeeze out and the Victoria park call option.

I know that many of you also look at debt to EBITDA in addition to LTV, so do we. As you tend to have a timing effect when you do acquisitions (you already have the debt accounted for but not the full EBITDA benefit), the way we look at it is Adjusted net debt average 2018 over Total EBITDA 2018 estimate. And that number is below twelve times.

On page 13, you will see the well recognizable funding and maturity profile. Our financing structure is not much different from Q2 and I don't think I need to spend too much time on this slide. Our view on the impact of rising interest rates remains the same. Much of the debt that will be maturing over the next quarters is more of an opportunity than a threat and even in a slightly higher interest rate or spread environment, we will be benefiting from refinancings.

So with that, we get to the final guidance for 2018, which is basically unchanged except for a few minor adjustments on the sales numbers. So if you take the midpoint of our guidance, you end up with a dividend per share of €1.44 for

2018 and that's what we intend to propose to the AGM in May next year. Given where we are within the current financial year, we feel comfortable in guiding an EPRA NAV of €52 per share and an adjusted net asset value of €45 by the end of 2018.

And back to Rolf.

Rolf Buch

Thank you Helene. So, then we are coming to page 15. Let me spend a bit of time on our European expansion. It represents only 10% of our portfolio but obviously we spend a lot more time talking about it with the sell side and also the buy side.

Things basically started with our Conwert acquisition that brought with it a small Austrian exposure. My appointment to the D. Carnegie Board in Sweden gave me further insight into non-German resi markets and intensified our efforts to analyze housing markets across Europe. The result is that we have identified four markets in addition to our German home market where we believe it can, not must, make sense to grow because of the significant overlap with the German residential market dynamics. I would exclude all other markets for the time being. But even among these four, we are at very different stages.

We are by far the largest owner in Austria and we will be running the operations there as a scalable business.

France could probably be the biggest potential at some point down the road because it is a very concentrated ownership structure. But as long as the legislation is the way it is and economic dividends cannot be paid out from social housing, it remains only a potential. We are preparing here for the long-term future, but this is nothing which you have to think short-term. Any substantial investment would require legislative changes first. As for the Netherlands, we like the market but we’re not actively engaged. If we’re contacted, we’ll take a serious look but it is not a focus at this point. That leaves Sweden, where we have a good exposure via Victoria Park. We love the management, the cooperation is perfect. We will focus all our efforts and all our capacity to develop and help the management and to show that we can repeat our business model also outside Germany.

Helene von Roeder

The next slide talks about the integration of BUWOG and Victoria park. On page 16, we give you a bit more color on those 2 acquisitions. In terms of FFO accretion you see that both BUWOG and Victoria Park separately were FFO per share accretive on a pro forma basis when applying our acquisition criteria of 50% equity and 50% debt. Also, and probably more important, when you look at the actual financing of the two transactions and the 26 million shares we issued, the accretion is even more material.

Rolf Buch

So then coming to something that will be picked up in the Q&A section and which is heavily discussed. Page 17 - a new rental law was approved by the German parliament last week and will take effect from January 1 next year. On this page, we’ve summarized the main changes and the impact we see on our business. I think we have gone through this page already, so I don't have to read it but of course in the questions and answers, we'll answer all your questions.

In relation to the legislation there is an increasing debate in Germany and I am on page 18, today between acceptance of modernization on the one hand and the need to do energetic efficient modernization on the other. We continue to believe that energy efficiency of residential buildings is a key component to reach our climate protection target, but we cannot do the energetic modernization against the will of our tenants. Legally we could, but morally we don’t.

Acceptance of this modernization has changed. This is why we have decided to do only modernization which do not lead to a rental increase of more than €2/sqm.

As for the financial impact of this decision, I'm proud to say that our investment program has become diverse enough that we can shift things around so that the reduction in one area can be compensated by redirecting funds into others. Upgrade Buildings and Optimize Apartments together combined in 2019 will probably only be slightly below the 2018 levels but with increasing volumes in new construction and also more investments in Sweden, we do not expect to see material impact on our overall KPIs.

The next page 19 is a very important one and a little bit more complex. You know, our basic business used to be and will be to manage residential apartments, to collect rents and to develop actually value-add business on top of it. While we have started the new construction inside Vonovia and especially after the acquisition of BUWOG we've now a new value generating activity which is actually by building buildings and generating an EBITDA which is the delta of the cost of construction and the value of the market building.

On the other hand, we had always in Vonovia and we know also getting from BUWOG business which was not properly or was not explicitly enough reported, which is generating a significant cash flow for our business which is the selling business of roughly 2,000 apartments per year. This also adds values.

As the run rate of new constructions and recurring sales should be broadly similar around 2,000 units per year, you have a very stable model that plays the full residential real estate life cycle. In terms of earnings, we have the EBITDA Operations from the rental portfolio (rental EBITDA plus Value-add EBITDA). But we also have value generation in Development to hold as our development costs are below the fair market value. And finally we have recurring sales where we make a profit by selling to our retail customers above the fair market value.

From an NAV perspective, the three value creation phases are: 1: In development where the average spread between fair market value and development cost have been between 15 and 20%. 2: Once included in the rental portfolio value growth comes from rent growth and of course investments. For the Vonovia portfolio that number has been around 4.5 % per year since the IPO. 3: And towards the end of value chain we have retail sales to capture the spread between discounted rental values and retail pricing.

Helene von Roeder

So why are we so confident to call recurring sales recurring sales? In order to run a long-term business model on the pillars Rolf described on page 19, you need sufficient potential for recurring sales. Our track record which we analyzed should give a certain comfort level that we are indeed able to execute at least 2,000 individual retail sales per year because we have done just that over the last almost 10 years.

I think there is one important difference between our recurring sales channel and other real estate sales channels in other real estate sectors. Our recurring sales business does not hinge on volatile real estate cycles or asset clusters that make or break the sales success of any given year. Rather, the granularity of this business gives enormous stability because our annual sales result does not depend on being able to sell a certain landmark asset or a specific, meaningful part of the portfolio.

On page 21, we describe the fresh look of the performance metrics. Given the evolution of the business and the value creation across the full life cycle that Rolf has just described we feel that valuing Vonovia on an FFO1 basis alone falls short of our earnings growth potential, cash flow generation potential and value creation potential.

By comparison, the contribution from the recurring sales segment and the development segment are considerably smaller than the EBITDA Operations generated by the rental and value add segment. But to completely ignore them in an earnings or FFO-based view of the company seems unfair. However, that is exactly what happens if you look at FFO1. That is why we have decided to look at each of the four segments individually and in aggregate on an EBITDA level. That is how we actually manage the business, and that is how we will be reporting on our business performance from 2019 onwards.

EBITDA per segment is what we internally use to steer these businesses and we want to reflect the same methodology in our external communication. As we finance on a group level and actually not individual projects, we will be deducting the interest expense as one aggregate amount from the total EBITDA; and the same goes for taxes. Any allocation by whatever method would be arbitrary.

So, Total EBITDA captures the full earnings potential of Vonovia. And that includes non-cash elements such as the spread between fair value and development costs we will be adjusting for this and other non-cash effects in the consolidation line to get to Group FFO. This FFO will be the yardstick for our dividend capacity as it reflects the sustainable cash flow profits generated across the different business segments.

On page 22, we show you a bridge between the 2018 FFO 1 guidance and the 2019 guidance for the Group FFO. In 2019, the dividend capacity is expected to be about €100 million Euros higher than in 2018.

I would like to say a few words on the so-called Customer First program element that we have included with €20 million. This to be seen as a clear sign of our strong commitment that we view customer satisfaction as a bedrock of our business model. We want to do even more to make sure that our customers and their individual needs are properly dealt with. So this program includes inter alia, additional personnel to deal with hardship cases, funds for better communication on a local level, and several additional measures improving our face to the customers.

So with that, and is the first time in the new structure our guidance for 2019, which you will see on page 23.

As you can see we have eliminated a few items because frankly we feel that –at least for the time being- guidance on vacancy rates or non-core sales figures has become not very meaningful because neither is a real performance driver at this very point. Even this somewhat shorter guidance is still rather comprehensive compared with the peer group and also with other industries. We have introduced guidance on Total EBITDA and Group FFO, which replaces the FFO 1 guidance. The target payout ratio of 70% remains unchanged.

Finally on page 24, we are giving you guidance for the old FFO 1 logic in 2019. As a hope, I've been able to make clear we believe that FFO 1 as an insufficient metric to look at, and that is why we will not continue reporting it.

We did feel however that in this phase of transition we need to also show how the business would evolve if we were to look at it on an FFO 1 level only.

Adjusted for portfolio effects from acquisitions and sales, we're expecting a 7.5% growth of FFO 1 in 2019. Now we are aware that the current consensus is roughly €50 million above that. I think there's a few items we would like you to look at in order to understand the discrepancy. One is, as I mentioned, the customer first program was approximately €20 million and we do have a maintenance cost inflation which we account for as roughly €12 million and we are doing a BUWOG portfolio restructuring where we optimize that portfolio which will bring us €15 million of less rental income. So with that, back to Rolf for the wrap up.

Rolf Buch

Okay. Thank you, Helene. So operating business to continue to be very strong and we are very positive for the year 2018 and as you have seen also for the year 2019. Investment volume will grow and you'll see a shift towards more construction and more optimize apartment and away from upgrade building. Market fundamentals remain very attractive as you have seen as evidenced in the H2 valuation, and the new performance KPIs will better reflect Vonovia, full earnings growth, and cash flow generation capacity, and value creation potential.

And with this, I think we are ready for questions.

QUESTION AND ANSWER SECTION

Operator

First question is from Thomas Neuhold, Kepler Cheuvreux.

Thomas Neuhold

Good afternoon, ladies and gentlemen. Thank you very much for taking my questions. I have several ones and I think it's best if you take them one by one. Firstly on the new guidance, thank you very much for the detailed FFO bridge, that's very helpful. I was just wondering if I compare slides 22 to 24, I see that you expect an EBITDA contribution from recurring sales and development of €130 million to €160 million in 2019, but the net effect on the Group FFO is only €30 million -- €60 million. So there seems to be a €100 million of burden by the cash interest payments, taxes or consolidation. I was wondering if you can give us some details here why you have such a big hit on the bottom line here in this sales and development business.

Helene von Roeder

Yes, indeed. Those are non-cash effects because as we explained to you, we are looking at the development business as a standalone business, where we have development to sell and development to hold. The development to hold business what we will be doing is we will take the cost of construction, and then if and when the building is finished and sort of sold to the operating basis, we will sort of like find the difference between the then market value and the cost of construction. Now clearly that’s an development profit because the development segment is generating that value, however if we look at an aggregated balance sheet that is only an NAV effect and not a cash effect for Vonovia overall. But we've decided to do it that way, because that's the only way we are steering development as a standalone segment and how we look at its standalone profitability and are able to measure development on that basis.

Thomas Neuhold

Okay, understood, thank you. And the next question is regarding slide 19, the construction of units you have 2,000 units to hold and 2,000 recurring sales planned going forward. I was just wondering are these figures including or excluding BUWOG and maybe you can also give us some figures, what is the contribution of BUWOG in terms of units to hold, developed units which will be sold in 2019 and 2020, if you can?

Rolf Buch

So 2020 is of course a little bit more difficult, but we have done as we announced before, we looked on this BUWOG development pipeline and we have shifted some of the pipeline from development to sell to development to hold. So in the moment, our run rate for 2019 will be roughly 2,900 units which we will built to hold, and this includes the part of the originally Vonovia apartments and then the BUWOG apartments, and we are assuming that we are selling around 2,000. So for 2019 we will increase a little bit the portfolio, but in this slide we wanted to mention to use a long-term perspective and this is actually to build 2,000 and to sell 2,000. So apart of the 2,900, a significant part is coming from BUWOG. Vonovia’s old standalone long-term target was 2,000. So let's say half of the 2,900 are coming from BUWOG roughly and half is coming from Vonovia.

Thomas Neuhold

Okay. Just a final question here. So you build and sell 2,000 from BUWOG and the 2,000 units to retail customers you mentioned on page 19 that is out of your current existing Vonovia portfolio?

Rolf Buch

And the BUWOG portfolio...

...these are actually the apartments which have an individual land register. So because only then you can sell individual apartments. We have enough for the next 10 years. This is a run rate so that's why we're saying recurring in 10 years and probably our successors have to decide if they split additional buildings, which of course is possible to generate more uplift. So your question might be why you are not selling faster than 2,000? We feel that 2,000 is a magnitude in Germany, which the market can adapt. If you would speed up significantly, this will have an impact on the price.

Thomas Neuhold

Okay, understood. Thank you. The next question is then on cost inflation. Some of your peers are claiming that for some cost items, they see substantial cost inflation, 5% to 7%. I was just wondering if you could share with us what you currently see for key cost items in your business?

Rolf Buch

It is right that we see cost inflation in construction cost index by above 5%. So I don't want to debate it between 5% or 6%. So it's definitely above 5%. You see that we have actually shown in the slide and Helene told you, what happens actually within maintenance, an increase of 1.5 to 2 % which we cannot compensate. So in the end, we see also the 5%, but we think we will probably compensate above 3% but we are not able to compensate everything and that’s why you see the deviation in the maintenance and the bridge.

Thomas Neuhold

Okay, thank you. My last question is on financing cost and financing strategy. We have seen recently an increase in the bond spreads. So I was just wondering if you can give us an update on the various sources of financing: bonds, bank debt, what kind of financing costs you would see for typically debt maturing, of 8 years to 10 years currently and what you think that the difference would be at the moment for mortgage financing and then bond financing?

Helene von Roeder

Yeah, I mean as you rightly pointed out, we've seen spreads widening, you will have probably also observed also Vonovia spreads were nearly doubled out of that from a very, very, very low base, so nothing to be materially worried about. If I sort of look at the available financing instruments to me clearly given that Mario Draghi is slowly stepping out of the market, it means that the Eurobond arbitrage, let's call it like that its maybe not as attractive as it has been, and especially on the long-term financing we are seeing a delta of up to 60 basis points for 10 year between a Eurobond and a secured financing. I think that shows it all and in terms of that we will be very opportunistic or which instruments we will use aiming to achieve the best optimal financing mix clearly you will understand that I'm not committing to one way or another.

Thomas Neuhold

Yeah, thank you very much.

Operator:

Next question we received is from Sander Bunck, Barclays.

Sander Bunck

Hi, afternoon everyone. I got a couple of questions as well. And I also will do them one by one. First one is on your comment that you're changing some of the energy efficient measures because it's some people have struggled to afford that and you are able to replace that with investments in senior homes et cetera. Can you just give us a bit of a feeling on the returns you're getting there, are these probably similar and is the pool of opportunities within the portfolio deep enough to stay in this program also in the longer term.

Rolf Buch

So definitely it is deep enough. What we – when we stick with the 7%, what you see is actually is an Optimize Apartment and slightly higher profitability than the average. The new construction has the initial profitability of the new construction, so a little bit lower than average, but then you are gaining significant rent levels over the next years, so and of course there's enough and again, we are not stopping the energetic modernization of the buildings, we're just taking out some big modernizations, which is probably one third, because this is more than two Euros.

We are in heavily debates with the politicians and that is not a long term sustainable way in Germany. We have to find ways how we also can do the energetic modernization in the big scale; there are building that need big energetic modernizations and I think we will come up or the politicians and together with the big market leaders in the market, we will come up with a new solution how to redesign the KfW programs, it's just a fact that today our tenants are not able and not willing anymore to accept rent increases significantly above €2 and that's why we still believe that customer’s satisfaction is an important part and that's why we've taken the decision. On the long term we have to find other ways how we get energetic modernization because without energetic modernization of the buildings Germany will fail its climate target for 2030 and 2050, which is not an alternative, because it will cost an enormous amount of money – for the German state to pay to the European Commission.

Sander Bunck

Sure, okay. And therefore it is fair to assume that with the knowledge you have today based on energy efficiency programs and regulations that the 4.5% like-for-like – growth is also sustainable in the future?

Rolf Buch

Yes, that's definitely the case.

Sander Bunck

Perfect. Then two questions on your guidance. The first one is how much of new construction do you currently include in your guidance, and kind of what are your assumptions here in terms of how much are you delivering and how much do they contribute to rental growth? And also how much disposals in terms of million euros, and also how much development to sell in million euros is currently included in the guidance for the Group FFO basis?

Helene von Roeder

I think we will need to dig out these exact numbers for you. There is nothing that we can deliver to you off the cuff at this point in time if that's okay.

Sander Bunck

Okay. But at the same time it's quite important right because it's part of the new kind of disclosure announced today that you're splitting the segments. So therefore, the question whether you can like kind of assign numbers to the various categories where you're going to deliver adjusted EBITDA.

Helene von Roeder

Yeah, but we don't guide on development on a singular basis. So I think ultimately the key number to look at is the €1.3 billion to €1.6 billion of investments. But the clear answer of the same sustainable margins on the back of that.

Sander Bunck

Okay, fine. I put the question slightly differently, if I compare your FFO1 for next year the guidance or the group FFO for next year, the difference I think is mainly going to be sales and developments. And just looking at that you kind of currently expect from the midpoints, the FFO to increase by broadly €45 million, which leads me to think that this is broadly mainly from privatization sales going forward. So is it a fair assumption, is it mainly privatization sales that you're currently assuming for your group FFO next year or bigger –which would actually mean that it will be slightly lower compared to this year or does it also include developments?

Helene von Roeder

Yes. Good spot. The interesting business like with the acquisition of BUWOG, we had to revalue all of the entire pipeline that BUWOG currently has in construction in our PPA. So that means that like the current construction that BUWOG has on its book as – at the point in time when we purchased it are already a sort of like in our numbers. So hence 2019 is going to be a pretty skimpy year for development, but more for a technical reason than for the reason that development doesn't produce value.

Sander Bunck

Okay. So is a depressed number and should therefore the €45 million midpoint should be actually quite a lot higher going into 2020?

Helene von Roeder

We would expect so, indeed. It's just the technical effect of the fact that the numbers have been good at fair market value at the point of acquisition.

Sander Bunck

Okay, that's extremely useful. Thank you. And then the last one and this is kind of touching on your external acquisition strategy. The good thing is that you today reported a very strong revaluation going into FY 2018. The more difficult that is actually it means you're currently trading at discount to NAV, I think? And at the same time, you just mentioned that your financing costs are increasing as well, and how are you looking at your acquisition strategy going forward given that your cost of capital both from the equity point of view as well from your debt point-of-view is actually increasing?

Rolf Buch

So it's clear, as long as we are trading below NAV, we have to buy below NAV, and if nobody is selling below NAV, then we are not buying, so very simple. These are the mechanisms for acquisitions I think, that is also a good news. If we think that especially in some simple portfolios which we see trading in the German market are from our feeling very expensive, so that's why we should not buy. And the opposite in Sweden where we still see portfolios which are available for reasonable prices especially from the one million apartment program. And so we are optimistic to acquire but we don't need to acquire if the prices are too high. And that's why the rule is the rule and NAV accretion is a rule which we respect also in the future.

Sander Bunck

Okay. I think, Victoria Park on a standing NAV basis you paid a premium and on the forward-looking NAV it was of course a – it was a discount, how do you quantify that, how do you look at that? Does it need to be at a discount today or does it need to be at a discount in the future, any potential acquisitions?

Rolf Buch

So as potential acquisition has to be NAV accretive in the first full year for consolidation.

Sander Bunck

Perfect, that's very clear. Thanks, guys.

Operator

Thank you. Next we received is from Valerie Guezi-Jacob from Exane BNP Paribas.

Valerie Guezi

Hello. Good afternoon. So a couple of questions from me. The first one is, your organic growth guidance for next year is 4.5%. And earlier this year you said that the run rate you're aiming to achieve is 5%. So I was just wondering if this is the 2019 and 2018 actually guidance and if you are still aiming for a 5% or if given cost and regulation which will expect something to that 4.5%?

Rolf Buch

So I would say long-term it is the figure between 4.5% and 5%.

Valerie Guezi

Okay, thank you. And my second question, I mean you've already described about it, but I just want to make sure that I understood correctly, what you said is that on the development to own, you're not going to take any profit at the EBITDA level, is it correct or?

Helene von Roeder

No that's incorrect. At the developmental-to-hold, we will be looking at the EBITDA like we would be looking at a standalone developer. And that means that we will sort of like look at the development EBITDA on the to hold level as the developer is creating a profit between the construction costs and the fair market value of the asset at the point in time when it's quote unquote sold into the operations.

That's a non-cash item we all agree which is why we deduct it when we get to the group FFO. But to be fair to the developer and in order to be able to see the value that the developer creates for the company, we have decided that this is really the only way to look at this.

Rolf Buch

To be also very clear to manage the business, I think in the interest of Vonovia that we develop as most as possible development-to-hold because as you can see on the slide with development-to-hold, we do not only generate value between the construction costs as the fair market value. But over the years where we operate it, we will generate additional value and then potentially we can sell it in the individual apartment. So it is our interest to motivate the development people to develop for hold. That's why we have to treat the development for hold not worse than the development-to-sell. That's why we have to measure them on an EBITDA independent to hold or sell and that's why I see this is a must for the management KPIs. And as you know, we have to use the management KPIs also for reporting.

Valerie Guezi

Okay, that's very clear. So just one very detailed question, but are you going to use IFRS 15? I mean are you going to book the development as soon as you start the construction or are you going to book it when you sell the flats?

Helene von Roeder

So there is a difference between to-sell and to-hold. IFRS 15 is applicable to the development-to-sell whereas the development-to-hold has the accounting that we just described. So simply the delta between the fair market value and the construction costs. It's not easy, I'm really sorry.

Valerie Guezi

Thank you. Thank you very much.

Operator

Next question we received is from Christopher Fremantle, Morgan Stanley.

Christopher Fremantle

Hi, good afternoon. I just wanted to follow up on the CapEx point in the development activity, the CapEx that you're spending in particular. The way you talk about the like-for-like rental growth suggests that around 3 percentage points of your rental growth is CapEx driven. In euro million terms versus your €1.9 billion of rental income, that to me equates to about €50 million to €60 million of rental income from CapEx driven measures. On the basis of €1 billion of CapEx that you spend in 2018, that strikes me as a relatively low yield on CapEx. Is there something that I'm missing there or is that the sort of yield on CapEx, the rental yield on your CapEx that we should expect? I appreciate there are different sorts of CapEx with different yields attached, but in the round if you could help us understand that figure please because it clearly drives the value creation from the CapEx that you are intending to spend? Thank you.

Rolf Buch

I think what you are doing is actually you're saying the CapEx of €1 billion should lead exactly to the rent increase in the next year. And I know in the beginning Stefan always has explained it. Today, of course part of the CapEx leads to rent increase in the year this CapEx is done, this is for example for optimized apartment, and some is leading actually to rent increase even more than 12 months ago. So for example, the rent increase which will – so there is a CapEx which we're doing in November and December will probably lead to rent increase in January 2020. So that's why you base as your core calculation is a little bit too simple and that's why a bit more too simple to answer. So in the end if you look project-by-project, we are delivering as the initial 7% yield, keeping in mind that in new constructions the beginning is a little bit lower but later it'll be significant higher. So you know in internally as we have said I think Q2 reporting, we manage the business not only on static yield, but on IRR, which is higher than 7%.

Christopher Fremantle

Okay. Thank you.

Operator

The next question received is from Jason Ball, ING.

Jason Ball

Yeah. Thanks for taking the question. Just also on the CapEx program and the regulation, my understanding is that a two-year old cap came as quite a surprise. So can you just give us some context for how you are able to take such a seemingly large decision around the modification of the program so quickly, and how sustainable should we see this level of investment going forward? And then, second also on regulation, and it seems like the Mietspiegel period could still be extended from two to three years next year. Just curious, if you have any sort of updated views on the expectation of that actually happening, is that something we should prepare ourselves for as well? And do you kind of contemplate that in your longer term like-for-like guidance? Thanks.

Rolf Buch

So first of all, to be concrete, we don't have a longer term like-for-like guidance we have just a corridor and it is wide enough to compensate for this. And – but anyhow, I think the two years to three years, it is probably a little bit going back. I think in the legislation that has just passed first this should have been a part of this legislation but that didn't happen, so we don't think that we will see early next year a new legislation, of course to be clear all legislation purposes depend very much on tomorrow, this depends on who will be the leader of the CDU and who will be the new Chancellor. So if Merz will win, the situation will be complete different if others will win, so I think there is an uncertainty in the legislation process in this moment. Of course, if Merz will win, the situation for companies like us will be significant much better and improving. To tell you just about the €2. I was not surprised about the €2, we were in direct contact over the whole period. There was a lot of debates coming from the rumor in the population saying rental increase is too big, the modernization impact is too significant for our rent, which was in a few years ago two years ago it was actually not an issue for the people because they got the modernization they have an alternative in the big cities and they could find an alternative apartment because it takes a while not more than a year. The situation is completely blocked today, so somebody who is forced to get out of his apartment do not have any alternative to find and that's why I think the climate in Germany changed and that's why politicians took this and saying we're not using the €3 but we are discussing to reduce it. So then as you know they reduce the €2 to all rent below €7 and €3 for all rent above €7. So we are applying now the €2 for a very simple analytics because we have looked in all our modernizations and we have seen that all modernizations below €2 and actually do not generate significant or even no kickback and we have seen that this rental increases close to €3 as a push-back from the tenant were significant. So that's why we came to the conclusion, independent from the politicians, to actually the €2 and that's why we decided to apply the 2 euros. Of course, during the whole process, we were in discussions with the politicians, so there might be a correlation between the legislation and our decision which we had prepared in the summer maybe.

Jason Ball

Okay. Thanks. That's good context. And so, just to be clear though the – so €1.3 billion is now at the low end of the range. I mean, should we expect that kind of investments can continue for the next couple of years or is this a bit of a re-juggling in the pipeline bring forward some things that are now possible. I mean, how should we think about your spending going forward?

Rolf Buch

No. I think, you could – should assume €1.3 billion to €1.6 billion. This big corridor was actually related because it was a new construction. We always have this construction permission issue and that's why we think it is better to have a wider corridor. So in the end, the €300 million adding is more or less coming from BUWOG. So you take the old €1 billion which was always our guidance to keep the €1 billion and add 300 and then, you have the €1.3 billion NAV potential up to €1.6 billion, but I think it's a fair assumption to assume that we are spending between €1.3 billion and €1.6 billion in the next years.

Jason Ball

Yeah. Okay. Thank you.

Operator

Next question we received is from Manuel Martin, ODDO BHF.

Manuel Martin

Thank you, ladies and gentlemen. Three questions. Maybe go one-by-one through them. First question is also on your investment program, your shift from energy efficient modernization to more affordable housing. Does it change your yield expectations in the program? I think it was something like 8% in average. That's the first question.

Rolf Buch

We are not shifting from energetic modernization to affordable housing, we are shifting from energetic modernization to Optimize Apartments, we're shifting from energetic modernization a little bit to Sweden and we are shifting from energetic modernization to new construction. So we complete for hold in the BUWOG portfolio and the yield which we got from the energetic modernization is actually lower than what we get from Optimize Apartment, it is lower than what we get from Sweden, but it is slightly higher than the initial static yield from new construction. That's why for new construction the static yield is probably not the best measure point because you get a building where you see significant rent increases in the next years. Then you see lower maintenance in the first years, so that's why overall we are coming up with the same static yield. Having said this we think that the static yield is getting more and more complex to measure our program, that's why we've shifted internally to an IRR, which is above 7%, more close to 8%.

Manuel Martin

Okay. Okay. So no material change in that regard.

Rolf Buch

No, no new change, so there is no material change.

Manuel Martin

Second question to come back again to the new FFO guidance and you know it might be complicated, is it possible to give indication of how much FFO does BUWOG contribute in your 2019 FFO guidance.

Helene von Roeder

Actually because you know, we are including German BUWOG portfolio into our German Vonovia portfolio and in order to get the scale effect, and then we have the BUWOG Austrian portfolio, it is virtually impossible to split BUWOG out in 2019.

Rolf Buch

Also to be very clear, what happens, we have sold 13,000 units this year, which will have a negative impact of our rental growth of our top line. We are just in the process of selling a part of the German BUWOG portfolio, so this will also have a significant impact as Helene mentioned before and then of course, we've got a full year effect of BUWOG and these all together had actually had an impact, so it's not only positive effect from BUWOG or Victoria Park, but also negative effect from the disposal which will end in the next year, because we are not doing additional disposals. And again, as we own BUWOG and the company does not exist anymore, so that's why we don't have BUWOG figures. Squeeze-out is signed and closed and BUWOG will be integrated on January 1, 2019 so, there is no BUWOG left.

Manuel Martin

Okay. Last question on your European expansion, we learn that you focus on four countries, question for understanding, I miss the UK market although there is a built to rent initiative, is there any reason why you still shy away from the UK market?

Rolf Buch

So, to be very clear, first of all, the UK market for obvious reasons, I think for us it is too early to go to the UK, get currency risk or Brexit risk obvious reasons why we are shying away from the UK and also to be very clear, we do not have four countries with the same priority. We are in Austria, we are the market leader in Austria, so this is more or less a stable business where we don't have any further activity to be bigger as the normal business, of course we will do acquisition like we do in Germany. We have BUWOG or Vonovia today in Austria has the same market positions and in Germany except that there is no number two in Austria, so we are the only one. We have said that in France, we are developing for us very long term, because we have to wait until the legislation is changing and I don't see it as very probable with this legislation change very soon, but you never know. But as long as the legislation has not changed, we cannot invest in France, but we are preparing because this market is enormous.

And then we have Netherlands, where we are saying this is the interesting market, but we are actively not pursuing Netherlands in the moment, because we want to focus on Sweden. So in the end Vonovia today is Germany and Austria stable markets, market leader and in Sweden, we're investing our efforts and our concentrating to show that we are able to replicate our business model which we have executed in Germany since 2013 in Sweden. I have no idea what happens in the UK, but also we have decided in Sweden, because of the similarity of the buildings, similarity of the rental regulation, it's much closer to Germany and that's why we prefer it in comparison to all other markets.

Manuel Martin

Okay. Thank you. That's clear.

Operator

Next question we received is from Jonathan Kownator, Goldman Sachs.

Jonathan Kownator

Hi, thank you very much. Three questions if I may. In your like-for-like guidance of 1.5% is obviously space creation there, are you able to give us the contribution from that, in considering the fact that you said that you will increase your investments into Space Creation, that's first question. Second question, can you perhaps elaborate on your guidance that you're giving on FFO and group FFO, what is the contribution of the Value-add business and if you expect this business to continue growing at the sort of 20% rate, it's been growing at. Previously, particularly given ambitions that you're highlighting in your getting the contribution from energy going forward. And the third question, so you're talking about 2,000 units for disposals which has been in line with actually slightly lower than your previous level of recurring sales. How about the contribution from BUWOG build to sell. Are you expecting to continue that plan or actually are you expecting to discontinue that BUWOG build to sell line and actually do only build to rent? Thank you.

Rolf Buch

Start with the last point first. The 2,000 you're right, it's below what we have done. There's probably some room for improvement. I think we want to make sure that we optimize the prize and not the volume. So of course, we are not refusing if people are coming to us and want to buy more individual apartments, of course we are not refusing to sell. But I think we are happy with the 2,000 there might be some upside potentials. The 2,000 does not include the development to sell business of BUWOG and this includes actually buildings and apartments which we have owned for years, which we are now privatizing because we have no additional value generation potential left. And because we have a single land register for that apartment. So, does this answer your first question.

Your second for the value-add. You took 20%, I always said, it's €20 million. 20% on top of €100 million is €120 million. 20% of €120 million is a little bit different than €20 million and this will be very significant different if we are at €200 million in value-add in a few years. So I think, it is fair to say, €20 million for the value-add business is a fine number, and which of course by definition does not include a lot of energy. This is a long-term perspective and this is all a very long-term business value. This is nothing where you can expect a significant surprises from one year to the other. So you will see us developing the energy business on the long-term, nothing we have seen on the slide we have shown you, and that we have the significant potentials in all parameters.

Your last question was construction. And so you see on page – I think, it's page 5, you see actually a split in the tendency for what we think will be the impact of the different parameters. Again, not disclosing exact figures at this moment of time.

Jonathan Kownator

Okay. If I may come back to the build to sell from BUWOG, so what contribution should we expect from that business and do you think that obviously is not including in your FFO guidance from 2019 for – on the discussion previously, so what should we expect there?

Rolf Buch

So this is nothing that we are guiding but this is nothing that is meaningful changing the view on Vonovia.

Jonathan Kownator

Okay. All right, fair enough. Thank you.

Operator

Next question we received is from Tom Carstairs, Commerzbank.

Tom Carstairs

Yeah. Hi. I was wondering could you give us some indication of the split of the €350 million to €380 million valuation uplift that you expect in H2 between Victoria Park and BUWOG?

Rolf Buch

There is a press release from Victoria Park coming out yesterday. I don't know if they have released it, if not we're not definitely not going to release it because Victoria Park is a listed company.

Tom Carstairs

Okay.

Rolf Buch

Is your question answered?

Tom Carstairs

As much as it will be.

Helene von Roeder

We're just checking the press release for what it’s worth.

Rolf Buch

Really. But I think we have to keep governance here. In this call, we cannot disclose indirectly Victoria Park figures, specifically not.

Rene Hoffmann

We can talk about it on a reported basis at the year-end but looking ahead we simply can't Tom.

Tom Carstairs

That's fine. Thank you.

Operator

As far as there are no further questions, I'd like to hand back to the speakers.

Rolf Buch

Tom, last remark that I can say at Vonovia we will be achieving our targets of FFO and NAV accretion in the Victoria Park acquisition. So, this is probably a hint which can I can say. Okay. So if there're no further questions, then I'm happy to say thank you. Some of you I will see before Christmas and those who I will not I wish you all a Merry Christmas.

Rene Hoffmann

Thanks also from my side and everybody else on the team for joining this call. As a reminder, full year 2018 results will come out on March 7, next year. So we'll be on the road, quite a bit. And until then and I hope that we'll speak one occasion or the other before. As always, feel free to reach out to me or the team with any questions or comments you have. That's it for today from my side. From our side also, Merry Christmas and a Happy New Year to those we don't see and speak again soon. Have a great day. Thanks.

Operator

Dear, ladies and gentlemen, thank you for your attendance. And this call has been concluded. You may disconnect.