OUR CONTRIBUTION TO THE CURRENT DEBATE

Germany's housing industry is facing considerable challenges. This is one reason why housing is part of the current political and public debate. The continuing high demand for housing, demographic trends and migration to, but also and in particular within, Germany are resulting in a sustained **shortage of homes** in the country's urban areas, a problem that can only be solved by building new properties.

Age structures within our society are also shifting: By 2030, around three million senior-friendly apartments will be required in Germany. In addition, there is still considerable renovation work to do in order to make the country's buildings more environmentally friendly. However, in the conflict between climate targets and tenant interests, a balance has to be struck. The energy revolution will only be successful if modernization does not come at the expense of affordable rents.

At the same time, there is a special responsibility for ensuring social cohesion within neighborhoods. This once again involves implementing contemporary developments and innovations in the housing industry. These include, for example, progress made in digitization and sustainable mobility concepts.

Developing solutions to tackle these problems is a joint undertaking for policymakers, administrative agencies and the real estate industry. The Association of German Housing and Real Estate Companies (GdW) estimates that tackling the challenges that lie ahead will cost around € 800 billion between now and 2030. These funds cannot be provided by the government alone, but will require private funds to also be contributed by stock corporations with strong capital resources. As a socially responsible company, Vonovia is rising to these challenges and sees itself as an **active player in the quest to find solutions.** The company is a pioneer in modular construction, allowing it to create affordable homes in sought-after locations. Hand-in-hand with policymakers and local players, Vonovia is forging ahead with integrated neighborhood development across Germany. The company financed an endowed professorship at EBZ Business School in 2018 in order to ensure more in-depth research into the important role that neighborhoods play. At the same time, the first steps towards energy-neutral neighborhoods are being taken with photovoltaic facilities, electromobility (Open District Hub), car sharing offers and electric vehicle charging stations.

In order to contribute to the public debate and help resolve the challenges facing us, we have started by providing an overview of the key facts in the interest of solution-oriented discourse.

Who Owns the Apartments?

Housing is not a conventional product, but a basic need. As a result, it deserves our particular attention and protection. According to the latest estimates from the Federal Statistical Office, at least 42 million apartments are on offer for approx. 83 million people. At the time of the last microcensus (2014), the nationwide proportion of owner-occupied apartments came to around 45.5%, with rented apartments accounting for around 54.5%. The proportion of rented apartments tends to be even higher in urban regions. The vast majority of these apartments are made available by private, small-scale providers. In addition, the German real estate market features cooperative, municipal, public-sector and church landlords, as well as private-sector professional landlords such as Vonovia. According to the GdW, the latter provided a combined total of around 4.2 million apartments at the time of the microcensus. Vonovia rents out a total of around 358,000 apartments in Germany as of March 31, 2019. This corresponds to less than 2% of the total number of rented apartments in Germany. This means that Vonovia is a long way off a position that could be described in any way as **market control.** Vonovia cannot, however, rise to the challenge that lies in creating/providing affordable homes on its own; it can only do so by working in collaboration with partners, policymakers and administrative agencies. Nevertheless, as Germany's largest private-sector landlord, the company is aware of the particular significance of the housing issue and assumes a particular responsibility when it comes to finding solutions that are in the interests of tenants, society at large and the environment. With an average rent of € 6.52/m² and around 41,500 apartments that are subject to rent restrictions, Vonovia still sees itself as a provider of affordable homes.

Conflict Between Climate Protection and Affordable Housing

Germany's housing stock has a significant influence on greenhouse gas emissions, accounting for around 35% of the final energy consumption. The commitment made by the Federal Republic of Germany under the United Nations Paris Agreement on climate change can only be realized by carrying out substantial energy-efficient modernization work on portfolio properties. The current renovation rate in Germany stands at around 1%, considerably lower than the political target of 2%. The **Paris Climate Change Agreement** aims for building stock to be virtually climate neutral by 2050. Vonovia achieved a **renovation rate of around 5%** in 2018. The company invested around € 1 billion in upgrading buildings and new construction (2017: € 0.8 billion), and plans to invest a total of between € 1.3 billion and € 1.6 billion in 2019.

This does, however, give rise to a conflict between two social objectives: climate protection versus affordable housing. At the moment, these two objectives appear to be diametrically opposed to each other. We need an honest debate in Germany on how to **distribute the costs associated with climate protection** fairly, the aim being to define who has to make what contribution to protecting our climate. The following questions affecting society as a whole need to be answered at the very least:

> How are CO_2 savings to be achieved?
> What is the most effective way of saving CO_2 in an ecosystem, be it a city or a neighborhood?
> Who should bear the burden?
> What should the state do to promote this process in a meaningful manner?

Vonovia's roots and those of its predecessor companies extend back to the 19th century and lie in not-for-profit housing and housing for factory workers in Germany's Ruhr region. Many of the housing developments built in that era were model projects of the time and are now covered by preservation orders. As part of the politically motivated **trend toward privatization and liberalization within the residential property market,** public-sector and private-sector employers started to withdraw from the management of company-owned apartments, but also left behind a **housing stock with a considerable need for maintenance and modernization.** The German housing market as a whole underwent change. The age structure of Vonovia's approximately 358,000 German properties shows that around 69% were built between 1945 and 1980 and around 15% originate from the period before the

Second World War, while around 16% were built after 1980. Of these, only approximately 1% were built after the year 2000. Substantial investments are required in order to meet this need for maintenance and modernization and bring the apartments into line with contemporary living standards. The work that needs to be done to allow Germany to actually meet the climate protection targets is increased further by the valid energy efficiency regulations.

Expropriation Does Not Create New Homes

Demand for suitable and affordable homes in growing cities and regions is on the rise. Despite an increase in the number of completed developments, new construction is still lagging behind the demand for housing. Awareness of the **housing problem,** which is also reflected in rising home prices on both the rental and owner-occupied markets, has grown in recent years. The public debate is calling housing policy decisions into question, in particular, with criticism of what is seen as the passive role that policymakers continue to play.

This debate, along with people's understandable concerns that they might no longer be able to afford to move within the environment that they have come to call home, or to the neighborhood of their choice, has created a sense of injustice that pervades all sections of society and has also been voiced in public protests.

The initiative "Deutsche Wohnen & Co. enteignen – Spekulation bekämpfen" (Expropriate Deutsche Wohnen and its peers and combat speculation) has been launched in Berlin. It is aiming to achieve a referendum on the basis of which it wants the Senate of Berlin, the city's executive authority, to pass a law on "transferring land and residential property to public ownership to achieve socialization pursuant to Article 15 of the German constitution (Grundgesetz)". The law would affect "all companies striving to generate a profit, irrespective of their legal form, that hold apartments in a number above this threshold [of 3,000 apartments] in their portfolios (…)". The initiative wants these portfolios to become public property and to be managed by a new public agency "based on the majority democratic participation of the urban community, tenants and employees".

This would involve a three-step process: An application for a petition, requiring 20,000 valid signatures to be collected within a six-month period. The initiative started collecting signatures in April and is due to present them to the Senate authorities in June. The application is then expected to be assessed from a constitutional law perspective.

The second step would involve the petition for a referendum, requiring around 170,000 valid signatures to be collected within a four-month period. If the first two steps are completed successfully, this could then be followed by an actual referendum. The referendum process is similar to the process used in parliamentary elections. The proposal put forward in the petition would be put to a vote. The proposal is accepted if more than 50% of voters and more than 25% of the electorate vote in favor of it.

An initial expert opinion commissioned by the Senate Department for Urban Development and Housing in Berlin and prepared by attorney Dr. Reiner Geulen reaches the preliminary conclusion that expropriation appears unlikely as things stand at the moment: "[…] With regard to the referendum being sought on the socialization of major residential real estate portfolios, there is no need to reignite the sort of economic policy debates seen in the 1950s and 1960s on Article 15 of the GRUNDGESETZ. Socialization would, however, be inadmissible unless it is absolutely necessary; it is irrelevant whether this results from the inherent limitations set out in Article 15 GG or from Article 14 I GG. This means that legislation on socialization has to be assessed to determine whether the objective – the creation of appropriate housing – could also be achieved without socialization."

While this is the legal view, it is nevertheless crucial, first and foremost, that the concerns reflected in this initiative are taken extremely seriously, as they affect people's homes, a very emotional matter. It does, however, make sense to look at the debate from an objective standpoint.

Expropriation does not create new homes. On the contrary: The financial burdens on public-sector budgets would put undue pressure on future generations without combating the housing shortage. Expropriation would also send out dramatic signals for **Germany as a business location** and for the fundamental **socioeconomic order** in Germany.

Furthermore, this sort of "ideological trench warfare", as the German President Dr. Frank-Walter Steinmeier recently referred to it, is increasingly diverting the discussion away from effective potential solutions. An initial estimate puts the costs of expropriation at € 36 billion. These funds, which the city does not even have in this form, could be invested in education, infrastructure and new construction instead. **There is no alternative to the construction of new homes.** This is an area in which there is a lot of pent-up demand.

Four years ago, Vonovia started to build new homes, realize densification projects and add an additional floor to existing buildings where possible. The company has been accumulating experience, expertise and skills in this area ever since. Architects, engineers and craftsmen have been hired to ensure that the company has in-house construction and planning capacities. Serial construction, which involves entire modules being prefabricated in a factory and then merely assembled on site, reduces costs, construction times and inconvenience for residents. The development business acquired as part of the merger with BUWOG in 2018 expanded Vonovia's new construction program again, making it even more professional. For example, around 3,000 new apartments are to be completed in 2019 alone, some of which will also be eligible for public-sector subsidies, at a price of € 6.50/m².

This volume is not sufficient to counteract the market trends. The reasons why too little was built in the past and why too little is still being built today can be found at three levels: First of all, not enough land is earmarked for residential construction, the number of building permits granted is too low and whenever new construction projects do go ahead, the costs are too high, also due to the requirements imposed. This means that the formal prerequisites are simply not being met.

The second level relates to something known as the "not in my backyard" principle. Sought-after cities are becoming ever more densely populated. There are fewer open spaces available, and we are living in closer proximity to our neighbors. This process is one that entails huge changes for residents, many of whom have been living in a neighborhood for decades. Even if people are aware of the need for new homes, it is hard for them to accept these new homes being built on their doorsteps. This is an area in which more dialogue is required. Local policymakers often end up speaking out on behalf of the people already living in a neighborhood and not on behalf of the people who are in desperate need of these new homes. This ultimately means, however, that tenants in a poorer financial position are pushed out by higher earners or that they do not get the chance to move to a preferred area of the city in the first place. But diversity is important when it comes to shaping lively neighborhoods that are stable in the long run.

The third level relates to processes. Fast building permit procedures, type approvals and fewer requirements, for example when it comes to parking space regulations, could accelerate the process involved in building new apartments considerably.

Vonovia is Part of the Solution

The facts are as follows:

1. Business activities focus on **tenants** in their apartments and in their neighborhoods. Vonovia stands up for its customers as opposed to working against them. This means being available on site as a point of contact, offering transparency in terms of rent and ancillary expenses, performing forward-looking maintenance work, pursuing development measures in the surrounding environment and the neighborhood to improve quality of life as a whole and using energy-efficient modernization to promote climate protection as part of a future-oriented approach. Vonovia employs a total of 10,000 people, the majority of whom work in the local and central customer service centers and in the technical and residential environment organization.

2. Vonovia assumes responsibility for neighborhoods and gives people a home – including people who have lost their homes in their country of origin. Over the last three years, the company has rented around 8,000 apartments to refugees. In the process, Vonovia always seeks to ensure that housing communities and neighborhoods remain balanced and diverse. Integration is the responsibility of the housing industry and its success starts with a functioning neighborhood.

3. Market **rent increases** came to around 1.3% in 2018, compared with an inflation rate of 1.8%. The average increase in rent following modernization work came to € 1.50/m² in 2018. Vonovia has gone a step further than the statutory requirements by making a commitment not to implement any modernization projects that result in costs of more than € 2.00/m² being passed on to its customers. The company not only adheres to the overall statutory framework and the rent indices published by the municipalities and associations, but has also set up a hardship management system to ensure that nobody is "modernized out" of their apartment.

4. At the end of 2018, the German Tenants' Association (Deutscher Mieterbund) published the last **ancillary cost** survey for 2016, reporting a nationwide average of € 2.79/m² per month. Over the same period, ancillary expenses at Vonovia came to around € 2.61/m² per month, approximately 7% lower than the nationwide average calculated by the German Tenants' Association. The costs are even lower for services performed by Vonovia in-house. Vonovia provided building cleaning services, for example, at a cost that was around 16% lower than the average cost reported by the German Tenants' Association. Objections are raised in 5%, or 36,009, out of 714,192 ancillary expense statements, with 0.7%, or 5,145, ultimately being accepted and corresponding reimbursements being made. These also include cases in which it would not be cost-effective for Vonovia to pursue the matter further and in which the company opts not to initiate judicial proceedings or to resolve the dispute as a gesture of goodwill in the interests of maintaining a good relationship with its customers. It is our clear objective to reduce the error rate even further. Every mistake is one too many and should not be repeated. Around 35% of ancillary expenses are consumption-based, meaning that tenants influence them directly, and a further 24% or so result from insurance, taxes and levies. A further 36% is attributable to services that owners are/feel obliged to perform, e.g., the maintenance of technical facilities, compulsory public safety measures or measures to maintain the residential environment. The services that Vonovia performs itself, e.g., caretaking, residential environment and snow and ice-clearing services, are performed based on standard market conditions and are based both on the cost-effectiveness considerations that apply to ancillary costs and on the local ancillary cost surveys. Insourcing these services allows us to perform them using our own employees and maintain consistent quality standards.

The Group companies that are considered critical in this regard constitute an organizational insourcing instrument that allows similar activities by more than 10,000 employees within the Group to be bundled based on standard market transfer prices.

5. Vonovia also spent approximately € 430.4 million on maintenance (2017: € 346.2 million). This corresponds to € 17.72/m² of living area and represents an increase of 12.9% year-on-year (2017: € 15.70). This increase puts Vonovia's maintenance cost ratio above the average figure of € 15.84/m² published in the annual statistics released by the GdW on maintenance spending among its member companies for 2017.

6. In 2018, € 384 million was paid as a cash dividend. This corresponds more or less to the proceeds from the sale of individual apartments in the same year (income from disposals classed as Recurring Sales: € 356.1 million).

Origin and Appropriation of Profit

In the past fiscal year, Vonovia generated sustainable operating cash flow, in the form of the FFO 1, of € 1,064.7 million. € 1,006.0 million of this amount was invested back into the portfolio. The acquisition of BUWOG was debt-financed and the acquisition of Victoria Park was financed by the shareholders by way of a capital increase.

For the real estate industry, IFRS accounting generally shows higher results than accounting in accordance with the German Commercial Code (HGB). This is because HGB accounting does not involve performing property valuations and, in addition, deducts ongoing depreciation and amortization from the profit for the period, unlike IFRS. The HGB capitalization rules are also more restrictive.