

1ST HALF OF 2011

THE DEUTSCHE ANNINGTON REAL ESTATE GROUP

- German economy remains on expansion course
- Deutsche Annington continues positive development of business and remains unaffected by economic and financial crisis
- Property rental performance still at a high level
- Sales of apartments sharply increased
- Refinancing of Hallam securitisation transaction completed ahead of schedule, financial situation remains sound
- Market provides good conditions for further acquisitions



“We can be pleased with a successful first half of the year! The results show that we have managed to further improve our performance and efficiency in the past months: By redoubling our efforts, we have further reduced the vacancy rate. And our rental performance remained at a high level. At the same time, we increased the rent level by raising rents and through modernisation. The KPIs clearly show: our unconditional focus on our customers and the real estate is also increasing our earning power. We will also continue to systematically follow this path in the second half of the year.”

Overall Economic Development

Positive economic trend weakens slightly

The global economy got off to a very dynamic start this year. For example, the global economic climate indicator of the Institute for Economic Research at the University of Munich (ifo) increased slightly again. However, there is no uniform pattern of development in the different regions. Some emerging economies, in particular China and India, remain the powerhouses of the global economy. The International Monetary Fund (IMF) is expecting China's gross domestic product to grow by 9.6% and India's by 8.2% in 2011. The picture in the industrialised economies is heterogeneous. Whilst growth developed more positively than expected in the euro zone despite the challenges in Greece, Ireland, Spain, Portugal and Italy, the growth prospects of the USA and Japan are becoming more bleak. The IMF is expecting the global economy to grow by 4.3% in 2011.

Only the coming months will show how much the recent downgrading of the USA's credit rating will negatively impact the forecast developments. The concerted intervention of governments and central banks as well as the, on the whole, rather moderate reactions of the financial markets indicate that the economy will accept this revised rating without any major consequences. However, this presupposes that a chain reaction is not unleashed with the downgrading of other potential candidates such as France.

The situation on the European financial markets remained unstable in the first half of 2011. In addition to the continued uncertainty regarding the budget situation in Greece, Ireland and Portugal also had to be supported by the European bail-out package. Despite these measures, lasting confidence in the long-term creditworthiness and financial strength of the euro zone countries could not be sustained, which caused increased volatility across the board in the financial markets.

Nevertheless, the euro managed to remain stable against the US dollar, which was less due to greater confidence in the single currency than to the debt situation in the USA. In order to curb inflation in the euro zone which reached 2.7% in the first half of 2011 thus exceeding the European Central Bank's target of roughly 2.0%, the Central Bank increased the benchmark interest rate in two steps by 0.5 percentage points to 1.5%.

In Germany, price-adjusted gross domestic product (GDP) reached, according to the Federal Ministry of Economics and Technology (BMWi), the pre-crisis level of early 2008 in the first quarter of 2011. After exceptionally high growth in the first few months, the pace of expansion slowed in the second quarter, as expected. The momentum for growth shifted even more sharply to the domestic economy. It is characterised above all by continued brisk investment activity. Foreign trade also looks set to remain on track for expansion.

According to a forecast by the ifo institute, GDP will increase by 3.3% in Germany in 2011. The number of unemployed is set to fall by just under 300,000. In the coming year, the German economy should by and large maintain the pace of growth at which it ends 2011. It will therefore remain on the upswing.

Regional differences in rents and vacancy rates

According to the residential rent index regularly surveyed by the Hamburg research company, F+B, net rents in Germany have increased further. In the first quarter of 2011, rents under existing rental contracts rose by 0.7% compared with the previous year whilst rents under new contracts increased by 2.0%. According to the researchers, the reasons for this development are the continued positive economic prospects and the rise in the inflation rate.

Overall, there are great regional differences in the development of the residential rent index. The highest rent increases are to be seen in cities in the south of Germany and in the Rhine-Main region. With average monthly rents of € 11.60/sqm, Munich remains the most expensive rent market, followed by Unterschleißheim with € 10.10/sqm/month and Frankfurt am Main with € 9.70/sqm/month. The rents at these three locations increased by up to 1.8% compared with the previous year. The lowest residential rents are paid in the five new German states. Here the cheapest places to live are Staßfurt and Plauen where rents decreased by 1.0% compared with the previous year and the average monthly rent is € 4.10/sqm.

According to a forecast by GdW Bundesverband deutscher Wohnungs- und Immobilienunternehmen e.V., the vacancy rate will drop in 2011. The association is expecting the vacancy rate for the residential real estate companies it represents to decrease from 5.3% to 5.1%. Here the development in the "old" and "new" German states is likely to differ: in the "old" German states it will increase slightly by 0.1 percentage points to 3.0%. By contrast, it will probably decrease in the "new" German states by 0.3 percentage points to 8.0%. This trend has been seen since 2003 and is aided by the demolition of residential properties under the Urban Redevelopment East Programme (Stadtumbau Ost).

Housing prices increased

The prices for owner-occupied housing continued to rise according to the Association of German Pfandbrief Banks (vdp). In the first quarter of 2011, the prices for apartments and single-family houses increased by 3.3% and 2.9% respectively. At 1.8%, the price rise for multi-family houses was somewhat more moderate. Just as with the development of rents, the south German cities and above all Munich command the top purchase prices with an average price per square metre of € 3,580. The lowest purchase prices are fetched in towns of the "new" German states with Köthen bringing up the rear at € 660/sqm. The number of capital investors among apartment and house-buyers has risen significantly. According to the real estate and financial services provider, PlanetHome, it increased in the second quarter of 2011 by some 15 percentage points compared with the previous year to roughly 38% of sales. Given continued positive development of the economy, the vdp is expecting the demand for owner-occupied residential properties to remain stable. LBS, the building societies of the German savings banks, are anticipating rising demand for 2011 on a national average in all sub-markets with an average increase in prices of 3%.

Residential properties still in demand from investors

The demand for residential real estate portfolios has increased sharply in 2011 according to estimates of the experts at CB Richard Ellis (CBRE) and Jones Lang LaSalle (JLL). In the first quarter of this year, residential real estate portfolios with a volume of some € 1.45 billion changed hands; in the last quarter of 2010, the figure was only € 594 million. Residential real estate portfolios in Germany were again more interesting for foreign investors than in the previous quarters. JLL estimates their share of total sales for the first quarter of 2011 at 19% of completed acquisitions. In the first half of 2011, foreign investors were, according to the results of CBRE, above all involved in large transactions with a volume of € 100 million and more. German investors concentrated on medium-sized and small portfolios. The transaction volume was boosted by the greater willingness of German local authorities to sell. Alongside North Rhine-Westphalia, Berlin and Bavaria were the focuses of investment. The experts are expecting transactions with a volume of € 5 to 6 billion for 2011 as a whole. According to CBRE, the volume of residential real estate portfolios of 100 and more housing units sold in 2010 was € 3.25 billion.

Business Review

Earning power and performance improved

The Deutsche Annington Real Estate Group continued on its successful course in the first half of 2011. Customer satisfaction and customer service were further increased and performance was enhanced overall. At the same time, our economic performance indicators were in some cases well above the level of the first six months of 2010, despite the scheduled higher interest charges. The basis for the positive figures was the development of the Property Management segment and the much higher number of residential units sold.

Our processes are running at a very good level. With our modern customer centre, we can now take about 3,400 calls a day. In addition, some 2,400 customer inquiries and questions reach us by fax, e-mail or through our new Internet customer portal. The telephone availability rate averages up to 80%. We answer some 85% of the phone inquiries immediately and/or pass them on directly for processing. The customer centre can be reached six days a week for a total of 54 hours. The repair service is naturally available 24/7.

Another service we offer is our customer Internet portal which is available for their use at all times. Many matters can now be easily dealt with online. For example, tenants can apply for a rental certificate or request repairs online and they can track the current status of their request at any time or change their address details. Furthermore, all current and new customers can search for a new apartment conveniently and efficiently on the website at any time of the day or night and book viewing appointments online.

By continually refining our business processes, we are now faster and better in processing customer inquiries. Whereas in June 2009 less than 20% of all inquiries and orders received were handled in the first three days, the figure today is roughly 40%. Questions that the customer centre staff cannot answer on the phone are passed on directly to our field service workers who go out to the customers. Every day, they make over 1,100 local visits at some 610 locations throughout Germany.

As part of our efforts to further improve customer service, we are currently testing the use of facility managers or caretakers at nine locations throughout Germany. As permanent local employees, they not only perform the classic tasks of a caretaker but also assume the function of a quality manager and coordinator. They are the direct contact person for the tenants and for our local service providers. And they ensure orderliness and cleanliness in the residential estates.

Under the new service, our tenants are being offered the opportunity to personally discuss any issues they may have with the facility manager at regular consultation hours for tenants on site. In addition, the newly deployed staff check the quality of the work done by the service providers, such as craftsmen, cleaners and gardeners, used by Deutsche Annington in the residential estates.

We have made further advances on our way to increasing customer satisfaction by improving service quality. This is also shown in the customer surveys which we have been conducting every month since the end of 2010 with 600 tenants and potential customers: 81% of our new customers are satisfied to highly satisfied with our services; 88% would recommend us to others. With our long-standing tenants – those who have been living in Deutsche Annington accommodation for more than two years – overall satisfaction is currently still only 61%. Here, we want to improve by talking to them more in future. Repairs are rated better: 78% of our customers are satisfied with our repair service, 92% with the quality of the repair. The results of the surveys show us where we have to start with our improvements in future.

In June 2011, Deutsche Annington was awarded the quality seal of Geislinger Konvention. It certifies that we successfully work towards achieving low ancillary costs in our apartments and provide high transparency in our ancillary cost bills. A further important criterion for this award was the continual optimisation of ancillary cost bills. All Deutsche Annington tenants are to benefit even more from this in future. With the aid of precisely defined sub-categories, we will then be able to better compare the ancillary costs of different residential buildings for each type of cost. So cost variations can be clearly identified and we can take more targeted counteraction where necessary.

The Geislinger Konvention is a working group made up of associations of the real estate industry, housing industry services providers and real estate companies and headed by the Nürtingen-Geislingen University of Applied Sciences for the Economy and the Environment (Hochschule für Wirtschaft und Umwelt Nürtingen-Geislingen).

After receiving the quality seal of the Geislinger Konvention, we initiated the next steps in our quest to continually improve our ancillary cost billing. In the second half of 2011, we started a project entitled "Road to ISO 9001: Optimisation of Ancillary Cost Billing". The aim is to establish a robust quality management system by further optimising the ancillary cost billing processes and by obtaining ISO 9001:2008 certification.

New lets continue at a high level

The Property Management business segment continued to perform well in the first six months of 2011. For example, we increased our rent level by 1.4% by raising rents and through modernisation. At the same time, we managed to significantly reduce the vacancy rate by 1.6 percentage points to 4.9% in a year-on-year comparison. This was achieved above all by improving operating performance and by implementing targeted marketing measures for individual customer groups and certain locations.

Overall, our rental performance remained at a high level. In the reporting period, we signed up to 2,119 new rental contracts a month. In total, we managed to considerably increase the property management result for the first six months of this year compared with the first half of 2010.

Investment focuses on energy-saving modernisation measures

Deutsche Annington invests systematically in maintenance and modernisation measures to maintain and improve the quality of its housing. In the first half of 2011, we continued investing in our housing stock at the high level of the previous year. Energy-saving measures and measures to improve the housing quality account for a large proportion of these investments. We already implemented a substantial part of the modernisation projects planned throughout Germany for 2011 in the first six months. In total, we are planning 160 modernisation projects for 3,375 apartments this year.

Energy consumption falls significantly in our modernised residential estates, which in turn reduces climate-damaging CO₂ emissions. According to our own calculations, CO₂ emissions of the apartments modernised in 2011 will be cut by about 5,400 tonnes. The lower energy consumption not only benefits the environment but also our tenants in the form of lower ancillary costs. At the same time, with these investments we increase the attractiveness of our residential units and therefore ultimately ensure sustained rental income.

Energy management leads to lower costs for tenants

Alongside the energy-saving measures performed as part of our modernisation projects, we have also recently extended our energy procurement competence by setting up an energy management department in our company. Its job is to negotiate regional framework agreements for our tenants, for example for the supply of gas, electricity and oil. As part of these activities, we already successfully negotiated advantageous conditions for several locations in recent years. We also manage to achieve price advantages for our tenants over our competitors of up to 30% in other fields by bundling the purchase of services.

Number of apartments sold significantly increased

Through the selective sale of apartments, we give many tenants the chance to fulfil their desire to own their own home as an investment and provision for retirement. In our experience, a mix of tenants and owners in our residential estates has a positive effect on the living environment. In our privatisation programme, we offer apartments for sale primarily to tenants, potential owner-occupiers and small capital investors.

Compared with the same period last year, we sold considerably more apartments nationwide. We achieved this mainly by effectively further developing our sales activities.

Market still offers good chances for acquisitions

As a company which is geared to the long term, Deutsche Annington's aim is to continually expand its housing stocks. In the last three years, we have successfully integrated some 6,000 apartments into the company. In the future, we want to also stay true to this strategy of adding to our real estate portfolio where it makes sense and see clear opportunities for further acquisitions in the real estate market, which has now picked up after the financial crisis. The key criteria for any decision are still whether the housing portfolios offered fit in with the Deutsche Annington strategy and whether the acquisition makes economic sense.

We are expecting to find investment opportunities, particularly in the public sector. We are also anticipating that private-sector owners will continue to want to sell. In the first half of 2011, we analysed in detail some 200 offers for about 70,000 residential units. In the months to come, we will be closely following up options which we consider attractive.

Financial market crisis has no material effects on the financing conditions

The situation on the financial markets remains volatile. This is also having an effect on the housing industry. For example, the margin and equity requirements have increased significantly for acquisitions and re-financing. Nevertheless, particularly in these difficult times, Deutsche Annington is regarded as a reliable partner by the financing partners, as the successful refinancing of the Hallam securitisation transaction in April 2011 ahead of schedule shows.

Immediately following the successful Hallam refinancing, we started a project for refinancing the GRAND securitisation transaction due in 2013. As part of this project, we have entered into an open dialogue with many of our GRAND lenders by establishing an ad-hoc committee. Approaches and possible structures for the GRAND refinancing are to be discussed in this committee in the new few months.

The successful start to the refinancing and the dialogue with the creditors make us optimistic that we will successfully master the financing tasks ahead well before the due date despite the difficult conditions on the refinancing market.

The progress in the first half of 2011 confirms overall that, with its business processes and significantly greater financial and earning power, our company has a stable and promising foundation. We expect our company's performance to further increase and this will be reflected in a positive development of business in 2011.

Responsibility

Employees: Employees' mood is surveyed every year

Staff motivation and satisfaction are two of the most important goals in our company. If we want to satisfy our aspiration to provide high quality for our customers, we need people who identify with their tasks. Therefore, every year we have employee satisfaction measured by an independent institute. The first employee survey in 2010 gave a detailed overview of our employees' mood and was dominated by the upheavals in 2009 and 2010. The results of the survey gave us valuable information about how we can make further improvements and we have already successfully implemented some conclusions in day-to-day work. The results of the employee survey conducted in May 2011 confirm that the action taken is having an effect: employee satisfaction has increased significantly on a broad front. Encouraged by the positive results, we will be redoubling our efforts here.

In the first six months of 2011, we also remained committed to health and the family. All family and health promotion offers for our employees run under the name "Balance 2010". Individual part-time work arrangements, parent-child offices and cooperation with a provider of services for families are just three examples of the measures already implemented.

Customers and the local community: Active involvement as a socially responsible landlord and reliable partner

We have again been involved in many social projects on our residential estates. Through our two foundations and our sponsoring, we provided funding of some € 120,000 in the first half of 2011. As always, our focus is on helping in cases of personal hardship and sponsoring projects dealing with the major socio-political topics of the future "education" and "living in old age".

Together with ProFollow – Verein für Bildungsprojekte e.V., Deutsche Annington set up the "Learning Holidays 2011" project. It is directed at 6th grade pupils who are having learning difficulties in the core subjects (German, mathematics and English). The Deutsche Annington Foundation is financing the educational project to the tune of € 20,000 as the main sponsor. As part of the project, a total of 40 pupils will be helped by volunteers at a ten-day learning camp. The aim of the initiative is to close the gaps in the children's knowledge in all relevant core subjects and to teach them to enjoy learning as well as to provide a varied programme of recreational activities.

Since 2009, Deutsche Annington has been supporting the media educational school project “Newspaper and School” (Zeus) set up by the WAZ media group. With it, we want to make a contribution towards young people’s education and encourage media competence through newspapers and the Internet. At the same time, we are working together with the “Reading Foundation”: In order to improve the educational opportunities of the young people in our residential estates, together with the “Reading Foundation”, we offer our tenants material for developing language and reading skills in the family before the children start school. To make it easier for foreign families to help their children, we also offer the information material in both Turkish and Russian.

In several residential estates, Deutsche Annington and Auslandsgesellschaft Deutschland e. V. have joined forces and adopted new approaches: as part of the “Living and Learning” project, the estate residents are being offered German courses free of charge. Deutsche Annington is providing the rooms rent-free and also funding the first language course. With this project, Deutsche Annington wants to help overcome language barriers and create good neighbourhood structures. In view of the positive response, we are preparing further offers.

At the start of the year, we also expanded our urban district management activities. After opening advice centres in Gelsenkirchen and Dortmund in the last two years together with Caritas and Johanniter Unfallhilfe, we are now planning similar projects at further locations.

For example, in cooperation with the Duisburg branch of the German Red Cross as our partner, an advice centre is to be set up in the Duisburg district of Wedau. This centre is to serve as an open meeting place for young and old residents alike. The aim of the project is to offer all residents comprehensive help and services in all situations in life. Deutsche Annington will be making appropriately converted rooms available rent-free for three years.

Trägerwerk Soziale Dienste in Berlin und Brandenburg gGmbH (TWSD gGmbH) is planning to set up an advice and care centre in our residential estate in the Berlin district Mitte. In addition to Deutsche Annington, the cooperation project is supported by the German government’s initiative “At home rather than in a home”, Bundestag member Silvia Schmidt, the Berlin tenants’ association Berliner Mieterverein e. V. and health and nursing care insurance companies. The advice is to be primarily offered to tenants of Deutsche Annington as well as all local residents. As a cooperation partner, Deutsche Annington is supporting the project in the first three years by providing a specially converted apartment with barrier-free access rent-free as well as part of the project funding.

Deutsche Annington has been a cooperation partner of Johanniter Unfallhilfe since March 2011. As part of the cooperation, we can offer our tenants care and domestic services as well as advice on attractive conditions. At the same time, our vacant apartment offers appear in the member publications of Johanniter Unfallhilfe.

In addition, we support the integration initiative IFAK in Bochum. This organisation operates various facilities including kindergartens and further training centres for migrants in Bochum and the surrounding area. We are providing IFAK with funds for children’s facilities as well as for a two-year social counselling project in Bochum-Stahlhausen.