**Real Estate**
Germany

Colonia Real Estate

KBU GR Equity

Buy

Acquisition of 10,100 apartments

Colonia Real Estate (CRE €45.35), Buy, Target price: Under review (from €43.00)

Colonia Real Estate is continuing to build its integrated real estate service provider. It has acquired 51% of two SPVs, with a total of 10,100 residential apartments, in an off-market transaction. It claims the price paid was less than the market valuation, c. €360m (€577/sq m), and in line with its targets and previous transactions. Its asset management arm, Resolution GmbH, will manage the entire portfolio. The transaction puts the company among the top asset holders/managers in our opinion. Given the deal's excellent financing structure, we believe it will be earnings enhancing for the company.

Colonia Real Estate delivers – with a focus on portfolio building

Colonia Real Estate has acquired 51% of two SPVs with a total portfolio of 10,100 residential apartments, from the subsidiaries of two Australian real estate/development companies, Babcock & Brown and GPT Group (see Appendix 1 for the press briefing). While the price paid has not been disclosed, we understand that Colonia Real Estate did not alter its investment criteria for this deal, which is the largest single transaction in the company's history. We therefore assume that it paid an acquisition multiple of 11.0–12.0 times the initial rental income, or c. €345m before acquisition costs.

This transaction underlines Colonia Real Estate's ability to source attractive assets through its comprehensive network. Given the deal's excellent financing structure, (3.78% until 2013 for an LTV of 57%), high initial yield (we assume 8.7%), low rental level (we assume 15% rental increase potential in the next two years) and promising vacancy rates (we expect the current vacancy rate of 15% to decline to 7%-10% in the next three years) we believe it will be earnings enhancing.

Rental income of €30m annually has been disclosed, which would result in a return of 8.7%. The average vacancy rate of the portfolios (in Western Germany (Aachen, Freiburg, Hamburg, Kiel, Köln, Osnabrück and Salzgitter)) is 15%, which Colonia Real Estate expects to reduce to less than 10%, allowing for extra rental income. In addition, the occupied apartments are under managed, which would allow for rental increases of 10%-15% in the coming years.

This transaction would go a long way toward Colonia Real Estate's target of 20,000 units by the end of 2007, assuming it acquires the remaining 49%. We therefore expect it to increase its 2007 guidance from 20,000 units towards 30,000, with the assets-under-management target for Resolution rising towards €4.5bn-€5bn by the end of 2008, up from €4bn. Both businesses – asset management and rental – are generating recurring earnings, so recurring earnings overall should rise beyond our current estimate of 51% of 2007 EBITDA of €77.2m.

Portfolio characteristics

The portfolio is located in Western Germany, in the cities of Aachen, Freiburg, Hamburg, Kiel, Köln, Osnabrück and Salzgitter.

The portfolio consists of 6,500 units (65%) in Lower Saxony, 2,500 units in the Cologne and Aachen area, 780 units in Freiburg (7.7%) with the remaining 320 units in Schleswig Holstein. While the vacancy rates are below the portfolio average in the western area around Cologne and Aachen and in Freiburg, vacancy rates are higher in Salzgitter and Osnabrueck (Lower Saxony). Colonia Real Estate aims to bring down the vacancy rate in these areas in particular, using the proven programme that helped bring down vacancy rates in its northern German Grasmus portfolio and in Berlin

High vacancy rates are not a function of population drain, but rather of under management that has persisted for some time. The portfolio was acquired by the two Australian groups some years ago from VEBA/EON, but they have not managed the vacancy rates, apparently preferring to invest in the portfolio to keep the standard high. Colonia Real Estate assumes that no additional maintenance investments are necessary, other than a securitised €5m asset investment programme, which the 49% minority owners of the portfolio would share.

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www.cbksec.com/rsh/real_estate.html**For important disclosure information please see pages 7 and 8**

CHART 1: Colonia Real Estate portfolio locations



Source: Commerzbank Corporates & Markets

An indication of the under management can be seen from the fact that rents have not been increased for the past two years, and are currently c. €4.7/sq m – according to CRE – which is about 15% below comparable rental levels. Colonia Real Estate aims to raise rental rates in the coming two to four years towards market levels, which would mean additional rental income of up to €4.5m annually, based on the current vacancy rates.

Financials of the deal look value enhancing

Following the conference call with CEO Rind and IR Kauter, it transpires that the acquired portfolio is part of a securitised portfolio set up by the two Australian real estate groups. As such, the company acquired very attractive financing for the portfolio of 57% of the portfolio value of €360m. They said that the fixed interest rate on this portfolio was 3.78% until 2013, well below current rates and below the group’s overall financing level of 4.7%. Colonia Real Estate has said it planned to increase the LTV to c. 80%, in order to bring its overall group-wide LTV back in line with the target of 75%-80%. Based on this financing, we assume that the €175m purchase price is currently made up of €98m in securitised debt with a 3.78% interest rate, and equity. The company aims to bring down the equity component to 20% or €35m, leaving €42m for further debt financing. It said that it is looking for alternative opportunities, such as mezzanine debt, for which it expects to pay 5%-7%. Assuming an interest rate of 6.25%, the portfolio would then assume total debt servicing requirements of €6.33m, or 4.52%, i.e. less than the group’s current average debt service cost level.

Following on from this calculation, we assume that the transaction could lead to a pre-tax interest improvement of c. €4.0m-€5.4m, based on the following assumptions:

- Rental income of €12m (i.e. eight months of rental income on 51% of €30m annualised rental income).
- Costs of 10%-20% of rental income, i.e. €1.2m-€2.4m.
- €618,200 for property management by Krueger Immobilien (i.e. €180/unit on 51% of 10,100 units for 8 months).
- Interest costs of €5m (i.e. €6.3m annualised interest costs for eight months).
- (€12m-€1.2m/€2.4m-€5m) – €0.62m = €4.0 to €5.2m.

Based on invested equity of €35m, this translates to a ROE of 11.4%-14.8%, excluding the benefits to Resolution GmbH for managing the 49% of the portfolio currently not owned by Colonia Real Estate.

Against this background, we remain optimistic that that the company will at least reach our current net profit estimate of €57m (after minorities of €3.9m, mainly for the 44% of Resolution GmbH that Colonia Real Estate does not own). We also ignored the possibility of a significantly higher IFRS40 adjustment, which we believe is likely in Q3 2007 at the latest, when management has proved it can enhance the value of the asset. Note that we believe Colonia Real Estate acquired this portfolio for c. €345m against an independent market valuation of €360m before any value-enhancing measures.

Valuation

Colonia Real Estate has reached and passed our target price in the past week. We maintain our Buy recommendation for the time being, as the company has shown that it is able to effectively make attractive, value enhancing acquisitions. Based on our current earnings estimates (which are likely to be revised once the 2006 results are presented), the company still looks attractive. Our previous target price of €43/share (based on 15.7m shares) was derived from our DCF model, which included a discount rate of 9%. As recurring earnings should account for an even larger part of total earnings after this acquisition, the greater earnings stability could result in a lower discount rate, which would increase our target price.

TABLE 1: **Peer group**

Company	Price	P/E 2006E	P/E 2007E	P/E 2008E
Gagfah SA	€22.23	27.61	22.31	18.74
IVG Immobilien AG	€36.91	32.48	30.37	26.21
Deutsche Euroshop AG	€59.95	10.48	22.70	16.87
Deutsche Wohnen AG	€51.70	33.87	46.32	36.70
Patrizia Immobilien AG	€22.95	32.44	22.14	14.78
Vivacon AG	€32.00	14.95	12.91	11.70
TAG Tegerensee Immobilien	€11.66	114.86	32.50	21.09
Franconofurt AG	€15.25	25.41	14.22	11.36
Average		36.51	25.43	19.68
Colonia Real Estate AG (basic)	€45.35	18.01	12.43	9.64
Colonia Real Estate AG (fully diluted))		22.58	15.58	12.09

Source: JCF, Commerzbank Corporates & Markets

Appendix 1

Below we reproduce Colonia Real Estate's ad-hoc news briefing:

Colonia Real Estate AG acquires majority of two real estate companies holding 10,100 residential units

Colonia Real Estate AG's subsidiary Resolution GmbH to assume exclusive responsibility for asset management of the residential real estate portfolio

Cologne, 20 February 2007 – Colonia Real Estate AG (ISIN DE0006338007) announces its acquisition of 51 percent stakes in two residential real estate companies with aggregate holdings of 10,100 residential units from BGP Investment S.à r.l. and Babcock & Brown Residential Property 1 S.à r.l. & Co. KG. The residential units in the cities of Aachen, Freiburg, Hamburg, Kiel, Köln, Osnabrück und Salzgitter have an aggregate of 623,000 square meters of lettable space. Approximately 85 percent of the space is let at present, currently generating an annual net rental income of almost € 30 million. Colonia Real Estate AG has the right to acquire the remaining 49 percent of the companies from BGP Investment S.à r.l. - a joint venture between the Australian Babcock & Brown Group and GPT Group - and Babcock & Brown Residential Property 1 S.à r.l. & Co. KG until 30 November 2008. The sellers have an option to sell their remaining stakes to Colonia Real Estate AG that may be exercised until 30 June 2009 in the event Colonia Real Estate AG does not exercise its call option. The purchase price for the 51 percent stakes and the exercise price on both the call and the put option are based on a current valuation of the companies. The parties agreed not to disclose the purchase price and option exercise price. The implementation of the transaction is subject to merger control conditions.

Upon the acquisition, the current debt financing of the acquired residential real estate companies with an annual interest rate of 3.87 percent and a maturity of six years will remain. Colonia Real Estate AG's subsidiary Resolution GmbH will be exclusively responsible for the asset management of the two companies, while the previous property manager, Krüger Immobilien GmbH, will continue to be responsible for the property management.

Colonia Real Estate AG has sufficient equity capital to effect this transaction. Nevertheless, the company is considering a variety of financing alternatives, including a future increase in capital, to finance this and future transactions.

Explanatory part:

„Through the majority ownership of both residential real estate companies we reached our full-year 2007 target – to increase our residential real estate assets from 9,000 to around 20,000 units – ahead of schedule. Furthermore, we are pleased to have won BGP and Babcock & Brown as well-renowned business partners“, mentioned Stephan Rind, CEO of Colonia Real Estate AG, after the signing of the purchase contract. „In addition to a favorable financing structure of the residential real estate companies, we also expect to achieve economies of scale on our current residential real estate portfolio and therefore reduce costs on running the portfolios. We intend to reduce the current vacancy rates in the portfolios of the acquired companies through active asset management during the next years. With these measures, we plan to further increase the cash flows of the Colonia Real Estate Group. Furthermore, the transaction will diversify the portfolio of Colonia Real Estate AG beyond Hamburg and Lower Saxony to the Cologne, Aachen and Freiburg regions.“

About Colonia Real Estate AG

Colonia Real Estate AG (Reuters: KBUG.DE / Bloomberg: KBU GY) is a listed real estate investment and management group focusing on the German market. Its integrated business model consists of three synergistic cornerstones: The Investment Division concentrates on high-yield residential property portfolios held for the company's account and opportunistic co-investments in commercial real estate together with prominent partners. Resolution GmbH specializes in asset management for the Group as well as for complex domestic real estate portfolios held by international investors, whom it also advises on transactions. The focus is on yield optimization and realizing appreciation potential. CRE Fonds Management GmbH's core business is the conception, the marketing and the management of structured investment products such as closed-end real estate funds for institutional investors and private clients.

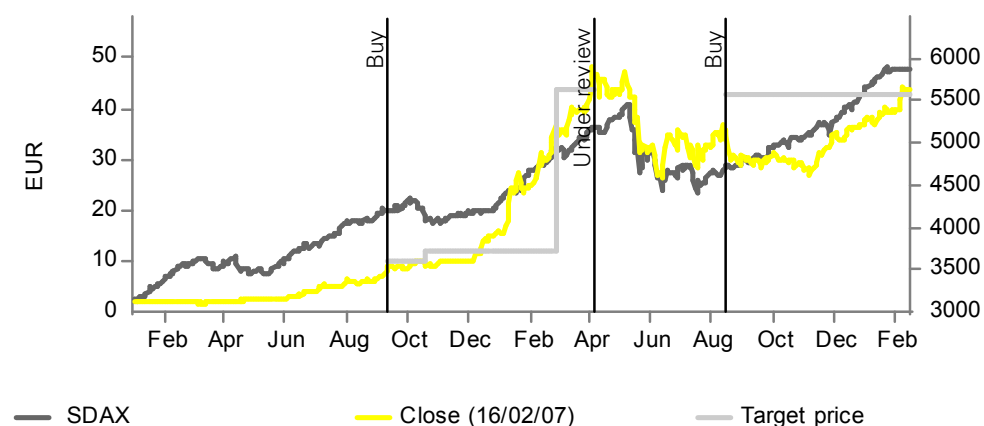
About Babcock & Brown

Babcock & Brown is a global investment and advisory firm with longstanding capabilities in structured finance and the creation, syndication and management of asset and cash flow-based investments. Babcock & Brown was founded in 1977 and is listed on the Australian Stock Exchange. Babcock & Brown operates from 26 offices across Australia, North America, Europe, Asia, United Arab Emirates and Africa and has in excess of 1000 employees worldwide. Babcock & Brown has five operating divisions including real estate, infrastructure and project finance, operating leasing, structured finance and corporate finance. The company has established a funds management platform across the operating divisions that has resulted in the creation of a number of focused investment vehicles in areas including real estate, renewable energy and infrastructure.

About GPT Group

GPT Group is one of Australia's largest listed property groups, with total assets of €7 billion and a market capitalization of €5.4 billion, making it one of the top 40 entities listed on the Australian Stock Exchange (ASX). GPT has a history of investment in high quality properties in the retail, office, industrial and business park sectors, as well as hotel and tourism. GPT has been listed on an Australian Stock Exchange since April 1971 and is one of Australia's longest running listed property groups. GPT management has a wealth of experience and has a substantial investor base. GPT securities are owned by over 40,000 investors, including large Australian and overseas institutions. The Group has a strong balance sheet, a diverse range of capital sources and is focused on further diversifying and expanding its real estate investments and operations in Australia and globally.

CHART 2: **Colonia Real Estate price chart**



Source: Commerzbank Corporates & Markets

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TABLE 2: **Stock rating allocation**

	Buy	Hold	Sell
No. of companies under coverage with this rating	39	40	6
% of companies under coverage with this rating	46%	47%	7%

Source: Commerzbank Corporates & Markets

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