

Research Update:

German Residential Landlord Vonovia SE Affirmed At 'BBB+/A-2'; Outlook Stable

July 22, 2020

Vendor headline

S&PGR Affirms Vonovia Rating At 'BBB+/A-2'; Outlook Stable

Rating Action Overview

- Vonovia's operations as a residential property owner in regulated real estate markets have proved highly resilient during the COVID-19 pandemic compared with other real estate segments, such as retail or hotels. We now evaluate the business risk profile as excellent versus strong before.
- The company is active in three strong economies, namely Germany, Sweden, and Austria, while it benefits from its large scale to generate consistent positive risk-adjusted returns.
- Vonovia's leverage remains well within our current rating assessment, despite an increase in the past four quarters, with debt to debt plus equity at 54.3% and debt to EBITDA at 16.8x (rolling 12-month average) as of March 31, 2020. Vonovia has a strong track record of successfully integrating large portfolio acquisitions and realizing synergies, while retaining its committed financial policy.
- Therefore, we are affirming our 'BBB+/A-2' long- and short-term ratings on Vonovia with a stable outlook.

Rating Action Rationale

Vonovia's operations have seen very little interference from COVID-19. The company's portfolio has shown high resilience with nearly no impact on rent collection compared with previous levels (roughly 99% rent collection). We continue to view the residential real estate sector as one of the most resilient real estate sectors during the pandemic, with very limited impact on rents and valuations. As a comparison, we forecast about 20%-25% negative rental impact for major retail landlords and roughly 5% for office landlords in 2020. We assume Vonovia will continue generating like-for-like rental income growth during 2020 of at least 2.0%, mainly reflecting modernization and new construction. We believe rental income growth from sitting tenants will remain flat because of lower tenant churn and Vonovia's decision not to increase rents during the

PRIMARY CREDIT ANALYST

Nicole Reinhardt
Frankfurt
+ 49 693 399 9303
nicole.reinhardt
@spglobal.com

SECONDARY CONTACT

Franck Delage
Paris
(33) 1-4420-6778
franck.delage
@spglobal.com

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

Research Update: German Residential Landlord Vonovia SE Affirmed At 'BBB+/A-2'; Outlook Stable

second quarter of 2020, as part of the company's social responsibility to its tenants during the peak of the pandemic. We also believe valuations for the company's assets will remain positive at 2%-4% in the next 12-18 months, reflecting modernization work carried out as well as strong demand for residential real estate in Vonovia's operating regions.

The company has a strong track record of market leadership and executing a clearly articulated strategy, consistent with its capabilities and the market environment. Although Vonovia continues to focus mainly on Germany (85% of its portfolio value as of March 31, 2020), we believe that the company's strong asset and tenant diversification, with over 400,000 residential units, its large portfolio scale of over €53 billion, and the strong market fundamentals in its operating regions, where demand outpaces supply, somewhat mitigate its lack of geographical diversification. As market leader, the company has a strong track record of successfully integrating large portfolio acquisitions, realizing synergies, and benefiting from economies of scales. As of March 31, 2020, the company's portfolio amounted €53 billion, comprising more than 400,000 owned residential units across Germany, Sweden, and Austria. Vonovia's strong growth path over recent years and geographical expansion outside Germany was within the company's capabilities and acquisition policy of investing in regulated residential real estate markets with fundamentals comparable with its core market of Germany. Vonovia's focus on long-term holdings with limited asset rotation and continuously high occupancy rates provides good cash flow predictability. As a result, we have revised our assessment of Vonovia's business risk profile to excellent from strong.

We expect Vonovia's leverage will remain commensurate with its financial policy over the medium term. We forecast leverage will remain at 50%-53% for the next 24 months and that Vonovia will use a balanced mix of equity and debt to support any upcoming growth. S&P Global Ratings' adjusted ratio of debt to debt plus equity increased to 54.6% (reported loan to value [LTV] stood at 43.1%) in 2019, mainly because of the debt-funded acquisition of Swedish residential player Hembla AB. The company remains well in line with its financial policy of a reported LTV ratio of 40%-45% (translating into our ratio of debt to debt plus equity of 50%-55%). Although we do not factor in potential debt-financed acquisitions in our forecast, we believe Vonovia will remain in a net buyer position this year and that the company will use a balanced mix of debt and equity to fund any growth and portfolio investments. In addition, we assume that the company's EBITDA coverage with interest will remain comfortably above 3x.

Vonovia remains concentrated on Germany, where assets are low-yielding and income generated to repay debt is low in an international comparison. We apply a one-notch downward adjustment through our comparable rating analysis to reflect the company's relatively small cash flow base compared with other residential real estate holding companies operating in less regulated, and therefore higher yielding, markets such as the U.S. This is reflected in a relatively high ratio of debt to EBITDA of 15x-17x, against less than 10x for some U.S. peers. That said, we take into account the company's expansion strategy in recent years, which generally leads to a distortion of this ratio. In addition, we believe that Vonovia's high concentration on Germany, with about 85% of assets, still brings some regulatory and reputational uncertainties compared to globally more diversified residential real estate peers in the same business risk category. Although landlords in Germany have supported their tenants during COVID-19, abstaining from any rent increases, social and political debates on rent affordability in Germany's metropolitan areas remain intact. In addition, the new "Klimaschutzgesetz" (climate protection law) by the German government sets high hurdles for CO2 reduction in coming years, which is likely to result in high ongoing investments, potentially reducing profitability.

Outlook

The stable outlook reflects our view that Vonovia will maintain robust and stable cash flow, supported by strong market fundamentals in Germany for ongoing demand for affordable housing, and to a lesser degree in Austria and Sweden. This should enable its EBITDA interest coverage to remain well above 2.4x for at least the next two years. We also expect the company will integrate its recent transactions while ensuring a sufficient liquidity cushion. We expect that Vonovia will finance any potential acquisitions with enough equity to maintain debt to debt plus equity well below 60% and stay within its publicly stated financial policy (reported LTV of 40%-45%).

Downside scenario

We could consider a negative rating action if:

- Vonovia deviates from its stated financial policy as a result of larger debt-financed acquisitions or larger shareholder returns;
- Debt to debt plus equity increases to 60% or above, as a result of unexpected debt-funded acquisitions or a deterioration of market conditions; or
- The liquidity cushion decreases, for example because of cash-funded transactions or late refinancing of upcoming maturities.

Upside scenario

We could raise our rating on Vonovia by one notch if:

- The company's financial policy becomes more conservative, demonstrated by a lower appetite for leverage and signs that debt to debt plus equity would sustainably stay below 50% while maintaining EBITDA interest coverage at 3x or above;
- The company increases the amount of income generated and available for paying down debt, so that its debt to EBITDA ratio falls to well below 14x, sustainably; and
- Vonovia further diversifies into markets with strong fundamentals and favorable demand trends, decreasing its concentration on the German economy and mitigating the potential further tightening of domestic regulation.

Company Description

Vonovia is the leading listed residential real estate holding company in Germany, and second-largest listed real estate landlord by portfolio size in Europe. Its portfolio was worth about €53 billion as of March 31, 2020, and comprised about 416,236 owned residential units in Germany, Austria, and Sweden. The company manages an additional 78,691 units for third parties.

Vonovia's strategy focuses on affordable apartments, leased at €6.93 per square meter on average (as of Dec. 31, 2019). The company is listed on the German stock index (DAX) with an average market cap of about €26 billion as of fourth-quarter 2019. The largest shareholders are BlackRock (7.4%) and Norges Bank (6.6%), with 79.3% free float.

Our Base-Case Scenario

Assumptions

- German real GDP to shrink by 6.2% in 2020, rebounding to growth of 4.4% in 2021 with unemployment to increase slightly to 4.5% in the next 6-12 months.
- Total revenue of about €2.2 billion-€2.4 billion for 2020, including rental benefits from last year's acquisition of Hembla.
- Like-for-like rental income growth of 2.0%-2.5% in 2020-2021, supported mainly by the boost to rental rates through modernization spending and new construction. We forecast relatively stable rents for sitting tenants on the back of COVID-19 and the Berlin rent freeze law.
- Occupancy to remain stable, at 97%-98% for 2020-2021.
- High cash calls from modernization capital expenditure (capex), including new building construction of about €1.5 billion per year.
- Conservatively assumed like-for-like portfolio revaluation of about 2%-4% in 2020-21, reflecting mainly value upside from investments and new construction.
- Average cost of debt to remain broadly stable at 1.5% to 1.7%.

Key metrics

	2019A	2020E	2021F
EBITDA to interest (x)	3.5	3.3-3.5	3.4-3.6
Debt to debt and equity (%)	54.6	52-54	52-54
Debt to EBITDA (x)	17.4	16-17	16-17

Liquidity

We assess Vonovia's liquidity position as adequate. We anticipate that liquidity sources will likely cover uses by more than 1.2x for the 12 months from March 31, 2020.

Principal liquidity sources:

- About €370.8 million of unrestricted cash and equivalents as of March 31, 2020.
- €1.0 billion of undrawn credit lines available, maturing in more than 12 months.
- Our forecast of €1.0 billion-€1.2 billion of cash funds from operations.
- About €3.1 billion of debt issuance, consisting of a €600 million secured term loan, €1 billion of senior unsecured notes, as well as recently issued €1.5 billion of senior unsecured notes.
- About €165 million of committed asset sales.

Principal liquidity uses:

- About €1.57 billion of short-term debt maturities, including debt amortization and accrued

interest, in the next 12 months.

- In addition, the company plans to repay €1.2 billion of Hembla debt with the proceeds from recently issued bonds.
- About €95 million for the squeeze-out of the minority interest for Hembla.
- Committed acquisition of about €120 million over the next 12 months.
- Committed capex of roughly €300 million for the next 12 months. We understand that the company estimates capex of about €1.6 billion for 2020, but we assume that most is not committed and project funding is in place.

We understand that Vonovia will likely pay a dividend in 2020. We believe that the company might pay part scrip dividends and part cash, in line with previous years.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

Business risk: Excellent

- Country risk: Very low
- Industry risk: Low
- Competitive position: Excellent

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: a-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

Research Update: German Residential Landlord Vonovia SE Affirmed At 'BBB+/A-2'; Outlook Stable

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Vonovia SE, April 6, 2020

Ratings List

Ratings Affirmed

Vonovia SE

Issuer Credit Rating BBB+/Stable/A-2

Vonovia Finance B.V.

Senior Unsecured BBB+

Subordinated BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.