S&P Global
Ratings

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Vonovia SE

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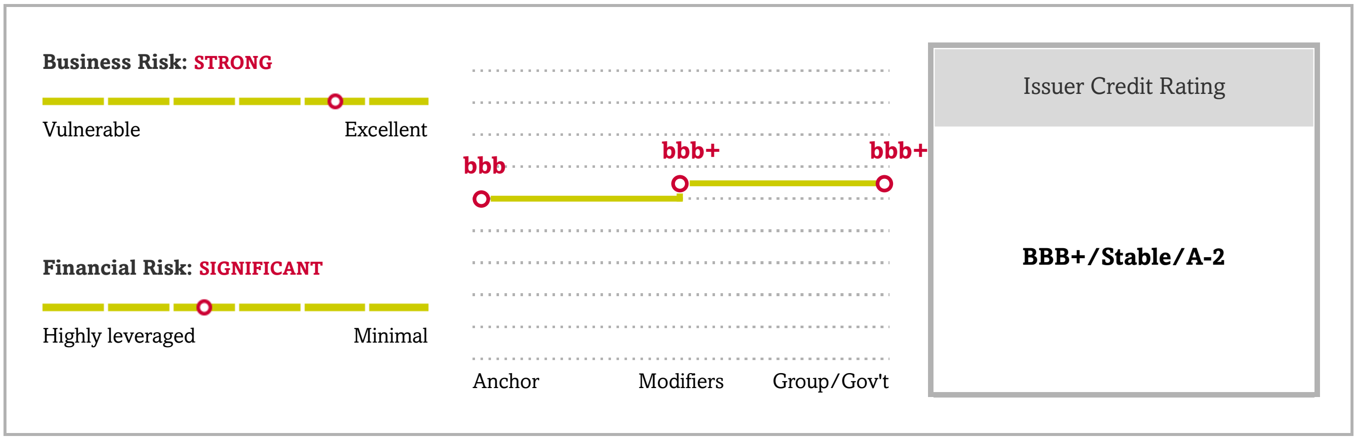


Credit Highlights

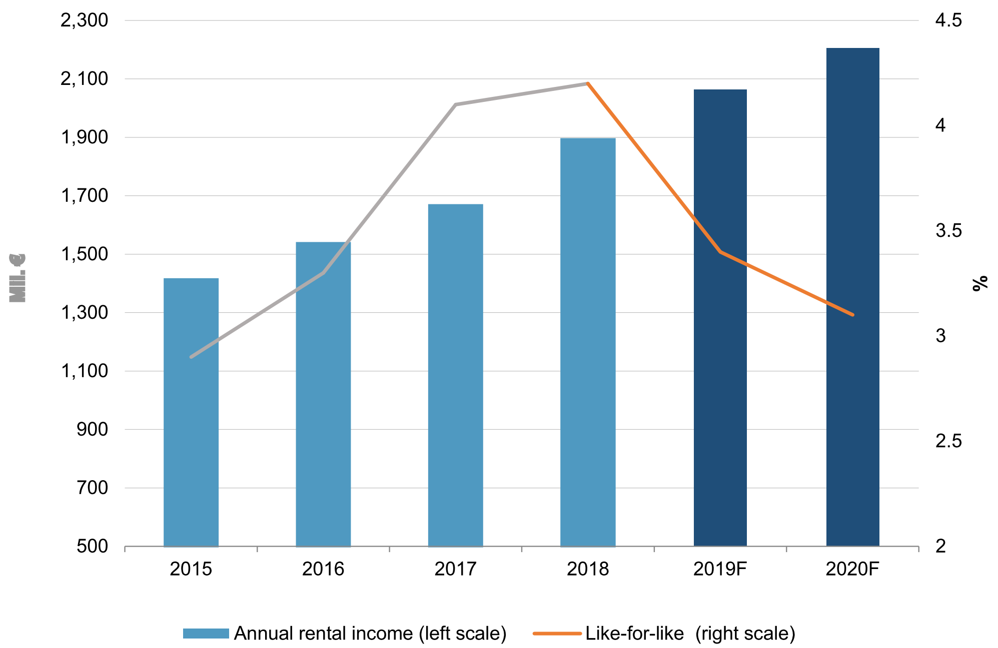
Overview

Key Strengths	Key Risks
Very large portfolio of income-producing residential property assets, worth about €44 billion as of Dec. 31, 2018.	High reliance on Germany, despite recent expansion into Austria and Sweden.
Good asset localization, with the majority of the portfolio in German regions that enjoy healthy economic and demographic trends.	Rising regulation and reputation risk in the German residential market on the back of current social and political debates, following strong rent and price increases in the past decade.
Strong track record of like-for-like rental income growth, supported by a highly diversified asset and tenant base, continuously high occupancy rates, and long tenant stays.	Moderate debt leverage, with the company's significant investment plans and leverage policy constraining debt reduction.
Market leadership in Germany and a track record of successful integration of acquisitions, supporting growth in Germany, Austria, and Sweden.	
Low cost of debt and solid capacity to cover interest, with good access to diversified funding sources.	

The fundamentals of the German residential property market will remain favorable for the next 12-24 months with further rent and price growth. S&P Global Ratings expects Vonovia to continue generating solid like-for-like rental income growth of at least 2%-3% over the next one-to-two years, excluding rent benefits from new construction and neighborhood development. We believe rents and residential real estate prices will continue rising this year on the back of strong market fundamentals, such as high demand for residential flats and limited new construction, particularly in metropolitan areas. The completed acquisitions of Austrian BUWOG AG and Swedish Victoria Park will also contribute to the company's cash flow generation during the forecast period.

Chart 1

Vonovia SE's Annual Rental Income And Like-For-Like Annual Rental Growth



Source: S&P Global Ratings. F--Forecast. S&P Global Ratings forecast like-for-like rental growth excludes construction and development.

Vonovia has adjusted its operational strategy toward new construction and neighborhood development. Vonovia will slightly shift its investment focus from modernization toward new construction and neighborhood developments, which will bring the number of units completed in 2019 and 2020 to about 1,600 and 2,700, respectively, up from 1,100 in 2018. Therefore, we expect capital expenditure (capex) to increase to €1.5 billion-€1.7 billion annually over the next 24 months. We understand that the company's exposure to development activities will remain limited and not exceed 10% of its total portfolio.

Social and political debates on rent affordability in Germany's metropolitan areas may increase regulation and reputation risk for residential landlords, including Vonovia. Strong rent and price increases over the past decade in Germany, particularly in metropolitan areas, have caused social as well as political debate about further regulation and the tightening of rent controls. Additional rent regulation may hinder like-for-like rental growth for Vonovia.

Vonovia's leverage level is unchanged, allowing some headroom for debt-financed mergers and acquisitions (M&A). We estimate that S&P Global Ratings' ratio of debt to debt plus equity will remain at 50%-51% for the next two-to-three years. This reflects the company's financial policy of a reported loan to value (LTV) ratio of 40%-45% (translating into our ratio of debt to debt plus equity of 49%-54%). Although we don't factor potential debt-financed M&A transactions in our forecast, we consider that Vonovia will remain in a net buyer position this year.

Outlook

The stable outlook reflects our view that Vonovia will maintain robust and stable cash flow generation, supported by ongoing demand for affordable housing in Germany, 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 to successfully integrate its recent transactions and ensure a large liquidity cushion afterward. In our view, Vonovia will finance any potential future acquisitions with enough equity to maintain debt to debt plus equity below 60%.

Downside scenario

We could consider a negative rating action if Vonovia deviated from its stated distribution policy, or if it decreased its liquidity cushion--for example, as a result of another cash transaction. A deterioration of market conditions or an unexpected debt-funded acquisition that prevents the company from maintaining the previously mentioned ratio targets would also generate downward rating pressure.

Upside scenario

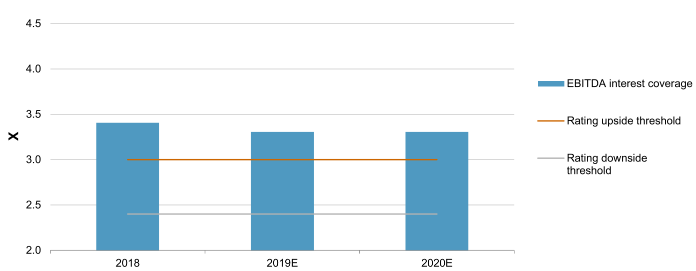
We could raise our rating on Vonovia by one notch if its financial policy became substantially more conservative. This would be demonstrated by a lower appetite for leverage and a sign that debt to debt plus equity would sustainably stay below 50% while maintaining an EBITDA interest coverage at 3x or above.

We could also take a positive rating action if Vonovia further diversified into markets with strong fundamentals and favorable demand trends, decreasing its concentration on the German economy and mitigating the potential tightening of domestic regulation.

We have adjusted our upside scenario to align the credit metrics more with peers' and take into account the resilient regulated residential markets where Vonovia is operating.

Chart 2

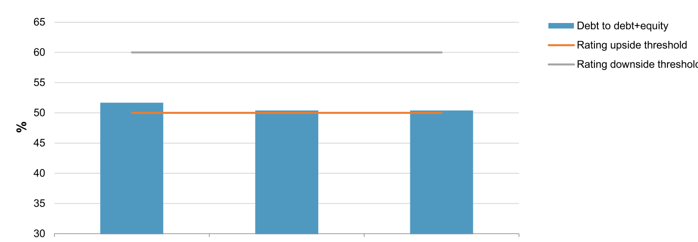
Vonovia SE's Outlook Thresholds For Adjusted EBITDA Interest Coverage



Source: S&P Global Ratings. E--Estimate.

Chart 3

Vonovia SE's Outlook Thresholds Adjusted Ratio Of Debt To Debt Plus Equity



Source: S&P Global Ratings. E--Estimate.

Our Base-Case Scenario

Assumptions	Key Metrics

Assumptions

- Total revenue of slightly above €2 billion for 2019, taking into account some rental benefits from last year's acquisitions of BUWOG AG and Victoria Park.
- Like-for-like rental income growth--excluding new construction and neighborhood development--of 2%-3% through 2019-2020, thanks to a boost to rental rates through modernization spending, as well as low but increasing rents for sitting and new tenants.
- Favorable underlying macro-economic fundamentals for Germany, with expected GDP growth of about 2.4% for 2019 and 1.9% for 2020 and a stable unemployment rate of about 3.5% for the same period.
- Occupancy to remain stable, at 97%-98% for 2019-2020.
- High cash calls from modernization capex, including new building construction of about €1.5 billion per year.
- Like-for-like portfolio revaluation of 6%-8% in 2019 and about 5% for 2020, reflecting further yield compression and value upside from investments and rental growth.
- Average cost of debt to remain at about 1.8%.

Key Metrics

	2018A	2019E	2020E
EBITDA to interest (x)	3.4	3.2-3.4	3.2-3.4
Debt to debt and equity (%)	51.6	50-51	50-51
Debt to EBITDA (x)	16.1	~15	~15

Note: All figures adjusted by S&P Global Ratings. A--Actual. E--Estimate.

Base-case projections

Recent acquisitions will likely underpin earnings stability. We expect Vonovia's earnings performance to be relatively stable, following an? increase in 2019. After the successful integration of its recent acquisitions, the company's EBITDA base should benefit from its additional scale and we estimate it will amount to €1.3 billion-€1.5 billion.

No significant M&A activity expected in this reporting period. Vonovia will likely maintain its net buyer position this year. We believe the company will continue expanding its portfolio, potentially outside of Germany. We have not anticipated major M&A transactions for the current reporting period, but take into account the company's appetite for further consolidation. We assume the company will expand in regulated markets, which have similar characteristics to the German residential market, including favorable demand for residential flats.

Company Description

Vonovia SE 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 €44 billion as of Dec. 31, 2018, and comprised about 396,000 owned residential units in Germany, Austria, and Sweden. The company manages an additional 84,000 units for third parties.

Vonovia's strategy is to focus on affordable apartments, leased at €6.52 per square meter on average (as of Dec. 31, 2018). The company is listed on the German stock index (DAX) with an average market cap of about €23 billion as of fourth-quarter 2018. The largest shareholders are BlackRock (8.2%) and Norges Bank (6.9%), with 77.5% free float.

Table 1

Vonovia SE--Portfolio Summary

Segment Focus	Residential
Total portfolio value	~€44 billion
Total residential units owned	395,769
Portfolio occupancy	98%
Tenant turnover rate	7%
EPRA net initial yield	3.5%
In-place monthly rent	€6.52 per sqm

Source: S&P Global Ratings estimates based on Dec. 31, 2018, company results. EPRA--European Public Real Estate Association. SQM--Square meter.

Business Risk

Vonovia's business risk is underpinned by its very large portfolio of income-producing residential assets, mostly located in Germany (90%) and to a smaller extent in Austria, and Sweden (together 10%). It is the largest residential property holding company and second-largest listed real estate owner in Europe, after Unibail-Rodamco-Westfield. The company's portfolio is also larger and more tenant diversified than other peers' we assess in the same business risk category, in particular those in the commercial real estate segment such as Gecina, Icade, and Foncière Des Régions.

We view residential property as less cyclical and volatile than most other commercial real estate segments and believe the German market provides strong fundamentals to landlords. These include a long average tenant stay (12-14 years versus less than five years in the U.K. or France), cultural preference for renting rather than owning despite a good affordability ratio, and a currently healthy domestic economy.

Moreover, Vonovia enjoys a very high degree of asset and tenant diversity, with more than 396,000 units owned and about 84,000 managed for third parties. We believe this diversity compares favorably with most peers' that we rate in the same business risk category, such as office or retail property investment holding companies. We highlight this comparative advantage by applying a one-notch uplift to the rating.

In addition, the company's strategic portfolio (about 89% of total German portfolio value) is well spread across different regions of Germany and, more specifically, in cities and regions that experience strong economic and demographic trends. These include Berlin (15.2% of Vonovia's property portfolio on Dec. 31, 2018), Rhine Main area (9.2%), Rhineland (8.7%), Southern Ruhr Area (7.8%), Dresden (7.2%), and Hamburg (5.7%). Austria makes up 5.9% and Sweden 4.1% of the total portfolio, and we believe both markets offer similar fundamentals to Germany.

In our view, Vonovia has a good track record of stable operating performance, including a high average occupancy rate (97.6% as of Dec. 31, 2018), high average tenant stay (about 13 years), and a low percentage of tenants leaving each year (less than 10%). Most of Vonovia's rents are unsubsidized and below the market average, suggesting there is potential for upward adjustment of renewal and re-letting. Vonovia currently refurbishes and renovates approximately 5% of its portfolio per year to comply with the latest standards in terms of thermal insulation and energy efficiency. In 2018, Vonovia invested €1.14 billion to upgrade existing buildings and new constructions, and an additional €430 million on maintenance. We note that the company has increasing exposure to construction activities due to the changing regulatory environment, with lower potential of allocating some modernization capex costs to tenants from this year. We estimate annual capex, including modernization and new construction, will amount to €1.5 billion-€1.7 billion over the next two years. However, we understand that overall construction exposure will remain limited at less than 10%. We also note that Austria's BUWOG, Vonovia's recent acquisition, has a good residential development track record in Germany.

Chart 4

Vonovia SE Maintenance and Capex Peer Comparison

Source: S&P Global Ratings based on company reports as of Dec. 31, 2018.

Nevertheless, Vonovia's operations remain concentrated in Germany, representing about 90% of its portfolio, with the remaining 10% split almost equally in Austria and Sweden. We believe this geographic focus leaves the company largely dependent on economic conditions in Germany, although we recognize that the market currently offers positive prospects for established real estate owners. That said, the strong rent and price increases over the past decade in Germany, particularly in metropolitan areas, have provoked wider social and political debate around affordability in the country. This may represent a reputation and a regulatory risk for Vonovia, as it could for other German residential peers.

Peer comparison

Table 2

Vonovia SE--Peer Comparison

Industry Sector: Real Estate Investment Trust or Company

	Vonovia SE	Unibail-Rodamco SE	Deutsche Wohnen SE	Grand City Properties S.A.	Akelius Residential Property AB
Rating as of May 8	BBB+/Stable/A-2	A/Stable/A-1	A-/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2
(Mil. €)	**--Fiscal year ending Dec. 31, 2018--**				
Revenue	1,958.1	2,555.5	920.8	545.0	482.0
EBITDA	1,293.6	2,126.9	619.8	275.5	236.0
Funds from operations (FFO)	801.6	1,714.2	433.6	176.5	85.5
Interest expense	379.6	336.1	124.3	61.1	154.5
Cash interest paid	325.6	346.9	112.4	70.7	147.5
Cash flow from operations	841.2	1,778.8	471.8	153.8	97.5
Capital expenditures	1,358.8	1,568.3	313.5	81.9	349.0
Cash and short-term investments	490.5	369.9	332.8	760.0	13.0
Debt	20,800.5	24,761.9	8,930.7	3,084.8	6,048.0
Equity	19,514.1	31,147.0	11,908.1	4,142.0	5,327.0
Debt and equity	40,314.6	55,908.9	20,838.8	7,226.8	11,375.0
Valuation of Investment Property	43,596.8	60,502.9	24,291.8	7,227.3	12,340.0
Adjusted ratios					
Annual revenue growth (%)	13.9	23.0	6.5	10.1	2.8
EBITDA margin (%)	66.1	83.2	67.3	50.6	49.0
Return on capital (%)	3.5	4.6	3.2	4.1	2.2
EBITDA interest coverage (x)	3.4	6.3	5.0	4.5	1.5
Debt/EBITDA (x)	16.1	11.6	14.4	11.2	25.6
Debt/debt and equity (%)	51.6	44.3	42.9	42.7	53.2

Financial Risk

In our view, Vonovia's debt leverage remains high relative to industry standards and rated peers' at the same rating level, with a ratio of debt to debt plus equity of slightly above 50% in the past four quarters (51.5% end-2018) following multiple acquisitions. We believe the company's leverage will remain close to 50% in the next 12-24 months, in line with its financial policy of a reported LTV ratio of 40%-45%. We view this level as consistent with the current rating.

The company generates solid interest coverage, with a ratio of EBITDA to interest at 3.4x, as of Dec. 31, 2018. This is due to its low cost of funding (1.8%) and the general low interest rate environment. We forecast that the ratio is likely to remain above 3x over the next two-to-three years, because Vonovia's debt is largely fixed or hedged (96%), with a long average debt maturity of 7.8 years. Ratio sensitivity to a potential interest hike is marginal.

We also note the company's relatively small cash flow base compared with that of other residential real estate holding companies operating in less regulated, and therefore higher yielding, markets, e.g. in the U.S. This is reflected in a relatively high ratio of debt to EBITDA of 15x-16x against some U.S. peers with below 10x. In addition, we take into account the company's expansion strategy in recent years, which generally leads to a distortion of this ratio.

Financial summary

Table 3

Vonovia SE--Financial Summary					
Industry Sector: Real Estate Investment Trust or Company					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018**	**2017**	**2016**	**2015**	**2014**
Revenue	1,958.1	1,719.7	1,581.8	1,442.8	807.5
EBITDA	1,293.6	1,150.7	999.3	740.9	447.9
Funds from operations (FFO)	801.6	777.8	551.3	380.6	218.7
Interest expense	379.6	326.1	354.5	330.0	272.9
Cash Interest Paid	325.6	321.5	384.3	344.2	224.1
Cash flow from operations	841.2	655.5	477.8	374.1	300.1
Capital expenditures	1,358.8	1,043.0	548.8	604.6	250.5
Dividends paid	437.3	314.1	481.6	292.0	22.8
Cash and short-term investments	490.5	229.9	1,489.1	3,023.7	1,532.0
Debt	20,800.5	14,799.7	12,679.1	12,692.3	5,861.2
Equity	19,514.1	16,541.2	13,738.4	11,716.9	5,812.2
Debt and equity	40,314.6	31,340.9	26,417.5	24,409.2	11,673.4
Valuation of Investment Property	43,596.8	32,553.3	27,012.0	24,109.1	12,743.2
Adjusted ratios					
Annual revenue growth (%)	13.9	8.7	9.6	78.7	8.1
EBITDA margin (%)	66.1	66.9	63.2	51.3	55.5
Return on capital (%)	3.5	4.0	3.9	4.0	4.2
EBITDA interest coverage (x)	3.4	3.5	2.8	2.2	1.6
Debt/EBITDA (x)	16.1	12.9	12.7	17.1	13.1
FFO/debt (%)	3.9	5.3	4.3	3.0	3.7
Debt/debt and equity (%)	51.6	47.2	48.0	52.0	50.2

FFO--Funds from operations.

Liquidity

We assess Vonovia's liquidity position as adequate. We anticipate that liquidity sources will likely cover uses for the next 12 months from about 1.2x as of Dec. 31, 2018.

Principal Liquidity Sources

- €490.5 million of unrestricted cash and equivalents as of Dec. 31, 2018.
- €1.0 billion of undrawn credit lines available, maturing in more than 12 months.
- €850 million-€950 million of cash funds from operations (FFO).
- €1.0 billion of debt issuance in 2019 so far, consisting of a €500 million term loan and a €500 million senior unsecured bond.
- €696 million of proceeds from the sale of the Deutsche Wohnen stake.
- About €300 million of other net income since the reporting date, mainly reflecting disposal proceeds of investment properties/condominiums.

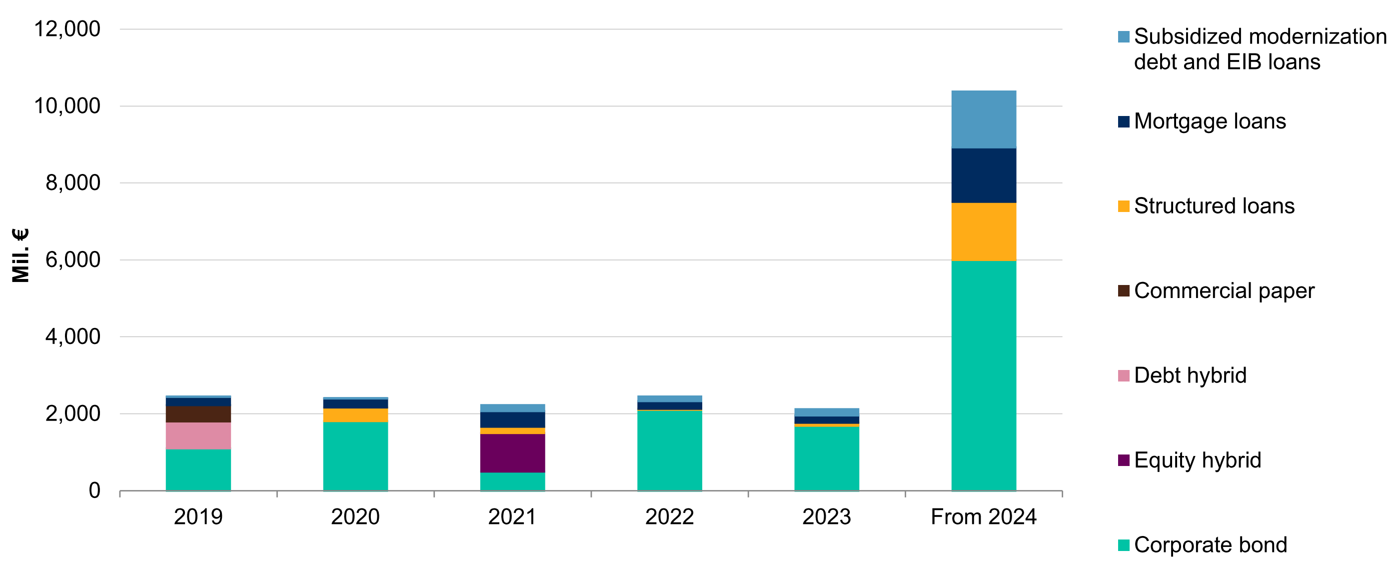
Principal Liquidity Uses

- About €2.7 billion of short-term debt maturities, including debt amortization and accrued interest, in the next 12 months.
- About €428 million squeeze out of the minority interest for BUWOG and call option on Victoria Park.
- Committed capex of at least €303 million, including about €100 million already spent in the year to date. We understand that the company estimates capex of about €1.6 billion for 2019 but assume that most is not committed and respective project funding is in place.
- We understand that Vonovia will likely pay out a dividend in second-quarter 2019. We believe that the company may partially pay scrip dividends and partially cash dividends, in line with previous years.

Debt maturities

Chart 5

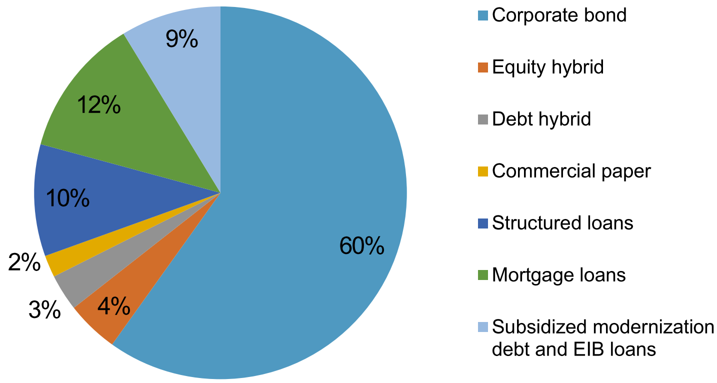
Vonovia SE's Debt Maturity Profile



Source: S&P Global Ratings. EIB--European Investment Bank.

Chart 6

Vonovia SE's Total Debt Maturities By Segment



Source: S&P Global Ratings based on company report as of Dec. 31, 2018.

Covenant Analysis

Compliance expectations

We expect that the company will maintain adequate headroom, greater than 10%, under all remaining covenants.

Requirements

Most of the company's bank debt facilities were granted for the purpose of financing real estate assets. Loan agreements are therefore mostly secured by land charges and assignment of rental payments, and the majority include financial covenants, such as LTV ratios and a debt-service coverage ratio.

In addition, the company has covenants under documentation for its outstanding corporate bonds, mainly relating to the LTV ratio (at less than 60%), secured LTV (at less than 45%), interest coverage ratio (greater than 1.8x), and unencumbered assets to unsecured debt ratio (greater than 125%).

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2018, the company's capital structure comprises 35% of secured debt and 65% unsecured debt. Unsecured bonds are issued under Vonovia Finance B.V.

Analytical conclusions

Vonovia's senior unsecured bonds are currently rated 'BBB+', in line with the issuer credit rating. The company's ratio of secured debt to total fair value assets at end-2018 was 12%, well below our threshold of 40%.

As of Dec. 31, 2018, Vonovia had two rated subordinated hybrid bonds outstanding, a €1.0 billion hybrid bond, reported as equity and €700 million hybrid bond, reported as debt.

We have assessed both hybrid bonds as intermediate equity content, we treat 50% of the principal outstanding and all related payments, including accrued dividends under the hybrid instruments, as debt and 50% as equity.

The hybrid bonds are rated 'BBB-', two notches below the issuer credit rating. One notch reflects the subordination and the other the deferability of the instruments.

The company redeemed its €700 million hybrid bond on April 8, 2019, at its first call date, with the proceeds from the recent sale of Deutsche Wohnen shares (see "Vonovia's Potential Hybrid Redemption Is Ratings Neutral," published Feb. 1, 2019, on RatingsDirect).

Reconciliation

Table 4

Reconciliation Of Vonovia SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2018--							
Vonovia SE reported amounts	**Debt**	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Adjusted EBITDA**	**Cash flow from operations**	**Dividends**
	20,235.40	18,881.80	1,510.30	4,290.30	350.9	1,293.60	1,132.50	441.1
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(166.4)	--	--
Cash taxes paid - Other	--	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(305.8)	--	--
Operating leases	259.7	--	30.4	16.0	16.0	(16.0)	14.4	--
Intermediate hybrids reported as debt	(350.0)	350.0	--	--	(16.2)	16.2	16.2	16.2
Intermediate hybrids reported as equity	500.0	(500.0)	--	--	20.0	(20.0)	(20.0)	(20.0)
Postretirement benefit obligations/deferred compensation	466.9	--	--	--	8.9	--	--	--
Accessible cash & liquid investments	(490.5)	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	32.1	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(301.9)	--
Non-controlling interest/minority interest	--	782.3	--	--	--	--	--	--
Debt - Fair value adjustments	15.7	--	--	--	--	--	--	--
Debt - Other	163.3	--	--	--	--	--	--	--
EBITDA - Gain/(loss) on disposals of PP&E	--	--	(275.6)	(275.6)	--	--	--	--
EBITDA - Inventory	--	--	6.9	6.9	--	--	--	--
EBITDA - Other	--	--	21.6	21.6	--	--	--	--
D&A - Asset valuation gains/(losses)	--	--	--	(3,517.9)	--	--	--	--

Table 4

Reconciliation Of Vonovia SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)								
D&A - Impairment charges/(reversals)	--	--	--	681.2	--	--	--	--
Total adjustments	565.1	632.3	(216.8)	(3,035.7)	28.7	(492.0)	(291.3)	(3.8)
S&P Global Ratings' adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends paid**
	20,800.50	19,514.10	1,293.60	1,254.60	379.6	801.6	841.2	437.3

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb

Modifiers

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

Related Criteria

- 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
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Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of May 8, 2019)*

Vonovia SE	
Issuer Credit Rating	BBB+/Stable/A-2
Issuer Credit Ratings History	
10-Mar-2015	BBB+/Stable/A-2
01-Dec-2014	BBB/Watch Pos/A-2
23-Jul-2013	BBB/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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