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## Vonovia SE

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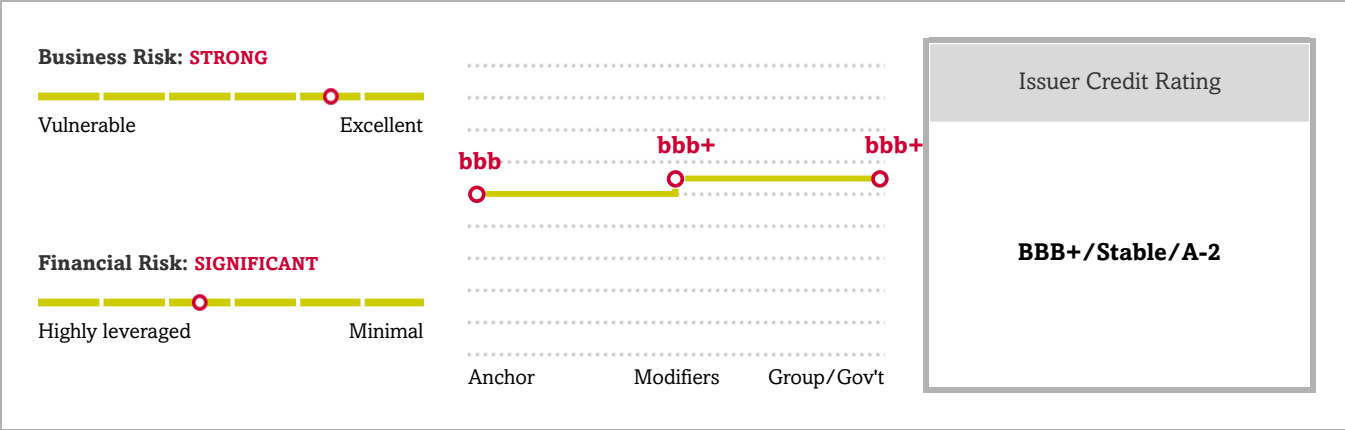
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# Vonovia SE



## Rationale

Business Risk	Financial Risk
<ul style="list-style-type: none"> <li>• Very large portfolio of income-producing residential property assets, worth about €38 billion as of March 31, 2018.</li> <li>• Good asset localization, with the majority of the portfolio in German regions that enjoy healthy economic and demographic trends.</li> <li>• Strong rental income supported by highly diversified asset and tenant bases, high occupancy, and long tenant stay.</li> <li>• Market leadership in Germany and a track record of successful integration of recent acquisitions, supporting continuous growth in wealthier and populous regions of Germany, Austria, and now also Sweden.</li> <li>• Geographic concentration and high reliance on Germany, despite recent expansion to the Austrian and Swedish residential property markets</li> </ul>	<ul style="list-style-type: none"> <li>• Moderate debt leverage with a debt-to-debt plus equity ratio of about 50%-53%.</li> <li>• Significant investment plans and leverage policy constraining ability to further reduce the debt burden.</li> <li>• Low cost of debt and strong capacity to cover interest, with ratio of EBITDA to interest remaining well above 2.4x.</li> <li>• Good access to bank financing and capital markets.</li> </ul>

## Outlook

The stable outlook reflects S&P Global Ratings' view that real estate company Vonovia SE will maintain robust and stable cash flow generation, supported by ongoing demand for affordable housing in Germany, to a lesser degree in Austria, and now also in Sweden, enabling its EBITDA interest coverage ratio to remain well above 2.4x at least over the next 24 months. We also expect that the company will successfully integrate its recent acquisitions and ensure a large liquidity cushion afterward. In our view, Vonovia will finance any potential future acquisitions with enough equity to maintain its ratio of 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 was decreasing 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 evidence that debt-to-debt plus equity would stay below 45% and EBITDA interest coverage at 3x or above.

## Our Base-Case Scenario

For Germany, we forecast low but positive inflation of 1.7% in 2018, 1.8% in 2019, and 1.9% in 2020, and real GDP growth of 2.4% in 2018, 1.9% in 2019, and 1.5% in 2020, which should support residential landlords' ability to increase their rents.

Healthy economic and demographic trends in most German cities where Vonovia operates are likely to support high occupancy and stable rent rates in the next two years, in our view.

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>Total revenues of close to €2 billion for fiscal year 2018, including a nine-month contribution of recent transactions, the Austrian BUWOG AG (BBB+/Stable/--) and six-month contribution from the Swedish Victoria Park (not rated).</li> <li>Like-for-like rental income growth--excluding new constructions and extra stories, at 2%-4% through 2018-2019, thanks to modernization capital expenditures (capex) boosting rental rates, as well as the low but increasing inflation rate.</li> <li>Occupancy to remain stable, at approximately 97%-98% for 2018-2019, with neutral asset rotation.</li> <li>High cash calls from modernization capex and new constructions, increasing to about €1 billion per year.</li> <li>4%-6% like-for-like revaluation of its portfolio in 2018 and 2019, reflecting stable yields and upside from modernization capex and rental growth.</li> <li>Average cost of debt to remain at about 1.8%-2%.</li> </ul>	<b>2017A    2018E    2019E</b>			
	<hr/>			
	EBITDA/interest (x)	3.5	3.0-3.1	3.0-3.2
	Debt to debt and equity (%)	47.2	51-53	50-52
<hr/>				
Debt to EBITDA (x)	13.1	~15.5	14-15	
<hr/>				
<p>*S&amp;P Global Ratings'-adjusted. A--Actual. E--Estimate.</p>				

## Company Description

Vonovia is the leading residential real estate holding company in Germany. Its portfolio was worth approximately €38 billion as of March 31, 2018, comprising about 394,000 owned units in Germany and Austria. The company manages an additional 58,000 units for third parties. Vonovia's strategy is to focus on affordable apartments, leased at €6.18 per square meter on average (as of March 31, 2018).

The company is listed on the German stock index (DAX) in Frankfurt.

## Business Risk

Vonovia's business risk profile is underpinned by its very large portfolio of income-producing residential assets, mostly located in Germany (94%) and to a smaller extent in Austria (6%). It is the largest residential property holding company and second-largest listed real estate owner in Europe (after Unibail Rodamco). The company's portfolio is also larger and more tenant-diversified than most other peers we assess in the same business risk category, such as Gecina, Icade, and Foncière Des Régions.

While we view residential properties as less cyclical and volatile than most other commercial real estate segments, we

believe the German market provides strong fundamentals to real estate landlords. That includes long average tenant stay (12-14 years versus less than five years in the U.K. or France), a 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 394,000 units owned and about 58,000 managed for third parties. We believe this diversity compares favorably with most of its 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 98% of total portfolio value) is well spread across different regions of Germany and, more specifically, in cities that experience strong economic and demographic trends, such as Berlin (15.8% of Vonovia's property portfolio on March 31, 2018), Rhine Main area (9.4%), Rhineland (8.7%), Southern Ruhr Area (7.8%), Dresden (7.8%) and Hamburg (6%). Austria makes up 6.6% of the total portfolio. In addition, we believe Vonovia's recent expansion outside of Germany, namely into the residential property market in Austria and Sweden, benefits from similar market fundamentals to Germany.

In our view, Vonovia has a good track record of stable operating performance, achieved by maintaining a high average occupancy rate (97.2% as of March 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 unregulated and below market average (€6.18 per square meter in average), suggesting there is a potential for upward adjustment of renewal and re-letting. We also note that there is very limited development risk in the portfolio, and that the company is maintaining a conservative approach to direct developments.

For these reasons, we view Vonovia's business risk profile at the high end of its category.

Nevertheless, Vonovia's operations remain concentrated in Germany, representing about 90% of its portfolio with the remaining 10% equally in Austria and Sweden. We believe this geographic focus leaves the company largely dependent on Germany's economic conditions, although we recognize it currently offers positive prospects for established real estate owners.

### S&P Base-Case Operating Scenario

Tenant demand for midsize affordable apartments should remain solid in Germany, Austria, and Sweden, with rents growing steadily in 2018-2019, thanks to a limited supply of new assets and an increasing number of households in most of the regions where Vonovia operates.

We see a prolonged increase in Vonovia's revenues in 2018 thanks to the rent contribution from the BUWOG and Victoria Park acquisitions in the first half of 2018 and the positive like-for-like growth from adjustments to the German rent mirror ("Mietspiegel")/indexation, re-letting, and renewals.

## Peer comparison

Table 1

Vonovia SE -- Peer Comparison						
--Fiscal year ended Dec. 31, 2017--						
(Mil. €)	Vonovia SE	Unibail-Rodamco Westfield N.V.	Deutsche Wohnen SE	Gecina	Akelius Residential Property AB	
Rating as of Aug. 1, 2018	<b>BBB+/Stable/A-2</b>	<b>A/Stable/A-1</b>	<b>A-/Stable/A-2</b>	<b>BBB+/Positive/A-2</b>	<b>BBB/Stable/A-2</b>	
Revenues	1,719.7	2,078.4	864.9	562.5	419.5	
EBITDA	1,128.3	1,556.1	552.6	458.7	225.9	
Funds from operations (FFO)	809.9	1,313.1	400.6	356.2	80.7	
Interest Expense	326.1	226.9	120.4	100.0	142.8	
Net income from cont. oper.	2,410.7	2,439.5	1,717.9	1,895.6	785.8	
Cash flow from operations	660.2	1,244.9	520.3	230.6	85.7	
Capital expenditures	1,043.0	1,349.5	227.4	378.2	282.6	
Cash and short-term investments	229.9	574.7	363.7	122.0	15.8	
Debt	14,799.7	14,731.3	6,931.2	8,641.3	5,079.5	
Equity	16,541.2	22,693.2	10,211.0	11,014.4	4,606.0	
Debt and equity	31,340.9	37,424.5	17,142.2	19,655.7	9,685.6	
Valuation of Investment Property	32,553.3	41,109.4	19,952.9	16,667.1	10,405.0	
<b>Adjusted ratios</b>						
EBITDA margin (%)	65.6	74.9	63.9	81.5	53.9	
Return on capital (%)	2.4	4.4	3.1	2.7	2.3	
EBITDA interest coverage (x)	3.5	6.9	4.6	4.6	1.6	
Debt/EBITDA (x)	13.1	9.5	12.5	18.8	22.5	
FFO/debt (%)	5.5	8.9	5.8	4.1	1.6	
Total debt/debt plus equity (%)	47.2	39.4	40.4	44.0	52.4	

## Financial Risk

In our view, Vonovia's debt leverage is high relative to industry standards, with a ratio of debt-to-debt plus equity of 50%-53%. That said, the ratio has been high in the past few years due to Vonovia's multiple acquisitions, and we expect it to stabilize at about 50%. We view this level as consistent with the current rating.

The company generates good interest coverage, with a ratio of EBITDA to interest at about 3.5x (rolling 12 month as of March 31, 2018). This is due to its low cost of funding of 1.8% and a general low interest rate environment. The ratio is likely to remain well above 2.4x over the long term, because Vonovia's debt is largely fixed or hedged, and 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 a less regulated, and therefore higher yielding environment, than Vonovia, e.g., in the U.S. This is reflected in a relatively high ratio of debt to EBITDA of about 13x-14x against that of some U.S. peers. In addition, we take into account the company's expansion strategy in recent years, which generally leads to a distortion of this ratio.

The company's pool of unencumbered assets, with net operating income generated by unencumbered assets, accounts for about 58% and its ratio of secured debt to total assets was at 12% as of March 31, 2018. We believe that the level of subordination of the senior unsecured notes remains acceptable at the current level, which is why we align our issue rating on the unsecured debt to our issuer credit rating on Vonovia.

### S&P Base-Case Cash Flow And Capital Structure Scenario

In our base-case scenario, we forecast an interest coverage ratio remaining close to 3x in the next two years. This mainly reflects our forecast of a stable EBITDA base and interest costs. We forecast a ratio of debt to debt plus equity at 50%-52%, including the funding of its recent transactions and 2%-6% revaluation gains for the current year.

## Financial summary

Table 2

Vonovia SE--Quarterly Data*					
	March 2018	December 2017	September 2017	June 2017	March 2017
<b>(Mil. €)</b>					
Revenues	429.0	436.3	429.4	426.8	427.2
EBITDA	281.8	287.8	285.2	276.5	279.8
Funds from operations (FFO)	198.2	226.7	195.6	203.9	183.0
Interest Expense	83.4	60.9	79.4	96.3	91.4
Net income from continuing operations	116.2	1,293.1	124.4	876.6	116.6
Cash flow from operations	227.4	126.4	178.6	179.8	175.5
Capital expenditures	156.7	392.5	228.0	290.7	131.8
Cash and short-term investments	730.5	229.9	272.0	322.6	955.2
Debt	19,033.1	14,799.7	14,542.7	14,854.7	14,351.4
Equity	16,720.1	16,541.2	15,326.1	15,125.1	14,120.6
Debt and equity	35,753.2	31,340.9	29,868.8	29,979.8	28,472.0
Valuation of Investment Property	37,941.5	32,553.3	31,553.5	30,495.7	29,607.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	65.7	65.6	64.2	63.8	64.0
Return on capital (%)	2.1	2.4	3.5	3.4	3.4
EBITDA interest coverage (x)	3.5	3.5	3.1	2.9	2.9
Debt/EBITDA (x)	16.8	13.1	13.5	14.2	14.0

**Table 2**

Vonovia SE--Quarterly Data* (cont.)					
	March 2018	December 2017	September 2017	June 2017	March 2017
<b>(Mil. €)</b>					
FFO/debt (%)	4.3	5.5	4.9	4.5	4.5
Debt/debt and equity (%)	53.2	47.2	48.7	49.5	50.4

\*Rolling 12 months' data.

## Liquidity

We assess Vonovia's ongoing liquidity position as adequate. We anticipate that liquidity sources will likely cover liquidity uses for the next 12 months by at least 1.2x as of March 31, 2018.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• €730 million of unrestricted cash and equivalents as of March 31, 2018;</li> <li>• €500 million of undrawn credit lines available, maturing in more than 12 months;</li> <li>• €500 million of senior unsecured bonds issued in June 2018; and</li> <li>• Our forecast of about €900 million-€950 million of cash funds from operations.</li> </ul>	<ul style="list-style-type: none"> <li>• €1.1 billion of debt maturities, including debt amortization and accrued interest, in the next 12 months;</li> <li>• €379 million of cash dividends paid during the second quarter of 2018; and</li> <li>• Approximately €1 billion of modernization capex, most of which we understand is not committed.</li> </ul> <p>Vonovia could also derive material additional liquidity from its large pool of unencumbered and highly demanded real estate assets. We also note that the company had sufficient headroom (greater than 10%) under its existing covenants and expect headroom to remain solid, as well</p>

## Debt maturities

**Table 3**

Debt Maturities As Of March 31, 2018	
<b>(Mil. €)</b>	
2018	993.7
2019	2,097.1
2020	2,321.1
2021	994.8
2022	2,420.6
after 2022	10,052.4
Total debt	18,879.7



## 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
- **Capital structure:** Neutral
- **Financial policy:** Neutral
- **Liquidity:** Adequate
- **Management and governance:** Satisfactory
- **Comparable rating analysis:** Positive

## Reconciliation

Table 4

Reconciliation Of Vonovia SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)										
--Rolling 12 months ended March 31, 2018--										
Vonovia SE reported amounts.										
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations	Dividends paid	Capital expenditures
Reported	18986.3	16233.1	1721.5	1246.0	4306.0	291.6	1246.0	966.8	317.9	1067.9
S&P Global Ratings' adjustments										
Interest expense (reported)	--	--	--	--	--	--	-291.6	--	--	--
Interest income (reported)	--	--	--	--	--	--	49.1	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	-35.2	--	--	--
Operating leases	196.9	--	--	27.5	14.2	14.2	13.3	13.3	--	--
Intermediate hybrids reported as debt	-350.0	350.0	--	--	--	-16.2	16.2	16.2	16.2	--

**Table 4**

Reconciliation Of Vonovia SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)										
Intermediate hybrids reported as equity	500.0	-500.0	--	--	--	20.0	-20.0	-20.0	-20.0	--
Postretirement benefit obligations/ deferred compensation	430.4	--	--	--	--	9.1	-10.0	4.7	--	--
Surplus cash	-730.5	--	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	49.1	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	-268.8	--	--
Non-controlling Interest/Minority interest	--	637.0	--	--	--	--	--	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	--	-143.5	-143.5	--	-143.5	--	--	--
EBITDA - Other	--	--	--	0.6	0.6	--	0.6	--	--	--
D&A - Asset Valuation gains/(losses)	--	--	--	--	-3434.1	--	--	--	--	--
Total adjustments	46.8	487.0	0.0	-115.4	-3513.7	27.1	-421.1	-254.6	-3.8	0.0

**S&P Global Ratings' adjusted amounts**

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from Operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	19033.1	16720.1	1721.5	1130.6	792.3	318.7	824.9	712.2	314.1	1067.9

**Related Criteria**

- 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: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

## Related Research

- Research Update: German Residential Property Owner Vonovia 'BBB+/A-2' Ratings Affirmed On Victoria Park AB Takeover Bid; Outlook Stable, May 07, 2018
- Research Update: German Residential Property Firm Vonovia 'BBB+/A-2' Ratings Affirmed On Buwog Takeover Bid; Outlook Stable, Dec 19, 2017

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
<b>Strong</b>	aa/aa-	a+/a	a-/bbb+	<b>bbb</b>	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 August 2, 2018)

#### 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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