Tear Sheet:

Deutsche Wohnen SE

September 5, 2023

Deutsche Wohnen SE's residential assets have rental growth potential, while its health care properties face a lack of qualified staff and cost pressures. Residential assets, which account for 89.8% of EBITDA and are mainly located in Berlin, reported a moderate 1.7% like-for-like growth in rental income for first-half 2023, thanks to slowly increasing indexation and a stable and low vacancy rate (1.9%). S&P Global Ratings believes rent growth in most German cities is accelerating. This is explained by multiple long-term factors such as a widening housing shortage, decreasing new supply, increased immigration, higher costs of ownership, and a strong preference for renting. Still, the company's ability to capture rental growth is limited by its commitment not to raise rents in Berlin in 2022 and 2023, lower investments in modernization, which allow it to increase rents beyond indexation levels, and very low tenant churn. Operating performance at nursing homes, accounting for 10% of EBITDA, was affected by higher personnel and energy expenses. The EBITDA decline in first-half 2023 was also exacerbated by the one-off positive revenue effect of COVID-19-related subsidies a year before. While margin pressures from energy costs should gradually ease given the lagging pass-through mechanism, we think the lack of qualified staff could remain a burden in 2023-2024.

We continue to view Deutsche Wohnen as a core subsidiary of Vonovia and therefore align the ratings and outlook with the parent. Following the successful takeover, we regard Deutsche Wohnen as a core subsidiary of Vonovia. Vonovia holds an 86.87% stake in Deutsche Wohnen, which is fully integrated as a core division of the Vonovia group. The two companies have complementary portfolios, comprising residential assets in Germany with similar rent levels and occupancy rates. Deutsche Wohnen's portfolio, which represents about 30% of the combined entity's portfolio value, also strengthens Vonovia's competitive position in Greater Berlin, where the former holds about 75% of its residential assets (in fair value). We believe Vonovia is able and likely to exert material influence over Deutsche Wohnen, which explains why our ratings on the two are aligned.

We expect Deutsche Wohnen's leverage and interest coverage ratios to weaken but remain commensurate with the standalone credit profile. The company's leverage, as indicated by adjusted debt to debt and equity, increased marginally to 35.7% as of June 30, 2023, from 34.9% as of Dec 31, 2022, due to a decline in property valuations. We expect adjusted debt to debt plus equity to remain at 35%-38% in the coming 12-18 months, which remains strong for the industry and commensurate with the intermediate financial risk profile. We also understand the group Is evaluating options to dispose Deutsche Wohnen's portfolio of nursing homes. Although we assume the company's EBITDA-interest-coverage ratio will likely deteriorate due to higher interest rates at debt refinancing, we still expect it will remain above 3.0x over the next 12-18 months. We also expect Deutsche Wohnen to maintain adequate liquidity headroom over our forecast period, although we understand liquidity is managed at the group level.

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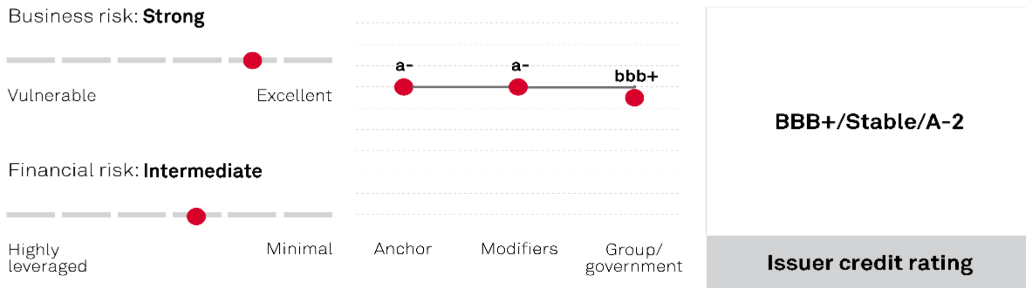
Ratings Score Snapshot



Recent Research

- Industry Top Trends Update Europe: Real Estate (REITs), July 18, 2023
- European REITs: The Great Repricing Continues, July 18, 2023
- Vonovia SE's €1 Billion Stake Sale Will Cushion Credit Ratios And Fuel Liquidity, April 28, 2023
- Credit FAQ: Spotlight On Refinancing Risks In European Commercial Real Estate, April 24, 2023

Company Description

Since October 2021, Deutsche Wohnen has been a subsidiary of Vonovia, the largest publicly listed residential property company in Germany, with a portfolio value of €88.2 billion as of June 30, 2023. On a stand-alone basis, Deutsche Wohnen's portfolio is the second-largest residential property portfolio in Germany, with about 140,168 residential and approximately 2,557 commercial units as part of the residential premises, as well as about 25,793 garages and parking spaces and 71 nursing homes. The total fair value is about €30.0 billion as of June 30, 2023, excluding assets held for sale. Approximately 77% of its residential assets (portfolio value) are in the greater Berlin metropolitan area.

The company is listed on the DAX of the German stock exchange. As of June 30, 2023, Vonovia is its largest shareholder with an 86.87% stake. Free float, according to the definition of Deutsche Börse, is 12.29%.

Outlook

The stable outlook on Deutsche Wohnen reflects our view of the overall group, Vonovia, which should continue generating robust rental growth, supported by strong undersupply of housing in Germany, increasing rent indexation, and low tenant defaults. This should enable the group's EBITDA interest coverage and debt to debt plus equity to remain above 1.8x and below 60%, respectively, for at least the next two years.

We expect Vonovia to preserve a sound liquidity cushion and adjust its capital-allocation strategy to fast-evolving financial market conditions. We also assume that management will take necessary steps to decrease leverage and comply with its publicly stated financial policy, which is centered on a maximum reported loan to value of 45% (comparable to S&P Global Ratings-adjusted debt to debt plus equity of 55%).

Downside scenario

We could consider a negative rating action on Deutsche Wohnen if Vonovia's:

- Debt to debt plus equity increases to 60% or above for a prolonged period, because of higher revaluation losses or lower asset sales than expected;
- The liquidity cushion significantly decreases, for example, because of a late refinancing of upcoming maturities or the issuance of debt with shorter maturities;
- EBITDA to interest moves toward 1.8x; or
- Outstanding secured debt exceeds 40% of the company's asset value, which may lead to notching down of unsecured debt.

Upside scenario

We could raise our ratings on Deutsche Wohnen by one notch if:

- The group is able to dispose substantial assets or development projects or raise enough equity such that Vonovia's debt to debt plus equity would sustainably stay below 55% while maintaining EBITDA interest coverage at 3x or above; and
- Vonovia increases its payback capacity via internal cash flow generation, so that its debt-to-EBITDA ratio (excluding revenue from sales) sustainably returns to its historical levels in the mid-teens or below.

Key Metrics

Deutsche Wohnen SE--Forecast summary

Period ending	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025
(Mil. EUR)	2019a	2020a	2021a	2022a	2023e	2024f	2025f
Revenue	1,108	1,102	1,110	1,049	1,070	1,095	1,110
EBITDA	715	695	670	675	653	668	677
Funds from operations (FFO)	496	506	489	399	456	453	429
Interest expense	166	184	173	174	158	177	209
Cash flow from operations (CFO)	454	505	465	365	458	455	431
Capital expenditure (capex)	367	377	778	789	550	550	550
Dividends	231	317	359	29	300	300	300

Deutsche Wohnen SE--Forecast summary

Debt	9,570	10,966	9,256	8,984	9,083	9,186	9,314
Equity	13,107	13,833	17,203	16,775	15,529	15,154	15,161
Adjusted ratios							
EBITDA margin (%)	64.6	63.1	60.3	64.4	61.0	61.0	61.0
EBITDA interest coverage (x)	4.3	3.8	3.9	3.9	4.1	3.8	3.2
Debt/EBITDA (x)	13.4	15.8	13.8	13.3	13.9	13.8	13.8
Debt/debt and equity (%)	42.2	44.2	35.0	34.9	36.9	37.7	38.1

Financial Summary

Deutsche Wohnen SE--Financial Summary

Period ending	Dec-31-2020	Jun-30-2021	Dec-31-2021	Jun-30-2022	Dec-31-2022	Jun-30-2023
Reporting period	2020a	RTM	2021a	RTM	2022a	RTM
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	1,102	1,102	1,110	1,320	1,049	1,089
EBITDA	695	695	670	651	675	668
Funds from operations (FFO)	506	466	489	510	399	460
Interest expense	184	192	173	152	174	187
Operating cash flow (OCF)	505	481	465	-26	365	390
Capital expenditure	377	531	778	198	789	746
Dividends paid	317	359	359	27	29	23
Cash and short-term investments	583	252	677	293	184	218
Debt	10,966	12,102	9,256	9,210	8,984	8,520
Common equity	13,833	13,743	17,203	18,147	16,775	15,361
Valuation of investment property	28,705	29,370	30,553	30,014	28,230	25,986
Adjusted ratios						
EBITDA margin (%)	63.1	63.1	60.3	49.3	64.4	61.4
EBITDA interest coverage (x)	3.8	3.6	3.9	4.3	3.9	3.6
Debt/EBITDA (x)	15.8	17.4	13.8	14.2	13.3	12.8
Debt/debt and equity (%)	44.2	46.8	35.0	33.7	34.9	35.7

Peer Comparison

Deutsche Wohnen SE--Peer Comparisons

	Deutsche Wohnen SE	Gecina	Vonovia SE	Akelius Residential Property AB	Grand City Properties S.A.
Foreign currency issuer credit rating	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Stable/A-2	BBB/Negative/A-2	BBB+/Negative/A-2
Local currency issuer credit rating	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Stable/A-2	BBB/Negative/A-2	BBB+/Negative/A-2
Period	RTM	RTM	RTM	RTM	RTM
Period ending	Jun-30-2023	Jun-30-2023	Jun-30-2023	Jun-30-2023	Jun-30-2023
Revenue	1,089	651	3,455	326	620
EBITDA	668	520	2,190	152	316
Funds from operations (FFO)	460	435	1,436	76	217
Interest expense	187	118	699	81	72
Operating cash flow (OCF)	390	397	1,392	178	158
Capital expenditure	746	387	1,569	191	77
Dividends paid	23	392	415	199	46
Cash and short-term investments	218	653	1,572	248	709
Debt	8,520	6,495	44,224	1,904	3,824
Equity	15,361	11,778	30,953	4,573	4,793
Valuation of investment property	25,986	16,629	85,683	6,147	8,990
Adjusted Ratios					
EBITDA margin (%)	61.4	79.9	63.4	46.6	50.9
EBITDA interest coverage (x)	3.6	4.4	3.1	1.9	4.4
Debt/EBITDA (x)	12.8	12.5	20.2	12.5	12.1
Debt/debt and equity (%)	35.7	35.5	58.8	29.4	44.4

Environmental, Social, And Governance

ESG factors are an overall neutral consideration in our credit rating analysis of Deutsche Wohnen. We believe German residential companies like Deutsche Wohnen are exposed to social risk, given ongoing political and social tensions arising from rising rents and property prices, particularly in Berlin where the majority of Deutsche Wohnen's portfolio is located (above 75% of portfolio value).

Rating Component Scores

Foreign currency issuer credit rating	BBB+/Stable/A-2
Local currency issuer credit rating	BBB+/Stable/A-2
Business risk	Strong
Country risk	Very Low
Industry risk	Low
Competitive position	Strong
Financial risk	Intermediate
Cash flow/leverage	Intermediate
Anchor	a-
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	Neutral (no impact)
Stand-alone credit profile	a-

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011