S&P Global
Ratings

RatingsDirect®

Research Update:

Vonovia SE Outlook Revised To Positive On Potential For Further Deleveraging; 'BBB+' Rating Affirmed

December 17, 2021

PRIMARY CREDIT ANALYST

Franck Delage
Paris
+ 33 14 420 6778
franck.delage
@spglobal.com

SECONDARY CONTACT

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

Rating Action Overview

- Germany-based residential property company Vonovia recently announced the acquisition of 87% of Deutsche Wohnen's shares and the success of its €8 billion equity raise, which is enough to maintain ratios commensurate with our 'BBB+' rating on the company.
- Now that Vonovia has reached a significant size (€91.5 billion) with limited impact on its balance sheet and no more execution risks, we believe further deleveraging could lead to a positive rating action, but only if the company manages to dispose significant noncore assets and limit debt-funded acquisitions in the short to medium term.
- We therefore revised our outlook on Vonovia to positive from stable, and affirmed our 'BBB+' long-term issuer credit rating on the company.
- We could take a positive rating action if Vonovia reduces debt leverage more than we currently expect over the next 24 months, such that its debt-to-debt plus equity falls sustainably below 55% while its debt-to-EBITDA returns to historical levels, in the 15x-17x range.

Rating Action Rationale

The success of Vonovia's €8 billion equity raise supports our ratio expectations and removes important execution risks. On Dec. 8, 2021, Vonovia announced the closing of its €8 billion capital increase, which should be used to repay amounts under the syndicated loan facilities agreement that partly funded the €16.5 billion required for the purchase of 87.6% shares in Deutsche Wohnen. The company should therefore be able to maintain debt-to-debt-plus-equity and debt-to-EBITDA ratios at about 55% and 18x-19x, respectively, in 2022-2023, after a temporary spike at 56%-57% and 25x-27x in 2021, mainly thanks to asset disposals (assuming €4 billion-€4.5 billion of asset disposals in 2022, followed by €400 million in recurring sales in 2023) and asset revaluations (10% in 2021, and 2%-3% in 2022-2023). We believe these levels are consistent with our 'BBB+' rating's ratio requirements, such as debt to debt plus equity below 60%. Moreover, the company's EBITDA-to-interest ratio should remain strong, at about 3.5x-4.0x, at least in the next two years, given the limited changes in its funding costs. Similarly, we recognize Vonovia's track record of restoring leverage levels in line with its 40%-45%

loan-to-value (LTV) target (corresponding to S&P Global Ratings-adjusted debt to debt plus equity of 50%-55%) after acquisitions.

There is a chance that the company will outperform our leverage expectations and prompt a rating upgrade, depending on net divestments in 2022 and 2023. Although we continue to see Vonovia's debt to EBITDA as higher than average, mostly because of the low-yield nature of residential assets, especially in Germany's most popular locations, we think that the company may achieve debt to EBITDA and debt to debt plus equity below 17x and 55% respectively, which would compare better with other peers rated in the same financial risk category. This could result from higher-than-expected noncore asset disposals, sale of development projects, or revaluation gains, for example. An upside would also depend on Vonovia's strategy toward Adler, because Vonovia can exercise a call option on 13% of Adler's shares until April 2023, which would induce additional cash spending and likely delay its deleveraging.

By gaining control of Deutsche Wohnen, Vonovia significantly grew its asset base and somewhat strengthened its business risk profile. Vonovia's assets, now worth about €91.5 billion (excluding signed acquisitions, up from €59 billion previously), should generate more than €1.8 billion annualized EBITDA, based on about 569,000 flats (compared with 415,000 previously). We expect the company to capitalize on resulting economies of scale, driving higher margins. Vonovia has demonstrated its capacity to integrate acquired portfolios to expand its business by keeping operating capabilities internally and developing an integration platform that accelerates integration. We think the company correctly addresses the growing environmental regulatory requirements by refurbishing and renovating approximately 3% of its portfolio per year to meet the latest standards in terms of thermal insulation and energy efficiency. We also think that potential rent regulations in Germany could hinder like-for-like rental growth for Vonovia and its peers, but we think the company's focus on affordable rents and its geographical diversity within Germany should minimize the potential impact. We therefore view the company's business risk profile comfortably positioned in the excellent category, and now require a less stringent debt-to-debt-plus-equity ratio for a rating upgrade (55% versus 50% previously).

Outlook

The positive outlook indicates that we could upgrade Vonovia if it decreases its debt leverage further than we currently expect over the next 24 months, as a result of more asset disposals, equity, or revaluation uplifts, for example. We also expect Vonovia to integrate Deutsche Wohnen, in line with its track record, while limiting acquisitions to comply with its publicly stated financial policy (with a reported LTV of 40%-45%, comparable with adjusted debt to debt plus equity of 50%-55%). We believe the combined entities should generate 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.

Downside scenario

We could consider revising the outlook to stable if:

- Debt to debt plus equity and debt to EBITDA ratios remain above 55% and 17x respectively over the next 24 months, because of unexpected debt-funded acquisitions or an inability to proceed with the planned asset disposals;

- The company's performance and overall asset liquidity significantly deteriorates as a result of more stringent social regulation or growing environmental requirements, for example; or
- The liquidity cushion decreases, because of a decreasing free operating cash flow base, additional cash-funded transactions, or late refinancing of upcoming maturities, for example.

Upside scenario

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

- The company is able to dispose sufficient assets or development projects, improve its asset value, or raise enough equity such that its debt to debt plus equity would sustainably stay below 55% while maintaining EBITDA interest coverage at 3x or above;
- Vonovia increases the amount of income available for paying down debt, so that its debt-to-EBITDA ratio returns to its historical average (15x-17x) sustainably; and
- The company further diversifies into markets with strong fundamentals and favorable demand trends, significantly decreasing its concentration on the German economy and mitigating the potential further tightening of domestic regulation, leading to stronger free cash flow.

Company Description

Vonovia is the leading listed residential real estate holding company in Germany, and largest listed real estate landlord by portfolio size in Europe. Its portfolio was worth about €91.5 billion as of Sept. 30, 2021 (including recently acquired Deutsche Wohnen and excluding signed disposals), and comprised about 569,000 owned residential units in Germany, Austria, and Sweden. The company manages an additional 74,000 units for third parties. Vonovia's strategy focuses on affordable apartments, leased at €7.18 per square meter on average (as of March 31, 2021). The company is listed on the German stock index (DAX) with an average market cap of currently about €38 billion. The largest shareholders are Norges Bank (11.1%), followed by BlackRock (8.3%) and APG (4.0%). Free float is 76.5%.

Liquidity

Liquidity sources as of Sept. 30, 2021 (including Deutsche Wohnen):

- About €5,082.2 million of unrestricted cash and equivalents as of Sept. 30, 2021;
- €2,621.7 million of undrawn credit lines available, maturing in more than 12 months; and
- Our forecast of €1.2 billion-€1.5 billion of cash funds from operations.

Liquidity uses as of Sept. 30, 2021 (including Deutsche Wohnen):

- About €2.8 billion of short-term debt maturities;
- Committed capital expenditure of roughly €400 million for the next 12 months; and
- A dividend of about €909 million. We believe that the company might partially pay scrip dividends and partially cash dividends, in line with previous years.

Ratings Score Snapshot

Issuer credit rating: BBB+/Positive/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)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

ESG Credit Indicators: E-2 S-2 G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- 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
- General Criteria: Methodology: Industry Risk, 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

Ratings List

Ratings Affirmed/ Outlook action

	To	From
Vonovia SE		
Issuer Credit Rating	BBB+/Positive/A-2	BBB+/Stable/A-2
Vonovia SE		
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/sourceId/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 © 2021 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.