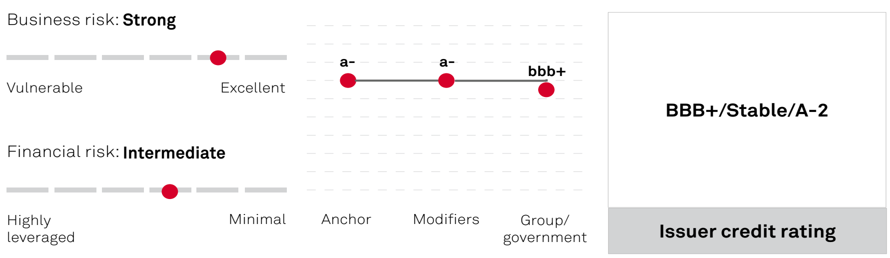
S&P Global Ratings

Research

Deutsche Wohnen SE

September 6, 2024

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
As a core subsidiary of Vonovia SE, the combined group is the largest listed German residential landlord, with a portfolio of €82.5 billion as of June 30, 2024, comprising more than 540,000 units.	Geographic concentration in Germany, a country with social and political debates on rent affordability, following strong rent and price increases in the past decade, particularly in Berlin, which represents about 77% of the stand-alone portfolio value.
Main focus on the regulated residential segment, which has proven resilient in the COVID-19 and high inflation periods and provides stable cash flow streams due to a favorable demand-supply unbalance.	High, albeit declining, debt-to-EBITDA ratio of about 12x-15x in 2024-2026 (12.8x as of June 30, 2024), owing to the low-yielding (3%-4%) nature of the German residential market, particularly Berlin. Core entity of the more leveraged Vonovia group (BBB+/Stable/A-2), and therefore vulnerable to potentially aggressive dividends or strategic decisions.
Moderate financial policy with a low reported loan-to-value (LTV) ratio of 30.0% as of June 30, 2024 (translating into a S&P Global Ratings-adjusted debt to debt plus equity of 36.7%) Strong EBITDA-interest-coverage ratio of 3x-4.0x (3.7 as of June 30, 2024), despite elevated rates environment, thanks to long-dated debt and low cost of debt.	

Deutsche Wohnen sold €150 million in assets to date and is aiming to dispose its €678 million portfolio of nursing homes by the year-end. We believe the company should achieve more disposals than in 2023, as the conditions improve now that interest rates are declining. We currently assume about €750 million disposals for 2024, which could include all or part of the

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portfolio of nursing homes that the company is planning to dispose. Deutsche Wohnen classified the nursing home business as discontinued operations in its last half-year report.

Devaluations are slowing, but our assumptions remain conservatively unchanged. The company reported an about 2.1% revaluation loss as of June 30, 2024, which was smaller than our 4.0% assumptions for 2024. We understand valuations are likely to stabilize in the second half of the year, and price of condominiums have started increasing in Germany according to some recent market research. This is thanks to stable interest rates and two years of unprecedented price correction. This should result in a debt to debt and equity of about 37%-40% in 2024-2026.

EBITDA-interest-coverage ratio should remain sustainable for the current rating level over the next 24 months. The ratio may slightly deteriorate over time, due to higher refinancing rates, but we still expect this ratio to remain close to 3.0x until 2026, thanks to growing revenue, asset disposals, and a relatively low leverage.

Deutsche Wohnen's liquidity position is supported by its good access to funding, asset disposals, and parent Vonovia's likely support in case of need. We also expect Deutsche Wohnen to maintain adequate liquidity headroom, while liquidity management is increasingly held at the group level. Over the next 12 months, we understand the company plans to roll over secured loan maturities (€769 million) and repay the unsecured debt maturities (€590 million) from disposal proceeds (€150 million as of June 30, 2024) and funds from operations (FFO) (€340 million-€360 million). We believe any shortfall would likely be covered by Vonovia's ample liquidity cushion (see Vonovia SE, Aug. 23, 2024).

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 with 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.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Germany of 0.3% in 2024 and 1.2% in 2025. We forecast rising consumer price index growth in the country of 2.7% in 2024, reducing thereafter to around 2.3% in 2025.
- Around 3.0%-3.5% annual like-for-like growth in rental income over 2024 and 2025, mainly supported by indexed leases contracts, partly offset by weaker rent affordability for tenants that should somewhat limit rental price uplifts.
- High and stable occupancy rates of about 98%-99% over the next 24 months.
- Negative portfolio revaluation of about 4% in 2024, conservatively assuming some further yield expansion would negatively impact market transactions.
- Annual capital expenditure (capex) of around €500 million-€550 million over the coming 24 months, including maintenance of the existing portfolio, investments for new construction, and refurbishment.
- We do not factor in any acquisitions but include annual disposal of around €250 million-€300 million, in line with the efforts to reduce leverage.
- Annual dividends of around €300 million.

Key metrics

Deutsche Wohnen SE--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026
(Mil. EUR)	2020a	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	1,102	1,110	1,049	876	898	920	932
EBITDA	695	670	675	606	548	561	569
Funds from operations (FFO)	506	489	399	410	354	341	311
Interest expense	184	173	174	175	157	183	221
Cash flow from operations (CFO)	505	465	365	296	357	343	313
Capital expenditure (capex)	377	778	789	904	550	550	550
Dividends	317	359	29	23	300	300	300
Debt	10,966	9,256	8,984	8,475	8,665	8,872	9,113
Equity	13,833	17,203	16,775	13,998	13,612	13,557	13,481

Deutsche Wohnen SE--Forecast summary

Adjusted ratios							
EBITDA margin (%)	63.1	60.3	64.4	69.2	61.0	61.0	61.0
EBITDA interest coverage (x)	3.8	3.9	3.9	3.5	3.5	3.1	2.6
Debt/EBITDA (x)	15.8	13.8	13.3	14.0	15.8	15.8	16.0
Debt/debt and equity (%)	44.2	35.0	34.9	37.7	38.9	39.6	40.3

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 €82.5 billion as of June 30, 2024. On a stand-alone basis, Deutsche Wohnen's portfolio is the second-largest residential property portfolio in Germany, with 140,195 residential and 2,517 commercial units as part of the residential premises, as well as 25,736 garages and parking spaces. The total fair value is about €22.5 billion as of June 30, 2024, 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, 2024, Vonovia is its largest shareholder with an 86.87% stake. Free float, according to the definition of Deutsche Börse, is 12.29%.

Peer Comparison

Deutsche Wohnen SE--Peer Comparisons

	Deutsche Wohnen SE	**Gecina**	**Vonovia SE**	**Vesteda Residential Fund FGR**	**Grand City Properties S.A.**
Foreign currency issuer credit rating	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Negative/A-2
Local currency issuer credit rating	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Negative/A-2
Period	RTM	RTM	RTM	Annual	RTM
Period ending	Jun-24	Jun-24	Jun-24	Dec-23	Mar-24
Mil.	EUR	EUR	EUR	EUR	EUR
Revenue	879	678	3,317	378	604
EBITDA	625	556	2,379	258	320
Funds from operations (FFO)	424	467	1,444	209	210
Interest expense	170	90	794	56	114
Operating cash flow (OCF)	460	462	1,417	213	187
Capital expenditure	927	429	1,043	302	83
Dividends paid	23	393	661	199	0
Cash and short-term investments	527	378	1,437	4	1,287
Debt	8,002	6,541	42,734	2,597	4,145
Equity	13,805	10,293	28,752	6,392	4,377
Valuation of investment property	23,559	14,834	80,720	8,674	8,681
Adjusted Ratios					
EBITDA margin (%)	71.1	82.0	71.7	68.3	52.9

EBITDA interest coverage (x)	3.7	6.2	3.0	4.6	2.8
Debt/EBITDA (x)	12.8	11.8	18.0	10.1	13.0
Debt/debt and equity (%)	36.7	38.9	59.8	28.9	48.6

Business Risk

Deutsche Wohnen's large portfolio of income-producing residential and nursing properties, worth about €22.5 billion as of June 30, 2024, underpins our assessment of the company's strong business risk profile. It operates as a core subsidiary of Vonovia, Germany's largest residential player, with a combined portfolio of €82.5 billion as of June 30, 2024. Vonovia acquired 87.6% of Deutsche Wohnen's share capital during 2021.

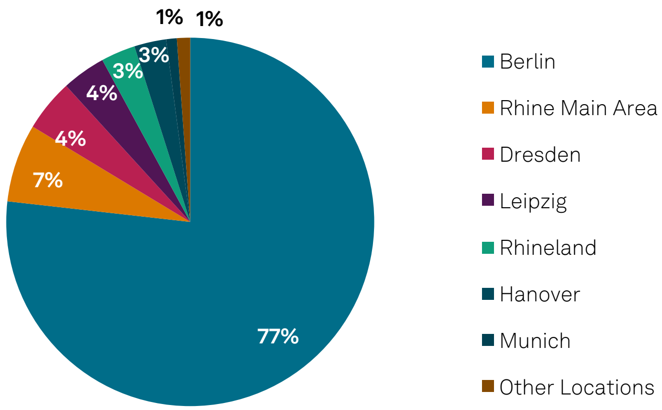
Deutsche Wohnen's strategy is to focus on creating affordable housing in metropolitan regions. It leased residential properties at €7.80 per square meter (sqm) on average in the first half of 2024 (versus €7.55 per sqm in the first half of 2023). We tend to view residential properties as less cyclical and volatile than most other real estate segments, in particular the affordable segment. In addition, we believe the German market provides strong fundamentals to real estate landlords. These include long average tenant stays (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 price affordability ratio; and a healthy domestic economy.

Our assessment also reflects Deutsche Wohnen's focus on German metropolitan areas with favorable market dynamics. Its residential portfolio in particular is focused on Greater Berlin (more than 77% of total portfolio value as of June 30, 2024), which benefits from favorable demand and supply dynamics, high population density, positive immigration balance, and insufficient new construction activity. The company has also been able to consistently maintain a very low vacancy rate in its residential portfolio (1.7% as of June 30, 2024, versus 1.9% as of June 30, 2023). It has also achieved positive like-for-like rental growth in the past few years, at about 3.7% for H1 2024.

With about 77% of its residential portfolio concentrated in Greater Berlin, Deutsche Wohnen's scale, scope, and diversity remain lower than that of its parent Vonovia--with €82.5 billion portfolio widely spread across Germany, Sweden, and to a lower extent, Austria. The concentration on Germany exposes the company to social, regulatory, and reputation uncertainties compared with globally more diversified residential real estate peers in the same business risk category. Social and political debates on rent affordability in Germany's metropolitan areas remain active. In addition, Germany's "Klimaschutzgesetz" (climate protection law) sets high hurdles for reduction of carbon dioxide in coming years, which is likely to result in high ongoing investments, potentially reducing profitability.

Deutsche Wohnen's Residential Portfolio is concentrated on Greater Berlin

% of Portfolio Value; as of June 30, 2024



Source: S&P Global Ratings.

We understand that Deutsche Wohnen is currently contemplating selling its nursing assets division (about 7% of EBITDA as of June 30, 2024, but already classified as "discontinued operations"), which would make it a pure residential player. Deutsche Wohnen is also engaged in development activities which we view as more cyclical and less predictable than real estate ownership. That said, we understand Deutsche Wohnen's development activities remain and should remain limited (less than 1% of EBITDA as of June 30, 2024).

Financial Risk

The company's leverage is low, with a debt-to-debt plus equity ratio of 36.7% (corresponding to a reported LTV of 30.0%) as of June 30, 2024, up from 33.8% as of June 30, 2022, owing to the portfolio devaluations. Despite our conservative assumption of additional devaluations (-4%) and limited disposals for 2024, we expect the company's debt-to-debt plus equity ratio to remain 37%-39% over the next two years. That said we also expect the portfolio valuations to stabilize within this period, reducing the reliance on divestments to keep leverage down.

Furthermore, debt to EBITDA improved to 12.8x as of June 30, 2024, versus 14.0x as of Dec. 31, 2023, as a result of growing revenue and deleveraging from disposals. This ratio continues to compare negatively with most companies at the same rating level, owing to the low-yielding (3%-4%) nature of the German residential markets, particularly in Berlin.

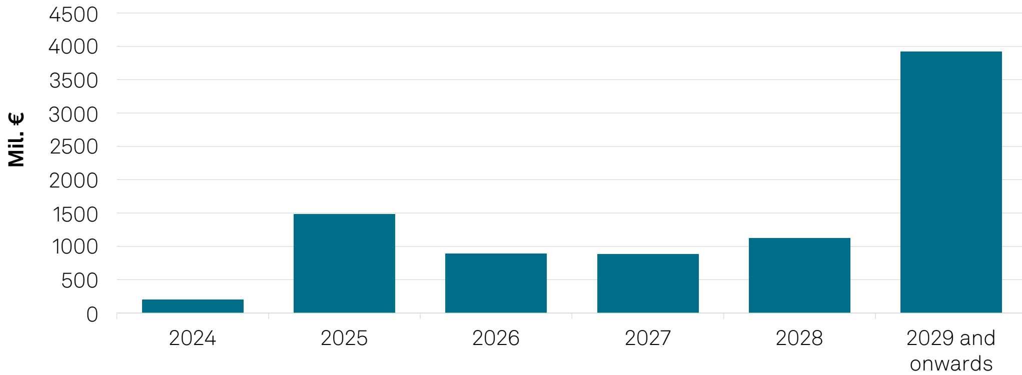
Interest rates have stabilized, and we expect the company's EBITDA interest coverage to remain above 3.0x, even if high interest rate environment has deteriorated the ratio below 4x. We assume the company will maintain good access to capital markets over the coming 24 months.

On the other hand, we believe Deutsche Wohnen could be subject to potentially aggressive dividends or strategic decisions from its core parent, Vonovia SE, which is more leveraged.

Debt maturities

Deutsche Wohnen's Debt Maturity Profile

As of June 2024



Source: S&P Global Ratings.

Deutsche Wohnen SE--Financial Summary

Period ending	Dec-22	Jun-23	Dec-23	Jun-24
Reporting period	RTM	RTM	RTM	RTM
Display currency (mil.)	EUR	EUR	EUR	EUR
Revenues	1,049	957	876	879
EBITDA	675	644	605	625
Funds from operations (FFO)	399	436	410	424
Interest expense	174	186	168	170
Operating cash flow (OCF)	365	390	297	460
Capital expenditure	789	746	905	927
Dividends paid	29	23	23	23
Cash and short-term investments	184	218	157	527
Debt	8,984	8,520	8,475	8,002
Common equity	16,775	15,361	13,998	13,805
Valuation of investment property	28,230	25,986	23,848	23,559
Adjusted ratios				
EBITDA margin (%)	64.4	67.3	69.1	71.1
EBITDA interest coverage (x)	3.9	3.5	3.6	3.7
Debt/EBITDA (x)	13.3	13.2	14.0	12.8
Debt/debt and equity (%)	34.9	35.7	37.7	36.7

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Reconciliation Of Deutsche Wohnen SE Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2023									
Company reported amounts	8,482	13,611	876	594	(3,236)	168	606	385	23	905
Cash taxes paid	-	-	-	-	-	-	(47)	-	-	-
Cash interest paid	-	-	-	-	-	-	(149)	-	-	-
Lease liabilities	105	-	-	-	-	-	-	-	-	-
Postretirement benefit obligations/ deferred compensation	44	-	-	-	-	3	-	-	-	-
Accessible cash and liquid investments	(157)	-	-	-	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	6	-	-	-	-	-
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(88)	-	-
Noncontrolling/ minority interest	-	387	-	-	-	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	(2)	(2)	-	-	-	-	-
EBITDA: other	-	-	-	14	14	-	-	-	-	-
D&A: Asset valuation gains/(losses)	-	-	-	-	3,722	-	-	-	-	-
Interest expense: other	-	-	-	-	-	3	-	-	-	-
Total adjustments	(8)	387	-	12	3,740	6	(196)	(89)	-	(0)
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	8,475	13,998	876	606	504	175	410	296	23	904

Liquidity

We assess Deutsche Wohnen's liquidity as adequate, supported by our forecast that the company's liquidity sources will comfortably exceed uses by more 1.2x over the 12 months from June 30, 2024.

Our assessment of Deutsche Wohnen's liquidity is supported by its good track-record of accessing capital markets, and its strong relationships with German banks. Furthermore, we understand that the company's liquidity management will be held at the Vonovia level. Although

Deutsche Wohnen doesn't need it now, we believe Vonovia would likely bring financial support and make up any shortfall its subsidiary may have.

Principal liquidity sources

- Cash and Liquid investments of around €529 million;
- Cash funds from operations of about €340 million-€360 million;
- Proceeds from contracted asset disposals of €150 million; and
- Vonovia's support in case of need.

Principal liquidity uses

- Around €1,358 million of debt maturities; 55% of which consist in secured bank loans that the company plans to rollover; and
- Net investments of around €300 million, which we understand are not fully committed.

Covenant Analysis

Requirements

Most of Deutsche Wohnen's bank debt facilities were granted for the purpose of financing real estate assets. Loan agreements are therefore mostly secured by land charges and assignments of rental payments, and most of them include financial covenants, such as LTV ratios, a debt service coverage ratio, and exit yields or multiples ratios.

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

Compliance expectations

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

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 77% of portfolio value).

Group Influence

We view Deutsche Wohnen as a core subsidiary of Vonovia. Vonovia holds 86.87% stake in Deutsche Wohnen, which is fully integrated as a core division of the Vonovia group. Deutsche Wohnen will be part of the group's identity and strategy, given its portfolio complements that of Vonovia; both portfolios comprise German residential assets with similar rent levels and occupancy rates. Deutsche Wohnen's portfolio represents around 30% of the combined entity's portfolio value, strengthening Vonovia's competitive position in Greater Berlin where Deutsche Wohnen owns about 77% of its residential assets (in fair value). We believe Vonovia would likely support Deutsche Wohnen under any foreseeable circumstances. Therefore, our ratings on Deutsche Wohnen are aligned with our rating on Vonovia.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2024, the company's capital structure comprises 58% secured debt and 42% unsecured debt. Unsecured bonds are issued under Deutsche Wohnen SE.

Analytical conclusions

Deutsche Wohnen's senior unsecured debt is rated 'BBB+', in line with the long-term issuer credit rating. The company's ratio of secured debt to total fair value assets as of June 30, 2024, was about 20%, well below our threshold of 40% for notching down senior our issue rating on unsecured debt.

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	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**a-**

Related Criteria

- 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, Jan. 7, 2024
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria| Criteria | Corporates | Industrials Key Credit Factors For The Real Estate Industry. February 26, 2018

Related Research

- Vonovia SE, Aug 23, 2024
- Industry Credit Outlook Update Europe: Real Estate (REITs), July 18, 2024
- Most European REITs' Valuations Should Bottom Out In 2024, July 10, 2024
- Highlights From Our 2024 European Real Estate Conference, June 20, 2024
- German Residential REITs Remain Supported By Funding Access And Solid Rent Fundamentals, May 31, 2024
- Bulletin: Vonovia's Disposals, Rental Growth, And Funding Access Mitigate Credit Pressure From Yield Expansion, April 4, 2024

Ratings Detail (as of September 06, 2024)*	
Deutsche Wohnen SE	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Issuer Credit Ratings History	
11-Nov-2022	BBB+/Stable/A-2
21-Dec-2021	BBB+/Positive/A-2
25-Oct-2021	BBB+/Stable/A-2
25-May-2021	A-/Watch Neg/A-2
20-Nov-2019	A-/Negative/A-2
Related Entities	
Vonovia SE	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+

*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.