S&P Global
Ratings

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Deutsche Wohnen SE

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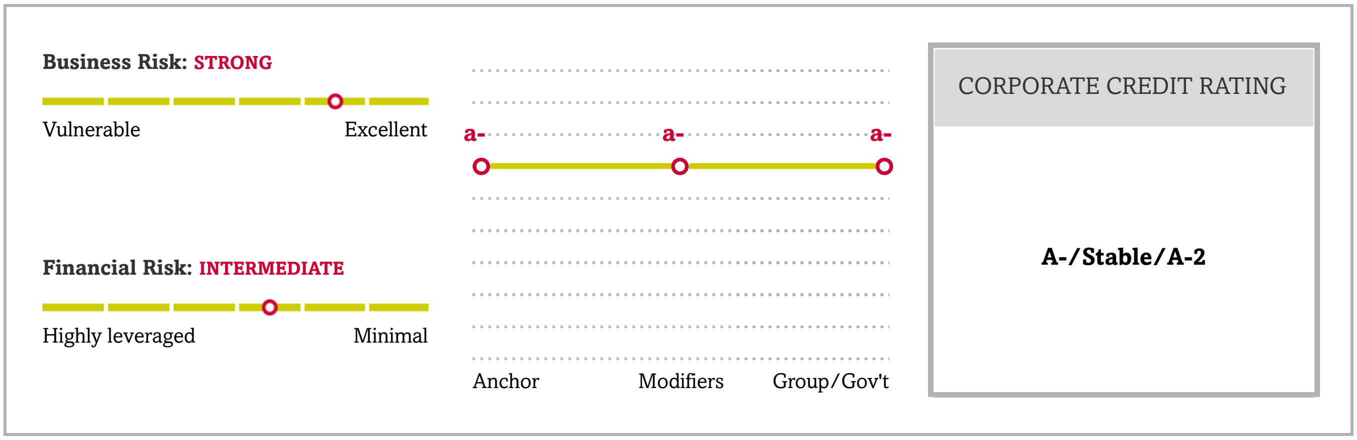
Deutsche Wohnen SE



Rationale

Business Risk: Strong

- Large portfolio of about 161,000 residential units and 6,700 nursing homes, for a total fair value of €18.3 billion as of Sept. 30, 2017.
- Residential portfolio mainly focused on the mid-range segment, with a large presence in Greater Berlin (71%), which benefits from favorable market dynamics.
- Positive like-for-like growth in rental income and resilient cash flows, supported by Deutsche Wohnen's highly diversified tenant base, focus on the mid-range segment, high occupancy rate, and long average lease duration.
- Expected moderate increase in the share of the higher yielding nursing homes business in line with the company's strategy. While the nursing homes segment has lower margins, it benefits from positive demographic trends and a favorable regulatory environment.

Financial Risk: Intermediate

- Moderate financial policy, with our S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio forecast at about 40% over the next two years.
- Management anticipates its reported loan-to-value (LTV) ratio with a target range of 35%-40%, supported by solid property revaluation.
- Low cost of debt and strong capacity to cover interest with a ratio of EBITDA to interest forecast at close to 4.0x over the next two years.
- Long-term maturities of about 8.3 years and good access to bank financing and capital markets.
- Improved level of liquidity facilities by added undrawn credit facilities earlier in 2017, although there is a low proportion of unencumbered assets compared with peers.

Outlook: Stable

The stable outlook reflects our view that German residential real estate company Deutsche Wohnen's portfolio should continue to generate resilient cash flows and positive like-for-like growth in its residential portfolio and nursing homes segment. We believe that the continued high demand for midsize residential apartments in affordable buildings in Deutsche Wohnen's main metropolitan locations, in particular Berlin, should support rental income and further boost asset value, although likely at a more moderate pace than in the past couple of years.

Our base case assumes that the EBITDA interest coverage ratio will remain at about 3.5x-4.0x over the next two years, and debt-to debt-plus equity close to 40%.

Downside scenario

We could lower the rating if debt-to-debt-plus-equity increases above 45%, which would most likely occur if Deutsche Wohnen funds large acquisitions or higher-than-anticipated capital expenditure (capex) with a high proportion of debt. We would also consider a negative rating action if EBITDA interest coverage drops below 3x, although this is not part of our base-case scenario.

Upside scenario

An upgrade would be contingent on Deutsche Wohnen's ability to improve its credit metrics with a debt-to-debt-plus-equity ratio decreasing to below 35% while maintaining like-for-like rental growth for its residential portfolio and high occupancy levels. In light of the current stated financial policy, we believe this scenario to be unlikely in the long term.

Our Base-Case Scenario

S&P Global Ratings forecasts relatively low real GDP growth for Germany for the next two years (2.1% in 2017 and 1.7% in 2018), while we expect inflation to slightly pick up to 1.8%-1.9% over the same period.

We believe that this macroeconomic environment should support residential landlords' ability to increase their rents, while we anticipate supply and demand dynamics to continue to be above the German average in Greater Berlin.

Assumptions

- About 10% overall revenue growth for 2017 as a result of the Pegasus acquisition at the end of last year, as well as the acquisition of 5,400 units in the first half of this year and mid-single-digit revenue growth for the following years.
- In the residential segment, we anticipate above 3% organic annual rental growth in the next two years, mainly stemming from the continuously strong performance of its Berlin assets where demand exceeds the new limited supply in the market, assuming no major tightening of German rent regulations.
- Robust and stable occupancy rates of about 98 % for the residential segment as well as for nursing homes and assisted living.
- EBITDA margins to remain at about 65%--excluding the privatization business, but including the nursing homes and assisted living segment--in line with the recent cost savings achieved.
- Uplift in the asset portfolio valuation of approximately 10% in 2017. We forecast mid-single-digit growth in the portfolio valuation for 2018 and 2019 in line with our forecasts for German housing prices (+6% in 2018 and +4% in 2019), which we view as relatively conservative, as Berlin tends to perform better than the country on average.
- Regarding asset rotation, we anticipate further acquisitions in the nursing homes segment in 2018-2019, in line with the company's intention to increase its exposure to this segment. In line with management's guidance, we assume privatization sales to slightly reduce in the next two years to about 1,000-1,500 units per year. Overall, our base case assumes the company will remain a net investor, but we understand that it may change on an opportunistic basis.
- We assume an increase in overall capex of about €300 million per year over the next three years. This includes about €200 million per year to modernize and renovate the flats over the next six years, and development capex of about €50 million-€100 million per year over the next five years, as Deutsche Wohnen plans to build about 2,200 units by 2020-2021. This will mainly entail adding

Key Metrics

	2016A	2017E	2018E
EBITDA interest coverage (%)	4.1	~3.8	~4.0
Debt to debt plus equity (%)	41.8	~40	~40
Debt to EBITDA (x)	11.3	~11.5	~12

A--Actual. E--Estimate.

additional floors to existing buildings, as well as adding buildings next to existing buildings. Deutsche Wohnen is mostly planning to use its own landbank for its development activities.

- We forecast the 2018 dividend payment will increase to about €300 million.

Company Description

Deutsche Wohnen is one of the largest publicly listed residential property companies in Germany. As of Sept. 30, 2017, its portfolio comprised approximately 161,000 residential units, as well as about 6,700 nursing homes, for a total fair value of about €18.3 billion. In the medium term, the company expects further investments in the nursing segment following their recent acquisitions, such as the Pegasus portfolio at the end of 2016.

Business Risk: Strong

Deutsche Wohnen's large portfolio of income-producing residential and nursing properties--worth about €18.3 billion as of Sept. 30, 2017--underpin the company's business risk profile. It is the second largest residential property holding company in Germany (after Vonovia, which has a portfolio of about €30.9 billion).

Deutsche Wohnen's strategy is to focus on affordable apartments, leased at €6.05 per square meter on average as of Sept. 30, 2017. We tend to view residential properties as less cyclical and volatile than most other commercial real estate segments, in particular in 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 good price affordability ratio, and a currently 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 (71.0% of residential units as of Sept. 30, 2017), which benefits from favorable demand and supply dynamics. In this context, Deutsche Wohnen has been able to maintain a very low vacancy rate in its residential portfolio (2.1% as of Sept. 30, 2017). It has also achieved robust like-for-like rental growth in the past few years; +4.1% in the past 12 months to Sept. 30, 2017, for its overall residential portfolio, and +5.0% for Greater Berlin only, over the same period. Although our base case anticipates that this trend should continue, the regulated residential property market limits realization of rent upside potential in line with market rents.

Deutsche Wohnen's scale, scope, and diversity remain lower than its residential peers such as Vonovia or Akelius. However, we believe that Deutsche Wohnen's large concentration in Berlin allows the company to benefit from economies of scale, as illustrated by a best-in-class cost ratio of about 11% (corporate expenses to gross rental income).

We understand that Deutsche Wohnen intends to increase the share of its nursing homes segment to up to 15% of the group's EBITDA from 8% of EBITDA at Sept. 30, 2017. The contribution to earnings of the nursing segment increased significantly to €36.9 million at Sept. 30, 2017 compared with €13.7 million the year before. This is primarily a result of the acquisition of the Pegasus and the HSD portfolio in the second half of 2016, and we expect the company to make further acquisitions in the nursing homes segment in the next 12 to 24 months.

Gross margins in this segment are much lower than in the residential segment, as Deutsche Wohnen partly acts as the facility operator. As of Sept. 30, 2017, the company operates 23 nursing facilities out of 51 owned facilities. The nursing home segments benefit from favorable demographic trends, thanks to the ageing population in Germany, a supportive regulatory environment, and a higher yield (about 6.5%) than in residential. Deutsche Wohnen's portfolio also enjoys an above average occupancy rate (about 97% to 98%) in this segment compared with the market average, which is much lower, mainly as a result of existing nursing units not at required standards (85%).

Our Base-Case Operating Scenario

- Tenant demand for midsize affordable apartments should remain solid in Germany, and in Berlin in particular, with rents growing steadily in 2017-2018. This assumes a low supply of new assets, a continued increase in the number of households in the cities where Deutsche Wohnen is present, and no major change in the regulatory framework.
- We anticipate the occupancy rate to stay high in both the residential and nursing homes segment.

Peer comparison

Table 1

Deutsche Wohnen SE--Industry Sector: Real Estate Investments

	Deutsche Wohnen SE	Vonovia SE	Grand City Properties S.A.	Akelius Residential Property AB	Klepierre
Rating	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	A-/Stable/A-2
Data source (RTM*)	September 2017 RTM	September 2017 RTM	September 2017 RTM	September 2017 RTM	June 2017 RTM
(Mil. €)					
Revenues	839.3	2,181.3	482.7	434.6	1,323.5
EBITDA	554.5	1,077.2	242.8	228.6	999.1
Funds from operations (FFO)	383.1	707.7	162.6	86.0	741.4
Interest expense	129.4	348.0	52.8	142.4	239.8
Net income from cont. oper.	1,644.6	3,235.6	474.9	1,015.7	1,663.8
Operating cash flow	154.2	627.3	145.3	34.1	787.4
Capital expenditures	208.6	871.9	72.7	296.0	352.4
Free operating cash flow	(54.4)	(244.6)	72.6	(262.0)	435.0
Dividends	268.3	(7.6)	95.4	832.6	610.7
Discretionary cash flow	(322.7)	(236.9)	(22.8)	(1,094.6)	(175.7)
Cash and short-term investments	395.0	272.0	536.0	114.0	461.4

Table 1

Deutsche Wohnen SE--Industry Sector: Real Estate Investments (cont.)					
Debt	6,550.6	14,542.7	2,549.2	4,707.4	9,328.5
Equity	9,146.6	15,326.1	3,248.4	4,430.7	12,351.9
Debt and equity	15,697.2	29,868.8	5,797.6	9,138.1	21,680.4
Valuation of investment property	18,316.9	31,553.5	5,803.9	10,114.0	21,220.6
Adjusted ratios					
Twelve-month revenue growth (%)	10.9	37.1	15.3	(9.6)	1.8
EBITDA margin (%)	66.1	49.4	50.3	52.6	75.5
Return on capital (%)	3.5	3.5	4.3	2.5	6.0
EBITDA interest coverage (x)	4.3	3.1	4.6	1.6	4.2
Debt/EBITDA (x)	11.8	13.5	10.5	20.6	9.3
FFO/debt (%)	5.8	4.9	6.4	1.8	7.9
Debt/debt and equity (%)	41.7	48.7	44.0	51.5	43.0

*Rolling 12 months.

Financial Risk: Intermediate

Deutsche Wohnen's leverage ratio has remained stable compared with last year. Our ratio of debt-to-debt-plus equity is 41.7% as of Sept. 30, 2017 (37% reported LTV), and we anticipate that it should stay well below 45% over the next two years.

Thanks to recent refinancing activities and the general low interest rate environment in Germany, Deutsche Wohnen has improved its cost of debt (1.4% as of Sept. 30, 2017) and maintains a long average debt maturity profile (8.3 years as of Sept. 30, 2017). Its ratio of EBITDA to interest is also currently very robust at 4.3x for the 12 months to Sept. 30, 2017 and we anticipate that the company should be able to maintain it close to 4.0x over the next two years.

Deutsche Wohnen's low amount of unencumbered assets (which currently generate less than 25% of the net operating income), and the large amount of secured debt (which represents 66% of total debt), continue to constrain the company's capital structure. This limits to some extent its financial flexibility, in our view. We also note the improvement in liquidity lines, with about €440 million of undrawn bank lines available as of Sept. 30, 2017.

Our Base-Case Cash Flow And Capital Structure Scenario

In our base-case scenario, we forecast that Deutsche Wohnen should be able to maintain an EBITDA interest coverage ratio of about 4x in the next two years. This mainly reflects our forecast of a slightly growing EBITDA base and stable cost of debt following recent refinancing.

We forecast a debt-to-debt-plus-equity ratio of close to 40%, positively impacted by asset valuations and equity increases, while its debt level may moderately increase to fund its capex program.

Financial summary

Table 2

Deutsche Wohnen SE--RTM				
Industry Sector: Real Estate Investment Trust Or Company				
	September 2017	**June 2017**	**March 2017**	**December 2016**
(Mil. €)				
Revenues	839.3	818.2	796.1	774.6
EBITDA	554.5	548.6	535.5	524.4
Funds from operations (FFO)	383.1	379.6	361.2	364.2
Interest expense	129.4	129.6	138.6	126.6
Net income from continuing operations	1,644.6	1,625.9	1,531.8	1,583.9
Cash flow from operations	154.2	149.7	98.9	24.7
Capital expenditures	208.6	182.0	162.5	150.0
Free operating cash flow	(54.4)	(32.3)	(63.6)	(125.3)
Dividends paid	268.3	274.1	188.6	188.6
Discretionary cash flow	(322.7)	(306.4)	(252.2)	(313.9)
Cash and short-term investments	395.0	323.1	592.9	184.7
Debt	6,550.6	6,511.6	6,023.5	5,915.6
Equity	9,146.6	9,111.8	8,737.2	8,231.9
Debt and equity	15,697.2	15,623.4	14,760.7	14,147.5
Valuation of Investment Property	18,316.9	17,768.2	16,935.5	16,415.8
Adjusted ratios				
Twelve month revenue growth (%)	10.9	11.0	11.4	10.5
EBITDA margin (%)	66.1	67.0	67.3	67.7
Return on capital (%)	3.5	3.4	3.6	3.7
EBITDA interest coverage (x)	4.3	4.2	3.9	4.1
Debt/EBITDA (x)	11.8	11.9	11.2	11.3
FFO/debt (%)	5.8	5.8	6.0	6.2
Debt/debt and equity (%)	41.7	41.7	40.8	41.8

Liquidity: Adequate

We assess Deutsche Wohnen's liquidity as adequate, supported by our forecast that the company's liquidity sources will exceed its funding needs by more than 1.2x over the next 12 months to Sept. 30, 2018.

Our assessment of liquidity is supported by Deutsche Wohnen's good track record of accessing the equity and capital markets and its strong relationships with German banks.

Principal Liquidity Sources	Principal Liquidity Uses
Deutsche Wohnen's principal liquidity sources over the next 12 months to Sept. 30, 2017 include: • About €383 million of unrestricted cash available and an addition of €440 million of undrawn committed bank lines, maturing in more than 12 months; • About €400 million to €430 million of cash funds from operations; and • Approximately €130 million of committed sale proceeds.	• About €52 million of short-term debt maturities, including debt amortization; • Roughly €300 million of capex spending for the next 12 months, albeit we understand that most of it is not committed; and • €153 million of committed acquisitions.

Debt maturities

Table 3

Deutsche Wohnen SE--Debt Maturities

	September 2017
Q4 2017	1
2018	5
2019	8
2020	721
2021	176
Thereafter	6,306
Total debt	7,217

Covenant Analysis

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 assignments of rental payments, and most of them include financial covenants, such as loan-to-value ratios, a debt service coverage ratio, and exit yields or multiples ratios.

We understand that the headroom for most of the facilities is above 10% for all three types of covenants, in line with our requirement for adequate liquidity for real estate investment companies. The headroom remains below 10%, however, on the LTV covenants for some facilities. This is because the covenants are based on the starting book value and do not capture any upside in valuation and rents, which have been material recently. In the unlikely event of a covenant breach, Deutsche Wohnen could do a down payment or provide additional collateral, without triggering an event of default.

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Issue Ratings

The issue ratings on Deutsche Wohnen's senior unsecured debt are currently rated at 'BBB+', one notch below the 'A-' long-term rating on Deutsche Wohnen, reflecting our view of the company's large proportion of higher-priority secured bank debt facilities. We estimate that the percentage of net operating income derived from unencumbered assets will be approximately 25%. This is below our current 50% threshold for equalizing the issue rating with the interest coverage ratio for investment-grade companies, and highlights that a significant amount of senior secured debt ranks ahead of the senior unsecured notes in terms of priority.

The company's secured debt to total assets is approximately 26% as of Sept. 30, 2017.

Capital structure

As of Sept. 30, 2017, the company's capital structure comprises 66% secured debt and 34% unsecured debt. Unsecured bonds are issued under Deutsche Wohnen SE.

Reconciliation

Table 4

Reconciliation Of Deutsche Wohnen SE Reported Amounts With S&P Global Ratings Adjusted Amounts

(Mil. €)	--Twelve months ended Sept. 30, 2017--									
Deutsche Wohnen SE reported amounts.										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**	**Capex**
Reported	7,180.30	8,842.20	839.35	587.36	2,865.25	127.74	587.36	151.93	268.32	208.60
S&P Global Ratings' adjustments										
Interest expense (reported)	--	--	--	--	--	--	(127.74)	--	--	--
Interest income (reported)	--	--	--	--	--	--	3.99	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(45.40)	--	--	--
Operating leases	7.13	--	--	1.70	0.50	0.50	1.20	1.20	--	--
Postretirement benefit obligations/deferred compensation	55.30	--	--	--	--	1.20	(1.68)	1.12	--	--
Surplus cash	(345.23)	--	--	--	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	--	5.75	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	(0.08)	--	--
Non-controlling interest/minority interest	--	304.40	--	--	--	--	--	--	--	--

Table 4

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

Debt - fair value adjustments	(353.50)	--	--	--	--	--	--	--	--	--
Debt - put options on minority stakes	6.50	--	--	--	--	--	--	--	--	--
EBITDA - gain/(loss) on disposals of PP&E	--	--	--	(36.40)	(36.40)	--	(36.40)	--	--	--
EBITDA - business divestments	--	--	--	1.80	1.80	--	1.80	--	--	--
D&A - asset valuation gains/(losses)	--	--	--	--	(2,822.25)	--	--	--	--	--
D&A - impairment charges/(reversals)	--	--	--	--	537.30	--	--	--	--	--
Total adjustments	(629.80)	304.40	0.00	(32.90)	(2,313.30)	1.70	(204.23)	2.24	0.00	0.00

S&P Global Ratings' adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	FFO	Cash flow from operations	Dividends paid	Capex
Adjusted	6,550.50	9,146.60	839.35	554.46	551.96	129.44	383.13	154.17	268.32	208.60

Capex--capital expenditures. FFO--funds from operations.

Related Criteria

- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- 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

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+
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 December 20, 2017)

Deutsche Wohnen SE	
Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured	BBB+
Corporate Credit Ratings History	
09-Dec-2016	A-/Stable/A-2
11-Feb-2016	A-/Stable/--
15-Oct-2015	A-/Watch Neg/--
18-Jun-2015	A-/Stable/--
20-Apr-2015	BBB+/Stable/--
17-Feb-2015	BBB+/Watch Neg/--
25-Nov-2014	BBB+/Stable/--

*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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