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Deutsche Wohnen SE

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Deutsche Wohnen SE

Business Risk: STRONG

Vulnerable — Excellent

Financial Risk: INTERMEDIATE

Highly leveraged — Minimal

Anchor	Modifiers	Group/Gov't
a-	a-	a-

Issuer Credit Rating
A-/Negative/A-2

Credit Highlights

Overview

Key strengths	**Key risks**
Second-largest listed German residential landlord with a portfolio of €26.3 billion as of Sept. 30, 2019, comprising about 162,700 residential units and 10,500 nursing home beds.	Further increased leverage during 2020, mainly due to external growth and its share buyback program, which we expect to decline by year-end 2020.
Main focus on the German residential segment, which has proved resilient in the current COVID-19 and economic crisis context and provides stable cash flow streams due to a favorable demand-supply mechanism.	Introduced Berlin rent freeze regulation (Mietendeckel) in 2020 harms like-for-like rental income growth and cash flow generation.
Moderate financial policy with a reported loan-to-value (LTV) ratio of 35%-40% (around 41%-46% S&P Global Ratings-adjusted debt to debt plus equity).	Geographic concentration in Germany, in particular Berlin, which represents about 75% of the total portfolio value.
Low cost of debt and strong capacity to cover interest, with forecast EBITDA to interest of 4.0x or above over the next two years.	

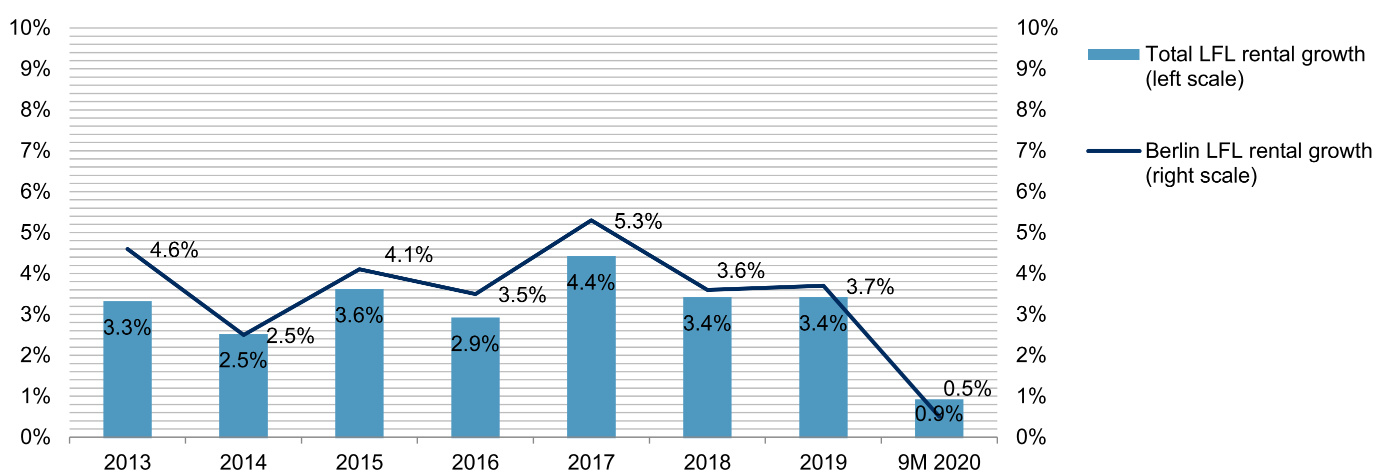
Deutsche Wohnen's credit metrics have deteriorated during the past 12 months, with limited headroom for its financial policy target and at the current rating level. S&P Global Ratings-adjusted debt to debt plus equity increased to 48.1% as of Sept. 30, 2020, versus 42.2% at end-2019. This mainly stems from almost €1.5 billion acquisitions and about €500 million share buybacks completed in the first nine months of the year, only partly offset by around €500 million disposals. We understand that the company is committed to restore some headroom under its financial policy, which targets limiting its LTV ratio to 35%-40% (translating into S&P Global Ratings-adjusted ratio of debt to debt plus equity of 41%-46%). As communicated in its third-quarter interim results, Deutsche Wohnen expects a revaluation of its portfolio of around 6% for full-year 2020. In addition, the company will receive proceeds of around €800 million signed disposals during the fourth quarter. We therefore expect our debt-to-debt-plus-equity ratio to revert just below 45% by year-end 2020, and to stabilize at 43%-45% during 2021, which would remain consistent with the current rating. However, we maintain our negative rating outlook to reflect a one-in-three chance that the company's credit metrics would not be restored within the next six-to-12 months.

The German residential asset class is proving resilient to the COVID-19 pandemic and economic crisis. Deutsche Wohnen's performance over the past nine months has demonstrated its strength in the face of the COVID-19 pandemic. As of September 2020, the company reported moderate like-for-like growth in rental income of 0.9% (versus 3.4% end of 2019). This slower rise is mainly attributable to the new Berlin rent regulation, capping absolute rent levels ("Mietendeckel") that came into force in February 2020. Occupancy levels remain high at above 98%, and we understand that less than 1% of its residential tenants have indicated payment difficulties related to COVID-19. This resilience mainly stems from the residential segment's high degree of asset and tenant diversification, and the favorable market fundamentals in Germany, including structural undersupply and strong demand in metropolitan areas.

Berlin's tightening rent regulation puts pressure on Deutsche Wohnen's rental growth prospects and cash-flow generation, while market fundamentals remain strong. Berlin's five-year rent freeze took effect on Feb. 23, 2020. Rents exceeding 20% of the rent ceilings ("Wuchermieten") shall be reduced to the rent ceiling level (taking into account premiums/discounts). This part of the law has taken effect nine months after it was enacted, therefore end-November 2020. Although it is unclear at this stage if the law is constitutional--being currently under review by the German federal court--the new regulation would include absolute rental ceilings, which the Berlin Senate has published, based on the construction year and features of the apartment. Since around 75% of Deutsche Wohnen's portfolio is in Berlin, like-for-like rental income has been declining since the implementation of the new regulation, with 0.9% year-on-year like for like rental growth as of Sept. 30, 2020 versus 3.4% for full-year 2019. In line with the company's published estimation, we anticipate an annual negative cash flow impact of approximately €25 million for 2021, mainly related to rents, which are currently at least 20% above the current respective rent ceiling. That said, the new regulation is unlikely solve Berlin's strong undersupplied market, and demand is likely to remain powerful, supporting high occupancy levels.

Chart 1

More Subdued Like-For-Like Rental Income Growth In 2020, Due To Berlin Regulation



Source: Company reports.

Outlook: Negative

We believe Deutsche Wohnen can overcome the challenges of the new Berlin regulation for residential landlords, and remain in line with its financial policy. This includes maintaining an LTV ratio of 35%-40%, translating into S&P Global Ratings-adjusted debt to debt plus equity of 41%-46%. However, we maintain a negative outlook because we believe there is a one-in-three chance that the company may not restore headroom within its financial policy in the next six-to-12 months, for example due to unexpected deteriorating operating performance or lower than anticipated asset revaluation gains.

Downside scenario

We could lower our ratings if Deutsche Wohnen experiences increasing operational costs, or if it is unable to offset operational costs following lower like-for-like rental income as a result of the new Berlin rent regulation, which would significantly reduce its cash-flow base. We also believe that its overall business profile could weaken compared with peers in the same category if the company considers additional disposals, which would significantly reduce its overall scale and size, or if it intensifies its geographical concentration in Berlin.

We would view it as credit negative if S&P Global Ratings-adjusted debt to debt plus equity remains above 45%, EBITDA interest coverage drops toward 3x, or we see a further surge in debt to annualized EBITDA close to 15x or above.

Upside scenario

We could revise the outlook back to stable if the company maintains solid operating performance in the next six-to-12 months, demonstrating the ability to offset any negative rent revision from the new Berlin rent regulation while maintaining a stable cost base. This would also require the company to maintain a large portfolio size, ensuring solid asset and tenant diversification, with exposure outside of Berlin.

We would also consider revising the outlook back to stable if Deutsche Wohnen reduces leverage to previous levels, leading to adjusted debt to debt plus equity well below 45% and debt to EBITDA of 14x or below.

Our Base-Case Scenario

Assumptions

- In the residential segment, we anticipate flat-to-slightly positive organic annual rental growth for 2020-2021 on the back of Berlin's new rental freeze.
- We believe the company could experience an annual negative cash flow impact of about €25 million in 2021, following the downward rent adjustment where actual rent levels exceed the rent ceiling by at least 20% or more. This should be partly mitigated by the company's 30% exposure outside of Berlin and its nursing home business, where contracts are linked to indexation. We therefore expect flat annual overall growth for 2020-2021, and 2.0%-3.5% in 2022, as market fundamentals will remain strong, including in Berlin where demand will continue to outpace new supply.

- Robust and stable occupancy rates of about 98% for the residential segment, slightly reducing in the nursing homes segment from 94.5% at the end of 2019 to around 92.0% during 2020-2022, notably due to facilities in Hamburg to be refurbished or rebuilt (88.3% in the city end of September 2020, versus 92.5% at end-2019).
- EBITDA margins to remain above 60%, excluding the privatization business but including the nursing home and assisted living segment. A slight drop in margins following the limited rent growth potential in Berlin is possible, while potential higher costs, for example due to maintenance or additional administrative costs, would be absorbed only to a limited extent.
- Uplift in the asset portfolio valuation of close to 6% for the full-year 2020, as estimated and communicated by the company's in its third-quarter interim results. We forecast conservatively around 2% annual organic growth in portfolio value for 2021-2022.
- We assume an overall annual capital expenditure (capex) of €500 million-€700 million (including capex required for new construction) over the next two-to-three years, in line with the company's strategy.
- In terms of asset rotation, we anticipate Deutsche Wohnen will be in a net buyer position in 2021.
- We assume, Deutsche Wohnen would likely fund any future external growth with a healthy mix of equity and debt, notably as it plans to increase its headroom within its financial policy in the next 12 months.
- We assume no more share buybacks in the next two years.
- Overall cost of debt should remain stable at 1.3%-1.5%.

Key metrics

Deutsche Wohnen SE--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
EBITDA	619.8	715.2	710 - 720	700 - 720	710 - 730
Debt	8,930.7	9,569.8	10,600 - 10,800	11,000 - 11,200	11,200 - 11,600
EBITDA interest coverage (x)	5.0	4.3	4.2 - 4.6	4.1 - 4.5	4.1 - 4.5
Debt to EBITDA (x)	14.4	13.4	14.5 - 15.0	15.0 - 16.0	15.0 - 17.0
Debt to Debt plus Equity (%)	42.9	42.2	44.0 - 45.0	43 - 45	43 - 45

a--Actual. e--Estimate. f--Forecast. *All figures adjusted by S&P Global Ratings.

We expect Deutsche Wohnen to remain resilient to the COVID-19 pandemic and economic crisis in the coming 24 months. German residential properties have proved relatively crisis-resilient over the past few months. Market fundamentals remain extremely favorable with structural undersupply, as well as strong demand, persisting in most metropolitan areas, while housing construction activity has further slowed as a result of the pandemic. We therefore do not expect any material impact from the pandemic on Deutsche Wohnen's rents or valuations for the next 24 months.

A long fixed-debt maturity profile should protect Deutsche Wohnen from rising interest rates. We believe Deutsche Wohnen is well positioned for short-to-medium term interest rate increases. The company has a debt maturity length of more than seven years, with exposure mainly to fixed interest rates. Including limited rental growth following the implementation of the Berlin rent freeze, we still believe EBITDA interest coverage will remain solid at 4x or above.

Company Description

Deutsche Wohnen is one of the largest publicly listed residential property companies in Germany. As of Sept. 30, 2020, its portfolio comprised approximately 165,700 residential and commercial units, as well as about 10,500 nursing home beds, for a total fair value of about €26.3 billion.

Table 1

Deutsche Wohnen--Company Summary (As Of Sept. 30, 2020)	
Portfolio value (EUR billion)	26.3
Segment (% of portfolio value)	91% Residential; 6% Nursing Homes; 3% Commercial
Number of units	162,706 Residential; 2,953 Commercial; 15,820 Nursing Beds
Geographic Spread	Germany, including 75% of portfolio value in Greater Berlin
In-Place Rent (EUR/sqm)	6.9
Vacancy (%)	1.7
Market Capitalization (EUR bn)*	15.0

Source: Company Report. Note: *As of mid Dec. 2020.

Peer Comparison

Table 2

Deutsche Wohnen SE--Peer Comparison					
Industry sector: Real estate investment trust or company					
	Deutsche Wohnen SE	**Gecina**	**Vonovia SE**	**Grand City Properties S.A.***	**Akelius Residential Property AB**
Ratings as of Dec. 1, 2020	A-/Negative/A-2	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/A-2
	--12 months ended--				
	Sept. 2020	**June 2020**	**Sept. 2020**	**Sept. 2020**	**Sept. 2020**
(Mil. €)					
Revenue	1,116.6	682.4	2,328.5	543.0	478.0
EBITDA	705.6	527.4	1,540.5	300.8	211.0
Funds from operations (FFO)	480.5	400.7	1,117.5	222.5	70.5
Interest expense	164.9	119.8	433.0	65.9	105.5
Cash flow from operations	432.5	414.8	1,040.1	182.2	77.5
Capital expenditure	313.8	589.4	1,658.9	73.8	434.0
Free operating cash flow (FOCF)	118.7	(174.6)	(618.8)	108.4	(356.5)
Dividends paid	317.4	407.9	939.4	71.0	105.5
Discretionary cash flow (DCF)	(797.7)	(692.7)	(1,558.2)	37.3	(1,069.0)
Cash and short-term investments	328.2	507.6	1,622.3	1,336.1	13.0
Debt	11,659.5	7,217.4	25,116.7	3,553.2	5,134.5

Table 2

Deutsche Wohnen SE--Peer Comparison (cont.)					
Equity	12,604.1	12,676.5	22,385.0	4,687.0	5,796.5
Debt and equity	24,263.6	19,893.9	47,501.7	8,240.2	10,931.0
Valuation of investment property	27,693.1	18,059.5	55,966.6	7,842.4	11,827.0
Adjusted ratios - RTM					
Annual revenue growth (%)	4.7	3.2	5.3	(3.0)	(4.6)
EBITDA margin (%)	63.2	77.3	66.2	55.4	44.1
Return on capital (%)	2.9	2.5	3.6	3.7	1.8
EBITDA interest coverage (x)	4.3	4.4	3.6	4.6	2.0
Debt/EBITDA (x)	16.5	13.7	16.3	11.8	24.3
FFO/debt (%)	4.1	5.6	4.4	6.3	1.4
Debt/debt and equity (%)	48.1	36.3	52.9	43.1	47.0

*Grand City Properties S.A. EBITDA margins are calculated on gross rental income, and not net rental income.

Business Risk: Strong

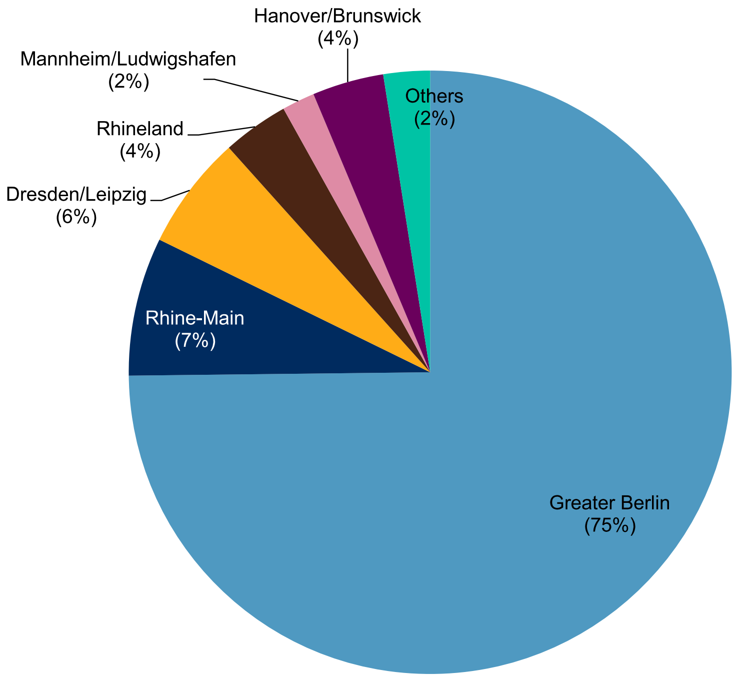
Deutsche Wohnen's large portfolio of income-producing residential and nursing properties worth about €26.3 billion as of Sept. 30, 2020 underpins the company's business risk profile. It is the second-largest residential property holding company in Germany (after Vonovia SE, which has a portfolio of about €56 billion), and among the largest real estate property companies in Europe.

Deutsche Wohnen's strategy is to focus on affordable apartments, leased at €6.93 per square meter (sqm) on average as of Sept. 30, 2020 (versus €6.82 per sqm over the same period last year). 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 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 (about 75% of total portfolio value as of Sept. 30, 2020), which benefits from favorable demand and supply dynamics. The company has also been able to consistently maintain a very low vacancy rate in its residential portfolio (1.7% as of September 2020, versus 2.1% as of Sept. 30, 2019). It has also achieved robust like-for-like rental growth in the past few years; 3.4% by the end of 2019, for its overall residential portfolio, and 3.7% for Greater Berlin only, over the same period.

Chart 2

Portfolio Spread--Deutsche Wohnen's Portfolio Is Concentrated On Greater Berlin
% of portfolio value; as of Sep. 30, 2020

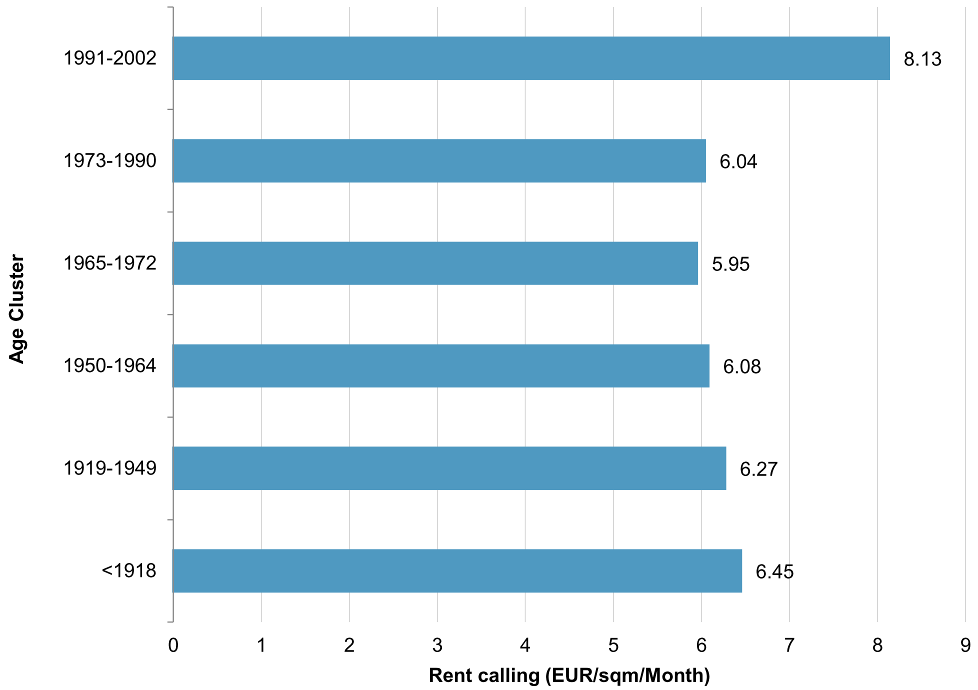


Source: Company report.

That said, we believe the new regulation, which includes a rent freeze in Berlin, puts pressure on Deutsche Wohnen's rental growth prospects and cash flow generation. We believe the majority of applicable rent ceilings for Deutsche Wohnen's portfolio will be between €6.08 and €6.45 per sqm for buildings constructed before 1990, compared with the company's average rent per sqm of €6.90 in Greater Berlin for the majority of buildings constructed between 1919 and 1999. Therefore, we anticipate, in line with the company's published estimation, an annual negative cash flow impact of approximately €25 million from 2021, mainly related to rents, which are currently at least 20% above the current respective rent ceiling.

Chart 3

Rental Ceilings (EUR/sqm/Month)



Source: Company report.

With 75% of its portfolio concentrated in Greater Berlin, Deutsche Wohnen's scale, scope, and diversity remain less than that of residential peers such as Vonovia--with a €56 billion portfolio widely spread across Germany, Sweden, and to a lower extent, Austria--or Akelius, with a €11.9 billion portfolio, spread across seven countries. However, we believe that Deutsche Wohnen's large concentration in Berlin allows the company to benefit from economies of scale, as illustrated by a low cost ratio of about 12% (corporate expenses to gross rental income).

We understand that Deutsche Wohnen aims to keep its share of its nursing home segment relatively stable going forward, representing 12% of the company's EBITDA of S&P Global Ratings adjusted rolling-12-months EBITDA on Sept. 30, 2019 (15% over the same period previous year). Gross margins in this segment are lower than in the residential segment, as Deutsche Wohnen partly acts as the facility operator. As of Sept. 30, 2020, the company operates 38 nursing facilities out of 77 owned facilities. The nursing home segments benefit from favorable demographic trends due to the ageing population in Germany, a supportive regulatory environment, and a higher yield (about 6%) than in residential (2%-3%). Deutsche Wohnen's operated portfolio historically reported a solid average occupancy rate, which slightly reduced from 94.5% at the end of 2019 to 92.3% at end-September 2020 due to current refurbishments and rebuilding works.

During 2020, Deutsche Wohnen expanded its development activities by acquiring 13 construction projects through the take-over of Munich-based ISARIA Wohnbau AG (2,700 residential units) and the acquisition of a 40% equity stake in Leipzig-based QUARTERBACK Immobilien AG (70 projects with around 7,700 residential units). We understand that two thirds of the projects will be "developed to hold" for the company's own portfolio, and one third will be "developed to sell". We view these development activities as more cyclical and less predictable than real estate ownership. That said, we understand Deutsche Wohnen will remain limited to development activities (less than 10% of portfolio value).

Financial Risk: Intermediate

Our rating assessment of Deutsche Wohnen takes into account the company's commitment to its financial policy, including a reported target LTV ratio of 35%-40% (translating into S&P Global Ratings-adjusted debt to debt plus equity of 41%-46%). The company's leverage has increased recently, with its S&P Global Ratings-adjusted debt to debt plus equity at 48.1% as of Sept. 30, 2020, versus 42.2% at the end of 2019, mainly due to the company's external growth and share buyback program. This ratio currently exceeds our 45% downside threshold, but we believe the company is likely to restore headroom under its financial policy, stating a LTV ratio of 35%-40%. We expect this ratio to revert below 45% by year-end 2020. This would be supported by around 6% positive revaluation gains, which Deutsche Wohnen expects according to its third-quarter reporting, and material proceeds of sales to be received during the fourth quarter (around €800 million) that should partly offset the material acquisition amounts (around €1.5 billion concluded at the end of September 2020) and share buybacks (€650 million for the full year). We expect our ratio of debt to debt plus equity to stabilize to 43%-45% during the next six-to-12 months.

Following those transactions, debt to EBITDA further increased to 16.5x at the end of September 2020 versus 13.4x at the end of 2019. We expect this ratio to decline slightly but to remain high in the next 24 months, in the 15x-16x range, capturing the full impact from the company's recent acquisitions, potentially offset by its increasing development activities together with potential growth in its lower-margin nursing home business.

For the next 24 months, we forecast EBITDA interest coverage to remain solid at about 4.0x-4.5x, thanks to low cost of debt of around 1.2% at the end of September 2020. Together with its long average debt maturity profile of more than seven years and mainly fixed-interest rate exposure, we anticipate that the company should be able to maintain EBITDA interest coverage well above 3x over the next two years.

Financial summary

Table 3

Deutsche Wohnen SE--Financial Summary					
Industry sector: Real estate investment trust or company					
	--12 months ended--				
	Sept. 2020	**June 2020**	**March 2020**	**Dec. 2019**	**Sept. 2019**
(Mil. €)					
Revenue	1,116.6	1,117.7	1,113.8	1,107.9	1,066.1
EBITDA	705.6	712.1	709.0	715.2	681.3
Funds from operations (FFO)	480.5	500.3	492.4	496.4	469.8
Interest expense	164.9	169.7	165.7	165.4	155.4
Cash flow from operations	432.5	436.0	449.7	454.4	460.7

Table 3

Deutsche Wohnen SE--Financial Summary (cont.)

Industry sector: Real estate investment trust or company					
	--12 months ended--				
	Sept. 2020	June 2020	March 2020	Dec. 2019	Sept. 2019
Capital expenditure	313.8	352.1	363.2	366.7	353.8
Free operating cash flow (FOCF)	118.7	83.9	86.5	87.7	106.9
Dividends paid	317.4	543.1	230.5	230.5	228.3
Discretionary cash flow (DCF)	(797.7)	(938.9)	(449.3)	(236.1)	(121.4)
Cash and short-term investments	328.2	1,319.7	297.2	685.6	341.6
Debt	11,659.5	10,580.5	10,008.8	9,567.1	9,935.7
Equity	12,604.1	12,634.3	13,097.4	13,107.3	12,241.8
Debt and equity	24,263.6	23,214.8	23,106.2	22,674.4	22,177.5
Valuation of investment property	27,693.1	26,989.2	26,722.8	26,473.4	25,657.2
Adjusted ratios-RTM					
Revenue growth, past 12 months (%)	4.7	9.9	15.0	20.3	18.2
EBITDA margin (%)	63.2	63.7	63.7	64.6	63.9
Return on capital (%)	2.9	3.0	3.0	3.1	3.0
EBITDA interest coverage (x)	4.3	4.2	4.3	4.3	4.4
Debt/EBITDA (x)	16.5	14.9	14.1	13.4	14.6
FFO/debt (%)	4.1	4.7	4.9	5.2	4.7
Debt/debt and equity (%)	48.1	45.6	43.3	42.2	44.8

Reconciliation

Table 4

Deutsche Wohnen SE--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Rolling 12 months ended Sept. 30, 2020--									
Deutsche Wohnen SE reported amounts										
	Debt	Shareholders' equity	Revenue	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Dividends	Capital expenditure
Reported	11,825.2	12,197.0	1,116.6	820.3	1,908.0	179.5	705.6	432.5	317.4	313.8
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(61.6)	--	--	--
Cash interest paid	--	--	--	--	--	--	(163.5)	--	--	--
Reported lease liabilities	169.4	--	--	--	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	92.9	--	--	--	--	1.5	--	--	--	--
Accessible cash and liquid investments	(278.2)	--	--	--	--	--	--	--	--	--

Table 4

Deutsche Wohnen SE--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)										
Dividends received from equity investments	--	--	--	0.3	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	--	17.2	--	--	--	--	--
Noncontrolling interest/minority interest	--	407.1	--	--	--	--	--	--	--	--
Debt: Fair value adjustments	(152.2)	--	--	--	--	--	--	--	--	--
Debt: Put options on minority stakes	2.4	--	--	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	(168.2)	(168.2)	--	--	--	--	--
EBITDA: Other	--	--	--	53.2	53.2	--	--	--	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	--	--	(1,129.9)	--	--	--	--	--
Interest expense: Other	--	--	--	--	--	(16.1)	--	--	--	--
Total adjustments	(165.7)	407.1	0.0	(114.7)	(1,227.7)	(14.6)	(225.1)	0.0	0.0	0.0
S&P Global Ratings' adjusted amounts										
	Debt	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
Adjusted	11,659.5	12,604.1	1,116.6	705.6	680.3	164.9	480.5	432.5	317.4	313.8

PP&E--Plant, property and equipment.

Liquidity: Adequate

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 Oct. 1, 2020.

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

Principal liquidity sources	Principal liquidity uses
• €311.4 million of unrestricted cash as of Sept. 30, 2020; • About €430 million of undrawn committed revolving credit facilities, maturing in more than 12 months; • Our forecast of €450 million-€470 million of cash	• €649.9 million of short-term debt maturities, including amortization; • About €270 million-€280 million of committed capex for the next 12 months; • About €120 million of committed acquisitions.

funds from operations for the next 12 months; and

- About €800 million of committed asset sales, relating mainly to the portfolio of around 6,400 units sold to LEG Immobilien AG.

Debt maturities

As of Sept. 30, 2020, the weighted-average debt maturity for the company stood at 7.5 years.

Covenant Analysis

Compliance expectations

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

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%).

Environmental, Social, And Governance

We believe Deutsche Wohnen's credit quality is more exposed to social risks than other German residential real estate companies given the 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. In February 2020, new regulation regarding rental caps ("Mietendeckel") was implemented in Berlin, which includes an absolute rental ceiling for landlords, capped for five years. As expected, Deutsche Wohnen's like-for-like rental income growth decreased to 0.9% in the first nine months of 2020 from 3.4% for the same period in the previous year and we expect like-for-like rents to remain at similar levels throughout 2021 and 2022, assuming the rent regulation remains in place. Although the underlying market fundamentals will remain intact, such as the strong undersupply of apartments in Berlin, we estimate that the company's cash flow will receive a hit of about €25 million in 2021 due to the downward adjustment of rents required for rents exceeding 20% or more of the respective rental ceiling (this part of the regulation was enforced in November 2020).

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Sept. 30, 2020, the company's capital structure comprises 55% secured debt and 45% unsecured debt. Unsecured bonds are issued under Deutsche Wohnen SE.

Analytical conclusions

Deutsche Wohnen's senior unsecured debt is rated 'A-', in line with the long-term issuer credit rating. The company's ratio of secured debt to total fair value assets as of Sept. 30, 2020 was about 22%, well below our threshold of 40%.

Ratings Score Snapshot

Issuer Credit Rating

A-/Negative/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

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:** Neutral (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Deutsche Wohnen's Operations Resilient To COVID-19 Impacts But Debt Metrics Teetered, Aug. 19, 2020
- Deutsche Wohnen's Financial Headroom Remains Tight Adter 2019 Results, April 3, 2020
- Berlin's Rent Freeze, As Adopted, To Have Little Effect On The Credit Quality Of Rated Residential Real Estate Companies, March 24, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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 14, 2020)*	
Deutsche Wohnen SE	
Issuer Credit Rating	A-/Negative/A-2
Senior Unsecured	A-
Issuer Credit Ratings History	
20-Nov-2019	A-/Negative/A-2
09-Dec-2016	A-/Stable/A-2
11-Feb-2016	A-/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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