



Rating Action: Moody's downgrades DEMIRE's rating to B2, outlook remains negative

29 Nov 2022

Frankfurt am Main, November 29, 2022 -- Moody's Investors Service ("Moody's") has today downgraded DEMIRE Deutsche Mittelstand Real Estate AG's ("DEMIRE") long term corporate family rating ("CFR") to B2 from B1 and concurrently downgraded to B2 from B1 the senior unsecured rating of its €600 million notes maturing in October 2024. The outlook remains negative.

The downgrade follows what we perceive as mounting refinancing pressure from a repayment wall under the company's senior unsecured notes maturing in October 2024. Higher economic uncertainty, continuously increasing interest rates and credit spreads will drive future funding cost to a level well above current one at an average of 1.67%. On the other hand, we acknowledge that the company has started targeted asset sales, in order to shore up liquidity and reduce the refinancing wall in 2024, with some of them already in advanced stages. However, we also note that the current market environment raises execution risk as to the pace and conditions for disposals.

RATINGS RATIONALE

DEMIRE's rating remains supported by a relatively small but well-diversified commercial real estate portfolio, the focus of its operations in Germany, a historically more liquid real estate market with a deep pool of financial institutions; its integrated business model and active portfolio management supporting an improved vacancy rate and solid earnings as of the LTM ended September 2022.

The corporate family rating also reflects the company's main credit challenges arising from heightened credit risk from a repayment wall under the company's senior unsecured notes maturing in October 2024; a private-equity-dominated ownership structure, which has demonstrated an aggressive financial risk appetite. The company's lower-quality portfolio than that of its higher-rated peers, without any meaningful environmental credentials, increases investment needs to respond to changing occupier preferences and more stringent environmental regulation while a weakening economic environment will weigh on DEMIRE's operating performance and vacancy reduction plans.

RATING OUTLOOK

Over the next 12-18 months, we expect DEMIRE to retain leverage and coverage metrics that are rather strong for its B2 rating. However, the negative outlook reflects our expectation of a much tougher economic and funding environment, challenging the company's ability to refinance its 2024 maturities at a cost that will allow it to keep its fixed charge cover commensurate with its rating.

The negative outlook further reflects a deteriorating operating environment for commercial real

estate companies across Europe, on the back of tightening financial conditions with rising interest rates weakening the outlook for property values and increasing the marginal cost of debt. A potentially sharper economic slowdown could also derive in higher number of business insolvencies, reduced demand for commercial real estate and negative pressure on rents.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A rating downgrade may occur if:

- The company fails to achieve material progress on the back of ongoing disposal processes
- Evidence of further deterioration of financial conditions raising the risk of noncompliance with covenants
- Failure to preserve liquidity including making distribution to shareholders
- Moody's-adjusted gross debt/total assets increasing to above 60%, accompanied by an increasing trend in net debt/EBITDA

A rating upgrade is unlikely at this point, but could occur in case of:

- Success in ongoing disposal processes that result in material net cash proceeds that reduce the amount of refinancing needs
- High visibility into company's success in addressing 2024 refinancing needs at an economic-efficient cost

LIQUIDITY

Pro-forma for the recent €50 million notes bought back, DEMIRE had a still adequate liquidity position, with €36 million available cash (excluding restricted one) and an undrawn committed €6 million revolving credit facility (RCF) as of end of September 2022, and we expect the company to be able to generate funds from operations of around €35 million (Moody's-defined) on an annual basis.

Additionally, a pool of around €739 million of unencumbered investment properties provides a source of alternative liquidity and refinancing optionality for the senior unsecured notes maturing in 2024.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

ESG considerations have a highly negative credit impact on DEMIRE. This reflects exacerbated governance risks due to the aggressive financial stance of its sponsors favouring shareholder distributions and leaving the company temporarily outside of financial policy during 2021. Credit risk is compounded by company's high exposure to environmental risks which represent investment requirements to respond to changing occupier preferences and more stringent environmental regulation and in order to avoid asset obsolescence risk.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms published in September 2022 and available at <https://ratings.moodys.com/api/rmc-documents/393395>. Alternatively, please see the Rating Methodologies page on <https://>

ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Headquartered in Langen, Germany, DEMIRE Deutsche Mittelstand Real Estate AG (DEMIRE) is a publicly listed commercial real estate company with a focus on offices in secondary locations across Germany. The company's portfolio currently comprises 64 single properties, with a total lettable floor space of around 913,000 square metres (sqm) and an aggregate portfolio value of around €1.4 billion.

The company's annualised contracted rent amounted to €83.8 million as of September 2022, with a 5-year weighted average lease term (WALT). DEMIRE holds an 84.35% stake in Fair Value REIT-AG, which is fully consolidated and accounted for around €335 million in assets, or around 20% of DEMIRE's total assets, as of 30 June 2022.

DEMIRE is listed on the Frankfurt stock exchange and had a market capitalisation of around €246 million as of 24 November 2022. Apollo-managed funds and Wecken Group together hold around 90.75% of DEMIRE's shares.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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