MOODY'S INVESTORS SERVICE

CREDIT OPINION
15 December 2022

Update

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RATINGS

DEMIRE Deutsche Mittelstand Real Estate AG

Domicile	Germany
Long Term Rating	B2
Type	LT Corporate Family Ratings
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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DEMIRE Deutsche Mittelstand Real Estate AG

Update following rating downgrade

Summary

On 29 November 2022, we downgraded DEMIRE Deutsche Mittelstand Real Estate AG's (DEMIRE) corporate family rating (CFR) to B2 from B1 and downgraded the rating on the senior unsecured notes due in 2024 to B2 from B1. The outlook remains negative.

The downgrade follows what Moody's perceives 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 materially above the current 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.

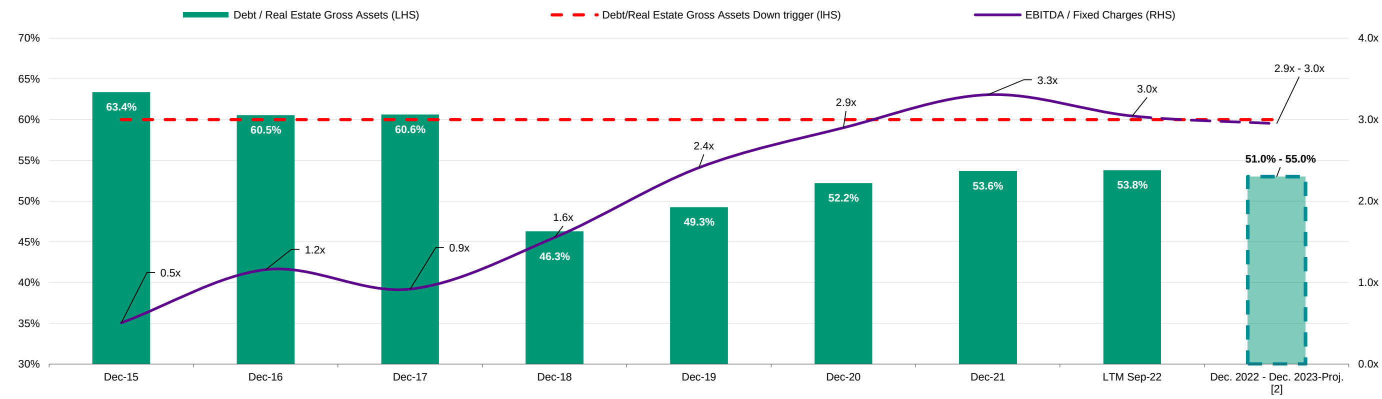
DEMIRE's rating remains supported by a relatively small but well-diversified commercial real estate portfolio, the focus of its operations in Germany, a historically more liquid real estate market with a deep pool of financial institutions; its integrated business model and active portfolio management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

The corporate family rating also reflects the company's other credit challenges arising from 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.

Exhibit 1

Over the next 12-18 months, we expect DEMIRE to retain credit metrics that are rather strong for its B2 rating

Moody's-adjusted leverage and fixed-charge coverage ratio [1]



[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations

[2] This represents Moody's forward view, not the view of the issuer

Source: Moody's Financial Metrics™ and Moody's Investors Service estimate

Credit strengths

» Relatively small but well-diversified commercial real estate portfolio

» Focus of its operations in Germany

» Integrated business model and active portfolio management supporting solid earnings

» Adequate liquidity

Credit challenges

» Heightened credit risk from a repayment wall

» Rising economic uncertainty and tightening financial conditions

» High leverage and a private-equity-dominated ownership structure, which has demonstrated an aggressive financial risk appetite

» Its lower-quality portfolio than that of its higher-rated peers, without environmental credentials, which will increase investment needs to respond to changing occupier preferences and more stringent environmental regulation

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 weaking 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

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

Factors that could lead to a downgrade

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

Key indicators

Exhibit 2

DEMIRE Deutsche Mittelstand Real Estate AG [1][2][3]

EUR Millions	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	LTM Sep-22	Moody's Forward View (Dec. 2022 - Dec. 2023)
Real Estate Gross Assets	1,094.8	1,148.7	1,378.7	1,677.4	1,625.3	1,705.6	1,694.9	1,300 - 1,800
Amount of Unencumbered Assets	N/A	N/A	N/A	51%	64%	55%	54%	43% - 55%
Debt / Real Estate Gross Assets	60.5%	60.6%	46.3%	49.3%	52.2%	53.6%	53.8%	51% - 55%
Net Debt / EBITDA	13.9x	14.8x	10.9x	12.5x	13.1x	13.4x	15.0x	13.0x - 15.0x
Secured Debt / Real Estate Gross Assets	50.6%	25.4%	20.0%	12.9%	14.7%	17.5%	16.8%	16.0% - 20.0%
EBITDA / Fixed Charges	1.2x	0.9x	1.6x	2.4x	3.3x	3.3x	3.0x	2.9x - 3.0x

[1] All figures and ratios are calculated using Moody's Estimates and Standard Adjustments.
[2] Periods are financial year-end unless indicated. LTM = Last 12 months.
[3] All ratios are based on "Adjusted" financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Investors Service

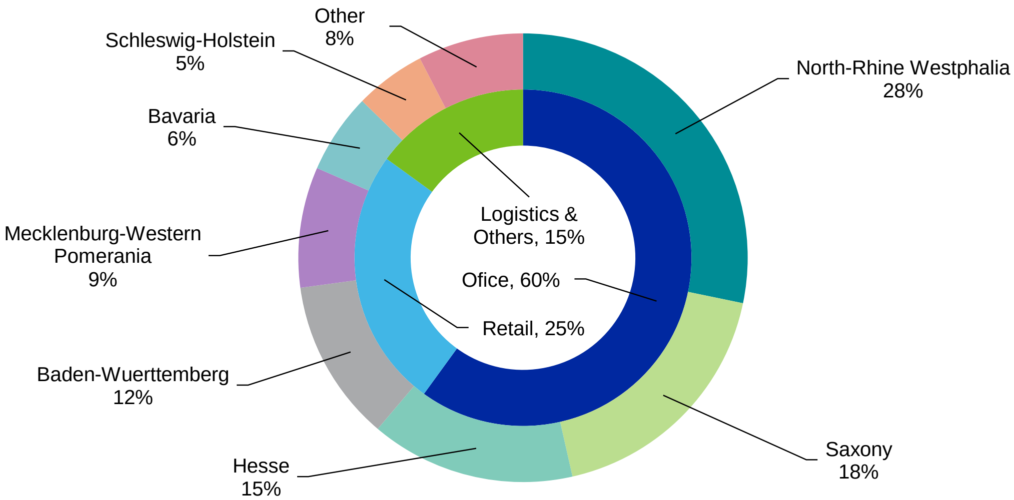
Profile

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 has 64 single properties, with a total lettable floor space of around 926,800 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 €334.5 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 €250.1 million as of 12 December 2022. Apollo-managed funds and Wecken Group together hold around 90.75% of DEMIRE's shares.

Exhibit 3
DEMIRE's portfolio
By gross asset value (GAV)



As of 30 September 2022.
Source: Company

Detailed credit considerations

Small but well-diversified commercial real estate portfolio primarily in secondary German locations

DEMIRE's portfolio is spread across several key regions in Germany (see Exhibit 3). The top 20 properties represent around two-thirds of the total investment portfolio, with around 10% located in the “Big Seven” German cities and the remainder in secondary locations.

The current portfolio's annual contracted Gross Rental Income (GRI) amounts to €83.8 million, which is derived from more than 800 individual tenants across diverse business sectors.

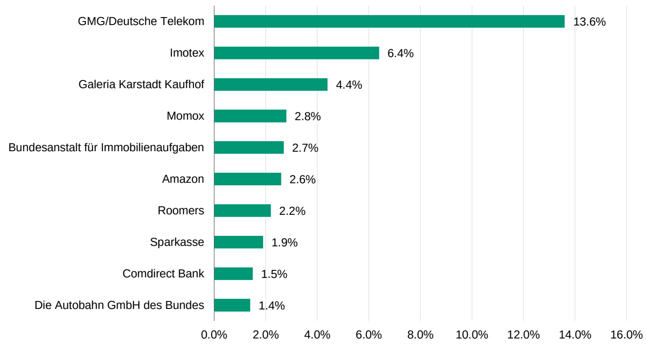
Deutsche Telekom AG (Deutsche Telekom, Baa1 stable) remained the largest tenant as of September 2022 and accounts for around 14% of DEMIRE's GRI, followed by the fashion distributor Imotex with 6.4% and the German retailer Karstadt, currently under restructuring, representing 4.4%. All other tenants account for 2.9% or less of DEMIRE's GRI.

Rental income concentration towards Deutsche Telekom is one of the highest among the company's peers that we rate but mitigated by the strong credit standing of its main tenant and notably reducing since 2018, where it accounted for 30%. We understand based on company information that upcoming lease maturities have been either extended or with some spaces already subleased by Deutsche Telekom and DEMIRE partly onboarding these tenants or signing new leases, mostly with local and federal administration entities.

Tenant credit quality is moderate because of its secondary locations and B-type properties attracting small and medium-sized enterprises (SMEs). This is partly balanced by public-sector tenants comprising more than 10% of DEMIRE's tenant base, whose credit quality is strongly correlated with the sovereign's credit strength. The historical default rate of the company's portfolio is below 2%. Uncollected rents were €1.5 million as of year-end 2021, representing around 1.8% of the 2021 gross rental income. Pandemic-related impairment of receivables was significantly down to €3.5 million from €6.1 million reported in 2020, reflecting a recovery, especially at the company's retail and hotel properties.

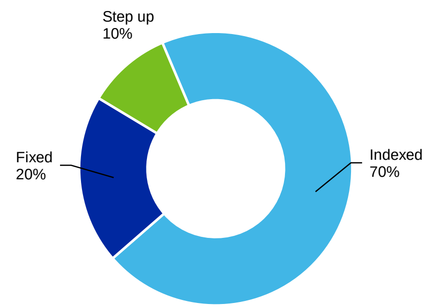
In the current inflationary environment, the company will benefit from a large share of lease agreements that include indexation clauses. However, a sharper macroeconomic deterioration in Germany would hurt commercial landlords' ability to get rent increases.

Exhibit 4
Top 10 tenants
Based on annualised contracted rents



Source: Company information, as of 30 September 2022

Exhibit 5
Lease types
By annualised contracted rent



Source: Company information

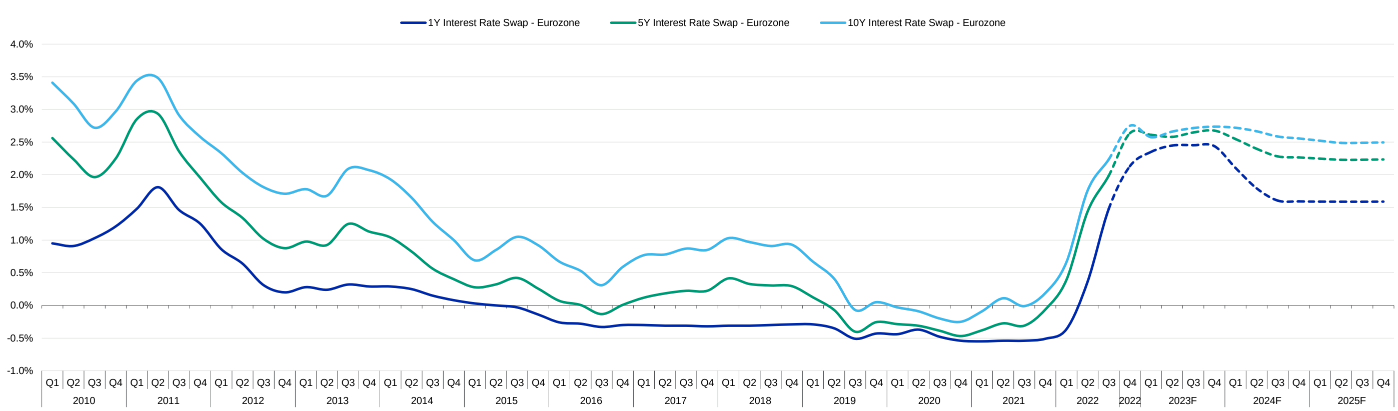
Weaker operating environment for European real estate amid tightening financial conditions and a deteriorating economic environment

The outlook for commercial real estate companies across Europe has turned negative because of higher economic uncertainty, tightening financial conditions and rising cost of capital leading to stalling commercial real estate investment activity, and the expected negative pressure on capital values over the next 12-24 months.

According to CBRE Research, as of the end of Q3 2022, the total investment volume in Germany reached €15.9 billion, down 41% year over year. For 9M 2022, the total investment volume was €51.9 billion (down 15% year over year). Real estate investment activity in Germany during Q2 and Q3 2022 has been significantly affected by concerns over the country's dependence on Russian energy and economic outlook, on top of rising debt costs.

We expect the much weaker capital market conditions with increasing interest rates and pronounced widening of credit spreads to significantly increase the company's funding costs from the current level of 1.67% and thus notably weaken its interest coverage at the point of refinancing from around 3.0x for the 12 months that ended September 2022.

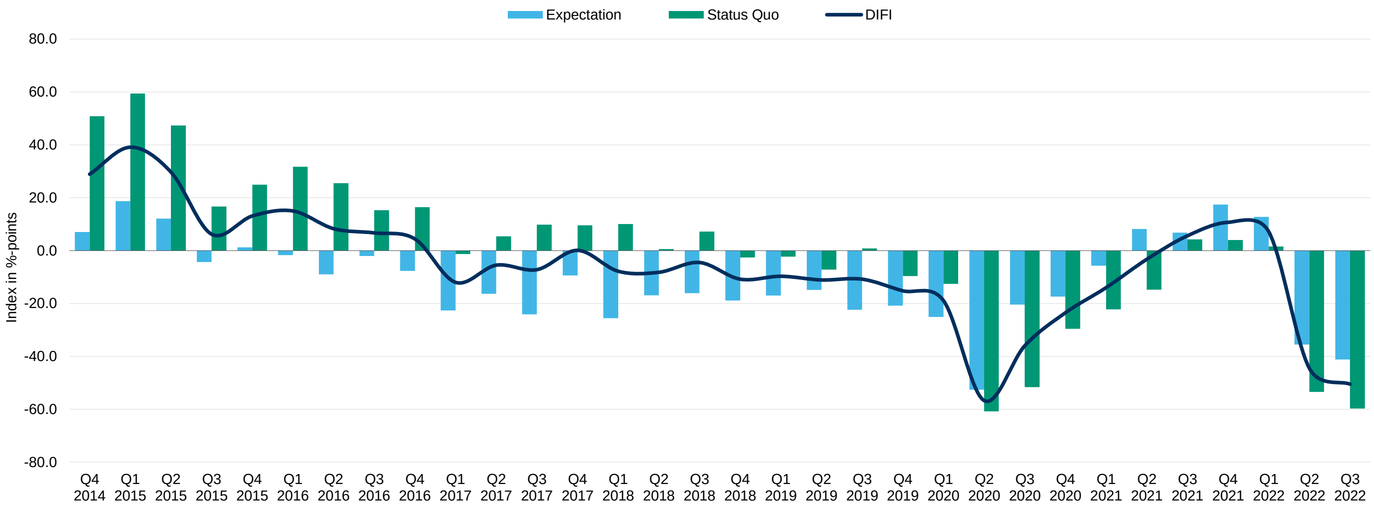
Exhibit 6
Eurozone swap rates have significantly increased since April 2022



Source: Moody's Investors Service and DataBuffet

The German Real Estate Finance Index (DIFI) further dropped to -50.5 points in Q3 2022 (-6 points from the level reported in Q2 2022). According to the report, the assessment of the current financing situation of the last six months and the outlook over the coming six months has worsened in the third quarter of 2022.

Exhibit 7
The DIFI Index decreased significantly in Q3 2022

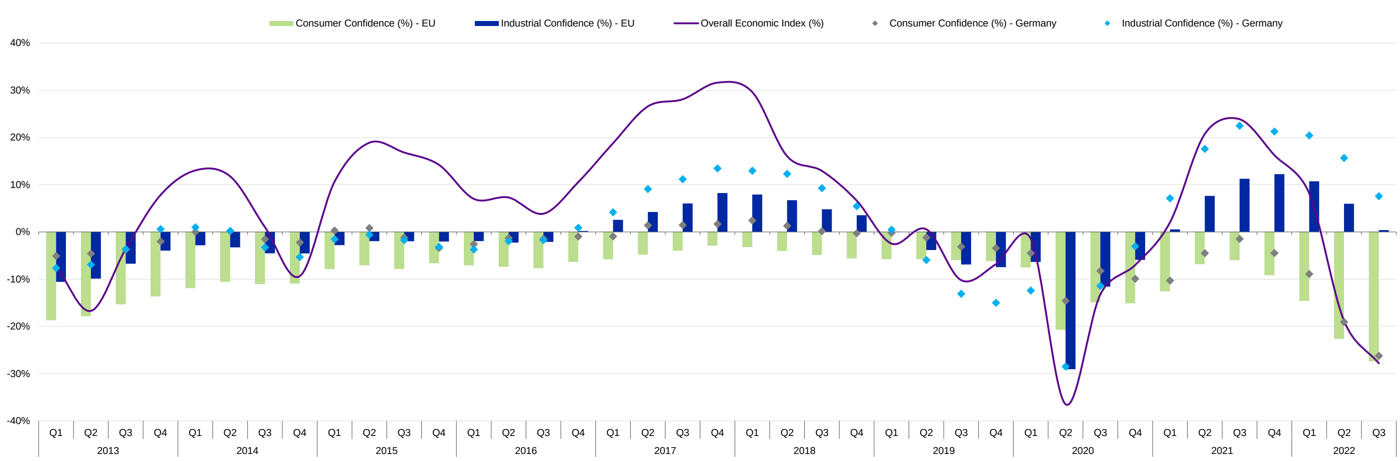


The DIFI depicts the situation/status quo (past six months) and expectations (coming six months) in respect of the German real estate financing market, as perceived by participants in a regular survey. The index is calculated quarterly as an average of the office, retail, logistics and residential segments of the real estate market. The results per segment are based on the percentage shares of positive and negative replies provided by participants regarding the situation/status quo, and their expectations from the German real estate financing market. The DIFI is published jointly by Zentrum für Europäische Wirtschaftsforschung (ZEW) and Jones Lang Lasalle (JLL).
Sources: ZEW and JLL

Higher economic uncertainty, continuously increasing interest rates and credit spreads will drive DEMIRE's future funding cost to a level well above current one at an average of 1.67%. In this context the company will also likely increasingly rely on alternative funding sources such as secured bank lending over the next 12-24 months, which is more cost-efficient but in turn will likely lead to a subsequent reduction in unencumbered assets and thus in the protection level of unsecured bondholders.

The high inflation and soaring energy prices are eroding real household income and continue straining business and consumer confidence.

Exhibit 8
Investor morale, consumer confidence and industrial confidence have significantly decreased in Q3 2022



Overall Economic Index is calculated from a monthly survey of private and institutional financial market investors on their assessment of the current economic situation and their economic expectations over the next six months. Survey responses are usually reported in terms of "percentage balance" - the difference between the percentage of respondents giving positive replies and that of those giving negative replies. Thus, a lower/negative value indicates weaker investor morale, and a higher/positive value indicates stronger investor morale.
Source: Harver Analytics and Moody's Investors Service

We expect the economy in Germany (Aaa stable) to decelerate with real GDP growth slipping from 2.6% in 2021 to 1.4% in 2022 and further down to -1.8% in 2023.

A potentially sharper economic slowdown could also result in a higher number of business insolvencies, reduced demand for commercial real estate, and negative pressure on rents and thus on property valuations.

Integrated business model continues supporting solid earnings as of end September 2022

DEMIRE benefits from an integrated business model comprising portfolio and asset management. Property and facility management services were outsourced to STRABAG SE in 2018, increasing the company's cost efficiency and operational scalability.

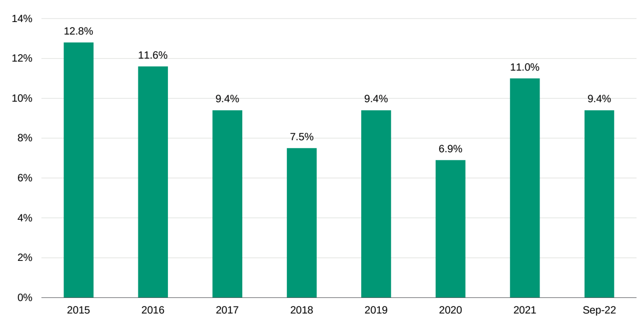
Through its integrated approach, the company is able to actively monitor properties' operating performance and maintain close relationships with tenants, which allows for proactive management of rental contracts and early marketing of expiring leases. This is reflected in the sustained strong letting performance of DEMIRE. The company has signed lease contracts for 194,840 sqm in 9M 2022 (up 41% from the levels signed in 9M 2021).

As of September 2022, company's like-for-like rents grew by 4.9% year-over-year and DEMIRE further reduced its European Public Real Estate Association (EPRA) vacancy rate based on rental value to 9.4% (see Exhibit 7) on the back of vacancy reduction in LogPark Leipzig, Kassel and Bad Vilbel.

Exhibit 9

Vacancy rate has returned to 2019 level [1]

In percentage terms



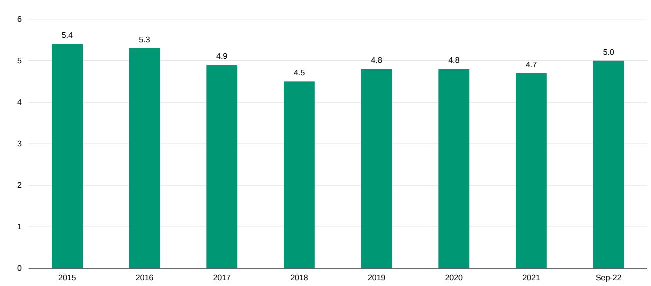
[1] EPRA Vacancy rate excludes properties held for sale and project developments

Source: Company information

Exhibit 10

WALT remained broadly stable over the last few years

In years



Source: Company information

While DEMIRE successfully disposed smaller properties in the last years, we consider its average portfolio quality still below that of its higher-rated peers. This is reflected in a current gross rental yield of 5.9% with an average in-place rent for the total portfolio of €8.37 per sqm per month. This low level of rent compared with prime office rents could in turn offer some buffer against the rising economic uncertainty and inflationary pressures. On the other hand a weakening economic environment will weigh on DEMIRE's operating performance and vacancy reduction plans.

Exhibit 11

Portfolio review

As of 30 September 2022

	No. of properties	GAV (€ m)	GRI p.a. (€ m)	EPRA Vacancy (in %)	WALT (years)
Office	42	843.7	49.4	11.9%	3.4
Retail	17	357.1	23.9	3.0%	5.7
Logistics & Other	5	221.6	10.4	12.4%	10.4
Total	**64**	**1,412.5**	**83.8**	**9.4%**	**5.0**

Source: Company information

High leverage ratio, but credit metrics are rather strong for its B2 rating

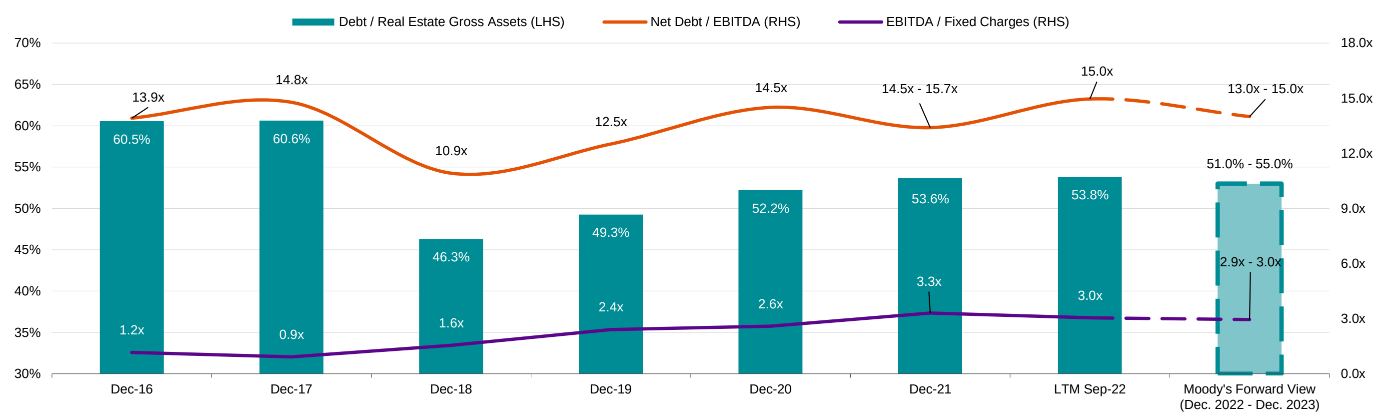
Higher debt costs and concerns over the economy regarding gas supply interruptions weigh on sentiment, leading to stalling commercial real estate investment activity and likely strain on capital values. In this context, we expect Moody's-adjusted gross debt/assets to remain between 51% and 55% over the next 12 months. The company remains committed to its publicly communicated financial policy of a reported net loan-to-value (LTV) target of maximum 50%.

On November 24, the company reported the completion of a buyback of €50 million nominal amount under its outstanding senior notes. The buyback was carried out at an average market value of 72 and resulted in a reduction of the total outstanding amount to €550 million under the companies senior notes maturing in 2024.

Additionally, the company has started targeted asset sales, in order to shore up liquidity and further 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.

Depending on the amount of net cash proceeds achieved under the targeted sales, we estimate net debt/EBITDA could be at a level between 13.0x - 15.0x over the next 12 months. Fixed charge coverage ratio will likely remain at a solid level of 2.9x - 3.0x over the same period, supported by previous refinancing activities that significantly reduced financing costs to the current level of 1.67%. However, the vast majority of its debt matures in H2 2024 and leaves Demire exposed to significantly higher refinancing costs. This puts Demire under pressure to sell certain assets in a declining business environment to help refinance, in combination with higher cost debt.

Exhibit 12
Leverage will increase while coverage will remain stable
In percentage and times



Source: Moody's Financial Metrics™ and Moody's Investors Service estimate

ESG considerations

DEMIRE Deutsche Mittelstand Real Estate AG's ESG Credit Impact Score is Highly Negative CIS-4

Exhibit 13
ESG Credit Impact Score

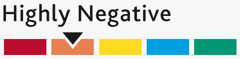
CIS-4
Highly Negative

For an issuer scored CIS-4 (Highly Negative), its ESG attributes are overall considered as having a discernible negative impact on the current rating. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-3.

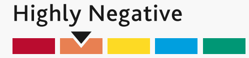
Source: Moody's Investors Service

ESG considerations have a highly negative credit impact (**CIS-4**) on DEMIRE. This reflects exacerbated governance risks due to the aggressive financial stance of its sponsors favoring shareholder distributions and leaving the company temporarily outside of its 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.

Exhibit 14
ESG Issuer Profile Scores

ENVIRONMENTAL
E-4
Highly Negative


SOCIAL
S-4
Highly Negative


GOVERNANCE
G-4
Highly Negative


Source: Moody's Investors Service

Environmental
DEMIRE's exposure to environmental risks is highly negative reflecting a lower-quality portfolio than that of higher-rated real estate companies, with no environmental credentials which makes it more vulnerable to rising regulation on carbon emissions and greater tenant scrutiny with respect to energy performance, while increases the investment requirements to upgrade the company's properties to prevent obsolescence risk.

Social
Credit exposure to social considerations is highly negative because occupier demand for the company's properties is vulnerable to rising hybrid-working models and accelerated shift towards e-commerce. Nonessential retail and non-prime office property landlords will need to adjust strategies and increase capital spending to adapt properties to changing consumer and working preferences. The economic and digital transformation will favour the company's logistics operations.

Governance
Credit exposure to governance risks is highly negative. Its majority shareholders, Apollo and Wecken, have demonstrated an aggressive financial stance, tolerant of debt-funded mergers and acquisitions, shareholder distributions and high leverage, which was temporarily outside of the company's publicly communicated financial policy in 2021. The continuation of a seasoned management team, on

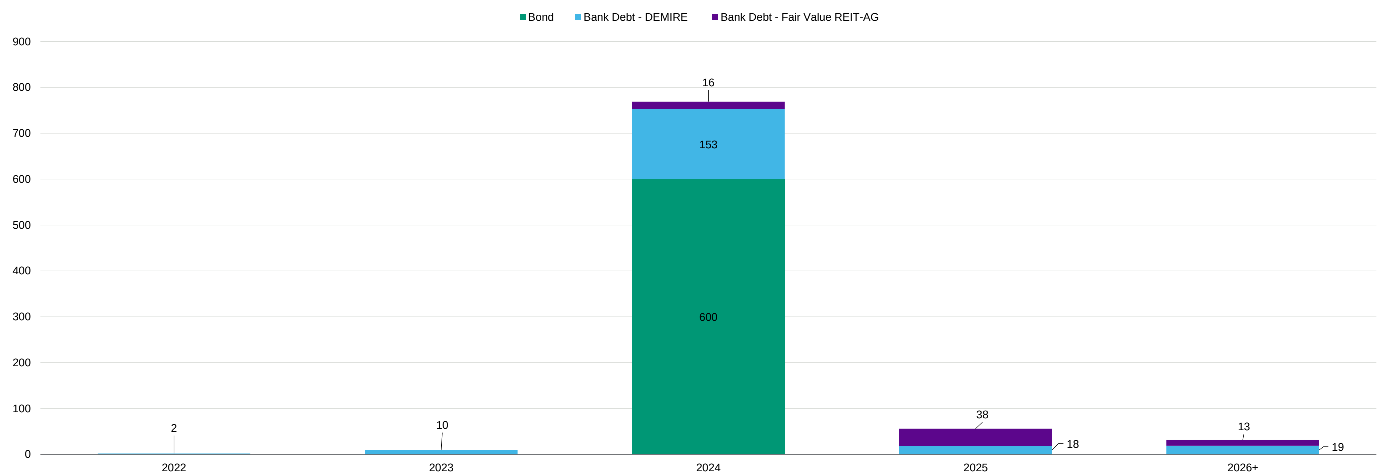
board since 2019, provides stability to DEMIRE's business strategy but does not mitigate the governance risks associated to the private-equity-dominated ownership of DEMIRE.

Liquidity analysis

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.

Exhibit 15
The company faces a significant refinance wall in 2024
DEMIRE's debt maturity (in € millions)



As of 30 September 2022.
Source: Company

Structural considerations

The current B2 rating of the senior unsecured bond, in line with the long-term CFR, reflects our view that most of the debt is senior unsecured. As of September 2022, senior unsecured creditors were adequately covered with unencumbered assets/unsecured liabilities of 1.5x. Bondholders are subordinated to existing secured debt of around €285 million.

Methodology and scorecard

The following table shows DEMIRE's scorecard-indicated outcome using the REITs and Other Commercial Real Estate Firms Methodology, with data as of 30 September 2022.

The scorecard-indicated outcomes for the 12 months that ended 30 September 2022 and under the forward view are above the assigned rating. Mounting refinancing pressure from a repayment wall under the company's senior unsecured notes maturing in October 2024 is straining the rating.

Exhibit 16

Rating factors

DEMIRE Deutsche Mittelstand Real Estate AG

REITs and Other Commercial Real Estate Firms Industry Scorecard [1][2]	Current LTM 09/30/2022		Moody's Forward View (Dec. 2022 - Dec. 2023) [3]	
Factor 1 : Scale (5%)	**Measure**	**Score**	**Measure**	**Score**
a) Gross Assets (USD Billion)	$1.7	Ba	$1.4 - $1.8	Ba
Factor 2 : Business Profile (25%)				
a) Market Positioning and Asset Quality	Ba	Ba	Ba	Ba
b) Operating Environment	Baa	Baa	Baa	Baa
Factor 3 : Liquidity and Access To Capital (25%)				
a) Liquidity and Access to Capital	Ba	Ba	Ba	Ba
b) Unencumbered Assets / Gross Assets	54.5%	Ba	43.0% - 55.0%	Ba
Factor 4 : Leverage and Coverage (45%)				
a) Total Debt + Preferred Stock / Gross Assets	53.8%	Ba	51.0% - 55.0%	Ba
b) Net Debt / EBITDA	15.0x	Ca	13.0x - 15.0x	Ca
c) Secured Debt / Gross Assets	16.8%	Baa	16.0% - 20.0%	Baa
d) Fixed Charge Coverage	3.0x	Baa	2.9x - 3.0x	Baa
Rating:				
a) Scorecard-Indicated Outcome		Ba2		Ba2
b) Actual Rating Assigned				B2

[1] All ratios are based on "Adjusted" financial data and incorporate Moody's Global Standard Adjustments for non-financial corporations.
[2] As of 30 September 2022.
[3] This represents Moody's forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Sources: Moody's Financial Metrics™ and Moody's Investors Service estimates

Ratings

Exhibit 17

Category	Moody's Rating
DEMIRE DEUTSCHE MITTELSTAND REAL ESTATE AG	
Outlook	Negative
Corporate Family Rating	B2
Senior Unsecured -Dom Curr	B2

Source: Moody's Investors Service

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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