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CREDIT OPINION
4 April 2023

Update

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RATINGS

DEMIRE Deutsche Mittelstand Real Estate AG

Domicile	Germany
Long Term Rating	B3
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 31 March 2023, we downgraded DEMIRE Deutsche Mittelstand Real Estate AG's (DEMIRE) corporate family rating (CFR) to B3 from B2 and downgraded the rating on the senior unsecured notes due in 2024 to Caa1 from B2. The outlook remains negative.

The downgrade reflects liquidity concerns resulting from large bond and loan maturities in 2024. Higher interest rates as well as geopolitical and financial market volatility provide for a weak property environment. In this environment, DEMIRE's task to refinance the remaining €550 million of bonds and €169 million of secured loans in 2024 is more challenging within the timeframe and the unencumbered asset base given.

DEMIRE has started to dispose of assets, and management focuses on both disposing and encumbering assets to enable refinancing of the bonds, in addition to cash needed for capital spending required under recently signed larger leases. We expect the capital structure to contain largely secured funding going forward, reflected in the notching of the senior unsecured rating.

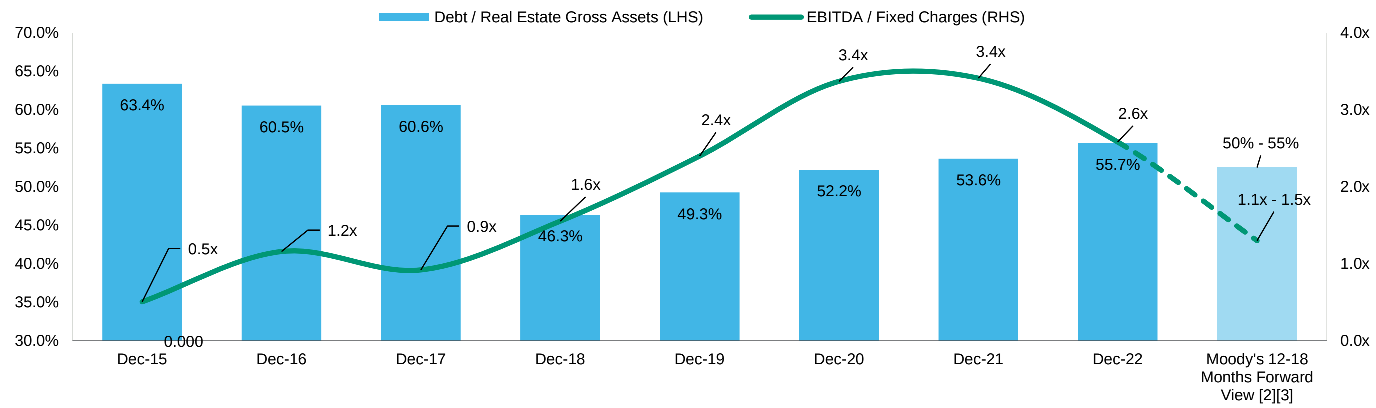
DEMIRE's rating remains supported by a relatively small but still diversified commercial real estate portfolio in Germany, a more liquid real estate market; its integrated business model and active portfolio management supporting a solid operational performance in 2022 in an overall uncertain environment.

Outside of refinancing concerns, the corporate family rating remains negatively affected by DEMIRE's 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. The continued economic and geopolitical uncertainties will weigh on DEMIRE's operating performance and vacancy reduction plans.

Exhibit 1

Interest cover to drop materially with refinancing needs

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] Moody's 12-18 Months Forward view for the fixed-charge coverage largely includes the impact of secured refinancing required in addition to disposals in order to repay outstanding bond maturing in October 2024

[3] 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

» Solid operating performance in 2022 despite economic and geopolitical uncertainties

Credit challenges

» High refinancing risk from a repayment wall in 2024

» Rising economic and geopolitical uncertainty paired with 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

The negative outlook reflects increasing uncertainty around property lending and the reducing time remaining to refinance the bond. We expect further activity from the company in securing disposals and secured financing in the next six to nine months to be key for DEMIRE's refinancing efforts.

Factors that could lead to an upgrade

A rating upgrade is less likely to occur given the negative outlook, but can occur if

» DEMIRE succeeds in disposing material asset volumes with moderate discounts and thereby secures repayment of the majority of the 2024 bond maturity

» The company succeeds in raising sufficient alternative debt financing to enable a bond refinancing at a sustainable interest cover

» Operating performance continues to be solid

Factors that could lead to a downgrade

Factors that could lead to a downgrade include:

» Failure to raise material further proceeds to address the refinancing of the upcoming debt maturity through disposal proceeds exceeding already signed transactions, as well as through encumbering existing assets

» A deterioration in the lending appetite for secondary German real estate assets making both disposals and refinancing from secured banks more unlikely

» Weaker operational performance of the asset portfolio

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	Dec-22	Moody's 12-18 Months Forward View [4][5]
Real Estate Gross Assets	1,094.8	1,148.7	1,378.7	1,677.4	1,625.3	1,705.6	1,536.9	800 - 1,200
Amount of Unencumbered Assets	N/A	N/A	N/A	50.6%	64.0%	55.0%	52.8%	10.0% - 30.0%
Debt / Real Estate Gross Assets	60.5%	60.6%	46.3%	49.3%	52.2%	53.6%	55.7%	50.0% - 55.0%
Net Debt / EBITDA	13.9x	14.8x	10.9x	12.6x	12.9x	13.0x	16.5x	13.0x - 15.0x
Secured Debt / Real Estate Gross Assets	50.6%	25.4%	20.0%	12.9%	14.7%	17.5%	18.3%	48.0% - 53.0%
EBITDA / Fixed Charges	1.2x	0.9x	1.6x	2.4x	3.4x	3.4x	2.6x	1.1x - 1.5x

[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
[4] Moody's 12-18 Months Forward view for the fixed-charge coverage largely includes the impact of secured refinancing required in addition to disposals in order to repay outstanding bond maturing in October 2024
[5] This represents Moody's forward view, not the view of the issuer
Source: Moody's Investors Service

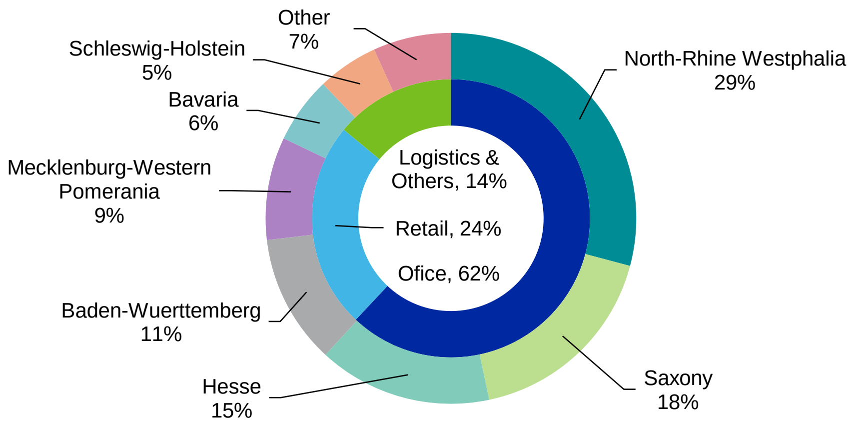
Profile

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 62 single properties, with a total lettable floor space of around 912,700 square metres (sqm) and an aggregate portfolio value of around €1.3 billion. The company's annualised contracted rent amounted to €85.1 million as of December 2022, with a 4.8-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 €314.4 million in assets, or around 20% of DEMIRE's total assets, as of 31 December 2022.

DEMIRE is listed on the Frankfurt stock exchange and had a market capitalisation of around €237.4 million as of 30 March 2023. 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 31 December 2022.
Source: Company

Detailed credit considerations

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

DEMIRE's portfolio is spread across several regions in Germany and typically focuses on secondary locations in larger cities or better locations in smaller cities. The current portfolio's annual contracted Gross Rental Income (GRI) amounts to €85 million, which is derived from a large number of leases in diverse business sectors.

The largest tenant remains Deutsche Telekom AG (Deutsche Telekom, Baa1 stable) contributing 14.2% of annual contracted rent, followed by fashion distributor Imotex with 6.3% and the German retailer Galeria Kaufhof, currently under restructuring, representing 4.6%. We understand that one Galeria asset is subject to close according to the recently agreed restructuring proposal. We remain cautious with respect to Telekom as a large tenant given the typically large, older assets in often secondary locations that provide for more challenging reletting in case Deusche Telekom vacates the assets. Historically, DEMIRE has been successful reletting or disposing some of the assets.

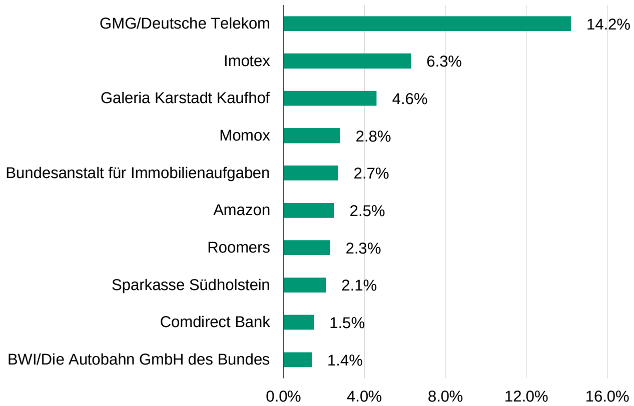
Tenant credit quality is moderate because of its secondary locations and B-type properties attracting small and medium-sized enterprises (SMEs). This is partly balanced by public-sector tenants comprising more than 10% of DEMIRE's tenant base, whose credit quality is strongly correlated with the sovereign's credit strength. DEMIRE's provisioning reduced from above 7% of rental income during the pandemic back to below 2% of GRI for FY 2022, partially helped by reversion of provisioning in earlier years.

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.

Exhibit 4

Top 10 tenants

Based on annualised contracted rents

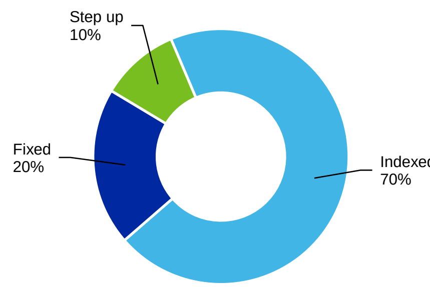


Source: Company information, as of 31 December 2022

Exhibit 5

Lease types

By annualised contracted rent



Source: Company information

Solid operating performance in 2022, outlook weaker due to operating environment

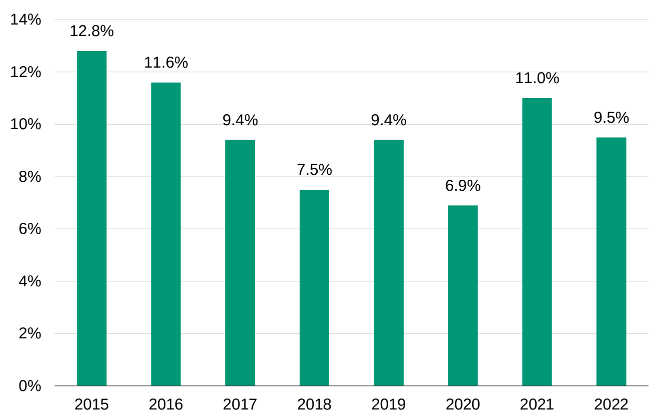
DEMIRE's operating performance held up well in 2022 despite a challenging operating environment. DEMIRE achieved substantially lettings during 2022, with large lettings in particular in its logistic and office segment. European Public Real Estate Association (EPRA) vacancy has been stable around 9.5% since H1 2022, down from 11% at FY 2021. Like for like contractual rent growth was high in FY 2022 (10.2%) helped by the reversion of some of the COVID-related effects.

In the current inflationary environment, the company will benefit from a large share of lease agreements that include indexation clauses. However, we expect the weak macroeconomic situation and geopolitical uncertainties to weigh on space demand, as well as working from home also reducing space demand in weaker quality assets.

Exhibit 6

Vacancy rate has returned to 2019 level [1]

In percentage terms

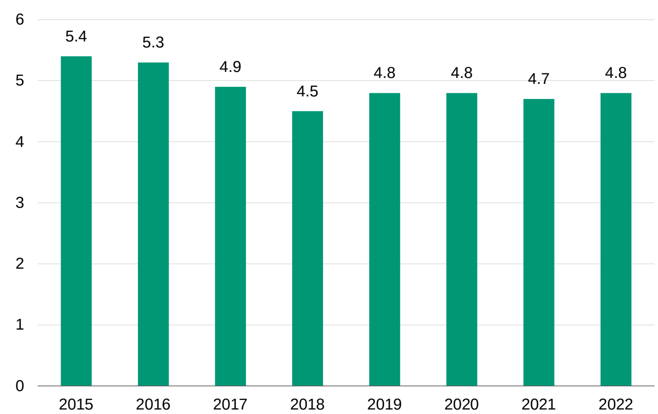


[1] EPRA Vacancy rate excludes properties held for sale and project developments
Source: Company information

Exhibit 7

WALT remained broadly stable over the last years

In years



Source: Company information

We consider its average portfolio quality below that of its higher-rated peers. This is reflected in a current gross rental yield of 6.4% with an average in-place rent for the total portfolio of €8.46 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. While leases are more affordable, the bifurcation we expect between higher and lower quality building performance will create challenges at least in parts of DEMIRE's portfolio.

Exhibit 8
Portfolio review
As of 31 December 2022

	No. of properties	GAV (€ m)	GRI p.a. (€ m)	EPRA Vacancy (in %)	WALT (years)
Office	40	821.1	50.3	12.0%	3.3
Retail	17	320.1	24.5	3.0%	5.6
Logistics & Other	5	188.5	10.4	18.0%	10.1
Total	**62**	**1,329.8**	**85.1**	**9.5%**	**4.8**

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 and geopolitical 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.

This environment leads to substantially increased execution risk for DEMIRE's disposal plan, as investors stay on the sidelines and investment volumes have declined. Property values will decline further, as also evidenced in discounting in recently signed transactions. Moreover the combination of higher market interest rates and tighter lending criteria leads to reduced availability of debt at much higher rates than DEMIRE's reported 1.67% nominal interest rate.

Consolidated leverage metrics will develop uneven but liquidity is the key rating driver

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. We have assumed further 10-15% falls in property values on top of the 4.7% declines the company has reported in H2 2022. A smaller offset will come from the capital spending the company will do in particular on the Essen asset that we expect to be value accretive.

DEMIRE will aim to dispose further assets, which we consider a requirement to enable the refinancing of the bond through secured debt with the remaining (unencumbered) assets. We would expect disposals required to exceed the already announced LogPark and Ludwigsburg disposal. Consequently DEMIRE will significantly shrink in size as well.

Moody's-adjusted gross debt/total assets will benefit from already signed disposal proceeds in particular for LogPark Leipzig. We have assumed some discounting on a material amount of further disposals but also included further value declines. As a consequence we estimate Moody's-adjusted consolidated debt/total assets to be around 50-55% in 2024.

One of the complexities in refinancing the bond maturity are the limitations in crystallizing the asset values at Fair Value REIT AG that has a lower LTV than DEMIRE on a standalone basis. Hence reported consolidated financial metrics do not fully reflect the financial position of DEMIRE on a standalone basis that is subject to refinancing. As of December 2022, Moody's adjusted gross debt/total assets was 55.7% on a consolidated basis, while separating DEMIRE (excluding Fair Value REIT asset and liabilities) would increase this ratio to 64.0% excluding the equity value in the entity.

The interest cover post repayment/refinancing of the bond is not very predictable at this point. Our forward view looks at 2024 more than 2023, as fixed charge coverage pre-refinancing of the bond maturity is sufficient to cover interest expense. Both EBITDA as well as interest rates payable depend strongly on disposal success, as much as on interest rates payable on new debt that is required for refinancing. We expect interest cover to drop to 1.1-1.5x from 2.6x as of FY 2022 because lower debt amounts will cost significantly more than the current 1.67% reported interest cost.

ESG considerations

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

Exhibit 9
ESG Credit Impact Score

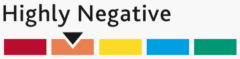
CIS-4
Highly Negative

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.

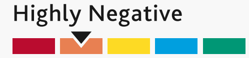
Source: Moody's Investors Service

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 10
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. We also note liquidity risks are rising with a maturity wall in 2024.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

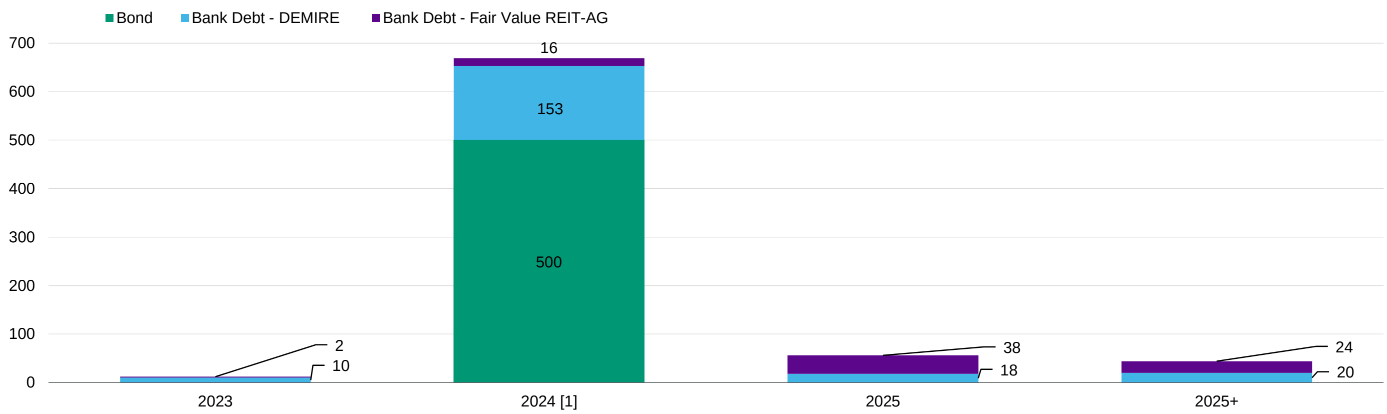
Liquidity is the key credit driver at this point. Liquidity needs stem from substantial debt maturities in 2024 and committed capital spending related to some recent letting activity. Around €720 million out of €830 million reported debt matures in 2024. The majority of this debt is the remaining €550 million bond, due in October 2024, after the company repurchased around €50 million in the market last year. At this point, the company does not have sufficient liquidity to cover these maturities, but works towards securing further disposal proceeds complemented by secured debt refinancing. The company also needs to fund committed largely project-based capital spending of more than €110 million, in addition to uncommitted spending on the portfolio over the next 3 years.

We do not have visibility into plans of its key shareholders, a fund run by Apollo acting in concert with the Wecken group, to support the refinancing efforts. Given the uncertain transaction market and anticipated reduction in bank lending availability, some equity support may be required to refinance the 2024 maturities.

Exhibit 11

The company faces a significant refinance wall in 2024

DEMIRE's debt maturity (in € millions) [1]



[1] As of 31 December 2022

[2] DEMIRE's bank debt includes Logpark loan that will be redeemed from sale proceeds

Source: Company

Structural considerations

The current Caa1 rating of the senior unsecured bond, one notch below the long-term CFR, reflects the anticipated change of the capital structure towards a largely secured funding mix. We recognise that the company intends to encumber its asset base to enable a refinancing of the bond after further anticipated disposals.

Methodology and scorecard

The following table shows DEMIRE's scorecard-indicated outcome using the REITs and Other Commercial Real Estate Firms Methodology, with data for the financial year ended 31 December 2022.

The scorecard-indicated outcomes for the financial year ended 31 December 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 12

Rating factors

DEMIRE Deutsche Mittelstand Real Estate AG

REITs and Other Commercial Real Estate Firms Industry Scorecard [1][2]	Current FY 12/31/2022		Moody's 12-18 Months Forward View [3]	
Factor 1 : Scale (5%)	**Measure**	**Score**	**Measure**	**Score**
a) Gross Assets (USD Billion)	$1.6	Ba	$0.8 - $1.3	Ba
Factor 2 : Business Profile (25%)				
a) Market Positioning and Asset Quality	Ba	Ba	B	B
b) Operating Environment	Baa	Baa	Ba	Ba
Factor 3 : Liquidity and Access To Capital (25%)				
a) Liquidity and Access to Capital	Ba	Ba	B	B
b) Unencumbered Assets / Gross Assets	52.8%	Ba	10.0% - 30.0%	B
Factor 4 : Leverage and Coverage (45%)				
a) Total Debt + Preferred Stock / Gross Assets	55.7%	Ba	50.0% - 55.0%	Ba
b) Net Debt / EBITDA	16.5x	Ca	13.0x - 15.0x	Ca
c) Secured Debt / Gross Assets	18.3%	Baa	48.0% - 53.0%	B
d) Fixed Charge Coverage	2.6x	Baa	1.1x - 1.5x	Caa
Rating:				
a) Scorecard-Indicated Outcome		Ba2		B2
b) Actual Rating Assigned				B3

[1] All ratios are based on "Adjusted" financial data and incorporate Moody's Global Standard Adjustments for non-financial corporations
[2] As of 12/31/2022
[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 13

Category	Moody's Rating
DEMIRE DEUTSCHE MITTELSTAND REAL ESTATE AG	
Outlook	Negative
Corporate Family Rating	B3
Senior Unsecured -Dom Curr	Caa1

Source: Moody's Investors Service

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EMEA	44-20-7772-5454

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