Rating Action: Moody's downgrades DEMIRE to Caa2; outlook remains negative

23 Nov 2023

Frankfurt am Main, November 23, 2023 -- Moody's Investors Service (Moody's) has today downgraded DEMIRE Deutsche Mittelstand Real Estate AG's ("DEMIRE" or "the company") long term corporate family rating ("CFR") to Caa2 from Caa1. At the same time the senior unsecured rating of its €600 million note issuance maturing in October 2024 was downgraded to Caa3 from Caa2. The outlook remains negative.

RATINGS RATIONALE

The downgrade reflects an increasing risk that DEMIRE will not repay its October 2024 senior unsecured bond in full and in time. Parallel to working on disposals, the company has started discussions with a group of noteholders that will likely aim to ease the refinancing pressure on the company with respect to its senior unsecured debt, indicating a risin likelihood of a restructuring or a distressed exchange. At the same time, the progress with respect to disposal of asset that could repay debt and hence facilitate a smaller refinancing proves to be difficult in the current market for commercial real estate transactions. Consequently the company considers alternative solutions and has hired advisors for the process.

Governance considerations have been a key driver of the rating action reflecting a high probability of a default given the refinancing needs. Moody's continues to expect the company to be successful disposing selected assets in the next 6 months, but the company would probably require more time to generate sufficient proceeds to fully repay the bond or enabling a refinancing of the remaining outstanding bond amount with secured and not yet encumbered property assets. Moreover, DEMIRE needs to roll about €160 million of bank debt maturing just ahead or after the senior unsecured bond maturity in 2024. Moody's also considers two larger development projects with significant capital spending that will require funding in the next years in its analysis.

In case of a restructuring or other distressed exchange, Moody's currently does not anticipate losses for secured creditors of the company. Recoveries for senior unsecured noteholders will depend on a variety of factors in such a scenario. The real estate backing can provide for meaningful recoveries, but will require time to execute. Furthermore disposal progress up to a potential agreement will have material implications on recoveries as well. Next to the currently challenging real estate transaction market, crystallizing the asset values at Fair Value REIT AG is less certain given the less than 100% stake and high share of indirectly held assets within Fair Value REIT AG. At the same time any refinancing of the unsecured bonds would have to come at a currently prohibitively high interest rate, which questions the sustainability of the funding structure from a fixed charge cover perspective.

The notching of the senior unsecured notes below the CFR reflects the anticipated higher recoveries on secured debt and still possible encumbrance of currently unencumbered assets.

RATIONALE FOR THE OUTLOOK

The negative outlook reflects continuing uncertainty around refinancing, disposal and ultimate recovery prospects.

LIQUIDITY

Liquidity concerns are the key credit driver for DEMIRE. The company faces significant debt maturities, as around €660 million outstanding debt is due in 2024. So far refinancing has not been secured. The company had €132 million of cash available as of Q3 2023 (including cash at Fair Value REIT AG level which Moody's considers not to be available for bond refinancing). DEMIRE bought back bonds that reduced the maturity needs in 2024 to €499 million, and may actively pursue additional secured debt refinancing. With no public announcement of key shareholders has been made, no shareholder support is visible at this point.

Moody's perceives the refinancing risk of the secured debt maturities on existing encumbered assets to be lower, eve if some assets may require asset management activities or cash support to facilitate a refinancing or re-leveraging.

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

Factors that could lead to an upgrade: A rating upgrade is less likely to occur given the negative outlook, but it can occur if:

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

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

Factors that could lead to a downgrade:

- Expected recovery rates in case of a default or distressed exchange to be lower than anticipated

PRINCIPAL METHOLOGY

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/rmc-documents/393395. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

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.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on https://ratings.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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

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_1355824.

The Global Scale Credit Rating(s) discussed in this Credit Rating Announcement was(were) issued by one of Moody's affiliates outside the UK and is(are) endorsed for use in the UK in accordance with the UK CRA Regulation.

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