FitchRatings

RATING ACTION COMMENTARY

Fitch Assigns DEMIRE First-Time 'CCC+' IDR; Senior Secured Bond 'B' Rating

Wed 18 Jun, 2025 - 1:31 AM ET

Fitch Ratings - Frankfurt am Main - 18 Jun 2025: Fitch Ratings has assigned DEMIRE Deutsche Mittelstand Real Estate AG a first-time Long-Term Issuer Default Rating (IDR) of 'CCC+' and senior secured rating of 'B', which is applied to its EUR252.5 million secured bond. Its Recovery Rating is RR2.

The ratings reflect the secondary EUR0.8 billion (end-2024) German office-weighted, non-central business district (CBD) portfolio that has low average rents and high vacancies in areas with multi-landlords offering an undifferentiated product in pockets of oversupplied markets. After a debt restructuring in 2H24, the new secured bond incentivises EUR100 million of debt reduction in 2025 and 2026, using proceeds from planned asset disposals or increased mortgage debt; the remaining EUR150 million matures at end-2027.

End-2024 Fitch-calculated loan-to-value ratio was about 35% but the company's interest coverage suffers from portfolio vacancies and their holding costs. Lack of financial flexibility, the shrinking of rental-derived EBITDA to EUR20 million and tighter interest coverage frames the 'CCC+' IDR.

KEY RATING DRIVERS

Secondary Portfolio: DEMIRE's end-2024 investment property portfolio, 51 assets, EUR0.8 billion in value, spans office (63% by value), retail (29%) and others (8%). The portfolio had reduced in size due to disposals, including LogPark in Leipzig and the LIMES portfolio. The portfolio's rent income yield of 7% (if fully let) denotes a high yield, whereas high vacancies result in the portfolio's net initial yield of 5.7%. The weighted average lease term is unchanged at 4.6 years.

Top Ten Assets: The top 10 assets represent a concentrated half of the group's portfolio (by value and rent). These average EUR42 million in lot size and are predominantly offices spread disparately across German markets. Within this top 10, the two sizeable

Rostock and Neuss assets are retail and hotel, and wholesale or business-to-business retail, respectively.

Not Commanding High Rents: Averaging EUR9.50 to EUR10.00 sq m/month rents, DEMIRE is targeting non-prime, non-CBD offices. These non-central locations, although some are located well for transport, have multi-participant landlords all competing for the same Mittelstand tenant base with little differentiated product. Tenants can include cost-conscious government departments and companies, where landlord-refurbishment or ESG spend on office spaces would make rents unattractive. Public tenants constituted 27% of end-2024 rent roll.

CPI Indexed Rents: The portfolio's leases have annual CPI indexation, which reflected sharp increases in rent in 2022. Around three quarters of the portfolio maintained or increased their rent year on year (yoy) during 2024, resulting in a total 2.2% rise (2023: two-thirds at 2.8% increase). The other quarter of the portfolio saw a near 20% decrease (2023: one third at 20% decrease) in rent due to vacancies or tenant insolvencies. This resulted in a blended 3.3% (2023: down 3.7%) decline in rent yoy. Attracting new tenants may be tough, given the weakening, Mittelstand economic backdrop.

High Vacancy Rates: End-2024 vacancy was 15.1% (1Q25: 18.1%), unaided by the MeinReal (Querfurt) insolvency and increased vacancies at Düsseldorf and Langenfeld assets. After end-2024, Deutsche Telekom, the major and multi-building tenant, exited some of DEMIRE's Bonn asset, part of which has been re-let. Planned disposals include offices with vacancies where a different owner with resources to invest may secure a letting and realise value, whereas capital-constrained DEMIRE has been selective over which reinvestments to undertake relative to their rental reward.

Planned Disposals: Planned disposals in 2025 and 2026 are likely to be a mixture of properties with high and low vacancies (the former reducing operating costs for the group) shrinking the balance sheet of near-7% rental-yielding investment properties. These will be mostly DEMIRE assets rather than those held in part-owned Fair Value REIT-AG or its funds.

Unpacking Cielo Joint Venture: This Commerzbank-let, long-dated WAULT, but unoccupied, office is not on-balance sheet. DEMIRE's exposure includes it 49% ownership in the RFR co-owned joint venture (JV) with ownership puts and calls. DEMIRE has a EUR25.2 million loan to the JV, and EUR60 million loan to related-RFR5. The latter instruments are partly-remunerated.

Potential Cash Inflow from LIMES: After the insolvency process of this portfolio of entities, DEMIRE may receive proceeds after the asset auction and repayments to secured creditors. These potential net proceeds are not included in Fitch's Rating Case.

Secured Debts and Secured Bond: As at end-2024, asset-specific propcos-level secured debts were EUR162.7 million and the new DEMIRE-level secured bond EUR252.5 million. Additional fees provide an incentive to reduce secured bond outstandings by EUR50 million in 2025 and EUR50 million in 2026. Before or at the end-2027 scheduled maturity, the secured bond may be grouped with some or all of Apollo's subordinated shareholder loan outstandings to create a new benchmark-size bond.

Apollo Subordinated Shareholder Loan: Although subordinated and accruing interest (at 22%), the loan from Apollo (a 58.61% shareholder) has a December 2028 maturity date. The loan was used to prepay previous, tendered, unsecured bonds. Fitch treats this subordinated shareholder loan as equity.

Capped Recovery Rating: Fitch's analysis assumes that pledged propco properties may come under the control, and monetisation timing preference, of banks with secured financings. Under this scenario, the group's remaining investment property collateral totals EUR407.4 million (of which EUR52.8 million is in 83.45%-owned Fair Value REIT-AG) relative to the EUR252.5 million secured bond. Under Fitch's recovery ratings criteria the secured bond is treated as second lien debt with the Recovery Rating capped at 'RR2', which warrants two notches above the IDR.

PEER ANALYSIS

Sirius Real Estate Limited (BBB/Stable) also invests in secondary German offices, but these are more strategically located close to key German cities. Sirius's approach to acquiring higher-yielding assets, with a moderate level of capex required (similar to DEMIRE's) is more standardised, with a record of improving cash flows and WAULTs. Sirius has an active in-house leasing team for the German operations, which have a digital approach to recruiting and retaining tenants.

KEY ASSUMPTIONS

Key Assumptions Within Our Rating Case for the Issuer

- Largely flat like-for-like rental growth due to CPI indexation of 2% a year; 85%-90% re-leasing of lease expiries in each year and rental uplift of only 1% on successful re-lets.

- Rent roll reduction due to disposals, and a starting point of no 2025 rent contribution from LIMES, Leipzig and lower rents from part-unlet Bonn.

- Not much improvement in vacancy rates, which is also a function of the disposals achieved.

- Fitch-calculated rental-derived EBITDA (used in interest cover and net debt/EBITDA) also deducts Fair Value REIT-AG's funds' minorities' cash dividend of EUR3.4 million a year (funds' minorities and Fair Value REIT-AG).

- Scheduled propcos' annual debt amortisations of EUR2.6 million in 2025 (updated for year-to-date refinancings), EUR3.0 million in 2026 and EUR2.7 million in 2027 (excluding facilities not prepaid by assumed asset disposals).

- Disposals of about EUR150 million-180 million, mainly in 2H25 and also in 2026. Net disposal proceeds reduce the secured bond by EUR53.8 million in 2025 and EUR50 million in 2026 - the remainder goes to cash.

- Mainly fixed-rate debt, with an additional 3% interest cost on the secured bond's 2027 outstandings.

- Subordinated shareholder loan capitalises its interest at 22% a year.

RECOVERY ANALYSIS

Our recovery analysis assumes that DEMIRE would be liquidated rather than restructured as a going concern in a default.

Using end-2024 independently assessed investment property values, Fitch deducts propcos' properties which are pledged to their respective direct secured creditors. The group's remaining investment property collateral totals EUR407.4 million, to which we apply a standard 20% discount. We assume no cash is available for recoveries. There are no undrawn revolving credit facilities. Additionally, a standard 10% deduction is made for administrative claims.

The resulting amount is compared against the EUR252.5 million secured bond. Fitch attributes no value to the two loans to the Cielo JV structure, or net proceeds from the LIMES portfolio, until these potential net proceeds are used to reduce debt.

Fitch's principal waterfall analysis generates a ranked recovery for the secured bond of over 100%, but under Fitch's Recovery Rating criteria, the secured bond is a second lien instrument whose Recovery Rating is capped at 'RR2'. The subordinated shareholder loan ranks behind the secured bond.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Lack of disposals, not achieving the secured bond's "bond reduction amount" for 2025 and 2026 of EUR50 million in each year

- Further examples of adverse forced disposals of propco entities in the group

- Lack of plans to refinance the secured bond 12 months-18 months ahead of its scheduled debt maturity

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Plans to refinance the secured bond (end-2027) before increased interest costs, with visibility on elongation of the subordinated shareholder loan maturing at end-2028

- Significant improvement in vacancies, which increases rental income, decreases void costs and raises property valuations

- Fitch-adjusted (for minority cash dividends) cash interest cover sustainably above 1.1x

- Net debt/EBITDA lower than 17x

- Loan-to-value ratio below 55%

- History of flat-to-positive year-on-year rent increases upon re-leasing

LIQUIDITY AND DEBT STRUCTURE

At end-2024, DEMIRE had EUR42 million of readily available cash. It has no undrawn credit facilities. Given the post-cash interest and tax funds from operations outflow in 2025 (Fitch's funds from operations includes the tax paid relating to 2023's disposals), internal liquidity will mainly stem from planned disposal of assets, aiming to fulfil the 2025 EUR50 million "bond reduction amount" and EUR50 million for 2026.

Targeted disposals include income-producing, and some properties with vacancies. Reduction of the secured bond outstandings to about EUR150 million avoids extension fees and makes a refinancing ahead of December 2027 more digestible, although still high yield.

Excluding the subordinated shareholder loan maturing December 2028, the weighted average debt tenor was 2.6 years at end-2024. The main obligation is the EUR252.5 million secured bond maturing in December 2027. The company has an incentive to refinance this debt early, as it incurs additional interest costs of 3% in 2027. Other secured debt includes propco-specific secured financings for assets which, after the LIMES refinancing insolvency event, the company has continued to access and refinance, lengthening the group's maturity profile.

DATE OF RELEVANT COMMITTEE

30-May-2025

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG CONSIDERATIONS

DEMIRE has an ESG Relevance Score of '4' for Management Strategy due to disruption in executing the strategy of re-investing in assets and financial inflexibility constraining future options for the company as the portfolio shrinks in size, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

DEMIRE has an ESG Relevance Score of '4' for Group Structure due to structural complexities within the group including part-owned entities, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY
DEMIRE Deutsche Mittelstand Real Estate AG	LT IDR	CCC+	New Rating	
senior secured	LT	B	New Rating	RR2
EUR 252.45 mln 5% bond/note 31-Dec-2027 DE000A2YPAK1	LT	B	New Rating	RR2

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

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APPLICABLE CRITERIA

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 06 Dec 2024) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 06 Dec 2024)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.2.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

DEMIRE Deutsche Mittelstand Real Estate AG	EU Issued, UK Endorsed

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