CREDIT OPINION

20 November 2024

Update

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RATINGS

DEMIRE Deutsche Mittelstand Real Estate AG

Domicile	Germany
Long Term Rating	Caa2
Type	LT Corporate Family Ratings
Outlook	Stable

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.

Contacts

Oliver Schmitt +49.69.70730.732
VP-Sr Credit Officer
oliver.schmitt@moodys.com

Lucille Duhamel +33.1.5330.1078
Ratings Associate
lucille.duhamel@moodys.com

Christian Hendker, CFA +49.69.70730.735
Associate Managing Director
christian.hendker@moodys.com

DEMIRE Deutsche Mittelstand Real Estate AG

Update post CFR affirmation and bond upgrade

Summary

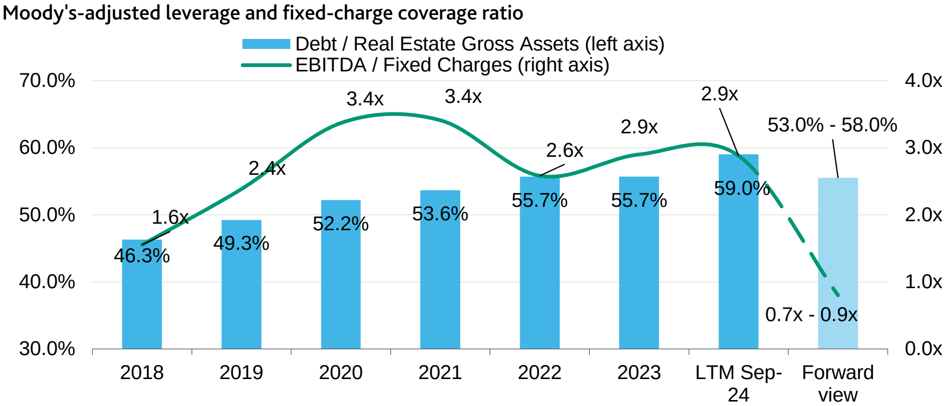
On 8 November 2024, we affirmed DEMIRE's CFR at Caa2, upgraded the bond ratings to Caa2 from Caa3, and changed the outlook from negative to stable, following the implementation of the restructuring. While we consider the restructuring a distressed exchange, future improvements of DEMIRE's credit quality are possible upon successful deleveraging through disposals and continued refinancing of upcoming secured debt.

The restructuring allows DEMIRE to continue with its disposal plan to reduce leverage and stabilise its capital structure. DEMIRE has started to reduce Moody's-adjusted debt/assets to 59% and aims to reduce through further disposals. We see material execution risks in selling DEMIRE's assets in a still weak German transaction market with economic weakness reducing investor appetite, but see high disposal volumes with moderate discounts as the main path to a sustainable capital structure. We expect Moody's-adjusted debt/gross assets remaining below 60% despite inclusion of a loan provided by a shareholder as debt, assumptions on value declines and some adjustments to other balance sheet assets. Interest cover will be a weak spot due to high shareholder loan interest expense that can be deferred. DEMIRE also needs to stabilise its asset performance following weak performance in 2024. DEMIRE's portfolio continues to shrink but is still diversified across Germany and asset types, which helps in a disposal process.

Exhibit 1

Balance sheet leverage to decline, interest cover to drop materially with refinancing and shareholder loan in debt

Moody's-adjusted leverage and fixed-charge coverage ratio



All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated. LTM = Last 12 months.
Moody's forecasts are Moody's opinion and do not represent the views of the issuer.
Source: Moody's Financial Metrics™ and Moody's Ratings forecasts

Credit strengths

- Relatively small but well-diversified commercial real estate portfolio
- Focus of its operations in Germany and access to a local bank market
- High share of high quality tenant

Credit challenges

- Structural challenges with constrained access to Fair Value REIT and some other balance sheet items
- Disposal execution risk that is key to refinance extended bond
- High leverage
- Weakening operating performance in a lower-quality portfolio than that of its higher-rated peers
- Difficult operating environment in Germany given economic outlook

Rating outlook

The stable outlook balances improving gross leverage expectations with ongoing operational headwinds in the portfolio, structural concerns and execution risk for the disposal plan.

Factors that could lead to an upgrade

- The company successfully disposes assets to meet the expected annual paydown of debt in the restructuring agreement
- DEMIRE manages to crystalise value in its Fair Value REIT stake and other complex claims like Cielo
- DEMIRE manages to roll its upcoming secured debt
- Moody's-adjusted debt/assets reduces well below 60%, including Moody's adjustments on balance sheet items next to investment properties
- Interest cover remains above 1x

Factors that could lead to a downgrade

- DEMIRE's liquidity weakens
- Operational weakness in the asset portfolio makes further disposal and refinancing activities challenging

Key indicators

Exhibit 2
DEMIRE Deutsche Mittelstand Real Estate AG

	2018	2019	2020	2021	2022	2023	LTM Sep-24	Forward view
Real Estate Gross Assets	1148.66	1378.69	1677.42	1625.31	1705.59	1536.85	1175.00	850.00 - 1000.00
Amount of Unencumbered Assets	N/A	N/A	50.6%	64.0%	55.0%	52.8%	53.2%	50.0% - 60.0%
Debt / Real Estate Gross Assets	60.6%	46.3%	49.3%	52.2%	53.6%	55.7%	59.0%	53.0% - 58.0%
Net Debt / EBITDA	14.8x	10.9x	12.6x	12.9x	13.0x	16.5x	11.1x	13.0x - 15.0x
Secured Debt / Real Estate Gross Assets	25.4%	20.0%	12.9%	14.7%	17.5%	18.3%	21.4%	15.0% - 20.0%
EBITDA / Fixed Charges	0.9x	1.6x	2.4x	3.4x	3.4x	2.6x	2.9x	0.7x - 0.9x

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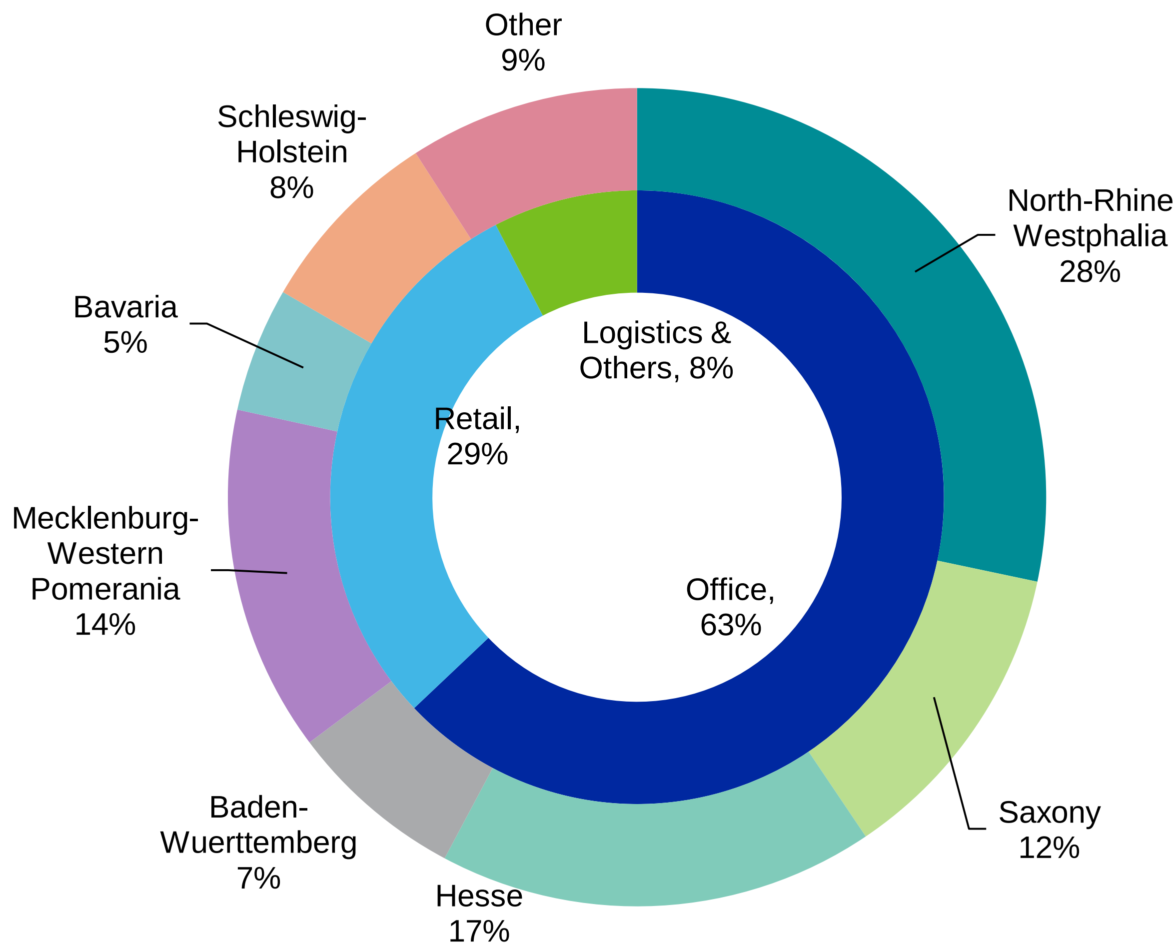
Profile

Headquartered in Langen, Germany, DEMIRE Deutsche Mittelstand Real Estate AG (DEMIRE) is a publicly listed commercial real estate company with a focus on offices and retail assets in secondary locations across Germany. The company's portfolio has 54 single properties, with a total lettable floor space of around 613,000 square metres (sqm) and an aggregate portfolio value of around €0.8 billion. The company's annualised contracted rent amounted to €57.6 million as of 30 September 2024, with a 4.4-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 €290.4 million in assets, or around 25% of DEMIRE's total assets, as of 30 September 2024.

DEMIRE is listed on the Frankfurt stock exchange and had a market capitalisation of around €84.4 million as of November 2024. Apollo-managed funds and Wecken Group together hold 90.75% of DEMIRE's shares.

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



Inner ring of 30 September 2024 and outer ring as of 30 June 2024
Source: Company information

Detailed credit considerations

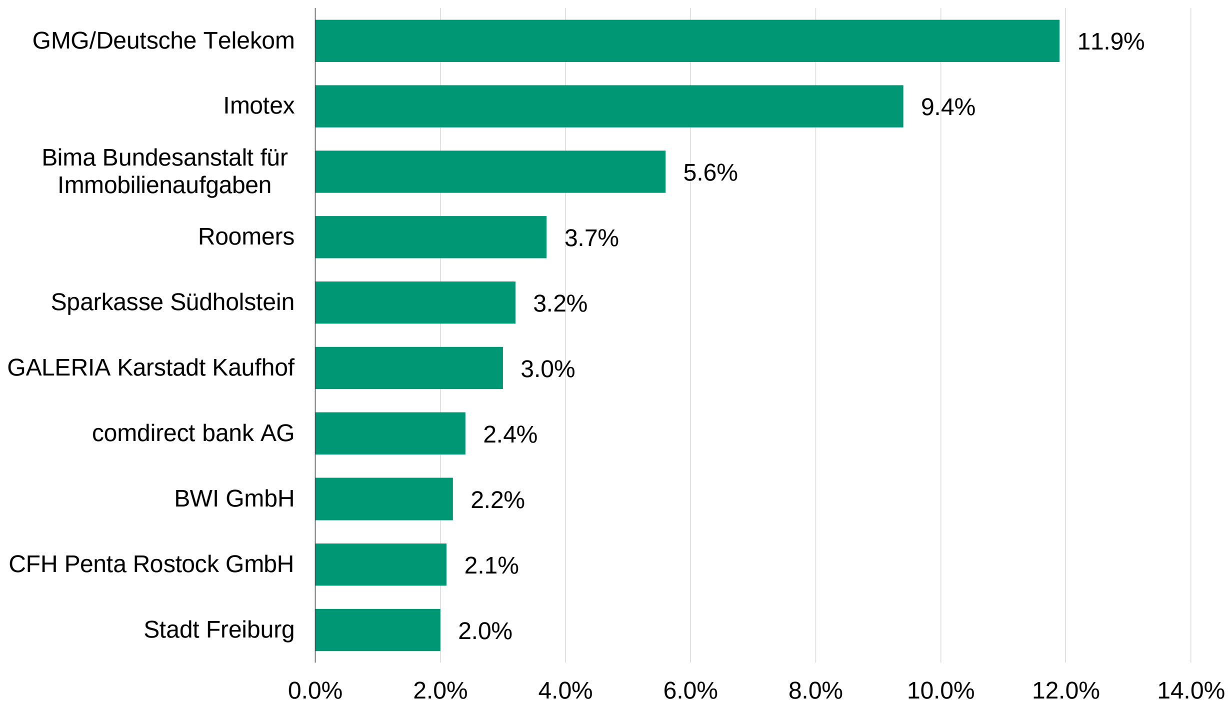
Small but still diversified commercial real estate portfolio primarily in secondary German locations

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 largest tenant remains Deutsche Telekom AG (Deutsche Telekom, Baa1 stable) contributing 11.9% of annual contracted rent, followed by fashion distributor Imotex with 9.4% and German government agency BImA (Bundesanstalt für Immobilienaufgaben) representing 5.6%. 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 Deutsche Telekom vacates the assets. Historically, DEMIRE has been successful reletting or disposing some of the assets.

Tenant credit quality is bifurcated. DEMIRE owns assets in secondary locations and B-type properties. Part of these assets attract weaker quality tenants. At the same time DEMIRE derives around 30% of its income from public-sector or highly rated tenants.

Exhibit 4
Top 10 tenants
Based on annualised contracted rents



As of September 2024
Source: Company information

Restructuring gives time to execute deleveraging and final refinancing of the bond

DEMIRE implemented a bond restructuring early November 2024. Key elements of the restructuring included the extension of the remaining bonds after agreed repayments and repurchases to end of 2027 with a 5% cash interest and the provision of security including share and account pledges to noteholders. The bond structural ranking remains below (mortgage) secured debt but ranks ahead of a loan provided by Apollo affiliates. The recent upgrade of the bond reflects its relatively stronger position in the capital structure compared to the loan provided by Apollo affiliates. The security package strengthens noteholder's position in case of future discussions with shareholders.

In total DEMIRE reduced the bond volume by a total of notional of roughly €250 million resulting from cash payment of €50 million at par and a tender for €195.4 million of bonds at a maximum price of 76.25%. The company used cash on balance sheet including disposal proceeds and a €93 million liquidity injection from shareholders to fund the payments. We do consider the shareholder loan provided by Apollo affiliates as debt given it does not meet our criteria to receive equity credit. The restructuring also contains €50 million bond paydown targets in 2025 and 2026 linked to a respectively a 3% and 2% potential fee penalty. A 3% extra payment applies to the bonds in 2027.

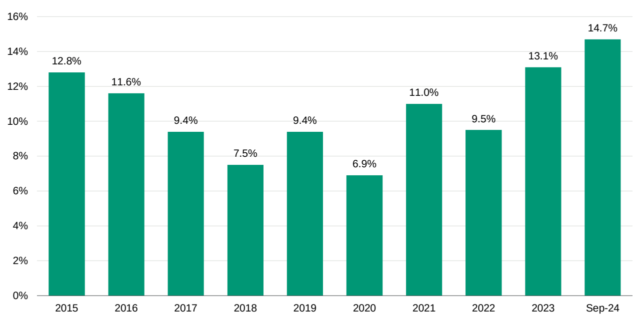
DEMIRE intends to sell assets from its directly held asset base. DEMIRE sold LogPark in Leipzig in Q1 2024 and used proceeds as a liquidity source to meet debt paydown requirements and to delever the company. The asset base of DEMIRE is relatively granular, hence there is no reliance on an individual sale. The company sold about €200 million of assets since 2022 (out of which €104 million related to LogPark), and has signed further sales for €8 million according to company information. Yet the weaker performance of the portfolio and lower attractiveness to investors result in execution and price risk for the disposal plan. The market for property disposals is improving slowly from a low level which should benefit DEMIRE's efforts. The German market, in particular for office and retail, still faces moderate investor interest compared to long term averages. We have considered €30-50 million annual repayments from future disposal expectations in the next 12-18 months.

Operating performance weakness in difficult leasing markets

DEMIRE's assets performed weakly compared to peers in the office and mixed asset owners segment. Vacancy has been at 14.7% in Q3 2024 from 9.5% in 2022 and 13.1% in 2023, peaking at 15.5% in H1 2024. Part of the vacancy stems from an opportunistic value add strategy with a relatively old building stock. Like-for-like rental income fell by 3.2% in Q3 2024 after strong indexation driven growth in 2022 and -3.5% in 2023. Given lease maturities on partially concentrated tenancies in non-prime assets and locations, asset and property management execution is key to maintain operating cash flows, including capital spending and tenant incentives. Management is aware of operating challenges and has increased focus on vacancy and leasing management.

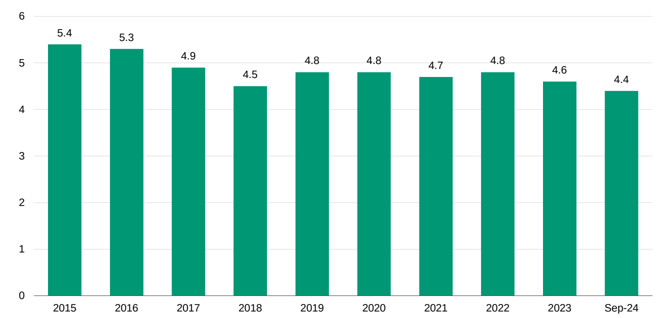
The company has not disclosed certifications for its assets that makes the energy performance difficult to assess. We expect the portfolio to face more challenges to withstand the impact of a sustainably weaker economic environment in Germany. The average rent of the portfolio is affordable and the company does not expect ESG-compliant stock to be the material competitor given their rental levels. We nevertheless expect further challenges to the portfolio earnings given already elevated vacancies and a German market with weak economic prospects.

Exhibit 5
Vacancy on an elevated leve



Source: Company information

Exhibit 6
Weighted average lease term remains roughly stable



Source: Company information

Disposal environment for landlords improving from a low level

The investment market in Germany will affect DEMIRE's disposal success. Property investments in Germany remain well below long term averages, even if we expect the market to benefit from declining interest rates. Germany's weak economic outlook and the structural concerns for offices with respect to a hybrid work model weigh on investor sentiment. A relevant share of investor will also only focus on prime assets and locations at lower yields but higher ESG credentials.

Leverage to decline from a high level, interest cover weak point with high shareholder loan interest

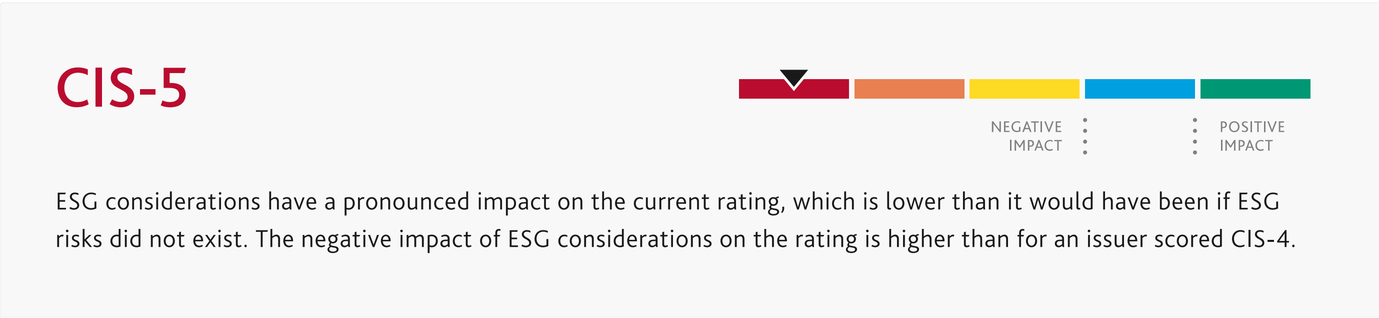
We expect Moody's-adjusted debt/gross assets remaining below 60% (Q3 2024 was 59%). Our assumptions driving down balance sheet leverage expectations include some further single digit value decline expectations, CAPEX spending including tenant incentives required to manage an asset management intensive portfolio, adjustments to some balance sheet items like claims related to Cielo and LIMES, and our inclusion of the shareholder loan in debt. Those adjustments are overcompensated by the positive impact from bond repayments, including €30-50 million annual repayments from future disposal expectations, in the next 12-18 months.

As a consequence of the loan provided by Apollo affiliates that we see as debt with a 22% interest rate, a currently weakening earnings base from the asset pool, and the increased interest rate on the bond, Moody's-adjusted fixed charge cover will drop below 1x. Excluding the effect of the shareholder loan, on which interest can be deferred at the option of the issuer, fixed charge cover will stay above 1.5x in 2025. We do not consider EBTIDA created by discounted buybacks as sustainable earnings and would hence remove it from the calculations. At the same time we did not incorporate potential penalties in case of lack of bond repayment in 2025 and 2026 in our projections. Given the high interest rate on the loan provided by Apollo affiliates, we expect DEMIRE to work on a longer term solution for a refinancing for this instrument in the absence of material disposal proceeds.

ESG considerations

DEMIRE Deutsche Mittelstand Real Estate AG's ESG credit impact score is CIS-5

Exhibit 7
ESG credit impact score



Source: Moody's Ratings

DEMIRE's **CIS-5** indicates that the rating is lower than it would have been if ESG risk exposures did not exist. This reflects exacerbated governance risks due to the aggressive financial stance of its sponsors favoring shareholder distributions, and lack of a risk management that resulted in a non-payment on a bond maturity we considered a distressed exchange. Credit risk also stems from environmental risks which represent investment requirements to respond to changing occupier preferences and more stringent environmental regulation and to avoid asset obsolescence risk.

Exhibit 8
ESG issuer profile scores

Source: Moody's Ratings

Environmental

E-4: DEMIRE's exposure to environmental risks reflects a lower-quality portfolio than that of higher-rated real estate companies. The lack of environmental credentials makes DEMIRE more vulnerable to regulatory or tenant requirements with respect to energy performance and increases the investment requirements to upgrade the company's properties to prevent obsolescence risk. We note that energy intensity improved in the last 2 years.

Social

S-4: Credit exposure to social considerations comes from rising hybrid-working models and accelerated shift towards e-commerce that weakens occupier demand for the company's properties. 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.

Governance

G-5: Credit exposure to governance risks comes from an aggressive financial stance that its majority shareholders, PE group Apollo and Wecken, have demonstrated, as well as the distressed exchange from its discounted bond buyback and extension of its bond maturity. DEMIRE has a history of debt-funded mergers and acquisitions, shareholder distributions and high leverage.

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.

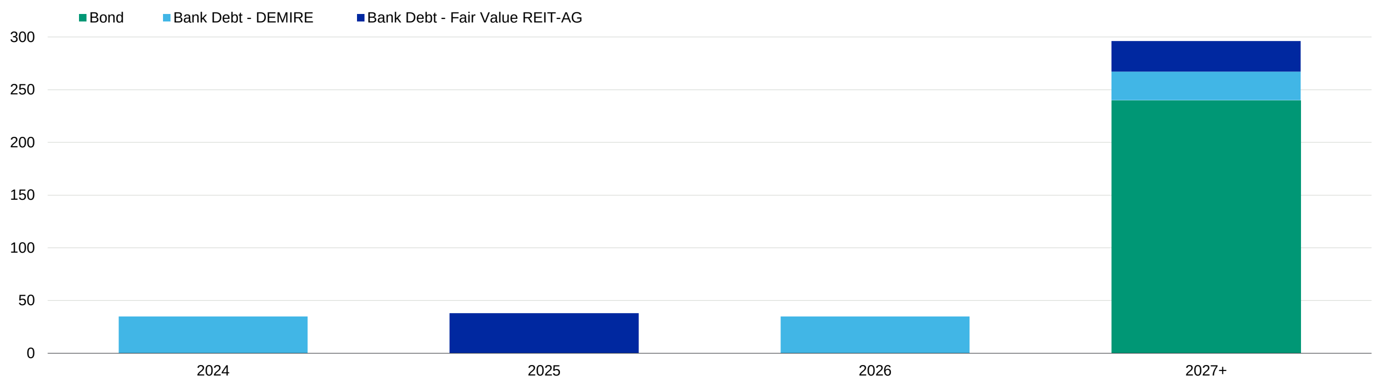
Liquidity analysis

Following the bond restructuring, DEMIRE's liquidity remains tight and relies on refinancing of secured debt. As part of the restructuring, we estimate about €200 million has been spent post Q3 reporting on the repayment and repurchase of the bonds as agreed in the restructuring. The company had €165 million cash on balance sheet as of September 2024 and will use up to €93 million shareholder loan. We expect Moody's-adjusted CFO below €10 million for 2024 and 2025. €35 million outstanding debt is due in November 2024 and €38 million in 2025, which we understand the company aims to extend, but we consider may require asset management or some debt deduction. DEMIRE also aims to actively dispose of assets to address its liquidity needs and has started to sign first smaller disposals.

Exhibit 9

Pro-forma October 2024 restructuring, loan extensions are main maturities for DEMIRE until Dec 2027

DEMIRE's debt maturities (in € millions)



As of 30 September 2024

Source: Company information

Structural considerations

The remaining bonds and secured property debt will be the main sources of debt for DEMIRE going forward. While the balance of unsecured debt will drop materially from the restructuring, secured debt will decline further from disposals going forward unless DEMIRE uses secured debt to fund bond repayments. Hence bonds will remain the majority class of debt by end of 2024 but trending down over time. At the same time, the bonds benefit from structural seniority to the initially €93 million shareholder loan provided by an Apollo affiliate, which supports the rating of the bonds despite subordination to material secured debt volumes.

One of the complexities in refinancing the bond are the limitations in crystallizing the asset values at Fair Value REIT AG (FVR) that has a lower LTV than DEMIRE on a standalone basis. DEMIRE controls the company but has refrained from selling any assets on FVR level to upstream cash to DEMIRE that allows a repayment of debt. Reported consolidated financial metrics do not fully reflect the financial position of DEMIRE on a standalone basis. DEMIRE also has claims related to the Cielo asset in Frankfurt that we consider complex and subject to challenges in recovering the full amount. DEMIRE continues to have an asset on balance sheet related to the defaulted LIMES portfolio, which will take material time and workout success above bank claims before recoveries can be secured.

Rating methodology and scorecard factors

The scorecard-indicated outcomes for the twelve months ended September 2024 and under the forward view are four notches above the assigned rating, respectively. This mainly reflects the ongoing challenges to stabilise the capital structure at a sustainable level.

Exhibit 10

DEMIRE Deutsche Mittelstand Real Estate AG

REITs and Other Commercial Real Estate Firms Industry Scorecard	LTM 09/30/2024		Moody's 12-18 month forward view	
Factor 1 : Scale (5%)	**Measure**	**Score**	**Measure**	**Score**
a) Gross Assets (USD Billion)	$1.3	Ba	$0.9 - $1.0	B
Factor 2 : Business Profile (25%)				
a) Market Positioning and Asset Quality	B	B	B	B
b) Operating Environment	Ba	Ba	Ba	Ba
Factor 3 : Liquidity and Access To Capital (25%)				
a) Liquidity and Access to Capital	Caa	Caa	Caa	Caa
b) Unencumbered Assets / Gross Assets	53.2%	Ba	50.0% - 60.0%	Ba
Factor 4 : Leverage and Coverage (45%)				
a) Total Debt + Preferred Stock / Gross Assets	59.0%	B	53.0% - 58.0%	Ba
b) Net Debt / EBITDA	11.1x	Caa	13.0x - 15.0x	Ca
c) Secured Debt / Gross Assets	21.4%	Ba	15.0% - 20.0%	Baa
d) Fixed Charge Coverage	2.9x	Baa	0.7x - 0.9x	Ca
Rating:				
a) Scorecard-Indicated Outcome		B1		B2
b) Actual Rating Assigned				Caa2

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Ratings

Exhibit 11

Category	Moody's Rating
DEMIRE DEUTSCHE MITTELSTAND REAL ESTATE AG	
Outlook	Stable
Corporate Family Rating	Caa2
Senior Unsecured -Dom Curr	Caa2

Source: Moody's Ratings

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