Credit Rating Announcement

02 July 2024

Scope affirms Vonovia's issuer rating at A- and maintains a Negative Outlook

The Negative Outlook reflects the significant risk that high leverage may persist for a prolonged period, despite the company's ongoing deleveraging efforts through asset sales.

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope Ratings GmbH (Scope) has today affirmed the A- issuer rating of Vonovia SE and maintained the Negative Outlook. Scope has also affirmed the A- senior unsecured debt rating and the S-1 short-term debt rating.

The Negative Outlook is maintained due to concerns over Vonovia's high leverage ratio which is expected to persist despite ongoing deleveraging efforts, including asset sales aimed at reducing debt. However, market value declines have been more severe than anticipated further exacerbating leverage risks. Vonovia plans to mitigate this by selling assets and raising capital through minority stake sales in certain portfolios over the next 18 months.

The full list of rating actions and rated entities is at the end of this rating action release.

Key rating drivers

Business risk profile: A. Vonovia's business risk profile remains robust underpinned by the company's unchanged status as Europe's largest residential landlord, with a portfolio of around 545,000 residential units and total assets* of EUR 91bn at the end-March 2024. Vonovia's well-diversified residential real estate portfolio in regulated European markets, mainly in Germany, provides the company with recurring rental cash flows. The company's absolute size and cash generation capabilities will keep it ahead of its peers affording excellent access to the capital markets for financing, as evidenced by its ability to issue bonds even in times of stress.

Vonovia's strong market positioning also supports its access to investment markets, as reflected by the EUR 4bn of divestments signed in 2023. The company is targeting further disposals (EUR 3bn in 2024), including portfolios sales to municipalities and its healthcare division. Scope views Vonovia's proven track record in sales as supportive in achieving these targets. As at April 2024, disposals totalled EUR 1.7bn in signed but not yet completed transactions, including an agreement to sell approximately 4,500 units and a land plot to city-owned housing companies, for a purchase price of EUR 700m.

Scope expects the portfolio’s key performance indicators to remain robust. Vonovia’s portfolio remains well-diversified across German (Berlin represents 26% of net rental income at end-March 2024), Austrian and Swedish metropolitan areas. Strong demand outstripping supply in these residential markets, results in a portfolio with high and stable occupancy rate (97.8% as at end March 2024), sticky tenant portfolio (13-year average lease) and rental income growth (3.8% like-for-like rental growth for the 12 months ending March 2024). The strong performance will also be supported by the good location of the properties in regions with positive demographics and liquidity as well as the improving condition of the properties, which will be underpinned by substantial capex and maintenance expenditure to maintain the high run rate for energy efficiency (EUR 1bn investment program targeted for 2024, EUR 0.8bn in 2023) which will also help to maintain high occupancy and ensure stable and predictable cash flows (ESG factor). This in turn, allows for further organic growth with rent increases in line with the cities' qualified rental indices, which are expected to increase significantly in 2024.

Vonovia exhibits solid business fundamentals, reflected in a stable like-for-like rental growth which Scope expects to remain positive at 3-4% per annum between 2024 and 2026, supporting Vonovia’s operating cash generation, despite investment cuts. The supply/demand imbalance in most of its markets has increased with fewer new flats being delivered and heightened demand from potential homebuyers forced out of the market by the sharp rise in interest rates. Scope expects profitability to remain stable at above 70% over the medium term (EUR 74.7% in 2023, down 2.5pp YoY) as rental growth helps to mitigate: i) the inflationary pressure on the company’s cost base, ii) the margin-diluting impact of the transformational shift in the development portfolio to develop-to-sell from develop-to-hold; and iii) a significant decline in the EBITDA contribution from value-added services.

Financial risk profile: BBB-. The financial risk profile reflects the increased risk that high leverage - at levels not consistent with the rating category – may persist, despite Vonovia's efforts to reduce its debt burden through asset sales. The agency expects Vonovia's loan/value* to decline slightly in 2024 (2024E: 46% compared to 2023: 48%) and to remain around 45% over the next 18 months.

Vonovia's debt protection, as measured by the EBITDA interest cover, remains strong (3.8x for FY2023). Scope expects interest cover to remain between 3x-4x, taking into account the drastically changed interest rate environment, which significantly increases funding costs in the medium term. However, the increase in funding costs is largely offset by: i) an increase in Scope's adjusted EBITDA, which is expected to grow by more than 3% annually, ii) a significant reduction in interest-bearing debt by approximately EUR 3.5bn by the end of 2025 through asset sales and limited capital expenditure (EUR 1bn in 2024), and iii) a high level of hedging (99% at end-March 2024) coupled with a long average debt maturity (6.9 years).

Significant market value declines in 2023 resulted in a deterioration of 13% of Vonovia’s portfolio value (mainly in H1 2023). The loan/value ratio increased significantly and stood at 48% at end-2023. Vonovia's deleveraging strategy through divestments and reduced investments to conserve cash, is expected to lead to a projected debt reduction of around EUR 3.5bn by end-2025. The achievability of the debt reduction is supported by Vonovia's proven access to capital and investment markets as evidenced by EUR 4bn of divestments signed in 2023 (EUR 3.3bn closed in the same year). However, the agency highlights that deleveraging capacity will remain under pressure due to risk of higher-than-expected market value declines in 2024 and 2025. In Scope's base case, the loan/value ratio should remain at around 45% over the next 12 to 18 months.

Liquidity: adequate. Vonovia’s liquidity is deemed adequate based on the agency’s expectation that sources of liquidity (EUR 1bn in available cash; EUR 3.0bn in undrawn committed credit lines - both at end-March 2024 - and EUR 1.2bn in forecasted free operating cash flow) will cover uses by about 159% in FY 2024.

Scope takes a positive view of the company's revised objective to meet refinancing needs well in advance (12-18 months) given the more challenging refinancing environment. In this context, Scope recognizes the company's strategy to also diversify its equity sources by inviting investors to take minority stakes in certain portfolios, as well as its ability to sell properties close to market value in the current environment to ensure repayment of unsecured bonds from available cash while prolonging secured financing or securing higher funding.

Supplementary rating drivers: credit-neutral. Supplementary rating drivers have no impact on the issuer rating.

One or more key drivers of the credit rating action are considered an ESG factor.

Outlook and rating sensitivities

The **Outlook** for Vonovia remains **Negative** due to the sustained risk that the loan/value ratio remains above 45%, despite ongoing asset disposals efforts. The Outlook assumes an annual like-for-like rental growth of 3-4% between 2024 and 2026, annual capital expenditure of EUR 1bn and estimated dividend annual payments of EUR 0.9bn, over the same period.

The **upside scenario** for the ratings and Outlooks is:

1. Loan/value ratio returns to below 45%, achievable through the rapid execution of the deleveraging strategy, supported by a capital release through the disposal of the non-core portfolio and market value declines that are less severe than anticipated.

The **downside scenarios** for the ratings and Outlooks are (individually or collectively):

1. Loan/value ratio is persistently at or above 45%, especially if a decline in portfolio value driven by a potential weakening of residential property values, is not sufficiently offset by debt reduction.

2. A negative rating action could also be triggered if the proportion of non-domestic net rental income fails to exceed 15% in the medium term, likely driven by limited success in divesting German assets.

Debt ratings

The senior unsecured debt rating has been affirmed at A-, at the same level as the issuer rating. As at end-May 2024, Vonovia had partially utilised a EUR 30bn EMTN programme with issuances by Vonovia SE (initially issued by Vonovia Finance B.V. that no longer exists following the merger with Vonovia SE). Senior unsecured debt continues to benefit from an unencumbered asset ratio of 159%, as disclosed by the issuer, which provides a pool of collateral to debt holders.

The short-term debt rating has been affirmed at S-1, based on the underlying A-/Negative issuer rating and supported by better-than-adequate internal liquidity, good banking relationships, strong access to diverse funding sources and access to undrawn, committed credit lines, which Scope believes allow the company to address short-term refinancing needs. Vonovia had a non-utilised EUR 3bn commercial paper programme as at end-March 2024.

Environmental, social and governance (ESG) factors

Vonovia's significant capex and maintenance expenditure that will remain at around EUR 1bn to maintain the high run rate for energy efficiency (at least 2% of the portfolio yearly), will help to keep occupancy high and ensure stable and predictable cash flows that allow for further organic growth with rent increases in line with the cities' qualified rent indices, expected to increase significantly in 2024.

Rating withdrawal

Scope has withdrawn all ratings on Vonovia Finance B.V. for business reasons due to the merger of the company with Vonovia SE in January 2024.

All rating actions and rated entities

Vonovia SE

Issuer rating: A-/Negative, affirmation

Senior unsecured debt rating: A-, affirmation

Short-term debt rating: S-1, affirmation

Vonovia Finance B.V.

Issuer rating: A-/Negative, withdrawal

Senior unsecured debt rating: A-, withdrawal

Short-term debt rating: S-1, withdrawal

**All credit metrics refer to Scope-adjusted figures*

Stress testing & cash flow analysis

No stress testing was performed. Scope Ratings performed its standard cash flow forecasting for the company.

Methodology

The methodologies used for these Credit Ratings and/or Outlook, (General Corporate Rating Methodology, 16 October 2023; European Real Estate Rating Methodology, 28 March 2024), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity and Scope Ratings' internal sources.

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Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlook and the principal grounds on which the Credit Ratings and/or Outlook are based. Following that review, the Credit Ratings and/or Outlook were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlook are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlook are UK-endorsed.
Lead analyst: Rigel Scheller, Director
Person responsible for approval of the Credit Ratings: Marlen Shokhitbayev, Senior Director
The Credit Ratings/Outlooks were first released by Scope Ratings on 13 December 2019. The Credit Ratings/Outlooks were last updated on 29 June 2023.

Potential conflicts

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With more than 300 employees operating from offices in Berlin, Frankfurt, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG analysis and fund research. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. Scope Ratings is registered in accordance with the EU rating regulation and operating in the European Union with ECAI status. Scope Ratings is the only European rating agency accepted by the ECB for the Eurosystem Credit Assessment Framework (ECAF). The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

Contact

Analyst	Rigel Scheller	r.scheller@scoperatings.com
Team leader	Sebastian Zank	s.zank@scoperatings.com

Scope Ratings GmbH • Lennéstraße 5 • D-10785 Berlin • Phone: +49 30 27891-0 • Fax: +49 30 27891-0
www.scoperatings.com

Executive Board: Guillaume Jolivet • District Court: Berlin: HRB 192993 B • VAT identification number: DE226486027

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