S&P Global
Ratings

RatingsDirect®

Research Update:

Germany-Based Adler Real Estate Upgraded To 'BB' On Expected Stronger Debt Metrics; Outlook Stable

Primary Credit Analyst:
Anton Geyze, Moscow (7) 495-783-4134; anton.geyze@spglobal.com

Secondary Contact:
Nicole Reinhardt, Frankfurt (49) 069 33 999 303; nicole.reinhardt@spglobal.com

Table Of Contents

Research Update:

Germany-Based Adler Real Estate Upgraded To 'BB' On Expected Stronger Debt Metrics; Outlook Stable

Overview

- Adler Real Estate AG announced the sale of 80% of its subsidiary Accentro Real Estate AG and 92% of its convertible bonds issued by Accentro to Vestigo Capital Advisors for a total price of about €180 million.
- In addition, Adler has revised its financial policy target to a loan-to-value ratio of below 55% from below 60%.
- We expect Adler's debt to debt plus equity will be below 65% by 2017-2018, factoring in the positive revaluations of its portfolio and the use of part of its proceeds from the Accentro transaction to repay debt.
- We are therefore raising our long-term corporate credit rating on the company to 'BB' from 'BB-'.
- The stable outlook reflects our expectation of continued favorable demand for residential real estate in Germany, translating into positive revaluations of Alder's portfolio.

Rating Action

On Oct. 25, 2017, S&P Global Ratings raised its long-term corporate credit rating on German property investment company Adler Real Estate AG to 'BB' from 'BB-'. The outlook is stable.

Rationale

The upgrade reflects Adler's recently revised financial policy with a tighter target loan-to-value ratio of below 55% (62% as of June 30, 2017, as per the company's calculation of total assets minus cash to reported debt minus cash, versus 67% debt-to debt-plus equity as calculated by S&P Global Ratings) We also factor in our expectation of improvements in Adler's debt-protection metrics already by end-2017 thanks to positive revaluations and debt repayment with part of proceeds from its sale of 80% of its subsidiary, Accentro Real Estate AG, which specializes in selling properties to individuals, to Vestigo Capital Advisors. Adler recently announced this transaction, which includes the sale of 92% of its convertible bonds issued by Accentro, for a total price of €180 million. We understand that Adler has already received the first payment and will continue to do so in tranches over the next 13 months. This transaction does not affect our calculation of Adler's EBITDA, as we originally excluded gains from the sale of apartments from it, since we treated such revenues as volatile and nonrecurring.

As a result, we project the S&P Global Ratings-adjusted ratio of debt to debt plus equity for Adler will be lower than 65%, and the adjusted EBITDA-to-interest-coverage ratio will exceed 1.3x by the end of 2017. We also understand that Adler plans to accelerate its disposal program of its non-core assets, and this should lead to improvements in its occupancy ratio by a few percentage points from the current 90%. We also expect improvement in occupancy on the back of Alder's strategy of active asset management and a better tenant proposition through integrating all property management services in-house.

In our view, Adler has a sound portfolio of residential properties in the north and west of Germany, mainly in smaller cities. Adler is one of the largest property companies in Germany, managing a portfolio of about 50,000 units valued at about €2.4 billion. Adler enjoys a high degree of tenant and asset diversity, which we believe compares favorably with that of most peers we rate in the same business risk category. The average stay per tenant is long, at 10 years, with a low percentage of tenants leaving each year.

Our assessment of Adler's business risk reflects our view that German residential properties benefit from lower volatility in rents and asset values than in other countries and the commercial real estate sector as a whole. We think that demand from German households for midsize apartments with midmarket rents will remain stable in the portfolio's main geographic locations. We believe that rents will continue to increase steadily in the next two to three years, due to low levels of new construction. We note that there is limited development risk in the portfolio because development is confined to the renovation of existing properties.

The main constraints to Adler's business risk profile are the smaller portfolio size than that of other rated German peers, relatively high vacancy rate (10%), exposure to smaller cities with limited opportunities for employment, and lower rent levels than the regional market average. While Adler focuses on smaller cities and secondary locations, its strategy is to choose apartment portfolios in cities with low unemployment and established employers in the region, or are close to large metropolitan areas. We understand that there is some potential rent adjustment at renewal and re-letting, since Adler's rent levels (€5 per square meter) are below market average in the respective regions.

In our base case for Adler, we assume:

- Like-for-like rental income growth of 1%-2% through 2017-2018, supported by improving occupancy;
- An increase in the occupancy rate to 91%-93% in 2017-2018, reflecting the company's active asset management and investments in renovation;
- Gradually improving profitability on the back of the company's efforts to integrate property management services, with the EBITDA margin in the 40%-43% range in 2018-2019; and
- Meaningful positive portfolio revaluation of 7%-8% in 2017, driven by

increasing net rental income and yield compression and slightly more moderate revaluation in 2018.

Based on these assumptions, we arrive at the following credit measures for Adler in 2017-2018:

- Debt to debt plus equity between 60% and 65%; and
- EBITDA interest coverage of 1.3x-1.5x.

Liquidity

We assess Adler's liquidity position as adequate. We anticipate that liquidity sources will likely cover liquidity uses by about 2.5x for the 12 months started Oct. 1, 2017. We assess debt covenant headroom as adequate. We don't consider the company's liquidity to be strong because it is unlikely that Adler will be able to absorb high-impact, low probability events without refinancing. Furthermore, the company's position in capital markets is satisfactory, in our view.

Principal liquidity sources as of Sept. 30, 2017:

- About €265 million of cash and liquid market investments;
- €64 million of undrawn committed credit lines, maturing in more than 12 months; and
- Our forecast of €15 million-€20 million in cash funds from operations for the next 12 months.

Principal liquidity uses as of Sept. 30, 2017:

- About €81 million of short-term debt, including debt amortization;
- Our forecast of €50 million of capital expenditures for property, plant, and equipment investments; and
- About €9 million of working capital growth.

Outlook

The stable outlook reflects our expectation of continued favorable demand for residential real estate in Germany translating into positive revaluations of Alder's portfolio. Over the next year we anticipate the S&P Global Ratings-adjusted ratio of debt to debt plus equity for Adler will be less than 65% and that its interest coverage ratio will be more than 1.3x.

Upside scenario

We could raise the rating if Adler demonstrates a stronger improvement in credit metrics than we anticipate in our base case and strengthens its financial risk profile. This could occur if the debt-to-debt-plus-equity ratio is below 60% and EBITDA interest coverage surpasses 1.8x on a sustainable basis. We consider that this could result from higher-than-expected positive portfolio revaluation in 2018 combined with the company's refinancing efforts.

Downside scenario

We could consider lowering the rating if, in particular, Adler's debt to debt plus equity stayed above 65% and its EBITDA interest coverage ratio drops below 1.3x, as a result of unexpected debt-financed acquisitions or lower-than-expected revaluations and higher cost of funding. A negative rating action might also follow if the company's operating performance is weaker than we anticipated. The company's ability to improve its vacancy rate will be a key area to monitor.

Ratings Score Snapshot

Corporate Credit Rating: BB/Stable/--

Business risk: Satisfactory
- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Aggressive
- Cash flow/Leverage: Aggressive

Anchor: bb

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology And Assumptions: Assigning Equity Content To Corporate Entity And North American Insurance Holding Company Hybrid Capital Instruments, April 1, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008

Edition, Sept. 15, 2008

Ratings List

Upgraded

	To	From
Adler Real Estate AG		
Corporate Credit Rating	BB/Stable/--	BB-/Positive/--

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.