Research Update:

German Real Estate Firm TAG Immobilien Outlook Revised To Negative On Narrowing Liquidity Cushion; 'BBB-/A-3' Affirmed

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Rating Action Overview

- We believe TAG Immobilien AG (TAG)'s upcoming sizable debt maturities of €460 million in 2023 and €570 million in 2024 weigh on its liquidity headroom and heighten its refinancing risks.
- Although, we understand that the company is in the process of partially closing the refinancing on upcoming maturities and securing additional funds, it still needs to agree a long-term funding plan, which hinges on the completion of disposals.
- In addition, current market uncertainties could lead to stronger valuation declines than we currently anticipate, leading S&P Global Ratings-adjusted debt to debt plus equity to increase above our rating threshold of 55%.
- We therefore revised our outlook on TAG to negative from stable and affirmed the 'BBB-/A-3' long- and short-term issuer credit ratings on the company.
- The negative outlook indicates that we could lower the rating in the next 12 to 24 months if the company fails to secure sufficient liquidity sources well ahead of its upcoming debt maturities, including secured debt financing and the outstanding bridge loan maturing in January 2024, or if debt to debt plus equity increases sustainably above 55% as a result of potential corrections in asset values beyond our current base case.

Rating Action Rationale

We expect TAG's liquidity to remain adequate but it still needs to secure a long-term funding plan to refinance bridge facility drawings and upcoming debt maturities in adverse market conditions. We understand the company is currently in the process of securing additional secured bank financing to refinance its upcoming debt maturities in 2023, totaling €460 million, including bank loans (31%), corporate bonds at the TAG and ROBYG levels (44%), and promissory notes (25%). The additional secured bank financing, available lines, and resilient cash flow from its German income-yielding portfolio worth €6.7 billion, should provide sufficient liquidity sources to cover uses at least 1.2x in the coming 12 months. TAG also still has about €450 million of unencumbered assets in Germany against which it can lever additional secured financing. At June 30, 2022, secured debt to total assets was about 26% and we expect it to increase as new financing is agreed amid current volatile conditions. Nevertheless, TAG still needs to secure long-term funding to refinance its 2024 debt maturities totaling €570 million, including €310 million outstanding under the bridge loan. The company has taken preemptive measures to build sufficient liquidity to refinance the bridge loan, such as the €200 million equity raise completed in July 2022 and the subsequent €340 million repayment under its outstanding €650 million bridge financing. However, it needs to secure asset disposals and long-term debt funding to cover long-term liquidity needs. The weakening economic context, rising interest rates, and inflationary pressures will result in higher funding costs and a deteriorating operating environment in the medium term, making it more difficult for TAG to secure attractive long-term financing.

Flexibility in the company's Polish development pipeline should support its liquidity profile in the short term. To preserve cash, TAG decided to postpone its capital-intensive Polish rental platform development program, prioritizing build-to-sell (BTS) assets. The company has limited investments in its build-to-hold (BTH) platform to units already under construction, reducing its Polish funding needs. In addition, the largely secured BTS pipeline, with 99% of 2022 and 62% of 2023 deliveries already presold and well advanced in the construction process, provides significant cash flow visibility. This will enable the company to partially fund its reduced capital expenditure (capex) program through internally generated funds, limiting its net cash outflow to about €45 million in 2023. Although we understand delays to the delivery of its Polish rental platform and resulting portfolio growth will increase the contribution from more-volatile development activities, the highly secured BTS pipeline and high presales levels partially mitigate associated risks. We believe rising interest rates will weigh on demand for residential properties from mortgage buyers, which coupled with rising construction costs will pressure margins and cash flows. However, high secured presales rates and revenue visibility should provide cash flow resilience in the short term despite these headwinds.

TAG´s credit metrics remains within our rating thresholds, despite our new assumption of a 5% portfolio devaluation in 2023. The €200 million equity raise and recently announced €300 million disposal program should provide a buffer to compensate for our expectations of asset portfolio devaluations as a consequence of rising interest rates and cap rate expansion. We assume a flat revaluation in 2022, with a negative revaluation in the second half mitigating the reported 4.0% like-for-like growth in the first half. We also assume further devaluations of about 5% in 2023, with debt to debt plus equity rising to about 50% in 2022 and 52%-53% in 2023 versus our previous forecasts of about 47%, although this remains within our rating thresholds. We believe rising interest rates will weigh on the company's EBITDA interest coverage in the medium term. However, it should remain above 5.0x in 2022 and about 4.0x in 2023, supported by contributions from development activities, the comparatively higher-yielding German residential asset portfolio, and the hedged debt profile (99% of total financial liabilities are at fixed or hedged interest rates) with a low average cost of debt of 1.5% at June 30, 2022.

Outlook

The negative outlook indicates that we could lower the rating in the next 12 to 24 months if TAG fails to secure sufficient funding to cover its upcoming bank debt and bridge loan maturities in a timely manner.

We would also take a negative rating action if debt to debt plus equity deteriorates to above 55% over a sustained period as a result of asset values being subject to higher-than-expected volatility, or a weakening of its yielding German asset portfolio or Polish development activities.

Downside scenario

We would lower the rating if TAG fails to secure, in a timely manner, sufficient funds to refinance its upcoming bank and bridge loan maturities and meet committed capex needs. This could happen, for example, if liquidity deteriorates and it fails to gain bank approvals for refinancing or loan extensions to cover upcoming debt maturities, or covenant headroom tightens.

We would also take a negative rating action if:

- TAG fails to sustain debt to debt plus equity below 55%, resulting from higher-than-expected negative portfolio valuations due to subdued market conditions;
- Consolidated EBITDA interest coverage (including German and Polish operations) is above 3.8x (2.4x excluding development activities); and
- Debt to EBITDA deteriorates materially from our base case over a sustained period.

Similarly, we could lower the ratings on TAG if we see a marked increase in exposure to development activities to the detriment of rental income.

Upside scenario

We could revise the outlook to stable if TAG secures funding to maintain sufficient liquidity headroom in the long term, providing an adequate cushion to cover its debt maturities and capex needs.

The revision to stable would also hinge on the company maintaining credit metrics commensurate with the rating such that:

- Debt to debt plus equity is sustainably below 55%;
- Consolidated EBITDA interest coverage remains above at least 3.8x, and 2.4x excluding development-to-sell activities; and
- Debt to EBITDA remains in line with our base case.

Company Description

TAG is a German real estate company that acquires and manages multifamily residential real estate properties, particularly in northern and eastern Germany. Since 2020, the company has also been active in the Polish market following the acquisition of residential property developers Vantage Development and Robyg. TAG currently owns about 87,576 units with a portfolio size of €6.7 billion. In addition, it had a secured pipeline of 12,557 units in Poland at year-end 2021.

TAG was founded in 1882 as a railway business and became a listed real estate management company in 1998. It is headquartered in Hamburg, Germany. Since 2012, it has been listed on the MDAX at the Frankfurt Stock Exchange.

TAG's largest shareholders were Massachusetts Financial Services Co. (9.9%), The Capital Group Companies Inc. (7.7%), and Black Rock (7.2%) at June 30, 2022.

Our Base-Case Scenario

Assumptions

- German real GDP expands 1.5% in 2022 before contracting 0.3% in 2023 on the back of persistent high inflation. We also forecast real GDP growth in Poland of 4.0% in 2022 and 1.2% in 2023. We expect unemployment rates to decrease to about 3.1% in Germany and 3.0% in Poland this year, with high inflation of about 7.0% in Germany and 11.7% in Poland in the next 12-24 months.
- Like-for-like rental income growth of 1.5% for the forecast period, supported by overall stable occupancy of about 95% for TAG's German assets. For the build-to-rent apartments in Poland, we expect high occupancy of 90%-95%.
- An overall flat like-for-like portfolio revaluation in 2022. For 2023, we assume value corrections of about 5% as a result of rising interest rates and expected yield expansion.
- The EBITDA contribution from development activities peaks in 2022 and 2023 at about 25% annually due to a higher contribution from BTS asset sales from ROBYG. This follows the recently announced delay to its BTH capex program into 2024 to preserve cash flow in the short term.
- No acquisitions, in line with management's forecasts.
- Disposals of German yielding assets of about €70 million-€100 million in 2022, of which we understand most have already been signed, and a further €50 million in 2023.
- Development capex of about €180 million (BTH portfolio only) in 2022 and €250 million in 2023. This is well below our previous forecasts because the company has delayed its capex program until 2024 to preserve cash, given it has full discretion and flexibility over investments.
- No minimum dividend requirements, leaving TAG with full flexibility on distributions.
- Increasing average cost of debt toward 2.0%-2.5% over the forecast period from 1.5% at June 30, 2022, in light of the upcoming refinancings and widening spreads.

Key metrics

- Adjusted debt to debt plus equity of about 50% in 2022 and trending toward 52%-53% in 2023.
- Adjusted debt to EBITDA of 11x-13x in 2022 and 2023.
- EBITDA interest coverage of above 5.0x in 2022 (3.8x excluding development activities) including EBITDA contributions from Polish BTS sales, and about 4.0x in 2023 (3.4x excluding development activities) based on an increasing average cost of debt.

Liquidity

We assess TAG's liquidity as adequate. We anticipate liquidity sources will likely cover uses more than 1.2x in the 12 months started Oct. 1, 2022. However, we note mounting pressures given the sizable debt maturities in the next 12 to 24 months, including the outstanding €310 million ROBYG bridge loan facility maturing in January 2024 and about €400 million of additional secured debt financing and promissory notes maturing in the next 12 months. That said, TAG's predictable and stable cash flow from rental income, notably via regulated residential assets, enhances its liquidity profile. Similarly, we view positively the company's flexible BTH development pipeline, which limits committed capex, supporting liquidity. In addition, TAG has a long track record of solid bank relationships.

We estimate principal liquidity sources for the 12 months from Oct. 1, 2022, include:

- Available unrestricted cash of €78 million;
- Undrawn back-up facilities of €148.7 million with a maturity of more than 12 months;
- Our estimate of funds from operations of about €160 million (excluding Polish operations);
- Proceeds from development sales totaling €38 million; and
- Signed secured debt refinancing of about €170 million.

We estimate principal liquidity uses for the 12 months from Oct. 1, 2022, include:

- Contractual debt amortization payments of €380 million; and
- About €90 million of net committed development capex from its Polish operations.

Covenants

TAG has limited covenants pertaining mainly to its bank loans, Schuldscheindarlehen issuances, and existing bridge loan. The most restrictive covenants are based on a loan to value (LTV) of under 60% and debt service coverage of at least 1.8x. The company also a net debt covenant for the polish bonds issued under ROBYG at 1.1x net debt to EBITDA.

We forecast the company will maintain sufficient headroom, with LTV well below the 60% threshold at 44.5% at June 30, 2022 (pro forma the July equity raise). Debt service coverage was also well above the 1.8x covenant at 5.4x on the same date.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Negative/A-3
Business risk:	Satisfactory
Country risk	Low
Industry risk	Low
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)

Issuer Credit Rating	BBB-/Negative/A-3
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; Outlook Action

	To	From
TAG Immobilien AG		
Issuer Credit Rating	BBB-/Negative/A-3	BBB-/Stable/A-3

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on 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

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