MOODY'S

Rating Action: Moody's downgrades TAG rating to Ba1, stable outlook

07 Oct 2022

Frankfurt am Main, October 07, 2022 -- Moody's Investors Service ("Moody's") has today assigned a new long term corporate family rating (CFR) of Ba1 to TAG Immobilien AG (TAG or the company). The company's short-term Issuer and commercial paper rating were downgraded to Non-Prime (NP) from P-3. The outlook was changed to stable from ratings under review.

Moody's has withdrawn TAG's long term issuer rating of Baa3 following its downgrade to Ba1, as per the rating agency's practice for corporates with non-investment-grade ratings.

A combination of factors resulted in the assignment of a Ba1 long term corporate family rating for TAG. TAG operates in a weaker operating environment with rising interest rates, reduced access to debt and equity capital markets, and concerns over property values. TAG's financial flexibility is reduced in this operating environment, which makes the company more susceptible to shocks while working to secure liquidity for 2023 including a repayment of the bridge facility maturing in early 2024. This is combined with reduced sales and a less predictable sales outlook for its Polish residential sales business that TAG acquired early 2022.

A full list of affected ratings is provided towards the end of this press release. This rating action concludes the review initiated on 4 July 2022.

RATINGS RATIONALE

The outlook for both the German and the Polish part of TAG's business has materially weakened over the last few quarters. While its German residential business operationally performs in line with expectations, rising interest rates increase marginal funding cost to the level of TAG's portfolio yield. As a consequence of rising interest rates, property value declines in Germany are inevitable in our view. The company will also face reducing fixed charge coverage. At the same time, the company's Polish business plan faces challenges from both reduced asset sales that were earmarked to fund the ramp-up of its rental business, as well as increased construction and funding cost for this business. Combined with more difficult access to equity, the ability to successful utilise the landbank and abilities acquired with ROBGY is uncertain, and funding risk is higher.

TAG has meaningfully downsized its business plan by largely stopping any new developments for its build to rent business and allocating more units to its sales programme in Poland. With the acquisition of ROBYG in early 2022, TAG's initial business plan included individual units sales over the next years alongside debt and equity to fund the further build-up of its build to rent portfolio. Unit sales in Poland have declined sharply after inflation has risen and interest rates rose strongly, which has reduced affordability for home buyers. Cost inflation has so far been buffered by rising sales prices, pointing to a more equity-driven buyer base, but the future attractiveness of residential unit sales remains uncertain. In the long run, owning a material rental business in Poland has strategic merits and brings an element of diversification to TAG's business model. The rental market in Poland is also intact, the influx of refugees had a positive impact on rental prices in this unregulated residential market. The challenge is the funding and capital structure that accompanies a transition to a meaningful income-generating portfolio in Poland in a higher interest rate environment.

The stable outlook reflects the corrective measures the company has taken alongside a moderately negative view on the German residential market. A further unfavourable change to funding conditions would weaken the outlook for the company.

TAG's financial metrics have weakened with the ROBYG transaction. The company raised equity and used balance sheet cash to pay down a first part of the bridge facility used to fund the acquisition. Anticipated disposals in Germany will also support lower balance sheet leverage and net debt/EBITDA.

TAG's debt/asset will likely remain around 45% in 2023, which includes Moody's assumption of up to 10% value declines in the next 12-18 months and largely successful property disposals. This is also a function of strongly reduced capital spending in TAG's build to rent portfolio in Poland, which reduces earnings growth but has a net positive impact on balance sheet leverage.

A key challenge for the entire sector is rising cost of debt. TAG's fixed charge cover will reduce to 3.2-3.6x compared to 4.2x for the last twelve months ending June 2022. While the increase in the marginal cost of debt is material, even when considering cheaper German mortgage debt, TAG will pay down debt and use German asset-based funding to support its Polish business. Other refinancing requirements from its German operations are well spread over the next years, which means higher interest cost only reduce fixed charge cover over time.

Net debt/EBITDA will reduce to 13-15x in 2023 from its 16.5x as of LTM June 2022. Earnings will grow also from anticipated sales in Poland. We consider the EBITDA from Polish sales in our projections despite their more risky nature.

LIQUIDITY

The company's liquidity is tight compared to other companies with investment grade ratings. The company has repaid part of the bridge facility since the June 2022 reporting date from capital raise proceeds and existing cash. Proceeds from the capital raise were lower than initially expected by Moody's, reflecting the reduced share price and market uncertainty at the time of the issuance. TAG actively works to secure additional funding that will be required to refinance both bank debt and unsecured financing until Q2 2023 in particular. The company also processes an active disposal programme for German residential portfolio, although we understand a large part of the proceeds are required to further pay down the bridge facility that expires in early 2024.

Given the substantial development activities in Poland, sales proceeds and construction cost from its build to sell business are a material driver of TAG's liquidity profile. 2022 deliveries are effectively sold and the cash flow risk associated with those projects is limited. The next 18 months of cash flow requirements in Poland will depend on the further development of new sales for 2023 deliveries (roughly 60% sold) and 2024 deliveries (largely to be sold), as well as the cost management associated with those projects. The company estimates around €50-75 million of liquidity needs for its Polish operations until YE 2023 in addition to platform cost. Liquidity needs will also arise from a mismatch of funding for energy cost between what TAG pays to energy suppliers and what TAG charges to its tenants. We understand this gap is reduced as tenants are encouraged to make higher prepayments, but uncertainty exists from tenant's ability to pay and the timing and shape of government support that we think will be implemented.

STRUCTURAL CONSIDERATIONS

TAG's CFR references to the majority class of debt, which is secured debt. Any future unsecured funding may be at or below the CFR in accordance with Moody's rating methodology for REITs and Other Commercial Real Estate Firms, 23 September 2022.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

A rating upgrade may occur if

- Polish sales volumes increase slightly from current lows while retaining their current margins, resulting in positive cash flow generation that contributes to a ramp-up of the Polish business

- Uncertainties with respect to pricing in the German residential market fade

- Longer term funding has been secured, including a repayment of the bridge facility, and sufficient financial flexibility is retained with quality unencumbered property assets.

- Visibility that fixed charge cover remains above 2.75x considering longer term higher interest rates

- Net debt/EBITDA remains well below mid-teens, and

- Debt/Asset remains well below 50%

A rating downgrade may occur if

- The company is unsuccessful to secure its (re)financing needs for the 2023 and 2024 maturities and its Polish operations

- The investment market for German residential assets weakens materially, raising concerns around further property value declines and execution risk for disposals

- Polish property sales volumes reduce further below current run-rate levels or margins reduce materially

- Fixed charge coverage declines below 2.5x

- Debt/Assets developing towards 55%

LIST OF AFFECTED RATINGS:

..Issuer: TAG Immobilien AG

Assignments:

.... LT Corporate Family Rating, Assigned Ba1

Downgrades, previously placed on review for downgrade:

.... ST Issuer Rating, Downgraded to NP from P-3

....Commercial Paper, Downgraded to NP from P-3

Withdrawals:

.... LT Issuer Rating, previously rated Baa3 and placed on review for downgrade

Outlook Actions:

....Outlook, Changed To Stable From Ratings Under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was REITs and Other Commercial Real Estate Firms published in September 2022 and available at https://ratings.moodys.com/api/rmc-documents/393395. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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