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Research Update:

TAG Immobilien AG Outlook Revised To Stable On Prudent Financial Policy And Moderate Leverage; 'BBB-' Rating Affirmed

March 28, 2024

Rating Action Overview

- German real estate company TAG Immobilien AG's (TAG's) solid 2023 operating performance and proactive capital structure management facilitated stable leverage, despite a 11.5% like-for-like portfolio devaluation in 2023. S&P Global Ratings-adjusted debt to debt plus equity of 52.0% in 2023, from 52.1% in 2022, fell short of our expectation of 54.5%.
- The company's track record of deleveraging measures--such as a €200 million rights issue in 2022, a dividend cancellation in 2023, and the proposal to cancel dividend payments in 2024--and asset disposals of €213 million in Germany, with strong residential sales in Poland, in 2023 increased headroom under the downside thresholds.
- We expect stable and moderate leverage, resilient operating performance, and further single-digit devaluation will result in debt to debt plus equity remaining well below 55% and EBITDA interest coverage remaining above 3.8x over the next 12-24 months.
- Additionally, TAG repaid its outstanding bridge loan facility in October 2023 and completed refinancings for a total of €400 million (excluding the repayment of the bridge loan) in 2023. We expect the company will maintain adequate liquidity because of successful bank refinancings and cash flow generation.
- We therefore revised to stable from negative our outlook on the ratings on TAG. At the same time, we affirmed our 'BBB-' long-term issuer credit rating.
- The stable outlook reflects our view that TAG's resilient residential real estate portfolio in Germany will continue to generate stable and predictable cash flows, while development activities, which benefit from supportive market dynamics, will support the funding of the company's build-to-hold platform in Poland.

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Rating Action Rationale

TAG's supportive capital structure measures provide headroom to absorb further asset devaluations over the next 12-24 months. The company reported a total valuation correction of €1.1 billion or 16.3% on a like-for-like basis from the peak in valuations between the first half of 2022 and year-end 2023. Despite the expansion in gross yields by 120 basis points and the subsequent effect on asset valuations, TAG's reported loan-to-value (LTV) ratio remained at 47.0% at year-end 2023, the same as it was on June 30, 2022. This translates into adjusted debt to debt plus equity of 52.0%. The company's supportive deleveraging measures--such as the €202 million rights issue in July 2022, the cancellation of dividend payments in 2023, and the successful completion of over €315 million in asset disposals over the past 24 months--enabled the company to absorb the material asset devaluation, maintain credit metrics commensurate with the current rating level, and maintain an adequate headroom under downside thresholds. We expect TAG's proposal to cancel 2023 dividends, which are paid out in 2024, and its track record of committing to maintaining leverage close to its long-term public financial policy of 45% of reported LTV will provide additional buffer to absorb further expected devaluations of 3%-5% and maintain debt to debt plus equity at 52%-53%, which is below our 55% threshold. Additionally, the company reduced adjusted net debt to €3.2 billion as of year-end 2023, compared with €3.6 billion in 2022. This was supported by asset sales of €215 million in Germany in 2023, as well as strong EBITDA cash flow generation from German rental activities and Polish development activities, which led to a decline in debt to EBITDA to 10.9x in 2023, from 14.3x in 2022. We expect debt to EBITDA will deteriorate slightly to 11x-12x in 2024 because of lower deliveries of build-to-sell units in Poland. This decline will be partially mitigated by slightly lower net debt levels and positive cash flow generation.

We expect the repayment of the more expensive bridge loan and overall lower leverage will maintain EBITDA interest coverage above 3.8x. TAG fully repaid the last outstanding amount on its bridge loan in October 2023. The bridge loan, which carried an average interest cost of 5.7% as of the first half of 2023, impaired TAG's average cost of debt, which stood at 2.3% as of June 30, 2023. Because of this and the significant net debt reduction in 2023, we expect the company will slightly reduce its interest burden in 2024, despite the higher interest rate assumed for upcoming refinancings in the current interest environment. Following the repayment of the bridge loan, TAG reported a slight improvement in cost of debt to 2.2% at year-end 2023. We expect the company's average cost of debt will trend toward 2.4%-2.6% over the next 12-24 months as it refinances upcoming debt maturities. On the back of stable EBITDA generation from the German portfolio and the positive contribution from development activities, we expect EBITDA interest coverage will remain above 3.8x over the next 12-24 months.

Cash flow generation from build-to-sell projects in Poland will help to partially fund the build-to-hold platform in Poland. Sales in the Polish residential market recovered strongly, with 3,586 units sold in 2023, compared with 2,389 in 2022. Reported price increases amounted to about 15%-20%. As a result, TAG generated cash flows of €480 million in 2023, compared with €265 million in 2022. Additionally, the company delivered 3,812 units in 2023, compared with 3,788 in 2022, and generated reported EBITDA of €100.6 million, compared with €81 million in 2022. The reported price increase helped absorb the higher construction costs, with EBITDA margins of about 20%. We understand the company will focus on build-to-sell projects in the short term to continue generating cash flows and fund the development of its build-to-hold

platform in Poland. TAG currently owns and operates 2,366 residential units in Poland and its medium-term objective is to deliver an additional 8,000 units by 2028. We understand that the current units under construction remain limited to 932 units. We also understand that the ramp-up in production will depend on TAG's overall leverage, its capacity to support its capital expenditure (capex) plans in Poland, and its ability to maintain leverage close to 45% of reported LTV. As a result, we expect rental contributions from Polish activities will be limited over the next 12-24 months as production increases progressively.

TAG's supportive track record of successful bank refinancings and cash flow generation will enable the company to maintain sufficient liquidity, despite upcoming sizable debt maturities. While the company has been successful in refinancing its upcoming debt maturities in advance, rolling over secured debt, refinancing more than €400 million in 2023, and repaying the outstanding €250 million on the bridge loan facility, it still has significant debt maturities of €300 million in 2024 and another €526 million in 2025. Most of the upcoming debt maturities are bank loans--€202 million in 2024 and €313 million in 2025--which are evenly spread across the 24 months. We understand the company has solid bank relationships in Germany. TAG has a strong track record of successfully rolling over bank debt and securing additional liquidity, which supports our liquidity assessment. We expect the company will continue to roll over its upcoming bank loan financing, although the limited amount of unencumbered assets in Germany will curb the potential for further liquidity uplift from secured financing.

Outlook

The stable outlook reflects our view that TAG's residential real estate portfolio will remain resilient. We expect the company's yielding assets in Germany and Poland will continue generating stable income over our forecast horizon, given supportive demographic trends bolstering demand and the structural undersupply of quality residential assets.

Under our base-case scenario, TAG will maintain adjusted debt to debt plus equity of about 51%-53%, debt to EBITDA of 10.0x-12.0x, and an EBITDA interest coverage above 3.8x over the next 12-24 months.

Downside scenario

We could lower the ratings if TAG's operating performance deteriorates, for example because of falling occupancy rates or underperforming rental operations in Germany or Poland, or if deteriorating residential development activities in Poland result in worsening credit metrics, including:

- Debt to debt plus equity trending toward 55%;
- Consolidated interest coverage falling significantly below 3.8x (2.4x excluding Polish development activities); and
- Debt to EBITDA deteriorating toward 13.0x.

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

We would also take a negative rating action if TAG failed to maintain a sufficient liquidity cushion to cover its liquidity needs.

Upside scenario

We could take a positive rating action if:

- Leverage significantly reduced, bringing debt to debt plus equity sustainably well below 50%;
- Consolidated debt to EBITDA trended toward 9.5x;
- EBITDA interest coverage remained close to 3.8x; and
- Exposure to yielding standing assets increased, including successful project deliveries in Poland, with high occupancy levels and resilient operating performance of the overall portfolio, while TAG's exposure to development activities decreased well below 20%.

Any positive rating action would also be conditional on the company maintaining an adequate liquidity headroom to meet its upcoming debt maturities.

Company Description

TAG is a German real estate company that acquires and manages multifamily residential real estate properties, particularly in north and east Germany. Since 2020, the company has also been active in the Polish market, following the acquisition of residential property developers Vantage Development and ROBYG S.A. TAG currently owns about 84,682 units in Germany and 2,417 units in Poland, with a total portfolio size of €6.6 billion.

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, the company has been listed on the MDAX at the Frankfurt Stock Exchange.

On Feb. 29, 2024, TAG's largest shareholders were BlackRock Inc. (5.9%), Massachusetts Financial Services Company (4.9%), BayernInvest Kapitalverwaltungsgesellschaft mbH (4.9%), Versorgungsanstalt des Bundes und der Länder (4.7%), Internationale Kapitalanlagegesellschaft mbH, and Resolution Capital Limited.

Our Base-Case Scenario

Assumptions

- German real GDP to grow by 0.3% in 2024 and 1.2% in 2025, recovering from a 0.3% contraction in 2023, on the back of easing inflation. We also forecast real GDP growth in Poland of 3.1% in 2024 and 3.0% in 2025. We expect unemployment rates will remain low at about 3.3% in Germany and 2.6% in Poland in 2024, with easing inflation of about 2.7% in Germany and 6.0% in Poland, down from 6.1% and 10.9%, respectively, in 2023.
- Like-for-like rental income growth of 2.0% over 2024-2025, supported by overall stable occupancy of about 95% for TAG's German assets and rental growth stemming from capex improvement in the portfolio. For the build-to-rent apartments in Poland, we expect high occupancy rates of 90%-95%.
- We expect the sustained EBITDA contribution from development activity peaks will amount to about 25% annually over 2024-2025. This is because of a higher contribution from build-to-sale asset sales from ROBYG on the back of resilient demand and price growth expectations.

- No acquisitions, in line with management's forecasts.
- Despite strong asset corrections of 16.3% since the first half of 2022 on a like-for-like basis and expected positive value contribution from build-to-hold deliveries in Poland, we assume conservative value corrections of about 3%-5% in 2024 and flat revaluations.
- We have not factored in any additional disposals of German assets over our forecast period as we understand the company will only dispose assets on an opportunistic basis.
- Development capex of about €120 million in 2024, mainly maintenance and renovation capex focused on the German portfolio, and €170 million-€190 million in 2025 as the ramp-up of the build-to-hold portfolio takes place.
- Further cancellation of dividend distributions in 2024, in line with the company's proposal to its shareholders. Although not yet confirmed, we understand shareholders support this measure. After 2024, we assume dividend distributions of about €130 million-€140 million, in line with the company's distribution policy.
- Average cost of debt to increase toward 2.4%-2.6% over the forecast period, from 2.2% as of Dec. 31, 2023, because of the upcoming refinancings at above-average rates.

Key metrics

- Adjusted debt to debt plus equity of about 52%-53% over 2024-2025.
- Adjusted debt to EBITDA of 11x-12x in 2024 and 10x-11x in 2025 on the back of the growing rental income base and the positive contribution from development activities in Poland.
- EBITDA interest coverage of above 3.8x in 2024, including EBITDA contributions from Polish build-to-sale projects, and 4.0x-4.2x in 2025 on the back of the stronger expected contribution from development activities.

Liquidity

We assess TAG's liquidity as adequate. We anticipate liquidity sources will likely cover uses by more than 1.2x over the 12 months from Jan. 1, 2024. Despite sizable upcoming maturities of about €300 million in 2024 and €526 million in 2025 (weighted average maturity: 4.8 years), the company has a long track record of bank loan refinancing and has already secured €141 million in new bank loans.

Additionally, the company has proposed, for the second year, the cancellation of dividend payments in 2024. TAG's liquidity profile also benefits from predictable and stable cash flows from rental income--notably via regulated residential assets--and the Polish portfolio performing better than expected. TAG aims to use the Polish build-to-sale segment for maximum cash generation so that the portfolio in Poland attains a self-funding stage.

We estimate principal liquidity sources for the 12 months from Jan. 1, 2024, include:

- Available unrestricted cash of €128.5 million;
- Undrawn back-up facilities of €135 million with a maturity of more than 12 months;
- Our estimate of funds from operations of about €180 million-€200 million; and
- Signed new liquidity of about €141 million.

We estimate principal liquidity uses for the 12 months from Jan. 1, 2024, include:

- Contractual debt amortization payments of about €300 million; and
- Capex of about €120 million.

Covenants

TAG has limited covenants, pertaining mainly to its bank loans, Polish corporate bonds, and Schuldscheindarlehen issuances. The most restrictive covenants are based on an LTV ratio of less than 60% and debt service coverage of at least 1.8x. The company also has 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 an LTV ratio of 47% as of Dec. 31, 2023, well below the 60% threshold. Debt service coverage was at 6.0x on the same date, well above the 1.8x covenant.

Environmental, Social, And Governance

ESG factors are an overall neutral consideration in our credit rating analysis of TAG. We believe German residential companies, such as TAG, are exposed to social risk because of ongoing political and social tensions that arise from high rents and property prices. That said, TAG also operates in secondary locations in north and east Germany, where the increase in rents and real estate prices was less pronounced than in large metropolitan areas. TAG's presence in these secondary locations limits the company's exposure to social risk, at least for now.

Ratings Score Snapshot

Issuer credit rating	**BBB-/Stable/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)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb-

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Outlook Action

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

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