

MOODY'S INVESTORS SERVICE

Rating Action: Moody's assigns first-time Baa3 issuer rating to TAG Immobilien

Global Credit Research - 09 Aug 2017

London, 09 August 2017 -- Moody's Investors Service, ("Moody's") today assigned a first-time Baa3 long-term issuer rating to TAG Immobilien AG (TAG), a residential real estate company that owns and manages around 83,000 multi-family residential units across Germany. The outlook on the rating is stable.

"TAG's Baa3 rating reflects its focus on affordable housing in Germany's regulated rental market leading to predictable rental income as well as our expectation that the debt to asset ratio will decline below 55% by year end" says Roberto Pozzi, a Moody's VP - Senior Credit Officer and lead analyst for TAG.

RATINGS RATIONALE

TAG's Baa3 long-term issuer rating mainly reflects its focus on regulated affordable housing activities which result in stable rental income, the broad tenant diversification derived from a sizeable portfolio of around 83,000 residential units across a number of regions in Northern and Eastern Germany, and some track record in reducing vacancy over time down to 5.5% at 30 June 2017. The rating also reflects the relatively large property portfolio valued at over €4 billion, a moderate fixed charge coverage ratio of 2.6x and, long dated debt maturities averaging 8.5 years.

The Baa3 rating reflects our positive view of the regulated rental sector in Germany that we believe is one of the most stable European real estate market. The sector is likely to see further value and rent increases because of the structural undersupply that current regulation tends to exacerbate by reducing incentives to build. While we do not expect major changes to the rental housing regulatory framework, more stringent rental regulation remains a long term risk for the sector.

These positives are partly offset by the secondary locations of the property portfolio in economically weaker regions of Germany, improving although still relatively high vacancy rates especially if compared to rated residential peers, and a strategy of acquiring properties with high vacancy. The company's portfolio is predominantly located in medium-sized cities in Eastern and Northern Germany, which are economically less wealthy parts of the country and which have suffered a decline in population which has only recently stopped. We expect the company to continue improving occupancy levels of its portfolio supported by increasing demand for its properties from the growth of German households and net positive immigration.

Other key constraints for TAG's rating are its still somewhat high leverage, with gross debt to total assets at 56.0% as of 31 March 2017, and limited financial flexibility, with unencumbered assets representing a low 8.3% of total assets at the same date.

Therefore, the rating is currently weakly positioned at Baa3 given the company's lower quality portfolio in terms of locations and vacancies compared to most rated peers, a somewhat high leverage and limited unencumbered assets. More positively, the company's net debt to EBITDA of 11.7x is more in line with our expectations for the rating and with peers, reflecting the higher yield of its portfolio (7.4%).

Moody's expects TAG to have adequate liquidity owing primarily to the operating cash flows generated by the company's core rental business and a moderate dividend payout of around 75% of FFO. Additionally, the company has access to short dated credit lines which it does not anticipate drawing. However, like many of its real estate peers, TAG would need market access for refinancing and for acquisitions. We factor in our assessment that the company will address the refinancing of €310 million unsecured debt due in August 2018 well ahead of its maturity through senior unsecured debt.

RATIONALE FOR STABLE OUTLOOK

The stable outlook reflects our expectation that leverage will decrease below 55% by the end of 2017 whilst maintaining its fixed charge coverage above 2.25x and successfully refinance its 2018 unsecured debt maturities well ahead of schedule through unsecured debt. The outlook also reflects our positive view on the German residential sector and a favourable German bank lending environment.

FACTORS THAT COULD LEAD TO AN UPGRADE

A rating upgrade is unlikely in the next 12-18 months; the company is weakly positioned at Baa3 namely because of its low level of unencumbered assets. However, an upgrade would be considered if:

- » Gross debt to Total Assets sustained towards 45%
- » Fixed charge coverage sustained above 3.0x
- » A significantly improved unencumbered assets ratio and coverage of unsecured debt by unencumbered assets

FACTORS THAT COULD LEAD TO A DOWNGRADE

- » Gross debt to Total Assets above 55%
- » Fixed charge coverage below 2.25x
- » Failure to refinance the 2018 unsecured debt maturities in a timely manner through debt having the same seniority

TAG Immobilien owns and manages a multi-family residential rental portfolio of approximately 83,000 units located across Germany. As of 30 June 2017, TAG's assets totalled €4.2 billion. Headquartered in Hamburg, TAG is listed on the MDAX Frankfurt Stock Exchange with a market capitalisation of €2.0 billion as of 17 July 2017.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Rating Methodology for REITs and Other Commercial Property Firms published in July 2010. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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