Vonovia SE

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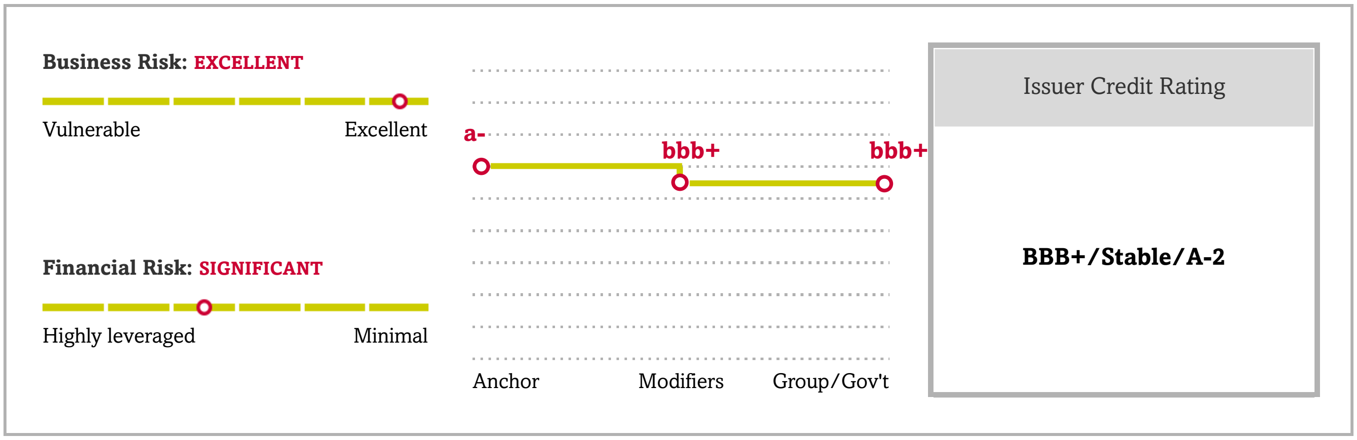


Credit Highlights

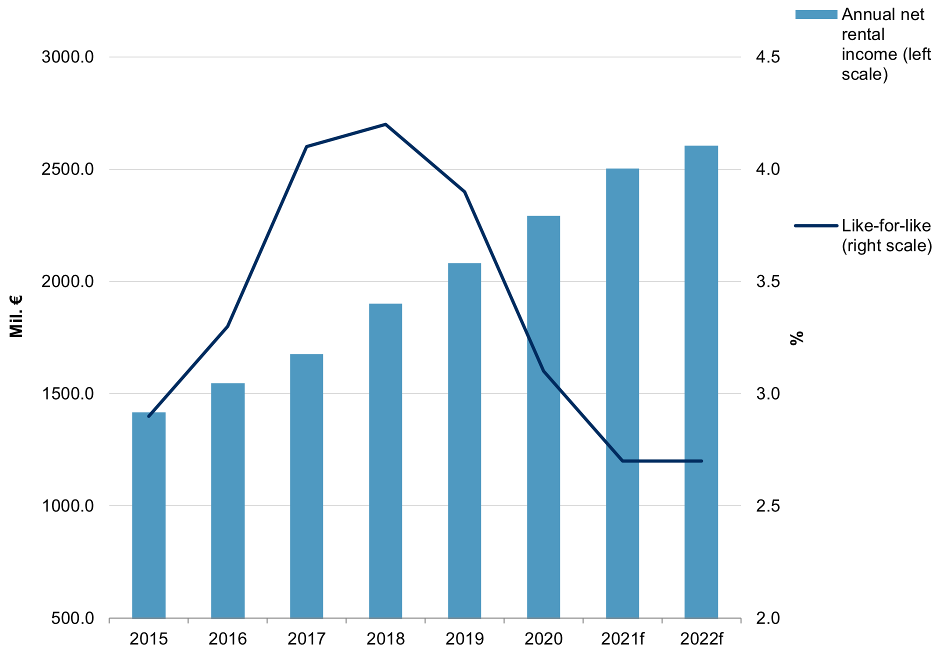
Overview

Key strengths	Key risks
Very large portfolio of income-producing residential property assets, worth about €57 billion as of Dec. 31, 2020.	High reliance on Germany (85% of portfolio), despite recent expansion into Austria and Sweden.
Good asset localization, with the majority of the portfolio in German regions that enjoy healthy economic and sociodemographic trends with limited impact from the COVID-19 pandemic.	Rising regulation and reputation risk in the German residential market on the back of social and political debates, following strong rent and price increases in the past decade.
Strong track record of like-for-like rental income growth, supported by a highly diversified asset and tenant base, continuously high occupancy rates, and long tenant stays.	Somewhat high debt leverage (debt to debt plus equity of 50%-55%), with the company's significant investment plans and leverage policy constraining debt reduction.
Market leadership in Germany and a track record of successful integration of acquisitions, supporting growth in Germany, Austria, and Sweden.	Weak debt-to-EBITDA ratio of about 15x, owing to past acquisitions and the low-yielding (3%-4%) nature of the German residential market.
Low cost of debt at 1.4%, and solid capacity to cover interest (EBITDA interest coverage ratio of 3.6x in 2020), with good access to diversified funding sources.	

Vonovia SE's operations have experienced very little disruption from COVID-19. The company's portfolio has shown high resilience to the pandemic's impact, with nearly no effect on rent collection compared with previous years (roughly 99% rent collection). We continue to view the residential real estate sector as one of the most resilient to the pandemic (see "COVID-19: Implications For European Real Estate Investment, As Tenants Begin To Suspend Rent Payments," published March 26, 2020), with very limited impact on rents and valuations so far (3.1% and 9.4% like-for-like growth, respectively, as of Dec. 31, 2020, including rental income from new developments). We assume Vonovia will continue generating organic like-for-like rental income growth during 2021 of 2.5%-3%, mainly reflecting modernization and new construction. We believe rental income growth from in-place tenants will remain flat. We also assume valuations for the company's assets will remain positive, conservatively at 2%-4% in the next 12-18 months, reflecting modernization work and strong demand for residential real estate in Vonovia's operating regions.

Chart 1

Vonovia SE's Annual Rental Income And Like-For-Like Annual Rental Growth



Note: Chart shows S&P Global Ratings' forecast like-for-like rental growth. f--Forecast. Source: S&P Global Ratings.

Berlin's rent freeze law has limited impact on Vonovia's rental growth and cash flow generation, but regulation and reputation risks for German residential landlords--including Vonovia's--remain high. On Feb. 23, 2020, Berlin's five-year rent freeze came into force. The new regulation includes an absolute rental ceiling on assets located in Berlin, published by the city's Senate and based on the construction year and features of the apartment (adjusted for location premiums/discounts). Berlin accounts for only 10% of residential units owned by Vonovia and 14% of total portfolio value as of Dec. 31, 2020. We therefore still believe the regulation will have a limited effect on like-for-like rental growth for Vonovia (0.5% impact reported in 2020, so far) and that the company will continue to offset any negative rent or valuation impact on its Berlin assets with its remaining exposure across Germany and abroad (see "Berlin's Rent Freeze, As Adopted, To Have Little Effect On The Credit Quality Of Rated Residential Real Estate Companies," published March 24, 2020). We believe that the fundamentals of the German residential market remain solid, with limited new supply not meeting strong demand. However, we think regulation and reputation risks for residential landlords in Germany are likely to remain, and we believe Vonovia will shift investments from Berlin to other regions to mitigate such risks.

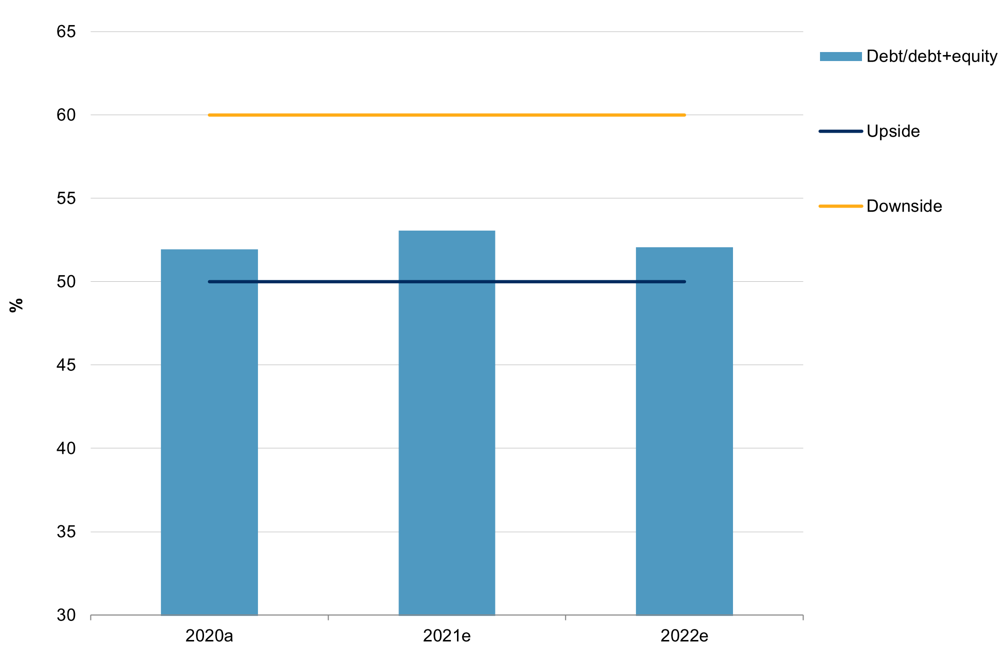
Vonovia continues to execute its operational strategy toward residential real estate developments. In 2020, Vonovia continued to shift its investment focus from modernization toward residential real estate development, both development-to-sell and development-to-hold. During 2020, Vonovia completed roughly 2,100 units, in line with our expectations. We expect completions for 2021 of about 2,500 units, as announced by the company, and annual capital expenditure (capex) of about €1.3 billion-€1.6 billion (including development as well as modernization capex), in line with the company's strategy. At the beginning of 2020, Vonovia acquired the German residential real estate developer

Bien Ries AG, which has about 10 projects in its pipeline, with a completion of about 2,500 units, mainly in the Rhine-Main region. We understand that Vonovia plans to develop to hold about two-thirds of its total development pipeline. In addition, we understand that Vonovia remains committed to limiting its exposure to development activities as an overall activity, and it does not exceed 10% of its total asset portfolio value.

We expect Vonovia's debt leverage will remain commensurate with its financial policy over the medium term. We forecast that the company's debt-to-debt plus equity ratio will remain at 50%-53% for the next 24 months and that Vonovia will use a balanced mix of equity and debt to fund any growth opportunity. S&P Global Ratings' adjusted ratio of debt to debt plus equity decreased to 51.9% (reported loan to value [LTV] stood at 39.4%) in 2020, from 54.6% in 2019, mainly benefiting from a strong positive like-for-like portfolio revaluation of 9.4% in 2020, thanks to a solid asset performance, further yield compression, and capitalized expenditures. Throughout 2020, Vonovia has issued nearly €1.4 billion of equity in 2020, including €1 billion through an accelerated book building and about €347 million via scrip dividends. The company has sufficient room within its financial policy target of a reported LTV ratio of 40%-45% (translating into our ratio of debt to debt plus equity of 50%-55%). Although we do not factor potential debt-financed acquisitions in our forecast, we believe Vonovia will remain in a net buyer position in 2021, and that the company will use a balanced mix of debt and equity to fund any growth and portfolio investments such that it remains well within its financial policy target.

Chart 2

Vonovia SE's Outlook Threshold For Adjusted Ratio Of Debt To Debt Plus Equity



a--Actual. e--Estimate. Source: S&P Global Ratings.

Outlook: Stable

The stable outlook reflects our view that Vonovia will maintain a robust and stable cash flow, supported by strong market fundamentals in Germany for ongoing demand for affordable housing, and to a lesser degree in Austria and Sweden. This should enable the company's EBITDA interest coverage to remain well above 2.4x for at least the next two years. We also expect the company to integrate any future transactions successfully, in line with its track record, while ensuring a sufficient liquidity cushion. We anticipate that Vonovia will finance any potential acquisitions with enough equity to maintain debt to debt plus equity well below 60%, and stay within its publicly stated financial policy (reported LTV of 40%-45%).

Downside scenario

We could consider a negative rating action if:

- Vonovia deviates from its stated financial policy as a result of larger debt-financed acquisitions or larger shareholder returns;
- Debt to debt plus equity increases to 60% or above, as a result of unexpected debt-funded acquisitions or a deterioration of market conditions; or
- The liquidity cushion decreases, for example because of cash-funded transactions or late refinancing of upcoming maturities.

Upside scenario

We could raise our rating on Vonovia by one notch if:

- The company's financial policy becomes more conservative, demonstrated by a lower appetite for leverage and signs that debt to debt plus equity would sustainably stay below 50% while maintaining EBITDA interest coverage at 3x or above;
- The company increases the amount of income generated and available for paying down debt, so that its debt to EBITDA ratio falls to well below 14x, sustainably; and
- Vonovia further diversifies into markets with strong fundamentals and favorable demand trends, decreasing its concentration on the German economy and mitigating the potential further tightening of domestic regulation.

Our Base-Case Scenario

Assumptions

- German real GDP should recover to 3.7% in 2021 and 3.2% in 2022 after an estimated 5.7% contraction in 2020 because of the pandemic, with unemployment remaining below 5% in the next 12-24 months.
- Total revenue of about €2.3 billion-€2.5 billion for 2021, excluding any potential mergers and acquisitions (M&A).
- Like-for-like rental income growth of 2.5%-3% in 2021-2022, supported mainly by the boost to rental rates through modernization spending and new construction. We forecast relatively stable rents for in-place tenants on the back of COVID-19 and the Berlin rent freeze law.

- Occupancy to remain stable, at 97%-98% for 2021-2022.
- High cash calls from modernization capex, including new building construction of about €1.3 billion-€1.6 billion per year.
- Conservatively assumed like-for-like portfolio revaluation of about 2%-4% in 2021-22, reflecting mainly value upside from investments on existing assets and new constructions.
- Average cost of debt to remain broadly stable at about 1.5%.

Key metrics

Vonovia SE--Key Metrics

	2020a	2021e	2022f
EBITDA-to-interest (x)	3.6	3.5-3.7	3.5-3.7
Debt-to-debt and equity (%)	51.9	52-54	51-53
Debt-to-EBITDA (x)	15.9	15-17	~16

a--Actual. e--Estimate. f--Forecast.

While the German economy will be affected by COVID-19, we forecast that Vonovia will continue to benefit from the country's favorable demand trends, with creditworthy tenants and limited new supply. We expect the company's earnings performance to remain relatively stable, with limited pandemic-related impact on the German residential sector. We believe that tenants' payment defaults and rent loss rate will not see a major increase in 2021, supported by the ongoing furlough scheme (Kurzarbeit) provided by the German government to tenants affected by the pandemic. We anticipate that occupancy levels will remain high, due to the country's demand-supply imbalance. We believe that Vonovia will be able to continue generating positive like-for-like rental income growth of more than 2% in 2021. This also includes the downward adjustment of rents stemming from the Berlin rent freeze from November 2020, reflecting approximately 11 months of the company's Berlin annual rental income in 2020.

We assume no significant M&A activity in 2021. Vonovia will likely maintain its net buyer position in 2021. We believe the company will continue expanding its portfolio, buying direct properties potentially outside Germany. However, we have not assumed major M&A transactions for the next 12-24 months, but take into account the company's appetite for further consolidation. We assume it could expand into regulated markets, which have similar characteristics to the German residential market, including favorable demand for residential flats. We understand such a growth scenario would remain subject to the company's maximum debt leverage policy.

Company Description

Vonovia is the leading listed residential real estate holding company in Germany, and largest listed real estate landlord by portfolio size in Europe. Its portfolio was worth about €58.9 billion as of Dec. 31, 2020, and comprised about 415,688 owned residential units in Germany, Austria, and Sweden. The company manages an additional 74,000 units for third parties.

Vonovia's strategy focuses on affordable apartments, leased at €7.16 per square meter on average (as of Dec. 31, 2020). The company is listed on the German stock index (DAX) with an average market cap of about €30 billion as of March 2021. The largest shareholders are BlackRock (7.3%), followed by Norges Bank (6.3%). Free float is 93.7%.

Table 1

Vonovia SE--Portfolio Summary	
Segment focus	Residential
Total portfolio value	About €59 billion
Total residential units owned	415,688
Portfolio occupancy	97.6%
Tenant turnover rate	7%
EPRA net initial yield	3.0%
In-place monthly rent	€7.16 per sq. m.

EPRA--European Public Real Estate Association. sq. m.--Square meter. Source: S&P Global Ratings estimates based on Dec. 31, 2020, company results.

Peer Comparison

Table 2

Vonovia SE--Peer Comparison

Industry Sector: Real Estate Investment Trust Or Company

	Vonovia SE	Deutsche Wohnen SE	Grand City Properties S.A.	Akelius Residential Property AB	Heimstaden Bostad AB
Ratings as of March 30, 2021	BBB+/Stable/A-2	A-/Negative/A-2	BBB+/Stable/A-2	BBB/Stable/A-2	BBB/Stable/--
	--Fiscal year ended--	**--Rolling 12 months--**	**--Fiscal year ended--**		
	Dec. 31, 2020	**Sept. 30, 2020**	**Dec. 31, 2020**	**Dec. 31, 2020**	**Dec. 31, 2020**
(Mil. €)					
Revenue	2,366.2	1,116.6	543.0	471.0	669.0
EBITDA	1,614.4	705.6	300.8	201.0	355.1
Funds from operations (FFO)	1,096.1	480.5	222.5	95.5	193.5
Interest expense	443.5	164.9	65.9	102.5	142.6
Cash flow from operations	998.7	432.5	182.2	126.5	157.8
Capital expenditure	1,614.0	313.8	73.8	392.0	297.1
Free operating cash flow (FOCF)	(615.3)	118.7	108.4	(265.5)	(139.3)
Dividends paid	530.8	317.4	71.0	127.5	178.5
Discretionary cash flow (DCF)	(1,146.1)	(797.7)	37.3	(393.0)	(317.8)
Cash and short-term investments	453.4	328.2	1,336.1	250.0	760.1
Debt	25,706.3	11,659.5	3,553.2	5,306.5	7,096.5
Equity	23,831.8	12,604.1	4,687.0	5,873.5	7,055.8
Debt and equity	49,538.1	24,263.6	8,240.2	11,180.0	14,152.3
Valuation of investment property	58,807.1	27,693.1	7,842.4	12,021.0	14,442.8

Table 2

Vonovia SE--Peer Comparison (cont.)					
Adjusted ratios - RTM					
Annual revenue growth (%)	10.2	4.7	(3.0)	(5.0)	55.5
EBITDA margin (%)	68.2	63.2	55.4	42.7	53.1
Return on capital (%)	3.3	2.9	3.7	1.8	2.9
EBITDA interest coverage (x)	3.6	4.3	4.6	2.0	2.5
Debt/EBITDA (x)	15.9	16.5	11.8	26.4	20.0
FFO/debt (%)	4.3	4.1	6.3	1.8	2.7
Debt/debt and equity (%)	51.9	48.1	43.1	47.5	50.1

Business Risk: Excellent

Vonovia's excellent business risk is underpinned by the company's very large portfolio of income-producing residential assets, mostly in Germany (85% of total portfolio value as of Dec. 31, 2020) and, to a smaller extent, in Austria and Sweden (together 15%). It has become the largest residential property holding company and listed real estate owner in Europe. We view residential property as less cyclical and volatile than most other commercial real estate segments, and believe the German market provides strong fundamentals to landlords. These include a long average tenant stay (12-14 years versus less than five years in the U.K. or France), and a cultural preference for renting rather than owning despite a good average affordability ratio. Moreover, Vonovia enjoys significant asset and tenant diversity, with more than 415,000 units owned.

The company's business model has so far proved highly resilient throughout the pandemic, with very little COVID-19-related disruption. This has translated into rent collection rates of about 99%, similar to pre-crisis levels, and solid like-for-like rental income growth of over 3%, supported by stable and high occupancy levels of 97.6% year-end 2020 (see "German Residential Real Estate Is Unfazed By COVID-19," published Nov. 30, 2020).

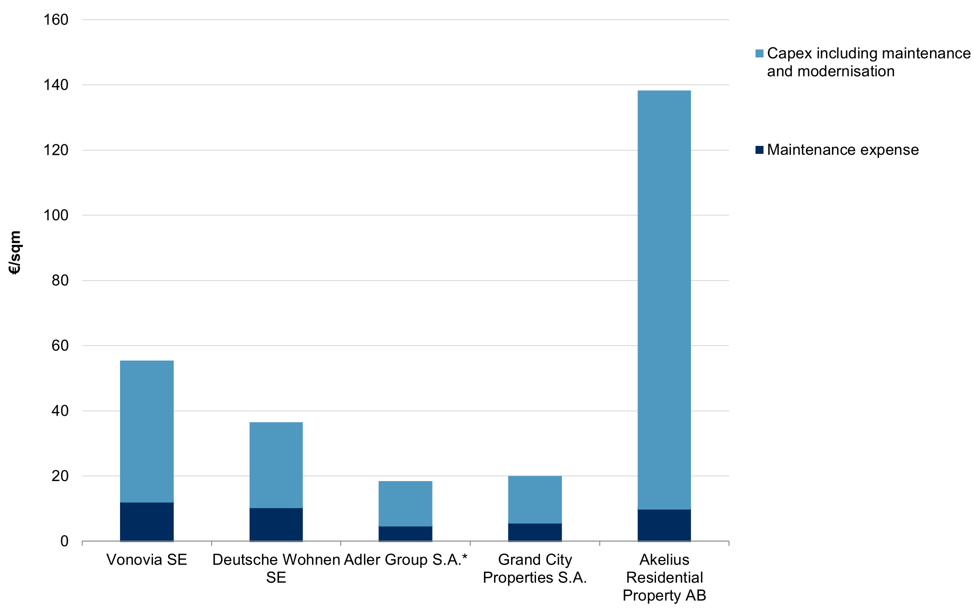
The company's strategic portfolio (about 77% of the total German portfolio value) is well spread across different regions of Germany and, more specifically, in cities and regions with positive economic and demographic trends. These include Berlin (14% of Vonovia's property portfolio on Dec. 31, 2020), Rhine Main area (9%), Southern Ruhr Area (8%), Rhineland (7%), Dresden (7%), and Hamburg (5%). Austria makes up 5% and Sweden 11% of the total portfolio, and we believe both markets offer similar fundamentals to Germany.

Our business risk assessment is also supported by the company's strong and long track record of market leadership and executing a clearly articulated strategy, consistent with its capabilities and the market environment. In the past few years, Vonovia has successfully integrated large portfolio acquisitions, realizing synergies and benefiting from economies of scale. Vonovia's strong growth path over recent years and its geographical expansion outside Germany was within the company's capabilities, and part of its acquisition policy of investing in regulated residential real estate markets with fundamentals comparable with its core market of Germany. Vonovia's focus on long-term holdings with limited asset rotation and continuously high occupancy rates provides good cash flow predictability.

Vonovia refurbishes and renovates approximately 3% of its portfolio per year to comply with the latest standards in terms of thermal insulation and energy efficiency. Through energetic renovation since 2015, Vonovia has improved the carbon dioxide profile of the portfolio by about 10%. In 2020, Vonovia invested €1.3 billion to upgrade existing buildings and new constructions, and an additional €321 million on expensed maintenance. The company has increasing exposure to construction activities due to changing regulations, with lower potential for allocating some modernization capex costs to tenants. We estimate annual capex, including modernization and new construction, will amount to €1.3 billion-€1.6 billion over the next two years. However, we understand that overall construction exposure will remain limited at less than 10%. Also, Austria's BUWOG, acquired by Vonovia in 2018, has a good residential development track record in Germany.

Chart 3

Vonovia SE Maintenance And Capex Peer Comparison



*Based on Q3 2020. Capex--Capital expenditure. Sq. m. --Square meter. Source: S&P Global Ratings based on company reports as of Dec. 31, 2020.

That said, our rating analysis includes a one-notch downward adjustment through our comparable rating analysis, to reflect the company's relatively small EBITDA base compared with other residential real estate holding companies that have similar LTV, but which operate in more volatile, higher yielding markets such as the U.S. This results in a higher ratio of debt to EBITDA of 15x-17x for Vonovia, against less than 10x for some U.S. peers. That said, we take into account the company's expansion strategy in recent years, which generally leads to a distortion of this ratio. In addition, we believe that Vonovia's high concentration on Germany, with about 85% of assets, still brings some regulatory and reputational uncertainties compared with globally more diversified residential real estate peers in the same business risk category. Although landlords in Germany have supported their tenants during COVID-19, abstaining from any rent increases, social and political debates on rent affordability in Germany's metropolitan areas remain intact. In addition, the new "Klimaschutzgesetz" (climate protection law) by the German government sets high hurdles for carbon dioxide reduction in coming years, which is likely to result in high ongoing investments, potentially reducing profitability.

Financial Risk: Significant

In our view, Vonovia's debt leverage remains high relative to industry standards and that of peers at the same rating level, with a ratio of debt to debt plus equity of slightly above 50% in the past three years (51.9% at end-2020) following multiple acquisitions. We believe the company's leverage will remain in the low 50% range in the next 12-24 months, in line with its financial policy of a reported LTV ratio of 40%-45% (translating into a debt to debt plus equity ratio of 50%-55%). We view this level as consistent with the rating.

The company generates solid interest coverage, with a ratio of EBITDA to interest at 3.6x, as of Dec. 31, 2020. This is due to its low cost of funding (1.4%) and the general low interest rate environment. We forecast that the ratio is likely to remain well above 3x over the next two to three years, because Vonovia's debt is largely fixed or hedged (99%), with a long average debt maturity of 7.9 years. Ratio sensitivity to a potential interest hike is marginal.

Financial summary

Table 3

Vonovia SE--Financial Summary

Industry Sector: Real Estate Investment Trust Or Company					
	--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**
(Mil. €)					
Revenue	2,366.2	2,147.8	1,958.1	1,719.7	1,581.8
EBITDA	1,614.4	1,421.6	1,293.6	1,150.7	999.3
Funds from operations (FFO)	1,096.1	1,056.7	801.6	777.8	551.3
Interest expense	443.5	405.9	395.0	320.8	326.8
Cash flow from operations	998.7	1,149.7	841.2	655.5	477.8
Capital expenditure	1,614.0	1,662.2	1,279.7	866.8	548.8
Free operating cash flow (FOCF)	(615.3)	(512.6)	(438.5)	(211.3)	(71.0)
Dividends paid	530.8	441.8	437.3	314.1	481.6
Discretionary cash flow (DCF)	(1,146.1)	(954.3)	(875.8)	(525.4)	(552.6)
Cash and short-term investments	453.4	403.4	490.5	229.9	1,489.1
Debt	25,706.3	24,783.8	20,778.1	14,798.7	12,681.8
Equity	23,831.8	20,569.7	19,514.1	16,541.2	13,738.4
Debt and equity	49,538.1	45,353.5	40,292.2	31,339.9	26,420.2
Valuation of investment property	58,807.1	53,229.0	43,903.9	33,325.4	27,012.0
Adjusted ratios					
Annual revenue growth (%)	10.2	9.7	13.9	8.7	9.6

Table 3

Vonovia SE--Financial Summary (cont.)

Industry Sector: Real Estate Investment Trust Or Company	--Fiscal year ended Dec. 31--				
	2020	2019	2018	2017	2016
EBITDA margin (%)	68.2	66.2	66.1	66.9	63.2
Return on capital (%)	3.3	3.2	3.5	4.0	3.9
EBITDA interest coverage (x)	3.6	3.5	3.3	3.6	3.1
Debt/EBITDA (x)	15.9	17.4	16.1	12.9	12.7
FFO/debt (%)	4.3	4.3	3.9	5.3	4.3
Debt/debt and equity (%)	51.9	54.6	51.6	47.2	48.0

Reconciliation

Table 4

Reconciliation Of Vonovia SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2020--								
Vonovia SE reported amounts									
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	S&P Global Ratings' adjusted EBITDA	Cash flow from operations	Dividends	Capital expenditure
Reported	24,084.7	24,145.5	1,809.0	5,436.5	406.9	1,614.4	1,430.5	560.8	1,614.8
S&P Global Ratings' adjustments									
Cash taxes paid	--	--	--	--	--	(78.3)	--	--	--
Cash interest paid	--	--	--	--	--	(409.2)	--	--	--
Reported lease liabilities	495.1	--	--	--	--	--	--	--	--
Debt-like hybrids	1,000.0	(1,000.0)	--	--	20.0	(20.0)	(20.0)	(20.0)	--
Intermediate hybrids reported as equity	--	--	--	--	10.0	(10.0)	(10.0)	(10.0)	--
Postretirement benefit obligations/deferred compensation	522.5	--	--	--	5.8	--	--	--	--
Accessible cash and liquid investments	(453.4)	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	0.8	(0.8)	(0.8)	--	(0.8)
Nonoperating income (expense)	--	--	--	35.3	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(401.0)	--	--
Noncontrolling interest/minority interest	--	686.3	--	--	--	--	--	--	--
Debt: Fair value adjustments	(18.4)	--	--	--	--	--	--	--	--
Debt: Other	75.8	--	--	--	--	--	--	--	--

Table 4

Reconciliation Of Vonovia SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)									
EBITDA: Gain/(loss) on disposals of PP&E	--	--	(243.9)	(243.9)	--	--	--	--	--
EBITDA: Inventory	--	--	9.3	9.3	--	--	--	--	--
EBITDA: Other	--	--	40.0	40.0	--	--	--	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	--	(3,719.8)	--	--	--	--	--
Total adjustments	1,621.6	(313.7)	(194.6)	(3,879.1)	36.6	(518.3)	(431.8)	(30.0)	(0.8)
S&P Global Ratings' adjusted amounts									
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends paid**	**Capital expenditure**
Adjusted	25,706.3	23,831.8	1,614.4	1,557.4	443.5	1,096.1	998.7	530.8	1,614.0

PP&E--Plant, property, and equipment.

Liquidity: Adequate

We assess Vonovia's liquidity position as adequate. We anticipate that liquidity sources will likely cover uses for the next 12 months from about 1.2x as of Dec. 31, 2020.

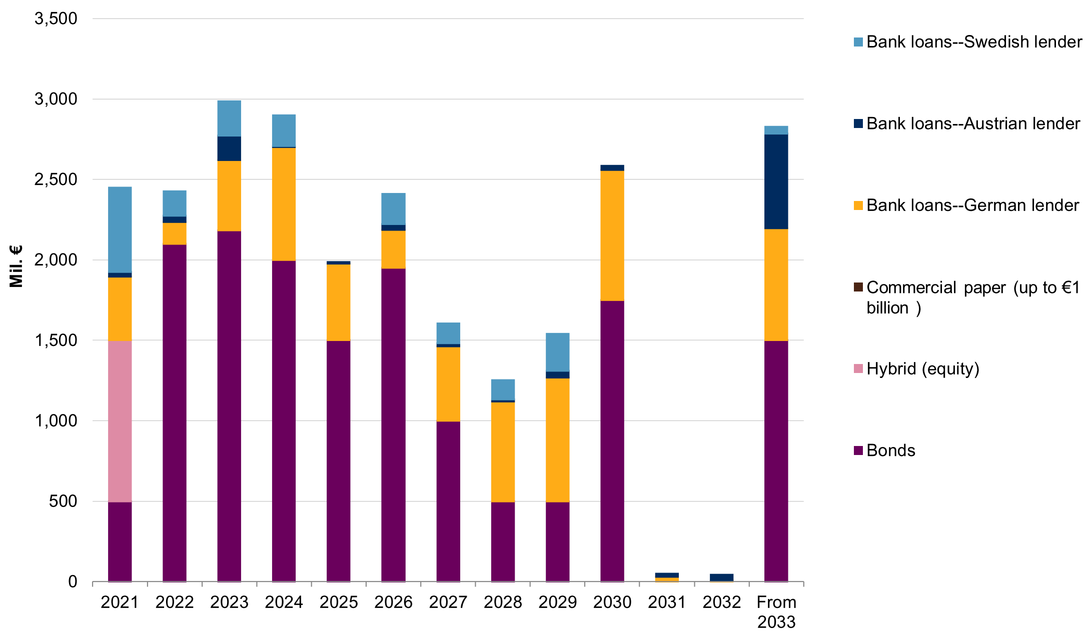
Principal liquidity sources	Principal liquidity uses
• About €453.4 million of unrestricted cash and equivalents as of Dec. 31, 2020; • €1.0 billion of undrawn credit lines available, maturing in more than 12 months; • Our forecast of €1.0 billion-€1.2 billion of cash funds from operations (FFO); and • About €1.5 billion of debt issuances year-to-date.	• About €1.7 billion of short-term debt maturities, including debt amortization and accrued interest, in the next 12 months; and • Committed capex of roughly €300 million for the next 12 months. We understand that the company estimates capex of about €1.3 billion to €1.6 billion for 2021, but assume that most is not committed and that respective project funding is in place. We understand that Vonovia will likely pay out a dividend in 2021. We believe that the company might partially pay scrip dividends and partially cash dividends, in line with previous years.

Debt maturities

Vonovia's weighted average debt maturity was 7.9 years as of Dec. 31, 2020.

Chart 4

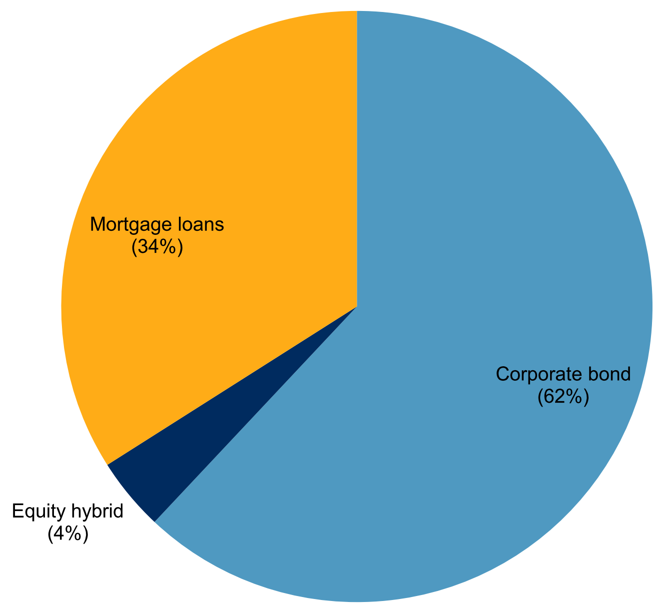
Vonovia SE's Debt Maturity Profile



EIB--European Investment Bank. Source: Company latest report; S&P Global Ratings.

Chart 5

Vonovia SE's Total Debt By Funding Source



Source: S&P Global Ratings based on company report as of Dec. 31, 2020.

Covenant Analysis

Compliance expectations

We expect that Vonovia will maintain adequate headroom, greater than 10%, under all remaining covenants.

Requirements

Most of the company's bank debt facilities were granted for the purpose of financing real estate assets. Loan agreements are therefore mostly secured by land charges and assignment of rental payments, and the majority include financial covenants, such as LTV ratios and a debt-service coverage ratio.

In addition, Vonovia has covenants under documentation for its outstanding corporate bonds, mainly relating to:

- LTV ratio (at less than 60%);
- Secured LTV (at less than 45%);
- Interest coverage ratio (greater than 1.8x); and
- Unencumbered assets to unsecured debt ratio (greater than 125%).

Environmental, Social, And Governance

We consider Vonovia's exposure to social and environmental factors as being on a par with the German residential industry. That said, social and political debates on rent affordability in Germany's metropolitan areas may increase regulation and reputation risk for the largest German residential real estate company. Vonovia, together with its peers, has become a target of social protests against rising rents in German metropolitan cities as well as nontransparent utility costs charged to the tenants. We believe additional rent regulation may hinder like-for-like rental growth for Vonovia. The company refurbishes and renovates approximately 3% of its portfolio per year to meet the latest standards in terms of thermal insulation and energy efficiency. In 2020, Vonovia invested €1.3 billion to upgrade existing buildings and new constructions, and €321 million on expensed maintenance. The German government has published a climate package which aims to reduce the carbon dioxide emissions for buildings by 66% (compared with 1990) by 2030.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Dec. 31, 2020, the company's reported debt structure comprises 30.3% of secured debt and 69.7% unsecured debt. Unsecured bonds are issued under Vonovia Finance B.V.

Analytical conclusions

We rate Vonovia's senior unsecured bonds 'BBB+', in line with the issuer credit rating. The company's ratio of secured debt to total fair value assets at year-end 2020 was 11.8%, well below our threshold of 40%.

As of Dec. 31, 2020, Vonovia has one rated subordinated hybrid bond outstanding of €1.0 billion, reported as equity.

We have assessed the hybrid bond as no equity content, given the company's announcement in 2020 to call the hybrid at its first call date in December 2021. Therefore, we treat 100% of the principal outstanding and all related payments, including accrued dividends under the hybrid instrument, as debt (see "Vonovia's €1 Billion Capital Increase Unlikely To Tip Leverage Metrics," published Sept. 4, 2020).

We rate the hybrid bond 'BBB-', two notches below the issuer credit rating. One notch reflects the subordination and the other the deferability of the instruments.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Excellent

- **Country risk:** Very low

- **Industry risk:** Low
- **Competitive position:** Excellent

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: a-

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012

Related Research

- German Residential Real Estate Is Unfazed By COVID-19, Nov. 30, 2020
- Vonovia's €1 Billion Capital Increase Unlikely To Tip Leverage Metrics, Sept. 4, 2020
- German Residential Landlord Vonovia SE Affirmed At 'BBB+/A-2'; Outlook Stable, July 22, 2020
- COVID-19: Implications For European Real Estate Investment, As Tenants Begin To Suspend Rent Payments, March 26, 2020

- Berlin's Rent Freeze, As Adopted, To Have Little Effect On The Credit Quality Of Rated Residential Real Estate Companies, March 24, 2020

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	**a-**	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of March 30, 2021)*

Vonovia SE	
Issuer Credit Rating	BBB+/Stable/A-2
Issuer Credit Ratings History	
10-Mar-2015	BBB+/Stable/A-2
01-Dec-2014	BBB/Watch Pos/A-2
23-Jul-2013	BBB/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.