

Research Update:

# German Real Estate Company DIC Asset AG Downgraded To 'BB-' On Tightening Liquidity; Outlook Negative

July 10, 2023

## Rating Action Overview

- DIC Asset AG (DIC) has renegotiated its €400 million bridge loan, originally due Jan. 31, 2024, including a partial repayment of €200 million, with the remaining amount optional to extend its maturity to July 31, 2024. The company also announced the disposal of assets for a total of €118.3 million, and a net cash inflow of €37.2 million.
- While we view these transactions as supportive for its immediate liquidity, the company's ability to sufficiently cover its funding needs for the next 12 months has become more constrained.
- Additionally, market uncertainties, including potential devaluation of properties, will likely keep the S&P Global Ratings-adjusted ratio of debt-to-debt plus equity for DIC close to our rating downside threshold of 60%.
- Consequently, we lowered our long-term issuer credit rating on DIC and its senior unsecured debt to 'BB-' from 'BB'. Our recovery rating on the senior unsecured debt remains unchanged at '3'.
- The negative outlook reflects the current challenging market environment for real estate companies, including rising interest rates, pressure on property valuations, and low activity on the transaction market. We believe this could lead to a further weakening of the company's creditworthiness within the next couple of quarters.

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## Rating Action Rationale

**DIC's recent announcement on disposals and renegotiation of the bridge loan are not sufficient to clear our liquidity concerns.** DIC has announced several transactions aimed at strengthening its liquidity position. The company agreed the disposal of two assets for a total of about €118.3 million, which it expects to close in third-quarter 2023 with a net cash inflow of about €37.2 million. In addition, it renegotiated its €400 million outstanding bridge loan, originally maturing in

January 2024, including an immediate repayment of €200 million of the outstanding amount, expected to complete in July 2023, with the option to extend the maturity for the remaining €200 million at its sole discretion to July 31, 2024. While we view those transactions as supportive for the company's overall funding profile, they do not allay our concerns regarding DIC's liquidity situation. As of March 31, 2023, and pro forma recent transactions, we estimate that DIC's outstanding short-term debt maturities of: approximately €485 million (excluding the €200 million bridge extension, now due July 2024); a cash dividend payment of about €60 million; roughly €55 million of committed capital expenditure (capex); and net cash outflow on signed acquisitions over the next 12 months, are tightly covered with its cash position of about €470 million, our forecast of cash funds from operations (FFO) of €60 million-€65 million for the next 12 months, and a net cash inflow of recent signed disposals of €37.2 million. In addition, over €500 million of debt will become due in the subsequent 12-month period, including the extended €200 million bridge maturity and €248 million ESG-linked promissory notes. We therefore revised our liquidity assessment to less than adequate from adequate, leading to a one-notch downward adjustment of our rating. We understand that DIC is strongly committed to raising sufficient funding to improve its liquidity situation, but we remain cautious about the timing and price of further disposals, given the volatile market environment and expected further interest rate rise. We also understand that the company's headroom under its bond covenants for loan to value (LTV; set at 60%) remained tight at below 10% as of March 31, 2023. Additionally, we understand that the renegotiations of the bridge loan have brought an additional financial covenant, which we will monitor very closely over the next few quarters and update our analysis if necessary.

**Our base case remains unchanged with little headroom on DIC's debt-to-debt-plus-equity ratio.**

Incorporating recent transactions, our base case remains broadly stable. We expect the company's debt-to-debt-plus-equity ratio to remain at 57%-59% (58.4% as of first-quarter 2023) over the next 12 to 24 months, and EBITDA interest coverage to drop slightly to about 2.2x (2.4x as of first-quarter 2023 on a rolling 12 months [RTM] basis) over the same period versus our previous base case of about 2.5x-2.7x, mainly because of the higher refinancing costs, including several step ups until final maturity. We expect debt to annualized EBITDA to be at about 13x to 14x (15.3x as of first-quarter 2023 RTM). Thanks to recent refinancing efforts, including the bridge renegotiations, we estimate that the company's average debt maturity profile improved to 3.8 years from 3.5 years as of Dec. 31, 2022.

**DIC's main shareholders opted for cash dividends, highlighting some potential strategic differences.**

Following the acquisition of VIB Vermögen AG at the beginning of 2022, which was mainly funded by debt, DIC committed to deleveraging. The tough environment for the property market has delayed the execution of DIC's strategy to raise equity and secure sufficient asset disposals to compensate for the leverage rise. In addition, rising interest rates and the limited access to debt capital markets constrained the company's liquidity situation. DIC offered its shareholders scrip dividend, aiming to support its credit metrics and cash outflows. However, only 6.6% of shareholders opted for this, leading to a cash dividend payment of about €60 million. As of June 30, 2023, DIC's largest shareholders were Deutsche Immobilien Chancen Group (34.3% equity stake), Yannick Patrick Heller (10.1%), and RAG Foundation (10%). As a result, we have lowered our assessment of DIC's management and governance to fair from satisfactory.

**We expect operating fundamentals to remain stable for DIC's properties.** As of March 31, 2023, the fair value of the commercial portfolio stood at €4.1 billion, partially contracted from €4.5 billion in December 2022, following the transfer of about 31 properties to the recently established VIB retail fund. The European Real Estate Association's (EPRA) vacancy rate for its owned portfolio

stood at a low 4.9%, albeit slightly increased from the 4.3% reported in December 2022. DIC achieved solid like-for-like annualized rental growth of 7.8% in first-quarter 2023, benefiting from lease renewals and lease indexation. We forecast Consumer Price Index (CPI) inflation for Germany of 6.7% for 2023 and 2.9% for 2024, which should further support rental growth, because more than 90% of the contracts are linked to the CPI. Although the ongoing tough market environment, combined with cost-saving initiatives and potential reduction of required office space, could represent a threat to further operational growth for office real estate landlords--and slowing demand could affect occupancy levels and rental income over the next two to three years--DIC's lease portfolio is well spread, with only 2.6% of leases maturing in 2023 (as of first-quarter 2023) and 6.6% in 2024, limiting short-term vacancy risks.

**The recovery rating remains at '3'.** We maintained our recovery rating on the €400 million senior unsecured bonds, due September 2026, at '3', indicating our expectation of 50%-70% recovery (rounded estimate: 55%) in the event of a payment default. Our issue rating is 'BB-', in line with the issuer credit rating.

## **Outlook**

The negative outlook reflects the current challenging market environment for real estate companies, including rising interest rates, pressure on property valuations, and low activity on the transaction market. We believe this could lead to a further weakening of the company's creditworthiness within the next couple of quarters.

## **Downside scenario**

We could lower the rating by multiple notches if DIC fails to secure at least €250 million-€300 million of funding sources over the next three to six months and we see a likelihood that material covenants will be breached.

We could also lower the rating if:

- DIC's debt-to-debt-plus-equity ratio deteriorates to above 60%;
- Debt to annualized EBITDA deviates strongly from our forecast; or
- Its EBITDA interest coverage declines to 1.8x or below over the forecast period.

## **Upside scenario**

We could revise our outlook back to stable if the company sustainably:

- The company maintains a liquidity situation that does not lead to a deterioration as described above;
- Debt to debt plus equity remains well below 60%;
- Debt to EBITDA does not deviate from our current base case at 12x-13x; and
- EBITDA interest coverage remains well above 1.8x.

A stable outlook would also depend on the company continuing to generate a steady, predictable cash flows, including the maintenance of high occupancy levels.

## Company Description

DIC is a listed company that specializes in management of commercial real estate properties in Germany. It manages a portfolio of €14.1 billion (as of March 2023), split in two segments:

- Commercial portfolio: Comprising about 174 properties with a market value of €4.5 billion, generating about 86.9% of EBITDA; and
- Institutional business (IB): Comprising 183 properties with a value of €10.0 billion, generating 13.1% of EBITDA.

## Liquidity

We revised our liquidity assessment to less than adequate, as we estimate that DIC's liquidity sources will likely cover uses by less than 1.2x during the 12 months from March 31, 2023.

Principal liquidity sources:

- Unrestricted cash balances of about €470 million as of March 31, 2023;
- Our forecast of cash funds from operations of €60 million to €65 million; and
- Signed disposal proceeds of €118.3 million, with a net cash inflow of about €37.2 million.

Principal liquidity uses:

- About €484.9 million of short-term debt maturities, including the €200 million repayment of the bridge loan expected in July 2023;
- About €15 million of committed capex for the next 12 months;
- Cash dividend payments of about €60 million; and
- Net cash outflow of committed acquisitions of about €35 million.

## Covenants

DIC has financial covenants under some of its secured and unsecured outstanding debt, related to its LTV, bond LTV, secured LTV and interest coverage ratio.

The bond carries covenants related to a maximum 60% adjusted LTV, 45% secured LTV, and interest coverage ratio of minimum 1.8x. The calculation of the company's bond covenants differs from the S&P Global Ratings-adjusted ratio calculations.

We understand that DIC has maintained adequate headroom (at least 10%) for most of its financial covenants. That said, we understand that the covenants of the company's bond related to LTV, and promissory notes related to LTV, is tight at below 10% as of the end of March 2023, and pro forma committed sales year-to-date.

We expect the company to ensure sufficient headroom under all its covenants.

## Ratings Score Snapshot

Issuer credit rating	BB-/Negative/--
Business risk:	Fair
Country risk	Very Low
Industry risk	Low
Competitive position	Fair
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Less than adequate (-1 notch)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bb-

## 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
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- German Real Estate Company DIC Asset AG Downgraded To 'BB' On Still High Leverage; Outlook Negative, March 2, 2023

## Ratings List

### Downgraded

	To	From
<b>DIC Asset AG</b>		
Issuer Credit Rating	BB-/Negative/--	BB/Negative/--
<b>DIC Asset AG</b>		
Senior Unsecured	BB-	BB
Recovery Rating	3(55%)	3(55%)

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](http://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](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](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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 Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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