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# Fitch Affirms Peach Property at 'BB'; Outlook Stable

Fitch Ratings - Warsaw - 10 Oct 2023: Fitch Ratings has affirmed Peach Property Group AG's (Peach) Long-Term Issuer Default Rating (IDR) at 'BB' and its unsecured rating at 'BB'/'RR4'. The Outlook is Stable. A full list of rating actions is below.

Peach's ratings reflect the stability of the rental income from its EUR2.6 billion German regional residential-for-rent portfolio. As part of the mechanisms of regulated rent indices (including regional Mietspiegels), inflation-related rental uplifts are phased and will take time to monetise compared with more immediate increases in Peach's cost of debt, which re-sets as debt is refinanced.

Although Peach's net debt/EBITDA leverage is consistent with the rating, interest cover will decline with the higher cost of debt upon refinancing. At end-June 2023 (1H23), liquidity and tangible plans covered small 2024 debt maturities, but end-2025 debt maturities consisting of a EUR300m unsecured bond and a EUR230 million secured debt funding pose significant refinancing risks.

Market fundamentals remain solid for German residential-for-rent assets, such as Peach's, with reduced supply and increased demand, resulting in rental stability. With liquidity, including no dividends, diverted to aid debt requirements, maintenance spend to spur future years' rent increases or to meet ESG requirements may be constrained and weaken the portfolio.

## Key Rating Drivers

**Stable Rent Increases:** FY22's like-for-like in-place rent growth was 4.4% (FY23 target: 3.6%). Fifty percent was attributable to annual increases in in-place rents (uplifts allowed, including the period's CPI-driven increases). Twenty percent was attributable to rent increases upon vacancy reduction (YE22 occupancy: 93.1%), and 30% was due to re-letting at higher rents upon tenant churn.

Peach cannot immediately maximise rents by recent inflation due to Mietspiegel phasing of rent uplifts and tenant affordability considerations. Uplifts closer to market rents are crystallised when units are refurbished upon tenant churn, which is included within Peach's EUR30-40 million maintenance spend per year.

**Fundamentals of Supply & Demand:** The market fundamentals of strong demand from housing (including from increased migrants), yet little supply (recently accentuated by German development company insolvencies and granting of building permits), particularly at the affordable level of housing stock, points to strong fundamentals for Peach's asset class.

**Non-Prime Portfolio:** Peach's portfolio focusses on average quality residential-for-rent units in non-prime, but often large, nationally relevant cities, of which most are located in North-Rhine-Westphalia.

The portfolio is clustered, helping to create efficiencies in provision of local services to tenants (local Peach Points). Within the group's stubborn vacant units (YE22: 1,899 units, 6.9%; 1H23: 1,988 units or 7.2%), some inherited upon portfolio acquisitions in 1999 and 2000, Peach has identified 130 units where capex can achieve a target 10% return-on-cost threshold, but the bulk of the remainder of the portfolio may not achieve this threshold, so could be sold instead.

The portfolio's average 1H23 in-place rent is EUR6.11 sq m per month (comparable to Vonovia's EUR7.49 at YE22, Heimstaden's group-implied EUR9.7 at YE22, D.V.I.s Berlin-weighted portfolio of EUR8.5 at YE22). Peach's lower rents represent the quality and locations of the portfolio.

**Swiss Development Started:** The CHF140 million Peninsula Wadenswil residential-for-sale development at Lake of Zurich has started with 60% of units notarised or reserved, with handover planned for 2024/2025. Despite netting purchasers' advance payments, there is a working capital burden upon Peach that inflates group debt until completion receipts.

**High Leverage Persisting:** The improvement of Peach's net debt/EBITDA leverage will take longer until 2025 when Fitch forecasts the ratio to settle at around 19.4x, aided by annual 3.0%-4% organic rental growth and the completion of its Swiss development project. However, increased cost of debt puts interest cover under pressure which will remain at or below 1.3x throughout 2023-2024 before improving to 1.4x in 2025.

**Focus on End-2025 Debt Maturities:** Management is focused on addressing two scheduled key bullet debt maturities in 2025: the EUR300 million unsecured bonds maturing November 2025, and EUR230 million secured bank funding due December 2025. Fitch believes that German banks are conducive to refinancing existing secured debt. Unsecured bonds will be more expensive to refinance given Peach's step back from investment-grade rating ambitions and 2022's refinancing with secured debt.

Consistent with other residential-for-rent property companies, the interest coverage ratio at today's higher cost of debt determines lower leverage for companies funding sub-3% net income-yielding residential assets. Fitch has calculated that should Peach's 2025 debt be financed at around 5%, its interest coverage ratio would be 1.4x (or 1.2x at 7%). Fitch-calculated YE22 loan-to-value (LTV) was near-60%.

**Refinance Options:** The company is investigating various options including asset disposals to increase cash resources to reduce indebtedness, but peers are also looking to sell residential-for-rent units in a dry market. Peach has cancelled the 2022 cash dividend payable in 2023 and EUR4.5 million of hybrid instruments' interest is to be deferred for the time being, subject to a likely continued suspension of dividend payments.

**Unencumbered Asset Cover:** With the increase in secured debt, and some reduction in the YE22 portfolio valuation, the unencumbered investment property/unsecured debt ratio is 0.9x. At this level of ratio, Peach's unsecured rating is at the same level as its IDR.

## Derivation Summary

Fitch-rated residential-for-rent investment property companies D.V.I. Deutsche Vermogens- und Immobilienverwaltungs GmbH (BBB-/Stable) and Heimstaden Bostad AB (BBB/Rating Watch Negative) have the most relevant portfolios of comparison for Peach Property Group.

German cities are classified into A-D categories, mainly based on the reach of a city's relevance (international to local). The seven German cities in the 'A' category include Berlin, which is where DVI's assets (EUR3.1 billion at end-FY22) as well as many of Heimstaden Bostad's German assets (around EUR9.3 billion) are located. Berlin's prime-character is reflected in the gross rental yields for these peers of around 2.7% and 2.2% respectively at YE22. In contrast, Peach's more secondary portfolio (EUR2.6 billion) shows a higher 4.4% gross rental yield. It is more diversified and consists of 'B' cities, that have over 250,000 inhabitants and national significance, such as Bochum and Dortmund (together 13% of portfolio value), but also smaller 'D' cities with a regional focus such as Kaiserslautern and Gelsenkirchen (together 16% of portfolio value).

Contrary to other European markets, regional cities in Germany have high economic relevance and are historically more resilient to economic downturns than the top cities. This is less relevant for residential assets where, due to supply & demand imbalances, market vacancies are low in both prime and lower-category cities, consequently they provide a stable rental income profile.

However, future rent indexation in top cities, especially in Berlin, are significantly limited by local reference rents (Mietspiegel) and extensive capex is required for more pronounced rent increases. Peach's affordable rents of EUR6 sq m per month (below DVI's Berlin-weighted EUR8.5 equivalent) are less constrained by local rental indices, but instead are bound by affordability issues. Additionally, within Peach's portfolio, in some cases, capex-based rent increases can't be realised as they wouldn't achieve required returns because of elevated construction and financing costs.

At end-FY24, driven by its high LTV ratio of 57%, we forecast Peach's net debt/EBITDA at around 21x, slightly below Heimstaden's 23x which is more justified through relatively higher quality assets. This is well above the more comparable and investment grade-rated DVI at around 13x for its residential portfolio. In addition to the burdening amount of debt relative to Peach's higher-yielding assets, given indicative pricing of its unsecured debt, we expect the company to increase secured lending (potentially at the cost of pledging more assets): both these factors restrict Peach's rating to the 'BB' rating category.

## Key Assumptions

Fitch's Key Assumptions within our Rating Case for the Issuer

- Annual rental growth of 3.0%-4.0% (higher in 2023, then decreasing) from indexation and re-lettings

- We assume around EUR40 million of renovation and development capex per year during 2023-2026, down from EUR76 million in 2022. This will not reduce vacancy (further) but will keep it stable at around 7%-8%.

- We assume completion of Peach's Swiss residential-for-sale development in 2025 with net disposal proceeds of EUR30 million. Receipt of these funds have been smoothed over the next three years in our forecasts.

- Disposal of 2,000 units in 2024 generating around EUR100 million of net disposal proceeds (assuming EUR100,000 value per unit).

- Interest costs on euro-denominated variable-rate funded debt rise due to policy rate changes (FY23 policy rate: 4.5%, FY24: 3.75%) and higher cost of new debt generally (FY25 refinancings' all-in: 4.5%).

## RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Net debt/EBITDA below 17x

- EBITDA net interest coverage above 1.75x

- Vacancies below 7%

- Liquidity score above 1.0x, and debt maturities refinanced well in advance and supported by undrawn committed credit facilities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Tangible plans in place by June 2024 for end-2025 debt refinancings

- Delays in planned 2024 disposals and lower values realised

- Net debt/EBITDA above 19x

- EBITDA net interest coverage below 1.5x

- Costs for holding vacancies increasing to 5% of rent roll

- For the senior unsecured debt rating: the unencumbered assets/unsecured debt ratio declining to less than 1.0x and higher proportions of secured debt

## Liquidity and Debt Structure

**Focus on Debt Refinancings:** During 1H23, Peach repaid upcoming debt maturities with a combination of cash on balance sheet, by tapping secured debt, and by issuing a convertible, and a mandatory convertible, bond. At end-1H23, the remaining EUR31 million of debt maturities over the following 18 months are well covered by EUR59 million of undrawn RCF.

Peach faces two main bulk maturities of EUR586 million at end-2025, including a secured funding and the EUR300 million unsecured bond. Fitch expects management to have tangible plans in place to refinance end-2025 debt by mid-2024.

With 91% of fixed-rate debt at end-FY22, Peach's imminent interest rate risk is limited, however the reported average interest costs of 2.7% do not include expensive hybrid debt with a 9.25% margin since the June 2023 step-up event.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

## Fitch Ratings Analysts

**Radoslaw Beker**
Director
Primary Rating Analyst
+48 22 103 3034
Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce Marszalkowska 107, 00-110 Warsaw

**Felix Raquet**
Senior Analyst
Secondary Rating Analyst
+49 69 768076 249

**Andrea Bonaventura**
Senior Director
Committee Chairperson
+39 02 9475 7015

## Media Contacts

**Isobel Burke**
London
+44 20 3530 1499
isobel.burke@thefitchgroup.com

## Rating Actions

| ENTITY/DEBT | RATING | | | RECOVERY | PRIOR |
|---|---|---|---|---|---|
| Peach Property Group AG | LT IDR | BB | Affirmed | | BB |
| • senior unsecured | LT | BB | Affirmed | RR4 | BB |
| Peach Property Finance GmbH | | | | | |
| • senior unsecured | LT | BB | Affirmed | RR4 | BB |

| RATINGS KEY | OUTLOOK | WATCH |
|---|---|---|
| POSITIVE | | |
| NEGATIVE | | |
| EVOLVING | | |
| STABLE | | |

## Applicable Criteria

Climate Vulnerability in Corporate Ratings Criteria (pub.21 Jul 2023) (including rating assumption sensitivity)

Corporate Hybrids Treatment and Notching Criteria (pub.12 Nov 2020)

Corporate Rating Criteria (pub.28 Oct 2022) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

## Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

## Additional Disclosures

Solicitation Status

## Endorsement Status

| | |
|---|---|
| Peach Property Finance GmbH | EU Issued, UK Endorsed |
| Peach Property Group AG | EU Issued, UK Endorsed |

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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