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RATING ACTION COMMENTARY

Fitch Places Peach Property's 'BB' IDR on Rating Watch Negative, Downgrades Snr Unsecured to 'BB-'

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Fitch Ratings - Warsaw - 12 Apr 2024: Fitch Ratings has placed Peach Property Group AG's 'BB' Long-Term Issuer Default Rating (IDR) on Rating Watch Negative (RWN) due to the uncertainties surrounding the refinancing of the company's EUR300 million unsecured bond maturing in November 2025. Its senior unsecured rating has been downgraded to 'BB-' with a Recovery Rating of 'RR5' and placed on RWN, from 'BB'/RR4. A full list of rating actions is listed below.

The RWN reflect Peach's constrained liquidity ahead of debt maturities bunched at end-2025. Although the secured debt due in 2025 and 2024 is likely to be refinanced by existing banks, the options to refinance the unsecured bond maturing in 2025 are affected by Peach's constrained liquidity, announced (but not quantified) asset disposals that entail execution risk, unattractive pricing for the unsecured bond refinancing, and limited unencumbered investment properties to raise secured debt. Further equity may be an option. Recent senior management changes at Peach have not been conducive to addressing the debt maturities.

The downgrade of the senior unsecured rating reflects the higher proportion of secured debt, which is increasingly shrinking the unencumbered pool of assets. Fitch expects Peach to conclude negotiations on the refinancing options before end-August 2024, failing which, the IDR may be downgraded to the 'B' rating category.

KEY RATING DRIVERS

Bond Maturity and Refinancing Strategy: Peach's EUR300 million unsecured bond due in November 2025 is unlikely to be refinanced with new unsecured debt due to current bond pricing indications. Realistically, (i) repayment may be through a mix of newly issued secured debt alongside proceeds from planned asset disposals, or (ii) part-repayment from asset disposal proceeds with remaining amounts requiring an extension request to existing debtholders.

We expect Peach's December 2025 secured funding of EUR233 million to be rolled over by domestic banks. Peach has raised EUR17.7 million from shareholders in April 2024, but Fitch understands that further equity raising is also an option.

Unconducive Asset Disposal Conditions: Peach is actively pursuing a strategic plan to dispose of unquantified assets despite the German residential-for-rent market having subdued transaction volumes. Over the past 12-18 months, in the market we have seen privatisation of individual residential units instead of larger block transactions, thus Peach's proposed portfolio sale may be at discounted prices, which could erode shareholder value.

Rental Growth is Capex-Dependent: Peach significantly reduced its 2023 capex to EUR19 million (2022: EUR58 million). Vacancy increased over the same period to 7.4% (around 2,000 units) from an improved 6.9% (around 1,900 units). Peach's portfolio includes a proportion of apartments that are not lettable without renovation spend. Peach's tenant churn rate was high compared with peers at 11% in 2022 (2023 figure not disclosed). Assuming similar levels of tenant churn in 2024 and thereafter, and capex remaining suppressed, we expect vacancy to increase further.

Furthermore, Peach's 3.5% like-for-like rental growth target depends on vacancy reduction (20% of the increase) including the benefits of capex; and tenant churn (30% of the increase). Only up to 50% of the growth target relies on increased rents from regional rent indices including Mietspiegel which is less dependent on capex. Peach states that it wants to be closer to its long-term average in terms of capex spent per square metre, but this might be difficult given constrained liquidity and pressure from increased vacancy costs.

Small Pool of Unencumbered Assets: The company increased its secured debt to EUR1 billion by end-2023 (2021: EUR770 million), which, together with a fall in asset values (2023: net -7%), has reduced the pool of unencumbered investment property to EUR371 million (2022: EUR484 million). Depending on secured debt lenders' loan-to-value (LTV) or interest coverage appetites, this pool's possible secured debt would be insufficient to replace the EUR300 million 2025 unsecured bond maturity, which underscores Peach's dependence on asset disposal proceeds.

Inherent Steady Rental Growth: Peach had consistent like-for-like yoy rental growth of 4.6% in 2023, illustrating the sustained demand for residential apartments in Peach's German B-Cities. This growth trajectory suggests that significant capex is not always a prerequisite for enhancing rental income, though it contributes to further increments. We anticipate continued rent inflation of approximately 4%, as regulatory mechanisms, such as the Mietspiegel, phase the impact of 2022's CPI increase, and higher operating costs and cost of capital.

Swiss Development Pre-Sales Stagnating: The group's sole construction project is 57 condominiums with 33 units notarised at end-2023 (end-2022: 19), or 58% of sales volume. As Peach is reporting an impairment loss of EUR13.2 million (for a EUR130 million project) due to increased construction costs, it is not clear if sales can be achieved at current (albeit lowered) prices to cover development costs. As the pre-sales only have 20% pre-payments, the project is a burden on the group's working capital, although construction funding is provided by a committed loan available until completion in 2025.

Interest Cover Under Pressure: Due to reduced policy rates and effective in-place interest rate hedging, and if deleveraging from asset disposals takes place, Fitch calculates that Peach's EBITDA interest coverage ratio will stabilise at around 1.4x in 2025 (2023: 1.4x including part-year hybrid interest). Although Peach reduced 2023 capex, Fitch-calculated funds from operations (FFO) of around EUR20 million (2022: EUR9 million) barely covers reduced tenant improvement and refurbishment capex and 2024's EUR30 million-35 million capex guidance, particularly after recent rises in cost of debt.

Significant Management Changes: There have been significant senior management changes over the past two years with the original team that amassed Peach's off-market piecemeal secondary residential-for-rent portfolios now gone. A new joint-CEO and CFO is joining at end-April 2024. The strategy of cherry-picking clustered portfolios to realise synergies in maintenance and localised customer service (Peach Points) was achieved, but the company has yet to resolve stubborn vacancies from inherited portfolios, hampered by rising costs, skills shortage and desirability of these locations' units.

DERIVATION SUMMARY

In terms of size, Peach's portfolio of EUR2.4 billion at end-2023 is materially smaller than Fitch-rated German residential-for rent peers Vonovia SE's (IDR: BBB+/Stable) EUR81 billion and Heimstaden Bostad AB's (BBB-/Negative) EUR28.6 billion. Peach's portfolio is more comparable to D.V.I. Deutsche Vermoegens- und Immobilienverwaltungs GmbH's (DVI, BBB-/Stable) EUR3.1 billion at end-2022.

The Peach portfolio's average end-2023 in-place rent was EUR6.2 per sq m per month, indicating lower quality assets and locations compared with Vonovia's Germany portfolio, which had rent of EUR7.74 at end-2023, and DVI's Berlin-weighted portfolio had rent of EUR8.5 at end-1H23. The difference in these portfolios' qualities is also reflected in their respective vacancy rates, where Peach reported 7.4% at end-2023, above the 1.5% of both DVI and Vonovia at 1H23 and end-2023 respectively.

Peach's interest cover, forecast at 1.3x in 2024, is lower than Heimstaden Bostad's at 1.4x (increasing thereafter). Interest cover of DVI and Vonovia are both forecast to remain at or above 2.3x over the coming years. Peach's end-2023 remaining average debt maturity is low at 2.9 years, compared to Vonovia's 6.9 years, and at or above 8 years for Heimstaden Bostad and DVI, putting liquidity under significant pressure and driving Peach's RWN.

KEY ASSUMPTIONS

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

- Annual rental growth around 3.5%-4.0%, of which phased indexation/re-lettings (+1.5%), reletting of units that had capex (+2.4%)

- Hybrid bond interest not deferred but paid at 9.25% margin plus policy rate

- Dividends of 50% of cash from operations (CFO) from 2026 onwards

- We assume around EUR35 million of renovation and development capex per year during the forecast period (2023: EUR13 million). This will not reduce vacancy but will keep it stable at around 7%-8%.

- Completion of Peach's Swiss residential-for-sale development in 2025 with net sales proceeds of EUR30 million.

- Interest costs on euro-denominated variable-rate funded debt to rise due to Fitch's Global Economic Outlook policy rate assumptions (2024: 3.75%; 2025 and thereafter: 3.0%), and new refinanced debt at variable rates.

RATING SENSITIVITIES

Factors that Could Individually or Collectively, Lead to Resolving the RWN

- Execution, or visibility, of a plan to mitigate 2024's refinance risk by end-August 2024.

- Forecast metrics not indicating a rating downgrade

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%

- 12-month liquidity score above 1.0x, and debt maturities refinanced well in advance or supported by undrawn committed credit facilities

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

- Lack of substantially advanced plans to address debt maturities by the end-August 2024, including lack of progress in the announced asset disposals

- Net debt/EBITDA above 19x

- EBITDA net interest coverage below 1.5x

- Costs for holding vacancies increasing to 5% of rent roll (2023: 5%)

- Affecting the senior unsecured rating: further reductions in the unencumbered portfolio relative to unsecured debt, adversely affecting recoveries.

LIQUIDITY AND DEBT STRUCTURE

Liquidity Constraints in 2025: At end-2023, readily available cash of EUR19.7 million (excluding EUR1.8 million of cash pledged as collateral) together with EUR64 million undrawn of the EUR75 million revolving credit facility (RCF, maturity in April 2025) covered EUR31 million of secured debt maturing in 2024 (if this is not rolled over by existing lenders). In order to preserve liquidity, Peach has stopped paying interest on its hybrid warrant bond since 3Q23 and did not pay a cash dividend in 2023. The April 2024 equity raising will bring in EUR17.7 million.

End-2025 Refinance Risk: In 2025, Peach will face EUR588 million of bulk debt maturities, comprising a EUR55 million promissory note (March), the EUR300 million unsecured bond (November), and EUR233 million of secured debt (mainly December). Consistent with sector peers, we expect German bank secured loans to be rolled over, aided by a secured LTV (excluding developments) of 41% at end-2023. As Peach's capital market access is currently limited, this is unlikely to be a source of funding for the repayment of its unsecured bond. Repayment therefore depends on disposals, but execution risk remains high and a discount to end-2023's asset values may be realised.

2023 Refinance Risks Were Mitigated: In January 2023, Peach repaid the year's only debt maturity - the remaining EUR96 million of its EUR250 million unsecured bond. Thereafter, through a mandatory convertible bond issued in January 2023, Peach raised EUR68.4 million of equity cash proceeds and converted EUR11.3 million of hybrid debt into equity. Further debt proceeds of EUR33 million were received from newly issued secured debt in 2H23 and another EUR17.7 million of equity was raised in March 2024 from shareholders.

Swiss Residential-for-Sale Development: Cash outflows to Peach's Switzerland Wadenswil development project are covered by a dedicated secured construction loan, the outstanding amount of which has increased by EUR9.1. million to EUR22.8 million by end-2023. The project is expected to generate net proceeds of around EUR30 million when completed during 2025.

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.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY	PRIOR
Peach Property Group AG	LT IDR	BB Rating Watch Negative	Rating Watch On		BB Rating Outlook Stable

senior unsecured	LT BB- Rating Watch Negative Downgrade	RR5	BB
Peach Property Finance GmbH			
senior unsecured	LT BB- Rating Watch Negative Downgrade	RR5	BB

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

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

Felix Raquet
Senior Analyst
Primary Rating Analyst
+49 69 768076 249
felix.raquet@fitchratings.com
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Josephine Ngiam
Associate Director
Secondary Rating Analyst
+44 20 3530 1115
josephine.ngiam@fitchratings.com

Alex Griffiths, FCA
Managing Director
Committee Chairperson
+44 20 3530 1709
alex.griffiths@fitchratings.com

MEDIA CONTACTS

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

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

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

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

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

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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