FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Peach Property's IDR to 'CCC+', Unsecured Bond to 'B-'

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Fitch Ratings - Frankfurt am Main - 27 Jun 2024: Fitch Ratings has downgraded Peach Property Group AG's Long-Term Issuer Default Rating (IDR) to 'CCC+' from 'BB' and its senior unsecured rating to 'B- from 'BB-'. All ratings have been removed from Rating Watch Negative (RWN). The Recovery Rating on its senior unsecured debt is 'RR3'. A full list of rating actions is detailed below.

The downgrades reflect Peach's constrained liquidity ahead of its bulk debt maturities at end-2025, including its EUR300 million unsecured bond due in November 2025. Limited capital-market access means refinancing renegotiations will be a balance between willing shareholders, bondholders, and funding the group's needs for operational and capex requirements to improve the portfolio for the longer term. Fitch understands from management that the previous route of significant asset disposals is now less favoured. Secured debt due in 2025 and 2024, on the other hand, is likely to be refinanced by existing banks.

The 'CCC+' IDR reflects the possibility of a restructuring of the unsecured bond.

KEY RATING DRIVERS

November 2025 Bond Refinancing: Management intends to focus on improving the portfolio's quality and lower vacancies to facilitate the bond refinancing in 2025, as capital-market access is limited and asset disposals are now not favoured. Fitch believes that this may result in negotiations to extend the bond maturity and other changes. An improved portfolio will also facilitate subsequent refinancings or disposals plans.

Negotiations will likely include Peach's receptive shareholders who will want to protect their investment and promote the inherent long-term value of stable German residential-for-rent assets.

Capex to Enhance Portfolio Quality: Peach plans to improve its residential-for-rent portfolio by reducing vacancy (end-2023: 7.4% or 2,000 units) through capex, which would increase rents and lower vacancy costs (5.2% of rents), thereby improving EBITDA and capital values. Achieving an estimated rent of around EUR7 per sqm per month for a previously vacant unit (Peach's in-place rent is EUR6.2 and recent lettings have been above EUR7) would reflect a double-digit return on capex. However, execution risks are tenant affordability, timing and costs to refurbish vacant units, and supply and demand dynamics of specific locations.

Funding Constraints: The capex programme requires a combination of debt and equity funding. Peach currently does not have the liquidity for rent-and value-accretive capex and, hence, depends on a mix of shareholder funding, potential disposals and revolving credit facility (RCF) drawdowns, to improve the portfolio's quality and create additional rental income. Furthermore, a higher coupon for an extended bond, even if part-repaid, would constrain the group's cash flow.

Unconducive Market Environment for Selling: Refinancing the bond by selling blocks of residential-for-rent assets would result in a significant reduction in Peach's equity value. If perceived as a distressed seller Peach would face unpalatable discounts for such portfolios, and also as the German residential-for-rent market has yet to trough. Further, retaining a smaller overall portfolio would reduce Peach's already weak profit margins.

Updated Recovery Estimate: Fitch calculates recoveries at 55% based on the remaining unencumbered properties, which lead to a ranked recovery for senior unsecured debt of 'RR3' under our principal waterfall analysis. Fitch's previous 'RR5' for the BB IDR was not a bespoke calculation. The updated 'RR3' recovery estimate does not include residual values within pledged assets (loan-to-value (LTV) ratios at Peach's secured-funded SPVs average 43%) as the timing of each entity's monetisation is controlled by prior-ranking secured creditors.

Constrained Financial Profile: Fitch forecasts Peach's net debt/EBITDA to remain around 19x-22x and interest cover to average 1.4x during 2024-2027. Even with no dividend, the group's free cash flow is an outflow, assuming EUR35 million of capex to maintain and enhance the portfolio. The group's end-2023 LTV was high at around 60%.

DERIVATION SUMMARY

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 sqm per month, indicating lower- quality assets and locations than Vonovia's German portfolio, which had rent of EUR7.74 sqm at end-2023, and DVI's Berlin-weighted portfolio rent of EUR8.5 sqm 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 end-1H23 and end-2023, respectively.

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

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Annual rental growth around 4.0%, comprising 1.5% for phased indexation/re-lettings and 2.4% for reletting of units that have been refurbished

- 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 2024-2027 (2023: EUR13 million). This will not reduce vacancy further but will keep it stable at around 7%-8%

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

- Interest costs on euro-denominated variable-rate debt to rise based on Fitch's Global Economic Outlook policy rate assumptions (2024: 3.75%; 2025 and thereafter: 3.0%)

RECOVERY ANALYSIS

Our recovery analysis assumes that Peach would be liquidated rather than restructured as a going-concern (GC) in a default.

Recoveries are based on the EUR371 million unencumbered portfolio, using the end-December 2023 independently-valued investment property portfolio. Fitch applies a standard 20% discount to these values.

We assume no cash is available for recoveries and that its EUR75 million RCF is fully drawn (end-2023: EUR10.6 million drawn). After deducting a standard 10% for administrative claims, the total amount of unencumbered investment properties we assume available to unsecured creditors is EUR266 million. This compares with unsecured debt totaling EUR488 million, including the EUR300 million bond, an equally-ranking EUR51 million convertible bond, the RCF and EUR55 million promissory notes.

Fitch's principal waterfall analysis generates a ranked recovery for senior unsecured debt of 'RR3' (a waterfall generated recovery computation output percentage of 55% based on current metrics and assumptions). The 'RR3' indicates a 'B-' unsecured debt instrument rating.

RATING SENSITIVITIES

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

- Execution of a plan to address 2025's refinance risk that is not viewed by Fitch as a distressed debt exchange

- Twelve-month liquidity score above 1.0x combined with a sustainable capital structure with limited funding risks

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

- A material likelihood of a debt restructuring on terms that would constitute a distressed debt exchange

- Senior unsecured rating: reductions in the unencumbered property portfolio relative to unsecured debt, adversely affecting recoveries

LIQUIDITY AND DEBT STRUCTURE

Main 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 under the EUR75 million RCF (maturity in April 2025) covered EUR31 million of secured debt maturing in 2024 (if this is not rolled over by existing lenders). To preserve liquidity, Peach has stopped paying interest on its hybrid warrant bond since 3Q23 and did not pay a cash dividend in 2023. Its April 2024 equity raise brought in EUR17.7 million.

End-2025 Refinance Risk: In 2025 Peach will face EUR588 million of bulk debt maturities, comprising EUR55 million promissory notes (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 43% 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.

In January 2023, Peach repaid the year's only debt maturity - the remaining EUR96 million of its EUR250 million unsecured bond. Thereafter, through a CHF112.4 million 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 one of its anchor shareholders.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

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	CCC+	Downgrade		BB Rating Watch Negative
senior unsecured	LT	B-	Downgrade	RR3	BB- Rating Watch Negative
Peach Property Finance GmbH					
senior unsecured	LT	B-	Downgrade	RR3	BB- Rating Watch Negative

VIEW ADDITIONAL RATING DETAILS

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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. 21 Jun 2024)

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

ENDORSEMENT STATUS

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

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