S&P Global Ratings

RatingsDirect®

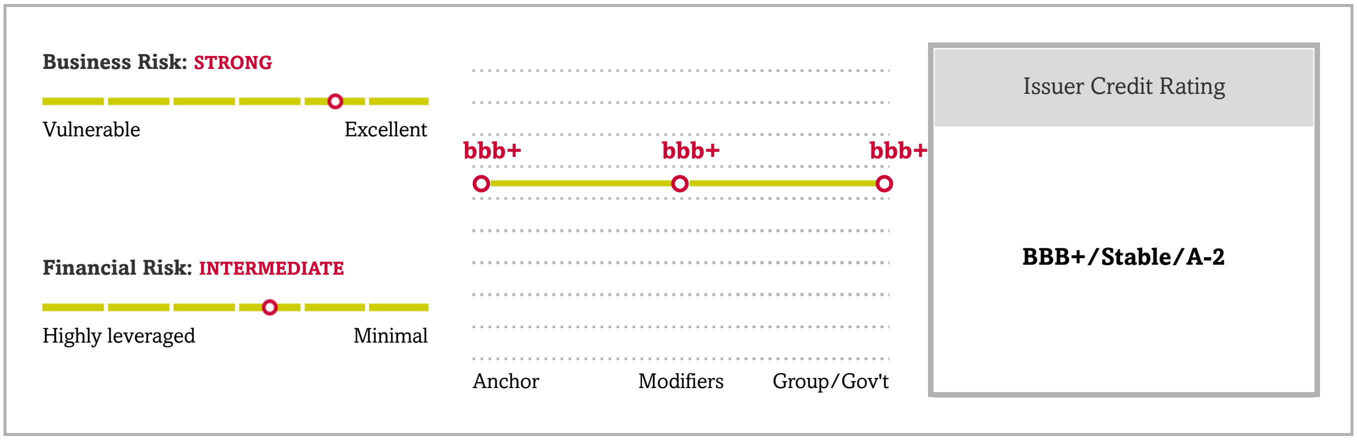
Grand City Properties S.A.

Primary Credit Analyst:
Carlos Garcia Bayon, CFA, Madrid + 34 91 423 3195; carlos.garcia.bayon@spglobal.com

Secondary Contact:
Nicole Reinhardt, Frankfurt + 49 693 399 9303; nicole.reinhardt@spglobal.com

Table Of Contents

Grand City Properties S.A.



Credit Highlights

Overview

Key strengths	Key risks
Exposure to the regulated German residential segment, which has shown resilience, with minimal disruption from COVID-19-related headwinds.	Increasing exposure to the non-regulated London market (currently 17% of total gross asset value) where rent collection and occupancy rates have dropped more than in other European markets.
Large portfolio of average-quality residential assets mainly located in or close to metropolitan German cities and in London.	Social and political debates on rent affordability, which could lead to further regulation and tighter rent controls that could affect like-for-like rental growth.
Strong track record of positive like-for-like rental income growth, supported by a highly diversified asset and tenant base and long tenant stays.	A weaker occupancy rate than similarly rated peers of 93.8% as of Sept. 30, 2020, with average rent at €7.3 per square meter.
Moderate leverage and financial policy, with debt to debt plus equity expected to remain below 45%.	Relatively high ratio of debt to EBITDA of about 11x compared with peers operating in a higher yield environment, for example in the U.S. residential market.

Grand City Properties S.A.ś (GCP's) operating performance remains resilient to the impact of COVID-19. GCP's rent collection was close to 100% in the first nine months of 2020 with only about 1% of total rent subject to deferral. The company's high collection rate is similar to that of other rated residential players operating in regulated rental markets, and compares significantly better with rent collection in the commercial property segment, especially in retail or hotel assets. This shows the stability of residential portfolios and that's why we continue to consider this property segment, especially in regulated markets such as Germany, among the most resilient.

Increasing exposure to the non-regulated London market, could bring certain volatility to GCP operations. The pandemic's impact on the U.K. residential real estate market has been greater than on the residential property markets in other European countries, like Sweden, the Netherlands, or Germany (see "COVID-19 Is Only Part Of The Threat Facing U.K. Real Estate Companies," published Nov. 16, 2020, on RatingsDirect). S&P Global Ratings believes the London market is facing significant challenges at the moment and this could affect GCP's overall performance. We note that individuals have started to move toward the suburbs as a consequence of long-term remote working trends. At the same time, we observe an increase in supply coming from short-term lets (such as Airbnb), which are moving to long-term leases. Moreover, we remain cautious about how Brexit could affect the market. We note that GCP's London vacancy rate increased to 8.2% on Sept. 30, 2020, from 4% at year-end 2019, and is now significantly higher than GCP's overall average vacancy rate. That said, GCP's exposure to London remains low (17% of total gross asset value) and we don't expect it to increase materially.

In line with its moderate financial policy, we expect GCP's credit metrics will remain relatively stable in the coming years. We assume that capital expenditure (capex) and acquisitions will be funded through cash flow generation and a mix of funding, in line with GCP's financial policy. We forecast that the company's debt to debt plus equity will remain below 45% in the coming years, supported by sustained asset revaluations. The company's long average debt maturity profile of seven years, and low cost of debt (1.3% as of September 2020) with 95% being at fixed rates or hedged, will continue to support its healthy EBITDA interest coverage ratio at comfortably above 4x. We expect GCP's debt to EBITDA will be at 11x-12x.

Outlook: Stable

The stable GCP reflects our expectation that GCP's portfolio will continue to show resilience to COVID-19-related headwinds and attract steady tenant demand over the next 24 months. We expect the company will maintain a prudent approach to its overall investment activities and lease vacant spaces in its newly purchased assets.

Based on management's financial policy, we expect the company will use debt only moderately, such that debt to debt plus equity remains below 45%, debt to EBITDA at 11x-12x, and EBITDA interest coverage comfortably above 4x.

Downside scenario

We would downgrade the company if, on a prolonged basis:

- Debt to debt plus equity did not stay below 45%, for example as a result of easing the existing financial policy;
- Acquisitions of properties with renovation needs increased substantially, resulting in lower free operating cash flow (FOCF) and higher vacancies; or
- GCP experienced a significant decline in occupancy rates in its matured portfolio.

Upside scenario

We would upgrade the company if, on a prolonged basis:

- Debt to debt plus equity improved to about 35% as part of a more conservative financial policy; and
- Debt to EBITDA improved from current levels while EBITDA interest coverage stayed comfortably above 3.5x; or
- The portfolio showed strong growth, significantly exceeding €10 billion without raising existing leverage. We would expect the new assets to be of at least the same quality as the existing ones, and that such growth would dilute GCP's exposure to assets with renovation potential that generally exhibit higher vacancy rates, allowing the group's average vacancy rate to fall below 5%.

Our Base-Case Scenario

Assumptions

- Real GDP decline of 5.6% in Germany in 2020, followed by a rebound of 3.7% in 2021. We forecast the consumer price index in Germany at 0.3% and 1.4% in the same period.
- Like-for-like rental income growth of 1.5%-2.0% in 2020 and then around 2.0% in the coming years. Our forecast incorporates the effects of the recent rent cap in Berlin and flattish rental growth in its London portfolio.
- Stable occupancy levels of 93%-94% in the coming 12-24 months.
- Positive like-for-like increase in the overall portfolio's market valuation of 3%-4% in 2020 and 2.5%-3.0% per year in 2021-2022, on the back of rental growth and solid investor demand for German residential assets.
- Total capex of €100 million a year, mainly linked to repositioning activities and modernization projects in existing assets. Maintenance capex is expected to remain stable at €35 million-€40 million per year.
- Steady gross EBITDA margins of 52%-53% in the next few years, due to a stable cost base.
- Portfolio value to reach €8 billion by year-end 2020. We then expect annual net acquisitions of €150 million-€200 million.
- Stable dividend policy, with cash distributions to shareholders following a payout policy of 65% of reported funds from operations.
- Average cost of debt to remain stable at around 1.3%.

Key metrics

Grand City Properties S.A.--Key Metrics*

	--Fiscal year ended Dec. 31--				
	2018a	**2019a**	**2020e**	**2021f**	**2022f**
EBITDA	275.5	297.7	~300	300-315	315-330
EBITDA margin (%)**	50.6	53.1	52-53	52-53	52-53
Dividends	79.4	105.0	60-65	~150	~150
Debt	3,084.8	3,272.5	3400-3500	3500-3700	3600-4000
Debt to EBITDA (x)	11.2	11.0	11-12	11-12	11-12
EBITDA interest coverage (x)	4.5	4.8	~4.5	~4.5	~4.5
Debt to debt plus equity (%)	42.7	42.4	42-44	42-44	42-44

*All figures adjusted by S&P Global Ratings. **Margin is based on gross revenues. a--Actual. e--Estimate. f--Forecast.

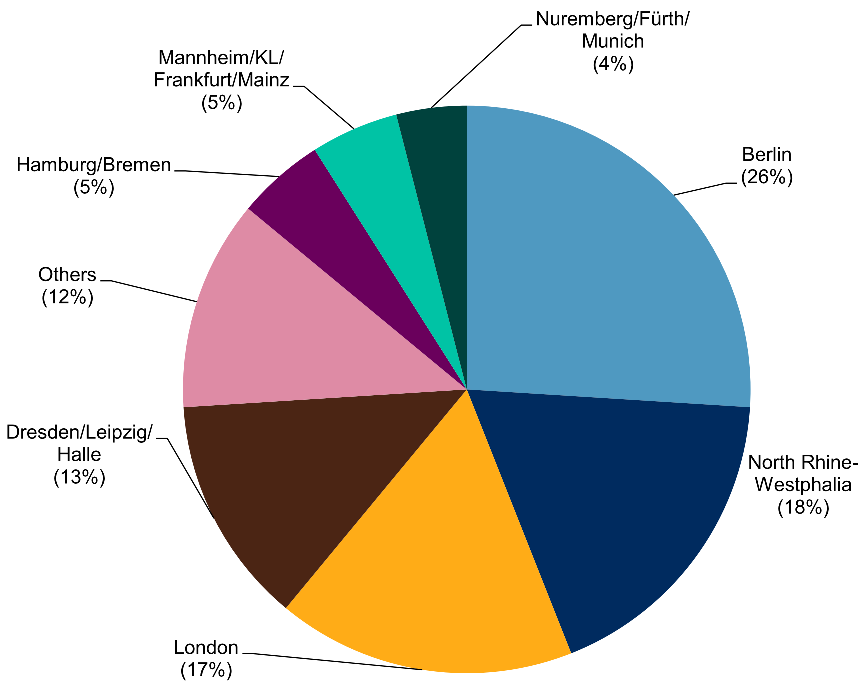
GCP decided to offer a scrip dividend this year, which was accepted by 57% of shareholders. This explains the lower amount of cash dividend distributed in 2020 compared with other years. We conservatively assume full cash dividend distributions in subsequent years.

Company Description

GCP is a Luxembourg-incorporated property investment company, focusing on owning and managing properties, mainly in the German residential real estate market. As of Sept. 30, 2020, its total portfolio value amounted to about €7.9 billion, consisting of 63,223 owned units located in densely populated areas, with a focus on Berlin (26%), North Rhine-Westphalia (18% of portfolio value), and the cities of Dresden, Leipzig, and Halle (together 13%). The company has expanded its footprint to London, which now represents 17% of its portfolio value.

Chart 1

Grand City Properties S.A.--Geographic Diversity
Distribution by value; as of September 2020



Source: Company report.

The company is listed on the MDAX on the Frankfurt stock exchange. The shareholder structure is composed by a free float of 60%. Aroundtown SA, through its subsidiary Edolaxia Group, owns the remaining 40% stake.

Peer Comparison

Table 1

Grand City Properties S.A.--Peer Comparison				
	Grand City Properties S.A.	**Deutsche Wohnen SE**	**Vesteda Residential Fund FGR**	**Adler Group S.A.**
Issuer credit rating as of Dec. 9, 2020	BBB+/Stable/A-2	A-/Negative/A-2	BBB+/Stable/A-2	BB/Stable/B
Business risk profile	Strong	Strong	Strong	Satisfactory
Financial risk profile	Intermediate	Intermediate	Intermediate	Significant
Portfolio value (bil €)*	7.859	24.9 residential/commercial buildings; 1.2 nursing and assisted living	8.1	7.9
Asset diversity*	100% Residential	Mostly residential (in addition 3,000 commercial units and 77 nursing properties)	100% Residential	100% Residential

Table 1

Grand City Properties S.A.--Peer Comparison (cont.)				
	Grand City Properties S.A.	**Deutsche Wohnen SE**	**Vesteda Residential Fund FGR**	**Adler Group S.A.**
Geographic diversity*	83% Germany, 17% U.K.	100% Germany	100% Netherlands	100% Germany
Exposure to Berlin by value (%)*	26	71.2	0	50.8
Occupancy (%)*	93.8	98.3	97.5 (H1 2020)	96.1
EBITDA interest coverage (x) (Sept. 30, 2019-Sept. 30, 2020)§	4.6	4.3	5.6	1.8
Debt/EBITDA (x) (Sept. 30, 2019-Sept. 30, 2020)§	11.8	16.5	8.7	52.3
Debt/debt and equity (%) (Sept. 30, 2019-Sept. 30, 2020)§	43.1	48.1	24.4	61.4

*Note: Data is based on latest available information. § For Vesteda Residential Fund FGR data refers to full-year 2019.

Business Risk: Strong

GCP's business risk profile is underpinned by its large income-producing asset portfolio of about €7.9 billion (plus €0.6 billion of held-for-sale properties) as of Sept. 30, 2020, generating stable and recurring cash flows across Germany. The company benefits from a broad geographic spread across densely populated regions, with good growth prospects in Germany. It focuses mainly on metropolitan areas with favorable macroeconomic fundamentals and solid demand for residential premises.

GCP is present in regions with healthy rental growth prospects, such as North Rhine-Westphalia--which includes cities such as Cologne, Duisburg, and Dortmund--as well as Berlin, and the cities of Dresden and Leipzig. Demand continues to outpace supply of new property developments in GCP's core regions, further facilitating improvements in occupancy rates (overall vacancy reduced slightly to 6.2% in September 2020, from 6.7% on Dec. 1, 2019).

The company has expanded its operations to London, which now represents 12% of the total annualized rent as of Sept. 30, 2020. Although the exposure is small compared with the overall portfolio size, we remain cautious on any potential rent and valuation impact from uncertainties linked to Brexit and COVID-19. London vacancies increased to 8.2% as of Sept. 30, 2020, from 4% at year-end 2019, surpassing the overall average vacancy rate in GCP's portfolio. We expect GCP will remain mainly a player in Germany, but note that the exposure to London could potentially increase to 20% of the portfolio in the near future.

We see the asset quality of most apartments in GCP's portfolio as in line with the German average, reflecting that the company still has some exposure to lower-quality premises, which points to GCP's previous acquisition strategy. Vacancy rates remain high compared with levels at other residential real estate companies we rate, such as Vonovia SE (BBB+/Stable/A-2) or Deutsche Wohnen SE (A-/Negative/A-2). We acknowledge that this is related to GCP's acquisitive profile and value-added strategy in the past, which saw it constantly add above-average-vacancy assets to its portfolio.

GCP has limited exposure to development activities. Investments relate mainly to the maintenance and renovation of acquired premises. GCP's property portfolio now consists of about 63,223 owned units and, like its residential property peers, has broad asset and tenant diversity. In addition, GCP's assets are rented at 10%-20% below the market average rates, providing them headroom in a market downturn scenario, where rents would start declining. We believe the residential asset class, especially in Germany, is more resilient than commercial properties, which are more cyclical and vulnerable to economic downturns.

Financial Risk: Intermediate

Our assessment of GCP's financial risk profile reflects the company's prudent financial policy of maintaining its debt-to-debt-plus-equity ratio at or below 45% on a sustainable basis.

GCP enjoys a solid capital structure with no significant debt maturities until 2024 (average debt maturity of seven years) and a low cost of debt on Sept. 30, 2020, of 1.3%. GCP's proportion of unencumbered assets is relatively high at about 79% (about €6.7 billion) of the total portfolio value. The company enjoys well-diversified funding sources, which include mortgage debt, convertible and straight bonds, perpetual notes, and straight common equity. GCP has also demonstrated a very good track record of accessing both equity and debt capital markets in the last few years.

Partly offsetting these strengths is the company's somewhat weaker cash flow generation, mainly due to the low yield profile of its assets compared with those of other residential peers operating in a higher yielding environment (such as the U.S.) or other commercial landlords.

Financial summary

Table 2

Grand City Properties S.A.--Financial Summary

Industry sector: Real estate investment trust or company					
	September 2020	**June 2020**	**March 2020**	**December 2019**	**September 2019**
(Mil. €)					
Revenue	133.5	132.4	135.3	141.8	140.3
EBITDA	76.0	73.1	74.0	77.7	73.7
Funds from operations (FFO)	52.0	60.4	39.5	70.7	37.7
Interest expense	18.2	17.4	15.1	15.2	15.3
Cash flow from operations	41.7	45.2	30.8	64.6	40.0
Capital expenditure	18.7	16.8	18.3	20.0	27.6
Cash and short-term investments	1,336.1	1,524.6	948.8	1,062.8	1,061.9
Debt	3,553.2	3,505.9	3,506.6	3,272.5	3,205.5
Equity	4,687.0	4,482.9	4,446.2	4,441.6	4,333.1
Valuation of investment property	7,842.4	7,961.1	7,827.7	7,956.0	7,583.3
Adjusted ratios					
EBITDA margin (%)*	55.4	54.3	53.7	53.1	52.2
EBITDA interest coverage (x)	4.6	4.7	4.9	4.8	4.7
Debt/EBITDA (x)	11.8	11.7	11.7	11.0	11.0

Table 2

Grand City Properties S.A.--Financial Summary (cont.)

Industry sector: Real estate investment trust or company

	September 2020	June 2020	March 2020	December 2019	September 2019
Debt/debt and equity (%)	43.1	43.9	44.1	42.4	42.5

*Margin is based on gross revenues, unlike other peers where top line is net.

Reconciliation

Table 3

Grand City Properties S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Rolling 12 months ended Sept. 30, 2020--									
Grand City Properties S.A. reported amounts										
	Debt	**Shareholders' equity**	**Revenue**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
Reported	4,303.3	4,688.9	543.0	333.6	674.2	49.4	300.8	231.8	71.0	73.8
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(25.6)	--	--	--
Cash interest paid	--	--	--	--	--	--	(33.1)	--	--	--
Cash interest paid: Other	--	--	--	--	--	--	(3.0)	--	--	--
Reported lease liabilities	61.0	--	--	--	--	--	--	--	--	--
Intermediate hybrids reported as equity	525.0	(525.0)	--	--	--	16.5	(16.5)	(16.5)	(16.5)	--
Accessible cash and liquid investments	(1,336.1)	--	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	2.0	--	--	--	--	--	--
Income (expense) of unconsolidated companies	--	--	--	(3.7)	--	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	(33.1)	--	--
Noncontrolling interest/minority interest	--	523.1	--	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	(31.1)	(31.1)	--	--	--	--	--

Table 3

Grand City Properties S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)

	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations	Dividends	Capital expenditure
Depreciation and amortization: Asset valuation gains/(losses)	--	--	--	--	(345.0)	--	--	--	--	--
Dividends: Other	--	--	--	--	--	--	--	--	16.5	--
Total adjustments	(750.1)	(1.9)	0.0	(32.8)	(376.2)	16.5	(78.2)	(49.6)	0.0	0.0
S&P Global Ratings' adjusted amounts										
Adjusted	3,553.2	4,687.0	543.0	300.8	298.1	65.9	222.5	182.2	71.0	73.8

Liquidity: Strong

We assess GCP's liquidity as strong because we forecast that the fund's liquidity sources will exceed its funding needs by at least 1.5x over the next 12 months, and by more than 1x over the subsequent 12 months.

The company benefits from the absence of large debt maturities in the short term. With the exception of its convertible bond (€277 million outstanding as of Sept. 30, 2020) maturing in 2021, there are no significant maturities until 2024. In addition, GCP enjoys very high cash balances.

Principal liquidity sources

- About €1343 million of unrestricted cash and liquid market investments.
- Our forecast of about €200 million in cash funds from operations for the next 12 months.
- Signed asset disposals for a value of about €500 million.
- A new hybrid instrument of about €700 million issued in December 2020.

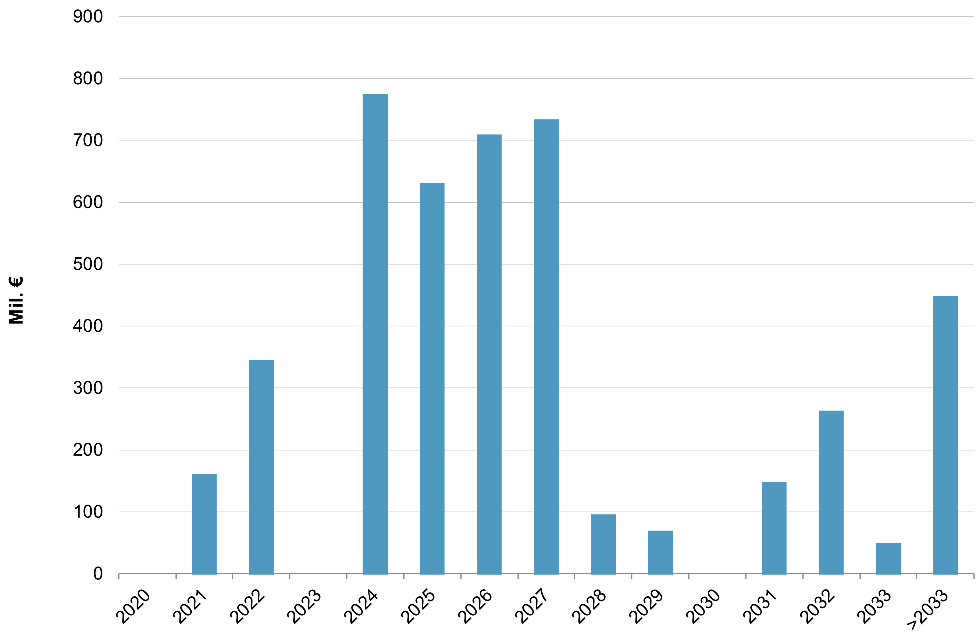
Principal liquidity uses

- About €175 million of short-term debt maturities, including regular debt amortization.
- Our forecast of €100 million of capex for property, plant, and equipment, and property investment, most of which is not committed.
- About €250 million in signed acquisitions.
- About €100 million of planned dividend distribution (including perpetual notes).
- About €500 million in connection with the tender offer on the existing hybrid instrument, with a first call date in February 2022.

Debt maturities

Chart 2

Debt Maturity Profile
As of Sept. 30, 2020



Source: Company report

Covenant Analysis

GCP has several covenants under its bond and bank loan documentation. The straight bonds and convertible bonds are unsecured and have the following covenants:

- Limitation of debt: Total debt/assets of less than or equal to 60%.
- Limitation on secured debt: Secured debt/total assets of less than or equal to 45%.
- Interest coverage ratio: Adjusted EBITDA/net cash interest of greater than or equal to 2.0x.
- Maintenance of unencumbered assets: Unencumbered assets/unsecured net debt of greater than or equal to 125%.

GCP was in compliance with all its covenants as of Sept. 30, 2019. We expect GCP will maintain significant headroom (more than 30%) under the financial maintenance covenants in its various debt agreements.

Issue Ratings--Subordination Risk Analysis

GCP's proportion of secured debt remains limited and its ratio of secured debt to total assets stood at 6% as of Sept. 30, 2020. Therefore, we continue to align the ratings on the senior unsecured debt with our 'BBB+' issuer credit rating.

We assign intermediate equity content to GCP's outstanding subordinated hybrid instruments. The issue rating of 'BBB-' is two notches below our issuer credit rating, one notch for subordination and one for deferability.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb+

Modifiers

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

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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
- 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

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 December 9, 2020)*

Grand City Properties S.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Subordinated	BBB-
Issuer Credit Ratings History	
21-Dec-2016	BBB+/Stable/A-2
23-Nov-2016	BBB+/Stable/--
13-Jun-2016	BBB/Positive/--

*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.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com