S&P Global Ratings

RatingsDirect®

Research Update:

Public Housing Provider Gewoba Aktiengesellschaft Wohnen und Bauen Ratings Affirmed At 'A/A-1'; Outlook Stable

July 27, 2023

Overview

- We expect German public housing provider Gewoba Aktiengesellschaft Wohnen und Bauen (Gewoba) will emphasize capital expenditure in its existing housing stock, which generates lower rent return than new construction.
- Ongoing annual investments of, on average, €170 million in new and existing assets will require the company to continue borrowing.
- That said, we expect management will maintain solid margins in its core letting business by effectively managing inflationary pressure on its cost base.
- We therefore affirmed our 'A/A-1' long- and short-term issuer credit ratings on Gewoba. The outlook remains stable.

PRIMARY CREDIT ANALYST

Sabine Daehn
Frankfurt
+ 49 693 399 9106
sabine.daehn
@spglobal.com

SECONDARY CONTACT

Michael Stroschein
Frankfurt
+ 49 693 399 9251
michael.stroschein
@spglobal.com

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Rating Action

On July 27, 2023, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on Gewoba. The outlook remains stable.

Outlook

The stable outlook on Gewoba balances inflation-related risks, which put pressure on operating margins, and investment plans, which will increase debt, with strong market demand and a stable liquidity profile.

Downside scenario

We could lower the ratings if the political objectives of Gewoba's government owner lead to a substantial increase in the company's debt burden, or if margins weaken due to other near-term challenges, for example failure to manage inflationary pressure on its cost base, and we thus observed a material deterioration of its financial metrics.

Upside scenario

We could raise the ratings if Gewoba maintains its debt to nonsales adjusted EBITDA sustainably below 10x, or if it improves its margins materially.

Rationale

In our view, the key challenge for Gewoba will be to protect its strong financial performance and balance sheet, while intensifying its energy efficiency efforts. The latter is in line with the intentions of its government owner and will be reflected under the company's ongoing strategic review.

We expect Gewoba's debt burden will increase from its current modest position, due to significant investments in its existing stock and new construction. Investments related to improving existing properties' energy efficiency have comparatively lower rental returns versus new constructions and therefore put pressure on margins. Potentially stricter carbon dioxide reduction targets that come into force earlier than expected could increase the company's debt beyond our current expectations.

Enterprise profile: Challenging strategic review requires Gewoba to strike a balance between housing demand and climate targets

Gewoba, which owns almost 43,000 units, is the German city of Bremen's leading public housing provider and benefits from strong demand. It also has sizeable activities in the nearby towns of Bremerhaven and Oldenburg. Our ratings on the company are underpinned by its almost exclusive focus on traditional residential letting activities. We assess the inherent industry risk of Gewoba's operations as low. The company pursues a narrowly defined mission--codified in the articles of association--to provide adequate housing to large parts of society. This explicitly includes socially disadvantaged groups. Gewoba's auxiliary activities comprise a small utility subsidiary that provides metering services and small volumes of, mostly self-produced, heat and electricity. It has minimal development for sales activities.

We consider the regulatory framework for German public housing operators, including Gewoba, broadly supportive. Although there is no national regulator, entities are usually subject to close and direct supervision by their local government owners. Rent adjustment mechanisms are codified in the German civil code. Absent a voluntary agreement on rent restraints, housing providers can adjust their pricing within the legally prescribed limits. Notably, energy efficiency measures can, in principle, be amortized through increases of the in-place rent. Available promotional bank lending at substantially subsidized interest rates augments market funding, particularly for borrowers that commit to building rent-restricted units reserved for low-income tenants.

We understand that Gewoba is undergoing a strategic review process involving its majority owner, the city-state of Bremen, that could have a major impact on the organization's strategic direction. We believe this could, among other things, result in stricter carbon dioxide reduction targets for the company that could come into force earlier than expected. In this context, required future spending may partially replace spending on new construction but, in our view, refurbished units will generate less additional rental income than new units. Still, we believe the management can maintain strong financial metrics and weather those near-term challenges. We consider their plans are realistic and executed with attention to detail. Risk management and financial policies are formalized. We note that Bremen's newly elected government has recently stated an appetite for purchases of existing housing assets from private sector owners to increase the number of affordable assets under government control. The "Grohner Düne" building complex with its more than 500 units could be a first case. According to a recent city press release and media reports, Bremen has mandated Gewoba to negotiate a potential acquisition--on behalf and for the account of the city--with the current owner.

Gewoba charged an average rent of €6.50 per square meter at year-end 2022, about 15% below our estimate for the weighted average in-place market rent in its area of operation. We consider the operating environment in the territorial exclave of Bremerhaven, where about 20% of the company's assets are located, more challenging, due to a weaker socioeconomic structure. However, Gewoba has managed to limit void rates in this part of its portfolio to just 1.3%. Helped by the influx of Ukrainian refugees who need housing, this closes the gap toward its overall portfolio target rate. Vacancies across its entire asset base amount to only 0.7%. This compares favorably with a reported market void rate of 2.0%-3.0% across the city-state of Bremen and is in line with German public housing provider peers. There is strong demand for Gewoba's properties. On average, the number of applicants exceeds the number of units that become available each year by five times. The turnover rate is up to 10%.

Financial profile: Margin compression follows after strong financial performance in 2022

Following a strong 2022 with adjusted EBIDTA margins at 38%, we expect inflationary cost pressure will weaken Gewoba's financial performance but believe the company can maintain adjusted EBITDA margins above 30%. Stricter energy efficiency rules, limits to the pass-through of carbon dioxide costs to tenants, elevated interest rates, and significantly higher prices for energy, construction, repairs, and maintenance represent clear challenges for the company. We understand that the management is proactively addressing these adverse developments, for example by bringing services back inhouse and replacing general contractors with more competitively sourced individual construction services. Furthermore, the company has reduced the budget for large-scale maintenance to reign in cost growth. It also has some scope to increase rents to legal limits, which could give additional headroom on the revenue side.

We expect Gewoba's debt will increase modestly from a low base but maintain very strong interest coverage, despite rising interest rates. Capital expenditure projects in our forecast mainly consist of new construction that has already started or is in the advanced planning stage, with no new projects about to be added in 2023 or 2024. Coupled with investments in existing stock, this implies more than €435 million of additional debt by 2025, taking into account expected delays. Rental revenue will also expand, with new constructions generating more rental revenue than refurbished units. We therefore predict a rise in debt to nonsales adjusted EBITDA to slightly above 10x by 2025.

Gewoba extended the range of funding instruments in recent years. It issued a registered bond ("Namensschuldverschreibung"), used its European Investment Bank loan facility, and is currently in advanced negotiations with another supranational multilateral lender. Gewoba regularly borrows from commercial and promotional banks. The latter are particularly attractive, not least because Gewoba pays 0% interest on €50 million of loans currently sourced from Bremer Aufbaubank, Bremen's promotional lender. This, in part, explains the company's very strong

EBITDA interest coverage. To reflect the recent rise in market rates, which will eventually creep into fully fixed-rate portfolios, we forecast nonsales EBITDA interest coverage will reduce to a still very strong 7x by 2025.

Gewoba maintains a strong liquidity position. The company has over €100 million of committed, but yet to be drawn, long-term loans that it agreed mainly with the German federal promotional lender KfW. Combined with roughly €110 million of revolving lines and a similar level of cash generated from continuing operations, this means the ratio of liquidity sources to uses is stable at 1.5x as of June 30, 2023. The main uses of liquidity over the coming 12 months are investments estimated at about €180 million and debt service of €65 million.

We evaluate Gewoba's access to external liquidity as satisfactory. This is based on the company's established presence in the private capital market and its reliable access to a diversified pool of commercial, promotional, and mortgage banks. Sufficient unencumbered assets facilitate borrowing from the latter.

Government-related entity analysis

We believe that there is a moderately high likelihood that Gewoba, as a government-related entity, would receive timely and sufficient extraordinary support from its 75% majority shareholder, the city-state of Bremen. However, the impact of such support is currently neutral on our ratings. We assess the link between Gewoba and Bremen as strong. This is demonstrated, for example, by the fact that the head of the state government's housing and urban development department is usually the chairman of Gewoba's supervisory board. Other government officials and state parliamentarians are ordinary members of the supervisory board. Considering that Gewoba effectively helps Bremen address its constitutional mandate to provide adequate housing and the high significance this has on the political agenda, we assess the company's role as important.

Selected Indicators

Table 1

Gewoba Aktiengesellschaft Wohnen und Bauen--Key statistics

	--Year ended Dec. 31--				
(Mil. €)	**2021a**	**2022a**	**2023bc**	**2024bc**	**2025bc**
Number of units owned or managed	42,784	43,088	43,353	43,520	43,922
Adjusted operating revenue	298.1	303.8	339.0	359.0	389.3
Adjusted EBITDA	109.2	116.7	115.7	119.7	124.5
Non-sales adjusted EBITDA	104.8	111.2	111.3	116.1	121.4
Capital expense	118.0	146.0	193.8	167.2	165.2
Debt	874.9	933.3	1,058.2	1,166.7	1,260.7
Interest expense	10.9	10.7	11.4	14.4	17.5
Adjusted EBITDA/adjusted operating revenue (%)	36.6	38.4	34.1	33.3	32.0
Debt/non-sales adjusted EBITDA (x)	8.4	8.4	9.5	10.1	10.4
Non-sales adjusted EBITDA/interest coverage(x)	9.6	10.4	9.7	8.0	7.0

a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Enterprise risk profile	3
Industry risk	2
Regulatory framework	3
Market dependencies	3
Management and governance	3
Financial risk profile	3
Financial performance	3
Debt profile	2
Liquidity	3

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers , June 1, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions , March 25, 2015
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating , Oct. 1, 2010

Related Research

- Economic Outlook Eurozone Q3 2023: Short-Term Pain, Medium-Term Gain, June 26, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2023, March 27, 2023
- Non-U.S. Social Housing Providers Ratings History: March 2023, March 27, 2023
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021

Ratings List

Ratings Affirmed	
Gewoba	
Issuer Credit Rating	A/Stable/A-1