S&P Global
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Research Update:

State of Hesse's Public Housing Provider Nassauische Heimstaette 'A+/A-1' Ratings Affirmed; Outlook Stable

September 23, 2024

Overview

- We forecast State of Hesse-based public housing provider Nassauische Heimstaette (NH) to achieve S&P Global Ratings-adjusted EBITDA margins just slightly below 30% over our 2024-2027 forecast horizon, reflecting its growing lettings portfolio and moderate rental increases, alongside more benign cost inflation than previously assumed.
- Although the scheduled delivery of development-for-sale units over the next few years should benefit EBITDA in absolute terms, we anticipate a dampening impact on margins and see a possibility that more units than already decided in 2023 could be retained for lettings rather than sold.
- NH's more than €200 million cut to capital expenditure in its updated 2024-2028 business plan should slow the construction-induced weakening of the company's debt metrics.
- We affirmed our 'A+/A-1' long- and short-term issuer credit ratings on NH. The outlook is stable.

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Rating Action

On Sept. 23, 2024, S&P Global Ratings affirmed its 'A+/A-1' long- and short-term issuer credit ratings on Nassauische Heimstaette Wohnungs- und Entwicklungsgesellschaft mbH (NH). The outlook is stable.

Outlook

The stable outlook reflects our view that NH will maintain a robust lettings business and carefully manage its capital expenditure (capex), thereby containing any weakening of the group's credit metrics.

Downside scenario

We could lower our ratings if higher-than-anticipated cost inflation, insufficient rent growth, or the ramp-up of NH's development program--jointly or individually--materially deteriorate NH's financial indicators. This could also point to weaker management.

In addition, we could downgrade the company if we consider that the likelihood of support from the State of Hesse has diminished.

Upside scenario

An upgrade would likely imply a more positive view on management, for example in response to a broad and sustained improvement in the provider's financial indicators.

An upgrade might also follow a similar action on the State of Hesse, NH's majority owner, or if we assess a higher likelihood of extraordinary support from Hesse if the company faced financial distress.

Rationale

The ratings on NH continue to reflect our positive view on the robustness of the public housing provider's underlying core business of letting affordable units and our assumption of a high likelihood that its 61%-owner, the German State of Hesse, would provide extraordinary support if needed. NH recently adjusted its capex further, in response to higher interest rates, signaling a more measured spending approach. That said, ongoing construction and refurbishments--and higher rates gradually feeding into NH's cost base--should moderately weaken the provider's debt metrics. Financial performance could be supported by NH's owners being more permissive with limits for rent growth at the company. Support could also stem fromcost inflation recently becoming lower and less volatile.

Enterprise profile: A robust business, focused on growth in the attractive Rhine-Main metropolitan area

NH benefits from generating most of its earnings in the predictable and non-cyclical business of letting affordable housing units, with a generally cautious approach to sales risk. Including consolidated group companies, NH owns and operates slightly above 60,000 units across entire Hesse, with an increasing focus on the prosperous Rhine-Main metropolitan area around Frankfurt. The relevance of the development-for-sale business for NH, while expected to rebound in 2024-2027--when numerous units in Frankfurt and neighboring state capital Wiesbaden are scheduled for delivery--is limited to 5% of adjusted operating revenue when averaged over 2022-2027. Even in 2025, an anticipated peak year, sales won't exceed 10% of S&P Global Ratings-adjusted revenue, according to our forecasts.

We assess as strong the regulatory framework under which German public housing providers like NH operate. Although there is no dedicated national regulator, we observe strong oversight by government owners. In our view, the existing rent setting rules, the pass-through of--recently volatile--utility cost to tenants, and access to government-subsidized loans through Germany's well-developed promotional banking system support providers' financial viability (see "Regulatory Framework Assessment: German Public Housing Providers Face Increasing Political Demands But

Benefit From Strong Institutions", published Oct. 3, 2023, on RatingsDirect).

Market dependencies remain balanced for NH. Particularly in the wider Rhine-Main area--where NH now directs almost all its capex--NH benefits from the region's tight housing market and offers its units at a material discount to market rent. For example, we calculate that the average in-place rent of the units owned by NH within the city of Frankfurt has dipped below 70% of the city's official rent index. For NH's wider portfolio, stretching across Hesse, we use data from Germany's recently published 2022 census and calculate an average rent-to-market-rent ratio of about 82%. Furthermore, we consider that the company's vacancy rate is well aligned with the market. Our view is based on a calculated total rent loss rate of 3.5% for NH and its, more narrowly defined, stated vacancy rate of 2.8%, which compare with an average vacancy rate of 3.6% across Hesse, according to the latest census.

Positively, in our opinion, NH's experienced management continues to align the company's strategy with prevailing market conditions, thereby prioritizing financial stability. We understand, for example, that NH has set a limit on gearing and adjusts construction plans accordingly. Amid rising interest rates, for example, management reduced its capex budgeted for 2024-2028 by more than €200 million compared with the previous business plan. Furthermore, we would describe the company's revised strategy on decarbonization as one of sober realism. Given finite financial resources, NH has moved away from full-scale, gold standard modernization of the entire portfolio, now prioritizing smaller projects that yield the highest CO2 reduction per money spent. We generally perceive NH's management team as highly experienced, note the executive's long tenure, and think that it will keep NH conservatively run.

Financial profile: NH's solid profitability should somewhat offset further rising debt levels

Over our 2024-2027 forecast horizon, we expect NH to post fairly stable S&P Global Ratings-adjusted EBITDA margins just slightly below 30%. NH achieved a stronger-than-expected adjusted EBITDA in 2023, when the company avoided almost €12 million of costs previously anticipated for mandatory checks of the energy efficiency of its units' heating systems and deferred some other maintenance cost. Although we don't anticipate this will happen again, future results should see some benefit of the recently more moderate rate of cost inflation. Furthermore, we think that ongoing negotiations between NH and Hesse could result in a less restrictive ceiling for rent increases than during 2019-2023, possibly even providing for upside to our current forecast. The planned delivery of originally 585 development-for-sale units in Frankfurt and Wiesbaden over 2024-2028 will augment EBITDA in absolute terms, even as we make conservative assumptions on cost and sales prices. However, due to relatively lower profitability, we assume these sales will likely weigh on the company's overall EBITDA margins. It should therefore not be detrimental if, as we consider possible, NH increases the number of units it retains for lettings rather than sells. NH redesignated 45 units in this way in 2023, on account of sluggish demand.

Despite the recent cutbacks to planned capex, the consolidated indebtedness of NH will rise and its interest coverage will decline in 2024-2027, although now slightly slower than we previously assumed. We calculate that NH remains on track to add more than 1,800 new units to its portfolio during this time. Incorporating above €80 million of planned spending on energy-efficient modernization per year, our estimate for annual borrowing needs at NH now nears €230 million on average for 2024-2027. This should push NH's debt-to-non-sales-adjusted-EBITDA ratio past 15x by 2026. Although we expect the non-sales adjusted EBITDA/interest coverage to also weaken, we predict the ratio to stay above 3.0x until the end of 2027. The latter ratio remains supported by NH's access to substantially subsidized funding from Hesse's promotional lending arm WI Bank, currently--and in our view, also in the future--representing about one-third of total borrowing. The remaining, essentially all fixed rate debt has been sourced via traditional mortgage loans next to funds raised in the form of senior unsecured Schuldschein loan certificates placed in the German private capital market.

Based on our calculation that NH's liquidity sources will cover its liquidity uses by 1.6x over the next 12 months, we assess the company's liquidity position as strong. Our calculation factors in sources of €626 million, consisting of cash generated from operations, bank deposits and other liquid financial instruments held, undrawn and available revolving credit facilities, and agreed long-term loans not yet disbursed. Estimated uses of €386 million mainly comprise anticipated capex and debt service. Reflecting its established presence in the Schuldschein market, relationships with several mortgage loan lenders from the banking and insurance sector, and the ability to source funding from WI Bank, we evaluate NH's access to external liquidity as satisfactory. Notably, NH has concluded framework agreements with various key partners on funding that partially still fall outside our 12-month horizon but should nevertheless also provide liquidity in future years.

Government-related entity analysis

Our ratings incorporate a two-notch uplift to our 'a-' stand-alone credit profile (SACP) on NH, which we consider a government-related entity. We believe there is a high likelihood that the company would receive timely and sufficient extraordinary support from its 61% owner, the State of Hesse (AA+/Stable/A-1+), in case of financial stress, even if the 26 other share-owning Hessian municipalities and other holding vehicles remain passive. We assess the link between NH and Hesse as very strong. This reflects a track record of two capital injections of €200 million each, exclusively provided by the state in the last eight years. It further incorporates Hesse's minister of economic affairs chairing a supervisory board where state appointees dominate, and a very close monitoring of NH through a dedicated division in Hesse's finance ministry. We consider the role of NH important, given the weight that housing availability and affordability has on the regional political agenda, and that NH is Hesse's only tool to directly intervene in the housing market.

Selected Indicators

Table 1

Nassauische Heimstaette--Key Statistics

Mil. €	2022a	2023a	2024bc	2025bc	2026bc	2027bc
Number of units owned or managed*	60,252	60,883	61,645	62,016	62,389	62,876
Adjusted operating revenue	426	439	495	542	536	540
Adjusted EBITDA	123	143	145	156	155	154
Non-sales adjusted EBITDA	123	143	137	142	147	148
Capital expense	222	313	292	285	308	313
Debt	1,698	1,892	2,009	2,110	2,300	2,491
Interest expense	25	31	33	35	40	47
Adjusted EBITDA/Adjusted operating revenue (%)	28.9	32.5	29.4	28.8	28.9	28.5
Debt/Non-sales adjusted EBITDA (x)	13.8	13.3	14.7	14.9	15.7	16.8

Table 1

Nassauische Heimstaette--Key Statistics (cont.)

Mil. €	2022a	2023a	2024bc	2025bc	2026bc	2027bc
Non-sales adjusted EBITDA/interest coverage(x)	5.0	4.6	4.2	4.0	3.7	3.2

*Residential, commercial, and other units, regardless of size differences, at end of period. Parking spaces/garages not included. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. Figures are based on German GAAP data.

Ratings Score Snapshot

Table 2

Nassauische Heimstaette--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	4
Debt profile	3
Liquidity	3
Stand-alone credit profile	a-
Issuer credit rating	A+

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

Related Research

- No Material Change To Hesse's Net Financial Position From Plans To Replace In-Kind Contribution At Helaba With Cash, April 30, 2024
- European Housing Markets: Better Days Ahead, July 17, 2024
- Economic Outlook Eurozone Q3 2024: Growth Returns, Rates Fall, June 24, 2024
- Non-U.S. Social Housing Providers Ratings Score Snapshot: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings Risk Indicators: March 2024, March 11, 2024
- Non-U.S. Social Housing Providers Ratings History: March 2024, March 11, 2024
- Full Analysis: State of Hesse, Oct. 16, 2023
- Regulatory Framework Assessment: German Public Housing Providers Face Increasing Political Demands But Benefit From Strong Institutions, Oct. 03, 2023

Ratings List

Ratings Affirmed	
Nassauische Heimstaette	
Issuer Credit Rating	A+/Stable/A-1