S&P Global
Ratings

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Research Update:

State Of Hesse's Housing Provider Nassauische Heimstaette Rated 'A+/A-1'; Outlook Stable

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Overview

- Nassauische Heimstätte (NH) benefits from the strong support of its 61% owner, the German state of Hesse, and the stability of its underlying business of letting affordable housing units.
- That said, higher operating cost and limited rent growth will still pressure its financial performance.
- Ongoing construction of new units and energy-efficient modernization will increase the company's debt burden, and we expect its currently very strong interest coverage will eventually soften on the back of subdued S&P Global Ratings-adjusted non-sales EBITDA growth and higher interest rates.
- We assigned our 'A+/A-1' long- and short-term issuer credit ratings to NH. The outlook is stable.

Rating Action

On March 24, 2023, S&P Global Ratings assigned its 'A+/A-1' long- and short-term issuer credit ratings to Nassauische Heimstätte Wohnungs- und Entwicklungsgesellschaft mbH (NH). The outlook is stable.

Outlook

The stable outlook reflects our view that NH will be able to mitigate the impact of sector headwinds such that the weakening of the group's credit metrics will be contained.

Downside scenario

We could lower our ratings if operating cost or capital expenditure increase materially above our base-case expectations. This could materialize, for example, from higher-than-anticipated inflation or a ramp-up of NH's development program. This could lead to materially weaker liquidity or debt metrics, and might also reflect weaker management.

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

Upside scenario

An upgrade would depend on NH's financial indicators strengthening significantly, which could additionally result in a more positive view on management.

An upgrade could also follow a similar action on the majority owner of NH, Hesse, or if we assess a higher likelihood of extraordinary support from the state in case of financial distress.

Rationale

The ratings on public housing provider NH reflect our view on the robustness of its underlying business of letting affordable units, and our view that there is a high likelihood that NH, in case of financial distress, would receive extra-ordinary support from its 61% owner, the German state of Hesse. However, we note a currently challenging operating environment for NH, due to increasing operating cost and limits on rent growth weighing on its adjusted EBITDA margins. Lower EBITDA growth compared with historical numbers, in combination with rising debt--caused by material borrowing needs for ongoing construction and refurbishments, and significantly higher interest rates--will pressue NH's debt metrics compared with the stronger financial indicators of previous years.

Including consolidated group companies, NH owns and operates about 60,000 housing units across Hesse, with an increasing focus on the prosperous Rhine-Main metropolitan area around Frankfurt. In our view, the group benefits from generating most of its earnings in the predictable and non-cyclical affordable housing sector, supported by a solid market position together with a generally cautious approach to sales risk. We estimate that the relevance of the development-for-sale business of NH, while a boost to performance until 2021 and presumably again in 2025/2026--when numerous units in Frankfurt's new Schönhof quarter are scheduled for delivery--is limited to 5% of adjusted operating revenue when averaged over the 2021-2025 period.

Market dependencies are balanced for NH. In the wider Rhine-Main area, where the bulk of its capital expenditure now takes place, it benefits from the region's very tight housing market and, according to our estimates, offers its units at a discount to market rent. For example, we calculate that the average in-place rent of the units owned by NH in the city of Frankfurt itself amounts to below 76% of the city's official rent index. For the wider NH portfolio, we estimate an average rent-to-market-rent ratio of about 85%, albeit based on very limited market reference data only. Given NH's operations across the entire state of Hesse, which comprises also areas with less strong dynamics, we consider its stated overall portfolio vacancy rate of 2.7% per end of 2022 as aligned with that of peers in its area of operations.

We understand that NH's experienced management has, in the face of higher construction costs and interest rates, scaled back new developments of affordable rental homes and understand that NH applies a limit on gearing, thereby containing the increase in debt. In our view, NH's leadership has opted to reduce risks and preserve the financial stability of the company rather than accomodate non-commercial housing policy goals. We generally perceive NH's management team as highly experienced, note a long tenor of the company's executives, and believe that it will keep NH conservatively managed.

We project NH's group financial performance, as measured by its adjusted EBITDA margin, will soften to below 30% over our forecast period, compared with 30% in 2022. Our expectation reflects an increase of cost in categories that the company cannot apportion to tenants, particularly maintenance, compliance with regulation, and personnel expenditure. Furthermore, we anticipate only subdued rent growth relative to rising expenditure, which assumes NH's current rent restriction agreement with Hesse being extended from this year. It is our view that an expected strong peak in unit deliveries in 2025 from the Schönhof quarter project, comprising more than 400 units centrally located in Frankfurt, will support EBITDA generation. The margin effect will, however, depend on realized costs and sales prices.

NH's consolidated indebtedness will increase and its interest coverage will likely decline over our 2023-2025 forecast period, despite the recent scaleback in construction plans. Still, ongoing projects should add close to 2,000 letting units to NH's portfolio over the next three years. Together with about €80 million of planned spending on energy-efficient modernization per year, we calculate annual borrowing needs of above €300 million for each of these years at NH. With subdued EBITDA growth and higher interest rates, NH's ratio of debt to non-sales adjusted EBITDA will therefore quickly exceed 15x, up from 13x in 2022, and its non-sales adjusted interest coverage ratio will fall gradually toward 2.5x, down from 5.2x in 2022, in our view.

We consider the regulatory framework for NH broadly supportive. While there is no national regulator for German public housing operators, they are usually subject to close supervision by their government owners. This is particularly the case for NH, given that Hesse's state administration maintains dedicated experts for its monitoring. NH operates under an explicit agreement with its key owner that, through various components, limits rent growth to substantially below what the otherwise applicable rent-adjustment rules of the German civil code would permit. While partially expiring in 2023, we expect this agreement will be extended on largely unchanged terms, to the detriment of NH's revenue growth. We further note a recent revision of the rules on federally subsidized loans for housing construction under which energy-efficiency requirements have been tightened and obtainable amounts reduced.

Our rating incorporates 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 related holding vehicles remain passive. We assess the link between NH and Hesse as very strong. This reflects a track record of two €200 million in capital injections exclusively provided by the state in the last seven years, 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. Furthermore, 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 market.

Liquidity

Based on a calculated coverage of liquidity uses by liquidity sources of almost 1.4x over the next 12 months, we assess the liquidity position of NH as strong.

Our liquidity sources calculation as of beginning of March 2023 included:

- Forecast cash generated from continuing operations of €126 million over the next 12 months;
- Existing cash and liquid assets of €158 million;
- Available and unused revolving credit lines with commercial banks of €140 million; and

- Not yet disbursed funds under individual and umbrella long-term loan agreements for construction of €209 million.

Our calculation of liquidity uses comprises:

- Assumed €343 million of capital expenditure on construction, acquisition, and retrofitting of housing assets;
- €98 million of expected interest and principal repayments over the next 12 months; and
- Working capital needs of €24 million.

We evaluate the access of NH to external liquidity as satisfactory. This reflects its established presence in the German market for "Schuldschein" promissory notes--where it has placed in excess of €500 million--relationships with a number of mortgage loan lenders from the banking and insurance sector, and access to funding from WI Bank, Hesse's promotional bank, which is already NH's largest funding provider.

Key Statistics

Table 1

Nassauische Heimstätte -- Key Statistics

	--Year ended December 31st--					
Mil. €	**2020a**	**2021a**	**2022e**	**2023bc**	**2024bc**	**2025bc**
Number of units owned*	59,049	59,649	60,262	60,960	61,671	62,359
Adjusted operating revenue	430	432	424	445	504	675
Adjusted EBITDA	143	138	127	125	130	169
Non-sales adjusted EBITDA	128	130	127	125	130	136
Capital expense	239	275	239	344	340	329
Debt	1,431	1,550	1,695	1,948	2,186	2,414
Interest expense	27	25	25	30	41	52
Adjusted EBITDA/Adjusted operating revenue (%)	33.2	32.1	30.1	28.1	25.7	25.0
Debt/Non-sales adjusted EBITDA (x)	11.2	12.0	13.3	15.6	16.9	17.7
Non-sales adjusted EBITDA/interest coverage(x)	4.7	5.2	5.2	4.2	3.2	2.6

*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 for better comparability with national peers.

Ratings Score Snapshot

Table 2

Nassauische Heimstätte -- Ratings Score Snapshot

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Financial risk profile	3
Financial performance	4
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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

- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Economic Outlook Eurozone Q1 2023: Reality Check, Nov. 28, 2022
- German State of Hesse Affirmed At 'AA+/A-1+'; Outlook Stable, Oct. 21, 2022
- Non-U.S. Social Housing Providers Ratings Risk Indicators: July 2022, July 27, 2022
- Non-U.S. Social Housing Providers Ratings Score Snapshot: July 2022, July 27, 2022
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers

Published, June 8, 2021

Ratings List

New Rating	
Nassauische Heimstaette	
Issuer Credit Rating	A+/Stable/A-1