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S&P Global Ratings

Brack Capital Properties N.V.

September 12, 2023

Ratings update

Removing the Company from having a negative CreditWatch designation and affirming issuer's rating of 'ilBBB-'; negative rating forecast

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Overview of ratings action

- In the last year Brack Capital Properties N.V. (hereinafter: the "Company" or "Brack Capital") completed three refinancings of material bank loans. Additionally, in August the Company completed an exchange tender offer for bonds series 'b' and extended the repayment date for half of the shareholder loans and repaid half. We believe that these measures have improved the Company's liquidity and we now assess it as "less than desirable".
- Over the last two and a half years there has been an ongoing decline with the adjusted interest coverage ratio and in H1 2023 it was approximately 0.8x. Furthermore, in 2022 and H1 2023 the Company presented a negative cashflow from its operating activities (including interest paid). Therefore, and in light of our assessment that the interest coverage ratio will continue to be less than 1.0x over 2023-2024, and we only anticipate that the cashflow will only be positive in 2024, we believe there has been a decline in the financial risk profile.
- Considering the Company's leverage of approximately 40.3% at the end of H1 2023, the types of properties owned by it and the existing debt mix, we assess the debt recovery grade remaining at '1', reflecting our assessment that the debt recovery rate is anticipated to be greater than 90%.
- On September 12, 2023, we removed Brack Capital Properties N.V. from having a negative CreditWatch outlook, we affirmed the issuer's rating of 'ilBBB-'; and the ratings of its series of bonds (series 'b' and 'c') at 'ilBBB+'.
- The negative ratings outlook reflects the risk that the Company's ratings are liable to be adversely impacted by the Adler Group's credit quality also due to the Group's negative ratings outlook. Moreover, the negative ratings outlook reflects the risk that there will be a decline in the Company's liquidity profile due to significant maturities over 2024-2025 and the dependence on property sales or refinancings under challenging market conditions.

Main considerations with the ratings action

Removing the Company from having a negative CreditWatch designation is primarily due to our assessment of a certain decline in the liquidity risk in the 12 months from July 1, 2023. From December 2022 the Company completed three refinancings of material bank loans secured by property for a period of two-three years totaling approximately EUR 158 million, excluding an amount totaling approximately EUR 23 million paid from the Company's independent sources. Additionally, in August 2023 the Company completed an exchange tender offer for bonds series 'b', as part of which the Company repaid approximately ILS 390 million par value of the total bonds (series 'b') constituting approximately 92% of the total series in consideration for approximately ILS 226 million in cash and approximately ILS 214 million par value from an expansion of series 'c'. Similarly, according to the agreements with the parent company Adler Real Estate AG (CCC+/Negative), the Company repaid EUR 75 million, constituting half of the credit line drawn by the Company from Adler, while the balance, totaling EUR 75 million, was extended until the end of 2024. We assess that these measures resulted in an improvement in the average lifespan of the Company's debt and reflect an improvement in the Company's access to sources of financing. We believe that the Company has to a certain extent succeeded in reducing its liquidity risks, also due to completing the sale of properties as part of the property sale strategy announced by the Company in September 2022. Among other things, at the beginning of 2023 the Company completed the sale of residential properties in the city of Leipzig constituting approximately 13% of the Company's total property portfolio for which the Company received a net cashflow totaling approximately EUR 126 million. However, we believe that the Company's liquidity profile depends on its ability to continue to sell properties, to refinance loans through the German banking system and its access to the capital markets.

Decline in NOI and the value of the property portfolio. In the last year there has been a decline in the portfolio value of the income-generating properties and it totaled approximately EUR 1 billion as of June 30, 2023 compared with approximately EUR 1.36 billion as of June 30, 2022. The decline is primarily due to the sale of properties and due to an increase in discount rates; among other things, the Company recorded a decline in property value of approximately EUR 159 million in 2022 and of approximately EUR 58 million in H1 2023. The NOI in Q2 2023 declined to approximately EUR 10.4 million compared with approximately EUR 12.4 million in the same quarter YoY due to the sale of properties in Leipzig and the sale of commercial properties in 2022. The average occupancy level remains high and stable and totaled approximately 96% at the end of Q1 2023. We believe that the scale of operations and the operating results are consistent with the current commercial risk profile, however, a continued decline in the value of the property portfolio and NOI may negatively impact the ratings, including on the backdrop of the current interest environment.

We assess that the continued decline in the coverage ratio of adjusted EBITDA to financing expenses and a negative cashflow from operating activities attest to weaknesses with the financial risk profile. In H1 2023 there was a further decline in the interest coverage ratio to approximately 0.8x, compared with approximately 1.7x in 2022 and approximately 3.0x in 2021. Furthermore, in 2022 and H1 2023 the Company presented a negative cashflow from operating activities. The decline in the coverage ratio and cashflow from operating activities primarily resulted from the increase in the interest environment, including the impact of the decline in the quality of the Company's credit due to increased inflation in Israel (due to the fact that the Company's bonds are index linked), and due to the material scope of non-income generating land and cash balances financed by debt. Considering the macro forecasts of S&P Global Ratings, including the growth forecasts for the German economy and the inflation expectations in Israel, we assess that over 2023-2024 the coverage ratio will remain weak at less than 1.0x, and the cashflow is only anticipated to be positive in 2024. Our base scenario includes the continued sale of properties which will result in a decline in the base EBITDA, while the sale of the non-income generating land and reduction of the associated debt will occur over time, whereby the decline in financing expenses will be more gradual. We assess that the continued decline in the coverage ratio of EBITDA to financing expenses together with a continued negative cashflow from operating activities reflect a weaker financial risk profile.

Moderate increase in (but still relatively low) leverage. The ratio of the leverage of the adjusted debt to debt and equity increased to approximately 40.3% at the end of H1 2023, compared with approximately 37.6% at the end of 2022. The increase primarily resulted from the decline in the equity base of approximately EUR 734 million at the end of 2022 to approximately EUR 637 million at the end of H1 2023 – this despite the decline in the adjusted financial debt from approximately EUR 442 million at the end of 2022 to approximately EUR 430 million. The decline in equity is primarily due to negative revaluations of the properties and a reduction in the value of inventory, while the moderate decline in the debt is primarily due to completing the sale of properties. In the future the leverage ratio may be materially impacted by the scale of revaluations and sale of properties, sale prices relative to book value, timing of completion of the transactions and the designated use of proceeds from the sales.

We believe that the strategy and management of the Company rely, among other things, on the strategy of the Group. The Group's corporate governance framework is insufficiently clear and transparent, with frequent changes in strategy and structure of holdings which have limited its ability to meet the operating and financial targets. Furthermore, in recent years Brack Capital and the companies in the Group have experienced a high turnover of senior management and board members. Additionally, in June 2023, at the directive of the German investigation authorities, there was a raid at the Company's office related to commercial transactions associated with the "Gersheim" property executed by the controlling shareholder over 2019-2020. The fact that the current as well as the preceding CEOs also serve/served as co-CEO of the Adler Group supports our assessment. However, it should be emphasized that the Company's financial statements do not include any qualifications by its auditor KPMG Israel (Somekh Chaikin) and the Company's internal auditor is a partner at the auditing firm of Deloitte Israel. Furthermore, we should note that the current board composition has four out of seven of its members being independent and external directors. These are some of the reasons that we assess that there is justification to make a certain distinction between the Company's ratings and those of the Adler Group.

Ratings Outlook

The negative ratings outlook reflects the risk that the Company's ratings may be adversely impacted by the credit quality of the Adler Group, including on the backdrop of the Group's negative rating. The negative ratings reflect the risk that there will be a decline in the Company's liquidity profile due to a significant maturity over 2024-2025 and the reliance on the sale of properties or refinancings under challenging market conditions.

The negative scenario

We may take a negative rating action if we assess that the credit quality of the Adler Group is having a negative impact on the credit quality of the Company, which, among other things, impacts the Company's access to sources of financing and an increase in the liquidity risks. A negative rating action may ensue following weak cashflow from operating activities, an increase in leverage beyond our base scenario or a decline in the ratio of EBITDA to financing expenses, thereby reflecting a debt and equity structure which is unsustainable in the long-run.

The positive scenario

We will consider changing the ratings outlook to stable if we assess that there has been an ongoing improvement in the credit quality of the Adler Group or if we assess that the negative impact of the Group on the Company has significantly declined. A positive rating action is dependent upon maintaining stable operating results and having a stable liquidity profile.

Description of the Company

Brack Capital Properties N.V. is an income-generating real estate company operating in Germany. On June 30, 2023, the value of the Company's income-generating property portfolio was approximately EUR 1 billion, and it included approximately 9,600 residential units, and income-generating commercial properties with approximately 16,000 sqm of total areas for rent. The Company is also engaged in developing residential projects and land betterment in the cities of Dusseldorf and Aachen; however, the Company does not currently have projects underway or being marketed.

The Company is approximately 63% owned by Adler Real Estate AG, approximately 35.7% owned by LEG Immobilien SE, with the rest publicly owned.

Base scenario

Our base scenario is based on the following key assumptions:

- S&P Global Ratings forecasts that in 2023 Germany will have a 0.1% decline in GDP, inflation of approximately 6.5% and an unemployment rate of approximately 3.1%. In 2024 the GDP is forecasted to grow by approximately 0.8%, inflation is expected to moderate to approximately 2.9% and unemployment is forecasted at approximately 3.2%.
- S&P Global Ratings forecasts that in 2023 Israel will have inflation of approximately 3.8% and approximately 2.5% in 2024 (the Company's bonds series are traded in Israel and are index-linked).
- Stable rental income and occupancy levels, primarily based on the Company's presence in cities with good demographic data and stable demand for rental homes.
- Annual NOI from the income-generating property segment of approximately EUR 35-40 million in 2023-2024, considering the current occupancy rate, moderate growth in existing residential properties and no profit from the residential development segment.
- Sale of properties according to the Company's strategy.
- Single digit declines in property revaluations over 2023-2024, considering the pressures on the discount rates due to the relatively high interest environment and sale of properties in a challenging market.
- Payment of approximately EUR 16 million in tax due to a sale of Company shares by LEG, pursuant to German tax laws.
- No dividend payments.

Our base scenario, the coverage and leverage ratios are forecasted to be:

- Ratio of adjusted EBITDA to financing expenses of approximately 0.8x-1.0x in 2023-2024.
- Ratio of adjusted debt to debt and equity of approximately 35%-40% over 2023-2024.

Liquidity

We assess that in the 12 months from June 30, 2023, the ratio of the Company's sources to its utilizations will be greater than 1.2x. Despite our assessment that there has been an improvement in the Company's liquidity, we believe that it is still less than desirable because we do not have sufficient information about the Company maintaining a policy of having suitable long-term liquidity. At this stage we assess that the Company's liquidity is dependent upon its ability to sell properties and suitable and long-term access to sources of financing, including the German banking system and Israeli capital market.

In our base scenario we assume that the Company will have the following sources of financing available to it in the 12 months from July 1, 2023:

- Cash and cash equivalents totaling approximately EUR 211 million.

Our assumptions regarding the Company's utilizations in the same period:

- Short-term credit, payment of long-term debt maturities including payment of the cash component of the exchange tender offer of bonds series 'b' and repayment of half of the shareholder loan totaling approximately EUR 145 million.
- Negative cash FFO (funds from operation) of approximately EUR 3-5 million (our estimate).

- Ongoing capital expenditure in existing properties (capex) totaling approximately EUR 10 million.

Covenant analysis

The Company has several financial covenant obligations to banks and bondholders. We understand that the Company has a suitable safety margin for the financial covenants as of June 30, 2023.

Impact of the Group

We believe that the Company's credit quality is adversely impacted by the credit quality of the parent company, Adler Real Estate AG (CCC+/Negative), which owns approximately 63% of the Company's shares, and the credit quality of the controlling shareholder, Adler Group SA (CCC+/Negative), which owns approximately 97% of the parent company (jointly: the "Adler Group" or the "Group).

On April 27, 2023, S&P Global Ratings raised the ratings of these two companies due to the completion of a debt arrangement as part of which the controlling shareholder raised secured debt totaling approximately EUR 937.5 million which will primarily be used for bond repayments on the level of Adler Real Estate over 2023-2024. Despite the immediate improvement in the Group's liquidity, we believe that the Adler Group is still dependent upon selling properties in order to maintain a sufficient liquidity margin and its new capital structure, and it will continue to be exposed to risks of litigation over the next 24 months. We assess that the sale of properties in the current macro-economic environment may protract beyond the anticipated timeline which is liable to increase the liquidity risks over the next 18-24 months.

The negative outlook of the parent company and the controlling shareholder reflect the risk that the Adler Group will fail to sell properties as planned due to the current market situation and the liquidity margin will decline. Furthermore, a negative rating action may result from potential findings in the audited financial statements which we assess will be material on the Group's credit quality or the actualization of legal risks.

We assess that the Adler Group's credit quality will adversely impact the Company's ratings, however, at this stage we assess that there is justification to make a particular distinction between the Company's ratings and those of the Adler Group. This assessment primarily reflects the fact that Brack Capital operates as a separate and independent entity, and we do not foresee exceptional negative interference by the Group in the short-medium term. This assessment [is supported] by the current composition of the board of directors comprising four out of seven members being independent and external directors. We further consider the Company's current ownership structure, which includes material minority holdings by LEG (35.7%) which has in total invested approximately EUR 320 million in the Company's shares. We assess that the existence of material minority shareholders with a financial interest can significantly restrict the Group's ability to impact the Company unfavorably for all its shareholders.

We should note that, to our understanding, Israeli regulation imposes strict corporate governance rules and approval processes, primarily regarding interested party transactions. In our opinion, several provisions in the Israel Companies Law support suitable corporate governance rules for corporate groups and strengthen the minority's ability to prevent interested party transactions not in the Company's best interests. We therefore assess that the law limits the ability of controlling shareholders to interfere in public subsidiaries (or bond issuers) in a manner liable to adversely harm the Company's best interests.

Ratings Adjustments

Commercial diversification: Neutral.

Capital structure: Neutral.

Liquidity: Neutral.

Financial policy: Neutral.

Management, strategy and corporate governance: Weak.

Place in comparison group: Neutral.

Debt Recovery Analysis

Primary considerations

- We are removing the ratings of the series of bonds of Brack Capital Properties from being designated a negative CreditWatch outlook, and we are affirming the rating of 'ilBBB+', two notches (levels of ratings) above the issuer's rating. The debt recovery grade for these series is '1' and reflects our assessment that the recovery level will be greater than 90% in a hypothetical default scenario.
- Despite that presented in the payment waterfall, our assessment of the rate of the debt recovery is limited because these bond series are not secured by property.
- Our assessment of the rate of debt recovery is based on the Company's relatively low rate of leverage, its existing and anticipated debt mix, including the ratio between the scope of secured and unsecured debt and the types of property owned by it. Changes with the leverage and mix of debt are liable to impact the assessment of debt recovery and the ratings of the series of bonds.

Primary assumptions underlying a hypothetical default scenario

- Year of hypothetical default event: 2025
- A severe recession in the German economy will result in a significant decline in occupancy rates, a decline in rental revenues and material decline in the value of the property portfolio, all of which will materially harm the Company's ability to meet the debt repayments.
- The Company will continue to operate as a going concern, an assessment supported by the central locations of its properties and suitable operating performance.
- The value of the Company's commercial property portfolio will decline by 50% due to its value being concentrated in several large properties.
- The value of the Company's rental residential property portfolio will decline by 30% due to its spread of tenants and the relatively large number of properties.
- The value of the inventory under construction for sale and virgin land held by the Company will decline by 70% due to their locations, the levels of engineering completion, rates of the marketing, the state of the planning and the status of the construction permits.

Base payment waterfall in a default

- (Gross) value as a going concern according to asset value: Approximately EUR 743 million.
- Administrative expenses: 5%.
- Available value to cover secured debt: Approximately EUR 706 million.

- Total secured senior debt: Approximately EUR 494 million (including utilization of credit facilities).
- Available value to cover unsecured debt: Approximately EUR 212 million.
- Total unsecured debt (series 'b' and 'c'): Approximately EUR 100 million.
- Assessment of recovery of unsecured debt: 90%-100% (limited as stated above).

The debt figures include interest compounded semi-annually.

Impact of the assessed debt recovery on the ratings of the debt relative to the issuer's rating			
Debt recovery assessment (%)	**Description**	**Debt recovery assessment grade**	**Rating of series above/below the issuer's rating**
100%-10%	Expectation of full repayment	1+	+3 notches
90%-100%	Very high debt recovery	1	+2 notches
70%-90%	High debt recovery	2	+1 notch
50%-70%	Significant debt recovery	3	0 notches
30%-50%	Average debt recovery	4	0 notches
10%-30%	Modest debt recovery	5	-1 notch
0%-10%	Negligible debt recovery	6	-2 notches

The debt recovery ratings are limited in some countries in order to take into account the prospects of debt recovery in these countries. Ratings of debt recovery for unsecured bonds are also generally limited (for more information see stage 6, paragraphs 90-98 of the methodology for assessing debt recovery of non-financial corporations, December 7, 2016).

Environmental, social and governance factors

Corporate governance factors are a very negative factor in the analysis of the credit rating of Brack Capital Properties N.V. This is because its strategy partially relies on the general strategy of the Adler Group, and the Group's corporate governance framework is not sufficiently transparent. In our view, frequent changes in strategy and the Group's holding structure limit its ability to meet its operating and financial targets. We believe that the high turnover of the senior management and with the board of Brack Capital Properties and other companies in the Group attest to a weakness with the corporate governance of Brack Capital Properties. The fact that the Company's CEO also serves as co-CEO of the Group supports this assessment.

Methodology and Related Articles

- **Methodology: General: S&P Rating Principles**, February 16, 2011.
- **Methodology – General: Methodology for Using CC and CCC Class Ratings**, October 1, 2012.
- **Methodology: Methodology for Assessing the Management and Corporate Governance of Corporations and Insurers**, November 13, 2012;
- **Methodology: Industry Risk**, November 19, 2013.
- **Methodology: Methodology for Assessing State Risk**, November 19, 2013.
- **Methodology: General Methodology for Rating Corporations**, November 19, 2013.
- **Methodology: Methodology for Assessing Corporate Liquidity Profile**, December 16, 2014.

- **[Methodology: Methodology for Assessing Debt Recovery of Non-Financial Corporations](),** December 7, 2016.
- **Methodology: Key Factors for Rating Real Estate Companies**, February 26, 2018.
- **Methodology – General: credit rating in local scales**, June 25, 2018.
- **Methodology: Methodology for Calculating Financial Ratios and Adjustments**, April 1, 2019.
- **Methodology – General: Rating Companies in a Group**, July 1, 2019
- **Methodology – General: Credit Risks from Environmental, Social and Corporate Governance Factors**, October 10, 2021.
- **Methodology – General: Credit Ratings for Locating Rating Scale**, June 8, 2023.
- **Rating Definitions of S&P Global ratings**, June 9, 2023.
- **Opinions and Interpretation: Correlation between the Global Rating Scale and the Israeli Rating Scale**, June 26, 2018.

List of ratings

Brack Capital Properties N.V	Rating	Date rating first issued	Most recent rating update
Issuer's rating			
Long term	ilBBB-/ Negative	April 1, 2012	September 8, 2022
Issuance rating(s)			
Unsecured senior debt			
Series B	ilBBB+	April 3, 2013	September 8, 2022
Series C	ilBBB+	June 23, 2014	September 8, 2022
Issuer's rating history:			
Long term			
September 12, 2023	ilBBB-/Negative		
September 8, 2022	ilBBB-/Watch Neg		
May 16, 2022	ilA-/Watch Neg		
February 15, 2022	ilAA-Watch Neg		
December 9, 2021	ilAA-/Negative		
October 14, 2021	ilAA-/Watch Neg		
March 15, 2016	ilAA-/Stable		
April 3, 2013	ilA+/Stable		
April 1, 2012	ilA/Stable		
Additional details			
Time event occurred	September 12, 2023 16:00		
Time event first learned of	September 12, 2023 16:00		
Party initiating the rating	The rated company		

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