

RESEARCH

Summary:

Befimmo S.C.A.

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Credit Rating: BBB/Positive/A-2

Rationale

The ratings on Belgium-based real estate company Befimmo S.C.A. reflect Befimmo's portfolio of commercial real estate, which produces resilient cash flow streams. This is the result of the good quality of the company's assets, which are leased on long contracts to strong tenants; overall positive indexation in its lease portfolio; and limited exposure to speculative developments over the cycle. This is offset by Befimmo's relatively small portfolio of assets with nearly full exposure to the Brussels office real estate market, which heightens concentration risk, and its exposure to more volatile areas outside the Brussels central business district (CBD) area. Gross financial debt was €439 million at March 31, 2006.

The ongoing downturn in the Brussels office real estate market has had an adverse effect on market rent and vacancy levels. In contrast to the market trend, however, Befimmo's vacancy level decreased slightly to 6.4% at June 30, 2006, which compares favorably with the overall vacancy level in Brussels at 10%. Newly signed and extended lease contracts are at lower levels, however, which will negatively impact future cash flows. Nevertheless, Befimmo's average lease duration for its 20 largest clients (about 71% of total rents) in the portfolio was about 7.6 years at the end of September 2005, which limits the yearly amounts exposed to rent renewal at lower levels. Furthermore, the company's existing lease portfolio allows for positive indexation, which mitigates the lost margin in rental renewals.

Befimmo's financial profile is strong for the ratings. The LTV ratio was a low 40% at the end of March 2006, supporting the ratings. The company's tax-exempt status as a SICAFI (a Belgian tax-transparent vehicle) currently imposes a 65% maximum gearing level (it was recently revised up from 50%). Standard & Poor's Ratings Services does not, however, anticipate that Befimmo's historically conservative financial policies would change following the revision. Gearing was a modest 41% according to the SICAFI definition at June 30, 2006. EBITDA net interest coverage remained very strong at 5.4x for the six-month period ended March 31, 2006, mainly as a result of very low average debt cost (3.3%) and short debt term structure. The ratio of funds from operations (FFO) to net debt stood at a solid 12% for fiscal year 2005.

Short-term credit factors

The short-term rating is 'A-2'. Lower rent levels for new or extended lease contracts, combined with increasing expenses for new leasing activity (in the form of tenant improvements, incentives, and commissions) are expected to lead to a slight reduction in the operating margin and cash flows in the near term. Furthermore, the company is expected to continue to renovate properties in its portfolio and invest in new assets, albeit on a continued cautious basis. If any new asset investments are not met by matching asset disposals, this would lead to increased debt levels, as most of Befimmo's operating cash flows are required to be distributed as dividends.

Since Befimmo's free cash flows are expected to be distributed to shareholders, existing and future debt is expected to be refinanced rather than repaid. Maintaining adequate backup liquidity resources is therefore important. Liquidity at Befimmo is adequate, consisting primarily of a €350 million syndicated bank facility due in 2009. Part of this syndicated facility is expected to remain permanently undrawn and used as a backup line (€300 million was undrawn at March 31, 2006) for the company's heavy CP drawings (€282 million was outstanding at March 31, 2006). Short-term debt maturities were €315 million at March 30, 2006--adequately covered by undrawn committed facilities and €26 million in cash on balance sheet.

Due to Befimmo's short-term debt structure, the ratings are exposed to interest rate hikes. Befimmo is expected to maintain adequate hedging and backup credit lines to limit any such risks in the medium to

longer term. Overall exposure to interest rate (EURIBOR-based) hikes is substantially capped (at 5%) until year-end 2008. Thus, Befimmo is exposed to interest rate increases up to its 5% ceiling until the end of 2008, and will be fully exposed afterwards. Although satisfactory, Befimmo's hedging package is slightly less comprehensive than those of its rated peers, which rely more heavily on pure interest rate swaps with a longer average duration.

Outlook

The positive outlook reflects the company's financial profile and policies, which are stronger and more conservative than expected. If it is assumed that they are sustainable on a permanent basis, this could lead to the ratings being raised by one notch. Standard & Poor's expects that Befimmo will continue to benefit from stable cash flows and value retention in its core real estate business. Befimmo's manageable lease expiration schedule, as well as the above-average credit profile of the portfolio's largest tenants, should further support stable core earnings.

Investments by Befimmo will need to be managed in such a way that they do not lead to a significant deterioration of the balance sheet (maximum LTV of 50% is expected), despite the increased flexibility provided by the new SICAFI regulation. Moreover, any material weakening in the conditions of the Brussels market could lead to the outlook to being revised to stable.

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