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Summary:
Befimmo S.C.A.

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Summary:

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Credit Rating: BBB/Stable/A-2

Rationale

The ratings on Belgian property investment company Befimmo S.C.A. reflect Standard & Poor's Ratings Services' view of the good quality of the company's assets, which are leased on long contracts to strong tenants; the overall positive indexation in the lease portfolio; and very limited exposure to speculative developments. These strengths are tempered by the company's relatively aggressive capital structure; the cyclical nature of the office real estate market, which now faces structural challenges with high vacancy rates; decreasing rent levels, and low occupier demand. Additional weaknesses are the low-yield nature of real estate assets.

We view Befimmo's business risk profile as strong. The company's property portfolio, valued at €1.9 billion on Sept. 30, 2010, comprises office assets mainly situated in Brussels. The portfolio is large, with an average lease maturity of 9.1 years and a tenant base with strong credit quality. About two-thirds of rental income comes from the public sector (mainly the Belgian state). The company's high-quality, well-located, and cash-producing assets usually have a strong ability to retain value and attract new tenants.

Befimmo's development strategy remains relatively cautious in our view. We expect that future large renovation projects will be backed by long-term lease commitments from strong tenants, which offset redevelopment and renting risks. We understand the group has no ambitions for international growth, which we believe is positive for the ratings. Befimmo's strategy is mainly focused on the long-term holding and renting of real estate assets, which, from a credit standpoint, is associated with passive low-risk property ownership and rent collection.

While demand for office leasing in Brussels has recently started to increase, the peripheral districts have very high vacancy rates, at above 20%, creating pressure for rent renewals in the near term. The 9.3% rent exposure to these areas and the lack of diversification remain a risk factor for Befimmo, in our view, because the bulk of its rental income comes from the cyclical office segment.

Befimmo's financial risk profile, which we assess as significant under our criteria, is underpinned by the company's loan-to-value (LTV) internal limit set at around 50% and its relatively short-term debt structure. Mitigating factors are the resilience and the stability of Befimmo's cash flows and its good access to capital markets, which remain key rating drivers given the capital intensive characteristics of the sector. Befimmo's tax-exempt status as a SICAFI (a Belgian tax-transparent vehicle) currently imposes maximum gearing of 65%.

Key business and profitability developments

On a like-for-like basis, Befimmo's net rental income decreased 1.2% in fiscal 2010 (year ended Sept. 30, 2010), mainly due to the effect of higher costs and a loss of revenue resulting from a building under refurbishment. Befimmo reported 1.4% net rental income growth for the same period, supported by the acquisition of Axento's portfolio and a decreasing occupancy rate at 95.5%. Rents still remain under pressure in a very competitive market. The change in portfolio valuation is less volatile, contracting by 1.8% in the year versus a 3.7% reduction for fiscal 2009. While the volume of new lease take-up in Brussels increased considerably during the first nine months of 2010

and values are starting to stabilize especially in the central business district, we do not anticipate pronounced growth before 2013.

Key cash flow and capital-structure developments

The company's adjusted LTV ratio on Sept. 30, 2010, remained at 41%, stable versus one year earlier, which is comfortable for a 'BBB' rating, given Befimmo's business risk profile, which we consider to be strong. Funds from operations (FFO) increased to €94 million during fiscal 2010, translating into an improvement in cash flow generation from continued operations. Befimmo further strengthened its repayment capacity over the year, recording adjusted debt to EBITDA of 7x (against 7.4x in 2009) and a ratio of FFO to debt of 11.9% (versus 10.5%). The lower financing costs—down 60 basis points--and higher EBITDA considerably increased Befimmo's debt service, leading to comfortable EBITDA interest cover of 5.4x.

Short-term credit factors

The short-term rating is 'A-2'. We classify Befimmo's liquidity as adequate since we expect liquidity sources to be adequate to meet funding needs in the next 12 months.

On Sept. 30, 2010, the company's cash position was limited to €3.5 million. Befimmo's €791 million financial debt includes a €400 million commercial paper program and two €100 million bilateral credits maturing in February and March 2011. To cover this refinancing risk, Befimmo has equivalent undrawn committed credit lines. Since Befimmo distributes free cash flows to its shareholders, we think existing and future debts are likely to be refinanced rather than repaid. The maintenance of adequate back-up liquidity resources is therefore important. Befimmo has a satisfactory hedging strategy, consisting of a combination of caps and swaps. Overall, Befimmo's interest rate hedging policy is to have 50%-75% of total debt fixed or hedged over three to five years. That said, the company has indicated that almost 100% of total debt was hedged as of Sept. 30, 2010. The average debt maturity was 2.9 years and the debt ratio calculated according to local requirements was 44.1%. The company has about €48 million investments costs committed for the next year, which we expect to be fully covered by the remaining available debt and the proceeds of the Empress Court and Kattendijkdok sales agreements.

Outlook

The stable outlook reflects our view of Befimmo's good-quality and stable income producing office property portfolio. We understand that the company aims to strengthen its efforts on reducing exposure to Brussels suburbs and increase the share of private sector companies among its tenants to optimize occupancy and rental performance. We also expect that it will maintain an EBITDA interest-coverage ratio of more than 2x and a ratio of debt to EBITDA of a maximum of 10x in the medium term. We understand the company's LTV is likely to remain below 50% and we expect Befimmo to maintain adequate hedging and back-up credit lines to limit any interest-rate-related risks in the medium to long term.

We could take a negative rating action in the event of an unexpected significant downward revaluation of the real estate portfolio, combined with an absence of deleveraging actions, because this would have an adverse impact on the LTV ratio. Large debt-financed acquisitions could also trigger a negative rating action. Lastly, rising interest rates, increasing vacancies, or a decrease in rents could weigh on the ratings.

Ratings upside is limited, in our view, owing to the company's financial leverage targets.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria: Key Rating Factors for European Real Estate Companies, November 24, 2004

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