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October 5, 2011

Summary:
Befimmo S.C.A.

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Table Of Contents

Summary:

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Credit Rating: BBB/Stable/A-2

Rationale

The ratings on Belgium-based real estate company Befimmo S.C.A. reflect Standard & Poor's Ratings Services' view of the company's good-quality assets; its long-term leases to creditworthy tenants; and its limited exposure to development activities. We consider the strength and diversity of real estate companies' asset portfolios to be the most relevant factors in assessing their business risk profile. These strengths are tempered by the cyclical nature of the office real estate market and Befimmo's high exposure to the oversupplied Brussels office market, which continues to face high vacancy rates, falling rents, and low occupier demand.

We view Befimmo's business risk profile as strong. 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. The portfolio is large (€1,957 million on June 30, 2011), composed of offices mainly situated in Brussels with a long average lease maturity of 9.22 years and a tenant base that has strong credit quality. Some 9.3% of rent comes from peripheral districts of Brussels, which carry high vacancy rates. We view this as a risk factor, together with Befimmo's strong focus on the somewhat cyclical office segment. Befimmo's development strategy is relatively cautious in our opinion, since large renovation projects are backed by long-term lease commitments from strong tenants, which offsets redevelopment and renting risks.

Our assessment of Befimmo's financial risk profile as "significant" under our criteria is based on 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, the predictability, 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

We anticipate that Brussels' office market's yields won't start compressing until the end of 2012 at the earliest, provided that the current oversupply is absorbed. This should progressively drive Befimmo's capital values up over the coming two to three years. Additionally, we believe it is unlikely that the rental decline will bottom out before 2014, considering a time lag effect after the yields stabilize.

Befimmo's profitability was weakened by a decline in its occupancy ratio to 94.4% on June 30, 2011 (from 95.5% on Sept. 30, 2010) and large renovation works. However, it remains significantly above the market at 88.4%, owing to the quality of its assets and its long-term leases which help to secure at least two-thirds of total rental income over the next five years. Befimmo's portfolio value and average yield were stabilized, down by 1.14% and nil, respectively, during the nine months ended June 30, 2011, showing less volatility than in previous years.

Key cash flow and capital-structure developments

We foresee no pronounced growth in revenues over the coming two years, as tenant demand in Belgium remains subdued. Still, the likely increase of the share of corporates in the total tenancy should support solid cash flow generation through higher rents and occupancy rates. We anticipate that the LTV ratio will grow by another 3%-5% over a two-year period, since Befimmo's capital values will remain fairly stable and the company is likely to refinance its coming debt maturities to fund its large renovation works and pay an interim dividend.

Befimmo reported a 1% like-for-like revenue decline for the nine months ended June 30, 2011, as a result of downward lease renegotiations and the end of a rental guarantee on the Axento building on Dec. 31, 2010. On the other hand, its cash flow predictability improved through the extension of the average lease duration to 9.22 years (from 9.14 years on Sept. 30, 2010). We calculate that the LTV ratio (including our adjustments) increased to 43% on June 30, 2011 (from 42% on Sept. 30, 2010), owing to the acquisition of the Pavilion complex (almost 20,000 square meters) and large renovation works, partly compensated by the sale of the Empress Court and Kattendijkdok buildings. However, this LTV ratio remains consistent with a significant financial risk profile.

Liquidity

The short-term rating is 'A-2'. We classify Befimmo's liquidity as adequate, because we anticipate that its liquidity sources will be sufficient to meet its funding needs over the next 12 months.

On June 30, 2011, short-term debt maturities amounted to €134 million, including a €130 million syndicated loan expiring on March 30, 2012. In addition, Befimmo issued €199 million under a €400 million commercial paper program that is fully backed up by an equivalent amount of undrawn lines of credit. The company had also committed about €50 million in investment costs and we forecast it will distribute approximately €70 million of annual dividends in the year ahead.

To cover these short-term cash calls, Befimmo reported €431 million of committed credit facilities available and €6 million of unrestricted cash on June 30, 2011. During the first half of 2011, Befimmo issued a six-year €162 million bond to repay part of matured bilateral lines. In addition, we anticipate about €75 million of funds from operations over the coming 12 months.

Because Befimmo distributes free cash flows to its shareholders under its SICAFI status, we think the company is likely to refinance rather than repay existing and future debt. The company's maintenance of adequate backup liquidity resources is therefore important.

Supporting liquidity are the company's good access to the capital market as evidenced by the successful closing of a €162 million bond in April 2011, the extended average debt maturity of 3.7 years (from 2.9 years prior to the bond issuance), and the headroom under the covenants, which we estimated was adequate on June 30, 2011.

Befimmo has what we view as 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 91.5% of total debt was hedged on March 31, 2011.

Outlook

The stable outlook reflects our view of Befimmo's good-quality office property portfolio and long-term leases, which will likely enable it to continue generating stable and predictable income.

We also anticipate that Befimmo will maintain an EBITDA interest-coverage ratio of more than 2.5x, a ratio of debt to EBITDA of a maximum of 8x, and a maximum LTV ratio of about 50%.

In addition, we believe that Befimmo will likely maintain adequate hedging and backup credit lines to limit any interest rate-related risks in the medium to long term.

Ratings upside is limited, in our view, by business risk considerations, such as the current size of the company's portfolio relative to peers'.

Conversely, we might take a negative rating action in the event of an unexpected and significant downward revaluation of the company's real estate portfolio, combined with an absence of deleveraging actions to maintain adequate headroom under debt covenants, or if Befimmo made large debt-financed acquisitions.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Key Credit Factors: Global Criteria For Rating Real Estate Companies, June 21, 2011

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