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Research Update:

Belgium-Based Property Investment Company Befimmo Affirmed At 'BBB'; Outlook Stable

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Research Update:

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Overview

- We are affirming our long- and short-term corporate credit ratings on Belgian real estate investment trust (REIT) Befimmo at 'BBB/A-2'.
- We have revised our financial risk profile assessment to "intermediate," in line with Befimmo's key credit metrics.
- We apply a one-notch downward adjustment for negative comparable rating analysis to reflect Befimmo's business risk profile being at the low end of the "strong" category.
- The stable outlook reflects our view that Befimmo's predictable rental income should allow it to maintain EBITDA interest cover above 3.0x, while debt to debt plus equity stays below 50%.

Rating Action

On May 22, 2015, Standard & Poor's Ratings Services affirmed its 'BBB/A-2' long- and short-term corporate credit ratings on Belgium-based property investment company Befimmo S.A. The outlook is stable.

Rationale

We have revised our assessment of Befimmo's financial risk profile as we believe that its credit metrics are more commensurate with an "intermediate" financial risk profile, rather than "significant" in our previous assessment. This is because we continue to forecast EBITDA interest coverage remaining between 3.0x and 4.0x in the next two years, and debt to debt plus equity staying below 50%. These two ratios, key to our analysis, are commensurate with the "intermediate" category and in line with EMEA real estate peers with similar financial risk profiles. We are also now using a negative comparable rating analysis to reflect our view of Befimmo's business risk profile being at the low end of the "strong" category.

These two changes in the rating components do not affect the overall 'BBB' rating but, in our view, better reflect the credit quality of Befimmo among our rated universe of European real estate investment companies.

Our assessment of Befimmo's financial risk profile as "intermediate" also factors in the resilience and predictability of cash flows from Befimmo's mostly long-term tenancies. We note that the cash flow base remains relatively low, however, constrained by the small size of the assets portfolio. The rating also captures the company's low cost of debt (3.16% in 2014). We believe that Befimmo will likely maintain adequate hedging and back-up credit lines to limit any interest-rate-related risks in the medium-to-long term. We forecast that the adjusted ratio of debt to debt plus equity will increase to be closer to 50% in 2015 and 2016 (46.7% as of December 2014), as a result of the acquisition of the Gateway project, which may be mostly funded by debt. We expect this increase to be temporary as the company already has a tenant secured under a long lease of 18 years. We understand that management's financial policy is still to maintain leverage below 50% on a long-term basis.

We continue to view Befimmo's business risk profile as "strong." Our assessment of the competitive position is supported by the company's good-quality assets, long-term leases to creditworthy tenants, and limited exposure to development activities. The portfolio totaled €2.3 billion on Dec. 31, 2014, and consists of office assets, of which 56% are located in the center of Brussels and the remainder mostly in Brussels' peripheries (about 10%), Flanders, Wallonia, and Luxembourg.

Befimmo's focus on Brussels' central business district (CBD) allows it to benefit from better occupancy rates (94.1% as of Dec. 31, 2014 on the full portfolio) than the Brussels market average (about 89%-90%). Weighted-average leases remained long at about 8.6 years in 2014, mostly with creditworthy tenants (the Belgian public sector and EU Commission represent about 70% of total rental income). Approximately 90%-95% of the rental income is contracted for the next two years. We believe that Befimmo should retain a high degree of rent predictability, although we understand that rent renegotiations in the Brussels office market still lead to negative adjustments of about 10%.

We use a one-notch downward adjustment to our initial analytical outcome for negative comparable rating analysis to reflect our view that Befimmo's business risk profile is at the lower end of the "strong" category. This is partly driven by its focus on the office sector, which we view as more volatile than residential, and the smaller size of the portfolio compared with our universe of European rated office peers. This adjustment also reflects Befimmo's large rent concentration in a single regional market, the Brussels office market, which is still recovering, and the risks stemming from the concentration of public-sector tenants. Lastly, the negative comparable rating analysis also captures Befimmo's positioning at the weaker end of the "intermediate" financial risk profile, given our expectation that debt-to-debt-plus-equity will increase to 47%-50% over the next two years.

Our base case assumes:

- Like-for-like rental income declines of 2% to 3% per year in 2015 and 2016, mainly due to lease renewals at less favorable terms.
- Occupancy rate steady at about 93% over the next two-to-three years, as project deliveries should broadly compensate for a few tenants departing.
- Portfolio valuation to fluctuate mildly in the next two years on a like-for-like basis, due to stabilizing vacancy levels and low speculative supply of high-quality offices in the Belgian market. Overall portfolio value should moderately increase as a result of acquisition and

development activities.
- Capital expenditure (capex) of about €20 million-€30 million per year to support the development of upcoming projects, including maintenance capex of existing properties.
- About €145 million of acquisitions in 2015-2016 relating to the Gateway project.
- Minimal levels of asset disposals assumed in our base case.

Based on these assumptions, we arrive at the following credit measures:
- EBITDA interest coverage between 3.0x and 4.0x in the next two years.
- Standard & Poor's-adjusted debt-to-debt-plus equity on a fair value basis between 47% and 50% over the next two years, reflecting the impact of the Gateway acquisition.

Liquidity

We assess Befimmo's liquidity as "adequate". According to our calculation, the ratio of liquidity sources to uses will be about 1.2x in the 12 months to March 31, 2016.

As of March 31, 2015, we estimate that liquidity sources over the next 12 months will mostly consist of:
- €661 million available under the credit facilities as of March 31, 2015.
- Forecasted FFO of €82 million.
- New debt issuance of €55 million in 2015 through private placement. We understand that Befimmo is currently involved in other refinancing processes.

This compares with our estimate of liquidity uses for the next 12 months of:
- Debt amortization of €43 million and €110 million of bond repayment.
- Commercial papers of €385 million maturing within 12 months.
- Capex of about €30 million-€35 million.
- Dividend payment of €63 million. We assume that 70% will be distributed in cash and balance in shares, in line with previous years.
- Acquisitions of €97 million related to Gateway tower to be paid in 2015 (€47 million to be funded in 2016).

We consider that Befimmo has well-established and solid relationship with banks, with a generally high standing in the credit markets. Our assessment of Befimmo's "adequate" liquidity also includes our view of its generally very prudent financial risk management.

Outlook

The stable outlook continues to reflect Befimmo's stable and predictable rental income from its good-quality office property portfolio and long-term leases with trustworthy tenants.

We anticipate that Befimmo will be able to maintain an EBITDA interest-coverage ratio of about 3.0x to 3.5x and a Standard & Poor's-adjusted ratio of debt to debt plus equity of less than 50% over the next two years.

Upside scenario

An upgrade would require Befimmo's business risk profile to improve toward the middle of the "strong" category, as a result of a step change in the company's earnings base and improved diversification of income streams. A positive action would also depend on Befimmo's ability to improve its adjusted debt to debt-plus-equity ratio to less than 40% on a sustainable basis, with EBITDA interest coverage of more than 3.5x.

Downside scenario

We could lower the ratings if adjusted debt to debt plus equity increases persistently above 50%. We believe that this would most likely occur if Befimmo funds more and more projects and acquisitions with debt only. We might also consider lowering the ratings if we see a material shift in the supply and demand characteristics in the Brussels office market or if negative reversions have a greater effect on rental income than anticipated, leading to a significantly lower forecast for cash flows than we currently expect from the leased portfolio in properties.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

Business risk: Strong
- Country risk: Low
- Industry risk: Low
- Competitive position: Strong

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

Ratings Affirmed

Befimmo S.A.

Corporate Credit Rating	BBB/Stable/A-2

Additional Contact:
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