S&P Global
Ratings

Research

Summary:
Befimmo S.A.

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Summary:

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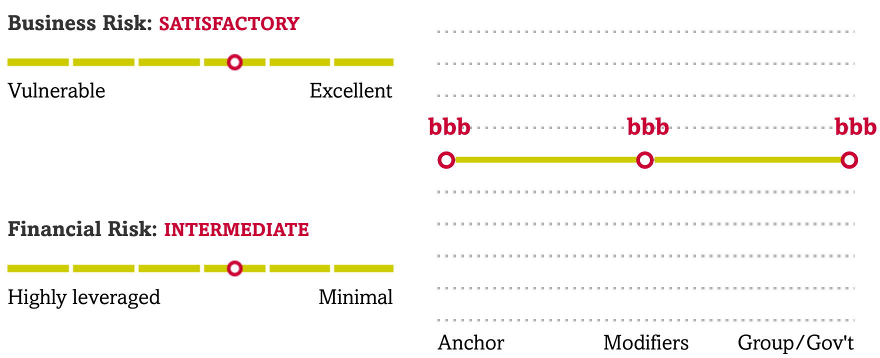

CORPORATE CREDIT RATING

BBB/Stable/A-2

Rationale

Business Risk: Satisfactory	Financial Risk : Intermediate
• Good-quality office assets, with the majority of the portfolio located in the central business district of Brussels, generating stable and recurring cash flows. • Very long-term lease structure of about eight years, supporting above-market occupancy rates. • High exposure to the cyclical office segment and still-oversupplied Brussels market. • Some concentration risks among public sector tenants.	• Resilience and predictability of cash flows, although the cash flow base is fairly low. • Moderate leverage, with an S&P Global Ratings-adjusted ratio of debt to debt plus equity of about 40%-45%. • Low financing costs, supported by Befimmo's good access to capital markets.

Outlook : Stable

The stable outlook on Belgium-based property investment company Befimmo S.A. continues to reflect Befimmo's stable and predictable rental income from its good-quality office property portfolio and long-term leases with trustworthy tenants. Our stable outlook also anticipates that Befimmo will be able to maintain an EBITDA interest coverage ratio of at least 3.5x and an adjusted debt-to-debt-plus-equity ratio of less than 50% over the next two years.

Upside scenario

An upgrade would 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 remaining comfortably above 3.5x. An upgrade would also require Befimmo to build a track record of generating positive rental growth on a like-for-like basis and a step change in the company's earnings base, with improved diversification of income streams.

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 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 of the Brussels office market, with rising vacancies or negative reversion rates having a greater effect on Befimmo's rental income than we anticipate. This could lead to significantly lower cash flows than we forecast for the leased property portfolio.

We could also lower the ratings if Befimmo significantly increases its usage of commercial paper and short-term debt without increasing available liquidity sources sufficiently, thereby constraining our liquidity assessment.

Our Base-Case Scenario

Assumptions

- Flat like-for-like rental income growth in the next two years. We assume that GDP growth in Belgium will remain in the low-single-digit range of about 1.3%-1.5% for the next 12-24 months. Compulsory lease indexation (we forecast consumer price index inflation at 2.5% in 2017 and 1.8% in 2018 for Belgium) will be offset by less-favorable pricing for lease renewals and new rental agreements, given the company's negative rent reversion of -9.5% at year-end 2016.
- A stable occupancy rate of around 94%, supported by Befimmo's long lease duration. Nevertheless, total rental income will be reduced in 2018 by the lease expiry on the Noord Building in January 2018. Leases in this building make up about 5.4% of Befimmo's total annual rental income.
- A relatively flat portfolio valuation in the next two years on a like-for-like basis (following 0.85% growth in 2016), due to stabilizing vacancy levels and a low speculative supply of high-quality offices in the Belgian market. Overall, the portfolio value should modestly increase on an absolute basis as a result of capital expenditure (capex).
- Capex of about €55 million-€60 million per year to support the development of upcoming projects, including maintenance capex on existing properties, in line with management's expectations.
- Asset disposals of about €120 million for 2017, reflecting the agreement from March 2017 with CBRE Global Investors of a 99-year lease on the Brederode complex. We do not forecast any further asset disposals or acquisitions, in line with the company's strategy.

Key Metrics

	2016a	2017e	2018e
EBITDA margin (%)	81.5	82-82.5	~82.5
EBITDA interest coverage (x)	4.4	~4.5	~4.5
Debt to debt plus equity (%)	43.4	42-43	~43

a--Actual. e--Estimate.

Business Risk : Satisfactory

Our business risk assessment reflects Befimmo's robust performance in the past few years, despite the still-sluggish macroeconomic environment and subdued demand for office space in Brussels. The company maintained its occupancy rate at around 94.8% in 2016, in line with the previous year and above the average occupancy rate in the Brussels market, which remains around 90%. In our view, Befimmo's occupancy rate is supported by the high share of its portfolio (about 60%) located in the center of Brussels.

Weighted-average leases remain long, at about eight years, with mostly creditworthy tenants (the Belgian public sector and EU Commission jointly represented about 66% of 2016 total rental income). Most rental income is contracted for the next two years, with only 1% of rent at risk in 2017 and about 5% in 2018. We believe that Befimmo should retain a high degree of rent predictability, although its portfolio continues to show potential negative rent renegotiations that are currently at about -9.5%. We note that this figure should decrease to about -5% once the leases on the Noordbuilding and World Trade Center Tower II (WTC II) are excluded when they expire in January 2018 and December 2018, respectively.

There is visibility beyond 2018 on the rental terms for the project that will be developed on the Noordbuilding site. Befimmo is still considering its options for WTC II.

The business risk profile also reflects Befimmo's relatively small portfolio size of about €2.5 billion as of March 31, 2017, compared with other European office players such as Derwent London or Alstria Office-REIT AG. The business risk profile also reflects Befimmo's high rent concentration, mainly in a single regional office market in Brussels, which is still recovering and is significantly less liquid than other Western European office markets, such as Paris.

Financial Risk : Intermediate

Befimmo's financial risk profile is supported by our adjusted debt-to-debt-plus-equity ratio of well below 50% (43.4% at year-end 2016) and its solid EBITDA interest coverage of above 4x. EBITDA interest coverage is, in turn, supported by the relatively high-yield environment in Befimmo's main markets and by the company's low cost of debt, which improved in 2016 to 2.26% (compared with 2.66% in 2015). 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 understand that management remains committed to its financial policy of maintaining leverage below 50%.

Lastly, our assessment of the financial risk profile also factors in the resilience and predictability of cash flows from Befimmo's mostly long-term tenancies. We note that the company's cash flow base remains relatively low compared to that of its peers, which is the result of the small size of the asset portfolio.

Liquidity : Adequate

We assess Befimmo's liquidity as adequate as we anticipate that the ratio of liquidity sources to uses will be a relatively tight 1.2x in the 12 months to March 31, 2017.

We consider that Befimmo has well-established and solid relationships with its 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 and our expectation that Befimmo will maintain adequate headroom under all its maintenance covenants.

Principal Liquidity Sources	Principal Liquidity Uses
• About €32 million of unrestricted cash available as of March 31, 2017; • €780 million available under committed undrawn credit facilities (with a maturity date in more than six months); and • Our forecast of cash funds from operations of about €90 million.	• Short-term debt maturities of about €600 million, including the expiry of a €162 million bond, drawn commercial paper of €360 million, as well as about €67 million of maturing bank funding. We understand that the commercial paper is backed by long-term bank facilities, which are included in the €780 million credit facilities mentioned above; • Committed capex of about €55 million-€60 million, mainly related to Befimmo's project pipeline, as well as investments in energy efficiency improvements in buildings; and • A dividend payment of about €90 million. For the purposes of liquidity, we assume that the dividend will be paid in cash, although the company has a track record of offering the possibility of dividend distribution in a mixture of cash and shares.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/A-2

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Low
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	**bbb/bbb-**	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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