Research Update:

Belgian Real Estate Owner Befimmo S.A. Downgraded To 'BB+' On Brookfield's Takeover; Outlook Stable

July 28, 2022

Rating Action Overview

- On July 12, 2022, Brookfield Strategic Real Estate Partners IV (Brookfield), via its fully owned subsidiary Alexandrite Monnet Belgian BidCo S.A., obtained 79.86% of Befimmo S.A.'s share capital and therefore gained control over the company.
- Including the debt raised at the BidCo level, we understand that the takeover will result in higher leverage on a consolidated basis than Befimmo's financial policy of a 50% loan-to-value (LTV) ratio. This translates into S&P Global Ratings-adjusted debt to debt plus equity of between 50% and 55% over the next 12-24 months, according to our estimates.
- In addition, Befimmo plans to dispose of assets over the next few years, reducing its portfolio's overall scale and scope.
- We therefore lowered our long-term issuer credit rating on Befimmo to 'BB+' from 'BBB' and our short-term issuer credit rating to 'B' from 'A-2'. We also removed the ratings from CreditWatch negative, where we had placed them on March 2, 2022.
- The stable outlook reflects Befimmo's stable and predictable rental income from its good-quality office property portfolio and long-term lease profile with high exposure to public tenants.

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Rating Action Rationale

On July 12, 2022, Brookfield, through its subsidiary Alexandrite Monnet Belgian BidCo, completed its takeover of Befimmo. Brookfield obtained a 79.9% stake in Befimmo at the closing of the first acceptance period, thereby gaining control over the company. Brookfield has voluntarily opened the second acceptance period, which starts on Aug. 29, 2022, and runs until Sept. 16, 2022, whereupon its stake in Befimmo could increase further. We understand that Brookfield will likely take majority seats on Befimmo's supervisory board. We view Brookfield as a strategic owner, based on its commitment to long-term ownership of Befimmo and its alignment with Befimmo's new strategy of asset rotation and refocusing on core assets and central locations. We also understand that Brookfield is aligned with the company's strategy for geographical diversification, whereby it aims to become a Benelux real estate platform and reduce concentration on its main market in Brussels. Although Brookfield's controlling ownership means that it can promote its interests above those of other shareholders, we take a positive view of Brookfield's support for Befimmo's incumbent management team, which has a sound track record of operations. We reflect the change in Befimmo's ownership and more aggressive financial policy with a downward revision of our assessment of our management and governance score to fair from satisfactory.

Deleveraging post transaction hinges on the completion of material asset disposals. Brookfield financed its acquisition of Befimmo's shares partly with debt, namely a €547 million bridge facility (assuming a 100% acceptance rate) and a €1.27 billion backstop facility covering debt at the Befimmo level. As a result, Befimmo's adjusted debt to debt plus equity will increase, according to our estimates, to above 50% in 2022 from 42.6% at year-end 2021, and remain close to 50% in 2023 (including our adjustments of the debt at the BidCo level). We understand that Befimmo plans to dispose of significant mature office assets in the next 12-24 months and upstream part of the proceeds to repay the debt at the BidCo level. We understand that Befimmo's asset-disposal plans to reduce leverage could, if successful, create additional headroom under its financial policy of 50% LTV, thereby allowing for future growth. That said, in the short term, the higher leverage resulting from the transaction will increase Befimmo's interest burden, weighing on its interest coverage ratio, which we expect to deteriorate to 2.0x-2.2x in the next 12-24 months from 4.9x at year-end 2021. Additionally, we expect that Befimmo's ratio of debt to EBITDA will remain above 15x over the coming two years. As a result, we have revised our assessment of the company's financial risk profile downward by one category to significant from intermediate.

Long leases and a high proportion of public tenants continue to underpin our business risk profile assessment. We expect Befimmo's plan to deleverage through asset disposals to shrink its asset base and increase its concentration in terms of its number of assets. However, we understand that pro forma the planned disposals, the company will continue to benefit from its long lease terms in excess of seven years and a creditworthy tenant base, with over 50% of rents coming from public sector tenants. We view Befimmo's asset and tenant profile as credit supportive. Supporting cash flow stability and predictability are the long lease terms and good asset locations, where supply is low and demand from public and private sector tenants remains resilient. This is especially the case in the current context of growing economic uncertainty, rising interest rates, and decreasing business and consumer confidence, which could weigh on the demand for office space in the medium term. Although we expect the disposal plan to weigh on the scale and scope of Befimmo's portfolio, as well as reduce its diversification over the short term, we acknowledge the company's medium-term strategy to grow and diversify again.

Liquidity remains adequate but could come under pressure over the medium term. We understand that Brookfield has signed a bridge facility and a backstop facility covering any potential change-of-control put options by the debt lenders at the Befimmo level. The facilities have a 12-month maturity date and two subsequent three-month extension periods starting on the closing date, which mitigates any short-term liquidity risks. We understand that the company plans to execute its disposal plans in order to generate sufficient proceeds to repay the debt at the BidCo level and finance its capital expenditure (capex) and investment program. However, current headwinds on the demand for office space and investors' demand for assets on the back of deteriorating economic prospects and higher interest rates raise some execution risks for the material asset-disposal plan. We will closely monitor the company's disposal plan, the timing of its execution, and its liquidity position in the coming six-to-12 months, ahead of the bridge facility's final maturity date.

Outlook

The stable outlook reflects Befimmo's stable and predictable rental income from its good-quality office property portfolio and long-term leases with high exposure to public tenants. The outlook also reflects our expectation that Befimmo will maintain EBITDA interest coverage above 2.0x and adjusted debt to debt plus equity sustainably below 55%, in line with its long-term financial policy of 50% LTV.

Downside scenario

We could lower the rating if:

- Befimmo's adjusted debt to debt plus equity exceeds 60% for a prolonged period;
- Debt to annualized EBITDA differs materially from our base-case projections;
- EBITDA interest coverage falls to 1.8x or below; or
- Befimmo's liquidity cushion tightens.

We would also consider taking a negative rating action if Befimmo's operating performance deteriorated beyond our base case due to weaker fundamentals or lower demand for its assets. A shift in the company's financial policy, for example, resulting in a substantial increase in dividends beyond our base case, would also trigger a negative rating action.

Upside scenario

We might consider taking a positive rating action if Befimmo were to significantly expand its portfolio's scale and scope so that it becomes more aligned with that of peers in a higher rating category, while maintaining financial ratios commensurate with our base-case scenario.

Alternatively, we could raise our rating if:

- Debt to debt plus equity decreases well below 50% on a sustainable basis and thanks to a more conservative financial policy;
- The interest coverage ratio improves well above 2.4x; and
- Debt to EBITDA decreases toward 9.5x.

Company Description

Befimmo operates in the office real estate segment, with a focus on Belgium (93.7% of the portfolio value, with around 69% of the total portfolio located in Brussels) and, to a lesser extent, Luxembourg (5.5%). The company's portfolio consists of more than 100 buildings, with a total value of €2.9 billion as of June 30, 2022. It is listed on Euronext Brussels with a market capitalization of about €1.35 billion as of July 20, 2022. Befimmo has B-REIT (listed real estate investment trust) status. Befimmo is owned by Brookfield, via Alexandrite Monnet Belgian BidCo, with a current shareholding of 79.9%.

Our Base-Case Scenario

- GDP growth in Belgium of 2.1% in 2022 and 1.6% in 2023. We expect the unemployment rate to remain at 5.5% over the next 12-24 months, based on decreasing business confidence and clouding economic prospects. We continue to expect high consumer price inflation of 8.9% in 2022 and 3.6% in 2023.
- Positive gross rental income on a like-for-like basis of around 3.0% in 2022 and 2.0% in 2023, mainly driven by strong indexation expectations as the majority of Befimmo's contracts are indexed.
- Stable occupancy rates of 94%-95% in 2022 and 2023, given limited lease expirations over the next 12-24 months (about 6% of gross rental income in 2022 and 5% in 2023).
- Flat like-for-like asset revaluation over 2022-2023.
- Redevelopment capex of about €150 million-€160 million in 2022 and €270 million-€280 million in 2023, as the main projects are under way and approaching delivery. These projects are ZIN: About €340 million, delivery in 2023 and 2024; LOOM: About €80 million, delivery in 2026; Pacheco: About €40 million, delivery in 2024; and PLXL: About €55 million, delivery in 2025.
- No acquisitions in 2022 and some acquisitions costing around €20 million-€40 million in 2023.
- Sizable asset disposals of €1.0 billion plus over the next 24 months, in line with the company's strategy to deleverage post transaction and be in line with its financial policy of 50% LTV.
- Use of the disposal proceeds to upstream some cash to the BidCo level to repay the outstanding bridge facility.
- Ordinary dividends of about €55 million in 2022, corresponding to Befimmo's announcement.
- An average cost of debt of about 2.0%, excluding the bridge facility.

Key metrics

- Debt to debt plus equity of 50%-52% in 2022 and around 50% in 2023, including the bridge facility at the holding company and subject to the pace and size of asset disposals;
- A temporary increase in adjusted debt to EBITDA to around 20x in 2022, stabilizing in 2023 at around 15x-16x; and
- A deterioration in EBITDA interest coverage to around 2.0x-2.2x in the next two years, taking into account the interest expenses for the bridge facility at the BidCo level.

Liquidity

We view Befimmo's liquidity as adequate, based on the company's ratio of liquidity sources to uses of above 1.2x over the 12 months from April 1, 2022. The signed bridge facility and backstop facility cover Befimmo's debt liabilities and support liquidity in the short term. However, the refinancing of the facilities hinges on the success of the company's disposal plan, which we will monitor closely over the coming 12 months.

We estimate that Befimmo's principal liquidity sources for those 12 months will comprise:

- Unrestricted cash balances of about €2 million;
- About €575 million available under committed undrawn credit facilities maturing in more than 12 months; and
- Our forecast of cash funds from operations of approximately €90 million.

We estimate the following principal liquidity uses for the same period:

- Short-term debt maturities of about €335 million, mainly related to the use of commercial paper;
- Committed capex of about €170 million for renovation and refurbishment; and
- A minimum cash dividend of about €55 million, excluding any potential extraordinary dividends.

Covenants

Befimmo maintained substantial headroom under its financial covenants on Dec. 31, 2021. We expect that the company will maintain adequate headroom under all its maintenance covenants over the next 12-24 months.

Ratings Score Snapshot

Issuer Credit Rating	**BB+/Stable/B**
Business risk:	Satisfactory
Country risk	Low
Industry risk	Low
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Befimmo S.A.		
Issuer Credit Rating	BB+/Stable/B	BBB/Watch Neg/A-2