S&P Global
Ratings

Research

Summary:
Befimmo S.A.

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2038381

Summary:

Befimmo S.A.

Business Risk: SATISFACTORY

Vulnerable — Excellent

Financial Risk: INTERMEDIATE

Highly leveraged — Minimal

Anchor	Modifiers	Group/Gov't
bbb	bbb	bbb

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, where demand for office properties remains moderate. • Long-term lease structure of just about eight years, supporting stable and recurring rental income generation and above-market occupancy rates. • High exposure to the cyclical office segment and still-oversupplied Brussels office market. • Risk from concentration on public sector tenants, coupled with negative rent reversion rates.	• Moderate leverage, with an S&P Global Ratings-adjusted ratio of debt to debt plus equity of about 40%-45% and strong EBITDA interest coverage of above 4x. • Low financing costs, supported by Befimmo's good access to capital markets. • Resilience and predictability of cash flows, although the cash flow base is fairly low.

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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.

Downside scenario

We could lower the ratings if adjusted debt to debt plus equity increases persistently to 50% or above. 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 rent 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 having sufficient available liquidity sources, thereby constraining our liquidity assessment.

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.

Our Base-Case Scenario

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Assumptions

- Flat like-for-like rental income growth in the next two years. We assume that GDP growth in Belgium will remain in the range of about 1.6%-1.8% for the next 12-24 months. Compulsory lease indexation (we forecast consumer price index inflation at 1.9% in 2018 and 1.8% in 2019 for Belgium) will be offset by less-favorable pricing for lease renewals and new rental agreements, given the company's negative rent reversion rate of -10.8% at year-end 2017.
- A stable like-for-like occupancy rate of around 94%, supported by Befimmo's long lease duration. Nevertheless, total rental income will be reduced in 2019 by the lease expiries in the World Trade Center Tower (WTC II) building at the end of 2018. Leases in this building make up about 9% of Befimmo's total annual rental income. We believe that Befimmo can only partly offset the decline with new lettings.
- A relatively flat portfolio valuation in the next two years on a like-for-like basis (following 0.54% growth in 2017), 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 because of capital expenditure (capex), mainly related to renovation projects.
- Capex of about €100 million-€130 million per year to support the development of upcoming projects, including maintenance capex on existing properties, in line with management's expectations.
- Limited asset rotation in 2018 and 2019, mainly reflecting the acquisition of the Art 56 building, completed at the end of January 2018 for about €113 million, and which generates about €5.2 million in gross rental income annually.

Key Metrics

	2017A	2018E	2019E
EBITDA margin (%)	82.2	~81-82	~81
EBITDA interest coverage (x)	6	~4.5-4.8	~4
Debt to debt plus equity (%)	40.7	~45	~47

A--Actual. E--Estimate.

Company Description

Befimmo operates in the office real estate segment, with a focus on Brussels (68% of portfolio value) and to a lesser extent, Luxembourg (4%). Befimmo's portfolio consists of more than 100 buildings, with a total portfolio value of €2.5 billion as of year-end 2017.

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The company is listed on Euronext Brussels with a market capitalization of roughly €1.4 billion. Befimmo has B-REIT status (regulated Belgian Real Estate Investment Trust).

Business Risk: Satisfactory

Our business risk assessment reflects Befimmo's robust performance in the past few years, despite the ongoing challenging macroeconomic environment and subdued demand for office space in Brussels. The company maintained its occupancy rate at around 94% in 2017, in line with the previous year and above the average occupancy rate in the Brussels market of around 92%. In our view, Befimmo's occupancy rate is supported by the high share of its portfolio (about 58%) located in the center of Brussels.

Weighted-average leases remain long at about 8.4 years, albeit declining, with mostly creditworthy tenants (the Belgian public sector and EU Commission jointly represented about 63% of 2017 total rental income). We believe that Befimmo should retain a high degree of rent predictability, although its portfolio continues to show negative rent reversion that are currently about -10.7%. We note that this figure should decrease to about -5.9% once the leases in the WTC II building are excluded when they expire at the end of this year.

That said, the lease agreements in the WTC II building represent about 9% of Befimmo's annual rental income. Therefore we believe that the loss of this income will burden Befimmo's cash flow generation from 2019 as the company plans to refurbish the building without re-letting it during that period. However, we believe that the company will be able to partly mitigate the vacancy with new lettings of finished projects in 2019 or of vacant space in its remaining portfolio.

The business risk profile also reflects Befimmo's relatively small portfolio size of about €2.5 billion as of Dec. 31, 2017, compared with other European pure office players such as Derwent London PLC, Societe Fonciere Lyonnaise or Alstria Office REIT-AG. In addition, Befimmo has 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 and London.

Peer Comparison

Table 1

Befimmo S.A. Peer Comparison

(Mil. €)	Befimmo S.A.	Derwent London PLC	Icade S.A.	Cofinimmo S.A./N.V.	Alstria Office REIT-AG
Revenues	143.2	196.9	1,654.2	204.0	193.7
EBITDA	117.7	156.0	534.7	156.8	150.4
Funds from operations (FFO)	97.2	111.1	440.8	126.9	115.1
Interest expense	19.5	41.0	93.7	34.9	36.2
Net income from continuing operations	136.1	353.8	170.0	137.4	297.0
Cash flow from operations	105.3	84.2	329.9	128.6	122.3
Capital expenditures	40.5	180.9	677.9	69.7	59.4
Free operating cash flow	64.8	(96.7)	(348.0)	58.9	62.9
Dividends paid	89.3	136.2	343.5	81.1	79.7

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Table 1

Befimmo S.A. Peer Comparison (cont.)					
(Mil. €)	**Befimmo S.A.**	**Derwent London PLC**	**Icade S.A.**	**Cofinimmo S.A./N.V.**	**Alstria Office REIT-AG**
Cash and short-term investments	0.3	98.0	420.3	22.5	102.1
Debt	995.8	765.4	5,617.9	1,655.2	1,385.7
Equity	1,448.5	4,724.1	7,448.9	1,898.1	1,954.7
Debt and equity	2,444.3	5,489.5	13,066.8	3,553.3	3,340.4
Valuation of investment property	2,494.4	5,464.3	12,786.9	3,507.0	3,392.1
Adjusted ratios					
Annual revenue growth (%)	3.9	10.8	10.8	0.5	(4.4)
EBITDA margin (%)	82.2	79.2	32.3	76.8	77.7
Return on capital (%)	4.8	2.9	1.7	4.6	5.6
EBITDA interest coverage (x)	6.0	3.8	5.7	4.5	4.2
Debt/EBITDA (x)	8.5	4.9	10.5	10.6	9.2
FFO/debt (%)	9.8	14.5	7.8	7.7	8.3
Total debt/debt plus equity (%)	40.7	13.9	43.0	46.6	41.5

All data as of Dec. 31, 2017.

Financial Risk: Intermediate

Befimmo's financial risk profile is supported by our adjusted debt-to-debt-plus-equity ratio of well below 50% (40.7% at year-end 2017) and its solid EBITDA interest coverage of about 6x at year-end 2017. The strong coverage ratio is supported by the relatively high-yield environment in Befimmo's main markets and by the company's low cost of debt, which improved to 2.08% in 2017 (compared with 2.26% in 2016) due to higher usage of commercial paper instruments. We believe that Befimmo will likely maintain adequate hedging and back-up credit lines to limit any significant 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%. However, we believe that the adjusted ratio of debt to debt plus equity may increase toward 45%-47% in the next 12-24 months to fund the company's upcoming capex pipeline.

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.

Financial Summary

Table 2

Befimmo S.A. Financial Summary					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Revenues	143.2	137.8	140.1	139.7	137.8
EBITDA	117.7	112.2	115.1	113.4	113.8

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Table 2

Befimmo S.A. Financial Summary (cont.)

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Funds from operations (FFO)	97.2	86.4	84.2	84.2	84.2
Interest expense	19.5	25.0	30.6	28.0	28.8
Net income from continuing operations	136.1	90.4	97.9	68.9	79.2
Cash flow from operations	105.3	90.1	87.7	66.8	91.5
Capital expenditures	40.5	32.8	30.1	69.0	38.4
Free operating cash flow	64.8	57.2	57.5	(2.2)	53.1
Dividends paid	89.3	78.5	57.5	48.8	54.3
Cash and short-term investments	0.3	0.2	0.2	0.1	1.5
Debt	995.8	1,074.3	1,099.4	1,042.6	985.7
Equity	1,448.5	1,401.3	1,265.8	1,195.4	1,165.6
Debt and equity	2,444.3	2,475.7	2,365.2	2,238.1	2,151.3
Valuation of investment property	2,494.4	2,511.7	2,387.8	2,283.2	2,184.1
Adjusted ratios					
Annual revenue growth (%)	3.9	(1.6)	0.3	1.4	6.6
EBITDA margin (%)	82.2	81.5	82.2	81.2	82.6
Return on capital (%)	4.8	4.7	5.0	5.2	5.5
EBITDA interest coverage (x)	6.0	4.5	3.8	4.0	3.9
Debt/EBITDA (x)	8.5	9.6	9.6	9.2	8.7
FFO/debt (%)	9.8	8.0	7.7	8.1	8.5
Debt/debt and equity (%)	40.7	43.4	46.5	46.6	45.8

Liquidity: Adequate

We assess Befimmo's liquidity as adequate as we anticipate that the ratio of liquidity sources to uses will be just about 1.2x for the 12 months from March 31, 2018.

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.

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Principal Liquidity Sources	Principal Liquidity Uses
• About €16 million of unrestricted cash available as of March 31, 2018; • Approximately €700 million available under committed undrawn credit facilities (with maturity dates in more than 12 months); and • Our forecast of cash funds from operations of about €80 million-€90 million.	• Short-term debt maturities of about €509 million, including the expiry of a €32.3 million loan and drawn commercial paper of €476 million. We understand that the commercial paper is backed by long-term bank facilities, which are included in the €700 million credit facilities mentioned above; • Committed capex of about €45 million-€50 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 a 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)

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Reconciliation

Table 3

Reconciliation Of Befimmo S.A. Reported Amounts With S&P Global Ratings' Adjusted Amounts

	--Fiscal year ended Dec. 31, 2017--						
Befimmo S.A. reported amounts							
(Mil. €)	**Debt**	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	1,002.1	1,448.5	139.5	152.3	19.5	139.5	105.4
S&P Global Ratings' adjustments							
Interest expense (reported)	--	--	--	--	--	(19.5)	--
Interest income (reported)	--	--	--	--	--	0.6	--
Current tax expense (reported)	--	--	--	--	--	(1.6)	--
Postretirement benefit obligations/deferred compensation	--	0.0	0.0	0.0	0.0	0.0	(0.1)
Surplus cash	(0.3)	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	0.6	--	--	--
Debt--accrued interest not included in reported debt	5.5	--	--	--	--	--	--
Debt--fair value adjustments	(11.6)	--	--	--	--	--	--
EBITDA--gain/(loss) on disposals of PP&E	--	--	(21.8)	(21.8)	--	(21.8)	--
D&A--asset valuation gains/(losses)	--	--	--	(13.4)	--	--	--
Total adjustments	(6.3)	0.0	(21.8)	(34.6)	0.0	(42.3)	(0.1)
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	995.8	1,448.5	117.7	117.7	19.5	97.2	105.3

Related Criteria

- 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: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

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- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: 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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