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Research Update:

Germany-Based Alstria Office REIT-AG Affirmed At 'BBB'; Outlook Stable

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Research Update:

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Overview

- Germany-based commercial real estate company Alstria Office-REIT AG (Alstria) owns and manages a portfolio of over €3 billion, consisting mostly of office properties in metropolitan cities in Germany.
- Alstria has strengthened its liquidity by issuing more than €1 billion in senior unsecured debt in the past 12 months and the absence of large debt maturities in the next two to three years.
- We are affirming our 'BBB' long-term rating on Alstria and our 'BBB' issue rating on its senior unsecured bonds.
- The stable outlook reflects our view that Alstria's portfolio should generate stable cash flows in the next 24 months, thanks to a very stable office leasing market in Germany's metropolitan cities and the company's long-term tenant relationship.

Rating Action

On Sept. 26, 2016, S&P Global Ratings affirmed its 'BBB' long-term corporate credit rating on Germany-based real estate company Alstria Office REIT-AG. The outlook is stable.

At the same time, we affirmed our 'BBB' issue rating on Alstria's senior unsecured debt.

Rationale

The affirmation reflects Alstria's enhanced scale and market standing following the takeover of Deutsche Office AG, in line with our anticipations. The company's portfolio value as of June 30, 2016, amounted to €3.3 billion and consisted of 117 properties. The buildings are mainly office assets located around metropolitan areas in Germany, such as the Rhine-Ruhr region (25% of the portfolio value), Hamburg (24%), the Rhine-Main region (21%), Stuttgart (14%), and Berlin (8%).

Most of Alstria's assets are in or close to city centers where demand for office assets tends to be stronger. They have access to good infrastructure and positive rental growth prospects thanks to low unemployment and good tenant demand for office spaces. As the largest listed office player in Germany, Alstria is the market leader in Germany for office real estate, but its market share remains limited because the German real estate market is highly fragmented. We assess Alstria's office buildings as being of average quality. There are some renovation and refurbishment requirements of approximately €50 million to €60 million annually.

The portfolio is characterized by its relatively long average lease length of close to five years, supported by its exposure to tenants from the public sector. That compares positively with the average term of about 3.6 years for office property investors in Germany.

Our business risk assessment is further supported by the absence of speculative development activities in Alstria's portfolio, which limits the risk of revenue volatility. We anticipate some asset rotation in the next two years, mainly the disposal of €200 million-€300 million of noncore assets in Munich and nonoffice properties from Deutsche Office's portfolio, in line with Alstria's strategy.

Alstria's tenant base is somewhat concentrated on the City of Hamburg, which accounts for approximately 15% of total annual rental income. We do not consider that this exposure carries any major risk for Alstria's cash flow generation, given that the relationship between Alstria and the City of Hamburg has lasted for a long time and leases are spread over 20 lease agreements. Nevertheless, with the consolidation of the portfolio of Deutsche Office, some further tenant concentration exists in the portfolio, with Daimler AG (A-/Stable/A-2) as second-largest tenant, accounting for 12% of total rental income, followed by GMG Generalmietgesellschaft mbH as third-largest tenant with 9% of total rental income.

Although Alstria's scale and market position have strengthened through the Deutsche Office transaction, its business risk remains constrained because the company has a smaller portfolio than most European rated office players in the strong business risk category. The company reported an occupancy ratio of 90.2% as of June 30, 2016 (excluding surface under renovation), which is somewhat below that reported by most rated peers in the European office market. However, we expect this ratio will improve further in the next two years, due to the planned disposal of the partly vacated noncore properties in Munich and the adjustment of some rents in the Deutsche Office portfolio to closer to market level to support leasing activities.

Alstria's like-for-like property value growth will remain flat in the next 12-24 months, in our view. Although property prices are rising in some major cities in Germany, we still foresee some oversupply in cities like Frankfurt and in the Rhine-Ruhr area.

Our assessment of Alstria's financial risk profile remains unchanged. In line with our expectations, the company successfully issued over €1 billion of senior unsecured debt to refinance most of the mortgaged debt taken over from the Deutsche Office portfolio. We expect the S&P Global Ratings-adjusted ratio of EBITDA interest coverage to increase to above 3x by the end of 2016 and remain at similar levels in 2017. Due to its recent property sales, Alstria's ratio of debt to debt plus equity will likely decrease to approximately 43% in 2016, and remain around 45% in the following years, in line with the company's commitment to its 45% targeted loan-to-value ratio in the next few years.

In our base case, we assume:

- Approximately 1%-2% like-for-like rental income growth over the next 12 to 24 months, stemming from positive GDP growth of about 1.7% in 2016 and 2017, low growth in the consumer price index of 0.6% in 2016 and 1.6% in 2017, and some small improvements in occupancy levels;
- Some asset rotation, including disposals of up to €400 million in 2016, mainly of noncore assets from Deutsche Office's portfolio and some smaller acquisitions of up to €60 million;
- Flat to low positive-single-digit portfolio revaluation in next 12 months; and
- Cost of debt to remain stable at around 2% thanks to recent refinancing activities.

Based on these assumptions, we arrive at the following credit measures:

- S&P Global Ratings-adjusted EBITDA interest coverage of above 3x in the next 12 to 24 months;
- An improving ratio of debt to debt plus equity of approximately 43% to 45% in the next 24 months, which could stabilize at 45%-46% in the following years; and
- Debt to EBITDA of below 10x.

Liquidity

We have revised upward our assessment of Alstria's liquidity to strong from adequate. This is based on its ratio of liquidity sources to uses of well above 1.5x over the next 12 months as of June 30, 2016. The strong liquidity is supported by the absence of debt maturities for the next two to three years, and the company's solid cash balance and low requirements for capital expenditures.

As of June 30, 2016, we forecast that Alstria's liquidity sources over the next 12 months will include:

- Unrestricted cash balances of about €165 million;
- Our forecast of cash funds from operations of approximately €100 million; and
- Proceeds from committed asset sales of around €297 million, including the recent sale of the Treptowers in Berlin.

This compares with our estimate of liquidity uses for the next 12 months of:

- Minimum capital expenditures of about €20 million for renovation and refurbishment;
- Contracted acquisitions of about €8.4 million; and
- Estimated dividend payments of around €90 million.

We expect Alstria will maintain adequate headroom (greater than 10%) under the financial covenants in its debt agreements.

Outlook

The stable outlook reflects our view that Alstria's property portfolio should generate steady cash flows over the next 24 months. Our view is based on the resilient operating performance of Alstria's office buildings, which are mostly in metropolitan areas across Germany and have good economic growth prospects. It also captures Alstria's plan to improve the overall occupancy rate further.

We forecast EBITDA interest coverage will remain well above 2.5x over the next two years and debt to debt plus equity below 50%, in line with the company's financial policy.

Downside scenario

We could consider lowering the rating if Alstria's vacancy rate increased again to above 10% on a sustainable basis or if the company deviates from its stated distribution and leverage policy, with EBITDA interest coverage decreasing below 2.5x and debt to debt plus equity above 50%.

Upside scenario

We could raise the rating if Alstria increased its EBITDA interest coverage to 4x or above on a sustainable basis or reduced its leverage, with the ratio of debt to debt plus equity falling below 35%. Such an improvement could come from a material debt reduction. A positive action may also come from a continued increase in the portfolio size and significant reduction in the portfolio vacancy to 5% or below.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/--

Business risk: Satisfactory
- Country risk: Very low risk
- Industry risk: Low risk
- Competitive position: Satisfactory

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)

- Management and governance: Satisfactory (no impact)
- Comparable ratings analysis: Neutral (no impact)

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
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

Alstria Office REIT-AG	
Corporate Credit Rating	BBB/Stable/--
Senior Unsecured	BBB

Additional Contact:
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.