S&P Global
Ratings

RatingsDirect®

Research Update:

Alstria Office REIT-AG Outlook Revised To Positive On Lower Debt Leverage; Ratings Affirmed At 'BBB'

September 2, 2019

PRIMARY CREDIT ANALYST

Teresa Stromberg
Stockholm
(46) 8-440-5922
teresa.stromberg@spglobal.com

SECONDARY CONTACT

Nicole Reinhardt
Frankfurt
+ 49 693 399 9303
nicole.reinhardt@spglobal.com

ADDITIONAL CONTACT

Yilin Li
Frankfurt
+ 49 693 399 9107
yilin.li@spglobal.com

Rating Action Overview

- Alstria's credit metrics have improved more than we anticipated in the first half (H1) of 2019 following further asset sales and revaluation gains.
- Given the positive trends in Alstria's office portfolio, Alstria is likely to keep its credit ratios strong for the current rating.
- We are therefore revising our outlook on Alstria to positive from stable, and affirming our 'BBB' issuer credit rating. We are also affirming our issue ratings of 'BBB' on the unsecured debt.
- The positive outlook reflects our view that Alstria's S&P Global Ratings-adjusted ratio of debt to debt-plus-equity may not increase back to 35% or above and EBITDA interest coverage should stay well above 4.0x over the next two years.

Rating Action Rationale

The revision of the outlook to positive reflects the significant improvement in Alstria's credit metrics in the last 12 months, which we believe may stay strong over the next two-to-three years. In our view, this may result from the company sticking to a disciplined financial policy and well-balanced asset rotation strategy in the next 12-24 months. The reduction in S&P Global Ratings' adjusted ratio of debt to debt-plus-equity to 29.6% as of June 30, 2019, from 35.5% in the same period one year ago, mainly reflects the sale of some noncore assets as well as the ongoing positive portfolio revaluation. While ratios are very strong due to the recent efforts of liability management, our assessment incorporates potential acquisitions and renovation projects that push leverage closer to 35%. However, we consider that, at current levels, Alstria has headroom under the current rating to sustain strong ratios, including debt to debt-plus-equity of around 35% on a consistent basis and an EBITDA interest coverage ratio of 4x or above.

Although Alstria's management financial policy does not include any loan to value (LTV) target, we expect the LTV ratio to remain below 35% on a long-term basis. We expect the ratio of debt to debt-plus-equity to stay at 30%-35% over the next 12 months in our base case, which includes Alstria's current pipeline of renovation projects and anticipated asset rotation activity. Our base case, however, does not factor in any additional acquisitions. Any large debt-funded acquisitions or higher-than-expected capital expenditure (capex) projects could lead to LTV ratios of 35% or above, which could lead us to revise the outlook back to stable.

We believe Alstria's office portfolio will continue benefiting from the favorable market in Germany, in particular in and close to metropolitan areas where demand is outpacing new supply, and where the majority of Alstria's portfolio is located. As of H1 2019, the company reported like-for-like rental income growth of 4.9% and a European Public Real Estate Association (EPRA)-defined vacancy rate of 7.6%, declining from 9.7% at year-end 2018. We noticed the company's overall net rental income has been declining in the last two years due to the company's position as net seller. We forecast its cash flow generation will remain stable and that rental growth of existing lease agreements and improved occupancy levels will fully offset any negative rental impact from asset sales. Therefore, we anticipate the ratio of debt to EBITDA will remain between 8x and 9x.

We believe the company's capacity to cover its interest charges will remain strong, with its EBITDA interest coverage expected to remain well above 4x. This is explained by the lower leverage and the company's relatively low cost of debt (1.8%) and debt maturity of around 5 years. As a result, we have revised our assessment of Alstria's financial risk profile to modest from intermediate.

With a total value of €4.2 billion and 118 properties as of June 30, 2019, the company remains one of the largest listed office players in Germany. That said, we continue to view the German market as highly fragmented. Most of Alstria's assets are in or near 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 solid tenant demand for office spaces.

Our rating incorporates a one-notch downward adjustment on our comparable rating analysis modifier to reflect our expectations that Alstria's leverage could remain at the weaker end of its financial category, meaning close to 35%. In addition, compared to other 'BBB+' rated companies, Alstria remains small.

Outlook

The positive outlook reflects the chance that Alstria will maintain strengthened credit ratios over the next few quarters, assuming a disciplined financial policy and a well-balanced asset rotation strategy. This includes notably an EBITDA interest cover ratio above 4x and a debt-to-debt-plus-equity ratio sustainable well below 35%.

We expect its property portfolio to continue to generate stable cash flow thanks to its improved occupancy rate and lease maturity length, and its focused investment strategy on centrally located offices within German metropolitan cities.

Downside scenario

We could revise the outlook back to stable if Alstria's leverage increases to previous levels, most likely as a result of larger-than-anticipated debt-funded acquisitions or higher-than-anticipated renovation projects. We would also revise the outlook back to stable if the debt to debt-plus-equity rose to 35% or above.

Upside scenario

We could raise the issuer credit rating if Alstria maintains its debt-to-debt-plus-equity ratio well below 35% on a permanent basis, with EBITDA interest coverage remaining well above 4.0x or above. An upgrade would also be contingent on Alstria's ability to demonstrate healthy organic rental income growth and a stable or further improving occupancy rates in its office portfolio.

Company Description

Alstria is one of the largest listed office real estate company in Germany. The company is focused on the acquisition and management of office properties mainly in metropolitan areas such as Hamburg, Frankfurt, Düsseldorf, Berlin, or Stuttgart. Alstria's portfolio combines 118 assets at about €4.2 billion (as of June 2019).

Alstria became the first German REIT in 2007 and is listed in the SDAX.

Our Base-Case Scenario

- Approximately 1.5%-2.0% like-for-like rental income growth over the next 12-24 months, stemming from positive German GDP growth of about 0.5% in 2019 and 1.3% in 2020, and low growth in the consumer price index of 1.7% in 2019 and 1.8% in 2020; while occupancy levels remain stable, with EPRA occupancy of around 92% (excluding vacant premises for renovation and refurbishment needs);
- Annual net rental income of about €170 million for 2019;
- Overall stable portfolio size with limited asset rotation;
- About 5%-7% like-for-like portfolio revaluation for 2019, taking into account reported revaluation gains of the first half of the year and 0%-3% for the following year; and
- Cost of debt remains close to 1.8%.

Based on these assumptions, we forecast the following credit measures for Alstria:

- S&P Global Ratings-adjusted EBITDA interest coverage above 5x over 2019-2020.
- Debt to debt-plus-equity of around 30% to 33% over the next two years.
- A debt-to-EBITDA ratio of 8x to 9x over the next two years.

Liquidity

We continue to view Alstria's liquidity as strong, based on its ratio of liquidity sources to uses of above 1.5x over the next 12 months as of June 30, 2019; on the absence of large debt maturities for the next few years, and solid cash balance and available undrawn committed revolving credit lines; and on our expectation of ample headroom (greater than 15%) under the financial covenants in its debt agreements.

Our forecast for Alstria's liquidity sources for the next 12 months as of June 30, 2019, are as follows:

- Unrestricted cash balances of about €107 million and undrawn committed revolving credit facility of €100 million, maturing in more than 12 months; and
- Our forecast of cash funds from operations of approximately €120 million-€140 million.

Over the same period, we estimate principal liquidity uses as:

- Short-term debt maturities of about €44 million;

- Annual capital expenditures of about €100 million-€120 million for renovation and refurbishment, of which we understand most is not committed; and
- Estimated cash dividend payment of around €95 million in second-quarter 2020.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2019, Alstria's capital structure comprises about 15% secured debt, mainly mortgaged bank loans and 85% unsecured debt, including mainly senior unsecured bonds and promissory notes. The unsecured bonds are issued under Alstria Office REIT-AG.

Analytical conclusions

We assess the issue ratings on the company's senior unsecured bonds at 'BBB', in line with the issuer credit rating. This is because the company's exposure to secured debt is limited (secured debt to total fair value assets is below 10%).

Ratings Score Snapshot

Issuer Credit Rating: BBB/Positive/--

Business risk: Satisfactory

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

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers

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

Related Criteria

- 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Alstria Office REIT-AG		
Issuer Credit Rating	BBB/Positive/--	BBB/Stable/--
Senior Unsecured	BBB	BBB

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.capitaliq.com. All ratings affected by this rating action can be found on 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.