S&P Global
Ratings

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Alstria Office REIT-AG

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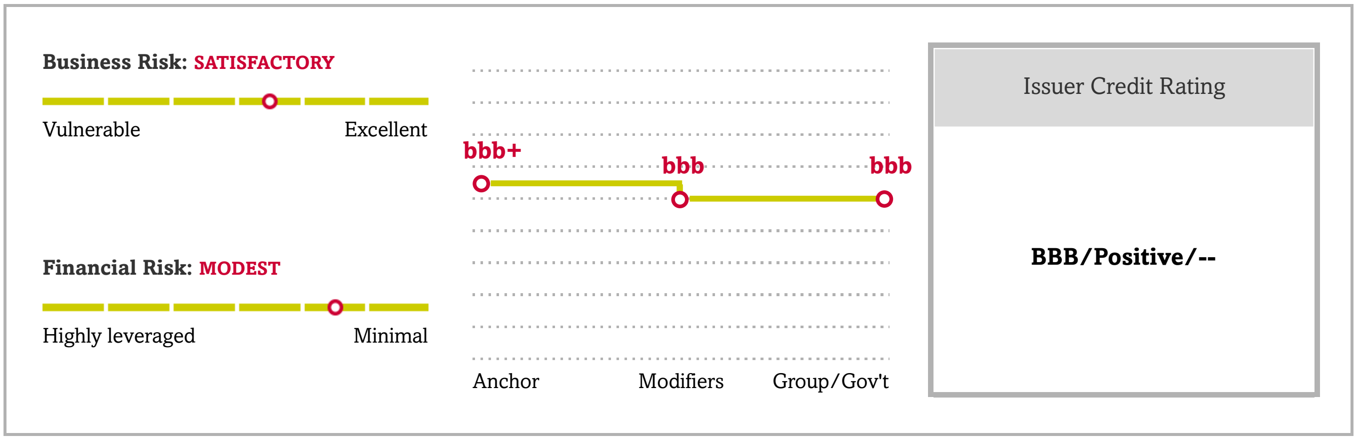


Credit Highlights

Overview

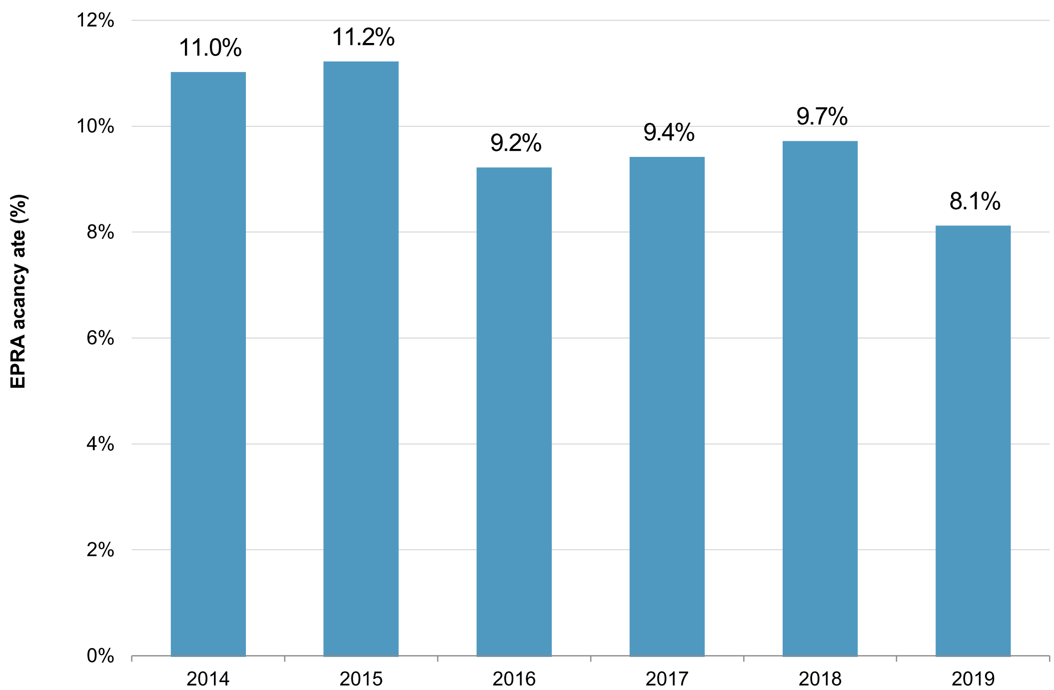
Key strengths	Key risks
Strong portfolio, with about €4.4 billion of office assets, mainly in German metropolitan cities with good macroeconomic fundamentals.	100% exposure to office segment, which we view as more volatile and cyclical than the residential sector.
Consistent strategy of long-term property holding with average lease maturities of about six years, in line with industry standards.	Relatively high vacancy rate of about 8.1% compared with that of other rated investment-grade peers, excluding buildings vacant for renovation needs.
Relatively low leverage, with S&P Global Ratings-adjusted debt to debt plus equity expected at 30%-33% for the next 12-24 months.	Some tenant concentration to the City of Hamburg and Daimler AG, although tenant contracts are spread across several lease agreements.
Robust EBITDA interest coverage ratio of about 5.2x as of Dec. 31, 2019, which we expect to remain at similar levels.	

Alstria Office REIT-AG undertook strong deleveraging in 2018-2019, supported by noncore asset sales and positive portfolio revaluation, and we believe that the company is likely to keep its leverage low, underpinned by our positive outlook. Alstria reported positive portfolio revaluation gains of €450 million in 2019 and €399 million in 2018. This, along with some noncore asset sales and equity issuances, translated to an improvement in its S&P Global Ratings-adjusted ratio of debt to debt plus equity to 27.7% at end-2019, from 41.1% at year-end 2017. Although Alstria's financial policy does not state any specific loan-to-value (LTV) target, we expect the LTV ratio to remain below 35% (translating into S&P Global Ratings-adjusted debt to debt plus equity of below 35%-36%) for the next 12-24 months. In September 2019, we revised our outlook on the company to positive from stable, reflecting that we could raise the rating on Alstria if the company maintains its leverage ratios long term.

German office real estate market dynamics remain supportive, which should bolster positive rental growth and occupancy levels for Alstria. We believe the company's office portfolio will continue benefiting from the favorable market conditions in Germany, in particular in metropolitan areas of the top 5 cities, where the majority of Alstria's portfolio is located. We believe that the locations where the majority of the company's assets are based will continue experiencing solid demand over the next two years. We forecast conservatively 1%-2% like-for-like annual rental income growth for 2020 and 2021 and stable vacancy levels at 8%-9%. Nevertheless, we remain cautious about any potential impact on the overall office sector in Germany from an expected slowing macroeconomic environment, in particular in the auto and manufacturing sectors, where some of Alstria's tenants are operating. The consequences of the coronavirus outbreak could also exacerbate any economic slowdown and impact on the auto and manufacturing sectors.

Chart 1

Alstria Office REIT-AG--EPRA Vacancy



Source: S&P Global Ratings.

The issuance of the €400 million bond in 2019 has optimized the company's capital structure further, resulting in lower financing cost and longer average debt maturities. In September 2019, Alstria issued €400 million of senior unsecured notes, at 0.5%, maturing in 2025. The company intends to use the majority of the proceeds mainly to refinance the €37 million Schuldschein and €326.8 million corporate bond, due in May 2020 and March 2021, respectively. We understand that the company plans to repay the existing two debt facilities when they come due to avoid higher financing cost incurred for early repayment. Therefore, the proceeds are held as fixed deposits and cash presumably until the maturity dates. This does not affect Alstria's S&P Global Ratings-adjusted net debt amount, because we reflect the proceeds in our net debt calculation of the company's leverage ratios. Including recent issuance, the company's cost of debt declined to 1.3% at year-end 2019 from previously 1.8% while its average debt maturity remains solid at above 5.8 years.

Outlook: Positive

The positive outlook reflects the possibility 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 coverage ratio above 4x and a debt-to-debt-plus-equity ratio sustainably well below 35%.

We expect the company's 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 to stable if Alstria's leverage increases to previous levels, most likely following larger-than-anticipated debt-funded acquisitions or renovation projects. We would also revise the outlook 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% permanently, with EBITDA interest coverage remaining well above 4.0x or above. An upgrade would also be contingent on the company's ability to demonstrate healthy organic rental income growth and stable or improving occupancy rates in its office portfolio.

Our Base-Case Scenario

Assumptions

- An approximately 1.5%-2.0% like-for-like rental income growth over the next 12-24 months, stemming from positive GDP growth of about 0.5% in each year of 2019 and 2020, low growth of the annual CPI of 1.4% for the next two years. We assume occupancy rates will be stable, with EPRA (European Public Real Estate Association) vacancy of about 8% (excluding vacant premises for renovation and refurbishment needs)
- Annual net rental income of about €160 million for 2020
- Overall stable portfolio size with limited asset rotation
- Conservatively, 0%-3% like-for-like portfolio

Key Metrics

	2019A	2020E	2021E
EBITDA/interest (x)	5.2	5.2-6.2	5.3-6.3
Debt/debt plus equity (%)	27.7	30-33	30-33
Debt/EBITDA (x)	8.8	8.8-9.8	8.8-9.8

A--Actual. E--Estimate.

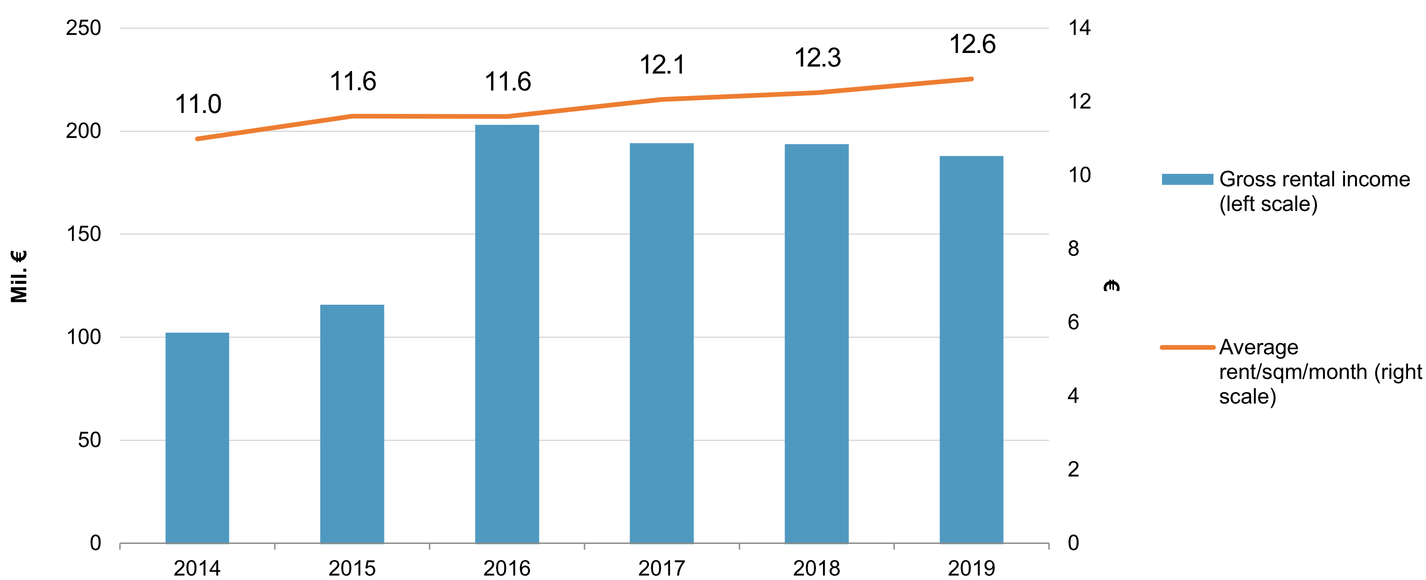
revaluation in next 12 months • Cost of debt continuing at about 1.3%	

Base-case projections

Alstria's strong leasing performance should continue despite its net seller position, which could reduce EBITDA for the next 12 months. As of Dec. 31. 2019, Alstria reported positive like-for-like contractual rental growth of 9.7% (3.6% in 2018) and an EPRA-defined vacancy rate of 8.1%, declining from 9.7% at end-2018. We noticed the company's overall net rental income has fallen in the past two years due to its position as net seller. However, we forecast its cash flow generation will be stable, and the rental growth of existing and new lease agreements and improved occupancy levels should partially offset the negative rental impact from asset sales. Moreover, Alstria's low leverage and relatively low cost of debt (1.3%) have also contributed to our expected ratio of EBITDA interest coverage well above 4x and debt to EBITDA of 8.5x-10x in the next 12 months.

Chart 2

Alstria Office REIT-AG--Rental Income



Source: S&P Global Ratings.

We expect credit metrics to be stable, with debt to debt plus equity at 30%-33% over the next 12 months, including Alstria's renovation pipeline and anticipated asset rotations, in line with the company's strategy. In the absence of a published LTV target by the company, we anticipate that the LTV ratio will likely remain at 30%-32% for the next 24 months (corresponding to S&P Global Ratings-adjusted ratio of debt to debt plus equity of 30%-33%). This is underpinned by the company's disciplined financial policy in terms of years of deleveraging in the past and asset rotation strategy focusing on internal growth through refurbishments instead of external low-yield acquisitions. That said, our base-case projections exclude any large debt-funded acquisitions or higher-than-expected capital expenditure (capex) investment. Nevertheless, we see Alstria has some headroom at the current level to keep leverage below 35%.

Company Description

Table 1

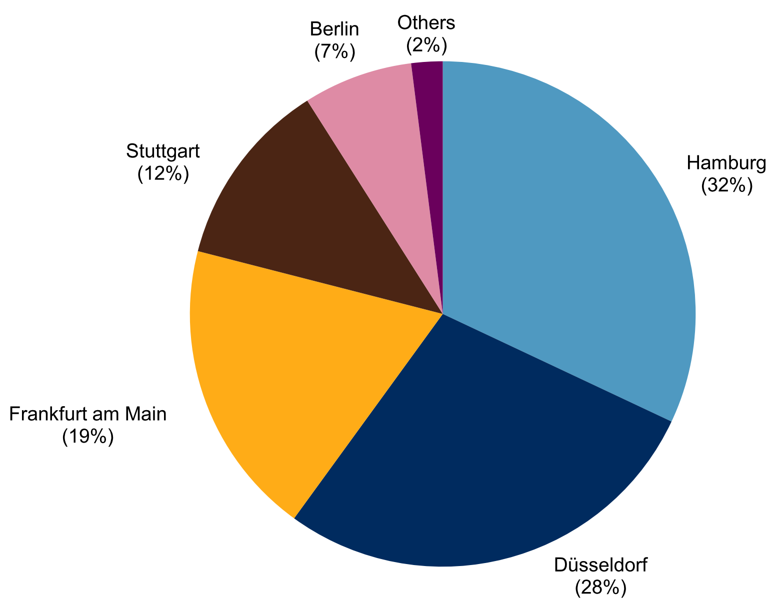
Alstria Office REIT-AG--Portfolio Summary For Fiscal Year 2019	
Total portfolio value (bil. €)	4.4
Total number of assets	116.0
EPRA vacancy rate (%)	8.1
Average lease maturity (years)	6.3
Current valuation yield (%)	4.7

Source: Company reports.

Alstria is one of the largest listed office real estate companies in Germany. The company is focused on the acquisition and management of office properties across Germany with locations mainly in or close to metropolitan areas such as Hamburg, Frankfurt, Düsseldorf, Berlin, or Stuttgart. Alstria's portfolio combines 116 assets at about €4.4 billion (as of Dec. 31, 2019).

Chart 3

Alstria Office REIT-AG--Geographic Diversity
% of portfolio value, year-end 2019



Source: S&P Global Ratings.

Alstria became the first German REIT in 2007 and is listed on the MDAX. The company's free float is 100% according to the definition of Deutsche Börse AG.

Business Risk: Satisfactory

The ratings reflect the company's market standing as one of the largest-listed office players in Germany, as well as its solid scale and scope with portfolio value as of Dec. 31, 2019, of about €4.4 billion, comprising 116 properties. The buildings are mainly office assets in metropolitan areas in Germany, such as Hamburg (32% of the portfolio value), Düsseldorf (28%), Frankfurt am Main (19%), Stuttgart (12%), and Berlin (7%).

Most of Alstria's assets are in or near city centers, where demand for office space tends to be stronger. They have access to good infrastructure and positive rental growth prospects due to low unemployment and solid tenant demand. Although Alstria is one of the largest listed office players in Germany, its market share remains limited because the German real estate market is highly fragmented. We assess the asset quality of the company's office building as average and in line with the overall German office market. The properties require some renovation and refurbishment measures with capex estimated at approximately €100 million annually.

The portfolio is characterized by its relatively firm average lease length of close to 6.3 years, supported by its exposure to tenants from the public sector. Our assessment of Alstria's business risk is further supported by the absence of speculative development activities in the company's portfolio, which limits the risk of revenue volatility. We anticipate limited asset rotation for the company in the next few years, due to the absence of well-priced office buildings in the market.

Alstria's tenant base is somewhat concentrated on the City of Hamburg and Daimler AG (A-/Negative/A-2), which account for approximately 11% each of total annual rental income. We understand that leases with Hamburg are spread over 20 lease agreements, limiting the risk of cash flow volatility. Furthermore, the 10 largest tenants represent a concentration of 42% of annual rental income.

The company reported an EPRA vacancy ratio of 8.1% as of Dec. 31, 2019 (excluding surface under renovation), which is somewhat above that reported by most rated investment-grade peers in the European office market. We note, however, the good progress in occupancy levels in 2019, mainly driven by a strong fill-up of a number of vacant buildings at this point of Alstria's capital recycling cycle when their refurbishments have been completed. Alstria has higher geographic, segment, and tenant concentration compared with those of peers rated a notch above. However, we believe it enjoys exposure to top metropolitan cities of Germany with good growth prospects and being amongst top players in German office market partially mitigates the risk.

Peer comparison

Table 2

Alstria Office REIT-AG--Peer Comparison

Industry sector: Real estate investment trust or company

	Alstria Office REIT-AG	Aroundtown S.A.	Societe Fonciere Lyonnaise S.A.	CPI Property Group SA	Immofinanz AG
Ratings as of March 3, 2020	BBB/Positive/--	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/--	BBB-/Stable/--
		--Rolling 12 months--			
	Fiscal year ended Dec. 31, 2019	**Ended Sept. 30, 2019**	**Ended June 30, 2019**	**Ended June 30, 2019**	**Ended Sept. 30, 2019**
(Mil. €)					
Revenue	162.9	1,075.1	195.4	467.3	193.3
EBITDA	139.1	713.1	170.3	291.1	164.5
Funds from operations (FFO)	114.5	427.2	119.3	205.5	104.9
Interest expense	27.0	186.9	32.0	76.3	71.9
Cash flow from operations	121.7	476.5	123.1	172.4	(23.1)
Capital expenditure	116.6	170.7	47.1	208.9	200.2
Dividends paid	92.3	435.0	129.5	6.3	88.1
Cash and short-term investments	298.2	3,137.8	43.0	925.9	256.9
Debt	1,219.3	9,840.2	1,825.9	2,972.7	2,541.5
Equity	3,175.6	12,159.0	4,667.5	4,541.2	2,784.9
Debt and equity	4,394.9	21,999.2	6,493.4	7,513.9	5,326.4
Valuation of investment property	4,438.6	21,104.2	6,711.9	7,604.0	5,117.4
Adjusted ratios					
Tweleve-month revenue growth (%)	(3.6)	26.6	1.1	7.7	18.7
EBITDA margin (%)	85.4	66.3*	87.2	62.3	85.1
Return on capital (%)	3.3	4.8	2.6	3.7	3.3
EBITDA interest coverage (x)	5.2	3.8	5.3	3.8	2.3
Debt/EBITDA (x)	8.8	13.8	10.7	10.2	15.4
FFO/debt (%)	9.4	4.3	6.5	6.9	4.1
Debt/debt and equity (%)	27.7	44.7	28.1	39.6	47.7

Note: Based on gross rental income.

Financial Risk: Modest

Our assessment of Alstria's financial risk profile reflects the significant improvement in the company's credit metrics in the recent years, which we believe will stay strong over the next two-to-three years. In our view, this might result from the company sticking to a disciplined financial policy and well-balanced asset rotation strategy in the next 24 months.

The S&P Global Ratings-adjusted ratio of debt to debt plus equity has continued being low at 27.7% as of Dec. 31, 2019, compared with 31.2% the same period a year earlier, mainly reflecting the sale of noncore assets and ongoing positive portfolio revaluations. Following the €400 million bond issuance in September 2019, the average cost of debt fell further to 1.3% from 1.8% as of June 30, 2019 with an average debt maturity of about 5.8 years. The recent refinancing activities will further strengthen the company's capacity to cover its interest charges with EBITDA interest coverage expected to remain well above 4x. In addition, we anticipate the ratio of debt to EBITDA will be stable, at 8.5x-9.5x.

While ratios are very strong due to the recent efforts of liability management, our assessment incorporates potential debt-funded acquisitions and renovation projects that push leverage closer to 35%. However, we believe that, at current levels, the company has headroom under the rating to sustain strong ratios.

Although Alstria's management financial policy does not include any LTV target, we expect the ratio of debt to debt plus equity to stay at 30%-35% over the next 12 months in our base-case scenario, which includes the company's pipeline of renovation projects and anticipated asset rotation activity. Our base-case scenario, however, does not factor in additional acquisitions. Any large debt-funded and higher-than-expected acquisitions or capex projects could lead to LTV ratios of 35% or above, which could lead us to revise the outlook to stable.

Our rating incorporates a one-notch downward adjustment on our comparable rating analysis. We believe Alstria's leverage is slightly higher than those of peers that we assess in the modest financial risk category such as Prologis European Logistics Fund (A-/Stable/A-2) and could remain at the weaker end of its financial category, meaning close to 35%. In addition, compared with other 'BBB+' rated companies, the company is relatively small in portfolio size.

Financial summary

Table 3

Alstria Office REIT-AG--Financial Summary

Industry sector: Real estate investment trust or company					
	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. €)					
Revenue	162.9	169.1	172.3	179.0	102.1
EBITDA	139.1	143.7	150.4	154.8	86.0
Funds from operations (FFO)	114.5	117.1	114.1	128.1	50.5
Interest expense	27.0	29.8	36.2	45.1	34.3
Cash flow from operations	121.7	119.0	122.3	120.5	45.6
Capital expenditure	116.6	88.6	59.4	31.8	28.0
Dividends paid	92.3	92.2	79.7	76.6	43.5
Cash and short-term investments	298.2	132.9	102.1	247.5	428.2
Gross available cash	498.0	132.9	102.1	247.5	428.2
Debt	1,219.3	1,217.4	1,366.3	1,238.4	1,663.8
Equity	3,175.6	2,684.1	1,954.7	1,728.4	1,657.7
Debt and equity	4,394.9	3,901.4	3,321.0	2,966.8	3,321.4
Valuation of investment property	4,458.2	3,968.5	3,392.1	3,013.8	3,329.6

Table 3

Alstria Office REIT-AG--Financial Summary (cont.)					
Industry sector: Real estate investment trust or company					
	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
Adjusted ratios					
Annual revenue growth (%)	(3.6)	(1.9)	(3.8)	75.3	13.5
EBITDA margin (%)	85.4	85.0	87.3	86.5	84.2
Return on capital (%)	3.3	3.9	5.7	5.1	3.5
EBITDA interest coverage (x)	5.2	4.8	4.2	3.4	2.5
Debt/EBITDA (x)	8.8	8.5	9.1	8.0	19.3
FFO/debt (%)	9.4	9.6	8.4	10.3	3.0
Debt/debt and equity (%)	27.7	31.2	41.1	41.7	50.1

Liquidity: Strong

We continue to view Alstria's liquidity as strong, based on the company's ratio of liquidity sources to uses of above 1.5x over the next 12 months as of Dec. 31, 2019. The strong liquidity is supported by Alstria's cash balance, its reserved bond proceeds from the issuance of €400 million in September 2019 to cover the upcoming maturing corporate bond in 2021, and available undrawn committed revolving credit lines.

Principal Liquidity Sources

Our forecast for Alstria's liquidity sources for the next 12 months as of Dec. 31, 2019, are as follows:

- Unrestricted cash balances of about €500 million including fixed deposits €200 million as part of the bond proceeds reported under financial assets
- Undrawn committed revolving credit facility of €100 million, maturing in more than 12 months
- Our forecast of cash funds from operations of approximately €100 million-€120 million
- Proceeds from committed asset sales of about €63 million

Principal Liquidity Uses

For the same period, principal liquidity uses include:

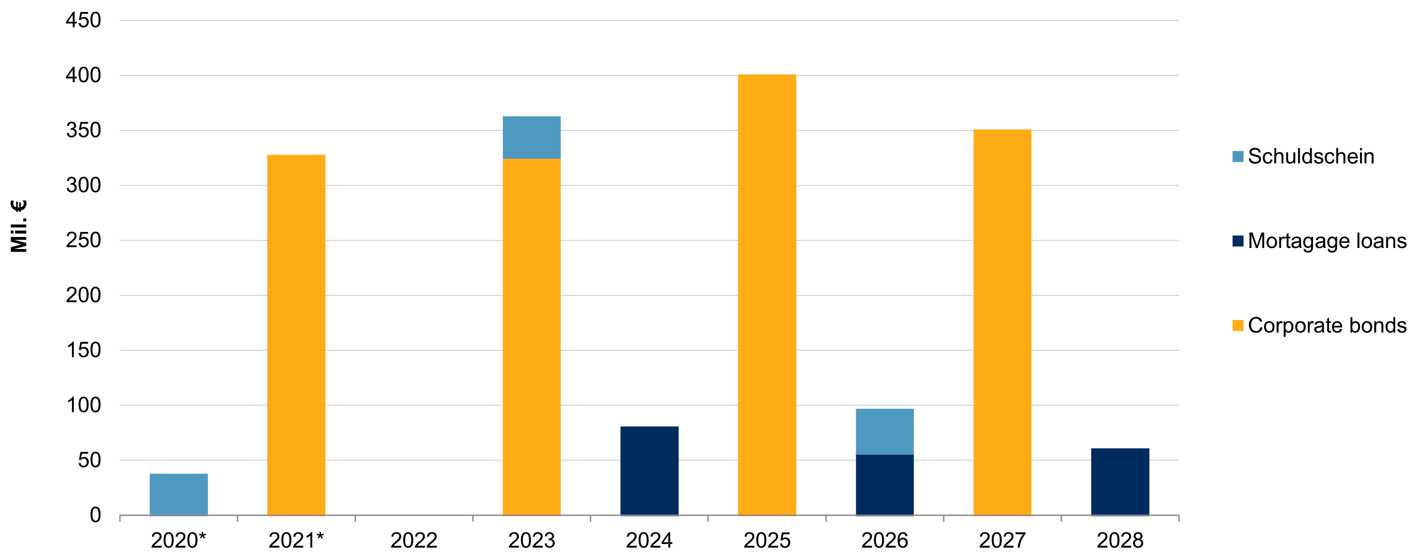
- Short-term debt maturities of about €37 million
- Annual capital expenditures of €100 million-€120 million for renovation and refurbishment, of which we understand most of it is not committed
- Estimated cash dividend payment of about €95 million in second-quarter 2020

Debt maturities

The average remaining debt maturity was 5.8 years year-end 2019.

Chart 4

Alstria Office REIT-AG--Debt Maturities
December 2019



*Refinancing funding already in place. Source: S&P Global Ratings.

Covenant Analysis

We understand that Alstria has financial covenants for its existing debt. We estimate that the headroom for these covenants is adequate (more than 15%).

Issue Ratings - Subordination Risk Analysis

Capital structure

Table 4

Alstria Office REIT-AG--Capital Structure And Liquidity

(%)	2019A	2018A
Average interest cost	1.30	1.80
Weighted-average debt maturity (years)	5.80	5.50
Composition of debt (secured; %)	11	17

Source: Company reports. A--Actual.

As of Dec. 31, 2019, Alstria's capital structure comprised about 11% secured debt, mainly mortgaged bank loans; and 89% unsecured debt, including mainly senior unsecured bonds and promissory notes.

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%).

Reconciliation

Table 5

Reconciliation Of Alstria Office REIT-AG Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2019--				
Alstria Office REIT-AG reported amounts					
	Debt	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**
Reported	1,711.7	154.3	608.0	26.9	139.1
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	--	--	--
Cash taxes paid: Other	--	--	--	--	--
Cash interest paid	--	--	--	--	(24.7)
Reported lease liabilities	5.6	--	--	--	--
Accessible cash and liquid investments	(498.0)	--	--	--	--
Share-based compensation expense	--	2.2	--	--	--
Nonoperating income (expense)	--	--	0.4	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	(17.4)	(17.4)	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	(454.8)	--	--
Interest expense: Other	--	--	--	0.1	--
Total adjustments	(492.3)	(15.2)	(471.7)	0.1	(24.7)
S&P Global Ratings' adjusted amounts					
	Debt	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**
Adjusted	1,219.3	139.1	136.3	27.0	114.5

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

Related Research

- Alstria Office REIT-AG Outlook Revised To Positive On Lower Debt Leverage; Ratings Affirmed At 'BBB', Sept. 2, 2019

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-

Ratings Detail (As Of March 9, 2020)*

Alstria Office REIT-AG	
Issuer Credit Rating	BBB/Positive/--
Senior Unsecured	BBB
Issuer Credit Ratings History	
02-Sep-2019	BBB/Positive/--
24-Nov-2015	BBB/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.