

Research Update:

German Real Estate Company Alstria Office REIT-AG Upgraded To 'BBB+' On Sustained Low Debt Leverage; Outlook Stable

March 4, 2021

Rating Action Overview

- Alstria Office REIT-AG's (Alstria's) credit metrics remained strong during 2020 despite the COVID-19 pandemic, supported by its financial discipline and relatively resilient office portfolio.
- In addition, we view positively the company's first public commitment to a maximum financial leverage target of 35% loan-to-value (LTV), translating into S&P Global Ratings-adjusted debt to debt plus equity of about 35%.
- We are therefore raising our long-term issuer credit and issue ratings on Alstria and its senior unsecured debt to 'BBB+' from 'BBB'.
- The stable outlook reflects our expectation that Alstria's focus on German metropolitan cities and limited asset rotation strategy will enable it to generate stable rental income while maintaining its current credit metrics over the next two years.

Rating Action Rationale

Alstria has demonstrated strong financial discipline throughout 2020 and committed to a maximum leverage target for the first time. Despite the challenging market environment due to the COVID-19 pandemic in 2020, Alstria has maintained a low ratio of debt to debt plus equity of 27.6%, well in line with our rating upside threshold. In addition, with the publication of its full-year financial statements last week the company stated an LTV target for the first time of a maximum 35%, translating into our ratio of debt to debt plus equity at similar levels. We view positively the company's public commitment to maintain low leverage despite market uncertainties around future property valuations. We expect that debt to debt plus equity will range between 28% and 30% in the coming 12-24 months. In addition, the company's favorable refinancing activities in recent years have allowed it to cover interest costs at close to 5x over the past 24-36 months (4.2x at year-end 2020, including approximately €5 million additional interest burden). This includes the €400 million bond at 0.5%, issued in 2019 to replace the outstanding 2.25%, €326.8 million bond,

PRIMARY CREDIT ANALYST

Yilin Li
Frankfurt
+ 49 (69) 33999 107
yilin.li
@spglobal.com

SECONDARY CONTACT

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

ADDITIONAL CONTACT

Industrial Ratings Europe
Corporate_Admin_London
@spglobal.com

which was repaid in fourth-quarter 2020. We forecast EBITDA interest coverage will increase back to 4.5x-5.0x in 2021. That said, we have noticed a continuous decrease in the company's absolute EBITDA base to €133.5 million in 2020 from €154.8 million (S&P Global Ratings-adjusted) in 2016, mainly as a result of noncore asset disposals and limited new acquisitions. In combination with office yield compression in the past few years, debt to EBITDA increased unfavorably to 9.3x at year-end 2020 from 8.0x at year-end 2016. We anticipate that Alstria has only limited noncore assets left in its current portfolio and that any further disposals will be fully offset by new acquisitions or new leasing activity. Therefore, we anticipate debt to EBITDA will remain at 9.0x-9.5x over the next 12-24 months. Overall, we believe Alstria is now more comparable with other European rated commercial real estate holding companies at the 'BBB+' rating level.

Despite recent trends for remote working, we believe Alstria will weather any headwinds, supported by its material share of public tenants and long lease maturity profile. In 2020, Alstria's operational performance remained relatively robust, with a limited effect from the COVID-19 pandemic. We understand that the company's annual rent collection was close to 99%, and at about 100% in 2021 so far. Despite a small drop in like-for-like rents of about 0.8%, Alstria improved its vacancy rate slightly to 7.6% last year. We believe the company should withstand any further pressure from the COVID-19 pandemic and we expect revenue and EBITDA will remain broadly stable this year, with limited asset rotation. We note the company's annual lease expiry of close to 10% over the next three years. Our forecast incorporates a cautious view about the successful re-leasing of expiring contracts, and we have taken into account a potential minor impact on occupancy and rent levels over the next 24 months. Overall we believe that Alstria's diversified asset base, located mainly in or close to German metropolitan cities where new supply is often limited, together with its relatively long lease maturity of 6.1 years, should allow the company to absorb any decline in demand for office space in the near-term. We believe the company's tenant base, with about 30% of annual rental income stemming from public tenants, also supports cash flow stability and visibility.

Alstria's liquidity profile remains robust. We continue to view Alstria's liquidity position as strong, thanks to its sufficient cash balances of about €461 million as of Dec. 31, 2020, including the recent bond issuance with proceeds of €350 million, and no material debt maturities in 2021 and 2022. In addition, the company has an undrawn revolving credit facility of €100 million available, maturing in more than 12 months. The company's average debt maturity profile stood at 4.9 years as of Dec. 31, 2020, with an average interest cost of 1.4%. In fourth-quarter 2020, Alstria repaid its nominal 2.25%, €500 million senior unsecured bond (with €326.8 million outstanding) early. Including 2020 refinancing activities, we anticipate approximately €5 million of annual interest cost savings this year compared with 2020.

Outlook

The stable outlook reflects our expectation that Alstria's asset focus on German metropolitan cities and limited asset rotation strategy will enable it to generate stable rental income while maintaining its current credit metrics over the next two years. This includes, notably, EBITDA interest coverage well above 4x, debt to debt plus equity sustainably well below 35%, and debt to EBITDA of 9.0x-9.5x.

We believe that the company's property portfolio will withstand any further effects from the COVID-19 pandemic, supported by its stable occupancy rates and solid exposure to public tenants with long-term leases, providing cash flow visibility and stability.

Downside scenario

We could lower the rating if:

- Alstria's debt to debt plus equity rises to 35% or above, most likely following larger-than-anticipated debt-funded acquisitions or renovation projects;
- Debt to annualized EBITDA materially deviates from 9.5x, for example, as a result of an EBITDA drop due to lower rent renewals or releasing levels, or higher-than-expected asset disposals; or
- EBITDA interest coverage falls below 3.8x.

Upside scenario

Rating upside is currently limited unless Alstria significantly improves its portfolio's scale and scope with assets of similar quality and underlying market dynamics, so that it becomes more aligned with that of other rated commercial real estate peers in the 'A' category. An upgrade would also hinge on the company maintaining its current financial ratios.

Company Description

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 109 assets worth about €4.6 billion (as of Dec. 31, 2020).

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

Our Base-Case Scenario

Assumptions

- German GDP growth will recover to 3.7% in 2021 and 3.2% in 2022 after an estimated 5.7% contraction in 2020 because of the pandemic, with unemployment at 4.8% in 2021 and 4.3% in 2022
- Annual consumer price index growth in Germany of about 1.5% in 2021 and 2022.
- Overall flat like-for-like net rental income growth in 2021, since the majority of Alstria's 2021 lease maturities are due close to year-end. For 2022, we forecast flat to slightly negative like-for-like rental growth, following our conservative assumptions that re-leasing rent levels may be partly lower or expiring leases may not all be directly extended or re-leased.
- Occupancy levels will remain broadly stable or decline only marginally, due to a potential delay to releasing activities for expiring leases.
- Alstria will remain a net buyer over the next 12-24 months, however, with limited overall asset rotation, in line with the company's strategy.
- Annual capital expenditure investments of €150 million-€200 million in the next two years.

- Overall flat like-for-like portfolio revaluation for the same period.
- Stable cost of debt at about 1.5%.

Key metrics

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

- Debt to debt plus equity at 28%-30% over the next 24 months.
- Adjusted debt to EBITDA at 9.0x-9.5x.
- Strong adjusted EBITDA interest coverage of 4.5x-5.0x in the next two years.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/--

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)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Alstria Office REIT-AG, Oct. 27, 2020.

Ratings List

Upgraded; Outlook Action

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

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