

Research Update:

German Alstria Office REIT-AG Downgraded To 'BBB-' On Brookfield's Completed Takeover; Outlook Stable

February 11, 2022

Rating Action Overview

- As of Feb. 8, 2022, Brookfield Strategic Real Estate Partners IV holds 92% of Alstria Office REIT-AG's share capital, closing the voluntary public takeover offer for the German office property company.
- We understand that the takeover has prompted Alstria to significantly raise its target loan-to-value (LTV) ratio of 50%-55% from 35%, translating into S&P Global Ratings-adjusted debt to debt plus equity of up to 55%, according to our estimates.
- We therefore lowered to 'BBB-' from 'BBB+' our long-term issuer credit rating on Alstria and the rating on the company's bonds. We also removed the ratings from CreditWatch negative, where we had placed them on Nov. 8, 2021.
- The stable outlook reflects our view that Alstria will continue to generate robust and stable cash flow, supported by solid demand trends in the German office market for good quality assets in metropolitan areas, and that the company's credit metrics will align with the revised financial policy and our 'BBB-' rating.

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Rating Action Rationale

On Feb. 8, 2022, Brookfield, through its subsidiary Alexandrite Lax Lux Holdings S.a.r.l., completed its takeover of Alstria. Brookfield holds 92% following the end of the second acceptance period, and the remaining 8% are free float. We understand that Brookfield will likely gain control of Alstria's supervisory board and represent the majority of board members. We view Brookfield as a strategic owner, based on its commitment to a long-term ownership and support of Alstria's strategy with limited dividends and maintaining a disciplined financial policy in line with our 'BBB-' rating level. Although we note that Brookfield's controlling ownership means the fund can promote its interest above other shareholders', we view positively that Brookfield supports Alstria's incumbent management team, which also has a sound track record with Alstria.

We reflect the change in ownership and more aggressive financial policy with a reassessment of our management and governance score to fair from satisfactory.

Alstria's new LTV target following the takeover will likely translate to a higher consolidated debt burden and interest expenses that will weaken credit metrics. Under a revised financial policy, Alstria is now committed to an LTV of 50%-55% on a consolidated basis (including any potential debt at the direct holding). According to our estimates, this would translate to an S&P Global Ratings-adjusted ratio of debt to debt plus equity of 55% or below. Because this LTV target is significantly higher than the company's previous maximum LTV of only 35%, we reassessed the company's financial risk profile by two categories to significant from modest. Under our updated base case, we believe leverage will temporarily jump with debt-to-debt plus equity at 55% or above but will reach just below 55% by end of 2022 and near 50% or even below in 2023, also factoring in any potential debt sitting at the direct holding company, which can only be served by Alstria's cash flow. We understand that the company intends to sell off some assets over the next 24 months in order to deleverage and create further headroom under its financial policy. We expect the ratio of debt to EBITDA will settle around 15x over the coming two years. Because of higher debt and therefore heavier interest burden, the interest coverage ratio will likely drop to 2.2x-2.5x in the next 12-24 months. Our revised forecast envisages that the company maintains an average cost of debt of 1.5%-1.7% and a balanced debt maturity profile with limited short-term refinancing needs.

We understand Alstria will continue to focus on German office properties in or close to metropolitan areas. Although we expect some disposals will support deleveraging over the coming two years, we believe Alstria's portfolio will expand again in the longer term. The company's strategic area of operations is characterized by unwavering demand and limited supply. Also, we understand assets with upside potential will continue to be a priority for Alstria, and that the company will maintain its exposure to public tenants, which we view as very stable and long term. Although the office sector in general is coping with potentially changed office needs following the pandemic, we believe that prime office assets with good quality in popular locations will continue to receive solid demand. This directly benefits Alstria, in our view, since its assets are well located in or near city centers and benefit from a diversified tenant base and an average lease maturity of over 5.6 years, above industry average.

Outlook

The stable outlook reflects our expectation that Alstria's focus on office assets in German metropolitan cities will yield stable rental income. Based on Alstria's financial policy of maintaining LTV of 50%-55%, we expect our ratio of debt to debt plus equity to remain below 55% over the next 12-24 months. In addition, we forecast EBITDA interest coverage to remain well above 2x and debt to EBITDA to stabilize at about 15x over the same period.

Downside scenario

We could lower the rating if:

- Alstria's debt to debt plus equity exceeds 55% for a prolonged period;
- Debt to annualized EBITDA materially exceeds our base-case projections; or
- EBITDA interest coverage falls to 1.8x or below.

We would also consider taking a negative rating action if liquidity deteriorates or if the company further alters its financial policy, for example, resulting in substantial increase in dividends.

Upside scenario

We could raise our rating if:

- Debt to debt plus equity decreases well below 50% on a sustainable basis and thanks to a more conservative financial policy;
- Interest coverage ratio improves above 3x; and
- Debt to EBITDA decreases to below 13x.

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 comprises 111 assets that value a total of about €4.7 billion (as of Sept. 30, 2021).

Alstria became the first German REIT in 2007 and is listed on the MDAX. The company is controlled by Brookfield (92% of shares). The remaining 8% are free float.

Our Base-Case Scenario

Assumptions

- German GDP of 4.3% in 2022 and 2.5% in 2023, with unemployment remaining low at approximately 3.4%.
- Annual consumer price index growth in Germany of around 2.2% in 2022 and 1.7% in 2023.
- Positive like-for-like net rental income of about 2.5% in 2022, supported by solid demand trends for good quality office assets in or near larger German cities and supported by inflation expectations.
- Occupancy to remain stable at around 90%-93%.
- Some asset disposals in the next 12-24 months to ease deleveraging efforts, in line with the company's strategy.
- Annual capital expenditure (capex) of €150 million-€200 million in the next two years.
- Flat like-for-like revaluation over the coming two years.
- Cost of debt to remain favorably at 1.5%-1.7%, including future issuances.

Key metrics

- Debt to debt plus equity just below 55% in 2022 and close to 50% or even below in 2023,

including any potential debt at the holding and depending on the speed of asset disposals;

- Adjusted debt to EBITDA to temporarily increase to around 19x in 2022 and stabilize in 2023 at around 15x; and
- Declining EBITDA interest coverage to around 2.2x-2.5x in the next two years.

Liquidity

We view Alstria's liquidity as adequate, based on the company's ratio of liquidity sources to uses of above 1.2x over the next 12 months as of Jan. 1, 2022.

We estimate Alstria's principal liquidity sources for those 12 months will comprise:

- Unrestricted cash balances of about €314 million and undrawn committed revolving credit facility of €100 million, maturing in more than 12 months;
- Our forecast of cash funds from operations of approximately €115 million; and
- Signed asset disposals of €97 million.

We estimate the following principal liquidity uses for the same period:

- Short-term debt maturities of only about €8 million, mainly related to amortization of mortgage loans;
- Committed capex of about €110 million for renovation and refurbishment; and
- Estimated cash dividend of about €38 million, following the company's strategy to reduced dividend distribution.

Issue Ratings – Subordination Risk Analysis

Capital structure

As of Dec. 31, 2021, Alstria's capital structure comprised about 13% secured debt, mainly mortgaged bank loans; and 87% unsecured debt, including mainly senior unsecured bonds and promissory notes.

Analytical conclusions

The issue ratings on the company's senior unsecured bonds are '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 well below 40%).

We understand that the leverage of Alstria will likely increase over the next few months. That said, we believe that the level of secured debt remains very limited and the ratio of secured debt to total assets well below 40%, in line with the company's strategy.

Ratings Score Snapshot

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

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

Financial risk: Significant

- Cash flow/Leverage: Significant

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: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, 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

- German Alstria Office REIT-AG 'BBB+' Rating Placed On CreditWatch Negative After Takeover Offer By Brookfield, Nov. 8, 2022

Ratings List

Downgraded; Outlook Action

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

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.

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