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Research Update:

German Real Estate Company Alstria Office REIT Downgraded To 'BB+' On Announced Extraordinary Dividend; Outlook Negative

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PRIMARY CREDIT ANALYST

Gabriel Zurita
Frankfurt
+49 6933999193
gabriel.zurita
@spglobal.com

SECONDARY CONTACT

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

Rating Action Overview

- Alstria Office REIT-AG announced on Oct. 13 its intention to pay out a special dividend of €250 million until year-end.
- We forecast that with this dividend, the company's credit metrics will no longer be in line with our requirements of an investment-grade rating, with S&P Global Ratings-adjusted debt to debt plus equity staying above 55% and an EBITDA interest coverage below 1.8x over the next 12-24 months.
- We continue including the debt and related interest expenses of Alstria's direct holding company in our credit metrics and understand the shareholder will use the majority of dividend proceeds to reduce its debt at the holding level.
- Consequently, we lowered our issuer credit rating on Alstria to 'BB+' from 'BBB-' and affirmed our 'BBB-' issue ratings on the company's senior unsecured bonds. We assigned our '2' recovery rating to the bonds.
- The negative outlook reflects our view of the challenging market environment for real estate companies, including rising interest rates, pressure on property valuations, and low activity on the transaction market, which could impair Alstria's credit metrics beyond our forecast over the next 12 months.

Rating Action Rationale

In our revised base-case forecast, which includes Alstria's announced extraordinary dividend, we no longer anticipate the company's credit metrics will be in line with an investment-grade rating. Alstria's S&P Global Ratings-adjusted debt-to-debt plus equity ratio stood at 55.4% June 30, 2023, and EBITDA rolling-12-month interest coverage dropped to 1.3x, breaching our downside thresholds for an investment-grade rating. Including the anticipated special dividend payment, we now forecast that S&P Global Ratings-adjusted ratio of debt to debt plus equity will be 57%-59%

over the next 24 months and EBITDA interest coverage near 1.3x. Our calculations include the holding company's debt, which we expect to remain at about €800 million after the dividend, as well as our assumptions of a portfolio devaluation of 5% in 2023. We understand Alstria will pay the dividend from existing cash resources. We assume that the holding debt, which matures in January 2024, will be refinanced at current market conditions and that debt to EBITDA will stay high, at 20x-22x.

We have applied a positive comparable rating analysis modifier, reflecting that Alstria's contractual debt obligation is significantly below S&P Global Ratings' adjusted leverage benchmark for the rating. We include in Alstria's adjusted credit metrics the debt sitting at the direct holding company, Alexandrite Lax Lux Holdings S.a.r.l. We understand that post-dividend, the holding company debt will decrease to about €800 million, or 25%-30% of S&P Global Ratings-adjusted net debt. Furthermore, Alstria's adjusted EBITDA interest coverage ratio is significantly affected by the inclusion of the interest costs related to the holding company's debt, with more than 50% of adjusted interest expense related to that debt. We understand that the remaining debt at the holding company is floating-rate, significantly higher than debt at Alstria's level (excluding the holding company debt, Alstria's average interest cost is 2.7% as of June 30, 2023). Alstria has no contractual obligation or guarantee to repay the holding company's debt. We also do not expect any further extraordinary special dividends by Alstria. We expect the company's debt to debt plus equity to remain at 55%-59% over the next couple of years, which compares favorably with that of peers in the same financial risk category. Excluding the holding debt, Alstria's debt to debt plus equity would be near 52% and EBITDA interest coverage at 3.0x.

We expect Alstria's operating performance to remain stable, benefiting from inflation-linked rental contracts, a relatively high exposure to public tenants, and ongoing demand for its office properties in central city locations. The company has increased its funds from operations guidance for fiscal 2023 to €84 million from €79 million. In line with its expectations, we believe Alstria's operations will continue gaining from elevated inflation (78% of the company's annual rent is linked to an index clause). We assume positive annual like-for-like rental income growth of 2%-3% for the next few years and broadly stable occupancy rates at 92%-93%. The company benefits from a good weighted-average lease term of more than five years and exposure to public tenants, with stable and predictable long-term cash flows. Alstria has a longstanding position in Germany's office market and a good track record of attracting and retaining long-term tenants.

Outlook

The negative outlook reflects our view of the challenging market environment for real estate companies, including rising interest rates, pressure on property valuations, and low activity on the transaction market, which could impair Alstria's credit metrics beyond our forecast.

Downside scenario

We could lower the rating if:

- Alstria's adjusted debt to debt plus equity increases to and stays well above 60%;
- EBITDA interest coverage declines below 1.3x; or
- Debt to annualized EBITDA materially exceeds our base-case projections.

We would also consider taking a negative rating action if liquidity deteriorates or a more aggressive financial policy is introduced. We might further consider a negative rating action if key performance ratios deteriorate significantly.

Upside scenario

We could raise the rating if:

- Debt to debt plus equity improves to and stays below 60%;
- EBITDA interest coverage ratio improves to 1.5x or above; and
- Debt to annualized EBITDA remains within our base-case scenario.

Company Description

Alstria is one of the largest listed office real estate companies in Germany. The company focuses on acquiring and managing office properties across the country, with locations mainly in or close to metropolitan areas such as Hamburg, Frankfurt, Dusseldorf, Berlin, and Stuttgart. Alstria's portfolio combines 106 assets with a market value of about €4.6 billion (as of June 30, 2023).

Alstria became the first German REIT in 2007 and is listed on the MDAX. As of Oct. 20, 2023, Brookfield Asset Management remained the largest shareholder, with 95% ownership.

Our Base-Case Scenario

Assumptions

- Real GDP in Germany to contract to near 0.2%, with growth returning in 2024 and 2025 at 0.6% and 1.4%, respectively. German consumer price index will remain high at 6.3% in 2023 before slowing to 2.8% in 2024. We expect unemployment to remain broadly stable and low, at 3.0% over the forecast horizon.
- Positive like-for-like rental income growth of 2%-3% over the next 12 months, mainly supported by inflation and lease renewals, and broadly stable occupancy rates of 92%-93%.
- Property devaluations of about 5% in 2023, mainly from increased capitalization rates.
- No significant acquisitions.
- Annual capital expenditure (capex) of €130 million-€140 million over 2024-2025.
- About €30 million disposals in 2023 (already completed year-to-date), and €100 million annually afterward, given an ongoing challenging transaction market.
- A special dividend payment of €250 million in 2023 and €10 million-€30 million annually from 2024 onwards, the latter representing the minimum dividend requirements by Alstria's German status as a real estate investment trust.
- Average cost of debt to remain near 3%, excluding the debt at the holding company level.

Key metrics

- Debt to debt plus equity to increase to 57%-59% over the next 24 months.
- Adjusted debt to EBITDA of 20x-22x in 2024 and 2025.
- EBITDA interest coverage to remain near 1.3x in that time.

Liquidity

We maintained our adequate liquidity assessment on Alstria, based on the company's ratio of liquidity sources to uses of above 1.2x over the next 12 months as of June 30, 2023.

We estimate Alstria's principal liquidity sources for the next 12 months to comprise:

- Unrestricted cash balance of about €300 million and an undrawn committed revolving credit facility of €200 million, maturing in more than 12 months;
- Our forecast of cash funds from operations of €85 million-€90 million;
- A loan of €100 million signed after June 30.

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

- Short-term debt maturities of about €154 million, mainly related to secured mortgage loans, maturing in second-quarter 2024;
- Committed capital expenditure of about €90 million for renovations and refurbishment; and
- The special dividend of about €250 million.

Covenants

Requirements

We understand that Alstria has financial covenants for its existing debt and that its headroom remained adequate (more than 10%):

- Consolidated net financial indebtedness over total assets of a maximum 60%, with headroom of 28%.
- Secured consolidated net financial indebtedness to total assets of 45% maximum, with headroom of 53%.
- Unencumbered assets to unsecured consolidated net financial indebtedness will be more than 150%, with a headroom of 90%.
- A consolidated coverage ratio of at least 1.8x (this was reported at 4x).

Issue Ratings - Recovery Analysis

Key analytical factors

- The issue rating on Alstria's senior unsecured bonds with a combined outstanding value of €1.1 billion is 'BBB-', one notch above the 'BB+' issuer credit rating.
- The recovery rating is '2', reflecting the valuable asset base, mostly consisting of properties with stable rental income generation. For asset-intensive companies such as real estate companies, we cap our recovery rating on senior unsecured debt at '2'. Our recovery prospects are constrained by the debt's unsecured nature and contractual subordination to the current secured debt.
- In our hypothetical default scenario assumed for 2028, we envisage a severe economic downturn in Germany, resulting in market depression and exacerbated competitive pressures.
- We value the group as a going concern and use a discrete asset value approach to consider Alstria's stressed yielding properties.
- The bond documentation includes limitations on indebtedness--a maximum debt to asset ratio of 60%--and a limitation on prior-ranking debt, with secured debt to total assets restricted to a maximum of 45%.

Simulated default assumptions

- Year of default: 2028
- Jurisdiction: Germany

Simplified waterfall

- Gross enterprise value (EV) at emergence: €3.04 billion
- Net EV at emergence after 5% administrative costs: €2.89 billion
- Estimated priority debt (mortgages and other secured debt): €1.35 billion
- Net EV available to senior unsecured bondholders: €1.54 billion
- Senior unsecured debt claims: €1.15 billion
- --Recovery expectation: 70%-90% (rounded estimate: 85%)

The recovery rating expectation includes the cap we have for asset-intensive companies. All debt amounts include six months of prepetition interest and assume 85% of the revolving credit facility and credit lines are drawn on default (Alstria's credit lines totaled about €200 million as of June 30, 2023).

Ratings Score Snapshot

Issuer Credit Rating	BB+/Negative/--
Business risk:	Satisfactory
Country risk	Very low
Industry risk	Low
Competitive position	Satisfactory
Financial risk:	Aggressive
Cash flow/leverage	Aggressive
Anchor	bb
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	Positive (+1 notch)

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: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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 Real Estate Company Alstria Outlook Revised To Negative On Tight Credit Metrics; 'BBB-' Ratings Affirmed, May 9, 2023

Ratings List

Downgraded

	To	From
Alstria Office REIT-AG		
Issuer Credit Rating	BB+/Negative/--	BBB-/Negative/--
Ratings Affirmed; New Recovery Rating		
Alstria Office REIT-AG		
Senior Unsecured	BBB-	
Recovery Rating	2(85%)	