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Research Update:

Alstria Office-REIT AG Downgraded To 'BB' On Higher-Than-Expected Property Devaluations; Outlook Negative

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Rating Action Overview

- Alstria Office REIT-AG (Alstria) reported a material property devaluation of about €770 million for fiscal 2023, leading to a S&P Global Ratings-adjusted ratio of debt to debt plus equity of 66%, including our adjustments of the debt at its holding company, versus our expectation of 58%.
- Furthermore, following refinancing activities, Alstria's EBITDA interest coverage dropped to 1.0x, including about €80 million of interests related to the debt at the holding level. This prompts us to assume Alstria's credit metrics will remain more commensurate with our 'BB' rating, including an adjusted debt-to-debt plus equity ratio of close to 65% and EBITDA interest coverage around 1.3x over the next 12 months.
- Although Alstria refinanced most of its short-term debt over the 12 months with only limited refinancing needs left for 2024, there is uncertainty around how the company might meet the September 2025 maturity of its €400 million senior unsecured bond.
- Consequently, we lowered our issuer credit ratings on Alstria to 'BB' from 'BB+' and the issue rating on the company's senior unsecured bonds to 'BB+' from 'BBB-'. The recovery rating remains at '2'.
- The negative outlook reflects that Alstria's debt metrics might not recover in 2024 or that liquidity could deteriorate in 2025 if debt maturities are not addressed in a timely manner.

Rating Action Rationale

Our downgrade captures the greater-than-anticipated property devaluation Alstria reported for 2023 that weakened the company´s credit metrics. In its recent publication of 2023 financial statements, Alstria reported a property devaluation of around €770 million or around 16% on a like-for-like basis, versus our expectations of around 5%. This led to a pronounced increase of S&P Global Ratings-adjusted debt-to-debt plus equity ratio to about 66%, surpassing the 60%

threshold for our 'BB+' rating. Our calculation includes our estimate of approximately €800 million of debt at Alexandrite Lax Lux Holdings S.a.r.l., Alstria's parent. In addition, Alstria's EBITDA interest coverage dropped to 1.0x (including around €80 million of interest expense related to its holding company debt), compared with the approximately 1.3x we had anticipated for 2023 and from the 1.7x the company reported in 2022. Considering the ongoing slow transaction market and potential further pressure on valuations, as well as our expectations that Alstria's shareholders will not support the company with equity in the near term, we expect the company's credit metrics will stay in line with our 'BB' issuer credit rating. We forecast that debt to debt plus equity will remain at about 65% in 2024, including another mid-single-digit devaluation, and that EBITDA interest coverage will improve slightly toward 1.3x-1.4x, following our understanding of more favorable refinancing conditions of the holding company's debt and Alstria's increased hedging ratio to 86% in 2023 from 65% in 2022. We project that Alstria's debt to EBITDA will stay high, at about 20.0x over 2024-2026 (compared with 21.3x in 2023).

Although Alstria has limited refinancing needs over the next 12 months, its 2025 bond maturities could pose a risk. The company reported about €267 million of short-term debt maturities, mainly related to two mortgage loans. We understand that about €107 million has been extended and that the company is currently in negotiations with its banks to refinance the remaining €150 million. With about €110 million of available unrestricted cash as well as its undrawn revolving credit facility of €200 million, Alstria enjoys a solid liquidity position for 2024. However, in our liquidity analysis from third-quarter 2024 on, we will factor in the company's senior unsecured bond with an outstanding amount of €353.4 million, due September 2025, representing about 16% of its gross balance sheet debt. Credit market conditions for real estate companies have deteriorated over the past year due to rising interest rates and weakening trading conditions, both in equity and debt capital markets. Failure to secure sufficient funding to meet this sizable debt maturity on time could harm Alstria's liquidity and would likely lead us to lower the rating. We note that, at end-2023, Alstria's weighted-average debt maturity (WAM) stood at 3.3 years, close to our threshold of a minimum of three years. That said, we understand that pro forma the refinancing of its 2024 maturities, its WAM will improve to about 3.5years. We expect Alstria will keep WAM comfortably above three years.

The property devaluations resulted in tighter financial covenants. We understand that Alstria's headroom under some of its financial covenants, mainly related to loan to value (LTV), has decreased below 10%. Following the strong property devaluation in 2023, LTV levels for its covenants under mortgage financing have exceeded 60%, sometimes 70%, with covenants ranging between 65% and 75%. For its unsecured financing, comparable LTV covenant is set at 60.0% with reporting of 56.4% at year-end 2023. We understand that the company does not plan to raise further debt, nor does it intend to pay non-mandatory dividends, and the next external property valuation will not be done before year-end. As such, we expect no breach of any financial covenants throughout the year. That said, the risk of a covenant breach has increased. We understand that all of Alstria's financial covenants are soft covenants and do not lead to any default scenario under its debt documentations. A breach of covenants could however entail further cash restrictions and limitations on the usage of operating income for its properties, burdening the company´s liquidity position.

We expect Alstria's operating performance to remain stable, benefiting from inflation-linked rental contracts and a relatively high exposure to public tenants, despite a slight drop in occupancy. We assume positive annual like-for-like rental income growth of 1%-3% for the next few years and a small contraction in occupancy levels to about 90% in 2024 from 92% at year-end

2023, given that we conservatively assume some leases will not be extended at expiry. The company enjoys a good weighted-average lease term of more than five years and exposure to public tenants, with stable and predictable long-term cash flow. 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 the risk that Alstria's credit metrics, as adjusted by S&P Global Ratings, may not recover in 2024 and that liquidity could deteriorate if 2025 debt maturities are not addressed in a timely manner.

We forecast debt to EBITDA will remain high at about 20x for the next 12 months and that S&P Global Ratings-adjusted ratio of debt-to-debt plus equity will be close to 65%. We expect a slight recovery in its EBITDA interest coverage ratio to about 1.3x-1.4x over the same period.

Downside scenario

We could lower the rating if:

- The company does not sustain debt-to-debt plus equity close to 65%;
- EBITDA interest coverage does not recover to 1.3x or above; or
- Debt to annualized EBITDA materially exceeds our base-case projections.

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

Upside scenario

We could revise our outlook to stable if:

- Debt to debt plus equity falls below 65%;
- EBITDA interest coverage ratio improves comfortably above 1.3x; and
- Debt to annualized EBITDA remains within our base-case projections.

We would also view positively an early refinancing of near-term debt maturities while maintain an average debt maturity of comfortably above three years.

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 billion (as of end-2023).

Alstria became the first German REIT in 2007 and is listed on the MDAX. As of March 18, 2024, Brookfield Asset Management is the largest shareholder, with 95% ownership.

Our Base-Case Scenario

Assumptions

- Real GDP growth of 0.5% in 2024 and 1.5% in 2025, following a contraction of 0.2% in 2023. German consumer price index to increase at a slower rate--3.0% in 2024 and 2.1% in 2025. We expect unemployment to remain broadly stable and low, at 3.0% over the forecast horizon.
- Positive like-for-like rental income growth of 1%-3.0% over the next 12-24 months, supported by inflation and lease renewals, with a slight decline in occupancy rates to about 90%.
- Further mid-single-digit property devaluations in 2024.
- No acquisitions forecasted, while we expect minimal disposals of around €50 million in 2024.
- Annual capital expenditure (capex) of €120 million-€140 million over 2024-2025.
- Minimal dividends paid of €10 million-€30 million, in line with requirements by Alstria's REIT status.
- Average cost of debt to remain near 3%, excluding the debt at the holding company level.

Key metrics

- Debt to debt plus equity of close to 65% over the next 24 months.
- EBITDA interest coverage to improve to 1.4x.
- Adjusted debt to EBITDA to remain high at about 20x in 2024-2025.

Liquidity

Alstria's liquidity remains adequate, in our view, based on our calculation that the company's liquidity sources will cover uses by more than 1.2x in 2024.

We estimate Alstria's principal liquidity sources for the 12 months started Jan. 1, 2024, to comprise:

- Unrestricted cash balance of about €108 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 around €100 million.

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

- Short-term debt maturities of about €150 million, mainly related to one secured mortgage loan, maturing in the second-quarter of 2024;
- Committed capex of about €90 million for renovations and refurbishment; and
- Mandatory dividend payment under the German REIT status of €10 million-€30 million.

Covenants

We understand that Alstria has financial covenants for its existing debt and that its headroom has deteriorated to below 10% for certain LTV covenants, due to the reported property devaluation in 2023:

- Consolidated net financial indebtedness over total assets of a maximum 60%, reported at 56%, with headroom of less than 10%.
- Secured consolidated net financial indebtedness to total assets of 45% maximum, reported at 30%, with headroom of around 50%.
- Unencumbered assets to unsecured consolidated net financial indebtedness will be more than 150%, reported at 207%, with a headroom of about 28%.
- A consolidated coverage ratio of at least 1.8x (this was reported at 2.8x).

We understand that all of Alstria's covenants are soft covenants and a breach does not trigger any default, and mainly relates to cash restrictions. That being said, we expect Alstria to take sufficient steps to ensure none of its covenants will be breached in the near-term and headroom will increase.

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 'BB+', 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 2029, 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: 2029
- Jurisdiction: Germany

Simplified waterfall

- Gross enterprise value (EV) at emergence: €2.6 billion
- Net EV at emergence after 5% administrative costs: €2.47 billion
- Estimated priority debt (mortgages and other secured debt): €1.35 billion
- Net EV available to senior unsecured bondholders: €1.12 billion
- Senior unsecured debt claims: €1.12 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 December 31, 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	Moderately Negative (no impact)
Comparable rating analysis	Neutral (no impact)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- 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 | 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- German Real Estate Company Alstria Office REIT Downgraded To 'BB+' On Announced Extraordinary Dividend; Outlook Negative, Oct. 20, 2023

Ratings List

Downgraded

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