

January 18, 2011

### Research Update:

## Belgian Property Company Cofinimmo Outlook Revised To Stable; 'BBB' L-T Rating Affirmed; S-T Rating Raised To 'A-2'

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## Research Update:

# Belgian Property Company Cofinimmo Outlook Revised To Stable; 'BBB' L-T Rating Affirmed; S-T Rating Raised To 'A-2'

## Overview

- Belgium-based property investment company Cofinimmo S.A./N.V. has slightly deleveraged its capital structure.
- The company's operating performance is supported by the good asset quality and diversity of its portfolio.
- We are therefore revising the outlook on Cofinimmo to stable from negative, affirming the 'BBB' long-term corporate credit rating, and raising the short-term rating to 'A-2' from 'A-3'.
- The stable outlook reflects our view that Cofinimmo's debt leverage is now adequate for the ratings and that the company has adequate financial flexibility.

## Rating Action

On Jan. 18, 2011, Standard & Poor's Ratings Services revised the outlook on Belgian property investment company Cofinimmo S.A./N.V. to stable from negative. At the same time, we affirmed our 'BBB' long-term corporate credit rating on Cofinimmo, and raised our short-term corporate credit rating to 'A-2' from 'A-3'.

## Rationale

The outlook revision reflects our view of a reduction in Cofinimmo's debt leverage, which we now view as adequate for the ratings. It also reflects the improved headroom under Cofinimmo's debt covenants, and our assessment of the positive contribution of the nursing homes and pub segments to the operating stability of the company's portfolio.

The ratings on Cofinimmo reflect our view of the company's diversified portfolio of good-quality assets that generate stable cash flows, the portfolio's long lease-maturity profile and high occupancy rate, and sufficient headroom under its debt covenants. Partially offsetting these strengths are Cofinimmo's highly leveraged capital structure, weak cash flow metrics, and its exposure to the depressed Brussels office market.

We assess Cofinimmo's business risk profile as strong. This is supported by the relatively large size of the company's portfolio, which was valued at €3 billion on Sept. 30, 2010. Most of the assets are office buildings (58% of the portfolio value) and are generally located in Belgium (84% of the portfolio

value). Cofinimmo has leading market positions notably in the Brussels office market, with about 40% of its offices located in the prime central business district.

We understand that Cofinimmo intends to continue expanding into nursing homes, while disposing of more volatile offices. We take a positive view of the increasing diversification of the company's portfolio into nursing homes, pubs, and public-private partnerships. We view these assets as of good quality, and generating stable cash flows thanks to long, indexed-linked leases, mostly with creditworthy tenants, and full occupancy.

However, due to the high overcapacity in the Brussels office market, we believe that rent incentives and potential negative reversion (office rental income is currently exceeding rental value) will continue to pressure office rents. In addition, counterparty risk remains high among small nursing homes operators, in our opinion. Finally, we see some tenant concentration risk in the company's whole portfolio, with 69% of the contracted rents paid by the top 10 tenants, although of majority of these tenants are government entities or companies rated above 'BBB+'.

We assess Cofinimmo's financial risk profile as significant. This reflects a weak, albeit improved, capital structure with a loan-to-value (LTV) ratio of 53% at end-September 2010, thanks to a lower level of debt. We forecast a Standard & Poor's-adjusted LTV ratio of about 54% in December 2011, an improvement from 55% in December 2009, and 58% in December 2008. Although Cofinimmo's capital structure remains weaker than that of most of its rated European peers, we believe that it is adequate for the ratings, given the stability of the company's operating performance.

The company's cash flow metrics (4% funds from operations [FFO] to debt) remain below those of its peers, although the trailing 12-month EBITDA interest coverage ratio is adequate, in our view, at about 2.4x. Looking forward, we anticipate that credit metrics will remain stable and cash flow ratios will improve slightly.

We consider that headroom under the debt covenants is adequate. The unadjusted LTV ratio reached 51.2% on Sept. 30, 2010, against a maximum ratio of 57.5%, which is allowed to rise to 60% for six months. The improvement in the LTV ratio was supported by about €100 million of asset disposals and a €69 million treasury shares sale in 2010. We also note that Cofinimmo has fully hedged its debt for interest rate risk.

## **Liquidity**

The short-term rating is 'A-2', reflecting our view that Cofinimmo's liquidity is adequate, offset by the company's relatively weak position within the 'BBB' rating category. On Sept. 30, 2010, short-term debt maturities amounted to €317 million, including €117 million issued under a €500 million commercial paper program. We also forecast over €100 million of capital expenditures and €90 million of dividends to be paid. These near-term cash calls are fully

backed by €362 million of undrawn committed credit lines with an average maturity of five years, and €2 million of unrestricted cash. We also forecast about €95 million of FFO for 2011 and over €100 million of asset disposals.

We anticipate that Cofinimmo will continue to enjoy good access to capital markets and bank financing, as evidenced by the €50 million private placement that it signed in September 2010. The low level of encumbered assets may provide a future source of liquidity, although secured issuances are limited to 20% of total debt.

The company's debt maturity profile remains relatively well managed, in our opinion, with an average debt tenor of about four years and no large maturities in the next two years. We consider that Cofinimmo has a satisfactory hedging policy, which aims to cover between 50% and 90% of the outstanding debt using a combination of interest rate swaps, caps, and floors. On Sept. 30, 2010, 100% of the debt was hedged against interest rate risk until 2015, and more than 70% was hedged until 2017.

The SICAFI ("Société d'investissement à capital fixe immobilier") tax regime requires the distribution of 80% of the company's recurring cash flow. However, SICAFI companies are also entitled to use this recurring cash flow to reduce their outstanding debt rather than pay dividends. Given that debt is likely to be refinanced rather than repaid because Cofinimmo does not generate sufficient free cash flow, we see this entitlement as providing the company with extra financial flexibility. Recent legislation now enables SICAFI companies to distribute their dividends in shares instead of cash, which we view as potentially credit positive for Cofinimmo's liquidity position.

## Outlook

The stable outlook reflects our view of Cofinimmo's improvements in terms of deleveraging and our view that there is adequate headroom under the debt covenants. Looking forward, we anticipate that Cofinimmo's EBITDA interest coverage ratio will remain at about 2.5x, FFO to debt at above 6%, and the adjusted LTV ratio at less than 55%.

We could lower the ratings if EBITDA interest coverage falls to less than 2.0x, if FFO to debt remains at less than 6%, and if the adjusted LTV ratio stays above 55%. This could occur if market trends and the company's letting performance are lower than projected, or if the company makes large, debt-financed acquisitions that push debt leverage to a higher level than we consider commensurate for the ratings.

Rating upside would depend mainly on Cofinimmo maintaining, on a sustainable basis, an EBITDA interest coverage ratio close to 3.0x, an FFO to debt ratio of about 8%, and an adjusted LTV ratio of less than 50%.

## Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Corporate Ratings Criteria 2008, April 15, 2008
- Key Rating Factors For European Real Estate Companies, Nov. 24, 2004

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action; Upgraded

	To	From
Cofinimmo S.A./N.V.		
Corporate Credit Rating	BBB/Stable/A-2	BBB/Negative/A-3
Commercial Paper	A-2	A-3
Senior Unsecured Debt	BBB	
Cofinimmo Luxembourg S.A.		
Senior Unsecured Debt*	BBB	

\*Guaranteed by Cofinimmo S.A./N.V.

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Complete ratings information is available to RatingsDirect subscribers on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com) and RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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) 495-783-4011.

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