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**Research Update:**

## Austrian Commercial Real Estate Company Immofinanz AG Rated 'BBB-'; Outlook Stable

**Primary Credit Analyst:**

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

**Secondary Contact:**

Franck Delage, Paris (33) 1-4420-6778; franck.delage@spglobal.com

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## Research Update:

# Austrian Commercial Real Estate Company Immofinanz AG Rated 'BBB-'; Outlook Stable

## Rating Action Overview

- Immofinanz AG owns and manages a property portfolio valued at about €4.3 billion as of Sept. 30, 2018, consisting of 223 office and retail assets across Central and Eastern Europe.
- We expect rental income growth for Immofinanz's portfolio will remain positive over the next 12-24 months, thanks to stable demand trends in the company's operating environment, stable occupancy levels, and rental growth from new lettings and upcoming project completions.
- We are assigning our 'BBB-' long-term issuer credit rating to Immofinanz and our 'BBB-' issue rating to its senior unsecured notes.
- The stable outlook reflects our view that strong demand for Immofinanz's office assets in several European capital cities should enable the group to generate resilient cash flows over the next 12-24 months.

## Rating Action Rationale

Our rating on Immofinanz reflects our view of the company's portfolio valued at about €4.3 billion, including approximately €360 million of properties under construction and €192.5 million of pipeline projects. Its standing portfolio of about €3.7 billion consists mainly of office properties (62% as of Sept. 30, 2018) and retail assets (38%) across Central and Eastern Europe (CEE), and we consider that it has relatively good scale and size. The company's standing portfolio is spread across seven core countries, including Austria (about 22% as of Sept. 30, 2018), Poland (20%), Romania (17%), Germany (8%), Hungary (13%), the Czech Republic (9%), and Slovakia (8%), with the remaining 3% in noncore countries. The company's strategy is to focus on office and retail real estate in CEE while ensuring exposure to development projects is less than 10% of gross asset value. Immofinanz is listed on the Vienna and Warsaw stock exchange and has a free float of about 78%. Its largest shareholder is S Immo AG, which has a 12% shareholding.

Although the market is very fragmented, the company has a good market position as one of the largest commercial property owners in CEE. We consider the company's office buildings to be good quality and they are mainly in the capital cities, such as Vienna, Prague, or Bucharest, which have good infrastructure and accessibility. The office portfolio benefits from a national as well as international tenant base, such as trivago N.V., O2, KPMG LLP, or Austria. The CEE office market should remain resilient for office landlords like Immofinanz because the region--in particular, Poland and

Romania (together about 37% of total portfolio value)--is a major outsourcing hub for multinationals and financial institutions, due to lower labor costs and a qualified workforce.

In our view, Immofinanz's retail portfolio focuses more on secondary and tertiary cities, which have less favorable dynamics than larger metropolitan areas. We consider that the company's retail assets are generally less stable and recession-proof than other segments, such as residential. The sector is also facing increasing pressure from e-commerce in mature markets, particularly in the fashion industry, which accounts for 32% of Immofinanz's tenant mix in its retail portfolio. We still consider that the retail markets where Immofinanz operates currently benefit from positive economic trends, such as positive real GDP growth, stable unemployment rates, and improving consumer spending, and that these should continue to support the company's cash flow generation over the next 12 to 24 months.

Our assessment of Immofinanz's financial risk profile is underpinned by its relatively weak EBITDA interest coverage of just 1.8x for the 12 months to Sept. 30, 2018. We expect this ratio will gradually improve close to 2x by the end of 2018 and toward 2.4x by the end of 2019, thanks to Immofinanz's recent refinancing activities and also assuming further successful refinancing of upcoming secured debt maturities with the senior unsecured bond of €500 million. We expect that upcoming debt issuances will be used to redeem short-term debt with higher average cost of debt than the company currently reports. We view as supportive the company's moderate leverage ratio; it had an adjusted ratio of debt to debt plus equity of approximately 38% as of Sept. 30, 2018 and its financial policy includes a net loan-to-value target ratio of about 45%.

Our rating on Immofinanz incorporates one notch of uplift from the anchor, based on our comparable ratings analysis. In our view, Immofinanz's EBITDA interest coverage will move to 2.4x in the next 12 months, and its hedging exposure will increase to 85% from 75%. We anticipate that this will bring the company's credit metrics in line with those of other investment-grade companies in the region. Our assessment also reflects Immofinanz's sizable portfolio and its limited dependency on single assets or tenants, compared with speculative-grade rated peers.

The ratings are in line with the preliminary ratings we assigned on Jan. 8, 2019 (see "Austrian Commercial Real Estate Company Immofinanz AG Assigned Preliminary 'BBB-' Rating; Outlook Stable" published on RatingsDirect).

## **Outlook**

The stable outlook on Immofinanz reflects our view that the company's income-generating property portfolio should continue to generate stable cash flows in the next 12 to 24 months. We base our view in particular on solid demand from corporations for Immofinanz's office assets, which are located mainly in European capital cities. We also believe that occupancy levels will

remain at the current level or higher in both core segments, office and retail, supporting further like-for-like rental income growth.

On this basis, we anticipate that Immofinanz will be able to maintain a debt-to-debt plus equity ratio of well below 50%, with EBITDA interest coverage improving to well above 2x in the next 12 months.

### **Downside scenario**

We could consider lowering the ratings if our ratio of debt to debt plus equity increased to 50% or above, or if the company failed to improve EBITDA interest coverage to more than 2x. Such a scenario could be the result of challenging refinancing conditions, significant negative revaluation or write-downs of assets, debt-financed acquisitions, or a deterioration in the CEE market, leading to declining occupancy levels or lower rental income.

### **Upside scenario**

We could raise the ratings if the company strengthens its business risk profile on the back of an increase in scale and diversification toward stable markets where demand and supply trends are favorable for its commercial segments, while keeping like-for-like rental income growth positive and occupancy levels high.

We could also raise the ratings if the company improved its credit profile, with its ratio of debt to debt plus equity moving to 40% or below and EBITDA interest coverage rising substantially to 3.5x or above, on a sustainable basis. This may result from a more conservative financial policy, sizable equity contribution for any new possible acquisitions, or significantly higher-than-expected revaluation gains on its properties.

## **Company Description**

Immofinanz was founded in 1990 and is one of the largest listed commercial real estate companies in Austria and the CEE market. The company operates in the commercial property segment, mainly offices and retail. As of Sept. 30, 2018, the company's total portfolio comprised 223 properties valued at about €4.3 billion, including approximately €360 million of properties under construction.

Immofinanz is listed on the Vienna Stock Exchange and the Warsaw Stock Exchange. Largest shareholder is S Immo with 12% holding, with free float of 78%.

## **Issue Ratings - Subordination Risk Analysis**

## **Capital structure**

As of Sept. 30, 2018, Immofinanz's capital structure comprised mainly of secured bank facilities of about €2.1 billion and convertible bonds of €281 million. Weighted average cost of debt stood at 2.17%, including hedging costs.

We understand that the company plans to use the proceeds of the issued €500 million senior unsecured bond, maturing in 2023, to refinance mainly secured debt of shorter debt maturities and higher cost of debt.

## **Analytical conclusions**

We assume, that the capital structure post transaction and refinancing will have a secured debt to total asset ratio below our threshold of 40%.

Therefore, we align our issue rating on the unsecured bonds with our issuer credit rating.

## **Ratings Score Snapshot**

Issuer Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

- Country risk: Intermediate risk
- Industry risk: Low risk
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: bb+

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

## **Related Criteria**

- 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: Ratios And Adjustments, Nov. 19, 2013
- 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

New Rating

Immofinanz AG

Issuer Credit Rating  
Senior Unsecured

BBB-/Stable/--  
BBB-

### **Additional Contact:**

Industrial Ratings Europe; Corporate\_Admin\_London@spglobal.com

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