

Rating Action: Moody's changes Colonial's outlook to negative from stable following tender offer for Axiare

Global Credit Research - 14 Nov 2017

London, 14 November 2017 -- Moody's Investors Service ("Moody's") has changed to negative from stable the outlook on the long term issuer rating on Madrid-based real-estate company Inmobiliaria Colonial S.A. ("Colonial"). At the same time Moody's affirmed the company's Baa2 issuer rating. Today's rating actions follow Colonial's proposed tender offer for the shares of Axiare S.A. ("Axiare", unrated) it does not already own.

"Today's outlook change to negative reflects our view that the leverage of Colonial pro-forma for the acquisition of Axiare, if successful, could increase towards the upper end of our expectations for the Baa2 rating" says Roberto Pozzi, Moody's Vice President - Senior Credit Officer and lead analyst on Colonial.

On 13 November 2017, Colonial increased its stake in Axiare to 28.8% from 15.5% and announced that it intends to launch a public tender offer for the remaining 71.2% shares of Axiare. The transaction is expected to close at the end of the second quarter of 2018, subject to clearance from the Spanish Securities and Exchange Commission and a minimum ownership of 50% and one share.

Axiare is a Spanish property company whose portfolio generated rental income of EUR42.4 million in 2016 and had a gross asset value of EUR1.7 billion at 30 June 2017, of which office buildings represented 74%, logistics 18% and retail and other properties 9%. Around half of Axiare's offices are located in Madrid and Barcelona's central business districts (CBD), partly consisting of grade-A properties and partly of properties slated for repositioning. The fair value of the office portfolio is around EUR1.2 billion of which 93% is located in Madrid and 7% in Barcelona.

In Moody's view, the acquisition will strengthen Colonial's market position and diversification in the Madrid office market and increase the reversionary potential and yield of its portfolio. However, the acquisition will also increase the percentage of assets held in lower rated Spain (Baa2 stable) compared to higher rated France (Aa2 stable) as well as lead to a slight deterioration in asset quality because only 42% of Axiare's property portfolio is stabilized.

Moody's estimates that pro-forma for the full ownership in Axiare, leverage as measured by Moody's adjusted gross debt to total assets will increase to around 48.5% from 42.8% as of 30 June 2017. However, Colonial plans to sell approximately EUR300 million of non-core assets in the second half of 2018 which should lead to a reduction in leverage below 47% (all figures based on a proportional consolidation of SFL and pro-forma for property sales completed last October). Whilst Moody's views favorably the EUR350 million capital increase that will fund the transaction as well as the planned asset disposals, the negative outlook reflects the increase in leverage at the outset of the transaction and the execution risk of the property sales.

RATINGS RATIONALE

Colonial's Baa2 long term issuer rating primarily reflects (i) the high quality of its office portfolio and a diversified tenant base, (ii) a stable to moderately positive outlook for the company's key occupier and investment markets, (iii) moderate leverage in terms of gross debt to total assets, as well as (iv) good liquidity and a high level of unencumbered assets.

Partly offsetting these strengths are (i) the structural subordination of Colonial lenders to the debt of its majority owned subsidiary Société Foncière Lyonnaise (SFL), (ii) elevated geographic concentration, with around three quarters of its portfolio located in Paris, (iii) moderate but improving fixed charge coverage and high leverage in terms of net debt to EBITDA. The assigned rating reflects our expectations that the company will continue to raise rents over the next two years, thus improving its EBITDA generation and fixed charge coverage.

When fully consolidating 58.6%-owned Société Foncière Lyonnaise (SFL), Colonial's effective leverage, measured as gross debt to total assets, is 40.0% as of 30 June 2017 (44.7% at the end of 2016), with fixed charge coverage of 2.65x (2.7x in 2016). When proportionally consolidating SFL, Colonial's effective leverage is 42.8% (46.1% in 2016) and the fixed coverage 2.3x (unchanged). Net debt to EBITDA stood at 14.5x (16.3x in 2016) when fully consolidating SFL and at 15.9x (18.3x in 2016) when proportionally consolidating it.

The Baa2 rating assigned to Colonial also reflects the structural strengths of France's (Aa2/ stable) economy and property markets despite persistently weak economic growth. The rating also reflects Spain's (Baa2/stable) ongoing economic recovery and improved property market conditions. Despite its Spanish headquarters, our credit assessment of the company's credit quality is not constrained by Spain's Baa2/stable sovereign rating.

FACTORS THAT COULD LEAD TO AN UPGRADE

We could change the outlook to stable if Colonial reduces its debt/assets ratio towards 45% on a sustainable basis whilst maintaining strong liquidity and an adequate fixed charges coverage

We could upgrade the rating if:

- Gross debt to total assets sustainably below 40% when proportionally consolidating SFL, together with
- Fixed charge coverage sustainably above 3.0x when proportionally consolidating SFL, as well as
- A positive outlook for the Paris, Madrid and Barcelona office markets

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Gross debt to total assets trending towards 50% when proportionally consolidating SFL, or
- Failure to improve fixed charge coverage sustained above 2.5x when proportionally consolidating SFL, or
- Expectations of a material deterioration of market conditions or of the quality of the property portfolio, or
- A reduction of Colonial's stake in SFL below 50% unless offset by a material reduction in Colonial's standalone leverage

The principal methodology used in this rating was Global Rating Methodology for REITs and Other Commercial Property Firms published in July 2010. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Colonial is a real estate company that owns and manages a portfolio of office properties in Madrid and Barcelona (Spain) and, through 58.6%-owned Société Foncière Lyonnaise S.A. ("SFL", unrated), in Paris (France). Based on a full consolidation of SFL, the portfolio generated an annualised rental income of EUR271 million in 2016 and has an estimated fair value of EUR8.3 billion as of 31 December 2016. The portfolio mainly includes 60 offices mostly located in prime CBD locations, of which 20 in Paris representing 71% of fair value and 73% of rental income.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related

rating outlook or rating review.

Please see www.moody's.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moody's.com for additional regulatory disclosures for each credit rating.

Roberto Pozzi
VP - Senior Credit Officer
Corporate Finance Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Mario Santangelo
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454



© 2017 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE

ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent

to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.