MOODY'S
INVESTORS SERVICE

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

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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.

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