S&P Global Ratings

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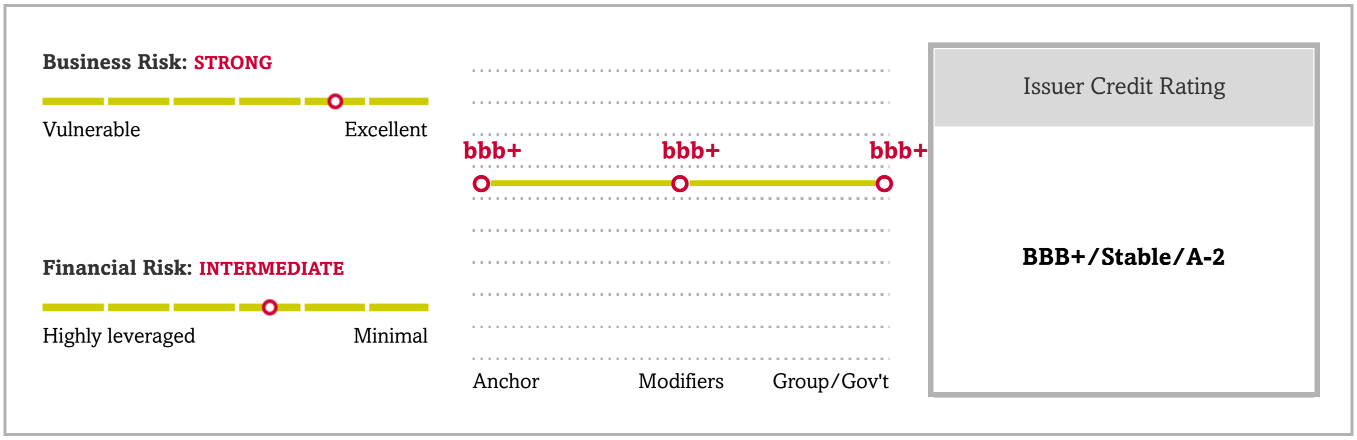
Inmobiliaria Colonial, Socimi, S.A.

Primary Credit Analyst:
Luis Peiro-camaro, Madrid +34 91 423 31 97; luis.peiro-camaro@spglobal.com

Secondary Contacts:
Marie-Aude Vialle, Paris +33 6 15 66 90 56; marie-aude.vialle@spglobal.com
Carlos Garcia Bayon, CFA, Madrid + 34 91 423 3195; carlos.garcia.bayon@spglobal.com

Table Of Contents

Inmobiliaria Colonial, Socimi, S.A.



Credit Highlights

Overview

Key strengths	Key risks
Sizable office assets worth €12.0 billion, with 77% of the gross asset value (GAV) in the Paris, Madrid, and Barcelona central business districts (CBDs), where supply remains scarce.	Uncertainty on how COVID-19-related trends and the increase in working from home trend could affect the office sector in the long term, with macroeconomic forecasts showing a moderate recovery in the eurozone.
Well located and high-quality portfolio (93% of GAV with ESG certification), which should continue to attract tenants and maintain high occupancy rates (95.2% as of Dec. 31, 2020)	Reliance on the office segment, which depicts higher volatility and is more susceptible to economic cycles than other asset classes in Europe, such as the German residential market.
Solid tenant base, mainly large corporates and multinationals (about 65% of rents), resulting in minimal disruption of rent collection in 2020 (99% of office rents due was collected).	Weaker interest and debt-coverage ratios than 'BBB+' rated peers, reflecting low-risk assets and the development activities.
Moderate debt leverage (adjusted debt to debt plus equity of 40.5% at year-end 2020), strong liquidity, and prudent financial policy.	

Economic uncertainty and an increase in working from home could reduce demand for office space and subdue rent levels. Inmobiliaria Colonial, Socimi, S.A. (Colonial; BBB+/Stable/A-2) collected 97% of office rents due in the last three quarters of 2020 thanks to its sound and diversified tenant base. Colonial also posted a 2.0% like-for-like increase in net rental income and a 1.2% portfolio revaluation, with occupancy falling slightly to 95.2% from 96.0% as of Dec. 31, 2019. S&P Global Ratings believes demand for office space will remain subdued in the next two years, due to fragile business confidence and heightened economic uncertainty resulting from the pandemic. Similarly, the pandemic-led increase in remote working and pressure on companies to control costs may reduce demand for office space as tenants reorganize their workforce and operations. We therefore expect on average flattish performance for office real estate investment trusts (REITs) like Colonial in 2021-2022, with any rental and valuation declines limited to 5% a year.

We forecast Colonial's net rental income to be flat to slightly negative in the coming two years. Colonial's high-quality assets are in the CBDs of Paris, Madrid, and Barcelona where current supply is scarce. Another positive is that demand for grade-A assets remains relatively robust. In the first two months of 2021, Colonial signed 21,697 square meters of renewals and new lettings, up 60% compared with the entire first quarter of 2020 before the pandemic. Lease renewals have positive release spreads (19% reported in January and February 2021) and rent for new contracts are 3% above the market average. However, we note a slowdown in the number of new lettings, at 22% of contracts signed in first-quarter 2021 versus 52% in first-quarter 2020, reflecting the uncertain environment for corporate entities. As a result, we assume a 15%-20% decline in revenue from leases to be negotiated in the coming quarters. This would translate into flat to slightly negative like for like rental growth for Colonial in the coming two years. Rental income would also be affected in 2021 by slightly higher vacancies in Paris linked to the 103 Grenelle, Edouard VII, and Le Vaisseau buildings. That said, we continue to think that companies like Colonial, with long lease profiles, creditworthy tenants, and well-located grade-A assets will fare much better than others.

Colonial's asset disposals should help the company absorb potential declines in asset values. As of March 31, 2021, Colonial had completed €617 million of asset disposals, mainly related to 112 Wagram and 9 Percier in the Paris CBD. The company received €334 million in 2020 that supported its debt-to-debt-plus-equity ratio of 40.5% at the end of the year. Colonial will receive €283 million in 2021, which could help it absorb potential declines in asset values. We expect Colonial to focus on asset-management initiatives and its pipeline, which will deliver approximately 190,000 square meters (about €1.3 billion of estimated cost) from 2021-2024. We forecast debt to debt plus equity to remain at 40%-43%, thanks to limited debt-funded acquisitions and prudently staggered cash calls from its development pipeline. We forecast EBITDA interest coverage at 2.5x-2.7x in 2021, owing to the loss of rental income after asset disposals, before it recovers toward 3x by 2022. Debt to EBITDA would also be affected in 2021, before progressively declining toward 15x beyond 2023 as new developments start contributing to rental income.

Outlook: Stable

The stable outlook reflects our view that Colonial can continue to withstand the pandemic's impact, on the back of the high quality of its portfolio, mainly in the CBDs of Paris, Madrid, and Barcelona; and its robust tenant base.

Downside scenario We would downgrade the company if, on a prolonged basis:

- EBITDA interest coverage dropped and stayed below 2.4x;
- Debt to debt plus equity increased meaningfully above 45%; or
- We saw material divestment or dilution of its Paris operations.

Upside scenario We would upgrade the company if, on a prolonged basis:

- EBITDA interest coverage increased above 3.8x;
- Debt to debt plus equity decreased below 35%; and
- Colonial ensured a stronger, more diversified cash flow base, as well as a new financial policy consistent with these stronger credit metrics.

Our Base-Case Scenario

Assumptions

- Recovery of real GDP in France and Spain of 4.7% and 5.7% in 2021 respectively, following an 8.2% and 11.0% contraction in 2020. We estimate consumer price inflation growth in both countries of 1.4%-1.6% in 2021 and 1.2%-1.4% in 2022.

- Flat to slightly negative like-for-like rental income growth in 2021 and 2022, affected by a challenging macroeconomic environment, lower indexation in France, and a slight decline in current occupancy.
- Slight decline in the overall occupancy to 93%-95% in the coming two years because of new assets, a longer time taken to lease out space, and certain refurbishment projects (mainly in Paris).
- Conservative flattish like-for-like asset value in 2021 and 2022, with potential declines limited to 5%.
- A stable EBITDA margin of 78%-79% over the coming two years.
- Balanced asset rotation, with the cost of asset acquisitions on an opportunistic basis being absorbed by asset disposals.
- Dividend distribution of €130 million-€150 million per year in 2021 and 2022

Key metrics

Inmobiliaria Colonial Socimi S.A.--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2019a**	**2020a**	**2021e**	**2022f**	**2023f**
EBITDA	284.7	275.1	235-245	260-270	270-290
EBITDA margin (%)	78.2	79.4	78-79	78-79	78-79
Dividends	132.3	134.8	130-140	145-155	160-170
Debt	4,727.7	4,651.4	4550-4600	4650-4700	4800-4900
EBITDA interest coverage (x)	2.8	2.1	2.5-2.7	2.6-2.8	2.8-3.0
Debt to EBITDA (x)	16.6	16.9	18-19	17-18	17-18
Debt to debt plus equity (%)	40.4	40.5	41-43	41-43	41-43

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Company Description

Colonial is one of the key players in the European prime office market, with a presence in the main business areas of Barcelona, Madrid, and Paris (see chart 1). Colonial's portfolio mainly includes office assets (more than 90% of total GAV) with a clear focus on CBDs, where about 77% of its assets are. As of Dec. 31, 2020, Colonial owned a portfolio valued at €12.0 billion (see charts 3 and 4). Its stake in core subsidiary Societe Fonciere Lyonnaise (BBB+/Stable/A-2) is 81.71% as of Dec. 31, 2020.

The company is listed on the Spanish stock exchange IBEX 35 and its main shareholders are the Qatar Investment Authority (20%), Grupo Finaccess (16%), and Aguila Ltd (6%). The remaining stake is free float.

Table 1

Inmobiliaria Colonial, Socimi, S.A. --Portfolio Summary

Segment focus	**Office**
Total portfolio value (bil. €)	12.0
Total GLA (square meters)	1,571,983
Occupancy (%)	95.2
Average lease maturity (Years)*	Paris, 6.3 years; Madrid, 6.2 years; Barcelona, 5.3 years

Table 1

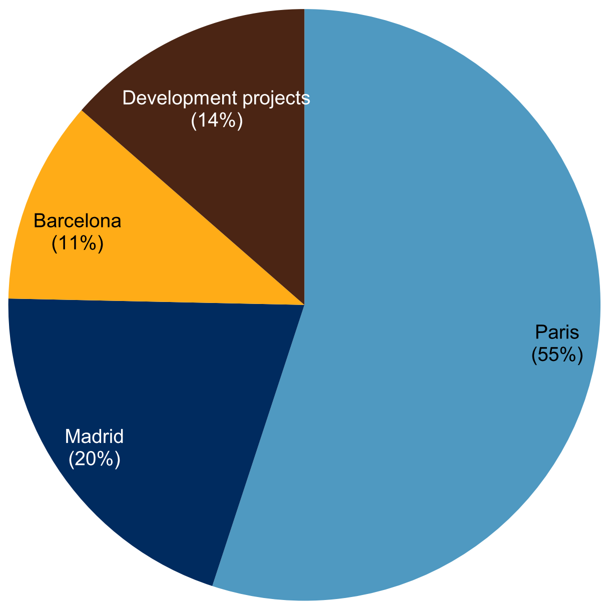
Inmobiliaria Colonial, Socimi, S.A. --Portfolio Summary (cont.)

Segment focus	Office
Overall portfolio quality§	Prime portfolio in terms of location and asset quality (yields, Paris: 3.01%; Madrid, 4.27%; gross yield, Barcelona: 4.38%)
Operational properties with sustainability certifications (% of GAV)	93 (BREEAM/LEED certificates)
Market capitalization (bil. €) †	4.17

*Average lease maturity of contracts till their expiry date. §S&P Global Ratings' view. †As of March 31, 2021. GLA--Gross leasable area.

Chart 1

Inmobiliaria Colonial, Socimi, S.A.--Geographical Diversity By GAV



Source: S&P Global Ratings, company report.

Peer Comparison

Table 2

Inmobiliaria Colonial, Socimi, S.A.--Peer Comparison

Industry sector: Real estate investment trust or company

	Inmobiliaria Colonial, Socimi, S.A.	Gecina	Aroundtown S.A.	Icade S.A.	Societe Fonciere Lyonnaise S.A.	Merlin Properties Socimi S.A.
	BBB+/Stable/A-2	A-/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB+/Stable/A-2	BBB/Stable/--

Table 2

Inmobiliaria Colonial, Socimi, S.A.--Peer Comparison (cont.)

Industry sector: Real estate investment trust or company

	Inmobiliaria Colonial, Socimi, S.A.	**Gecina**	**Aroundtown S.A.**	**Icade S.A.**	**Societe Fonciere Lyonnaise S.A.**	**Merlin Properties Socimi S.A.**
Business risk profile	Strong	Strong	Strong	Strong	Strong	Satisfactory
Financial risk profile	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate
Portfolio Value (bil. €)	12.0	19.8	21.2*	11.8	7.5	12.8
Assets diversity	Offices 96%, Retail, Logistics and Others 4%	Offices 81%, Residential 19%	Offices 51%, Hotel 24%, Residential 14%, Retail 7%, Logistics/Other 4%.	Office 60.7%, Healthcare 39.3%	Offices 80%, Retail 19%, Residential 1%	Offices 50%, Shopping Centers 18%, Net leases 14%, Logistics 12%, Other 6%
Occupancy (%)	95.2	92.0	91.1	Office: 92.5%, Healthcare: 100%	94.0	94.2
WAULT (years)	Paris, 6.3 years; Madrid, 6.2 years; Barcelona, 5.3 years	5.8	8.9*	Healthcare: 7.3, Office:4.1	6.3	5.4
Top 10 tenants as a % of GRI	N/A	28.0	18.0	30.0	40.0	17.6
Geography diversity	France 62%, Spain 38%	Paris 56%, Paris region 38%, Other French regions/international 6%	Mainly Germany (Berlin 27%, NRW 10%, Frankfurt 8%, Munich 8%, Dresden/Leipzig/Halle 6%, Rest of Germany 11%), London 5%, Netherlands, 5%, Others 20%	>90% Greater Paris region	Paris CBD 83%, Paris Other 15%, Western Crescent 2%	Spain ~91%, Portugal ~9%
% development	10.5	18.2	0.1	N/A	~2%	N/A
EBITDA interest coverage (x)	2.1	5.1	3.1	4.6	4.9	2.7
Debt/EBITDA (x)	16.9	14.3	14.0	11.4	12.5	15.1
Debt/debt and equity (%)	40.5	36.6	45.1	44.1	27.3	44.9

*Excluding GCP. Source: Latest Company Reports N/A--Not applicable.

Business Risk: Strong

We continue to view as positive the high quality of Colonial's office real estate portfolio in France and Spain, valued at €12.0 billion by year-end 2020. The company's properties are mostly in the CBDs of Paris, Madrid, and Barcelona, where supply of good-quality assets remains scarce. The number of Colonial's properties in these areas, with 77% of total GAV as of year-end 2020, compares favorably with that of other European office owners such as Icade Sante SAS

(BBB+/Stable/A-2) and Covivio (BBB+/Stable/A-2).

Besides this, Colonial benefits from long leases (average remaining term of 6.3 years in the Paris portfolio, 6.2 years in Madrid, and 5.3 years in Barcelona) and only 13.6% of them expire in 2021; as of March 31, Colonial had already secured renewals for more than 50% of these contracts. The company also enjoys a strong tenant base, mainly composed of large creditworthy corporates (more than 65% of rents), with only a limited share of small and midsize enterprises. This should mitigate any nonpayment or rent-reduction risk in the current environment. Social-distancing measures and mandatory lockdowns continue to affect the retail property segment. However, the company's low exposure to retail assets (less than 10% of its tenant base) should mean a limited impact on overall performance, especially because the majority of its tenants are large names such as Uniqlo and Zara, which enjoy solid credit profiles. Likewise, we do not expect any material impact from the pandemic at Utopicus (Colonial's flexible office brand), given the leases' structure, length (usually more than one year), and tenant profile (no significant exposure to small companies). We also believe that Utopicus could benefit from demand for more-flexible office space in the future.

We expect flattish operating performance for Colonial in 2021-2022. We forecast flat to slightly negative like-for-like rental growth (compared with positive 2.0% in 2020) over that period and some decrease in occupancy from 95.2% as of Dec. 31. 2020. Occupancy was down slightly in 2020 from 97.3% in 2019 as subdued demand resulted in delays in leasing out vacant spaces.

Colonial remains exposed to country risk in Spain, where a high proportion of its assets are located (about 38% of total GAV). Our assessment of the company's business risk profile factors in the historical volatility of the Spanish office market, especially compared with more mature and deep markets such as New York, Paris, or London. Colonial is also concentrated in the office segment, an asset class that we continue to view as less resilient than other real estate segments in Europe, such as the German residential segment.

Financial Risk: Intermediate

Our assessment of Colonial's financial risk profile is underpinned by the company's prudent financial policy and commitment to maintaining robust credit metrics commensurate with our rating. This includes an EBITDA interest coverage ratio above 2.5x and a loan-to-value ratio of 36%-40% (equivalent to a debt-to-debt-plus-equity ratio of 40%-44%).

Colonial completed €617 million in disposals up to March 2021, as part of its asset rotation plan and the disposal of noncore assets remaining help to finance the committed development pipeline and absorb potential asset devaluations. We expect debt to debt plus equity to increase slightly from the 40.5% at year-end 2020 and remain within the 40%-43% range in the next 24 months since, in our base case, we assume potential declines in asset values of up to 5%.

Debt service and payback ratios continue to compare slightly negatively against other companies we rate 'BBB+'. That said, this reflects the low-risk profile of Colonial's assets, especially in Paris where the net yield on its assets is close to 3%. This translated into debt to EBITDA of 16.9x and EBITDA interest cover of 2.1x at year-end 2020 (including one-off costs related to early repayment of bonds as part of a liability management strategy; and 2.6x excluding this one-off cost). We expect EBITDA interest coverage to remain above 2.5x in the next few years on the back of stable recurring rental income growth and a low cost of debt (1.70% as of Dec. 31, 2020). We also forecast Colonial's debt to EBITDA to improve progressively toward 15x after 2023 as new developments start generating rent. In addition, the company benefits from a staggered maturity profile thanks to its prudent liability management policy, with average debt maturity at about 5.2 years.

Financial summary

Table 3

Inmobiliaria Colonial, Socimi, S.A.--Financial Summary

Industry sector: Real estate investment trust or company

	--Fiscal year ended Dec. 31--			
Mil. €	**2020**	**2019**	**2018**	**2017**
Revenue	346.7	364.1	354.0	286.0
EBITDA	275.1	284.7	278.5	210.7
Funds from operations (FFO)	114.3	198.8	128.7	86.8
Interest expense	132.2	103.4	112.1	86.5
Cash interest paid	131.0	83.4	137.9	94.5
Cash flow from operations	90.5	233.4	36.0	155.9
Capital expenditure	209.0	262.6	314.7	133.0
Free operating cash flow (FOCF)	(118.5)	(29.2)	(278.7)	22.9
Dividends paid	134.8	132.3	129.9	89.7
Discretionary cash flow (DCF)	(276.4)	(164.9)	(409.8)	(73.6)
Cash and short-term investments	268.6	216.8	68.3	1,104.6
Gross available cash	268.6	216.8	68.3	1,104.6
Debt	4,651.4	4,727.7	4,762.7	4,215.4
Equity	6,833.2	6,960.5	6,101.8	5,679.7
Adjusted ratios				
Annual revenue growth (%)	(4.8)	2.9	23.8	4.2
EBITDA margin (%)	79.4	78.2	78.7	73.7
Return on capital (%)	2.3	10.2	9.4	13.1
EBITDA interest coverage (x)	2.1	2.8	2.5	2.4
FFO cash interest coverage (x)	1.9	3.4	1.9	1.9
Debt/EBITDA (x)	16.9	16.6	17.1	20.0
FFO/debt (%)	2.5	4.2	2.7	2.1
Cash flow from operations/debt (%)	1.9	4.9	0.8	3.7
FOCF/debt (%)	(2.5)	(0.6)	(5.9)	0.5
DCF/debt (%)	(5.9)	(3.5)	(8.6)	(1.7)
Debt/debt and equity (%)	40.5	40.4	43.8	42.6

Reconciliation

Table 4

Inmobiliaria Colonial, Socimi, S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts

	--Fiscal year ended Dec. 31, 2020--									
Inmobiliaria Colonial, Socimi, S.A. reported amounts (mil. €)										
	Debt	**Shareholders' equity**	**Revenue**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
	4,901.0	5,400.5	346.7	271.0	185.4	121.7	275.1	221.5	134.8	209.0
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(29.8)	--	--	--
Cash interest paid	--	--	--	--	--	--	(131.0)	--	--	--
Reported lease liabilities	12.0	--	--	--	--	--	--	--	--	--
Accessible cash and liquid investments	(268.6)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	10.5	--	--	--	--
Share-based compensation expense	--	--	--	5.7	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	--	1.1	--	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	(131.0)	--	--
Noncontrolling interest/minority interest	--	1,432.6	--	--	--	--	--	--	--	--
Debt: Guarantees	6.8	--	--	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	--	(1.6)	(1.6)	--	--	--	--	--
Depreciation and amortization: Asset valuation gains/(losses)	--	--	--	--	79.1	--	--	--	--	--
Total adjustments	(249.7)	1,432.6	--	4.1	78.6	10.5	(160.8)	(131.0)	--	--
S&P Global Ratings' adjusted amounts										
	Debt	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
	4,651.4	6,833.2	346.7	275.1	263.9	132.2	114.3	90.5	134.8	209.0

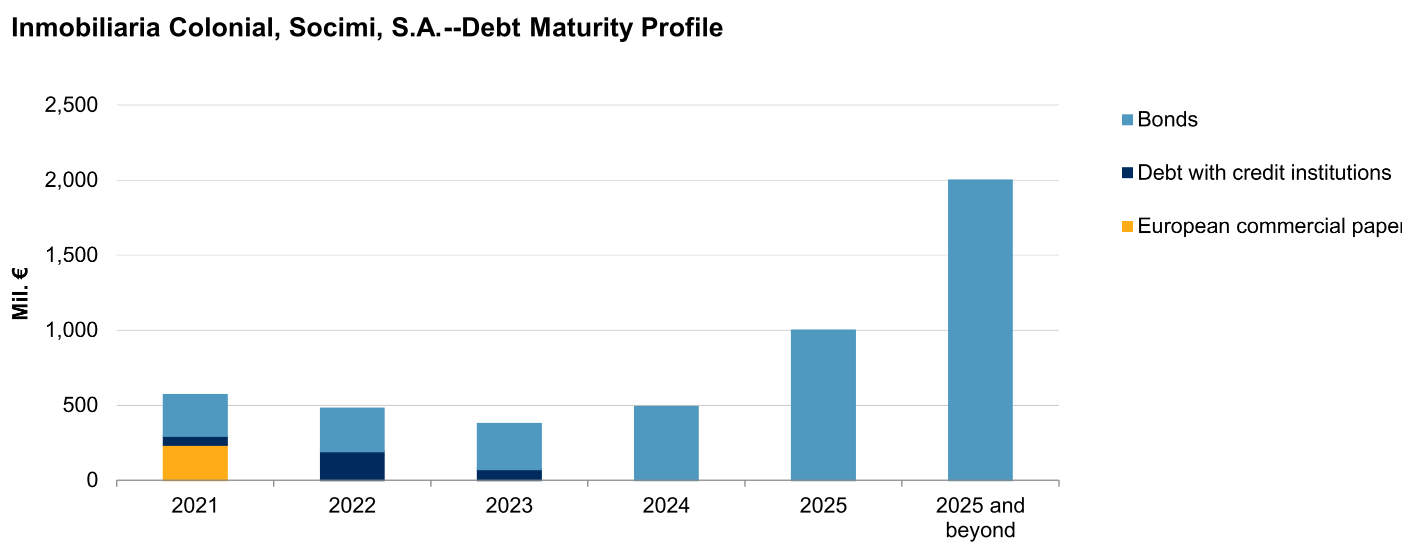
Liquidity: Strong

We view Colonial's liquidity as strong, with the ratio of liquidity sources to uses at about 3.0x for the 12 months started Jan. 1, 2021, and higher than 1x over the following 12 months. This is supported by the company's €2.0 billion of available backup facilities and moderate capital expenditure (capex) and refinancing needs in the next 24 months. Colonial has also demonstrated broad access to both the equity and debt capital markets, which enhances its liquidity profile. We have included €279.0 million of proceeds from the disposals signed in first-quarter 2021 in our liquidity assessment because they are committed.

Principal liquidity sources	Principal liquidity uses
• €305 million of unrestricted cash and cash equivalents; • €2.0 billion of undrawn committed backup facilities; • About €160 million of annual funds from operations; and • €279 million from asset sales.	• €490 million of debt maturities, mainly related to commercial paper; • About €290 million of capex; and • About €130 of planned dividend payments.

Debt maturities

Chart 2



Source: S&P Global Ratings.

Environmental, Social, And Governance

We believe Colonial's environmental commitment is a key differentiator, and also supports our assessment of its competitive position. Most of the company's operating portfolio (93% of its GAV) has obtained green certification from several organizations (including BREEAM, LEED, and HQE). These features emphasize the quality of its assets and translate into solid rental growth and high occupancy levels. Tenants are demanding greener buildings and this has become necessary to attract high quality occupants. Colonial's objective is to reduce energy and carbon-dioxide emissions, consumption of materials, waste, and water usage through the production of high-efficiency buildings.

In line with the company's commitment to develop more sustainable buildings, Colonial will develop the first office building in Spain made entirely of wood. This pioneer project reflects Colonial's engagement on emissions reduction and search for building processes less harmful to the environment, at all stages of the building life cycle, from construction to end user operation. The building will enjoy, as a result, the highest environmental certification with LEED Platinum and WELL Platinum.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of Dec. 31, 2020, Colonial's pool of unencumbered assets is significant, and less than 6% of its assets are encumbered by mortgage debt.

Analytical conclusions

We see limited subordination risk for Colonial's unsecured debt with regard to secured debt outstanding in its capital structure. The ratio of secured debt to total assets remains well below 40%, at less than 3%, so we continue to align our issue rating on the unsecured bonds with the issuer credit rating on Colonial.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb+

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria

- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- ARCHIVE | General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	**a-/bbb+**	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of May 20, 2021)*

Inmobiliaria Colonial, Socimi, S.A.	
Issuer Credit Rating	BBB+/Stable/A-2

Ratings Detail (As Of May 20, 2021)*(cont.)	
Senior Unsecured	BBB+
Issuer Credit Ratings History	
18-Oct-2018	BBB+/Stable/A-2
19-Apr-2017	BBB/Stable/A-2
29-May-2015	BBB-/Stable/A-3
Related Entities	
Societe Fonciere Lyonnaise S.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Commercial Paper	A-2
Senior Unsecured	BBB+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com