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CREDIT OPINION

24 October 2023

Update

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Inmobiliaria Colonial SOCIMI, S.A.

Update following H1 results

Summary

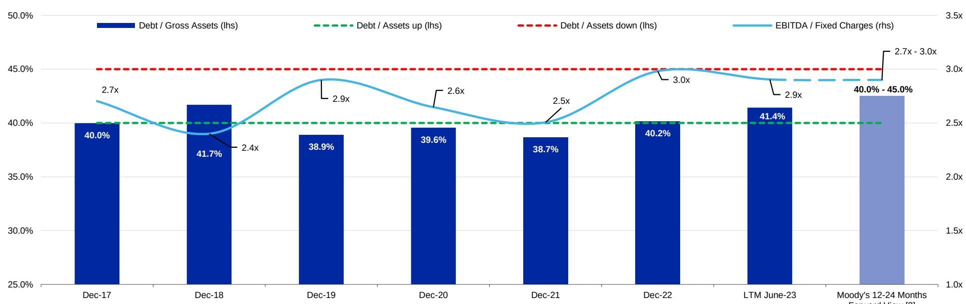
Inmobiliaria Colonial SOCIMI, S.A.'s (Colonial) Baa2 long-term issuer rating with a positive outlook reflects its leading position in the prime Paris, Madrid and Barcelona office market, with high quality offices and proven ongoing tenant demand; a solid balance sheet with Moody's-adjusted leverage of 41.4% as of 30 June 2023 and further improvements from disposals; good liquidity management, supported by good access to capital markets and a substantial amount of unencumbered assets. A forward-looking hedging policy will mitigate the impact of higher interest rates in the coming years.

Higher interest rates will result in moderate declines in the fixed charge cover ratio over the coming years given partial forward hedging, and weaken the attractiveness of real estate as an investment, exposing property values to declines. Further challenges include secular risks arising from a broader adoption of hybrid work models, where we see prime office providers such as Colonial to be better equipped. High geopolitical risks and subdued economic activities will weigh on office demand. The Spanish office market has historically been more volatile, but Colonial has a strong footing in Paris Central Business District (CBD).

Exhibit 1

We expect the debt/assets to remain in line with rating guidance despite value declines and fixed charge cover react only moderately to increased interest rates

Moody's-adjusted gross debt/assets and fixed-charge coverage [1]



[1] All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations

[2] This represents Moody's forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestitures

Source: Moody's Financial Metrics™ and Moody's Investors Service estimates

RATINGS

Inmobiliaria Colonial SOCIMI, S.A.

Domicile	Madrid, Spain
Long Term Rating	Baa2
Type	LT Issuer Rating - Dom Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Credit strengths

» Leading market position in the prime Paris, Madrid, and Barcelona office markets

» High-quality office properties with strong environmental credentials, attracting high-credit-quality tenants

» Solid balance sheet supported by the conservative financial policies endorsed by the company's shareholders

» Excellent liquidity management, supported by good access to capital markets and a substantial amount of unencumbered assets

Credit challenges

» Increased interest rates pressuring property values and fixed charge coverage

» Weaker EBITDA-based ratios due to low property yields, as well as development projects and the renovation programme

» Secular risks arising from a broader adoption of hybrid work models

» Risks relating to a slowdown of the economy / reduction in office-based employment

» Its exposure to the more cyclical Spanish office markets, which is well balanced by its strong footing in Paris CBD

Rating outlook

The positive outlook reflects a sustainably lower level of balance sheet leverage combined with increasing EBITDA though indexation, rent reversion and project deliveries. However, sustained higher interest rates may add pressures on interest cover ratios, which can drive an outlook revision.

Factors that could lead to an upgrade

» Reduced economic and property market uncertainty, leading to an expectation of stable property values and operational performance of the Paris, Madrid, and Barcelona office markets

» The company continues to demonstrate solid execution and prudent financial policies through real estate cycles, along with a balanced growth strategy and an excellent track record of access to all forms of debt and equity capital

» Moody's-adjusted gross debt/total assets sustained well below 40%, together with a significant decline in Moody's-adjusted net debt/EBITDA, which places the company more adequately also in the context of relative positioning against peers with high investment-grade ratings

» Fixed-charge coverage sustained above 3.25x

Factors that could lead to a downgrade

» A weaker funding environment for real estate companies resulting into increased refinancing risk and lower appetite to address upcoming maturities well in advance

» A deterioration in market conditions or in the KPIs of its property portfolio, such as vacancy rate, rental growth or weighted average lease term

» Moody's-adjusted gross debt/total assets above 45% or a failure to gradually reduce Moody's-adjusted net debt/EBITDA from the current high levels

» Fixed-charge coverage sustained below 2.75x

» Increased execution risk in view of a potentially more aggressive growth strategy

Key indicators

Inmobiliaria Colonial SOCIMI, S.A. [1][2][3]

USD Millions	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	LTM June-23	Moody's 12-24 Months Forward View [4]
Real Estate Gross Assets	8,677	12,616	13,064	14,027	15,104	14,460	14,365	13,934	13,400 - 14,000
Amount of Unencumbered Assets	89.5%	75.0%	84.5%	90.3%	90.3%	98.6%	99.9%	100.0%	100.0%
Debt / Real Estate Gross Assets	44.7%	40.0%	41.7%	38.9%	39.6%	38.7%	40.2%	41.4%	40.0% - 45.0%
Net Debt / EBITDA	16.3x	18.7x	17.6x	16.5x	17.3x	19.9x	19.1x	16.8x	17.0x - 18.0x
Secured Debt / Real Estate Gross Assets	2.9%	2.3%	4.5%	2.2%	2.2%	0.6%	0.6%	0.0%	0.0%
EBITDA / Fixed Charges	2.7x	2.7x	2.4x	2.9x	2.6x	2.5x	3.0x	2.9x	2.7x - 3.0x

[1] All figures and ratios are calculated using Moody's Estimates and Standard Adjustments
[2] Periods are Financial Year-End unless indicated. LTM = Last 12 Months
[3] All ratios are based on "Adjusted" financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations
[4] This represents Moody's forward view, not the view of the issuer
Source: Moody's Investors Service

Profile

Inmobiliaria Colonial SOCIMI, S.A. (Colonial) is a real estate company that owns and manages a portfolio of office properties in Paris, Madrid and Barcelona. The Paris assets are managed through 98.37%-owned SFL. As of 30 June 2023, the gross asset value (GAV) of Colonial's portfolio was €12.2 billion, of which 97% represented offices and 65% was located in Paris.

Colonial is listed on the Madrid stock exchange, with a market capitalisation of around €2.8 million as of 16 October 2023.

The company is a real estate investment trust (REIT) incorporated into the REIT tax regime of the Government of Spain (Baa1 Stable).

Detailed credit considerations

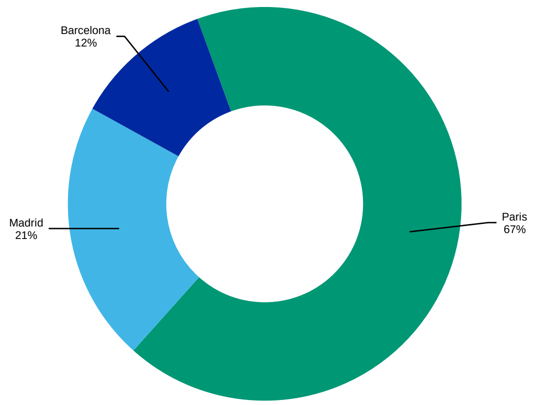
Leading position in the prime Paris CBD, Madrid and Barcelona office markets

Colonial ranks among Europe's largest listed office owners. As of 30 June 2023, the GAV of Colonial's portfolio amounted to €12 billion, and in terms of market capitalisation, Colonial is one of the two largest REITs in Spain, along with MERLIN Properties SOCIMI, S.A. (Baa2 Positive).

Colonial's portfolio is primarily located in the CBDs of Paris, Madrid and Barcelona, while a minority of assets is in semi-central areas of Madrid and Barcelona.

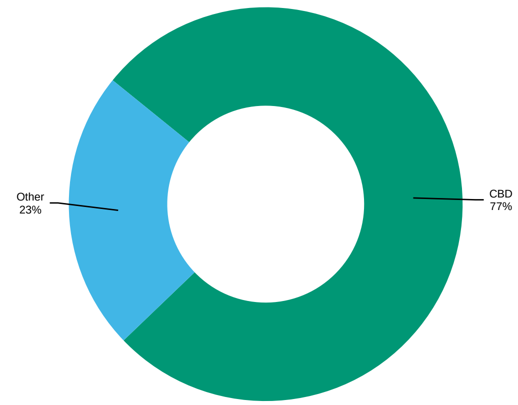
Office buildings generate the bulk of the group's rental income (97%), and the remainder comes from some retail and also flex-office space (under the brand "utopic_US"). The company generated €354 million in gross rental income in 2022 and €183 million in gross rental income in the first half of 2023. Offices in France represented around 61% of the gross rental income and Spanish properties accounted for the remainder 31%.

Exhibit 3
Portfolio split by cluster



As a percentage of the portfolio in operation, with a total GAV of €12,209 million as of June 2023.
Source: Company

Exhibit 4
Most assets are located in CBDs

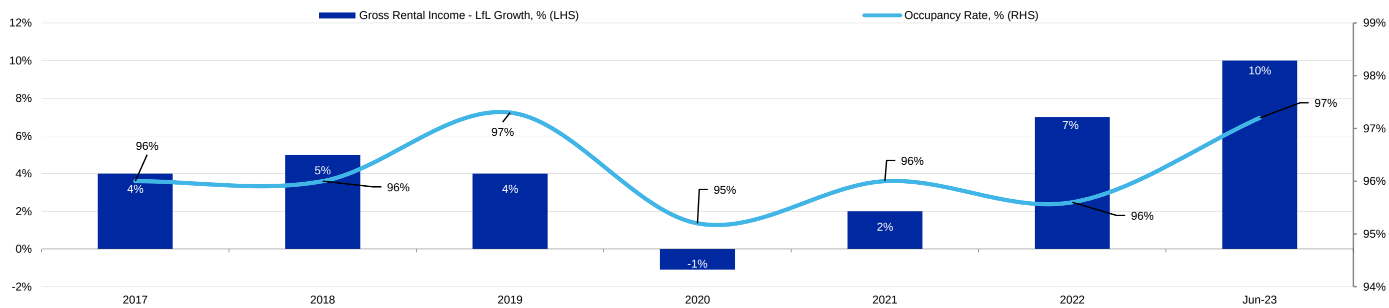


As a percentage of total GAV as of June 2023.
Source: Company

High-quality office portfolio with a strong tenant base and solid occupancy

Colonial's Grade-A office properties with strong environmental credentials and in prime locations attract and retain high-credit-quality tenants, and support the company's solid occupancy and continued rental income growth. Like-for-like rental growth was at a record high in Q2 2023 of 10%, and occupancy increased to a total company occupancy of 97.2%. So far rent reversion has also been positive and estimated rental values also continue to grow, meaning that inflation is not a short term driver of rents that will certainly revert upon lease expiry. Going forward we do not expect like-for-like rental growth to continue at that high level but to remain clearly positive for the next 12-18 months.

Exhibit 5
Colonial has maintained a high level of occupancy and rental growth since 2020



Source: Company

In the medium term, there are risks for office demand stemming from secular shifts towards hybrid work models. However, we now estimate such risks to be less disruptive and to lead to a greater focus on Class-A buildings in central locations featuring high technological, health and safety standards, with layouts that enable collaboration and well-being. Colonial's high-quality office properties with strong environmental credentials position the company solidly against a broader adoption of hybrid or remote work models, as well as in the context of potentially tightening environmental regulation. The market will further bifurcate into operational strong performers, which we consider Colonial to be part of, and weaker quality and location landlords that will struggle to maintain rental income in the long run.

Colonial's rental income stream is broadly diversified, as its buildings are predominantly multi-tenant and from diverse industries such as financial and industrial services, digital and IT, communications and energy. Along with consistency good / improving occupancy rates, tenant retention has been high. The company reports an average 17-year client relationship. Supported by its well-diversified and good-credit-quality tenant base, the portfolio's collection rate remains high at around 100%.

Developments and refurbishments keep asset quality high while reducing earnings and increasing funding needs

Colonial's asset quality and income benefits from its strategy of (re)developing and refurbishing assets to a very high standard. Colonial has finalised more than half of its announced roughly 184,000 sqm development pipeline, hence earnings-based metrics will improve from those developments contributing a full financial year. Mendez Alvaro is the largest remaining development that is due to complete in full during 2024 while not being largely let yet.

The company has indicated pending capital spending for its existing developments of €81-€86 million, but we have assumed overall higher capital spending to reflect regular and refurbishment capital spending as well as our expectation that over time new projects will follow. We expect Colonial to replenish projects to the pipeline while being fully cognizant of the changed financial environment, including de-risking of the pipeline as well as return expectations.

Exhibit 6

Colonial's Development Pipeline

As of H1 2023

Project	City	% Group	Delivery	GLA (sqm)	Total Cost (€ million)	Yield on Cost
Diagonal 525	Barcelona CBD	100%	Delivered	5,706	41	≈ 5%
83 Marceau	Paris CBD	98%	Delivered	9,600	154	≈ 6%
Velazquez 86D	Madrid CBD	100%	Delivered	16,318	116	> 6%
Miguel Angel 23	Madrid CBD	100%	Delivered	8,155	66	> 5%
Biome	Paris City Center	98%	Delivered	24,500	283	≈ 5%
Plaza Europa 34	Barcelona	50%	Delivered	13,735	42	≈ 7%
Louvre Saint-Honorè	Paris CBD	98%	Delivered	16,000	215	7% - 8%
Mendez Alvaro Campus	Madrid CBD South	100%	1H 24	89,871	323	7% - 8%
Total Office Pipeline				**183,885**	**1,241**	**6% - 7%**

Total Cost= Acquisition Cost/Asset Value Pre-Project + Total Capex to be Invested.
Source: Company

Rising rates weaken the operating environment for real estate

Business conditions for European real estate companies are difficult with a sustainably higher interest rate environment. Higher debt costs, doubts about actionable property values, and ongoing geopolitical and economic concerns weigh on sentiment, in addition to structural changes in particular in the office sector. As a result real estate investment activity has stalled, which in turn questions currently reported values.

Spain's investment market held up materially better than European averages, with 2022 office transaction volumes being roughly in line with 2021 levels according to CBRE. France was trailing lower in terms of office transaction volumes compared to 2021. However, the investment market dried up materially since end of 2022, and the gap between buyers and sellers price expectation increased. Ultimately the rate hikes question the attractiveness of property investments at current prices and yields, which is why we have assumed further value declines of around 10% in our projected credit metrics for 2023 and 2024.

Despite difficult market conditions, Colonial managed to sell €548 million in non-core assets, during the period of January to July 2023, without having to discount the assets, proving investor appetite for the company's assets. This element is important to facilitate further asset disposals that will be required to manage credit metrics and fund future developments. Colonial's business model focuses on repositioning and upgrading assets to meet highest standard. As such we expect capital recycling to be an ongoing feature in Colonial's capital structure management.

Solid balance sheet supported by conservative financial policies

Colonial benefits from a solid balance sheet while earnings-based credit metrics are weaker compared to peers on the same rating level. Management is guiding to company-defined LTV's below 40% going forward, which is fully endorsed by shareholders. Moreover Colonial proactively secured lower interest rates through forward hedging.

Colonial's balance sheet leverage is moderate and will remain well within the expectations for the rating even considering moderate property value declines. Thanks to recently announced and our expectation of future disposals, the company already secured and will secure further financial resources to fund its development and refurbishment programme as well as to reduce debt in the next years. Moody's-adjusted debt/gross assets was 41.4% as of June 2023, which will reduce pro-forma for disposals. Combined with capital spending needs and 5-10% value decline expectations in our forward view, Moody's-adjusted debt/total assets will remain between 40% and 45% in the next 18 months.

Increasing EBITDA from rental increases as well as the contribution from the developments and refurbishment pipeline will lift EBITDA above 2022 level despite negative impact from disposals. We expect Moody's-adjusted net debt/EBITDA to floating around 17x-18x compared to 16.8x as of LTM June 2023.

The weak capital markets and increased interest rates expose all real estate companies to higher funding costs. Colonial has demonstrated a conservative interest risk management commensurate with a high quality, but low-yielding, portfolio. The company entered into €2.9 billion of forward swaps that will help to mitigate the impact of rising rates on interest expense. Moody's-adjusted charge coverage was at 2.9x in LTM June 2023, and we expect that Colonial to remain just below 3x in the next 12-18 months despite higher interest rates in the market. We understand that over time forward hedges will crystallise their mark-to-market into cash (but reduce interest expense over the term of the instruments), resulting in higher interest cover from a cash perspective during the year where the swaps crystallise.

ESG considerations

Inmobiliaria Colonial SOCIMI, S.A.'s ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 7
ESG Credit Impact Score

CIS-2
Neutral-to-Low

NEGATIVE IMPACT
POSITIVE IMPACT

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Colonial's **CIS-2** indicates that ESG considerations are not material to the rating. The group's outstanding property quality and prime locations as well as strong risk management, high governance standards and conservative financial policies very well mitigate environmental and social risks.

Exhibit 8
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-3	S-3	G-2
Moderately Negative	Moderately Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

E-3: Colonial is moderately exposed to carbon transition risk, along its European real estate peers. However the company is a frontrunner with respect to portfolio decarbonization efforts as well as investments to upgrade the energy credentials of its office buildings. Its high-quality office portfolio in prime locations position the company strongly against tightening energy performance regulation and greater tenant and investors' environmental scrutiny. Its moderate exposure to physical climate risk is driven by the concentration of its operations in the cities of Paris, Madrid and Barcelona.

Social

S-3: Colonial's is moderately exposure to social and demographic shifts leading to hybrid workspace, which could lead to rationalization of the office space in the medium to long term. Colonial's high-quality office properties with strong environmental credentials and in prime locations position the company strongly against a broader adoption of hybrid or remote work models.

Governance

G-2: Colonial features strong risk management, high governance standards and an experienced management team with strong credibility and track record of maintaining conservative financial policies committed to a LTV ratio in the range between 36% and 40%. The company benefits from a supportive and long-term-oriented shareholder base comprised of institutional and private investors.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

Good liquidity supported by a substantial amount of high quality unencumbered assets

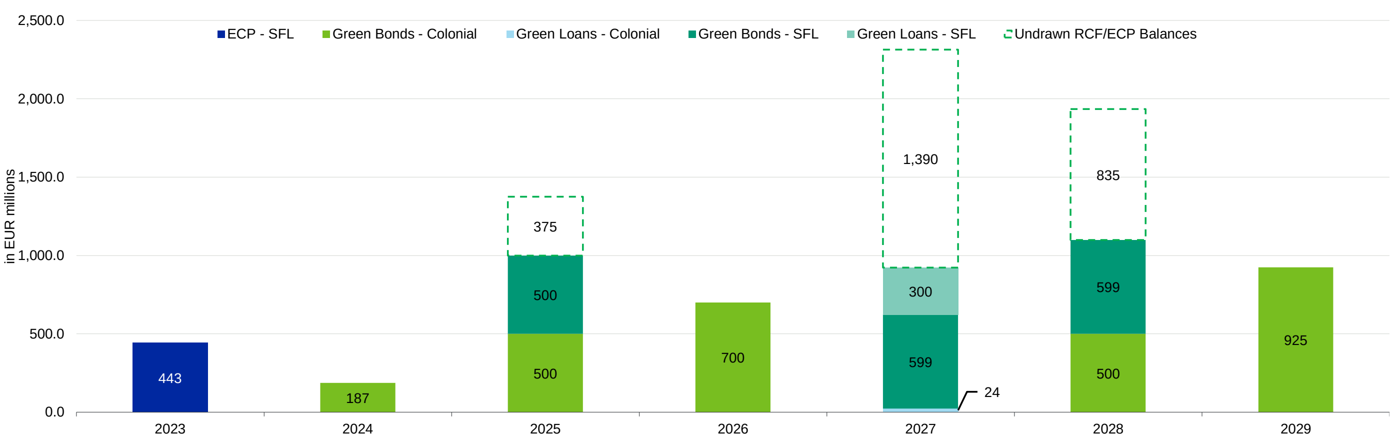
Colonial has a good liquidity, consisting of €257 million cash and cash equivalents as of 30 June 2023 and around €2,600 million committed undrawn Revolving Credit Facilities (RCF). We expect these liquidity sources, together with some remaining proceeds from announced assets disposals, to accommodate upcoming debt beyond 2024 plus capital spending on developments, renovations and regular investments into the property portfolio.

Colonial benefits from a staggered debt maturity profile that it has partially hedged with forward swaps covering a total of €2,407 million future maturities. The next relevant maturities that require refinancing without sources in place are €1 billion of bonds in 2025. Prior to that, Colonial has drawings under a European Commercial Programme of €443 million maturing in 2023 and a bond of €187 million maturing in October 2024.

Exhibit 9

Colonial's Average Debt Maturity is 4.7 years

In € millions



As of June 2023

Source: Company

Methodology and scorecard

The following table shows Colonial's scorecard-indicated outcome using our REITs and Other Commercial Real Estate Firms Methodology with data as of 30 June 2023. The scorecard-indicated outcome for the twelve months ended on 30 June 2023 and Moody's 12-18 Months Forward View are one notch higher than the assigned rating, reflecting an excellent market position and growth prospects.

Exhibit 10

Rating factors

Inmobiliaria Colonial SOCIMI, S.A.

REITs and Other Commercial Real Estate Firms Industry Scorecard [1][2]	Current LTM 06/30/2023		Moody's 12-18 Months Forward View As of October 2023 [3]	
Factor 1 : Scale (5%)	**Measure**	**Score**	**Measure**	**Score**
a) Gross Assets (USD Billion)	$13.9	A	$13.4 - $14.0	A
Factor 2 : Business Profile (25%)				
a) Market Positioning and Asset Quality	A	A	A	A
b) Operating Environment	Baa	Baa	Baa	Baa
Factor 3 : Liquidity and Access To Capital (25%)				
a) Liquidity and Access to Capital	Baa	Baa	Baa	Baa
b) Unencumbered Assets / Gross Assets	100.0%	Aaa	100.0%	Aaa
Factor 4 : Leverage and Coverage (45%)				
a) Total Debt + Preferred Stock / Gross Assets	41.4%	Baa	40.0% - 45.0%	Baa
b) Net Debt / EBITDA	16.8x	Ca	17.0x - 18.0x	Ca
c) Secured Debt / Gross Assets	0.0%	Aaa	0.0%	Aaa
d) Fixed Charge Coverage	2.9x	Baa	2.7x - 3.0x	Baa
Rating:				
a) Scorecard-Indicated Outcome		Baa1		Baa1
b) Actual Rating Assigned				Baa2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of the last twelve months ended June 30, 2023.
[3] This represents Moody's forward view, not the view of the issuer, and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Sources: Moody's Financial Metrics™ and Moody's Investors Service estimates

Ratings

Exhibit 11

Category	Moody's Rating
INMOBILIARIA COLONIAL SOCIMI, S.A.	
Outlook	Positive
Issuer Rating -Dom Curr	Baa2

Source: Moody's Investors Service

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454