S&P Global Ratings

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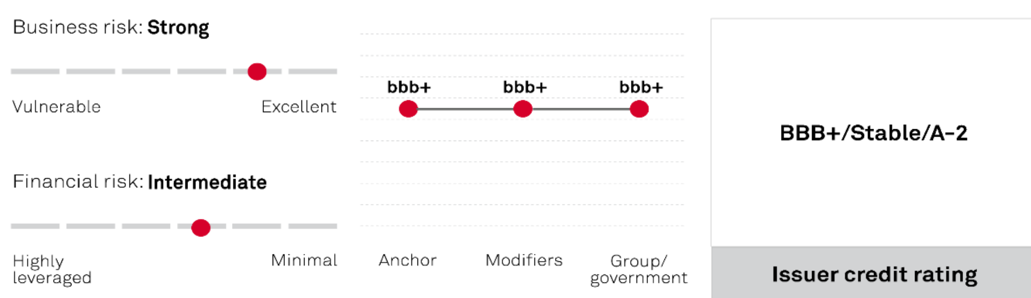
Inmobiliaria Colonial, Socimi, S.A.

May 9, 2024

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
Sizable office assets worth €11.3 billion, with 80% of gross asset value (GAV) in the Paris, Madrid, and Barcelona central business districts (CBDs), where supply remains scarce.	Economic uncertainty and business confidence could weigh on job creation, dampening demand for office space.
Well-located and high-quality portfolio (100% of GAV with green certifications), which should continue to attract tenants and result in high occupancy rates and positive release spreads.	Uncertain interest rate environment and potential pressure on real estate valuations could weigh on credit metrics and reduce rating headroom.
Solid tenant base, mainly large corporations and multinationals, with limited turnover and so-far limited impacts from work-from-home trends and hybrid working models.	Reliance on the office segment, which displays higher volatility in economic cycles and is subject to expanding working-from-home trends, potentially dampening demand over the medium-to-long term.
Strong liquidity and a prudent hedging policy that limits the effects of rising interest rates.	Moderate debt leverage, with S&P Global Ratings-adjusted debt to debt plus equity rising to 45.0% at year-end 2023, to reach our downside rating threshold, as a result of negative asset revaluations, although this should progressively improve.

Despite the expected economic slowdowns in France and Spain, the limited supply of high-quality CBD assets should continue to push rents up, albeit more slowly, which should benefit Colonial. While reduced job creation could somewhat weigh on demand for office space in the next 12-24 months, we believe employment rates in the two economies should remain supported by persistent solid business and consumer confidence. This, coupled with Colonial's market position in grade-A office properties in prime CBDs across Paris, Madrid, and Barcelona (78% of portfolio), where supply remains very limited, supporting high occupancy rates of close to 100% in Paris and 96.2% in Madrid.

Low supply and resilient demand, coupled with strong indexation of 5% in 2023 across the portfolio, has resulted in like-for-like rental growth of 8%. The group signed more than 158,000 sqm in 2023, representing €68 million in rental income with an average release spread of 5%. Paris drove the strong growth in contract renewals (up 12%), while renewals for Madrid and Barcelona remained flat. Release spreads in Spain decreased from last year (9% and 8% in 2022 for Madrid and Barcelona, respectively) as rents reached historical highs fueled by indexation and strong demand. We expect rental growth to soften as inflation continues to recede and demand softens. The company's strong tenant base, mainly large creditworthy corporates, should enable Colonial to pass on indexation to tenants without major difficulties, supporting its cash flow growth as well as its cash flow predictability. We therefore continue to forecast rental growth of 3%-4% in 2024 and 2025.

Colonial's asset quality also supports its capacity for disposals, despite market headwinds. Despite slow investment activity in commercial real estate, Colonial disposed of about €490 million in office and non-core assets in France and Spain in line with or slightly below latest appraisals in 2023 (€57 million completed in Paris and €433 million in Madrid and Barcelona). Colonial's geographic and asset diversity enabled it to successfully dispose assets in a less liquid market thanks to its overall very good asset quality, albeit lower-ticket asset portfolio in Spain. Larger assets in Paris, where such office-asset transactions were at a standstill amid decreasing valuations and uncertainty about long term interest rates, were less liquid in 2023. We expect the company to proceed with its announced €500 million asset disposal plan in 2024; as of today is has completed more than €200 million. Colonial's prime-asset-quality portfolio should continue to attract investors looking for office assets or assets to convert to residential. This should support assets' liquidity and valuations despite current market headwinds.

Announced and planned asset disposals should enable Colonial to absorb further asset devaluations of around 5% over the next 12-24 months. It has announced the completion of the sale of an additional €150 million in assets in Madrid in first-quarter 2024. Pro forma these disposals, Colonial's reported leverage, on a loan-to-value (LTV) basis, deteriorated to 39.5% at year-end 2023 from 38.7% at year-end 2022. This corresponds to S&P Global Ratings-adjusted debt-to-debt-plus-equity of about 44.6%, from 41.8% as of year-end 2022. Excluding the first-quarter 2024 disposals, reported LTV was 39.9%. This corresponds to debt to debt plus equity of 45.0%, which is at the level of our downside threshold.

The overall portfolio suffered a material valuation correction of 9.3% on a like-for-like basis in 2023. Portfolio yields expanded by 75 bps in 2023, with Paris taking the largest hit--as risk premium was tighter--by expanding 86 bps compared to 54 bps in Barcelona and 47 bps in Madrid. The yield effect had an about 18% negative impact on asset valuations, which was partially mitigated by positive cash flow growth helping valuations by about 8%. Asset valuation corrections should stabilize on the back of our expectation of interest-rate stability over the next 12 months. We assume further asset devaluations of 5% over the next 12-24 months stemming mainly from some additional yield expansion in the Paris portfolio. We think Colonial can offset the further expected asset valuation correction via its €500 million asset disposal plans this year (around €200 million already completed). This should enable Colonial to maintain debt to debt plus equity below our 45% downside threshold over the next 12-24 months, although with modest headroom. We also expect the reduction in net debt stemming from disposals and rental growth to support its debt to EBITDA despite lost rents associated with the assets staying about 15x over the next 12-24 months (15.3x at year-end 2023).

Colonial's solid liquidity position, prudent hedging policy, and well-spaced debt maturity profile partially mitigate its refinancing risks and interest service coverage. Its track record of access to the capital markets, as seen in the recent €200 million 2029 bond tap, together with its sizable cash balances of €436 million as of year-end 2023 (excluding €200 million in proceeds from signed disposals year to date) and over €2.4 billion in committed credit lines maturing beyond 12 months reduce the refinancing risks of the upcoming (2024) €500 million debt maturity and the two €500 million bonds, one at SFL and the other at the Colonial level, maturing in 2025. While we expect the average cost of debt to increase as Colonial refinances its existing stock of debt at higher interest rates, it has a pre-hedging strategy—a swap notional of €2.6 billion with a 0.6% strike price, covering 53% of the nominal debt in the capital structure. This and the current hedging strategy—with 100% of the debt as of year-end 2023 either fixed or hedged—should partially mitigate the impact of current higher interest rates on Colonial's interest burden. Coupled with the expected deleveraging, this should enable Colonial to maintain EBITDA interest coverage of 2.8x-3.0x over the next 12-24 months.

Outlook

The stable outlook reflects our view that Colonial will continue to generate stable and predictable income despite economic uncertainty, on the back of the high quality of its portfolio, mainly in the CBDs of Paris, Madrid, and Barcelona, and its robust tenant base. Its credit metrics should also stay within the current thresholds for the rating despite the rise in interest rates and subsequent asset devaluations, thanks to asset disposals and a prudent financial policy.

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 divestments or a dilution of its Paris operations.

Upside scenario

We would upgrade the company if, on a sustained 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

- Real GDP growth in France and Spain of 0.9% and 1.8% in 2024, and 1.5% and 2.0% in 2025, respectively. We estimate consumer price inflation in both countries of 2.5%-3.5% in 2024 and 1.5%-2.5% in 2025.
- Like-for-like rental income growth of 2.5%-3.5% in 2024, supported by persistent, although slowing, inflation indexation in France and Spain, partially offset by our expectation of lower letting activity on the back of subdued economic activity and some vacancies in 2024 project deliveries, then 2.5%-3.0% in 2025.
- Like-for-like decline in asset revaluations of about 4%-5% in 2024 and a further 1% in 2025, driven by some further yield expansion, especially in the Paris portfolio, partially offset by still-growing rents.
- EBITDA margin around 75%-77%, in line with historical performance.
- No acquisitions in 2024-2025.
- Annual capex of about €150 million-€250 million in 2024 and 2025.
- Asset disposals for around €600 million in 2024, of which around €200 million has already been completed as of today.
- Dividend distributions of about €140 million-€160 million per year in 2024 and 2025.

Key metrics

Inmobiliaria Colonial, Socimi, S.A.--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. EUR)	2020a	2021a	2022a	2023a	2024e	2025f	2026f	2027f
Revenue	347	322	371	400	378	375	417	435
EBITDA	275	244	285	317	288	288	319	333
Funds from operations (FFO)	114	89	173	198	198	186	202	215
EBIT	264	241	270	309	299	307	335	345
Interest expense	132	133	96	111	99	108	120	120
Cash flow from operations (CFO)	90	127	149	148	182	178	191	202
Capital expenditure (capex)	209	309	709	207	196	181	153	130
Free operating cash flow (FOCF)	(118)	(182)	(560)	(58)	(13)	(3)	38	72
Dividends	135	139	168	143	144	158	174	191
Debt	4,651	4,732	5,283	4,864	4,281	4,340	4,423	4,491
Equity	6,833	7,184	7,343	5,947	5,531	5,474	5,522	5,563
Adjusted ratios								
EBITDA margin (%)	79.4	75.9	76.7	79.4	76.1	76.7	76.6	76.5
EBITDA interest coverage (x)	2.1	1.8	3.0	2.9	2.9	2.7	2.7	2.8
Debt/EBITDA (x)	16.9	19.4	18.6	15.3	14.9	15.1	13.9	13.5
Debt/debt and equity (%)	40.5	39.7	41.8	45.0	43.6	44.2	44.5	44.7

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. EUR--euro.

Company Description

Colonial is a key player in the European prime office market, with a presence in the main business areas of Barcelona, Madrid, and Paris. Colonial's portfolio mainly includes office assets (more than 90% of total GAV) with a clear focus on CBDs, where about 78% of its assets are located. As of Dec. 31, 2023, Colonial owned a portfolio valued at €11.3 billion. Its stake in core subsidiary Societe Fonciere Lyonnaise (BBB+/Stable/A-2) is 98.3% as of Dec. 31, 2023.

The company is listed on the Spanish stock exchange IBEX 35 and its main shareholders are the Qatar Investment Authority (19%), Grupo Finaccess (15%),Puig S.A. (7%), Aguila Ltd (5%), Corporacion financiera Alba, S.A. (5%), Credit Agricole, S.A. (4%) and Blackrock Inc (3%). The remaining stake is free float.

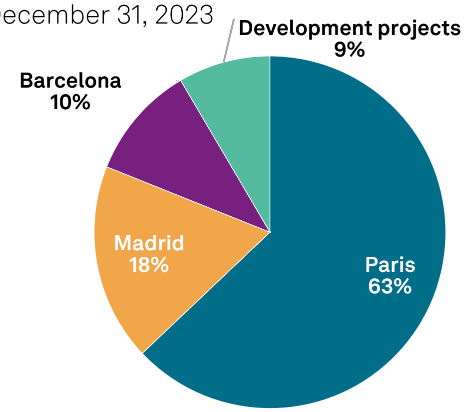
Inmobiliaria Colonial, Socimi, S.A. --Portfolio Summary

Segment focus	Office
Total portfolio value	€11.3 billion
Total gross leasable area	1.5 million sqm
Occupancy	96.8%
Average lease maturity*	Paris- 7.6 years; Madrid- 5.7 years; Barcelona- 6.3 years
Overall portfolio quality§	Prime portfolio in terms of location and asset quality (EPRA net initial yields, Paris: 4.13%; Madrid, 4.70%; Barcelona: 4.87%)
Operational properties with sustainability certifications	100% of gross asset value is BREEAM/LEED certified
Market capitalization†	€3.1 billion

*Average lease maturity of contracts until their expiry date. §S&P Global Ratings' view. †As of May 8, 2024. EPRA—European Real Estate Association.

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

As of December 31, 2023



Source: S&P Global Ratings, company report. GAV--Gross asset value.

Peer Comparison

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+/Negative/A-2	BBB+/Negative/A-2	BBB+/Stable/A-2	BBB+/Stable/--
Business risk profile	Strong	Strong	Strong	Satisfactory	Strong	Satisfactory
Financial risk profile	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate
Portfolio value (bil. €)	11.3	17.1	24.6	6.5	7.3	10.6
Assets diversity	Offices 97%; Retail and others 3%	Offices 80%; Residential 18%; Student Housing 2%	Offices 40%; Residential 33%; Hotel 21%; Retail 4%; Logistics/Other - 2%	Office 82%; Light Industrial 11%; Others 5% & Landbank 2%	Offices 81%; Retail 18%; Residential 1%	Offices 56%; Shopping centers 18%; Logistics 17%; Other 9%
Occupancy (%)	96.8	92.1	92.1	87.9	99.7	96.2
WAULT (years) (until first break)	Paris, 7 years; Madrid, 3 years; Barcelona, 5 years	4.3	7.4	3.6	7.6	3.2
Top 10 tenants (as a % of GRI)	N/A	25	<20	N/A	~40	21
Geography diversity	France 70%; Spain 30%	France 100% (86% of office portfolio in central Paris)	Germany 73%; Netherlands 9%; U.K. 8%; Other 9%	France 100%	France 100% (Paris CBD 77%; Paris other 22%; Western Crescent 1%)	Spain ~88%; Portugal ~12%
Development exposure (as a % of GAV)	<5	<5	~8	<5	~10	<5

Source: S&P Global Ratings, latest company reports. N/A--Not applicable. WAULT--Weighted average unexpired lease term . GRI--Gross rental income.

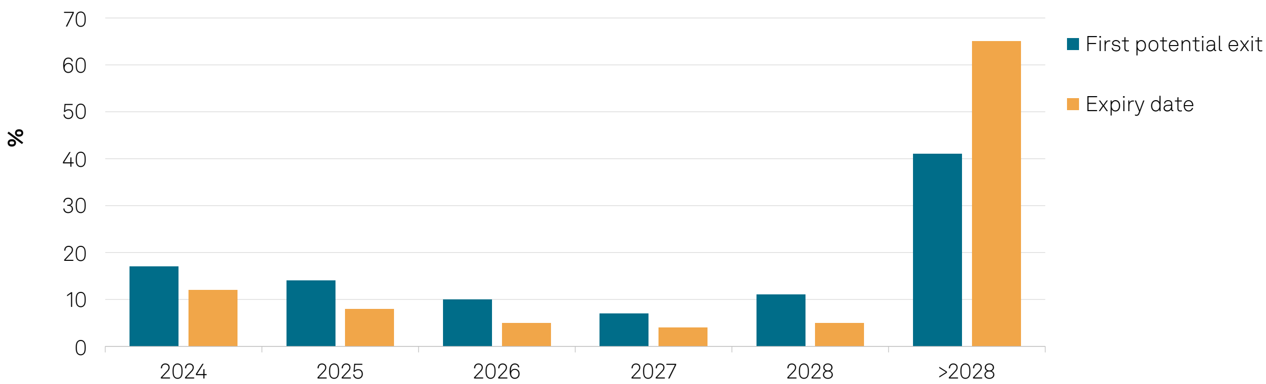
Business Risk

We note the high quality of Colonial's office real estate portfolio in France and Spain, valued at €11.3 billion at year-end 2023. Its properties are mostly in the CBDs of Paris, Madrid, and Barcelona, where the supply of good-quality assets remains scarce. The number of properties Colonial has in these areas (78% of total GAV as of year-end 2023) compares favorably with other European office owners, such as Icade and Covivio. We believe the shortage of high-quality, green-certified office space in these three cities, particularly in the CBDs, as well as continuously high demand from tenants, should support rental income growth over the next 12-24 months despite the economic and job creation slowdown we forecast as a result of the higher interest rate environment.

That said, Colonial benefits from long leases (average remaining term of 7.6 years in Paris, 5.7 years in Madrid, and 6.3 years in Barcelona) and 12% of leases expiring in 2024 with a supportive track record of contract renewal. The company also enjoys a strong tenant base, mainly large creditworthy corporates, with only a limited share of small and midsize enterprises. This should mitigate any nonpayment or rent-reduction risk in the challenged market environment. Amid current inflation, which is increasing the rental burden on tenants, we view Colonial’s creditworthy tenant base as supportive of its cash flow growth as well as cash flow predictability. Colonial should also benefit from additional rental income from Utopicus, its flexible office-offering subsidiary in Spain. The shorter term nature of Utopicus' leases, compared to traditional lease contracts, offers Colonial's tenants additional flexibility to align floorspace with their needs. We understand Utopicus' contracts are short-to-medium term (usually more than one year) and that its tenant profile is robust, with no significant exposure to small companies.

Inmobiliaria Colonial, Socimi, S.A. -- Commercial Lease Expiry

As of December 31, 2023



Source: Company report.

We expect the subdued macroeconomic context to weigh on job creation and therefore new demand for office space, leading to a slowdown in new office space uptake. That said, office supply remains historically low in Colonial's locations, and the supply-demand imbalance should continue to drive growth in market rents. Additionally, we expect indexation to support rental growth given that the majority of its lease contracts are inflation indexed. That said, we expect exits from some tenants and ensuing refurbishment periods to partially offset indexation. We forecast lower positive like-for-like rental growth (compared with positive 8% in 2023) on the back of a potential decline in occupancy, either due to maturing leases or assets undergoing redevelopment, some of which, mostly in Barcelona and Madrid, with still-low letting visibility.

Our assessment of Colonial's business risk profile is also supported by the diversification in terms of asset base and geographical exposure, which has enabled the company to dispose of over €490 million of office assets in 2023 and a further €200 million year to date. This diversified asset base has enabled Colonial to dispose of smaller ticket assets in its Spanish office portfolio in a market where liquidity for large office assets has been compromised by rising interest rates and economic headwinds.

Financial Risk

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 2.4x and an LTV ratio of 35%-40% (equivalent to a debt-to-debt-plus-equity ratio of 40%-45%).

The company's recently completed asset disposals of about €490 million have enabled it to absorb the 9.3% like-for-like decline (Paris -10.5%, Madrid -4.6%, Barcelona -11.4%) in asset valuations reported in 2023, maintaining reported LTV at 39.9% as of year-end 2023, up from 38.7% at year-end 2022. This translated into debt to debt plus equity of 45% at year-end 2023 up from 41.8% at year-end 2022. The announced further €500 million asset disposals expected in 2024 (€200 million completed year to date) coupled with a prudent investment strategy should help build a buffer to absorb the further asset portfolio devaluations we foresee stemming from rising interest rates and cap rate expansion. Similarly, the company has completed these asset disposals in line or with small discounts to the latest appraisal valuations, confirming independent appraisers' valuations and investor demand for primer office assets despite the current economic uncertainty.

The cash flow base growth effect from indexation and expected rental growth also compensated for the negative impact from rising yields on Colonial's portfolio valuation. The valuation impact stemming from yield expansion (by 86 bps in Paris compared to 54 bps in Barcelona and 47 bps in Madrid) resulted in a 18% negative impact on asset valuations, which was partially mitigated by positive cash flow growth helping valuations by about 8%. We forecast negative property revaluations of about 5% in 2024, which will weigh on valuation-driven metrics. That said, we expect the proposed disposal plan to offset the impact of negative portfolio revaluations and we forecast Colonial will maintain debt to debt plus equity below 45%, in line with the financial policy of maintaining LTV below 40%. This is thanks to the company's prudent financial policy of focusing on asset rotation initiatives to strengthen its capital structure and the high visibility of its cash flow growth.

We forecast debt to EBITDA and cash-flow-driven metrics, which have remained high amid large capex plans and active asset rotation, to remain at current levels. We understand the company has adjusted its investment plans for new, more expensive financing conditions, prioritizing asset disposals. Similarly, the growing rental and EBITDA base—fueled by positive indexation as well the contribution from fully pre-let project deliveries—should partially compensate the EBITDA lost from the asset disposals. We expect Colonial's debt to EBITDA to remain around 15.0x in the upcoming 12-24 months (15.3x at year end 2023).

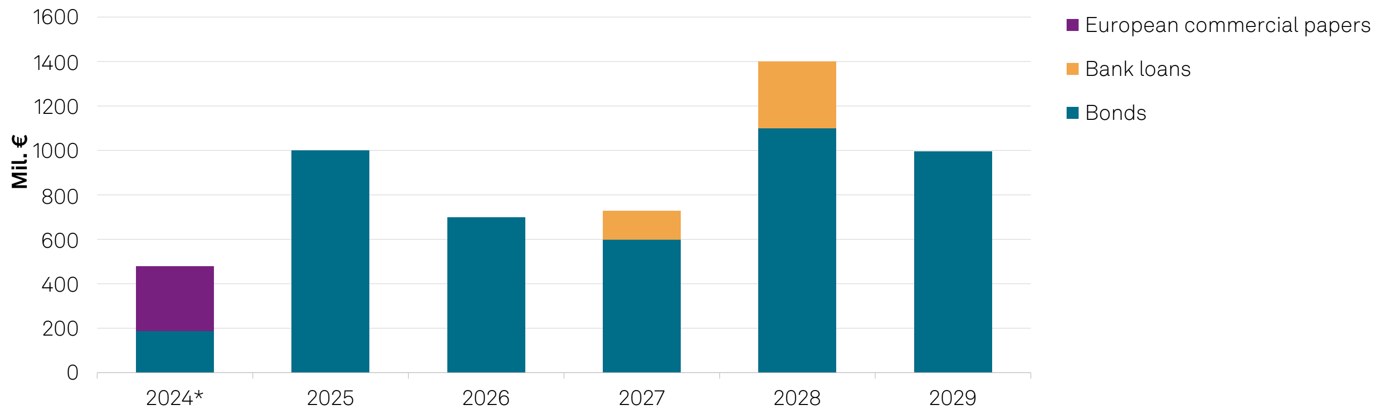
Lastly, Colonial's entire debt is either at fixed cost or hedged against interest rate changes, which provides significant interest expense protection. Additionally, the low short-term refinancing needs (€187 million in 2024, excluding the €292 million under the commercial paper program) limits the negative impact from rising interest rates on Colonial's debt service capacity over the next 12 months. This, coupled with our expectations of EBITDA growth, should result in EBITDA interest coverage remaining 2.8x-3.0x in the coming 12-24 months.

Debt maturities

Colonial's average debt maturity is 4.2 years.

Inmobiliaria Colonial, Socimi, S.A.-- Debt Maturity Profile

As of December 31, 2023



Source: S&P Global Ratings.* The 2024 €187 million bond maturity has been refinanced via the €200 million bond tap at the time of the publication of this report

Liquidity

We view Colonial's liquidity as strong, with a ratio of liquidity sources to uses above 1.5x for the 12 months started Jan. 1, 2024, and higher than 1x over the following 12 months. This is supported by its €2.47 billion of available backup facilities and moderate capex, enhancing its ability to withstand high-impact, low-probability events with limited need to refinance. Colonial has also demonstrated broad access to both the equity and debt capital markets, enhancing our assessment of its liquidity. Additionally, the company's long track record of solid relationships with banks supports its liquidity profile, in our view.

Principal liquidity sources

- €435.9 million of unrestricted cash and cash equivalents;
- €2.47 billion of undrawn committed backup facilities;
- About €200 million of annual funds from operations; and
- €200 million from asset sales.

Principal liquidity uses

- €479.4 million of debt maturities, including commercial paper;
- About €175 million-€200 million of capex; and
- About €140 million-€160 million of planned dividend payments.

Environmental, Social, And Governance

Environmental factors are a positive consideration in our credit rating analysis of Colonial. In total, 100% of its portfolio by GAV is BREEAM or LEED certified, and its buildings are centrally located close to public transport. In our view, this helps to attract high-quality occupants and supports its strong competitive position, given that tenants have increased their focus on the sustainability of buildings. These features emphasize the quality of its assets and translate into solid rental growth and high occupancy levels. In line with the company's commitment to develop nearly zero-energy buildings, Colonial will develop the first office building in Spain made entirely of wood. This pioneer project reflects Colonial's engagement with emissions reduction and its search for building processes that are less harmful to the environment, at all stages of the building life cycle, from construction to operation. The building will, as a result, have the highest environmental certification (LEED platinum and WELL platinum). Additionally, 90.5% of Colonial's outstanding debt and 100% of its bonds are classified as green, becoming the first IBEX35 company with such a high proportion of sustainable unsecured financing.

Social and governance factors are neutral to our credit analysis of Colonial.

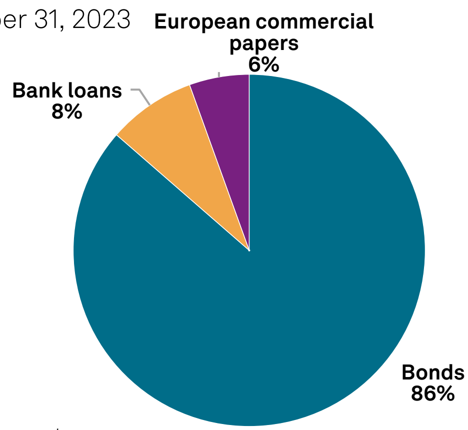
Issue Ratings--Subordination Risk Analysis

Capital structure

As of Dec. 31, 2023, Colonial's debt is all unsecured, Colonial no longer has mortgage debt in its capital structure.

Inmobiliaria Colonial, Socimi, S.A.--Debt Structure

As of December 31, 2023



Source: Company report.

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 at the end of 2023 was 0% (no outstanding secured debt), well below our threshold 40%, so we continue to align our issue rating on the unsecured bonds with the issuer credit rating on Colonial.

Rating Component Scores

Foreign currency issuer credit rating	BBB+/Stable/A-2
Local currency 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+
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb+

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
- ARCHIVE | General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- ARCHIVE | Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- ARCHIVE | General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (as of May 09, 2024)*

Inmobiliaria Colonial, Socimi, S.A.

Ratings Detail (as of May 09, 2024)*

Issuer Credit Rating	BBB+/Stable/A-2
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.