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CREDIT OPINION

18 September 2024

Update

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RATINGS

Inmobiliaria Colonial SOCIMI, S.A.

Domicile	Madrid, Spain
Long Term Rating	Baa1
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

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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Inmobiliaria Colonial SOCIMI, S.A.

Update following upgrade to Baa1

Summary

On 16 September 2024 we upgraded Inmobiliaria Colonial SOCIMI, S.A.'s (Colonial) rating to Baa1 as a consequence of expected improvements to credit metrics with a sustainably lower leverage driven by a conservative financial policy with the benefits of recent capital increase and continuing strong operating performance.

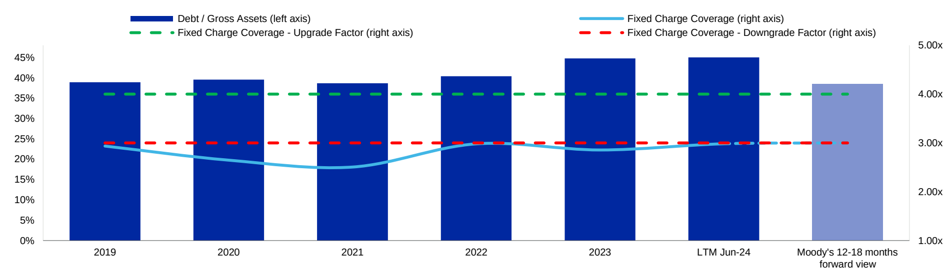
The Baa1 rating reflects Colonials leading position in the prime Paris, Madrid and Barcelona office market, with high quality offices and good operational performance; Moody's-adjusted debt/asset expected to decline below 40% from debt paydown; good liquidity management, supported by good access to capital 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. Despite remaining a relative weak point of Colonial's credit metrics, Moody's-adjusted fixed charge cover will stay at or above 3x in the next 18 months given like-for-like rental growth and paydown of debt alongside partial pre-hedging offsets higher cost of refinancing.

Despite being well prepared with a strong asset base, secular changes from a widely accepted hybrid work model remain a challenge for future performance. A very low property yield results in lower cash and earnings-based credit metrics, alongside pressure from higher interest rates. Capital recycling remains more difficult with low volumes of transactions in the market.

Exhibit 1

Debt/Asset set to decline with debt paydown

Gross debt/assets and fixed-charge coverage



All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Periods are financial year-end unless indicated. LTM = Last 12 months.
Moody's forecasts are Moody's opinion and do not represent the views of the issuer.
Sources: Moody's Financial Metrics™ and Moody's Ratings forecasts

Credit strengths

- Leading position in the prime Paris, Madrid and Barcelona office market, with high quality offices and good operational performance
- Expected decline in Moody's-adjusted debt/gross asset after a capital raise and conservative long term balance sheet strategy
- Strong liquidity management, supported by good access to debt and equity capital and a substantial amount of unencumbered assets

Credit challenges

- Secular risks arising from a broader adoption of hybrid work models
- Increased interest rates affecting interest expense over a multi-year period
- Weaker EBITDA-based ratios due to low property yields, as well as development projects and the renovation programme
- Risks relating to a slowdown of the economy / reduction in office-based employment
- Continued slow transaction markets making capital recycling more challenging

Rating outlook

The stable outlook reflects the stabilising business environment for landlords and limited impact of secular headwinds on Colonial's operating performance.

Factors that could lead to an upgrade

- Continued substantial outperformance of the office market resulting in strong rental growth
- Changes to the company's financial policy that will keep Moody's-adjusted debt/gross assets well below 35%
- Moody's-adjusted fixed charge cover sustainably towards 4x
- The rating of the government of Spain (Baa1 positive) may pose a constraint to the rating of Colonial

Factors that could lead to a downgrade

- Moody's-adjusted fixed charge cover sustained below 3x
- Moody's-adjusted gross debt/total assets above 40%
- Failure to maintain a positive operating track record
- Unfavourable changes to the business environment for property owners

Key indicators

Exhibit 2
Inmobiliaria Colonial SOCIMI, S.A.

	2019	2020	2021	2022	2023	LTM Jun-24	Moody's 12-18 Month Forward View
Gross Assets (in $ billions)	14.0	15.1	14.5	14.4	13.1	12.6	12.5 - 13.5
Unencumbered Assets / Gross Assets	90.3%	90.3%	98.6%	99.9%	99.9%	99.9%	100.0%
Total Debt + Preferred Stock / Gross Assets	38.9%	39.6%	38.7%	40.4%	44.8%	45.0%	37.0% - 40.0%
Net Debt / EBITDA	16.5x	17.3x	19.9x	19.2x	15.0x	14.1x	13.0x - 14.5x
Secured Debt / Gross Assets	2.2%	2.2%	0.6%	0.6%	0.0%	0.0%	0.0%
EBITDA / Fixed Charges	2.9x	2.6x	2.5x	3.0x	2.9x	3.1x	2.9x - 3.1x

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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 2024, the gross asset value (GAV) of Colonial's portfolio was €11.3 billion with around 66% of rental income generated by properties in Paris.

Colonial is listed on the Madrid stock exchange, with a market capitalisation of around €3.8 billion as of 11 September 2024.

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

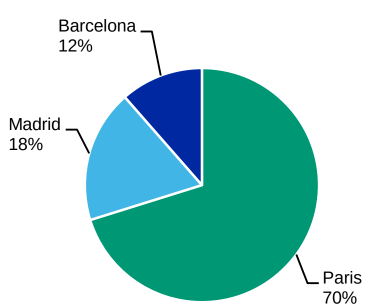
Detailed credit considerations

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 2024, the GAV of Colonial's portfolio amounted to €11.3 billion, and in terms of market capitalisation, Colonial is one of the largest listed landlords in Spain. 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.

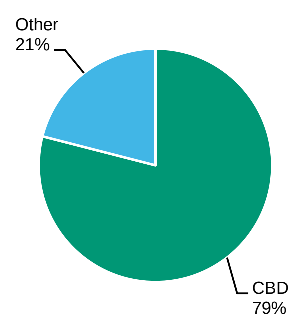
Rental income from office buildings generate the bulk of the income, and the remainder comes from some retail and also flex-office space under the brand utopic US. The company generated €192 million in gross rental income in H1 2024 after €377 million in gross rental income in 2023. Offices in France represented around 66% of the gross rental income and Spanish properties accounted for the remainder 34%.

Exhibit 3
Portfolio breakdown by cluster
As a percentage of the portfolio in operation, with a total GAV of €11,267 million as of June 2024



Source: Company

Exhibit 4
Most assets are located in CBDs
As a percentage of total GAV as of June 2024



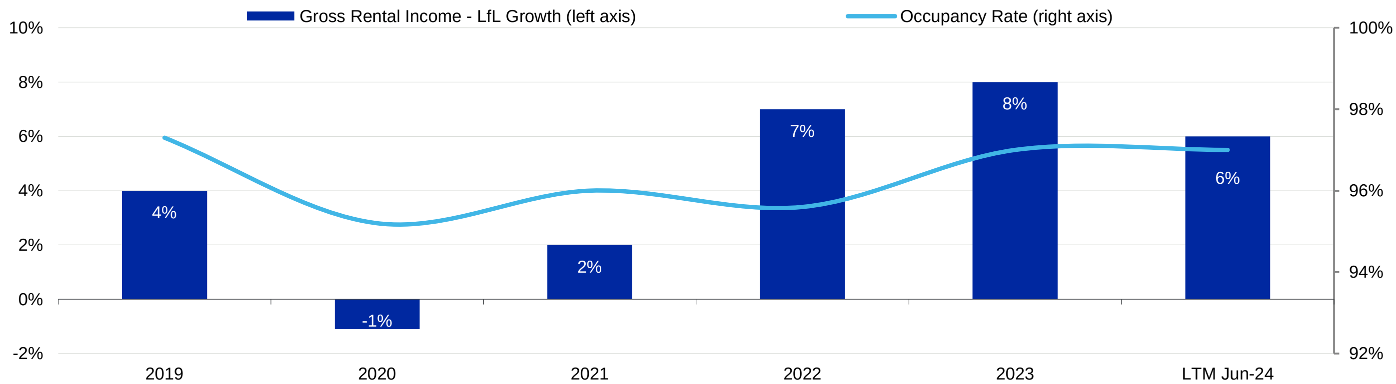
Source: Company

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

Colonial's operating performance remains strong despite sector wide concerns around structural changes in the office market. EPRA vacancy excluding assets in the project pipeline or under renovation is 2.7%, remaining persistently low throughout the last years. Like-for-like rental growth was 6.5% for the group in H1 2024, driven by reletting in Barcelona and strong performance in Paris. Release spreads above ERV show continued rent potential.

Exhibit 5

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



Periods are financial year-end unless indicated. LTM = Last 12 months.
Source: Company

Risks relating to the shift in occupancy towards the hybrid work models remain. We estimate such risk to be less disruptive for and to lead to a greater focus on Class-A buildings in central locations featuring high ESG credentials. Colonial's high-quality office properties with regular deep renovation and repositioning updates with strong environmental credentials position the company solidly against a broader adoption of hybrid or remote work. Within the bifurcation of the market, Colonial will be able to continue to attract tenants in contrast to weaker quality and location landlords.

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 tenants, the portfolio's collection rate remains high showing no signs of credit concerns in its tenant base.

Refilled developments pipeline 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 is finishing its Mendez Alvaro asset development and finalising a smaller refurbishment in Barcelona that stem from its previous project pipeline. The company has announced the launch of a new phase of developments with a total lettable area of 110,000 sqm in Paris, Madrid and Barcelona. The company expects a GRI of €82 million once the developments and refurbishments are completed and leased.

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 2024

Project	City/Area	Use	Delivery	GLA (sqm)	Total Cost (€ million)	Ungeared IRR
Scope	Paris City Center	Business Campus	2026	22,000	309	>9%
Sancho de Avilla	Barcelona @22	Life Science/Healthcare	2027	17,860	114	>7%
Condorcet	Paris City Center	Urban Mix-Use	2027	24,000	366	>9%
Santa Hortensia	Madrid City Center	Urban Mix-Use	2028	46,928	237	>9%
Project Alpha				**110,788**	**1,026**	**>9%**
Mendez Alvaro Madnum	Madrid Paseo de la Castellana	Offices and Retail	H2 2024	60,000	-	-
Total Pipeline				**170,788**	**-**	**-**

Total Cost= asset value pre-project + future capex

Source: Company

Property values remained stable in H1 2024, indicating an end to property value declines

Business conditions for European real estate companies have improved in the last 12 months as more visibility on future short-term interest rates improve the sentiment towards the sector and improve in particular debt capital access for the industry. Property values increased in H1 2024, which brings the total property value declines to around 11% peak to trough. We no longer expect material value declines in our assumptions for Colonial's assets despite very low yields (2.9% EPRA net initial yield). Nevertheless transaction volumes in particular in the office sector remain weak and make capital recycling more challenging. The company has indicated further capital recycling activity that we consider important for the overall deleveraging we expect.

Capital Raise in July 2024 reduced leverage and contributed assets

Colonial carried out a capital raise effective just after the H1 2024 balance sheet date. The raise contains a cash amount of €350 million and a contribution in kind of €272 million through assets held by Criteria Caixa. Colonial believes the asset fit well into their prime and deep refurbishment strategy with optionalities. The capital raise results in higher income and allows solid funding of Colonial's renewed project pipeline.

Financial Metrics to improve with debt paydown and positive effect of capital raise

After the capital raise, Colonial has outlined the expectation of stable net LTVs from their pro-forma 36.7%. Given continued capital recycling and a well defined development pipeline for the next years, we expect this to result in a reduction of debt in the next 12 to 18 months. We project Moody's-adjusted Debt/Gross Assets to reduce below 40% by 2025 from current 45%. We assume a repayment of debt from an existing higher cash balance while additional assets contributed as part of the capital raise mitigate the expected effect from disposals. We no longer forecast material negative implications of fair value changes on Colonial's balance sheet, as moderate further yield widening (if any) will be compensated by positive while moderating rental growth.

Moody's-adjusted fixed charge cover has become a weak point for many real estate companies with the new rate environment rolling into the company's interest expense over time. Colonial benefits from a partial pre-hedging of its debt maturity profile that mitigates the effect and allows income growth to further buffer the effect of increased interest rates. Moody's-adjusted EBITDA will likely decline given further capital recycling expectations. As such we expect Moody's-adjusted fixed charge cover to remain at or above 3x as of H1 2024 in the next 18 months. We consider accounting interest expense in this number, while we understand previously crystalised pre-hedges will result in a higher cash interest paid.

Moody's-adjusted net debt/EBITDA is also set to trend lower in the next 18 months from the 14.2x as of LTM June 2024. We note that the recently announced 4 large project developments will not contribute to income until 2028, which partially explains a degree of tolerance for weaker earnings-based metrics.

ESG considerations

Inmobiliaria Colonial SOCIMI, S.A.'s ESG credit impact score is CIS-2

Exhibit 7
ESG credit impact score

CIS-2

ESG considerations do not have a material impact on the current rating.

Source: Moody's Ratings

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
E-3

SOCIAL
S-3

GOVERNANCE
G-2

Source: Moody's Ratings

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. We expect the company to adhere to a net LTV ratio in the mid 30% range as defined by the company. Colonial 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

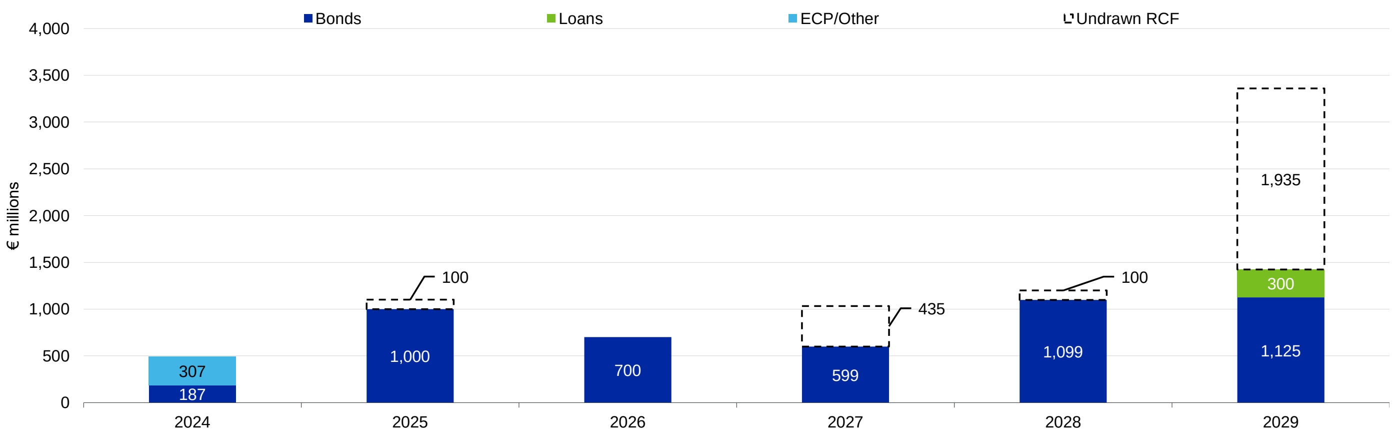
Good liquidity supported by a substantial amount of high quality unencumbered assets

Colonials solid liquidity is based on €425 million of cash and cash equivalent and €2.6 billion of RCF as of June 2024. The company also received €350 million of cash from its capital raise with Criteria and some disposal proceeds post balance sheet date.

Colonial faces around €1.5 billion in debt maturities until end of 2025. We also expect the company to spend €350 to 400 million mainly on capital expenditures related to its project pipeline, renovations and other property improvements during this period. Given its SOCIMI status we also included around €200 million of dividends until December 2025 in our assessment. The company has highlighted further potential for asset recycling that we expect to improve liquidity over time. The company's large unencumbered asset base provides financial flexibility if need be.

Exhibit 9

Colonial's Average Debt Maturity is 4.5 years as of June 2024



Source: Company

Methodology and scorecard

The following table shows Colonial's scorecard-indicated outcome using our REITs and Other Commercial Real Estate Firms Methodology.

The scorecard-indicated outcome for the twelve months ended on 30 June 2024 is in line with the assigned rating while the scorecard-indicated outcome for Moody's 12-18 months forward view is 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 Jun-24		Moody's 12-18 Months Forward View As of Sep-24 [3]	
Factor 1 : Scale (5%)	**Measure**	**Score**	**Measure**	**Score**
a) Gross Assets (USD Billion)	$12.6	A	$12.5 - $13.5	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	A	A	A	A
b) Unencumbered Assets / Gross Assets	99.9%	Aaa	100.0%	Aaa
Factor 4 : Leverage and Coverage (45%)				
a) Total Debt + Preferred Stock / Gross Assets	45.0%	Baa	37.0% - 40.0%	Baa
b) Net Debt / EBITDA	14.1x	Ca	13.0x - 14.5x	Ca
c) Secured Debt / Gross Assets	0.0%	Aaa	0.0%	Aaa
d) Fixed Charge Coverage	3.0x	Baa	2.9x - 3.1x	Baa
Rating:				
a) Scorecard-Indicated Outcome		Baa1		A3
b) Actual Rating Assigned				Baa1

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Ratings

Exhibit 11

Category	Moody's Rating
INMOBILIARIA COLONIAL SOCIMI, S.A.	
Outlook	Stable
Issuer Rating -Dom Curr	Baa1

Source: Moody's Ratings

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