S&P Global
Ratings

Research

Grand City Properties S.A.

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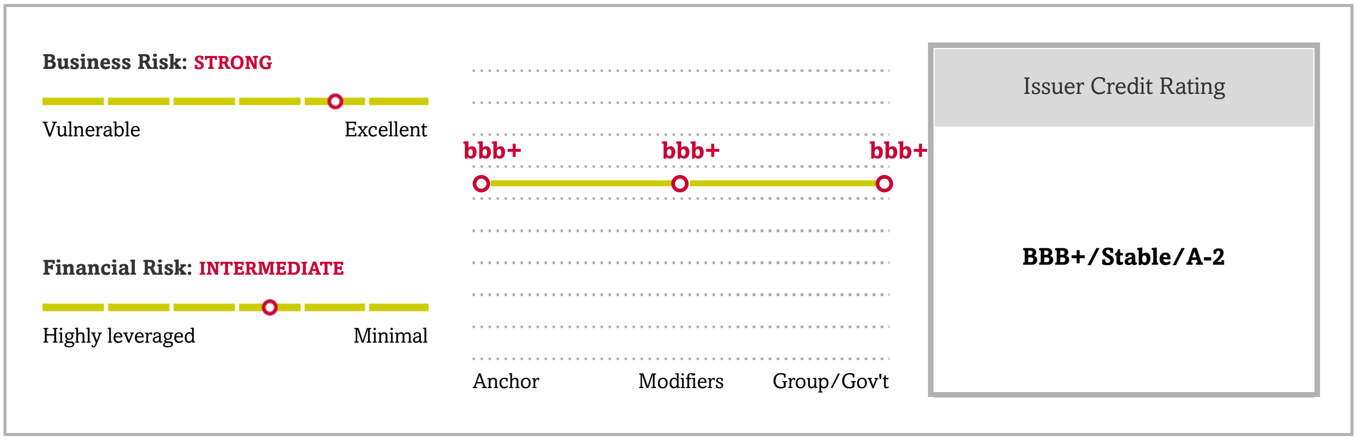
Grand City Properties S.A.



Overview

Key Strengths	Key Risks
• Large portfolio of income producing real estate assets with a well-diversified tenant base. • Very resilient asset class, with average quality, consisting of residential properties mainly in most dynamic German cities. • Good potential for reversionary income, with assets rented well below current market estimates. • Strong capacity to cover interest burden, with EBITDA interest coverage ratio exceeding 4x. • Moderate financial policy; the S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio is just below 45%.	• Full geographic dependence on one single economy, Germany. • Lower asset diversity in terms of portfolio size and number of units compared to more highly rated peers, like Deutsche Wohnen or Vonovia. • Newly acquired assets provide rental reversionary potential but exhibit higher-than-average vacancies, thereby weighing on consolidated performance measures such as occupancy ratio and average rent.

Grand City Property is a large residential asset landlord.

It holds a portfolio worth approximately €6.9 billion comprising about 85,000 apartments, mainly focused on the midrange segment. It has a well-diversified investment portfolio, chiefly spread in and around German metropolitan areas and midsize cities, with favorable demand for residential real estate and underlying healthy macroeconomic fundamentals.

The portfolio is of sound quality and offers strong rental reversionary potential.

GCP's assets are located mainly in cities with healthy rental growth prospects, where demand continues to outpace supply of new property developments. Moreover, the company's rents are still well below their estimated levels, creating significant upward potential. This is evidenced by a long track record of organic growth, with like-for-like rental income growth sustainably above 3% annually. That said, we believe that about 10%-15% of GCP's portfolio is in locations, mainly rural areas, with less favorable demand-supply trends compared to most mid-sized cities and metropolitan areas.

The company exhibits long debt maturities and solid credit metrics, particularly its interest coverage ratio.

Based on prudent gearing (debt to debt and equity at 40%-45%) and a very low cost of debt (1.6%), the company achieves an EBITDA interest coverage ratio in excess of 4x, while keeping a long debt maturity profile (8.3 years) and high interest rate hedging (99%).

Still, the company depends solely on the German economy, and its portfolio remains smaller than higher-rated peers.

GCP has significantly fewer assets than Vonovia and Deutsche Wohnen, which renders it more vulnerable to asset or tenant rotation. This is somewhat exacerbated by the fact that, compared to peers, more of GCP's portfolio consists of turnaround properties that have high vacancy rates, which weighs on the group's overall occupancy rate.

Outlook: Stable

The stable outlook on GCP reflects our expectation that favorable economic and demographic trends in Germany should continue to support steady tenant demand for GCP's residential apartments over the next 24 months. We expect the company to maintain a prudent approach to its overall investment activities and quickly lease vacant spaces in its newly purchased assets. Based on management's financial policy, we expect the company to use debt only moderately, such that debt to debt plus equity remains below 45% and its EBITDA interest coverage stays above 3.5x.

Downside scenario

We could lower our ratings on GCP if it failed to maintain its debt-to-debt-plus-equity ratio below 45% as a result of large debt-financed acquisitions and an easing financial policy. We could also consider a downgrade if the company substantially increased its acquisitions of turnaround properties, resulting in lower free operating cash flow (FOCF) and higher vacancies, or if it experienced a decline in occupancy rates in its stabilized assets.

We could also lower our ratings on GCP if the company continued to issue additional hybrid instruments such that the accumulated amount exceeded our threshold of 15% capitalization on a forward-looking basis. This would lead us to view its hybrid notes as having minimal equity content and would significantly increase our estimate of the group's debt burden to a level that was incompatible with the current rating.

Upside scenario

We could raise the ratings if GCP's portfolio showed strong growth to more than €10 billion, with new assets enjoying at least the same quality as existing ones. We would expect such growth to dilute GCP's exposure to turnaround assets which generally exhibit higher vacancy rates, allowing the group's average vacancy rate to fall below 5%. An upgrade could also depend on GCP continuing to reduce its leverage, with the ratio of debt to debt plus equity at about 35%, maintained at that level as part of a more conservative financial policy, while keeping strong EBITDA interest coverage of above 3.5x.

Our Base-Case Scenario

Assumptions

We forecast relatively low real GDP growth for Germany for the next two years: 1.8% in 2018, 1.7% in 2019, and 1.5% in 2020. Inflation should pick up slightly to 1.8% over the same period, from 1.7% in 2017.

We anticipate supply and demand dynamics will remain supportive of German residential landlords in the near term, underpinning rental income growth and stable occupancy levels.

Key Metrics

	2017A	2018E	2019E
Debt-to-Debt + Equity (%)	44.2	42.5-43.5	42-44
Ebitda to interest (x)	4.7	4.0-4.3	4.0-4.5
Debt to Ebitda (x)	11.2	10-11	9-11

A--Actual. E—Estimate

Base-Case Projections

- Gross rental income of about €510 million-€530 million for 2018 and slightly more than €550 million-€570 million for 2019, including some completed acquisitions during the year.
- Positive like-for-like rental income growth of 3.5%-4.0% for 2018 and around 3% for the following years. We believe this will result mainly from some increase in rental levels of existing as well as new leases.
- Mid-to-high single-digit asset valuation growth for the next 12-24 months, due to the good fundamentals of the German residential market and its favorable demand trends in GCP's key regions, such as Berlin, Cologne, and Dresden, where supply from new property developments remains limited.
- A stable adjusted EBITDA margin of about 50%-52% during 2018-2020, excluding gains on revaluation and asset disposals. We base the margin calculation on gross rental income as reported by GCP, including overheads received from tenants such as heating costs, waste, and recycling fees.

Company Description

GCP is a Luxembourg-incorporated property investment company, focusing on investing and managing properties in the German residential real estate market. As of June 30, 2018, its total portfolio value amounted to about €6.9 billion, consisting mainly of 85,000 owned units located in densely populated areas, with a focus on the state of North Rhine-Westphalia (27% of portfolio value), Berlin (23%), and the cities of Dresden, Leipzig, and Halle (together 15%). The company is listed on the MDAX on the Frankfurt stock exchange.

Business Risk: Strong

GCP's business risk profile is underpinned by its large income-producing asset portfolio of about €6.9 billion as of Sept. 30, 2018, generating stable and recurring cash flows across Germany. The company benefits from a broad geographic spread across densely populated regions with good growth prospects in Germany. It focuses on mainly metropolitan areas with favorable macroeconomic fundamentals and strong demand for residential premises. GCP has no exposure to development activities. Investments mainly relate to the maintenance and renovation of acquired premises. Our assessment also reflects GCP's geographic presence in well-balanced regions with healthy rental growth prospects, such as North Rhine-Westphalia (27% of portfolio value), including cities such as Cologne, Duisburg, and Dortmund; Berlin (23% of portfolio value), and the cities of Dresden, Leipzig, and Halle (15%). Demand continues to outpace supply of new property developments in GCP's core regions, further facilitating improvements in occupancy rates. GCP's property portfolio now consists of about 85,000 owned units, and, like its residential property peers, it has very good asset and tenant diversity. We believe the residential asset class, especially in Germany, is more resilient than the retail or office segments, which are more cyclical and vulnerable to economic downturns. We see the asset quality of most apartments in GCP's portfolio as average, reflecting that the company still has some exposure to lower quality premises, which points to GCP's previous acquisition strategy. Vacancy rates remain high compared with levels at other residential real estate companies that S&P Global Ratings rates, such as Vonovia SE (BBB+/Stable/A-2) or Deutsche Wohnen SE (A-/Stable/A-2).

Peer comparison

Table 1

Peer Comparison

	Grand City Properties S.A.	Deutsche Wohnen SE	Akelius Residential Property AB	Buwog AG	Vesteda Residential Fund FGR
Rating as of Nov. 13, 2018	BBB+/Stable/A-2	A-/Stable/A-2	BBB/Stable/A-2	-/-/-	BBB+/Stable/--
	--Fiscal year ended Dec. 31, 2017--	--Fiscal year ended Dec. 31, 2017--	--Fiscal year ended Dec. 31, 2017--	--Fiscal year ended April 30, 2018--	--Fiscal year ended Dec. 31, 2017--
(Mil. Mix curr.)	€	€	kr	€	€
Revenues	494.9	864.9	4,122.0	318.8	247.0
EBITDA	248.0	552.6	2,220.0	153.7	154.0
Funds from operations (FFO)	167.6	400.6	793.0	87.6	123.0
Interest Expense	52.3	120.4	1,403.0	52.3	31.0
Net income from cont. oper.	534.6	1,717.9	7,721.0	274.1	682.0
Working capital changes	(26.5)	9.5	(186.0)	(61.3)	20.0
Cash flow from operations	142.6	520.3	842.0	13.8	153.0
Capital expenditures	72.8	227.4	2,777.0	51.3	250.0
Free operating cash flow	69.7	292.9	(1,935.0)	(37.6)	(97.0)
Dividends paid	112.5	268.1	8,206.0	78.2	206.0

Table 1

Peer Comparison (cont.)	Grand City Properties S.A.	Deutsche Wohnen SE	Akelius Residential Property AB	Buwog AG	Vesteda Residential Fund FGR
Discretionary cash flow	(42.8)	24.8	(10,141.0)	(115.8)	(303.0)
Cash and short-term investments	401.5	363.7	155.0	204.9	13.9
Debt	2,775.2	6,931.2	49,913.0	1,748.4	1,165.5
Preferred stock	(350.0)	0.0	3,010.0	0.0	0.0
Equity	3,499.7	10,211.0	45,260.0	2,822.3	3,819.0
Debt and equity	6,274.8	17,142.2	95,173.0	4,570.7	4,984.5
Valuation of Investment Property	6,376.2	19,952.9	102,242.0	4,963.2	5,035.0
Adjusted ratios					
Annual revenue growth (%)	13.6	11.7	0.3	(2.4)	2.1
EBITDA margin (%)	50.1	63.9	53.9	48.2	62.3
Return on capital (%)	4.2	3.1	2.3	3.2	3.3
EBITDA interest coverage (x)	4.7	4.6	1.6	2.9	5.0
FFO cash int. cov. (X)	3.7	5.2	1.9	5.1	5.0
Debt/EBITDA (x)	11.2	12.5	22.5	11.4	7.6
FFO/debt (%)	6.0	5.8	1.6	5.0	10.6
Cash flow from operations/debt (%)	5.1	7.5	1.7	0.8	13.1
Free operating cash flow/debt (%)	2.5	4.2	(3.9)	(2.1)	(8.3)
Discretionary cash flow/debt (%)	(1.5)	0.4	(20.3)	(6.6)	(26.0)
Total debt/debt plus equity (%)	44.2	40.4	52.4	38.3	23.4
Loan to Value (%)	43.5	34.7	48.8	35.2	23.1

Financial Risk: Intermediate

Our assessment of GCP's financial risk profile is based on our forecast of an adjusted ratio of debt to debt plus equity of 42%-44% in the next 24 months and a sustained and sound EBITDA interest-rate-coverage ratio of just above 4x over the same period. These ratios are in line with the company's financial policy, which limits its target for debt to debt plus equity to 45%. In view of the currently favorable equity and debt capital markets, we consider that management has the means to undertake moderately sized acquisitions without increasing leverage in the company's capital structure. Thanks to ongoing refinancing activities and the general low interest-rate environment in Germany, GCP enjoys a strong cost of debt of 1.6% as of Sept. 30, 2018, while keeping a long average debt maturity profile of 8.3 years. In addition, the capital structure benefits from well-diversified funding sources, including mortgage debt, convertible and straight bonds, perpetual notes, and straight common equity. The company has a proven very good track record in accessing both equity and debt capital markets in the last couple of years.

Partly offsetting these strengths, our assessment of GCP's financial risk profile remains constrained by the company's somewhat weak cash flow generation, mainly due to the low yield profile and good quality of the company's assets. This translates into a weak average debt-to-EBITDA ratio of around 9x-10x.

Financial summary

Table 2

Grand City Properties Financial Summary

	June 2018	March 2018	December 2017	September 2017	June 2017
(Mil. €)					
Revenues	135.8	132.7	127.7	127.0	121.4
EBITDA	69.0	67.9	64.6	59.5	61.4
Funds from operations (FFO)	46.1	47.1	44.5	39.4	41.2
Operating income	68.2	67.1	65.3	56.2	60.6
Net income from continuing operations	118.9	116.9	198.3	144.6	113.5
Working capital changes	(6.0)	(4.4)	(13.2)	(6.2)	(4.8)
Cash flow from operations	40.0	38.2	24.2	43.6	29.3
Capital expenditures	19.8	18.1	13.1	21.8	19.8
Free operating cash flow	20.1	20.1	11.1	21.9	9.4
Dividends paid	0.0	12.9	(12.9)	112.5	0.0
Discretionary cash flow	20.1	7.2	24.0	(90.6)	9.4
Cash and short-term investments	924.5	900.8	401.5	536.0	454.2
Debt	3,059.8	2,881.8	2,775.2	2,566.3	2,359.4
Preferred stock	(525.0)	(350.0)	(350.0)	(350.0)	(350.0)
Equity	3,776.8	3,613.8	3,499.7	3,231.3	3,020.6
Debt and equity	6,836.6	6,495.6	6,274.8	5,797.6	5,380.1
Valuation of Investment Property	6,842.1	6,425.1	6,376.2	5,803.9	5,393.0
Adjusted ratios					
Twelve month revenue growth (%)	12.1	12.2	13.6	15.3	17.1
EBITDA margin (%)	49.9	49.8	50.1	50.3	51.6
Return on capital (%)	4.0	4.1	4.2	4.3	4.6
EBITDA interest coverage (x)	4.5	4.7	4.7	4.6	4.8
EBITDA cash int. cov. (x)	3.6	3.5	3.5	4.3	4.2
FFO cash int. cov. (x)	3.2	3.1	3.1	3.8	3.7
Debt/EBITDA (x)	11.7	11.4	11.2	10.6	9.8
FFO/debt (%)	5.8	6.0	6.0	6.3	6.9
Cash flow from operations/debt (%)	4.8	4.7	4.8	5.7	6.3
Free operating cash flow/debt (%)	2.4	2.2	2.1	2.8	3.5
Discretionary cash flow/debt (%)	(1.3)	(1.7)	(1.4)	(0.9)	2.6
Debt/debt and equity (%)	44.8	44.4	44.2	44.3	43.9
Loan to Value (%)	44.7	44.9	43.5	44.2	43.7

N.M. - Not Meaningful.

Liquidity: Strong

We assess GCP's liquidity as strong because we forecast that the fund's liquidity sources will exceed its funding needs by at least 1.5x over the next 12 months and by more than 1x over the following 12 months. The company benefits from the absence of large debt maturities in the next three-to-five years, an addition of €100 million of undrawn committed credit lines maturing in more than 12 months, and its high cash balance.

Principal Liquidity Sources	Principal Liquidity Uses
• About €885 million of cash and liquid market investments, including recent issuances during the first half of 2018. • €100 million of undrawn committed credit lines, maturing in more than 12 months; • Our forecast of around €200 million in cash FFO for the next 12 months.	• About €17 million of short-term debt maturities; • Our forecast of €100 million-€110 million of capital expenditure for PP&E and property investment, of which most of it is not committed; and • About €300 million in recently signed acquisitions.

Debt maturities

(mil. €)	June 30, 2018
Debt due in year 1	12
Debt due in years 2 - 5	1,324
Debt due after year 5	2,089
Total debt	3,425

Covenant Analysis

Compliance Expectations	Requirements
We expect GCP will maintain significant headroom--more than 15%--under the financial maintenance covenants in its various debt agreements.	GCP has several covenants under its bond and bank loan documentation. The straight bonds (Series D, Series E) & convertible bonds (Series F) are unsecured and have the following covenants: • Limitation of debt: Total debt/assets of less than or equal to 60%. • Limitation on secured debt: Secured debt/total assets of less than or equal to 45%. • Interest coverage ratio: Adjusted EBITDA/net cash interest of greater than or equal to 2.0x. • Maintenance of unencumbered assets: Unencumbered assets/unsecured net debt of greater than or equal to 125%. GCP was in compliance with all its covenants as of June 30, 2018.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Very 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)

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2018, 65% of GCP's asset were unencumbered, and the capital structure was composed of:

- 56% equity
- 29% bond
- 12% bank debt
- 3% convertible

Analytical conclusions

As of June 2018, GCP's ratio of secured debt to total assets was 10%, well below our 40% threshold for notching the issue rating. This is why we equalize the ratings on the senior unsecured debt with our issuer rating at 'BBB+'.

Regarding the two outstanding subordinated hybrids, we assign an intermediate equity content and notch the issue rating down by two notches to 'BBB-', one notch for subordination and one for deferability.

Reconciliation

Table 3

Reconciliation Of Grand City Properties S.A. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €)

	--Rolling twelve month ended Jun. 30, 2018--									
Grand City Properties S.A. reported amounts.										
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**	**Dividends paid**	**Capital expenditures**
Reported	3,425.4	3,946.9	523.3	262.1	959.5	43.9	262.1	219.2	112.5	72.8
S&P Global Ratings adjustments										
Interest expense (reported)	--	--	--	--	--	--	(43.9)	--	--	--
Interest income (reported)	--	--	--	--	--	--	--	--	--	--
Current tax expense (reported)	--	--	--	--	--	--	(26.3)	--	--	--
Intermediate hybrids reported as equity	525.0	(525.0)	--	--	--	13.7	(13.7)	(29.5)	(29.5)	--

Table 3

Reconciliation Of Grand City Properties S.A. Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €) (cont.)

Surplus cash	(924.5)	--	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	1.0	--	--	1.0	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	(43.7)	--	--
Non-controlling Interest/Minority interest	--	354.9	--	--	--	--	--	--	--	--
Debt - Accrued interest not included in reported debt	17.7	--	--	--	--	--	--	--	--	--
Debt - Equity component of convertible debt	12.7	--	--	--	--	--	--	--	--	--
Debt - Issuance cost	3.5	--	--	--	--	--	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	--	--	(6.5)	(6.5)	--	(6.5)	--	--	--
EBITDA - Gain/(Loss) on disposals of PP&E	--	--	--	4.4	4.4	--	4.4	--	--	--
D&A - Asset Valuation gains/(losses)	--	--	--	--	(700.6)	--	--	--	--	--
EBIT - Income (expense) of unconsolidated companies	--	--	--	--	6.0	--	--	--	--	--
Dividends - Other	--	--	--	--	--	--	--	--	29.5	--
Total adjustments	(365.6)	(170.1)	0.0	(1.1)	(696.8)	13.7	(85.0)	(73.2)	(0.0)	0.0

S&P Global Ratings adjusted amounts

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Funds from Operations	Cash flow from operations	Dividends paid	Capital expenditures
Adjusted	3,059.8	3,776.8	523.3	261.0	262.8	57.6	177.1	146.0	112.4	72.8

Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

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 November 26, 2018)

Grand City Properties S.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Subordinated	BBB-
Issuer Credit Ratings History	
21-Dec-2016	BBB+/Stable/A-2
23-Nov-2016	BBB+/Stable/--
13-Jun-2016	BBB/Positive/--
24-Jul-2015	BBB/Stable/--
21-Nov-2014	BBB-/Stable/--
14-Feb-2014	BB+/Stable/--
27-Nov-2013	BB/Stable/--

*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.