MOODY'S
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Rating Action: Moody's upgrades Grand City Property's ratings to Baa1; stable outlook

Global Credit Research - 07 Sep 2017

London, 07 September 2017 -- Moody's Investors Service has today upgraded to Baa1 from Baa2 the long-term issuer rating of Grand City Properties S.A. Concurrently, Moody's upgraded to (P)Baa1 from (P)Baa2 the company's senior unsecured Medium Term Notes program and to Baa1 from Baa2 the ratings of the senior unsecured notes due August 2026, April 2025, and senior unsecured convertible notes due March 2022. The rating of the two outstanding junior subordinated notes has been upgraded to Baa3 from Ba1. The outlook on the ratings has been changed to stable from positive.

Grand City is a listed residential real estate investment and management company headquartered in Luxembourg and operating in Germany.

"We have upgraded the long term issuer rating of Grand City to Baa1 from Baa2 because we expect Moody's adjusted gross debt to total assets to stay below 45% on a sustained basis. The rating upgrade also reflects a more prudent external growth strategy compared to previous years which has contributed to a notable reduction of vacancies, although still elevated" says Roberto Pozzi, VP - Senior Credit Officer at Moody's. "The stable outlook reflects management's commitment to maintain effective leverage below 45% at all times".

RATINGS RATIONALE

- - RATIONALE FOR THE UPGRADE - -

The upgrade of Grand City's issuer rating to Baa1 reflects: (1) the company's improved gross debt to total asset ratio, which Moody's expects to remain below 45% through a combination of a financial policy that is consistent with this level and a favorable outlook for the German residential market; (2) an increasing track record in reducing vacancies and increasing rental income from portfolio acquisitions that suffered from high vacancy rates and (3) Moody's expectation that the company will reduce expenditures on acquisitions.

As of 30 June 2017, effective leverage, as measured by gross debt to total assets, was 41.8%, down from 44.7% in December 2016 and 48.1% in December 2015, partly reflecting a €198 million equity capital increase completed last June. The company's gross debt to total assets ratio, as measured by Moody's, has been sustained below 45%, our threshold for an upgrade, since the last quarter of 2016. Previously, we had changed the outlook to positive from stable on the company's Baa2 rating in November 2016. Moody's understand that management is committed to maintaining leverage, as adjusted by Moody's, below 45% at all times.

Other key debt metrics, such as the fixed charge coverage and the unencumbered asset ratio, are also in line with our expectations for an upgrade to Baa1. Year to date as of 30 June 2017, the company's fixed charge coverage is 4.6x (4.7x in December 2016 and 5.2x in 2015) compared to expectations of at least 4.0x for an upgrade. Unencumbered assets represented 67.5% of total assets, broadly in line with previous levels and the highest level across rated residential peers in Germany.

Grand City's Baa1 issuer rating primarily reflects (i) its focus on stable residential activities and the ensuing granularity of its tenant base, (ii) the geographic diversification of its property portfolio across multiple German metropolitan areas, (iii) the company's new strategic focus away from acquisitions of turnaround portfolios resulting in an increasing track record of improving vacancies, (iv) its moderate leverage and financial targets, (v) excellent fixed charge coverage and (vi), ample liquidity with significant flexibility derived from substantial unencumbered assets and a growing track record of access to capital.

These positives are partly offset by (i) the moderate quality of the company's assets, as evidenced by a still much higher vacancy rate, albeit improving, compared to rated peers and (ii) a still limited, but growing, track record of stabilized revenues and cash flow generation.

Grand City has refrained from making major acquisitions with high vacancies over the last 12 months and, as a result, the company's average vacancy rate of its portfolio has improved to 7.4% as of June 2017, compared to

8.1% in October 2016, 13% in February 2015 and over 20% in 2011. Despite the improvement in average vacancies achieved by the company over the past two years, vacancies remain much higher compare to peers, particularly in Nordrhein-Westfalen (8.0% as of 30 June 2017), Dresden/Leipzig/Halle (9.1%) and other regions (8.1%) representing the bulk of the portfolio in terms of units, values and rents.

More positively, we believe that the company is less exposed to regulatory risk (rental caps) compared to other German residential landlords as part of its rental growth comes from reducing vacancies and only part from increased rents, which are subject to regulatory caps. This is evidenced by the company's 5% rental income growth (including occupancy gains) in the last two years, compared to 2-3% posted by peers.

The Baa1 rating also reflects the currently strong fundamentals of the German rental housing market and our expectations of broadly unchanged capital market conditions over the next 12-18 months. The German residential property market has historically shown limited downside risk with respect to asset values and rental income compared to other property sectors, which, in turn, has a positive effect on companies' cash flow and liquidity.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook mainly reflects our expectations of a continued robust operating performance and stable financial metrics over the next two years. The stable outlook also reflects our expectation of an unchanged favorable outlook for the German residential property sector as a whole.

What Could Change the Rating - Up

Upward rating pressure could develop if Grand City's occupancy levels continued to improve combined with effective leverage, as measured by Moody's Gross Debt to Gross Assets, sustained towards 35%, and fixed charge coverage around 5x or above. An upgrade would be conditional upon a sustained reduction of vacancies towards the levels achieved by peers whilst maintaining solid liquidity including a high unencumbered asset pool. An upgrade would also require an unchanged favorable outlook for the German residential property sector as a whole.

What Could Change the Rating - Down

Grand City's ratings could come under downward pressure if the company experiences a material increase in vacancy levels from current levels or if effective leverage increases above 45% or if the fixed charge coverage falls below 3.5x. The ratings could also be pressured if Grand City's liquidity materially and sustainably deteriorated from current levels, including a major deterioration of its unencumbered asset ratio. Unfavorable changes in the outlook for the German residential property sector as a whole could also put negative pressure on the rating.

The principal methodology used in these ratings was Global Rating Methodology for REITs and Other Commercial Property Firms published in July 2010. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Grand City Properties S.A. (Grand City) is a publicly listed real estate company that owns, manages and acquires residential properties in Germany, with reported gross assets of €5.4 billion and total assets of €6.7 billion, including cash of €455 million, as of 30 June 2017. The portfolio generated net rents of €159 million in the first six months of 2017, or €338 million on an annualized basis. As of August 2017, the company owned around 87,000 residential units mainly located in the metropolitan areas of Berlin, North Rhine Westphalia, Dresden, Leipzig, Halle, Nuerenberg, Munich, Mannheim, Frankfurt, Bremen and Hamburg. Grand City is registered in Luxembourg and listed on the Frankfurt stock exchange with a market capitalisation of €3.0 billion as of 30 August 2017, trading broadly in line with net asset value.

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