MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Baa2 rating to Grand City Properties; stable outlook

Global Credit Research - 09 Feb 2015

First-time rating

London, 09 February 2015 -- Moody's Investors Service has today assigned a first-time long-term issuer rating of Baa2 to Grand City Properties S.A. The outlook is stable. Grand City is a listed residential real estate investment and management company that operates in Germany.

RATINGS RATIONALE

Grand City's Baa2 rating is supported by moderate "effective" leverage, as measured by adjusted debt/gross assets of 46.3% and strong fixed charge cover of more than 4.0x, defined as adjusted EBITDA/gross interest expense + ground rents, as of the last 12 months to 30 September (Q3) 2014. The rating also reflects the company's scale, with total assets of EUR2.38 billion, which is smaller than most of its rated investment-grade peers, but is nonetheless geographically diversified across Germany with a granular tenant base. The asset quality of its property portfolio is mixed owing to its strategy to acquire under-managed properties for their turnaround potential. The portfolio exhibited an average vacancy rate of 13.3% reported at Q3 2014, which is above that seen at similarly rated peers, in part as a result of the acquisition of new properties. However, the company has developed a good track record of increasing the occupancy and rental income of acquired assets and reducing their operating and non-recoverable costs.

We expect Grand City's "stabilised" assets, ones that benefit from vacancy rates less than 5%, to provide steady cash flows. Its apartments are mostly small- to mid-sized, which appeal to households of one to three people. While the German population as a whole is shrinking and ageing, the total number of households and, in particular, smaller households is expected to grow by 2.9% between the years 2010-2025 (source BBSR -- Regional Planning 2030). Therefore, the company should experience sustained tenant demand owing to this demographic change.

In addition, multi-family residential rental growth in Germany has demonstrated a great degree of stability during the global financial crisis of 2008-2012 with rents in metropolitan areas gradually rising, which leads to the conclusion that it is currently less closely linked with broader economic development. Looking forward, rental growth in the German residential property market is supported by 1) stable macroeconomic environment; 2) population migration to metropolitan areas 3) limited amount of new property developments in the largest cities, 4) low percentage of owner-occupied housing, 5) population trend towards smaller households, and 6) increasing longevity of the population.

The Germany residential property market is more skewed towards renting compared with other European countries. In 2013, owner-occupied housing constituted only 53% in Germany while the EU average was 70%. The company therefore benefits from the unique stability of the multi-family residential property market in Germany where we believe there is less downside risk with respect to rental rates and asset values.

Grand City's profitability, as measured by its EBITDA margin (adjusted EBITDA/revenue),was 47.8% year-to-date at 30 September 2014, slightly higher than for other German residential property companies. The company's EBITDA margin has improved in each year since 2011 as the expansion of the business improved economies of scale. This positive progression, however, has led to a higher EBITDA margin volatility.

Grand City's financial strength metrics are stronger than those of similarly rated peers. As of 30 September 2014 "effective" leverage, as measured by adjusted debt/total assets, was moderate at 46.3% and we believe this ratio will continue to be managed at around 47% - 48% going forward. At the same date, leverage, as measured by net debt/EBITDA, was 7.5x on a last 12 months basis. This is lower than most Baa2-rated peers and we expect this ratio to remain at around this level. The company's fixed charge coverage ratio, as measured by adjusted EBITDA/interest expense + capitalised interest + ground rent, was solid at 4.47x on a year-to-date basis as of 30 September 2014. We expect this ratio to increase to around 5.0x by the end of 2015.

Grand City's good liquidity profile is underpinned by recurring contractual cash flow generation, accumulated cash and cash equivalents of around EUR 220 million as of 30 September 2014 and access to an undrawn committed revolving credit facility (RCF) of EUR 12 million that matures in December 2017. Grand City also has an active disposal programme. Over the past three years, in addition to its core rental business, the company has sold on average around EUR40 million of property assets annually, which supplements its cash flow. We expect these resources to cover cash outflows anticipated over the next 12-18 months.

Upcoming cash requirements consist of capital expenditure for the refurbishment of the portfolio that are at "early" and "advanced turnaround" stages, the acquisition of investment properties and dividend payments.

Grand City's liquidity is further supported by the absence of any material debt maturities in the next 12 months. The company's weighted average debt maturity is greater than 6 years and its annual amortisation level is below 1%. In addition, the company manages its interest rate risk through entering into hedging agreements for debt with floating interest payments. As of January 2015, 98% of debt had fixed interest rates or was hedged by derivate financial instruments.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Grand City's prudent financial policies as well as our expectation that the company will continue to reduce the vacancy rate of its overall portfolio as the acquisition of newly acquired properties becomes a more marginal activity in light of its increasing size. The stable outlook also assumes that the company does not undertake any transformational mergers or acquisitions and at all times maintains its good liquidity profile.

What Could Change the Rating -- Up/Down

Grand City's asset base has grown rapidly following its IPO, with total assets increasing by almost five times since year-end 2012. Upward pressure on the rating could occur as 1) the company develops experience and a track record as a larger property investment company and avoids leveraging transactions or those that put pressure on cash flows and 2) asset quality improves as an increasingly larger percentage of the portfolio becomes stabilized and overall vacancy rates drop. In addition, we would expect the company to maintain its current strong metrics, e.g. debt/assets around 47% - 48%, and fixed charge cover at least 4.5x.

Conversely, downward pressure on the rating could occur should vacancy rates rise sustainably, or the company adopts more aggressive financial or operating practices, or its financial metrics weaken with fixed charge coverage falling to 4.0x or less, or the ratio of adjusted debt/total assets rising to 50% or above on a sustainable basis.

PRINCIPAL METHODOLOGY

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

Grand City Properties S.A. is a residential real estate investment company that is registered in Luxembourg and listed on the stock exchange in Frankfurt. The company reports three lines of business, the ownership and management of over 48,000 residential units in Germany, the provision of property management services to third parties for an additional 22,000 units and asset sales that have averaged around EUR40 million per annum. Its strategy focuses on acquiring under-managed properties and improving their occupancy rates, rental levels and values. As of 30 September 2014, the company reported total assets of EUR2.38 billion and year-to-date revenues of EUR165.6 million.

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