STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Research Update:

Dutch Residential Property Fund Vesteda Assigned 'BBB' Rating; Outlook Stable

Primary Credit Analyst:
Marie-Aude Vialle, London (44) 20-7176-3655; marie-aude.vialle@standardandpoors.com

Secondary Contact:
Maxime Puget, London (44) 20-7176-7239; maxime.puget@standardandpoors.com

Table Of Contents

Research Update:

Dutch Residential Property Fund Vesteda Assigned 'BBB' Rating; Outlook Stable

Overview

- Dutch residential investment fund Vesteda Residential Fund FGR (Vesteda) owns and manages a portfolio of 23,800 apartments and single-family homes.
- We assess Vesteda's business risk profile as "strong" and its financial risk profile as "intermediate."
- We are assigning our 'BBB' long-term corporate credit rating to Vesteda. Our comparable rating analysis modifies the anchor of 'bbb+' down by one notch.
- The stable outlook reflects our forecast of stable rental income for Vesteda, which should support EBITDA interest coverage of more than 2.5x in the near-to-medium term.

Rating Action

On July 2, 2014, Standard & Poor's Ratings Services assigned its 'BBB' long-term corporate credit ratings to the Dutch residential real estate investment fund Vesteda Residential Fund FGR (Vesteda). The outlook is stable.

Rationale

The ratings reflect our assessment of Vesteda's business risk profile as "strong" and its financial risk profile as "intermediate," as our criteria define these terms. Our unfavorable comparable rating analysis results in a one-notch downward adjustment to arrive at a rating of 'BBB' on Vesteda. Vesteda is a leading residential investment fund in The Netherlands. It focuses on the mid-range unregulated rental segment (rents between €699 and €1,200 per month) in the stronger economic regions of The Netherlands. The company's annual rental income was €240 million as of December 2013, and its asset portfolio was valued at €3.7 billion.

Vesteda's "strong" business risk profile reflects our view of the fund's well-diversified portfolio of residential properties in The Netherlands. This is supported by the fact that Vesteda's residential tenants are employed by a diverse range of industries in some of Europe's largest and most-dynamic conurbations, as well as by the good quality of Vesteda's assets. The average age of the properties in the portfolio is 21 years, which compares relatively well with other rated residential real estate companies. About 56% of the portfolio is in the Randstad conurbation (which consists of the four largest Dutch cities: Amsterdam, Rotterdam, The Hague, and Utrecht), and another 27% is located in other large Dutch municipalities.

1341129 | 301701763

Our assessment of business risk also reflects Vesteda's strong track record of stable rental income despite difficult housing market conditions in The Netherlands during the past five years. The fund has been able to grow like-for-like rental revenues at an annual average rate of about 2.4% over the past three years, and to dispose of some noncore assets. We consider Vesteda well-positioned to benefit from the dynamics currently fueling the Dutch rental market, including low levels of new construction, an increasing number of households, and stabilizing housing prices. We view positively Vesteda's increasing focus on the mid-market unregulated segment (62% of its portfolio at year-end 2013), where we expect demand to be strongest over the next few years. Of its portfolio, 21% is in the regulated segment and 18% in the high-end unregulated segment.

In our view, Vesteda has a good track record of operating performance. The average occupancy rate is stable and high, at 96%, and the average stay per tenant is close to 11 years, with a low percentage of tenants leaving each year (12%). Lastly, the pipeline of development activities has significantly reduced in the past few years, although the development investment pipeline was still valued at about €310 million as of December 2013. We understand that the fund is committed to finishing existing projects by 2018 and will not start any new development projects in 2014 and 2015.

We consider that after a period of volatility--house prices have fallen by about 18% since 2008--the Dutch residential real estate market could see a return to rising prices. Although we expect macroeconomic conditions will improve during in the next two years, our base-case forecasts show that the pace of growth will be slow, with real GDP growth of 1.0% in 2014 and 1.5% in 2015. Consequently, we see our assessment of Vesteda's business risk profile as "strong" as being at the lower end of this category: although the company has changed the profile of its portfolio to generate stable rental income, residual macroeconomic uncertainty makes it difficult to estimate the scope of potential like-for-like growth.

Real estate valuations are also subject to investor sentiment regarding yields. We do not consider that the volatile real estate valuations of the past five years provide a good basis for capital value forecasts in The Netherlands. We chose an anchor of 'bbb+' for this rating, rather than 'a-', because in our view Vesteda's business risk profile is at the weaker end of the range for "strong".

Our assessment of Vesteda's financial risk profile as "intermediate" mainly stems from its modestly leveraged capital structure. It has a Standard & Poor's-adjusted debt-to-debt-plus-equity ratio of 37%, which we view as low compared with its investment-grade peers.

Vesteda currently has a moderate cost of debt of about 4%, and maintains hedging of its debt facilities at over 90%, which we view as credit positive. Its average debt duration is low (2.7 years as of December 2013), but we understand that the fund is in the process of refinancing its capital structure, which mainly comprises commercial mortgage-backed security (CMBS) notes, with unsecured bank and bond facilities. We view this diversification of funding as positive, and our assessment of Vesteda's financial risk profile as "intermediate" assumes a successful refinancing of the debt maturities due in the next two years.

We calculate that EBITDA interest coverage was 2.5x as of December 2013, which we view at the low end of the "intermediate" financial risk profile category. We forecast that Vesteda's EBITDA interest coverage will increase slightly to 2.6x-2.7x as the company refinances its CMBS notes.

Our base-case scenario for Vesteda assumes:

- About 1.5% of like-for-like growth in rental income in 2014, assuming: (i) an increase of about 2% of rents in the regulated segment, supported by recent regulations allowing an increase in regulated rents depending on tenants' income; (ii) a 1.5% increase in the mid-market unregulated rent segment, in line with our forecast of inflation for The Netherlands in 2014-2015; and (iii) less than 1% increase in the high-end segment, which still suffers from higher vacancy rates.
- Flat revenues overall in 2014, as a result of the disposal of noncore properties.
- A stable occupancy ratio of about 96% overall in the portfolio.
- Relatively low maintenance capital expenditure (capex) of €15 million-€18 million, assuming no material renovation work on the existing portfolio, and about €50 million of capex for development activities.
- A small negative revaluation of the overall portfolio of about 2% in 2014.

Based on these assumptions, we arrive at the following credit measures:

- Stable debt-to-debt-plus-equity ratio at about 37%.
- EBITDA interest coverage of 2.6x-2.7x.
- An EBITDA margin of about 63%-64%, broadly in line with Vesteda's peers in the residential real estate sector.

We assess Vesteda's financial policy as conservative, underpinned by the fund's strategy of long-term ownership and rental of real estate residential properties, and its stable investor base, comprising 17 major Dutch investors, including large pension funds. We also view positively the fund's long-term loan-to-value target of 30%. Another supporting factor is our view of Vesteda's management and governance as "satisfactory," in line with the solid real estate expertise of its executive managers and its strong internal control framework.

Our negative comparable rating analysis reflects some volatility in operating cash flows over the past few years as a result of disposals and development activities. We also view the absolute cash flow base as relatively small. Operating cash flows are constrained by the portfolio size and the recent change to the portfolio profile, which in our view makes medium-term operating cash flows less predictable.

Liquidity

We assess Vesteda's liquidity as "adequate" under our criteria, supported by our forecast that the fund's liquidity sources will exceed its funding needs by more than 1.2x over the next 12-24 months. We consider that Vesteda's refinancing program, combined with its FFO, good cash balance, and availability under a revolving credit facility (RCF), will be enough to cover its liquidity requirements over the next 12 months, including material debt maturities.

Vesteda's principal liquidity sources over the 12 months to March 31, 2015, are:

- A cash balance of €71 million as of March 31, 2014, and about €100 million available under the €300 million RCF.
- About €105 million of cash FFO.
- About €400 million of new debt that has already been secured, including a bridge facility of €300 million and a private placement of €100 million. We understand that the fund plans to issue two sets of unsecured notes to refinance the A4 and A7 CMBS notes due in 2014 and 2015.

Other sources of liquidity not yet secured include raising about €100 million in equity in 2014. Proceeds from disposals could amount up to €165 million, although only about €50 million is already committed.

Vesteda's principal liquidity uses over the 12 months to March 31, 2015, are:

- Debt repayment of about €397.5 million, including €47.5 million of mortgage loans due in 2014 and €350 million of CMBS notes due in 2014, which have already been repaid with the bridge facility in Q2 2014.
- About €13 million of working capital outflow.
- About €18 million of maintenance capex and €51 million of development capex committed to complete the construction of existing projects.

Other uses of uncommitted liquidity include:

- About €150 million for acquisitions, although we understand that Vesteda has not yet made a commitment and that the fund will make sure that disposals and acquisitions remain balanced.
- Dividends of about €80 million-€100 million and redemption of about €50 million in shares. The fund has no contractual or regulatory obligation to pay dividends, and management has confirmed that redemption of shares will only occur if the fund has sufficient liquidity.

As of December 2013, the fund had adequate headroom (above 10%) under all its financial maintenance covenants.

Outlook

The stable outlook reflects our opinion that Vesteda should continue to benefit from stable rental income from its residential property portfolio. We expect like-for-like rents to grow in line with inflation and the valuation of Vesteda's asset portfolio to stabilize over the next two years as the Dutch housing market recovers. The outlook is further supported by our view of favorable dynamics in the mid-market unregulated sector, and Vesteda's strong track record of low vacancy rates and continuous rent increases. Over the medium term, we anticipate that Vesteda will be able to maintain an EBITDA interest coverage ratio of 2.5x-2.7x and a debt-to-debt-plus-equity ratio of less than 40%.

Upside scenario

We consider the most likely trigger for an upgrade would occur if our comparable rating analysis no longer constrained the rating. This would most likely result if Vesteda improved the stability of its operating cash flows and reduced financing costs, with EBITDA interest coverage rising above 3.0x on a sustained basis.

Downside scenario

Conversely, we could lower the rating if Vesteda's EBITDA interest coverage ratio falls to less than 2.4x. This could occur if vacancies increase as a result of lower demand or increased competition from social housing associations or other institutional players. Such developments are not part of our central assumptions at present, however. We could also lower the rating following an increase in the debt-to-debt-plus-equity ratio to more than 50%, due to a large debt-financed acquisition, or higher renovation capex than we anticipate, combined with low levels of asset disposals. A change of this magnitude is not part of the company's stated financial policy.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/--

Business risk: Strong
- Country risk: Low
- Industry risk: Low
- Competitive position: Strong

Financial risk:
- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)

- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bbb

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

Ratings List

New Rating; CreditWatch/Outlook Action

Vesteda Residential Fund FGR	
Corporate Credit Rating	BBB/Stable/--

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.