

RatingsDirect®

Summary:

Vesteda Residential Fund FGR

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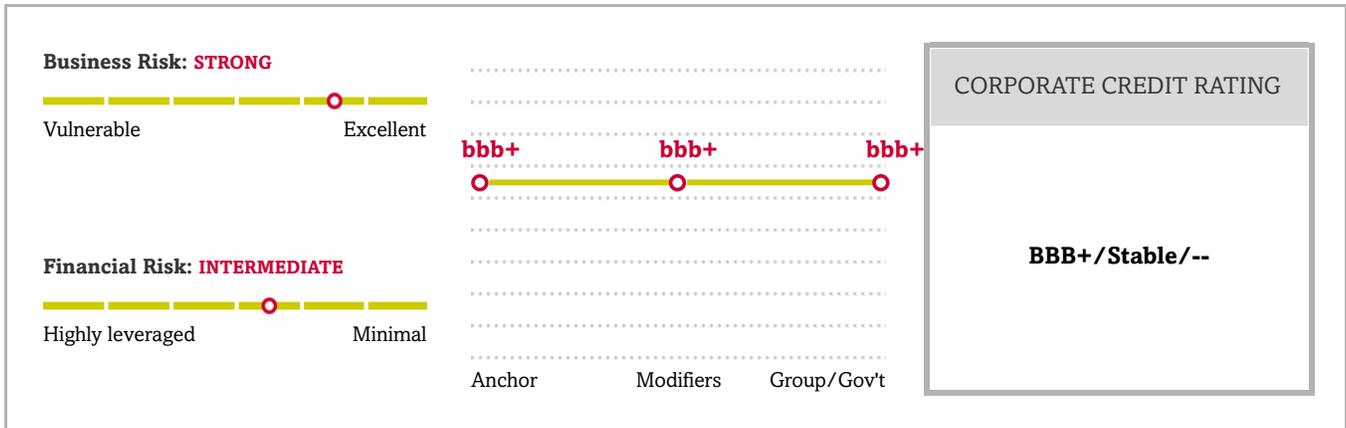
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Summary:

Vesteda Residential Fund FGR



Rationale

Business Risk: Strong	Financial Risk: Intermediate
<ul style="list-style-type: none"> • Good market position as the largest Dutch institutional residential investor and well positioned in the Dutch mid-market unregulated sector, where property values are continuing to recover. • Good track record of positive organic rental income growth, even during weaker periods for the Dutch property sector. • Operating stability supported by consistently high occupancy of above 95%, low tenant turnover (average stay of eight years), and limited exposure to development activities. • Full geographical focus on the Netherlands and therefore reliance on the performance of the Dutch economy. 	<ul style="list-style-type: none"> • Low leverage for the real estate industry, with debt to debt plus equity of close to 30%, supported by a conservative financial policy. • Moderate ratio of debt to EBITDA at approximately 7x. • Strong liquidity, underpinned by the absence of large upcoming debt maturities in the next 12 to 24 months, committed equity capital as well as undrawn available revolving credit facilities.

Outlook: Stable

The stable outlook on Vesteda Residential Fund FGR reflects S&P Global Ratings' view that the company should continue to benefit from stable rental income from its unregulated residential property portfolio in the mid segment. We expect like-for-like rents to grow by about 2.5%, in line with our forecast of increasing inflation in the Netherlands, broadly stable occupancy rates, and some positive valuation of Vesteda's asset portfolio, based on further recovery of the Dutch housing market.

Over the next 12 months, we anticipate that Vesteda will still benefit from the low interest rate environment and report an EBITDA interest coverage ratio of well above 4x and a debt-to-debt plus equity ratio of just below 30%. We also assume that the ratio of debt to EBITDA will remain stable at approximately 6.5x-7.0x for the next 12 to 24 months.

Downside scenario

We could lower the rating if Vesteda's debt-to-debt plus equity ratio increases to 40% or more, due to a large debt-financed acquisition, or much higher renovation capex than we anticipate, combined with a return to negative revaluations in the Dutch residential market. A change of this magnitude is not likely, in our view, and is part of the company's stated financial policy.

Upside scenario

The most likely trigger for an upgrade would be if Vesteda continued to increase its revenue diversification by expanding its portfolio size significantly, to a level consistent with peers rated 'A-'.

An upgrade could also occur if the company's debt-to-debt plus equity ratio fell to 25% or below, and we viewed such improvement as sustainable and part of a more conservative financial policy.

Our Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> • About 2.5% like-for-like growth in rental income for 2017 and 2018, based on our assumptions of real GDP growth in the Netherlands of around 1.5%, a pick up in indexation of 1.3% in 2017 and 1.4% in 2018, and some uplift in renegotiated rents, while occupancy rates remain broadly stable. • Relatively low maintenance capital expenditures (capex) of approximately €25 million annually on its owned portfolio, assuming no material renovation work on the existing portfolio. • Capex for construction and development of together about €430 million-€450 million for the next 24 months, including the project development pipeline, as well as forward-funding and turnkey projects. • Positive, mid-single-digit portfolio revaluation, underpinned by further house price growth of the Dutch housing market, with average house prices expected to rise 5% in 2017 and 3% in 2018. • EBITDA margin to remain stable at around 65%-70%. 	2016 2017E 2018E			
	EBITDA interest coverage (x)			5.2 ~5.5 ~5.5
	Debt to debt plus equity (%)			28.7 ~27 ~28
	Debt to EBITDA (x)			7.2 ~7 7.0-7.5
E--Estimate				

Business Risk: Strong

Vesteda business risk profile continues to be strong and reflects our view of the fund's well-positioned portfolio of residential properties in the Netherlands. This is supported by the relatively good quality of Vesteda's assets, whose average age of 27 years compares favorably with other rated residential real estate companies. Over 65% of Vesteda's portfolio is located in the Randstad conurbation (which consists of the four largest Dutch cities: Amsterdam, Rotterdam, The Hague, and Utrecht), which we view as more resilient compared with smaller Dutch cities, given its stronger economic and demographic trends.

Our assessment of the business risk profile also reflects Vesteda's good track record of stable rental income, despite difficult conditions in the Dutch housing market between 2008 and 2013. The fund has been able to grow like-for-like rental revenues at an annual average rate of about 1% to 2% over the past few years, and to dispose of some non-core assets. We consider Vesteda to be well positioned to benefit from the current dynamics of the Dutch rental market, including low levels of new construction, an increasing number of households, and increasing housing prices. We view as positive Vesteda's increasing focus on the midmarket unregulated segment (69% of its portfolio at year-end 2016), where we expect demand to be strongest over the next few years. Of its total portfolio, 14% is in the regulated segment and 17% in the high-end unregulated segment.

In our view, Vesteda has a good operating performance track record. The average occupancy rate is high and stable, at

97.8% in 2016, and the average stay per tenant is close to eight years, with a low 12.4% percentage of tenants leaving each year. Lastly, Vesteda has significantly reduced its pipeline of development activities in the past few years, in line with its strategy. We understand that the fund is committed to finishing its existing development projects by the end of 2018, and will not start any further new in-house development projects. Nevertheless, we believe that Vesteda will grow further by taking on turnkey-development projects, which we expect to remain limited to less than 10% to its overall portfolio exposure.

We forecast that growth in house prices and values will remain in low-to-mid-single digits in the next 12 to 24 months. Having said that, after a period of falling house prices (about an 18% drop in the period from 2008 to 2013), the Dutch residential real estate market has seen some price increases in 2014 and 2015.

Financial Risk: Intermediate

Vesteda's financial risk profile is supported by low leverage for the industry, with debt to debt plus equity close to 30% as of year-end 2016. Based on the company's financial policy of keeping its loan-to-value ratio (roughly equivalent to our debt-to-debt plus equity ratio) between 30% and 40%, we believe leverage could increase somewhat on increased investment activity. But recent capital structuring actions support our view that management's conservative financial policies will remain intact. The company successfully raised €600 million of new equity in 2015, of which €185 million remains undrawn as of now. Furthermore, the company put in place a new €600 million revolving credit facility (RCF) in June 2015, of which €238 million remained undrawn as of Dec. 31, 2016. With its €300 million, seven-year, senior unsecured notes issuance at 2.5% in October 2015, Vesteda fully paid back its remaining outstanding commercial mortgage-backed securities notes.

In addition, the company has shown good access to both equity and debt capital markets, with the issuance of a 10-year private placement of €100 million in December 2016 and about €95 million of additional new equity commitment mainly from existing investors. We expect the drawdown of the full equity commitment of about €280 million in 2017.

The financial risk profile is furthermore supported by the ratio of debt to EBITDA of about 7x and EBITDA interest coverage of well above 4x at the end of 2016, and we expect the company to benefit further in 2017 from its low average cost of debt of about 2.7%.

Vesteda maintains more than 90% of its debt at hedged or fixed interest rates, which we view as credit positive. Vesteda's average debt duration stood at 4.5 years in 2016 (improved from 2.9 years as of December 2014).

Liquidity: Strong

We view Vesteda's liquidity as strong, based on our analysis, including a stress scenario under which EBITDA declines by 10%.

We forecast that the fund's liquidity sources will exceed its funding needs by at least 1.5x over the next 12-24 months. The company benefits from the absence of large debt maturities in the next two years, an addition of €280 million of

undrawn equity commitment, and its committed RCF agreement of which €238 million was undrawn as of Dec. 31, 2016.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • About €17 million of unrestricted cash and about €238 million available under its RCF agreement; • Our forecast of about €140 million-€150 million of cash funds from operations; • €280 million of committed undrawn equity; and • Our estimates of about €20 million-€30 million of signed disposals in 2017 year to date, mainly reflecting the sale of privatization units. 	<ul style="list-style-type: none"> • About €12 million annual debt amortization for the next 12 months; • Approximately €209 million of committed capex for properties under construction; • About €20 million of contracted acquisitions; and • Roughly €200 million-€210 million of dividend payments, including the annual dividend payment for 2016 and the start of paying interim dividends in line with the management plan. <p>As of Dec. 31, 2016, Vesteda had significant headroom (above 30%) under all its financial maintenance covenants.</p>

Ratings Score Snapshot

Corporate Credit Rating

BBB+/Stable/--

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)

Business And Financial Risk Matrix						
Business Risk Profile	Financial 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-

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