Maalot
S&P Global Ratings

# Brack Capital Properties N.V.

**March 26, 2018**

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## Index



**Rating ratification**

# Brack Capital Properties N.V.

| The issuer's rating ratification | ilAA-/Stable |
|---|---|

## Major consideration for the rating

| Business profile | Financial profile |
|---|---|
| • Activity in the German income generating real estate market – a stable market over time with a positive growth outlook for the upcoming years<br>• Geographical distribution across a large number of cities in Germany and proper diversification between the residential segment and the commercial segment.<br>• Stable operating performance of the asset portfolio with high occupancy rates and rental fee growth over time.<br>• Certain dependency on two major tenants and certain exposure to two material commercial assets. | • Consistent growth of cash flows from operating activities<br>• Continued decline in the balance sheet leverage level in recent years.<br>• Good access to the German banking system as reflected in reducing the average interest on bank loans in 2017.<br>• The fact that all of the Company's assets are pledged, in our opinion, adversely affects financial flexibility. |

## Outlook: stable

The stable rating outlook reflects our estimate as to the Company's ability to create a stable cash flow from the income-generating asset portfolio. This estimate is supported, among others, by the positive economic growth forecast in Germany and the comfortable real estate market environment. Based on the current financial policy of the Company and our base scenario, we see a ratio of debt to debt and equity of up to 60% and EBITDA to financing expenses ratio of x 3.0 while maintaining adequate liquidity over the next 12 months, as appropriate for the current rating.

A change in the rating of the parent company, Adler Real Estate AG (BB/Positive) may have an effect of the Company's rating.

**The positive scenario**

We will consider a positive rating activity if the Company increases the volume of its income-generating asset portfolio such that it will lead to a significant reduction in dependency on major tenants while improving the financial portfolio such that the ratio of debt to debt and equity will be below 50% and the EBITDA to financing expenses ratio will be about x 4 over time as part of a more conservative financial policy.

**The negative scenario**

We will consider a negative rating activity if the Company deviates over time from the ratios that were defined as appropriate for the current rating, or if the Company increases significantly the weight of the development activity beyond our base scenario. In our opinion, such a scenario may occur, inter alia, if a material change occurs in the Company's business and/or financial strategy.

## The base scenario

Our base scenario includes the continued expansion of the asset portfolio in Germany mainly in the residential segment while maintaining a leverage rate that will not exceed 60% without a change in the weight of the development activity out of the total activity. A significant change in the investment policy or financial policy may result in updating the base scenario.

<table>
<tr><th>Key assumptions</th><th colspan="4">Key ratios*</th></tr>
<tr><td rowspan="3">• An annual increase of 2%-4% in rental income from identical assets.<br>• Rental yield of 6% on new assets.<br>• Maintaining high average occupancy rate.<br>• Revenue recognition from development project in the amount of € 70 million in 2018 – 2019.<br>• Purchase of income generating assets in annual scope of € 100-150 million.<br>• Moderate increase in leverage level, given the Company's dividend distribution policy, investment strategy and financial policy.</td><td></td><td>2017A</td><td>2018E</td><td>2019E</td></tr>
<tr><td>Equity/debt and equity</td><td>49.8%</td><td>51%-53%</td><td>52% - 54%</td></tr>
<tr><td>EBITDA/financing</td><td>3.2x</td><td>2.8x-3.1x</td><td>2.8x-3.1x</td></tr>
<tr><td></td><td>Debt/EBITDA</td><td>11x</td><td>12x-13x</td><td>11x-12x</td></tr>
<tr><td></td><td colspan="4">A – actual<br>E –expected</td></tr>
</table>

## The Business Profile

**Activity in the income-generating real estate sector in Germany, proper diversification between the residential segment and the commercial segment and growth in rental fees over time concurrently with expanding the asset portfolio.**

The business risk profile of Brack Capital Properties is supported by focusing the real estate actvity in Gemany, which we value as a stable economy with growth engines. The real estate market in Germany is a well-developed sector enjoying a steady demand in the areas of activity allowing the Company to present continuous improvement in operating performance. Among others, in 2017, the Company showed high growth rate of 6.6% in revenues from identical assets in the income generating residential real estate and 1% in commercial real estate while maintaining high average occupancy rate of 96%. In addition, the Company's asset portfolio is characterized by geographical distribution over a large number of cities in Germany and proper diversification between the residential and the commercial segments.

In the last year, the Company continued to expand the income generating residential assets portfolio (approximately 12,000 residential units compared to 10,400 last year) and at the same time realized several assets that are not at the core activity, which we believe confers operating stability and good appearance of cash flows. As of the end of 2017, the value of the asset portfolio increased to € 1.3 billion compared to € 1.1 billion last year resulting mainly from transactions carried out by the Company over the course of the year and due to revaluation profits reflecting a decrease in the average capitalization rate and land improvement.

On the other hand, it should be noted that the business profile will continue to be limited due to exposure to two material commercial assets represneting 15% of the income generating portfolio and due to the dependence on two major tenants in the commercial sector, which together constitute about 22% of rental income (and about 54% of total rental income in the commercial segment). Nevertheless, high duration of lease agreements in the commercial segment moderates the risk.

In early 2018, the Company acquired additional land in the city of Düsseldorf, thus increasing its exposure to a specific geographical area and the weight of residential development activity, which in our estimate represents higher industry and operational risks than the risks of the Company's income generating real estate actvity. Nevertheless, revenue recognition from handover of apartements the construction of which was completed in the Düsseldorf project reflects meeting the profitability targets and delivery dates, and there is adequate progress in the early marketing of the apartments under construction.

## The Financial Profile

**Decrease in leverage level, maintaining stable coverage ratios and reducing financing costs.**

The Company's financial risk profile is supported by continued decline in leverage level such that the debt to debt and equity ratio is 50% in 2017 compared to 56% in 2016 and 60% in 2015. The decrease derived, among others, from the appreciation of investment property and capital issuances taken place over the year. At the same time, the Company presents consistent growth in cash flows from the income generating real estate actvity, which we assess to be stable.

In addition, the Company has good access to financing sources, as reflected in the reduction of financing costs and improvement of maturities burden as a result of the refinance of a financial debt made in 2017 and the beginning of 2018 which positively effect the expected interest coverage ratios.

Based on our base scenario and the Company's current financial and investment strategy supporting the rating, we estimate that in 2018 -2019 the EBITDA to financial expenses ratio will be around 3.0x and the ratio of debt to EBITDA will be 11x- 13x provided that the increase in rental income from existing assets and new acquisitions will continue simultaneously with revenue recognition from handover of residential units in the development projects.

| Brack Capital Properties N.V. — Financial Summary | | | | | |
|---|---|---|---|---|---|
| **Industry Sector: Real Estate Investment Trust or Company** | | | | | |
| | —Fiscal year ended Dec. 31— | | | | |
| **(Mill. €)** | **2017** | **2016** | **2015** | **2014** | **2013** |
| Revenues | 160.1 | 171.6 | 161.1 | 153.6 | 67.7 |
| **EBITDA** | 63.0 | 64.2 | 61.3 | 55.7 | 34.1 |
| **Funds from operations (FFO)** | 36.2 | 41.1 | 40.2 | 35.5 | 15.3 |
| Interest Expense | 19.5 | 20.7 | 21.2 | 20.5 | 19.2 |
| **Net income from continuing operations** | 119.0 | 88.7 | 77.5 | 47.5 | 27.9 |
| **Cash flow from operations** | 58.5 | 80.7 | 60.8 | 51.3 | 19.8 |
| **Debt** | 692.2 | 661.2 | 667.8 | 668.3 | 555.1 |
| Equity | 698.6 | 520.1 | 454.1 | 379.2 | 340.4 |
| **Adjusted ratios** | | | | | |
| EBITDA margin (%) | 39.3 | 37.4 | 38.1 | 36.3 | 50.4 |
| **Return on capital (%)** | 4.6 | 5.3 | 5.4 | 5.6 | 4.2 |
| **EBITDA interest coverage (x)** | 3.2 | 3.1 | 2.9 | 2.7 | 1.8 |
| **FFO cash int. cov. (x)** | 3.3 | 3.3 | 3.2 | 2.9 | 2.1 |
| **Debt/EBITDA (x)** | 11.0 | 10.3 | 10.9 | 12.0 | 16.3 |
| **FFO/debt (%)** | 5.2 | 6.2 | 6.0 | 5.3 | 2.8 |
| Debt/debt and equity (%) | **49.8** | **56.0** | **59.5** | **63.8** | **62.0** |

## Liquidity: adequate

We assess the liquidity of Brack Capital Properties as "appropriate" according to our methodology. We assess that the ratio between the Company's sources and uses will exceed 12.x in the 12 months starting from January 1, 2018. This assessment is based mainly on the scope of current cash flows and the Company's ability to generate high positive and stable cash flows from the income generating asset portfolio. In addition, from the beginning of the year, the Company completed several refinances of real estate assets it owns while extedning the duration of debt and decrease in the average interest rate, which in our view supprts our estimate of the access to the banking system in Germany. However, since that all of the Company's assets are pledged, in our opinion, it adversely effects financial flexibility, but the fact that most loans against the assets are non-recourse and without cross default moderates this factor. Our scenario does not include the recycling of unsecured debt and bond raising, and on the other hand does not include future purchases of assets.

In the base scenario, we assume that the key sources and uses of the Company from January 1, 2018 through Dcemeber 31, 2018 are as follows:

| Key sources | Key uses |
|---|---|
| • Cash and marketable finacial assets in a scope of € 113 million;<br>• Cash flows from operating activities in a scope of € 55 -65 million;<br>• Recycling of bank loans in the amount of € 80 million (completed);<br>• Sale of hotel for a total consideration (net) of € 12 million (completed). | • Bond maturities of € 17 million and maturities of bank loans of € 160 million;<br>• Purchase of land in Dusseldorf for € 43 million (net, after completion of financing). |

| Brack Capital Properties N.V – debt maturities * | | | | | |
|---|---|---|---|---|---|
| **Year** | ****2018** | **2019** | **2020** | **2021** | **2022 onwards** |
| Maturities **(€ in millions)** | 177 | 55 | 61 | 165 | 327 |

* excluding project debt (construction loans)
** including debt the refinancing of which was completed over the year.

## Covenants' Analysis

As of December 31, 2017, the Company maintains an adequate margin with respect to its financial covenants.

## The Group's Impact Analysis

On March 25, 2018, Brack Capital Properties announced that the tender offer published by Adler Real Estate AG ("Adler" or "Group" BB/Positive) was completed. As a result, Adler became the controlling shareholder in the Company and holds approximately 70% of its shares. Adler is an income generating real estate company operating in Germany that owns about 47,000 residential units valued at € 2.6 billion. In our estimate, Brack Capital Properties is of strategic importance to the group, in part because it will be a material part of the consolidated operations. In addition, both companies operate in Germany in the income-generating real estate sector, with potential for integration of the activities mainly in the residential sector. At this stage, the group's impact is neutral, among other things given the rating levels of the companies.

## Rating adjustments

Sectoral distribution: neutral

Capital structure: neutral

Liquidity: neutral

Financial policy: neutral

Management, strategy and corporate governance: neutral

Comparison to reference group: neutral

## Debt recovery analysis

### Major considerations

- Following the initial implementation of debt recovery methodology for non-financial corporations, we examine the debt recovery rate of the various bond series given a hypothetical nonpayment scenario.

- We determine for Brack Capital Properties NV's unsecured bond series (Series A, B and C) the rating of ilAA- which is identical to the issuer's rating. The debt recovery rating for these series is '3' reflecting our assessment that given hypothetical nonpayment scenario, the debt recovery rate will be at the top of the range 50% -70%.

- Our assessment of the debt recovery rate is limited mainly due to the fact that the series are unsecured and are subordinate to the secured bank debt (to which all of the Company's assets are pledged), due to certain dependence on two major tenants and given certain exposure to two material commercial assets.

### Key assumptions for hypothetical nonpayment scenario

- Year of hypothetical nonpayment event: 2023

- A deep recession in German economy will cause a significant reduction in occupancy rates, a decrease in rental fees and substantial erosion in the value of the asset portfolio. The Company will continue to operate as a going concern, an estimate which is supported by the key locations of its assets that will allow it to obtain refinancing to repay some of its liabilities.

- The value of the Company's commercial asset portfolio will decrease by 50%, considering the concentration value of a number of large assets, depending on two major tenants and the quality and location of the assets.

- The value of the Company's residential asset portfolio will decrease by 30%, considering the distribution of tenants and the relatively high number of assets.

- The value of inventory in construction for sale and land for construction by the Company will decrease by 55% -60% considering the locations, completion rates, marketing rates and planning status.

### Basic payment waterfall upon nonpayment

- Value as going concern (gross) at asset value: € 952 million (including recently purchased lands).

- Administrative costs: 5%

- Available value to cover secured debt: € 904 million.

- Total secured senior debt: € 790 million (bank debt, including financing for recently purchased land) *).

- Available value to cover unsecured debt: € 114 million.

- Total unsecured debt (Series A, B and C): € 135 million *.

- Estimate of the unsecured rated debt recovery rate (Series A, B and C (50% -70%) is limited as noted above).

* Debt figures include semi-annual accrued interest

**Impact of Debt Recovery Estimate on Debt Rating with respect to Issuer's Rating**

| Debt recovery estimate in percentage | Description | Score of debt recovery estimate | Rating of series above/under the issuer's rating |
|---|---|---|---|
| 100% | Full repayment expected | 1 + | 3+ notches |
| 100%-90% | Very high debt recovery | 1 | 2+ notches |
| 90%-70% | High debt recovery | 2 | 1+ notch |
| 70%-60% | Significant debt recovery | 3 | 0 notches |
| 50%-30% | Average debt recovery | 4 | 0 notches |
| 30%-10% | Modest debt recovery | 5 | -1 notches |
| 10% -0% | Negligible debt recovery | 6 | -2 notches |

Debt recovery ratings are limited in some countries to take into account reduced debt recovery prospects in those countries. Debt recovery ratings of unsecured debt issuances are also generally limited (for more information, see Step 6, paragraphs 98-90 of the Methodology for Evaluating Debt Recovery of Non-Financial Corporations, December 7, 2016).

## Financial reporting adjustments

In order to bring the financial data to a common base compared to other rated companies, we adjust the reported data in the financial statements used by us in calculating financial ratios. Below are the key adjustments to the consolidated data of Brack Capital Properties NV for 2017:

- Offsetting surplus cash and cash equivalents, as we have defined, from the reported financial debt.
- Neutralization of income from increase in fair value of investment property from operating income.
- Deduction of interest expenses from cash flows from operating activities.

**Reconciliation Of Brack Capital Properties N.V. Reported Amounts with S&P Global Ratings Adjusted Amounts (Mil. €)**

| | —Fiscal year ended Dec. 31,2017— | | | | | |
|---|---|---|---|---|---|---|
| Brack Capital Properties N.V. reported amounts | | | | | | |
| | **Debt** | **Shareholders' equity** | **EBITDA** | **Operating income** | **EBITDA** | **Cash flow from operations** |
| Reported | 793.0 | 591.2 | 64.1 | 172.5 | 64.1 | 74.1 |
| S&P Global Ratings adjustments | | | | | | |
| Interest expense (reported) | — | — | — | — | (19.5) | — |
| Interest income (reported) | — | — | — | — | 0.0 | — |
| Current tax expense (reported) | | | | | (7.3) | |
| Surplus cash | (102.7) | — | — | — | | — |
| Non-operating income (expense) | - | - | - | 0.0 | - | - |
| Reclassification of interest and dividend cash flows | — | — | — | — | — | (15.6) |
| Non-controlling Interest/ Minority interest | — | 107.4 | — | — | — | |
| Debt -Accrued interest not included in reported debt | 1.9 | — | — | — | — | |
| EBITDA-Other | — | — | (1.1) | (11) | (1.1) | — |
| D&A - Asset Valuation gains (losses) | — | — | | (108.7) | — | — |
| Total adjustments | (100.8) | 107.4 | (1.1) | (109.8) | (27.9) | (15.6) |
| S&P Global Ratings adjusted amounts | | | | | | |
| | **Debt** | **Equity** | **EBITDA** | **EBIT** | **Funds from operations** | **Cash flow from operations** |
| Adjusted | 692.2 | 698.6 | 63 0 | 62.7 | 36.2 | 58.5 |

## Methodology and Related Articles

- Methodology: use of rating outlook and CreditWatch, September 14, 2009.
- Methodology: methodology for assessing the management and corporate governance of corporations and insurers, November 13, 2012;
- Methodology: timing of payments, grace period, guarantees and using the ratings of D' (Default) and SD (selective Default), October 24, 2013.
- Methodology: rating a group of companies, November 19, 2013
- Methodology: rating of companies – financial ratios and adjustments, November 19, 2013
- Methodology: general methodology for rating corporations November 19, 2013.
- Methodology: methodology for estimating country's risk, November 19, 2013.
- Methodology: sector risk, November 19, 2013.
- Methodology: key factors in rating real estate developers, February 3, 2014.
- Rating scales and definitions: credit rating in local scales, September 22, 2014.
- Methodology: methodology for implementing debt recovery ratings in issuances ratings in local rating scales, September 22, 2014.
- Methodology: methodology for assessing the liquidity profile of corporations, December 16, 2014.
- Methodology: methodology for assessing debt recovery of non-financial corporations, December 7, 2016.
- Rating scales and definitions: conversion tables of S&P between the ratings in the global scale and the local scales, August 14, 2017.
- Methodology: key factors for rating real estate companies, February 26, 2018.
- Rating definitions of S&P Global ratings, June 26, 2017.
- Opinions and interpretation: the link between the global rating scale and the Israeli rating scale, January 25, 2016.

**General information (as of March 26, 2018)**

| | |
|---|---|
| **Brack Capital Properties N.V** | |
| | |
| **The issuer's rating** | |
| Long term | **ilAA-/stable** |
| | |
| | |
| **Unsecured senior debt** | |
| Series A,B and C. | **ilAA-** |
| | |
| | |
| **Issuer's rating history:** | |
| | |
| Long term | |
| **March 14, 2016** | **ilAA-/stable** |
| **April 2, 2013** | **ilA+/stable** |
| **April 1, 2012** | **ilA/stable** |
| | |
| **Additional details** | |
| The time the event has occurred | March 26, 2018 13:03 |
| The time it was first learned about the event | March 26, 2018 13:03 |
| The party initiating the rating | The rated company |
| | |

**Monitoring credit rating**

We are regularly monitoring developments that may affect the credit ratings of issuers or of specific bond series that we rate. The purpose of the monitoring is to ensure that the rating will be updated regularly and identify the parameters that may lead to change in the rating.

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