S&P Global
Ratings

RatingsDirect®

Research Update:

Blackstone Property Partners Europe Holdings Outlook Revised To Negative On Increased Leverage; Affirmed At 'BBB'

June 23, 2023

PRIMARY CREDIT ANALYST

Manish Kejriwal
Dublin
+ 353 (0)1 568 0609
manish.kejriwal
@spglobal.com

SECONDARY CONTACT

Marie-Aude Vialle
Paris
+33 6 15 66 90 56
marie-aude.vialle
@spglobal.com

Rating Action Overview

- Blackstone Property Partners Europe Holdings S.a.r.l.'s (BPPEH's) S&P Global Ratings-adjusted debt-to-debt-plus-equity ratio increased to about 51.1% as of Dec. 31, 2022, above our 50% downside threshold. We anticipate more pressure on valuation as capitalization rates may widen further because of rising interest rates, although we understand the group is taking measures to address leverage.
- We believe the upcoming debt maturities of €2.6 billion in the next 2.5 years will be refinanced at a higher cost and this could reduce adjusted EBITDA interest coverage to 2.5x-2.6x in the next two years closer to our downside threshold of 2.4x. However, BPPEH's operating performance remains solid and the expected improvement in operating performance over the next 12-24 months could somewhat mitigate the impact of higher interest.
- Therefore, we revised our outlook to negative on BPPEH and affirmed our 'BBB' long-term issuer credit rating and 'BBB' senior unsecured debt rating.
- The negative outlook reflects that we could downgrade BPPEH over the next 12-24 months if our adjusted credit metrics do not improve despite the group's measures to reduce leverage, with debt to debt plus equity remaining above 50% and EBITDA interest coverage falling below 2.4x on a prolonged basis.

We expect BPPEH's ratio of debt to debt plus equity to remain above our rating downside threshold of 50% in 2023, although we understand the company is taking swift deleveraging measures. BPPEH's full-year 2022 results show S&P Global Ratings-adjusted debt to debt plus equity of about 51.1%. Although BPPEH is still in line with its own financial policy of maximum reported leverage of 50% (net loan-to-value target range of 45%-50%), it is operating at its maximum level (50% as of year-end 2022). This translates into S&P Global Ratings-adjusted debt to debt plus equity of 51.1%, slightly above our downside threshold of 50%. Considering that the European Central Bank (ECB) raised interest rates by another 25 basis points on June 15, and the still-limited amount of real estate transactions on the market, we think property yields may expand further. Hence, we assume a property devaluation of about 6%-7% in 2023, which keeps the ratio of debt to debt plus equity at about 51%-52% in 2023, above our downside threshold of 50%. However, we understand that BPPEH is taking steps to reduce leverage, which may include the sale of stabilized nonstrategic assets, equity injections, or the buyback of senior unsecured bonds at discounts. Additionally, we understand that rental income growth driven by the reversion of below market rents, as well as the company's asset management initiatives, may further mitigate the impact of wider property yields. Hence, we assume somewhat flat revaluation for 2024. We anticipate BPPEH's debt to debt plus equity will return to below our downside threshold in next 12-24 months, after management measures, but we believe that the ratio may remain above if the company fails to achieve its deleveraging targets or if property devaluations are higher than in our base case.

Increasing interest rates could affect BPPEH's EBITDA interest coverage in the next 12-24 months however, we understand that expected improvement in operating performance over the next 12-24 months could mitigate the impact. BPPEH reported solid like-for-like rental income growth at 5% per square meter in 2022, mainly driven by positive indexation, leasing activity, and upward rent reviews of existing leases, as well as occupancy improvement to 94% at year-end, from 93% as of June 30, 2022. We also note that in 2022 the company achieved a strong positive releasing spread in the portfolio. We expect overall like-for-like rental growth of 3.0%-4.0% in 2023 and 2.0%-3.0% in 2024, mostly spurred by leases either linked to the consumer price index (CPI) or the domestic equivalent, or subject to regular rent reviews (more than 90% of total leases) and positive reversions, especially as we understand that the portfolio is about 20% under-rented compared with current market levels. We understand from the company that growing rents should support EBITDA and may mitigate the interest pressure on the rating. However, we currently assume that this may not fully offset the pressure and therefore, we believe the upcoming debt maturities of €2.6 billion by 2025, which we assume will be refinanced with an average cost of about 5.0%-6.0%, could weaken our adjusted EBITDA interest coverage ratio closer to our downside threshold of 2.4x (2.5x-2.6x by 2024). We note 95% of the company's debt is fixed rate, which limits the risk from rising interest rates.

We expect BPPEH's liquidity will remain adequate. BPPEH's liquidity is mainly supported by cash and cash equivalents of €616 million, €434 million undrawn under the revolving credit facility (RCF), and €1,350 million of committed unsecured bank facilities as of March 31, 2023. In addition, we understand the company has secured additional secured refinancings of about €300 million in certain German residential portfolios at a margin of 140-150 basis points after March 31, 2023. We understand the company's upcoming maturities of about €1.0 billion in 2023 and €500 million in February 2024 are fully covered by current liquidity sources. In addition, the company has about €300 million of capacity remaining under its uncommitted unsecured bank facility, which we understand could be converted into a committed line on short notice to repay upcoming maturities, if needed. We note that average cost of debt increased to 1.9% at year-end 2022 from 1.5% at year-end 2021, mainly due to higher refinancing costs in 2022. We see significant debt maturities in the next two to three years of about €2.6 billion (2023: about €1.0 billion; 2024: €500 million; and 2025: €1.1 billion), but we understand that BPPEH plans to address these maturities well in advance and keep its weighted average debt maturity above three years (4.3 years as of Dec. 31, 2022). BPPEH's current capital structure comprises 96% unsecured debt, which means it has the flexibility to consider secured funding if access to capital markets should remain difficult to support its refinancing needs.

Blackstone Property Partners Europe, parent company of BPPEH, experienced an uptick in redemption requests from equity investors over the past 12 months, in line with most of our rated real estate funds. That said, we understand that redemption requests are satisfied at the discretion of the general partner of the fund, after giving due consideration to the fund's liquidity and leverage, which gives BPPEH flexibility to protect the long-term value of the portfolio in the interests of stakeholders. Furthermore, we understand that, as per the fund's documents, the fund is not required to sell assets to satisfy redemption requests. Therefore, we do not see material risks related to redemptions at this stage and we understand that the fund has seen a decline in overall redemption requests in 2023. BPPEH's structure is established as an open-ended perpetual life fund and investors have delegated the management and investment decision-making process to the general partner of Blackstone Property Partners Europe.

We continue to assess BPPEH's shareholder loans provided by its parent and co-investors as equity under our criteria as they remain a permanent part of the capital structure. This is because the instruments are structured with credit protective terms, and we view that shareholders have not altered the alignment of economic incentives between common equity and noncommon equity holders and did not result in any repayment of the shareholder loan's balance. Maturities of these loans also remain longer than all senior unsecured debt facilities.

Outlook

The negative outlook reflects our view that we could downgrade BPPEH over the next 12-24 months if our adjusted debt to debt plus equity remains above 50% and adjusted EBITDA interest coverage falls below 2.4x on a prolonged basis. However, we understand that the group is committed to reducing leverage and restoring ratios to well below our downside threshold.

Downside scenario

We could lower our rating on BPPEH in the next 12 months if on a prolonged basis:

- Debt to debt plus equity remains above 50%;
- EBITDA interest coverage falls below 2.4x; or
- The company fails to maintain adequate liquidity sources to cover the usage for next 12 months.

This could happen if BPPEH fails to execute its current deleveraging measures or experience higher portfolio devaluation than we currently assume.

Upside scenario

We could revise the outlook back to stable if BPPEH demonstrates financial discipline and restores its credit metrics back to:

- Adjusted debt to debt plus equity below 50% on a sustainable basis;
- EBITDA interest coverage above 2.4x; and
- We would also expect BPPEH to maintain adequate headroom under liquidity to cover the usage from sources for the next 12 months.

Such credit metrics would also imply that the operating environment remained solid with stable occupancy levels, positive like-for-like rental income growth, and a higher visibility of future property values.

Company Description

BPPEH is a wholly owned subsidiary of Blackstone Property Partners Europe, an open-ended, core plus fund managed by Blackstone Inc. (A+/Stable/--). The company had a gross asset value of €13.2 billion on Dec. 31, 2022, primarily across the logistics, residential, office, and retail sectors mainly in Western European countries.

Our Base-Case Scenario

Assumptions

- Flat eurozone GDP growth in 2023 and then picking up 1% in 2024. Unemployment of about 6.8%-7.3% over the next 12-24 months. We expect CPI of about 5.0%-6.0% in 2023 and 2.0%-3.0% in 2024.
- Like-for-like rental growth of about 3.0%-4.0% in 2023 and about 2.0%-3.0% in 2024, supported by good market fundamentals for logistics and residential assets, improving occupancy for residential assets after refurbishments, and positive indexation via inflation-linked leases and rent reviews, partly offset by continued challenging market dynamics.
- Widening capitalization rates mitigated by positive cash flow from rental growth. Therefore, we expect portfolio devaluations of about 6%-7% for 2023 and flat valuation thereafter.
- Capital expenditure (capex) of about €200 million-€230 million across the portfolio in 2023 and about €100 million-€150 million in 2024, including mainly maintenance and refurbishment capex.
- Asset disposals of €300 million-€350 million in 2023.
- We assume equity injection/asset transfer of €250 million-€300 million in 2023 and €90 million-€100 million in 2024.
- EBITDA margins of about 80%-81%, benefiting from the absence of one-off costs related to acquisitions.
- No major dividend payments in the next 12-24 months.
- Higher cost of debt for future refinancing, which would increase the average cost of debt to about 2.2%-2.5% in the next two years.

Key metrics

BPPEH--Key Metrics

	2021a	2022a	2023e	2024f	2025f
EBITDA (mil. €)	282.7	366.1	390-420	430-450	440-460

BPPEH--Key Metrics (cont.)

	2021a	2022a	2023e	2024f	2025f
Debt (mil. €)	6,262	6,691	6,350-6,400	6,150-6,200	5,950-6,000
Debt to EBITDA (x)	22.1	18.3	15.5-16.5	14.5-15.5	13.5-14.5
EBITDA interest coverage (x)	3.3	2.7	2.6-2.7	2.5-2.6	2.5-2.6
Debt to debt plus equity (%)	47.5	51.1	51.5-52.5	49-51	49-50

a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess BPPEH's liquidity as adequate. We anticipate that liquidity sources will likely cover uses by more than 1.2x in the 12 months from March 31, 2023.

Our assessment is supported by BPPEH's large cash balance, mostly undrawn RCF, and no obligation to pay dividends. We also note that BPPEH's policy is to obtain hard commitments for the unsecured bank facility around the signing of each investment.

We understand that the company also has €300 million of capacity remaining under its uncommitted unsecured bank facility, which could be used to repay upcoming maturities if needed, once committed.

Principal liquidity sources:

- About €616 million of cash and liquid investments.
- Our forecast of an estimated €250 million-€280 million of funds from operations.
- The €434 million undrawn portion of the RCF, maturing in more than 12 months.
- €1,350 million of committed unsecured bank facilities.
- Asset disposals of €250 million-€300 million.

Principal liquidity uses:

- Debt repayment of about €1.5 billion in the next 12 months.
- About €200 million of capex, which we understand is not fully committed.

Covenants

BPPEH's unsecured notes have robust financial covenant requirements, including:

- Total debt to total assets of 60% or less.
- Secured debt to total assets of 40% or less.
- Interest coverage of 1.5x or more.
- Unencumbered assets to unsecured debt of 150% or more.

We understand that BPPEH has financial covenants for its existing debt. It complied with all these covenants with adequate headroom on Dec. 31, 2022 (more than 10%).

Issue Ratings--Subordination Risk Analysis

We expect BPPEH's secured debt to remain lower than 40% of total assets (it was about 2% on Dec. 31, 2022). As a result, although unsecured debt issuance is structurally subordinated to other debt obligations, the subordination does not affect the rating on the unsecured debt.

Ratings Score Snapshot

Issuer Credit Rating	**BBB/Negative/--**
Business risk:	Satisfactory
Country risk	Low
Industry risk	Low
Competitive position	Satisfactory
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	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: The Treatment Of Non-Common Equity Financing In Nonfinancial Corporate Entities, April 29, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Outlook Action; Ratings Affirmed

	To	From
Blackstone Property Partners Europe Holdings S.a.r.l.		
Issuer Credit Rating	BBB/Negative/--	BBB/Stable/--
Senior Unsecured	BBB	