

Research Update:

# French Intermediary Housing Provider in'li Upgraded To 'A-' On Parent ALI's Stronger Creditworthiness; Outlook Stable

November 14, 2019

## Rating Action Overview

- Action Logement provided the market with greater financial transparency over recent months, improving our assessment of Action Logement Immobilier's (ALI's) creditworthiness, controlling shareholder of in'li.
- Since we view in'li as a strategically important subsidiary of ALI, we also see a positive effect on its creditworthiness.
- We are therefore raising our ratings on in'li and its senior unsecured debt to 'A-' from 'BBB+'.
- The stable outlook reflects our view that in'li's strong business model should enable it to generate at least steady revenue in the next 24 months, maintain prudent leverage, and remain a strategically important subsidiary of ALI.

## Rating Action Rationale

**Our view of ALI's credit quality has improved.** Action Logement's production of its first consolidated accounts for year-end 2018 provided greater transparency regarding its financial performance, strategy, and governance, including of ALI, the controlling shareholder of in'li. As France's largest social housing group, ALI is a non-asset-holding company controlling 59 social housing providers (SHPs), active in traditional social housing activities, managing over 931,000 social housing units spread throughout France, or over 17% of France's total. ALI also controls five companies, including in'li, that provide intermediary housing for middle-income households. In our assessment of ALI's credit quality, we consider, among other factors, the low-risk nature of its social housing assets in all French regions, where demand is particularly high, explaining overall low vacancy.

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**We believe that, unlike ALI, in'li would not receive any exceptional support from the French government if needed.** We would expect the central government to provide exceptional support to ALI's social housing activities if needed (on top of ongoing support mechanisms available to all French SHPs), but we would not expect its intermediary housing activities such as in'li to benefit from such extraordinary government support. Therefore, our assessment of ALI's group support to in'li incorporates only ALI's intrinsic credit quality, without factoring extraordinary government support.

**Our stronger assessment of ALI's stand-alone credit quality leads us to upgrade in'li.** We regard in'li as a strategically important subsidiary of Action Logement group via ALI, and we believe it is highly unlikely that ALI will sell in'li. We therefore believe the group would likely provide financial support to in'li if needed.

## Outlook

The stable outlook reflects our view that in'li's strong business model, under which the company rents out residential assets located in undersupplied areas at below-market rates, should enable the company to generate at least steady revenue in the next 24 months.

We also anticipate the company will maintain moderate leverage, in line with its current financial policy of keeping its reported loan-to-value ratio below 35%-40% over the long-term.

We also expect that in'li will remain a strategically important subsidiary for ALI, and that ALI will maintain its current solid creditworthiness.

## Downside scenario

We could consider lowering the rating on in'li if we perceived that ALI's approach toward in'li had changed such that we revised our view of in'li's status within the group. This could come from any indication the group would provide less financial support than we expect, or if we thought in'li's role within the group had weakened.

If ALI's creditworthiness deteriorated, because of, for example, the quality of financial disclosures, or a pressured financial profile through higher leverage or deteriorating margins, we could take a negative rating action on in'li.

Rating pressure could also come from any deterioration of in'li's stand-alone credit profile, which could result from higher-than-expected leverage or a change of business strategy, but this scenario is currently unlikely in our view.

## Upside scenario

We could raise the rating on in'li if it displayed a tighter financial policy, which could result from keeping its S&P Global Ratings' debt-to-debt plus equity below 35% over the long-term and debt-to-EBITDA below 7.5x.

However, upside potential for our rating on in'li is currently subject to seeing stronger credit quality for ALI, since we cap our rating on in'li by the parent's credit quality. This means a positive rating action on in'li would hinge on an upward assessment of ALI's credit quality, reflecting, for instance, a stronger financial profile, or greater transparency over its long-term financial profile and its financial strategy and policies.

## Company Description

France-based in'li owns a portfolio worth €7.9 billion as of year-end 2018 (appraisers' valuation is conservatively based on block rather than unit sales) comprising residential assets located solely in the greater Paris region (Ile-de-France). in'li's assets are in the intermediary market segment ("logement intermédiaire"), defined under French law since 2014, and reserved for households with specific tranches of income. Against a favorable tax regime, French intermediary housing providers offer housing to middle-income households, i.e., those with too high an income to have access to highly-subsidized French social housing, but whose income is too low to afford free-market rents, especially in high-demand and congested areas, such as the greater Paris region.

in'li is a 99.28%-owned subsidiary of the Action Logement group via ALI, a key player in France's social housing sector. We view in'li as a strategically important subsidiary of ALI.

## Our Base-Case Scenario

Our base case remains similar to our last review in May 2019. The main difference is the delay in in'li's planned investment program owing to the municipal elections in France that will occur in March 2020. The elections are expected to make it more difficult for real estate players to obtain building permits. In'li has adjusted its disposals program accordingly.

In our base case, we assume:

- Like-for-like growth in rental income of about 1.5% in 2019 and 2020, in line with our forecast consumer price index in France over the coming years, which should be close to the Indice de Référence des Loyers index. We also expect occupancy will remain stable at about 97%, even if in'li is able to favorably renegotiate the terms of some of its outstanding leases.
- Disposal proceeds of €114 million in 2019, including a portfolio of assets considered less core to the company's strategy, and some disposals, unit by unit, to individuals, including in-place tenants. We assume a slight postponement throughout 2020 of the large disposal program, which includes additional unitary disposals, but mainly the block sale of 6,000 housing units to the investment funds that in'li should by then have set up.
- Development capital expenditure (capex) of about €360 million in 2019 and €600 million in 2020, as part of in'li's strategy to produce about 37,200 new housing units by 2023, of which 19,100 will be owned by in'li. We understand the development plan will be phased in to match the pace of the company's completed disposals.
- Capital injections from ALI of €70 million in 2019 and €50 million in 2020, as part of the five-year agreement with the French government ("Convention quinquennale").

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

- Debt to debt plus equity remaining below 25% in 2019-2020 and increasing thereafter;
- EBITDA interest coverage of 3.5x-4.0x in the next two years, decreasing slightly thereafter with the ramp-up of the investment program; and
- Debt-to-EBITDA ratio of 10.0x-12.5x in the next two years, temporary increasing thereafter, with the production of new housing units.

## Liquidity

We assess in'li's liquidity as strong. We anticipate that liquidity sources will likely cover uses by more than 1.5x for the 12 months started Oct. 1, 2019, and by more than 1.0x over the 24 months from the same date.

We estimate the company's principal liquidity sources for the 12 months started Oct. 1, 2019, as follows:

- €613 million of cash and liquid investments;
- €800 million of undrawn bank lines;
- Our estimate of about €65 million cash funds from operations;
- A €70 million capital injection from ALL; and
- More than €110 million of proceeds from contracted asset sales.

We estimate the company's principal liquidity uses for the same period as:

- About €50 million of debt maturities for the next 12 months; and
- About €360 million of committed development capex, as part of the strategy to produce new housing.

## Ratings Score Snapshot

Issuer Credit Rating:	A-/Stable/--
Business risk:	Strong
Country risk:	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:	Fair (no impact)
Comparable rating analysis:	Neutral (no impact)
Stand-alone credit profile:	bbb+
Entity status within group:	Strategically important (+1)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Upgraded

	To	From
<b>in'li</b>		
Issuer Credit Rating	A-/Stable/--	BBB+/Positive/--
Senior Unsecured	A-	BBB+

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