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Research Update:

Luxembourg-Registered Prologis European Properties Fund II FCP Assigned 'BBB/A-2' Ratings, Outlook Stable

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Overview

- Luxembourg-registered property fund Prologis European Properties Fund II (PEPF II) has, in our view, a "satisfactory" business risk profile underpinned by a large portfolio of prime, recently built, logistics properties in Europe.
- We classify PEPF II's financial risk profile as "intermediate," reflecting an EBITDA-to-interest-coverage ratio of 3x and a loan-to-value ratio below 45%.
- We are assigning our 'BBB/A-2' long- and short-term corporate credit ratings to PEPF II.
- The stable outlook reflects our belief that PEPF II should continue to generate stable cash flows and maintain its current credit metrics over the medium term, and our assumption that the governance and financial policy of PEPF II's majority shareholder, U.S. based international property developer Prologis Inc., will remain constant.

Rating Action

On Sept. 7, 2012, Standard & Poor's Ratings Services assigned its 'BBB/A-2' long- and short-term corporate credit ratings to Luxembourg property fund Prologis European Properties Fund II (PEPF II). The outlook is stable.

Rationale

The ratings reflect our view that PEPF II has a "satisfactory" business risk profile and an "intermediate" financial risk profile, as our criteria define the terms.

The satisfactory business risk profile is underpinned by PEPF II's large pan-European portfolio of prime, recently-built logistics properties, the strong cash flow generated by these assets, an occupancy ratio of 95%, and high average lease duration of 4.8 years. We also view its lack of exposure to speculative development risk as credit positive.

These strengths are partly offset by the fund's substantial share of secured debt as a proportion of total debt, which, in our view, limits the fund's current financial flexibility. PEPF II is also exposed to currently fragile demand in the European industrial property market, and to some volatility

inherent in the real estate sector.

PEPF II's portfolio includes a strong presence in Western and Central Europe. The U.K. represents 21% of the portfolio's expected rental value, Poland represents 21%, Germany 18%, and France 15%. The portfolio mainly comprises prime-quality logistic properties, whose rent and asset valuations are generally more resilient than older or less specialized properties in the industrial and logistics segments. The low average age of five years and high 60% retention rate of PEPF II's assets gives it a good competitive advantage in a market where the supply of new modern warehouses is still at historically low levels. The portfolio was worth about €2.8 billion on June, 30, 2012, and provides the fund with strong and predictable cash flows derived from 95% occupancy and a long average lease duration of 4.8 years. That said, PEPF II has high exposure to the industrial property segment, which has suffered from a sharp fall in values over the past two years. Today, demand remains fragile, limiting scope for raising rents and increasing average lease duration.

After an initial three-year growth period, PEPF II reached critical size and entered into an ongoing active management phase in August 2010, maintaining no exposure to speculative development risks. We view these factors positively in our ratings. Another element supporting PEPF II's creditworthiness is its ability to maintain its Standard & Poor's-adjusted loan-to-value (LTV) ratio between 40% and 45%. This range is in line with PEPF II's stated financial policy and is more moderate than the industry average. As a result of equity-financed acquisitions and low leverage, PEPF II's cash flow adequacy is currently comfortable, in our view, in light of its funds from operations (FFO)-to-debt ratio above 10% and EBITDA-to-interest-coverage ratio around 3x, both of which are consistent with our definition of an intermediate financial risk profile for real estate asset management companies.

Balancing these financial strengths is PEPF II's current funding structure, which is constrained by a large amount of secured debt--91.5% of total debt--and a limited amount of backup credit lines. Average debt duration fell from 3.9 years on Dec. 31, 2010, to 2.7 years on June 30, 2012, as the fund started preparing for a broad refinancing, which will likely help diversify funding sources. Based on PEPF II's low leverage and the high quality of its €910 million pool of unencumbered assets, we view liquidity as adequate because of the fund's proven track record in raising secured debt, which it might use as an alternative source of financing if volatile credit conditions limit investor demand for unsecured debt instruments.

In assessing PEPF II's corporate governance, we note that the fund has a business relationship with its largest shareholder, U.S.-based international developer and manager of industrial properties Prologis Inc. (BBB-/Stable/--). Prologis owns a 29.7% stake in PEPF II, shares the same name and is PEPF II's fund manager through its 100% ownership of the management company Prologis Management II. We do not align our rating on PEPF II with that of Prologis, or cap it at the same level, as we do not factor in any extraordinary positive support or negative influence from Prologis. This is because PEPF II has a history of independent decision making on all major aspects of its business

and financial policy. We also believe that there are provisions included in the management contract that provide a degree of mitigation against the risk of undue influence by Prologis, particularly those governing related-party transactions. Such provisions include any purchases by PEPF II of properties developed by Prologis. We see, however, a strong link between the two entities and therefore continue to closely monitor this aspect of PEPF II's rating.

We anticipate that PEPF II's adjusted EBITDA should exceed €220 million over the next two years, mainly driven by rent contribution from planned new asset acquisitions. We have factored into our analysis a prolonged slowdown of leasing activity and stagnating yields, which would constrain any organic growth. As a result of largely equity-financed acquisitions, in line with the fund's growth strategy, we forecast that PEPF II should post a Standard & Poor's-adjusted EBITDA-to-interest-coverage ratio in the 3.0-3.5x range, and a LTV ratio between 41% and 43% over the next two years.

Liquidity

We classify PEPF II's liquidity as "adequate" under our criteria. We expect liquidity sources to meet funding needs by more than 1.2x in the next 12 months.

We estimate the main liquidity sources over the next 12 months, as of July 31, 2012, at about €415 million including:

- €28 million of committed asset sales;
- €58 million in cash and short-term investments;
- Sufficient availability under committed credit lines of revolving credit to cover the debt maturities over the same period; and
- Sufficient incoming FFO to more than cover planned dividends and capital expenditures (capex).

Over the same period, we estimate the main liquidity uses at about €275 million including:

- Debt maturities;
- Planned dividends; and
- Capital expenditure (capex).

We note a strong deterioration in average debt durations, which fell to 2.7 years on June 30, 2012, from 3.9 years on Dec. 31, 2010. This was owing to the absence of large refinancing over the past 12 months. That said, PEPF II is now looking at a range of funding options for extending its debt maturity profile, based on the step up in the fund's asset and income base over the past few years. PEPF II also has a significant unencumbered asset base as a back-up option for raising secured finance.

Outlook

The stable outlook reflects our belief that PEPF II will continue to generate stable cash flows and maintain its current credit metrics, and our assumption

that the governance and financial policy of majority shareholder Prologis Inc. will remain constant.

We believe PEPF II should be able to maintain high occupancy and long-term lease duration to generate stable operating cash flows over the medium term. We also expect the fund to maintain adequate liquidity and have an EBITDA-to-interest ratio of between 2.5x and 3x and a LTV ratio of close to 45%.

We might consider a negative rating action if credit metrics fell below these benchmarks for a prolonged period, or if PEPF II faced significant delays in its refinancing plans.

A positive rating action would depend on PEPF II being able to report an EBITDA-to-interest ratio higher than 3.5x and an LTV ratio below 40%. A higher rating level would also be contingent on PEPF II's ability to diversify its funding sources and lengthen its average debt maturity profile, in our view.

While PEPF II's rating is currently neither capped by nor aligned to that of its largest shareholder, Prologis, we will monitor this relationship closely. Any further increase in ownership by Prologis or change in Prologis' governance or financial policy that led to a more aggressive business or financial profile for PEPF II would result in a review of the rating. In addition, a change in the rating of Prologis could lead us to review a potential impact on PEPF II's rating.

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Table Of Contents: Standard & Poor's Corporate Ratings Criteria, Aug. 1, 2012
- Key Credit Factors: Global Criteria For Rating Real Estate Companies, June 21, 2011
- Corporate Criteria--Parent/Subsidiary Links; General Principles; Subsidiaries/Joint Ventures/Nonrecourse Projects; Finance Subsidiaries; Rating Link To Parent, Oct. 28, 2004

Ratings List

New Rating; CreditWatch/Outlook Action

Prologis European Properties Fund II FCP
Corporate Credit Rating BBB/Stable/A-2

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