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Research Update:

SL Green Realty Corp. Outlook Revised To Positive On Closing Of One Vanderbilt Joint Venture

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Research Update:

SL Green Realty Corp. Outlook Revised To Positive On Closing Of One Vanderbilt Joint Venture

Overview

- On Jan. 26, 2017, New York based REIT SL Green Realty Corp. announced that it has closed on a joint venture with the National Pension Service of South Korea (NPS) and Hines Interest LP for a 29% interest in the One Vanderbilt development project, which we believe mitigates some of the development risk it faces.
- For the full year 2016, the company reported a 6.0% increase in same-property cash net operating income (NOI) and maintained occupancy levels at 97.1% in its core Manhattan office portfolio.
- We are revising the outlook to positive from stable and affirming our ratings on the company, including the 'BBB-' corporate credit rating.
- The positive outlook reflects our expectation that SL Green will manage the development risk of One Vanderbilt while maintaining its current financial policy, with credit metrics improving in the next year, in S&P adjusted debt to EBITDA in the high-7x area.

Rating Action

On Jan. 26, 2017, S&P Global Ratings revised its rating outlook on SL Green Realty Corp. to positive from stable. At the same time, we are affirming our ratings on the company, including the 'BBB-' corporate credit rating.

Rationale

The outlook revision reflects our expectation that SL Green will remain committed to its stated financial policy and continue to strengthen its financial risk profile. Currently, debt to EBITDA is about 8x and fixed-charge coverage (FCC) is 2.4x under our calculation. Given its sizeable development exposure, we expect SL Green to maintain its financial discipline through its use of strategic joint ventures and application of asset sale proceeds to reduce debt.

In October 2016, SL Green broke ground on One Vanderbilt, an office building adjacent to Grand Central Terminal. Upon completion (expected in 2020), One Vanderbilt will be the second tallest tower in New York City and is expected to cost approximately \$3.2 billion to develop. To date, SL Green has secured a \$1.5 billion construction loan for this venture. The company also has mitigated some of the risk through its recently announced joint venture with

NPS (27.6%) and Hines (1.4%) for aggregate equity to the project totaling no less than \$525 million. We expect SL Green to continue to sell assets and capitalize on attractive asset disposition opportunities in the next year. We also expect proceeds from asset sales to fund development needs as they arise, repay debt, and bolster liquidity. Over the next two years, we expect debt to EBITDA to strengthen into the 7.5x to 8x area and FCC to remain in the mid-2x range. We do not anticipate any significant shifts in financial policy and believe the company will manage future acquisitions and development with a combination of debt and equity.

We derive our ratings on SL Green from our assessment of the company's status as the largest office landlord in New York City. SL Green's \$16.3 billion in undepreciated real estate assets is one of the largest asset portfolios among the REITs we rate. The company generates 93% of its property NOI from Manhattan, and held interests in 127 Manhattan buildings totaling 47.8 million square feet at Dec. 31, 2016.

We expect demand for N.Y. office space to benefit from job growth in the private sector. Over the next four years, approximately 13.5 million square feet of new office inventory to come to market in NYC. Still, we expect absorption to remain healthy given good demand from financial services, legal, and technology, advertising, and media tenants. Over the next few years, we expect demand for N.Y. office space to remain positive albeit at a more modest pace.

Over the past year, healthy supply and demand fundamentals have resulted in strong occupancy and rental rates. Same-property occupancy in its Manhattan properties was 97.1% as of Dec. 31, 2016, and rental rates accelerated about 27.6% over previously escalated rents on the same space for full-year 2016. Same property cash NOI rose by 6% in 2016 and we expect continued growth in 2017, albeit at a more modest pace.

Rising office asset values and interest from foreign investors have made acquisitions more challenging and cap rates are at relatively low levels. Opportunities in other asset classes have spurred the company to increase its exposure to street-level retail assets. As of Dec. 31, 2016, the company derived 14.6% of cash rental revenues from retail properties. Retail and residential assets in Manhattan have been among the best performing real estate since the financial crisis due to the booming New York tourism market and the strong appeal of living in Manhattan; nonetheless, pricing is also robust for these asset types, particularly Manhattan residential properties.

SL Green's development exposure (currently 9.5% of gross assets) is sizeable relative to its rated peers (in the mid-single-digit percent area) and the company is in the early stages of development with One Vanderbilt. However, the company has partially mitigated some of the risks associated with development following the closing of the (29%) joint venture. While the costs of the potential development could be very large, we expect the investment will be spread over several years and we expect that the company will achieve significant pre-leasing as construction progresses. During the third quarter,

SLG closed on a \$1.5 billion construction loan for One Vanderbilt, which addresses most of the near term funding needs for the development.

Key credit measures remain slightly weaker than rated office peers. As of Dec. 31, 2016, our calculated last-12-month debt to EBITDA (including preferred shares, the present value of capitalized leases, and SL Green's prorate share of joint ventures) was about 8x. Based on the company's stated financial policy, we expect debt to EBITDA to improve slightly from its current levels. SL Green successfully refinanced higher cost debt in 2016 and we expect FCC to strengthen further from the current 2.4x as of Dec. 31, 2016. We expect SL Green will continue its deleveraging efforts in 2017 as the company sells assets to reduce debt and incremental NOI growth remains strong. SL Green is also gradually paying off select mortgages and increasing its unencumbered asset pool.

Our base-case scenario assumes:

- Real GDP growth of 1.6% in 2016 and 2.4% in 2017;
- Same-property NOI growth of about 3% per year, supported by strong occupancy levels and modest rise in rental rates with a favorable employment fundamentals in New York City;
- Acquisitions in the \$200 million area in 2017;
- Development spending in the \$400 million to \$500 million
- Asset dispositions of \$500 million to \$700 million in 2017;
- Maintenance capital expenditures of \$150 million to \$200 million annually;
- Common dividend rises by about 5% per year; and
- New unsecured debt issuance of \$250 million to \$300 million annually.

Based on these assumptions, we arrive at the following credit measures in 2017:

- FCC in the mid-2x area;
- Debt to EBITDA in the 7.5x to 8x area; and
- Debt to capital (undepreciated) in the mid-50% area.

Liquidity

We believe SL Green's liquidity position is adequate and sources are adequate to cover uses by at least 1.2x over the next 12 to 24 months. Our liquidity assessment is based on the following factors:

- Liquidity sources less uses will be positive, even if forecasted EBITDA declines by 10% (a REIT specific threshold for adequate liquidity);
- Sufficient covenant headroom for forecasted EBITDA to decline by 10% without the company breaching covenant tests, and debt is at least 10% below covenant levels;
- The likely ability to absorb high-impact, low-probability events, with limited need for refinancing; and
- Sound relationships with banks.

Principal liquidity sources:

- Unrestricted cash totaled \$279 million as of Dec. 31, 2016;
- As of Dec. 31, 2016, the company had ample availability under its \$1.6 billion unsecured revolving credit facility maturing in 2019 with a

one-year extension option; and

- S&P Global Ratings' projected cash FFO of \$800 million to \$900 million in 2017.

Principal liquidity uses

- Interest expense declining to the \$400 million to \$425 million per year;
- Contractual amortization payments of \$40 million to \$50 million annually;
- Common dividends of about \$350 million annually and preferred dividends of about \$26 million;
- Total maintenance capital expenditures of \$150 million to \$200 million annually; and
- Development spending in the \$400 million to \$500 million area.

Outlook

The positive outlook reflects our expectation that SL Green will maintain its financial policy and that credit metrics will improve, resulting in a S&P Global Ratings adjusted debt to EBITDA in the high 7x area in the next year. Given its sizeable development exposure, we expect SL Green to maintain its financial discipline through its use of strategic joint ventures and application of asset sale proceeds to reduce debt. In our view, the company's competitively positioned, high quality N.Y. office portfolio is supported by strong occupancy levels, good quality tenants, and still favorable demand drivers, which will support improving financial leverage and FCC over the next 12 to 18 months.

Upside scenario

We could raise the ratings if SL Green continues to outperform similarly-sized peers as evidenced by occupancy and rental rate growth. We would also consider raising the ratings should the company further mitigate development risk by securing another joint venture partner, or by leasing up One Vanderbilt and signing key tenants by 2018. For an upgrade, we would need to see a slight improvement to credit metrics such that debt to EBITDA declines below 8x on a sustained basis, with fixed-charge coverage in the mid-2x area.

Downside scenario

We would revise the outlook to stable if operating performance deteriorates perhaps because of a development misstep, considerable weakness among tenants in the financial and legal sectors in N.Y. or if leverage increases resulting in debt to EBITDA above 8.5x or FCC declining to 2.1x on a sustained basis. We could also lower the rating on the senior unsecured notes by one notch if the company were to further encumber its portfolio with additional debt from acquisitions.

Ratings Score Snapshot

Corporate credit rating: BBB-/Positive/--

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/leverage: Significant

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: Satisfactory (No impact)
- Comparative rating analysis: Neutral (No impact)

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- 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: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 07, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; Outlook Action

To

From

SL Green Realty Corp.

SL Green Operating Partnership L.P.
Reckson Operating Partnership L.P.
Corporate Credit Rating BBB-/Positive/-- BBB-/Stable/--

Ratings Affirmed

SL Green Realty Corp.
Senior Unsecured BBB-
Preference Stock BB

Reckson Operating Partnership L.P.
Senior Unsecured BBB-

SL Green Operating Partnership L.P.
Senior Unsecured BBB-

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