FitchRatings

# FITCH UPGRADES SL GREEN TO 'BBB'; OUTLOOK STABLE

Fitch Ratings-New York-01 December 2017: Fitch Ratings has upgraded the ratings for SL Green (NYSE: SLG), including the company's Issuer Default Rating (IDR) to 'BBB' from 'BBB-'. The Rating Outlook is Stable. A full list of ratings follows at the end of the release.

KEY RATING DRIVERS

The upgrade reflects the company's adherence to tighter financial policies, including targeting leverage below 7.0x. It also considers the progress SLG has made against a transition to a predominantly unsecured borrowing strategy, including its recently demonstrated access to public unsecured bonds.

Fitch's ratings consider SLG's credit strengths, including its strong competitive position and high-quality New York office portfolio that enjoys high occupancy rates, long-term leases to solid credit tenants, and above-average contingent liquidity from institutional lenders and investors. The company's financial policy targets and capitalization strategy are appropriate for the 'BBB' rating, after considering the quality and low market capitalization rates warranted by its portfolio. SLG also has manageable, well-balanced lease maturity and debt expiration schedules as well as limited floating-rate debt exposure.

SLG's geographic portfolio concentration in the New York metro area, opportunistic capital allocation strategy and ownership of capital intensive office properties are factors that balance the company's credit positives. The persistent strength and economic diversity of Manhattan and high face rents help to mitigate these risks. SLG is also a less established unsecured borrower than many similarly or higher-rated REIT peers.

Appropriate Leverage: SLG's recurring debt-to-EBITDA leverage is in-line with similarly rated equity REIT peers, but is appropriate to conservative after adjusting for lower market-level cap rates for Manhattan commercial real estate. Fitch expects SLG to operate with leverage at 7.0x or below during the Rating Outlook horizon.

SLG has tightened its financial policies as it transitions to an investment-grade, unsecured borrowing strategy. Asset sales and incremental net operating income (NOI) from repositioning and leasing of value-add acquisitions have supported the company's de-levering.

The company's leverage ratio was 6.7x for the TTM ending in Sept. 30, 2017, compared to 7.0x for the year ended in 2016.

Appropriate Fixed Charge Coverage: Fitch expects SLG's fixed-charge coverage (FCC) to remain relatively flat, since growth in cash flow is partially offset by an environment in which landlords will continue to offer attractive tenant lease incentives. FCC was 2.1x for the TTM ending Sept. 30, 2017, compared to 2.4x for the year ended in 2016.

Adequate Unencumbered Asset Coverage of Debt: Fitch expects SLG's consolidated unencumbered asset coverage of net unsecured debt (UA/UD) to sustain in the low 2.0x during the Outlook horizon. The company's UA/UD (calculated as annualized third quarter 2017 unencumbered property NOI divided by a stressed 7% capitalization rate) results in coverage of 2.0x, compared to 2.3x as of Sept. 30, 2016.

The company's improved UA/UD ratio is an important credit positive. UA/UD coverage below 2.0x had historically hindered SLG's credit profile, when compared to similarly rated companies, particularly given that the stressed capitalization rate applied to SLG's NOI is the lowest across Fitch's rated universe. However, SLG's portfolio has stronger contingent liquidity relative to most asset classes in other markets, after considering that Midtown Manhattan assets are highly sought after by secured lenders and foreign investors.

Experienced Management Team: The ratings also consider SLG's experienced and cycle-tested management team, which demonstrated the ability to maintain portfolio occupancy and adequate liquidity levels through the downturn during 2008/2009. Risk mitigation is a cornerstone of SLG's opportunistic investment strategy, regularly demonstrated by management through its leasing, capital recycling and asset-level capitalization strategies.

Manageable Lease Expiration Profile: As of Sept. 30, 2017, SLG has a manageable lease expiration schedule with an average of only 9.4% of consolidated Manhattan rents expiring annually 2018-2021. While slightly more of the company's consolidated suburban property rents expire during that same period (11.8% on average), the suburban portfolio represents a limited portion of the company's total assets and only 7.1% of annualized cash rent.

Laddered Debt Maturities: Further supporting the ratings is SLG's manageable debt maturity schedule. Over the next five years, 2020 are the largest years of pro forma debt maturities with 12.7%, after accounting for the newly issued $500 million in notes, the payoff of the exchangeable notes and future indebtedness as well as the upsizing/extension of the company's term loan facility. The company has strategically positioned itself to have limited maturities and extend their average debt tenor to 5.3 years as of Sept. 30, 2017.

Reckson's IDR Linked to SLG's: Consistent with Fitch's criteria, "Parent and Subsidiary Rating Linkage," Reckson's IDR is linked and synchronized with SLG's due to strong legal, operational and strategic ties between it and SLG, including each entity guaranteeing certain corporate debt of the other.

Junior Subordinated Notes Notching: The one-notch differential between SLG's IDR and junior subordinated notes (trust preferred securities) is consistent with Fitch's criteria for corporate entities with an IDR of 'BBB-'. Based on Fitch's "Treatment and Notching of Hybrids in Nonfinancial Corporate and REIT Credit Analysis," these securities are senior to SLG's perpetual preferred stock but subordinate to SLG's corporate debt. Holders of such notes have the ability to demand full repayment of principal and interest in the event of unpaid interest.

Preferred Stock Notching: The two-notch differential between SLG's IDR and preferred stock rating is consistent with Fitch's criteria for corporate entities with an IDR of 'BBB-'. Based on Fitch's "Non-Financial Corporates Hybrids Treatment and Notching Criteria", these preferred securities are deeply subordinated and have loss absorption elements that would likely result in poor recoveries in the event of a corporate default.

## DERIVATION SUMMARY

SLG owns high-quality, primarily NYC office portfolios, with high occupancy rates, long-term leases to solid credit tenants. The company's New York-focused portfolio has better contingent liquidity from institutional lenders and investors than lower-rated peer Mack-Cali Realty Corp. (BB+/Stable). The persistent strength and economic diversity of Manhattan and its high face rents help to mitigate the geographic concentration risk. SLG approaches ground-up development more opportunistically, rather than as a key component of its operating strategy like higher-rated peer Boston Properties, Inc. (BBB+/Stable).

Fitch links and synchronizes the IDRs of the parent REIT and subsidiary operating partnerships due to entities operating as a single enterprise with strong legal and operational ties.

## KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
--Low single-digit annual SSNOI growth in 2018 to 2020;
--Maturing consolidated secured debt primarily refinanced with new mortgage capital;
--No equity issued through forecast period. Any share repurchases occur on leverage-neutral basis per the company's recent activity.

## RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
--Fitch's expectation of leverage sustaining below 6.0x;
--Proven and consistent capital access commensurate with a higher rating;
--Fitch's expectation of fixed charge coverage sustaining above 3x.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
--Fitch's expectation of leverage sustaining above 7.0x;
--Fitch's expectation of UA/UD sustaining below 2.0x;
--Fitch's expectation of fixed charge coverage sustaining below 2x.

## LIQUIDITY

Liquidity Coverage at 1.2x: SLG's sources of liquidity (cash, availability under its revolving credit facility, retained cash flow after dividends/distributions) cover its uses (pro rata debt maturities, recurring capital expenditures, non-discretionary development expenditures) by 1.2x for the period Oct. 1, 2017 through Dec. 31, 2019. Several as-of right extension options make the company's maturity schedule very manageable as management has consciously worked to extend their weighted average debt tenor to 5.3 years as of Sept. 30, 2017.

Fitch's liquidity analysis assumes SLG does not raise any external capital to repay debt maturities. This notwithstanding its demonstrated access to a variety of capital sources over time, which meaningfully mitigates refinancing risk in Fitch's view. Under a scenario where the company refinances 80% of maturing pro rata secured debt, SLG is operating with 1.6x coverage.

SLG's historically conservative common dividend policy supported its liquidity by allowing it to retain additional operating cash flow. As expected though, the company's AFFO payout ratio has trended toward industry averages and was 70.3% for the first nine months of 2017. SLG is still anticipated to retain well over $100 million in 2017 despite the normalized payout ratio which provides strong financial flexibility.

## FULL LIST OF RATING ACTIONS

Fitch has upgraded the following ratings of SLG and its operating partnerships:

SL Green Realty Corp.
--Issuer Default Rating (IDR) to 'BBB' from 'BBB-';
--Senior unsecured notes to 'BBB' from 'BBB-';
--Perpetual preferred stock to 'BB+' from 'BB'.

SL Green Operating Partnership, L.P.
--IDR to 'BBB' from 'BBB-';

--Senior unsecured revolving credit facility to 'BBB' from 'BBB-';
--Senior unsecured term loan to 'BBB' from 'BBB-';
--Senior unsecured notes to 'BBB' from 'BBB-';
--Junior subordinated notes to 'BBB-' from 'BB+'.

Reckson Operating Partnership, L.P.
--IDR to 'BBB' from 'BBB-';
--Senior unsecured notes to 'BBB' from 'BBB-'.

The Rating Outlook is Stable.

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Summary of Financial Statement Adjustments - Financial statement adjustments that depart materially from those contained in the published financial statements include:

--Fitch adds back non-cash stock-based compensation to EBITDA;
--Fitch includes operating income from discontinued operations, adds cash distributions from unconsolidated entities net of distributions to noncontrolling property interests to EBITDA;
--Fitch considers $80 million of cash necessary for working capital needs and otherwise unavailable to repay debt;
--Fitch includes 50% of SLG's preferred equity and 100% of preferred units as debt in certain leverage ratios.

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Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017)
https://www.fitchratings.com/site/re/901296
Non-Financial Corporates Hybrids Treatment and Notching Criteria (pub. 27 Apr 2017)
https://www.fitchratings.com/site/re/896881