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## Research Update:

# Kimco Realty Corp. 'BBB+' Corporate Credit Rating Affirmed; Outlook Stable

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## Research Update:

# Kimco Realty Corp. 'BBB+' Corporate Credit Rating Affirmed; Outlook Stable

## Overview

- Kimco Realty Corp. is among the largest shopping center landlords, owning a large, diverse portfolio of shopping centers located in the U.S. and Canada.
- We revised our assessment of Kimco's business risk profile to "strong" from "satisfactory" to reflect the scale and diversity of Kimco's platform and recent and continued expected improvements as the company continues to execute on its strategic initiatives to enhance and simplify the business.
- We affirmed our 'BBB+' corporate credit and senior unsecured debt ratings on the company, as well as our 'BBB-' rating on its preferred securities.
- The stable outlook incorporates the benefits of Kimco's large, diverse core shopping center portfolio, with its manageable lease expiration and below market rents, which should generate fairly predictable cash flow. Further recovery in occupancy and rents, along with redevelopment opportunities, support our expectation for EBITDA growth.

## Rating Action

On Sept. 30, 2014, Standard & Poor's Ratings Services affirmed its 'BBB+' corporate credit rating on Kimco Realty Corp. At the same time, we affirmed the 'BBB+' senior unsecured note and 'BBB-' preferred stock ratings. The outlook is stable.

## Rationale

The affirmation follows our revision of our assessment of Kimco's business risk profile to "strong" from "satisfactory". The strong business risk profile reflects Kimco's position as one of the largest shopping center landlords (\$11 billion of gross real estate investments), owning interest in a national portfolio (840 properties comprising 121 million square feet) that are well-occupied (95%) and favorable fundamentals that we expect will support continued occupancy and rent growth. The portfolio is also broadly diversified by tenant and geography. Kimco is the largest landlord to Costco, TJX, Home Depot, Target, Ross Stores, Walgreens, and Dollar Tree (no tenant accounts for more than 3.2% of annual base rents) with properties in 41 states, Puerto Rico, Canada, and Latin America. Kimco's tenants are also more necessity based and less vulnerable to internet sales. Incorporated into Kimco's business risk profile is the company's progress executing its "back-to-basics" strategy that includes upgrading the portfolio through asset recycling and reducing its

footprint in fewer, stronger markets where Kimco can leverage its scale and local presence, while retaining a national footprint, and pursuing low-risk, high-return redevelopment opportunities.

Kimco began a portfolio transformation strategy in 2010 that has yielded positive results as the company disposed of what it characterizes as lower-quality Tier II assets (180 properties) and recycled capital into higher-quality shopping center assets with stronger market demographics, occupancy, and average base rents. We view Kimco's portfolio quality as fairly consistent with the peer group, with average base rents that are about average compared with the peer group. The portfolio does include ground leases (11% of base rents) that carry low average rents, as well as the portfolio of Tier II properties targeted for disposition. We expect Kimco to continue to dispose of noncore assets and recycle proceeds into higher-quality retail properties in its long-term core markets and redevelopment, which should support more reliable cash flow.

Kimco's strategy has also entailed simplifying the business model by exiting nonretail investments, reducing its joint venture platform (down over \$2 billion in gross investments since 2010), and owning more properties outright. Nonetheless, Kimco still has a very large joint venture platform (\$10 billion gross assets), which the company may continue to trim over time. Kimco has also been exiting its Latin American investments (which should be largely complete over the next few quarters), leaving Kimco with a narrower geographic footprint in the U.S. and Canada.

Since 2010, Kimco has sold \$1.5 billion of U.S. assets reinvesting proceeds into higher-quality assets (higher occupancy, average rents and demographics), while also disposing of roughly \$1.1 billion of Latin American assets (recently contributing about 3% of annual base rents). The focus on core retail investments with recurring income is a shift away from management's broader investment pursuits of the past several years. However, that being said, Kimco participated in a follow-on transaction with a Cerberus-led investment group to acquire the outstanding shares of Safeway. As part of the transaction, Kimco contributed cash and its existing stake in Albertsons and will hold a 9.94% stake in the combined companies. Although Kimco's total investment will remain moderate, this does signal management's continued interest in opportunistic investment pursuits.

We expect a continued modest recovery in Kimco's core retail occupancy (up 50 to 75 basis points during 2014), which should result from continued occupancy improvement within the small shop space (up 200 basis points to 86.3% occupied at the end of the second quarter) and rent growth through a combination contractual rental increases, occupancy gains, and high single-digit leasing spreads (recent second quarter same-space U.S. releasing spreads increased 9.7%), which will produce same-property net operating income growth of 2.5% to 3.5%. Operating results will more than offset an environment of uneven transactions (and the potential for earnings dilution), in our view. Ground-up development activity remains modest as management has increased its pipeline of redevelopment projects. We view the company's redevelopment strategy

favorably as it should produce comparatively attractive (8% to 12%) expected yields with less risk than large-scale, ground-up development.

We view Kimco's financial risk profile as "intermediate". Debt (including preferred stock) to EBITDA was 7x on a trailing-12-months basis ended June 30, 2014, and debt-to-undepreciated capital was 50%, slightly elevated from year-end, but we expect leverage to edge down and remain in the mid-6x area and high-40% area, as we assume Kimco continues to monetize assets and use net proceeds to repay revolver borrowings and fund new investments, and fund net growth in a balanced manner. Consolidating Kimco's joint ventures on a pro rata basis we estimate 2014 debt-to-EBITDA will be in the mid-7x area and debt-to-undepreciated capital would end the year in the low-50% area.

We estimate that Kimco's debt service and fixed-charge coverage measures were 3.4x and 2.7x, respectively. We expect these measures to modestly improve, given the portfolio's positive mark-to-market on its expiring leases, continued opportunities to modestly improve occupancy, and interest savings resulting from favorable refinancing opportunities (5.22% weighted average cost for 2015 maturities). Kimco's average remaining lease term of more than seven years results in a manageable 1.8% of leased square feet expiring over the remainder of 2014 and 8.4% in 2015, assuming no tenants exercise their renewal options. If tenants exercise renewal options, these expirations decline to 1.1% and 2.9% in 2014 and 2015, respectively. Under either scenario there is embedded growth through contractual rent increases and/or positive mark-to-market spreads relative to in-place rents. Total coverage of all obligations (including the common dividend) was 1.2x

Our base-case forecast for 2014 and 2015 incorporates the following assumptions:

- Same-property net operating income (NOI) grows 2.5% to 3.5% in 2014;
- Occupancy rises 50 to 75 basis points;
- We assume 2014 acquisitions of \$1 billion at a low-to-mid 6% cap rate and dispositions of \$800 million to \$1 billion at a 7.5% to 8.0% cap rate. For 2015 we assume acquisitions and dispositions are balanced, but modestly dilutive.
- Heightened redevelopment expenditures of \$100 million during 2014 and \$150 million during 2015;
- Company refinances \$350 million 5.29% senior notes with a similarly sized issuance at an estimated 4% coupon.

Based on these assumptions, we estimate 2014 and 2015 fixed-charge coverage will be in the 2.8x to 2.9x range, debt-to-EBITDA in the low-to-mid 6x area, and debt-to-undepreciated capital in the 46%-48% range. We also estimate total coverage (inclusive of common dividends) to remain sound at around 1.2x to 1.3x range. Inclusive of Kimco's pro rata share of JVs we estimate fixed-charge coverage remains in the high-2x area, debt-to-EBITDA rises to the mid-7x area, and debt-to-undepreciated capital is in the low-50% area.

## Liquidity

Kimco has "adequate" sources of liquidity to cover its needs over the next 12 to 24 months. We expect that the company's sources of liquidity will exceed its uses by 1.2x or more, the minimum threshold for an "adequate" designation under our criteria, and that the company will also meet our other criteria for such designation.

The company was in compliance with its bank and bond covenants as of June 30, 2014. Key senior unsecured note covenants include: debt-to-total assets of no more than 60.0% (actual was 41%) and total unencumbered assets to unsecured debt greater than 1.5x (was 2.5x).

Principal liquidity sources include:

- Cash and marketable securities totaling \$267 million at June 30, 2014.
- \$1.4 billion of availability under a \$1.75 billion global revolving credit facility, which can be increased to \$2.25 billion through an accordion feature, due March 2018); and
- Assumed funds from operations (FFO) will total about \$550-\$600 million.

Principal liquidity uses include:

- \$350 million of senior unsecured notes mature in 2015.
- We assume all secured debt is refinanced.
- We assume \$100 million to \$150 million of discretionary redevelopment investments.
- Capital expenditures associated with Kimco's operating properties of roughly \$60 million annually.
- Common and preferred dividends in the \$425 million to \$450 million range.

Additional potential sources of capital include access to secured debt, though we have not factored this into our liquidity assessment. Kimco's encumbrance level was fairly modest at roughly 12% secured debt to undepreciated real estate, and we believe the company has some flexibility to layer in additional secured debt without jeopardizing its current credit rating.

## Outlook

The stable outlook incorporates the benefits of Kimco's large, diverse core shopping center portfolio, with its manageable lease expirations, which should generate fairly stable cash flow. Further recovery in occupancy and rents, along with redevelopment opportunities, support our expectation for EBITDA growth and support stable-to-modestly improving leverage and coverage measures.

## Downside scenario

We currently do not expect to either raise or lower the ratings over the next year or two (the time horizon for our outlook). However, if the company's recent improvement in debt coverage were to reverse course--such that

fixed-charge coverage falls below 2.2x--we could revise the outlook or lower the ratings.

### Upside scenario

While we consider an upside scenario unlikely, we would raise the ratings if Kimco continues to successfully execute on its business strategies, which should result in a more competitively positioned retail portfolio and leverage and fixed-charge coverage metrics based on Standard & Poor's adjustments (including joint-venture leverage) improve to the mid-to-strong end of the "intermediate" financial risk profile ranges.

## Ratings Score Snapshot

Corporate credit rating: BBB+/Stable/--

Business risk: Strong

- Country risk: Very 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)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria And Research

### Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

### Ratings Affirmed

Kimco Realty Corp.

Corporate Credit Rating	BBB+/Stable/--
Senior Unsecured	BBB+
Preferred Securities	BBB-

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