April 2018

(High Yield) Bonds in the European Real Estate Sector – UPDATE

In February, we published an article on High Yield Bonds by German Real Estate Companies, in which we noted the increasing convergence / overlap between traditional real estate finance, leveraged finance and debt capital markets products, as exemplified by a small but increasing number of high yield bond offerings by German real estate companies. Before the Easter break, we published our latest Update on what can likely be classified as a growing trend of "corporate-style" bond offerings by European real estate companies.

During the same week, Globalworth Real Estate Investments Limited (Moody's: Ba1; Fitch: BBB-), a fully integrated Guernsey real estate company operating in the CEE region with a primary focus on Romania and Poland, established a €1.5 billion EMTN program and priced an offering of €550,000,000 3.0% Senior Notes due 2025 with an issue price of 99.225%, for a 3.125% yield. The net proceeds from the offering of the (unsecured) notes will be applied by Globalworth for its general corporate purposes.

Globalworth is listed on the AIM section of the London Stock Exchange and its subsidiary, GPRE (Globalworth Poland), is listed on the GPW Main Market of the Warsaw Stock Exchange. As a result, Globalworth was already subject to the requirements of the EU Transparency Directive and the EU Market Abuse Regulation, which may be why it has applied for the notes to be admitted to trading on the regulated market of both Euronext Dublin (formerly: Irish Stock Exchange) and the Bucharest Stock Exchange. As most European high yield issuers are private companies, European high yield bonds historically tended to be listed on unregulated / exchange-regulated markets within the European Union, such as the Global Exchange Market of Euronext Dublin or the Euro MTF of the Luxembourg Stock Exchange, which does not trigger a requirement to publish a prospectus under the EU Prospectus Regulation or any ongoing reporting obligations under the EU Transparency Directive. Following the entry into force of the EU Market Abuse Regulation on July 3, 2016, which also applies to bonds listed on exchange-regulated markets within the European Union, European debut high yield issuers tend to list their bonds on The International Stock Exchange (formerly: Channel Islands Securities Exchange) to avoid the resulting compliance burdens, and there have also been a number of related migrations of existing (i.e. pre-July 3, 2016) high yield bond listings.

However, in line with the "cross-over" rating of the issuer and the use of English law governed EMTN program documentation (which is typically used for investment-grade issuers), the Globalworth notes do not contain most traditional high yield covenants. There is a Eurobond-style negative pledge, instead of a high yield-style limitation on liens covenant. In addition, there is no limitation on indebtedness covenant, no limitation on restricted payments covenant, no limitation on asset sales covenant and no limitation on affiliate transactions covenant. On the other hand, a traditional high yield bond covenant package would normally provide that all such covenants be suspended once the notes are rated with an investment grade rating by two rating agencies. In the case of Globalworth, this would merely require a single upgrade by one notch by Moody's. The terms and conditions of the notes do include a prohibition on payments of dividends by the issuer if an event of default or potential event of default has occurred and is continuing at the time of, or would result following, the payment of such dividends. In addition, the lack of the traditional limitation on liens, limitation on indebtedness and limitation on restricted payments covenants is arguably more than compensated by the inclusion of three financial maintenance covenants that require the issuer to ensure that:

- its consolidated leverage ratio (total debt/total assets) will not exceed 0.60;
- its consolidated coverage ratio (adjusted EBITDA/interest expense) will be at least 1.5:1 on the first and second (semi-annual) measurement dates and at least 2.0:1 on each

subsequent measurement date; and

- its consolidated secured leverage ratio (total secured debt/ total assets) shall not exceed 0.30 on any measurement date.

The inclusion of these types of maintenance covenants used to be (and to some extent still is) common in certain leveraged credit facilities. However, in our opinion, financial maintenance covenants are not normally appropriate or helpful in the terms and conditions of broadly marketed bonds, for a variety of reasons. For those reasons, financial maintenance covenants are not normally included in the terms and conditions of investment-grade bonds and never in traditional high yield bonds, and high yield investors would not expect to find financial maintenance covenants in a traditional high yield bond covenant package. The inclusion of financial maintenance covenants in the terms and conditions of the Globalworth notes is mitigated (from the issuer's perspective) by the existence of a fairly generous equity cure provision in relation to the consolidated leverage ratio and consolidated secured leverage ratio tests.

Even though not a traditional high yield bond, the recent Globalworth notes are another example that, at least in the current market environment, access to the debt capital markets on very favourable terms is clearly not reserved for just the very large and highly rated real estate companies anymore. They are also a useful reminder that one size does not fit all, but that any prospective issuer considering a bond offering should carefully consider, together with its legal advisers and the prospective underwriting banks, the appropriate format and documentation for the proposed offering, taking into the account the specific circumstances of the issuer and the target market for the bonds.

For more information generally about high yield bonds, please click on the following link to obtain a PDF copy of the 4th European Edition of our High Yield Bonds – An Issuer's Guide. As with earlier editions, the Guide is primarily intended for (first-time) issuers of high yield bonds.

For further information or advice or to request a hard copy of the Guide, please contact Bernd Bohr or your usual contact at Mayer Brown.

Learn more about our High Yield Bonds, Capital Markets and Real Estate practices.

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Other recent articles on trends and developments in the European high yield bond markets that you may be interested in include:

High Yield Bonds by German Real Estate Companies – UPDATE March 2018

(High Yield) Bonds – A Growing Trend in the European Energy Sector? – UPDATE March 2018

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