

RESEARCH

Research Update:

Archstone-Smith Trust Ratings Remain On Watch Neg; \$5.1 Billion Credit Facility Rated 'BB-'

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Rationale

On Sept. 26, 2007, Standard & Poor's Ratings Services said that its ratings on Archstone-Smith Trust (Archstone) and its operating subsidiary, Archstone-Smith Operating Trust, remain on CreditWatch with negative implications, where they were placed May 30, 2007. The CreditWatch placements followed the company's announcement that it had entered into a definitive merger agreement to be acquired by a partnership sponsored by Tishman Speyer Real Estate Venture VII L.P. (not rated) and Lehman Bros. Holdings Inc. (A+/Stable/--), collectively "the partnership," for about \$23.3 billion. In addition, Standard & Poor's today assigned a 'BB-' rating with a recovery rating of '4' to Archstone-Smith Operating Trust's proposed \$5.1 billion secured credit facility, which includes a \$2.4 billion term loan A, a \$1.98 billion term loan B, and a \$750 million revolver. The rating is based on the current structure (see list).

Archstone announced that it had entered into a definitive merger agreement to be acquired on May 29, 2007. The partnership will acquire all of Archstone's outstanding common shares for \$60.75 per share in cash, which represents almost a 19% premium over the May 24, 2007, closing price (the date before the potential merger was announced). The company's rated senior unsecured notes (\$3 billion) are expected to be repaid at or shortly after closing, and we expect the rated preferred stock (\$50 million) to be converted into new private preferred shares of the surviving entity. Archstone's shareholders have approved the transaction, and it is expected to close by Oct. 5, 2007, subject to customary closing conditions.

If the transaction closes as proposed, Standard & Poor's anticipates lowering its corporate credit rating on Archstone Smith Operating Trust (the surviving entity and borrower) to 'BB-' from 'BBB+' and withdraw its rating on the existing rated securities once they are refinanced.

The prospective corporate downgrade to 'BB-' reflects the more aggressive financial profile that will result from this go-private transaction. The pro forma capital structure will be more highly leveraged and secured, and it will have debt protection measures that are weak for the prospective rating. Furthermore, development will play a greater role in the company's growth. The weaker financial profile will be partly offset by the good quality and above-average historical operating performance of Archstone's portfolio, as well as the fact that the Archstone management team is expected to remain in place to manage the platform.

The pro forma capital structure will employ leverage of approximately 76% (including preferred securities), based on the purchase price at an approximate 4% cap rate. Leverage exceeds 100% if a more conservative cap rate in the 7% area is assumed. We expect leverage to decline primarily through the term loan A's amortization requirements through maturity in 2011, as well as through an excess cash flow sweep that is expected to further repay the term debt. However, this cash flow is heavily reliant upon asset sales, which can be unpredictable. With that in mind, we expect the future environment for multifamily asset sales and pricing to be less robust than it is currently.

Pro forma, the roughly \$16 billion of debt post-closing will be primarily made up of \$10.7 billion of secured debt, which encumbers the entire Archstone portfolio; the proposed \$4.4 billion of rated secured term debt; and nearly \$1.3 billion of mezzanine financing. Debt service coverage, even after the benefit of a \$500 million interest reserve that is projected to cover an interest deficit through the first three years, is projected to be weak at 1.0x in 2008-2010. Furthermore, the 1.0x debt service coverage measure does not include development interest that is capitalized into development projects. Capitalized interest reflects a cash outlay and will be substantial based on projected growth of the development platform. Roughly 50% of the LIBOR-based term debt is expected to be fixed through hedges, and we expect fixed-rate debt to constitute 70%-80% of total debt.

The corporate credit, senior unsecured, and preferred stock ratings will remain on CreditWatch negative until the merger is completed. We did not place our rating on the \$575 million of 4% exchangeable senior notes on CreditWatch due to the change-of-control covenant that gives holders the option to put the bonds to the company upon a change of control in exchange for 100% of principal and unpaid interest. We expect the \$3 billion of rated senior unsecured notes to be repaid at or shortly after the close of the merger. The \$50 million of rated preferred stock, as currently contemplated, will remain outstanding; however, the securities will be exchanged for a private, unrated preferred security.

Recovery analysis

We have assigned our 'BB-' rating to the \$5.1 billion secured term facility, which includes a \$2.4 billion term loan A due 2011, a \$1.981 billion term loan B due 2012, and a \$750 million revolver due 2011. We have assigned a recovery rating of '4' to the facility, indicating our expectation for an average (30%-50%) recovery in the event of a payment default. (For the complete recovery analysis, see Standard & Poor's recovery report on Archstone-Smith Operating Trust's secured financing, to be published on RatingsDirect following the release of this article.)

Ratings List

Ratings Assigned

Archstone-Smith Operating Trust

	Rating
Secured credit facility	BB- (Recovery rtg: 4)

Ratings Remaining On CreditWatch Negative

Archstone-Smith Trust/Archstone-Smith Operating Trust

	Rating
Corporate credit	BBB+/Watch Neg/--
Senior unsecured	BBB+/Watch Neg
Preferred stock	BBB/Watch Neg

Other Outstanding Rating

Archstone-Smith Operating Trust

Exchangeable senior notes	BBB+
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