

Fitch Downgrades Mack-Cali's IDR to 'BBB-'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings has downgraded the ratings of Mack-Cali Realty Corporation (NYSE: CLI) and its operating partnership, Mack-Cali Realty, L.P. (collectively, Mack-Cali) as follows:

Mack-Cali Realty Corporation

--Issuer Default Rating (IDR) to 'BBB-' from 'BBB'.

Mack-Cali Realty, L.P.

--IDR to 'BBB-' from 'BBB';

--Unsecured revolving credit facility to 'BBB-' from 'BBB';

--Senior unsecured notes to 'BBB-' from 'BBB'.

The Rating Outlook is Stable.

KEY RATINGS DRIVERS

The downgrade reflects the change in Mack-Cali's capitalization to levels consistent with a 'BBB-' rating. Persistent weak operating fundamentals and dilutive capital recycling into lower-yielding multifamily acquisitions have caused leverage to increase to a level more consistent with a 'BBB-' IDR. Share price weakness and strong liquidity have reduced the likelihood of CLI issuing equity to reduce leverage, in Fitch's view.

LEVERAGE CONSISTENT WITH 'BBB-'

Mack-Cali's expansion into multifamily is in large part a recognition of the challenging long-term growth potential for suburban office. However, the company has been unable to make the transition while maintaining metrics appropriate for the 'BBB' rating.

Mack-Cali's leverage was 6.0x and 6.5x for the year and quarter ended Dec. 31, 2013 as compared to the 4.5x to 5.5x range that it operated between since 2006. Fitch anticipates leverage will increase above 7.0x through 2016 due principally to continued declines in same store net operating income (SSNOI) and development expenditures. Fitch defines leverage as net debt to recurring operating EBITDA including cash distributions from joint venture operations.

Similarly, fixed charge coverage declined to 2.0x for 2013 compared with 2.3x - 2.5x from 2007 to 2012. Fitch expects fixed charge coverage will remain at or below 2.0x through 2016. Fitch defines fixed charge coverage as recurring operating EBITDA less straight line rent and maintenance capital expenditures divided by interest.

NEAR-TERM EQUITY ISSUANCE UNLIKELY

Throughout its history, Mack-Cali proactively kept metrics at levels appropriate for its ratings despite challenging operating fundamentals through two equity raises (2009 and 2011) and two dividend reductions, which Fitch viewed favorably. However, Fitch believes management endeavors to balance past creditor-friendly actions with its responsibilities to all constituents (notably shareholders), thus the probability of a material equity issuance to reduce leverage is low for the foreseeable future absent a narrowing in the equity's discount to net asset value.

PERSISTENT, WEAK OPERATING FUNDAMENTALS

Meaningful portfolio indicators reflect the continued challenging operating environment for suburban office properties in the greater New York metro area driven by limited job growth, corporate right-sizing of real estate foot prints and the reduction of core industries in New Jersey such as pharmaceuticals and telecommunications. Since 2009, Mack-Cali has experienced SSNOI declines of -2% to -7% due to negative leasing spreads, increasing leasing costs, shortening terms and lost occupancy (to 86.1% from 92.7% at Dec. 31, 2007). Fitch expects SSNOI declines will persist through 2016 driven by continued negative rent roll downs, 60-70% tenant renewals and new leasing volume that will be insufficient to offset lost occupancy.

WEAKENED CONTINGENT LIQUIDITY

Fitch estimates that the contingent liquidity provided by Mack-Cali's unencumbered assets has declined from approximately 2.5x at 4Q12 to approximately 1.9x at 4Q13. The decline is attributable to both the effects of declining SSNOI for the unencumbered assets and the investments in off-balance sheet joint ventures whose income is excluded from the calculation. Liquidity coverage below 2.0x is generally consistent with non-investment grade ratings. Fitch calculates unencumbered asset coverage as estimated unencumbered NOI divided by a stressed 9% capitalization rate over net unsecured debt.

STRONG LIQUIDITY REDUCES LIKELIHOOD OF CAPITAL OFFERINGS

Mack-Cali's liquidity is strong for the rating (1.3x) driven by limited debt maturities through 2016, developments that can be funded via in-place construction financing and acquisitions that benefit from the liquid multifamily secured debt market. However, this credit positive affords CLI the time to potentially proceed without consideration for the effects on the price at which it could issue equity or unsecured debt obligations. This dynamic is, in part, why Fitch has placed a lower probability on an equity issuance and expects metrics to be commensurate with the 'BBB-' rating through 2016.

Fitch calculates liquidity coverage as sources (unrestricted cash, availability under the line of credit and undrawn committed construction financings) over uses (pro rata debt maturities, committed development expenditures and maintenance capital expenditures) In July 2013, Mack-Cali extended its line of credit to 2017 and holds two six-month extension options.

Mack-Cali could further enhance its liquidity via retained cash flow from operations should it reduce its dividend again in 2014. Fitch estimates Mack-Cali's dividends comprised 86.3% of adjusted funds from operations (AFFO), down from 101.6% in 2012, however continued SSNOI declines may push the payout ratio towards 100% before a reduction.

STABLE RATING OUTLOOK

The Stable Outlook reflects Fitch's expectation that Mack-Cali's metrics will remain appropriate for the 'BBB-' rating over the next 12-to-24 months. However, Fitch notes the ratings have limited tolerance for leverage sustaining above 7.5x.

Although Fitch does not anticipate positive ratings momentum in the near to medium term, the following factors may have a positive impact on the ratings and/or Outlook:

--Fitch's expectation of leverage sustaining below 6.0x - 6.5x (increasing toward 6.5x as contributions from the multifamily portfolio grow; leverage was 6.0x and 6.5x for the year and quarter ended Dec. 31, 2013, respectively);

--Fitch's expectation of fixed charge coverage sustaining above 2.0x (coverage was 2.0x for 2013);

The following factors may result in negative momentum on the ratings and/or Outlook:

--Fitch's expectation of leverage sustaining above 7.0x - 7.5x (increasing toward 7.5x as contributions from the multifamily portfolio grow);

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--Fitch's expectation of fixed charge coverage sustaining below 1.5x;

--A sustained liquidity shortfall.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Rating U.S. Equity REITs and REOCs: Sector Credit Factors,' Feb. 26, 2014;

--'Recovery Rating and Notching Criteria for Equity REITs,' Nov. 19, 2013;

--'Corporate Rating Methodology,' Aug. 5, 2013.

Applicable Criteria and Related Research:

Rating U.S. Equity REITs and REOCs (Sector Credit Factors)

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=737957

Recovery Rating and Notching Criteria for Equity REITs - Effective May 12, 2011 to May 3, 2012

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=628490

Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715139

Additional Disclosure

Solicitation Status

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