FITCH UPGRADE'S STAG INDUSTRIAL, INC.'S IDR TO 'BBB'; OUTLOOK STABLE

Fitch Ratings-New York-04 May 2015: Fitch Ratings has upgraded the credit ratings for STAG Industrial, Inc. (NYSE: STAG) and its operating partnership, STAG Industrial Operating Partnership, L.P., (collectively 'STAG' or 'the company') as follows:

STAG Industrial, Inc.
--Issuer Default Rating (IDR) to 'BBB' from 'BBB-';
--Preferred stock to 'BB+' from 'BB'.

STAG Industrial Operating Partnership, L.P.
--IDR to 'BBB' from 'BBB-';
--Senior unsecured revolving credit facility to 'BBB' from 'BBB-';
--Senior unsecured term loans to 'BBB' from 'BBB-';
--Senior unsecured notes to 'BBB' from 'BBB-'.

The Rating Outlook has been revised to Stable from Positive.

KEY RATING DRIVERS

The upgrade reflects STAG's credit strengths, which include strong leverage and fixed charge coverage metrics for the rating, excellent liquidity, a sizable unencumbered asset pool and improving access to unsecured debt capital. Fitch expects STAG to operate through the cycle with metrics that are appropriate for the 'BBB' rating, including leverage sustaining in the low-to-mid 5.0x range and fixed charge coverage in the mid-to-high 3.0x range.

The company's portfolio concentration in secondary industrial markets - a byproduct of its relative value acquisition led growth strategy - and Fitch's expectation for modest near-to-medium term decreases in same-store net operating income (SSNOI) balance these credit positives.

Although Fitch continues to project modest single digit SSNOI declines in the near-to-medium term, we consider the company's relative underperformance to its peers on this metric to be a function of its single-tenant acquisition strategy (and the related binary nature of its property level cash flows at lease expiration) that should dissipate as the company grows, rather than an indication of concerning asset quality. Our recent property visits, the company's positive leasing spreads since 2011, STAG's strong tenant retention and its SSNOI performance by acquisition vintage year support Fitch's view. Fitch previously identified stabilization and improvement in STAG's SSNOI growth as an important sensitivity for positive rating momentum.

Strategy, Growth Pressuring SSNOI

Fitch expects STAG's SSNOI will decline at a low single digit rate through 2017 as occupancy losses should offset solidly positive leasing spreads. STAG's emphasis on acquiring 100% occupied single-tenant industrial buildings is the principal driver for its recent same-store NOI declines. As the company grows larger and its acquisitions season, the law of large numbers essentially pulls STAG's portfolio occupancy rate closer to market (roughly 93% to 95%). Fitch expects the company's SSNOI performance to be uneven, and generally negative, until the company grows to a size where a majority of its portfolio has seasoned, which typically occurs after five years of ownership. However, STAG is generally compensated for this occupancy loss through higher going-in yields for acquisitions.

STAG's cash same-store NOI declined by 2.3% during 2014, with the quarterly cadence including year-over-year decreases of 4.9% in the first quarter of 2014 (1Q'14), 1.2% in 2Q'14, 0.6% in 3Q'14 and 1.5% in 4Q'14. The company's annualized same store NOI change has been negative since 2Q'13. Positively, STAG retained 71.7% of its expiring leased square footage in 4Q'14, resulting in an annual tenant retention rate of 69.7%.

Low Leverage

Fitch's projections anticipate that the company will sustain leverage of approximately 5.0x during the next three years on an annualized basis that includes a full-year's impact of earnings from projected acquisitions. STAG's leverage was 4.7x based on an annualized run rate of STAG's recurring operating EBITDA for the quarter ending Dec. 31, 2014, which is strong for the 'BBB' rating. This compares with 4.9x on an annualized basis for the quarter ending Dec. 31, 2013 and 5.9x for the quarter ending Dec. 31, 2012. Adjusting 4Q'14 earnings for the impact of partial period acquisitions would reduce STAG's leverage to 4.5x.

Improving Capital Access

STAG's issuances of senior unsecured notes in July 2014, December 2014 and February 2015 have been important milestones in the company's transition to a predominantly unsecured borrowing strategy, evidencing broader access to unsecured debt capital. The company also completed a $600 million refinancing of its unsecured revolving credit facility and term loans in December 2014. Prior to the company's inaugural private unsecured notes placement, STAG's unsecured borrowings were limited to three bank term loans, as well as drawdowns under the company's unsecured revolver. However, STAG's unsecured debt capital access remains somewhat less established pending an inaugural public unsecured bond offering and further private placement issuance.

Strong Fixed-Charge Coverage

Fitch expects the company's fixed charge coverage to sustain in the high 3.0x's through 2017. The low interest rate environment and higher capitalization rates for properties in secondary markets should allow STAG to continue deploying capital on a strong spread investing basis. STAG's fixed charge coverage was 3.3x for the year-ended Dec. 31, 2014 and 3.3x and 2.8x for the years ending Dec. 31, 2013 and 2012, respectively.

Excellent Liquidity

STAG completed a $600 million refinancing of its unsecured bank debt in December 2014. The refinancing reduced the company's cost of fully committed unsecured bank debt to Libor + 1.41% from Libor + 1.66% and increased the weighted average term to 5.9 years from 3.8 years. STAG also replaced its $200 million unsecured revolving credit facility with a new $300 million revolver that has a lower cost and extends the maturity by three years to December 2019 through the refinancing. The company has minimal debt maturities over the next several years, providing full capacity to utilize the line for debt repayment, acquisitions and general corporate purposes.

STAG's unencumbered assets, defined as unencumbered NOI (as calculated in accordance with the company's unsecured loan agreements) divided by a stressed capitalization rate of 10%, covered its unsecured debt by 2.7 x in 4Q'14, which is strong for the 'BBB' rating. The company's substantial unencumbered asset pool is a source of contingent liquidity that enhances STAG's credit profile.

Straightforward Business Model

STAG has not made investments in ground-up development or unconsolidated joint venture partnerships. The absence of these items helps simplify the company's business model, improve financial reporting transparency and reduce potential contingent liquidity claims, which Fitch views positively.

While the company may selectively pursue the acquisition of completed build-to-suit (BTS) development projects in the future, Fitch anticipates only a moderate amount of such activity by STAG on an ongoing basis. Fitch views the acquisition of completed BTS projects developed by third parties as less risky than the speculative development undertaken by some of STAG's industrial REIT peers.

Secondary Market Locations

STAG's growth strategy centers on the acquisition of single tenant industrial properties (warehouse/ distribution and manufacturing assets). Its emphasis on relative value has predominantly led the company to acquire properties in secondary markets throughout the United States by sourcing third party purchases and structured sale-leasebacks. Such transactions typically range in price from $5 million to $50 million and have higher going-in yields, stronger internal rates of return, and less competition from institutional buyers.

As of Dec. 31, 2014, the company's portfolio was primarily in secondary markets (64.5% of annualized base revenue), followed by primary markets (20.0%) and tertiary markets (15.5%). STAG defines primary markets as the 29 largest industrial metropolitan areas, which each have approximately 200 million or more in net rentable square footage. It defines secondary industrial markets as the markets which each have net rentable square footage ranging from approximately 25 million to approximately 200 million and tertiary markets as markets with less than 25 million square feet of net rentable square footage.

The company has only minimal exposure to what market participants general consider 'core' U.S. industrial and logistics markets, which include Chicago, Los Angeles/Inland Empire, Dallas - Fort Worth, Atlanta and New York/Northern New Jersey. Fitch views this as a credit negative, all else equal, given superior liquidity characteristics for industrial assets in 'core' markets - both in terms of financing capacity and transaction volumes.

Differentiated Strategy within Fragmented Market

STAG's current market share of its target markets is less than 1% of the $250 billion single-tenant industrial market in secondary markets, providing growth opportunities in the company's target asset class. The company's management team focuses on the binary nature of the cash flow of individual, single-tenant, industrial properties and the opportunity for cash flow growth across markets, industries, segments and property sizes. This differentiated business model is thoughtful in its considerations of leasing, asset management, credit and capital market funding, which Fitch views favorably.

Preferred Stock Notching

The two-notch differential between STAG's IDR and preferred stock rating is consistent with Fitch's criteria for a U.S. REIT with an IDR of 'BBB'. 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.

KEY ASSUMPTIONS

Fitch's base case rating assumptions for STAG include the following:
--Same-store NOI declines within a range of 1-2% in 2015, 2016 and 2017;
--Acquisitions of $400 million, $550 million and $700 million in 2015, 2016 and 2017, respectively at cap rates of 8%;
--Dispositions of $50 million per year through 2017 at 10% cap rates;
--STAG funds its near-to-medium term external growth with roughly 60% equity and 40% debt financing;
--AFFO payout ratio around 95%-100%.

RATING SENSITIVITIES

Although positive rating momentum is unlikely in the near-to-medium term, the following factors may have a positive impact on STAG's ratings:

--Leverage calculated on an annualized basis adjusted for acquisitions sustaining below 4.5x (leverage was 4.5x as of Dec. 31, 2014 after giving effect to partial period acquisitions);
--Further development of STAG's unsecured debt capital access;
--Fixed charge coverage to sustaining above 4.0x (coverage was 3.3x as of Dec. 31, 2014).

The following factors may have a negative impact on the company's ratings and/or Outlook:

--Indications that STAG's property portfolio is not competing effectively within its markets, which could include below market leasing velocity and rent growth and weak SSNOI growth for seasoned acquisitions;
--Fitch's expectation for leverage sustaining above 5.5x;
--Fixed charge coverage sustaining below 3.0x;
--Unencumbered assets to net unsecured debt of below 2.5x;

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Applicable Criteria and Related Research:
--STAG Industrial, Inc. Rating Navigator' (Feb. 26, 2015);
--'Treatment and Notching of Hybrids in Nonfinancial Corporate and REIT Credit Analysis' (Nov. 25, 2014);
--'Recovery Ratings and Notching Criteria for Equity REITs' (Nov. 18, 2014);
--'Corporate Rating Methodology: Including Short-Term Ratings and Parent and Subsidiary Linkage' (May 28, 2014).

Applicable Criteria and Related Research:
STAG Industrial, Inc. - Ratings Navigator
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=862104
Treatment and Notching of Hybrids in Non-Financial Corporate and REIT Credit Analysis
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=821568
Recovery Ratings and Notching Criteria for Equity REITs
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Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
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