

CREDIT RATING ANNOUNCEMENT

GCR affirms Vukile Property Fund Limited's rating of AA_(ZA), Stable Outlook on strong operating performance

Rating action

Johannesburg, 14 July 2023 – GCR Ratings (GCR) has affirmed the national scale long and short-term issuer ratings of Vukile Property Fund Limited (Vukile or the REIT) at AA_(ZA) and A1+_(ZA), respectively. The Outlook is Stable.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Vukile Property Fund Limited	Long Term Issuer	National	AA _(ZA)	Stable Outlook
	Short Term Issuer	National	A1+ _(ZA)	

Rating rationale

The affirmation of Vukile's rating reflects its robust property performance metrics in both its South African and Spanish portfolios. While gearing metrics remain moderately high, the rating takes cognisance of the diverse funding structure and strong liquidity for a REIT.

Vukile's geographically diversified Spanish and South African retail portfolio of c.ZAR36 billion at 31 March 2023 (financial 2023) focuses on non-metropolitan, convenience-oriented shopping centres and retail parks, that are primarily anchored by grocery or essential services tenants. Corporate activity over the past 18 months has focussed on strengthening its current investments and market position. During financial 2023, Castellana Properties SOCIMI SA (Castellana) increased its shareholding in listed Lar Espana Real Estate SOCIMI, S.A. (Lar Espana) to 25.7%, from 21.7%, whilst post year-end Vukile raised its stake in Castellana to 99.5% by exercising its MEREV call option.

To ensure that its properties outperform the market, the REIT has focussed on enhancing the customer experience and collecting data so that it can position its centres to attract increased footfall and higher spend by customers. The success of these initiatives has translated into robust property performance metrics across the portfolio. The overall vacancy rate in South Africa fell to just 2% of GLA at financial 2023 (financial 2022: 2.6%), whilst trading densities increased by 6.2%. As a result tenant retention has been high at 93%, and rent reversions have turned positive across the portfolio. Castellana reported a similarly low vacancy rate of 1.3% (financial 2022: 1.6%), whilst normalised net operating income growth rose 9.0%, driven by record footfalls toward the end of the year and overall sales growth of 18% in its centres. Due to the combination of low vacancies, positive rental reversions and inflation linked rental increases in Spain, GCR expects rental growth of around 6.0% growing forward. Whilst inflationary pressures continue to raise property and administration expenditure, Vukile's focus on solar power and other green initiatives should help contain costs somewhat and protect the overall operating margin at around 65%.

Vukile's gearing profile remains moderately high. While gross debt increased to ZAR17 billion in financial 2023 (financial 2022: ZAR15 billion) much of this related to the translation effect of the weaker rand. As a result, GCR's calculated net LTV ratio remained relatively stable at 42.1%, and is projected to trend within the 40%-45% level over the medium-term. The interest coverage ratio, however, fell to 2.8x (financial 2022: 3.1x), due to higher interest rates. GCR expects more pressure on interest coverage over the next 12 months, but the ratio should remain well above the covenant level of 2x. Demonstrating its strong access to funding, Vukile's unsecured bond issuance in financial 2023 was oversubscribed, whilst

ZAR700 million in new equity was raised in May 2023, despite the general negative market sentiment. Funding is underpinned by facilities from a wide range of South African and European banks, with most facilities maturing in the medium to long term. ZAR1 billion/6% in debt is due in financial 2024 and ZAR2 billion/12% maturing in financial 2025. We do note a large concentration of ZAR5.7 billion (EUR292 million) in Spanish debt maturing in financial 2026, but expect proactive refinancing well ahead of time. Foreign exchange risk is considered low as debt in each jurisdiction is secured by the in-country assets and is serviced from the cashflows thereof.

Vukile demonstrates strong liquidity for a REIT, with GCR's liquidity coverage ratio of nearly 2.0x over 12 months. This is underpinned by cash holdings of ZAR1.3 billion and committed undrawn facilities of ZAR1.7 billion, as well as unencumbered listed equity. Near term debt maturities are minimal, whilst general capex spend is expected to be fairly low at around ZAR500 million in financial 2024 and 2025, and the ZAR400 million acquisition cost for a new centre in South Africa is fully funded. Although the dividend distribution will likely grow to ZAR1.3 billion in financial 2024, Vukile's strategy is to retain the maximum amount of operating profit without incurring tax.

Outlook statement

The Stable outlook reflects GCR's opinion that Vukile's operational performance and steady cash flow growth will benefit from the continued focus on sustaining strong portfolio metrics. Similarly gearing metrics are likely to remain around current levels, with rising earnings helping to partly offset the impact of higher interest rates.

Rating triggers

Factors that could lead to an upgrade include 1) if the REIT continues to boost its geographic diversification outside of South Africa; 2) sustained strong operating profile, with higher investment granularity, leading to earnings and cash flow growth ahead of its peers 3) strengthening in key gearing metrics.

Conversely, GCR could take negative rating action if 1) the LTV trends above 45% on a sustained basis; 2) net interest dips below 2.5x for a sustained period; 3) portfolio operating metrics and cash flows weaken; 4) and if any liquidity challenges are evidenced, such as a delay in refinancing large maturities.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, Jan 2022
GCR Rating Scales Symbols and Definitions, May 2023
Criteria for Rating Real Estate Investment Trusts and Other Commercial Property Companies, Jan 2022
GCR Country Risk Score report, May 2023
GCR SA Corporate Sector Risk Score report, March 2023
GCR Commercial Property Sector Risk Score report, June 2023

Ratings history

Vukile Property Fund Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term Issuer	Initial	National	A _(ZA)	Stable Outlook	February 2012
Short Term Issuer		National	A1 _(ZA)		
Long Term Issuer	Last	National	AA _(ZA)	Stable Outlook	July 2022
Short Term Issuer		National	A1+ _(ZA)		

Risk score summary

Rating Components & Factors

	Score
Operating environment	15.75
Country risk score	8.75
Sector risk score	7.00
Business profile	1.75
Portfolio quality	1.75
Management and governance	0.00
Financial profile	(1.00)
Leverage & capital structure	(1.00)
Liquidity	0.00
Comparative profile	0.00
Group support	0.00
Peer analysis	0.00
Total Risk Score	16.50

Glossary

Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Bond	A long-term debt instrument issued by either a company, institution or the government to raise funds.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
REIT	Real Estate Investment Trust. A company that owns, operates or finances income-producing real estate.
Rent	Payment from a lessee to the lessor for the temporary use of an asset.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.

Weighted Average	An average resulting from the multiplication of each component by a factor reflecting its importance or, relative size to a pool of assets or liabilities.
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Salient points of accorded rating

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

The rated entity participated in the rating process via face-to-face management meetings, as well as other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from the rated entity and other reliable third parties to accord the credit ratings included:

- The audited annual financial statements to 31 March 2023 (plus four years of audited comparative numbers)
- A breakdown of utilised and available debt facilities at 31 March 2023
- Covenant compliance certificates
- Analyst Presentations, SENS announcements and roadshows
- Property portfolio breakdown at February 2023

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