GCR RATINGS

Public Credit Rating Report | South African Corporate | November 2021

Investec Property Fund Limited

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

Rating Strengths

- Strong geographic diversification into highly developed territories
- Exposure to the high growth potential European logistics sector
- Good access to capital and strong treasury management

Rating Weaknesses

- High gearing on a look-through basis
- Weak local property fundamentals

Rating Rationale

The ratings reflect Investec Property Fund's ("IPF" or "the REIT") geographically diverse earnings base, with its exposure to the more stable, highly developed European region assuaging any weaknesses in its South African portfolio. The financial profile is still constrained by the high look through gearing due to the highly leveraged European business, albeit note is taken that the offshore debt is ringfenced and there is no recourse to local assets.

IPF's portfolio was written down by an aggregate R899m during the year and together with the disposal of certain properties, this saw the value of investment properties decline to R15.2bn (FY20: R16.0bn like for like). In particular, the REIT sold its minority interests in the UK, Australia and Pan-European Light Industrial investments, remaining with a 65% shareholding of its Pan European Logistics ("PEL") platform, which made up 44% of the group's consolidated balance sheet at FY21, with the remainder located in South Africa. GCR is cognisant of IPF exploring the potential introduction of additional capital partners in the PEL platform to facilitate growth and simplify the shareholding structure. Although this may result in dilution of the group's interest, it is envisaged that the value of their offshore investment will not be reduced as the European portfolio is going to be scaled up over the medium term.

The vacancy rate in SA shot up to 11.4%, in contrast to the offshore portfolio which recorded a 4.3% vacancy (FY20: 3.5% and 5.0% respectively). However, recent successful letting activity in the local market has put the group on track to achieve reduced vacancy levels by year end. Furthermore, the weighted average lease expiry has improved to 3.2 years from 2.7 years at FY20. Although prospects in SA are improving with the increased pace of vaccination rollouts and the easing of restrictions, the REIT's exposure to the oversupplied office sector and some entertainment focussed retail is still considered a constraint on the portfolio quality assessment, albeit it is somewhat mitigated by the robust performance of the offshore portfolio.

The proceeds from the abovementioned sales of offshore business units were utilised to reduce ZAR denominated debt and bring the reported LTV down to 38% at FY21 (FY20: 47.5%). Nevertheless, funding for the PEL platform is managed at much higher LTVs relative to the local portfolio, with a target LTV ratio in the 50%-60% range, relative to the 30%-35% range applicable in the local market. Although the Euro denominated debt has no recourse to the SA portfolio, GCR assesses IPF's leverage on a look through basis. The look through LTV ratio moderated to 53% and may reduce further should the potential reduction of IPF's stake in the PEL platform materialise. However, given the strategic intention to scale up the European business over time, this measure is expected to fluctuate in the 45% to 55% range over the medium term, thereby constraining the rating analysis.

Liquidity coverage is deemed to be adequate with GCR calculating a 12-month uses versus sources ratio in the range of 1.2x to 1.7x. This is backed by R2bn in available and unutilised facilities and IPF's track record of being able to refinance upcoming debt maturities in advance, thereby minimising the burden of debt redemptions. Furthermore, the REIT has minimal committed capital expenditure over the coming year, while it has some non-core assets that are available for disposal, which GCR stressed for consideration in its liquidity analysis.

Outlook Statement

The Stable outlook reflects our expectation that IPF will continue to benefit from the high-quality earnings generated by its offshore investment, while reporting a stable performance on the local front. Some volatility may be observed in the credit metrics considering a potential introduction of additional capital partners in the PEL platform, however, the outlook factors in high gearing on a look through basis.

Rating Triggers

An upgrade would depend on IPF's ability to notably improve leverage metrics on a look through basis. Improved profitability, evidenced by core net property income growth, particularly for the South African portfolio will also be positive for the ratings.

Negative rating action could arise if 1) debt increases or there are further write downs of property values such that the look through LTV rises above 55%; 2) liquidity coverage reduces or there is a perceived weakening in treasury management; or 3) unexpected underperformance of the Pan European Logistics portfolio that negatively affects cash flows.

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Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Real Estate Investment Trusts and Other Commercial Property Companies, May 2019
GCR's Country Risk Score report, October 2021
GCR Rating Scales Symbols and Definitions, May 2019
GCR's South African Corporate Sector Risk Score report, April 2021
GCR's Commercial Property Sector Risk Score report, July 2021

Ratings History

Investec Property Fund Limited					
Rating class	Review	Rating scale	Rating class	Outlook	Date
Long Term Issuer	Initial	National	BBB+(ZA)	Stable	November 2011
Short Term Issuer		National	A2(ZA)		
Long Term Issuer	Last	National	AA-(ZA)	Stable	December 2020
Short Term Issuer		National	A1+(ZA)		

Analytical Entity: Investec Property Fund Limited

Investec Property Fund Limited ("IPF", or "the REIT") was listed on the JSE in April 2011 and granted REIT status in FY14. IPF's property portfolio comprises a diverse mix of retail, office, industrial and logistics assets in South Africa, as well as a logistics focussed European portfolio. Local properties are managed and operated by Investec Property (Pty) Limited, which is 100% owned by Investec, while its offshore portfolio is managed by Urban Real Estate Partners Limited, a 100% subsidiary of the local property manager. IPF was the first South African REIT to issue sustainability-linked bonds, as part of its focus on strengthening ESG initiatives.

Operating Environment

IPF's operating risk is materially improved by the investment into logistics properties in highly developed European countries

Country risk

IPF is a South African domiciled Real Estate Investment Trust, with 56% of its proportionally consolidated balance sheet exposed to the local market which has a country risk score of '7.0'. The SA country risk score reflects the challenges facing the economy, including lower GDP per capita, worsening fiscal position, as well as rising unemployment and social inequality which all contribute to a broadly negative outlay on future prospects. The assessment is somewhat supported by fairly stable institutional scores based on the World Bank Governance Indicators & World Economic Forum Global Competitiveness Index, which are in the middle of the range, but better then regional peers. As with many global countries, South Africa implemented various financial stimulus and support packages to soften the devastating impact of the pandemic to the worst affected areas. Some of these relief measures have been extended into 2021 and are likely to place added stress to the fiscus. Government debt is fast approaching unsustainable levels, with debt to GDP forecast above 80% over the next two years.

Weaknesses in the South African portfolio are mitigated by the REIT's substantial exposure to the more stable, highly developed European region, which makes up the remaining 44% of the consolidated balance sheet. IPF's offshore investment consists of a 65% shareholding in the Pan-European Logistics ("PEL") platform, with 80% of its assets across Germany, France, Netherlands and Belgium, among other developed European countries. The PEL platform is primed for growth, given the prevailing low supply of logistics properties relative to strong demand, further increased by the shift to e-commerce which was accelerated by the pandemic. The strong fundamentals of the European territories where IPF has an exposure provide material benefit to the overall country risk score of '10.0' calculated for IPF.

Details of the discrete country risk scores are outlined in GCR's Country Risk Score report published in October 2021, available for download at https://gcrratings.com/risk-scores/.

Sector risk

Similar to the determination of the blended country risk score, the sector risk score for IPF blends the dynamics of the South African property sector, with the benefit of having offshore exposure through investment into the PEL platform. In SA, the property sector has stagnated somewhat, reporting rising vacancies and lower rental reversions, placing pressure on asset valuations. In the listed property space, much lower share prices (well below reported NAV) due to depressed equity markets, as well as repricing on the debt capital market led to a deterioration in access to capital, which was exacerbated by the onset of COVID-19. Assumptions regarding the stability of income were challenged as many tenants withheld rentals due to them not being able to trade, which required some property owners to withhold distributions to investors.

Conversely, the pandemic has accelerated structural changes in the European property market, particularly in logistics, which continues to evidence strong demand. Growth in the sector is expected to remain robust as e-commerce trends in the region remain unrelenting, whilst supply levels are limited. The offshore property sector is expected to benefit from investors' need to generate sound returns with (inter alia) permitted real estate exposures to segments with strong or resilient quality and performance expectations at a time of low interest rates.

Details of the GCR Commercial Property Sector Risk Score reports are available for download at https://gcrratings.com/risk-scores/.

Business Profile

Portfolio quality

The diversified portfolio suffered fair value write downs and rising vacancy rates in the South African market, mitigated by the robust performance of the streamlined offshore portfolio

IPF's gross property portfolio was reported at R15.2bn at FY21 (FY20: R16.0bn on a like for like basis), following the disposal of 12 properties valued at R1.1bn and fair value write downs which accumulated to R899m (5% of portfolio). The fair value adjustments were driven by a reduction in net property income due to negative reversions incurred, albeit this came with the positive trade off of an improved weighted average lease expiry. All the properties in the portfolio were externally valued over the last 18 months and as such, valuations are considered to be reflective of fair market values. GCR will therefore view any further write downs in a negative light. The REIT maintains a 35% equity interest in Izandla, a local empowerment fund, valued at R272m, and has also advanced mezzanine facilities for the fund's benefit. Furthermore, IPF reported R167m worth of assets held for sale at FY21, with only one (R28m) sale that was still pending at the time of this publication.

Figure 1: SA portfolio sectoral diversification (%)

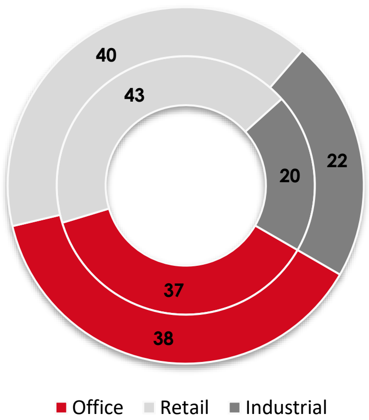
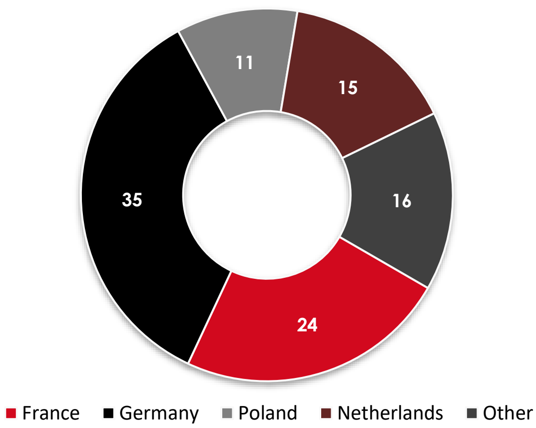


Figure 2: PEL platform geographic diversification (%)



In addition to the SA asset portfolio, IPF has a significant offshore investment, which comprises 44% of the proportionally consolidated balance sheet, but is equity accounted in the group's financial statements. During FY21, IPF disposed of its minority interests in Australia, the United Kingdom and Pan-European Light portfolios, remaining with only the PEL investment. The platform is co-owned by IPF through a joint venture and the portfolio of logistics and warehouse properties was valued at €1.06bn at FY21. The European logistics sector is characterised by robust demand and insufficient supply, which is expected to drive growth in the market. As such, further investments into the PEL platform are expected over the medium term, with a target to grow the portfolio to approximately €2.0bn. In order to access funding for the expected growth, IPF is exploring the possibility of enlisting a third-party capital investor and potentially diluting its ownership share of the PEL platform. This will have the benefit of a simplified capital structure and will leave IPF's offshore investment unchanged should it materialise.

The SA portfolio's overall negative performance echoes the challenges imposed by the COVID-19 pandemic and associated lockdown restrictions, resulting in a 21% drop in net property income, partly impacted by rental discounts of R62m granted to tenants. In addition, the vacancy rate shot up to 11.4% from 3.5% previously, led by industrial vacancies of 17%, while retail was the best performing segment with a 4% vacancy (FY20: 3% and 1% respectively). Letting activity has shown some positive signs since the close of the year, with 86% of 1H FY22 lease expiries being successfully renewed, enabling the weighted average lease expiry to be pushed out to 4.0 years. Nevertheless, this came at the expense of negative reversions of c.9.0% (FY21: 17.7%), reflective of the challenging environment. Furthermore, the vacancy rate has come down to single digits and this is expected to contribute to income growth in the range of 9%-11% for the interim period.

Table 1: Key Portfolio Metrics at FY21

	SA Portfolio	PEL Portfolio
No. of properties	90	47
Asset value (R'm)	15 227.3	6 553.8^
Base NPI growth (%)	(21.2)	(5.9)
Cost to income (%)	24.5	6.7
Total GLA (m^2)	1 081 114	1 134 429
Vacancy (%)	11.4	4.3
WALE (years)	3.2	5.0

^ Rand value of the PEL investment.
Source: Investec Property Fund 2021 Integrated Report.

The offshore logistics assets demonstrated resilience with minimal disruption from global lockdowns and positive letting activity. The shortage in supply of logistics and warehousing space is reflected in the low vacancy rate of 4.3% at FY21 (FY20: 5.0%), which is concentrated across three properties, of which two are undergoing refurbishments. Rental collections were strong with an average of 99% achieved for FY21. Net property income dropped by 5.9% (+1.3% excluding business failures) but is expected to rebound and grow by more than 5% (1H FY21: 2.7%) at the interim, supported by a reduction in bad debt provisions and positive rental reversions, albeit partially offset by increased void periods due to ongoing refurbishments at the above mentioned two properties. The growth strategy for the PEL platform is partly supported by its development pipeline, with 3 sites expected to deliver 64 000m^2 of additional GLA set to have development work start in 2H FY22.

Management and governance

Management and governance factors were considered to be neutral to the ratings.

Financial Profile

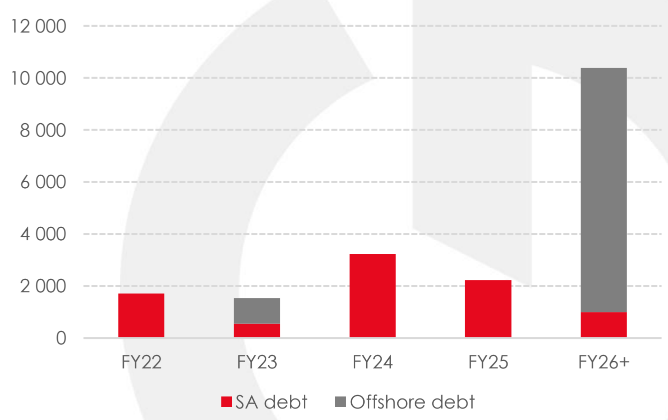
Leverage and capital structure

IPF's look through gearing profile is expected to remain high constraining the analysis, but the reduction in ZAR denominated debt does mitigate capital risks somewhat

Table 2: Balance sheet metrics (FY21)

	SA	Europe
Gross debt	R5.0bn	€587m
WA debt maturity (years)	3.2	4.3
WA swap maturity (years)	3.5	4.3
Gearing	38.3%	55.0%
Average all-in cost of funding	8.5%	2.2%
Average debt margin	1.8%	2.2%
Encumbrance ratio	48%	100%
% debt secured	47%	100%
% interest rate hedging	83%	100%

Figure 3: Debt maturity profile (R'm)*



* Rand equivalent of offshore debt calculated using the average exchange rate for FY21
Source: IPF and FY21 Results presentation.

The sale of IPF's offshore minority interests and various local assets raised an aggregate R5.8bn in cash proceeds, which were utilised to reduce outstanding ZAR denominated debt, successfully completing the REIT's de-leveraging flightpath. Overall, the group settled R6.3bn worth of debt during the year, reducing the reported LTV ratio to 38.3% at FY21 from 47.5% the previous year, relative to the 50% covenant limit. Interest cover moderated to 2.4x (FY20: 2.9x) at year end but managed to rebound and was calculated at 2.7x in August, following additional debt settlement and restructuring of swaps post the reporting period. In addition, IPF became the first REIT to issue a sustainability- linked bond in the South African market, which came with pricing upside and carries a further coupon reduction clause if certain targets are achieved. Altogether, the interest cover ratio is anticipated to stabilise at around 3x over time.

The major constraint to IPF's leverage profile emanates from the funding structure of the offshore portfolio. Gearing in the European market is considered on a risk-adjusted basis with the spread between debt and asset yields wide enough to absorb additional risk before compromising capital efficiency. In this regard, the refinancing of the European debt was done at an LTV of 60%, with the intention to maintain a range of 50%-60%. Although the Euro denominated debt is ringfenced with no recourse to the SA balance sheet, GCR's leverage assessment considers the proportionally consolidated position. Although moderating to 53% At FY21 (FY20: 55%) due to the reduction in SA debt, GCR considers this look through gearing level to be very high. The potential introduction of a third-party capital investor, which is currently under investigation, may impact the gearing level if it results in the dilution of IPF's ownership share in the PEL platform. Nonetheless, as new debt is utilised to grow the portfolio, IPF's look through gearing is expected to remain in the 45%-55% range.

Figure 4: SA debt split by bank

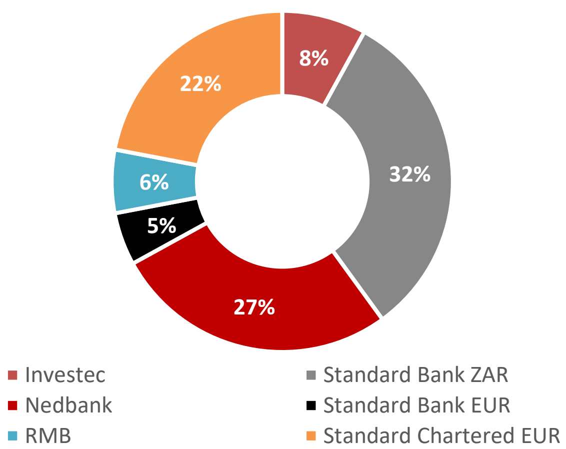
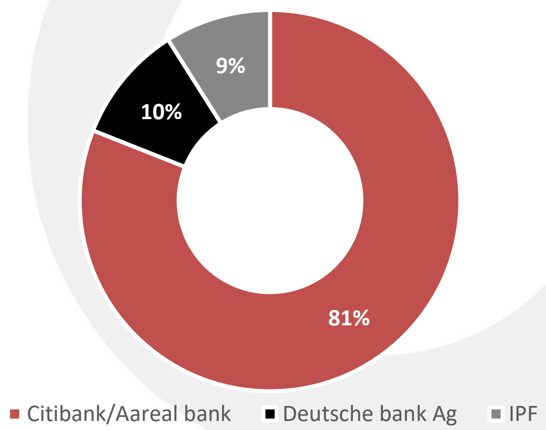


Figure 5: Europe in-country debt split by bank



IPF has good access to funding both in SA and Europe, with all assets matched against in-country debt. Proactive treasury management and solid relationships with its funders has historically enabled the group to refinance debt maturities ahead of time, resulting in a smooth debt maturity profile. The weighted average maturity of 3.2 years reported at FY21 is competitive relative to most REITs in the South African market.

Liquidity

The REIT has sufficient available facilities to cover short term uses of cash

Liquidity coverage is deemed to be adequate with GCR calculating a 12-month uses versus sources ratio in the range of 1.2x to 1.7x. This is backed by R2bn in available and unutilised facilities and IPF's track record of being able to refinance upcoming debt maturities in advance, thereby minimising the burden of debt redemptions. Furthermore, the REIT has minimal committed capital expenditure over the coming year, while it has some non-core assets that are available for disposal, which GCR stressed for consideration in its liquidity analysis.

Comparative Profile

The comparative profile is a neutral component for the ratings

Peer analysis

The peer analysis is neutral to the ratings.

Group support

Group support is not applicable to the ratings.

Rating Adjustment Factors

Structural adjustments

No structural adjustments have been made to the ACE in arriving at the final ratings.

Instrument ratings

No adjustments for instrument ratings are applicable.

Risk Score Summary

Rating Components and Factors	Risk Scores
Operating environment	**17.50**
Country risk score	10.00
Sector risk score	7.50
Business profile	**1.00**
Competitive position	1.00
Management and governance	0.00
Financial profile	**(3.50)**
Leverage and capital structure	(3.00)
Liquidity	(0.50)
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**15.00**

Glossary

Bad Debt	An amount owed by a debtor that is unlikely to be paid due, for example, to a company going into liquidation. There are various technical definitions of what constitutes a bad debt, depending on accounting conventions, regulatory treatment and the individual entity's own provisioning and write-off policies.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
Bullet Maturity	The settlement of a security at maturity in a single principal repayment.
Capacity	The largest amount of insurance available from a company. In a broader sense, it can refer to the largest amount of insurance available in the marketplace.
Capital Expenditure	Expenditure on long-term assets such as plant, equipment or land, which will form the productive assets of a company.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Debtor	The party indebted or the person making repayments for its borrowings.
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.
Income	Money received, especially on a regular basis, for work or through investments.
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.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
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.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Operating Margin	Operating margin is operating profit expressed as a percentage of a company's sales over a given period.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Recovery	The action or process of regaining possession or control of something lost. To recoup losses.
Short Term	Current; ordinarily less than one year.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the rating 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 party. The rating was 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 virtual management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Investec Property Fund Limited and other reliable third parties to accord the credit rating included:

- Audited annual financial statements for FY21 (plus four years of audited comparative numbers);
- Investor presentations;
- Projected leverage ratio inputs and calculations;
- A breakdown of current debt facilities available and related counterparties (including proportionally consolidated debt and related debt covenants).