GCR RATINGS

Credit rating report | South African Corporate | November 2020

Resilient REIT Limited

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Resilient REIT Limited	Long Term Issuer	National	AA(ZA)	Stable Outlook
	Short Term Issuer	National	A1+(ZA)	

Strengths

- Robust liquidity management, including proactive refinancing and covenant risk management
- Strong asset management
- Consistently prudent leverage and capital structure relative to peers

Weaknesses

- Increasing scale disparity relative to market leaders
- High concentration by property
- Exposure to market variability *via* listed security investments

Rating rationale

Resilient REIT Limited's ("Resilient" or "the REIT") credit ratings counterbalance its asset management rigour and conservative funding philosophy against its direct portfolio concentration and increasing scale disparity relative to market leaders.

Portfolio quality remains sound, with the domestic properties' solid performance further illustrating their defensive positioning relative to regional shopping centres in over-traded metropolitan areas. Resilient also has a demonstrated track record of strong through-the-cycle returns from offshore investments, which have historically supported robust cash generation.

That said, offshore earnings could be curtailed by, *inter alia*; investees' lower distributable income, reduced pay-out ratio(s), withheld distributions, or scrip paid out in *lieu* of cash in the short-term. In GCR's view, pressure on rentals amidst double-digit municipal cost inflation will also constrain net property income. As such, we expect the combined cash margin to moderate to a new low in FY21, before recovering fairly quickly thereafter. Overall, while the portfolio quality assessment is expected to remain positive, our view could be moderated by unmitigated value attrition and/or earnings underperformance that persists beyond the current market uncertainty.

The positive leverage assessment is underpinned by strong treasury management, mainly evidenced by consistently proactive refinancing and well-managed debt exposures. Despite some attrition of the security portfolio value, the LTV ratio remains comfortably below 40% (including planned capex) and is expected to trend between 30.0% - 37.5%. Beyond the short-term earnings distortion, interest coverage should also normalise between 2.5x - 3.75x. The well-managed capital structure notwithstanding, significant pressure on values or earnings beyond FY21 would weaken the leverage assessment.

The Lighthouse Capital ("Lighthouse") investment represents mixed opportunities for the REIT. Specifically, while Lighthouse focuses on more developed economies relative to Resilient's other exposures, this is counterbalanced by its small scale and high exposure to listed securities. GCR has noted Lighthouse's low leverage (September 2020: 21%), although it is still our view that debt could rise in the medium-term to fund acquisition-led growth. In this regard, Resilient will be expected to still adhere to a conservative funding profile as it grows its offshore earnings.

Liquidity continues to be supported by well-established relationships with leading domestic financial institutions, and strong secured facility headroom. Covenant risk and asset encumbrances are well managed, supporting sound access to capital despite the risk aversion presently impacting the capital markets. Notwithstanding that Resilient has maintained a 100% pay-out ratio, GCR expects the 12 months' liquidity coverage to continue to be managed comfortably above 1.25x over the outlook period, with further financial flexibility afforded by negligible capital commitments and the recycling of capital.

Outlook Statement

The Stable Outlook reflects the REIT's consistently conservative treasury management and proactive de-risking of its balance sheet, as well as GCR's expectation that earnings will remain robust despite the pressures facing the domestic property sector.

Rating Triggers

A further upgrade is only likely over the medium term if growth is underpinned by a higher earnings and investment contribution from highly developed jurisdictions. In addition, moderation of the net debt to operating income ratio to 3.0x - 3.5x, interest cover managed at/above 4.0x, and LTV ratios sustained within the 30% - 35% range would bode positively. Conversely, persistent downside pressure on interest cover, or upward creep in the LTV ratio due to 1) curtailed offshore earnings 2) international investments whose leverage is managed more aggressively than Resilient's conservative levels or 3) material pressure on investment portfolio valuations would be negatively viewed.

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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, November 2020
GCR Rating Scales Symbols and Definitions, May 2019
GCR's Commercial Property Sector Risk Score report, August 2020
GCR places South African commercial property on negative trend as fragile economy continues to drive high asset, liquidity and funding risks, August 2020

Ratings History

Resilient REIT Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term Issuer	Initial	National	A-(ZA)	Stable Outlook	Jun 2010
Short Term Issuer		National	A1-(ZA)		
Long Term Issuer	Last	National	AA(ZA)	Stable Outlook	Sep 2020
Short Term Issuer		National	A1+(ZA)		

Analytical Entity: Resilient REIT Limited

JSE-listed Resilient is a retail-focused REIT with a domestic portfolio consisting mostly of dominant regional shopping centres (FY20: 28). It also invests in other listed property funds, with its current investments comprising NEPI Rockcastle (NEPI"), a c.EUR6.1bn Central & Eastern European fund, as well as Lighthouse, which provides both direct and indirect exposure to European commercial real estate. Earnings growth in the medium-term is expected to be mostly organic, with operating income being driven by rising offshore distributions and resilient base portfolio performance.

Operating Environment

The operating environment assessment is anchored by Resilient's domestic portfolio, with modest uplift from the REIT's geographic diversification

Country risk

GCR moderated the South African country risk score by '0.5' to '7.0' to reflect our expectations of (amongst others) a much deeper recession in the wake of COVID-19 related disruptions, mixed results from relief interventions, and National Government's weakening fiscal position. This continues to be counterbalanced by strong institutional rigour, high regulatory quality, the strengths of the financial system, and the size and diversification of the South African economy relative to regional peers.

In view of Resilient's European exposure, we have noted expectations of a softer downturn in that region's GDP, on the back of, *inter alia*; its reserve currency status and the extensive stimuli (well over EUR3trn) injected to stabilise its territories' economies. The uplift of Resilient's country risk assessment from the South African base is, however, limited due to the REIT's relatively low geographic diversification.

Sector risk

GCR has materially lowered the South African sector risk score, based on our view of heightened asset, funding and covenant risk in the domestic real estate industry. While immediate operating risks continue to be alleviated by easing domestic lockdown restrictions, medium-term pressures continue to be driven by deep structural limitations in the local economy, which even a fundamental fiscal policy shift would not effectively reverse in the next 12-18 months. In the interim, the monetary policy intervention bodes positively, albeit access to capital markets is likely to be restricted to highly rated funds or portfolios closely held/backed by strong shareholders.

Financial institutions continue to support the industry, but are re-rating their property portfolios for high operating, liquidity and funding risk assumptions, which could lead to progressively reduced real estate exposures in the medium-long term. Banks are also viewed to be unable to cover the interim liquidity gap created by low institutional investor appetite to refinance maturing bond exposures (the latter reflected by disproportionally high spreads associated with new issuances relative to the cost of term facilities).

Against the backdrop of low disposals, GCR therefore expects liquidity risk to remain elevated in the next 12 months. Accordingly, GCR has placed the sector on Negative Trend, and only expects very few funds with (*inter alia*) low leverage, exposures to strong(er) territories likely to rebound quickly from 2020 recessions, or investments in defensive property segments whose momentum is supported by technological and globalisation trends, to achieve limited or short-lived financial profile variability over the outlook period.

The sector risk score assigned to Resilient counterbalances inherent strengths and risks in the South African market and Central & Eastern European ("CEE") territories in particular. The latter region presents the most robust dynamics and performance prospects in Eurozone real estate, underpinned by sustained economic growth expectations beyond 2020, enabling legislation, improving development indicators, and diverse international capital inflows. While generally positive, there are nonetheless nuances across different property sub-classes, which indicate diverging medium-term return prospects.

Looking ahead, the risk of constrained returns beyond the 2020 recessionary climate could arise from CEE's reliance on external stimulus, including the high import underpin to strong consumption expenditure and impetus from positive supply chain dynamics between key Eastern and Western hemisphere territories. GCR also views the upside to the region's commercial property fundamentals to be counterbalanced by its speculative investment profile relative to much more developed Eurozone markets. This could elevate the risk of intermittent capital flight, including knee-jerk reactions to perceptions of economic uncertainty or moderating real estate returns.

GCR has noted that Resilient's investment portfolio is evolving, recycling capital and increasing exposure to Western Europe. That said, we do not anticipate that this will result in a material change to the sector (or country) risk assessments over the rating horizon. We have also considered the second wave of COVID-19 restrictions in Europe and could moderate Resilient's sector risk assessment should the trading limitations and their impact on profitability persist beyond GCR's expectations.

Details of the latest updates to discrete country and sector risk scores are outlined in GCR's Risk Score reports, available *via* the following link: https://gcrratings.com/risk-scores/.

Business Profile

Resilient's business profile is underpinned by strong asset management, albeit counterbalanced somewhat by the property concentration in its direct portfolio and its smaller scale relative to market leaders

Portfolio quality

Figure 1: Portfolio value progression*

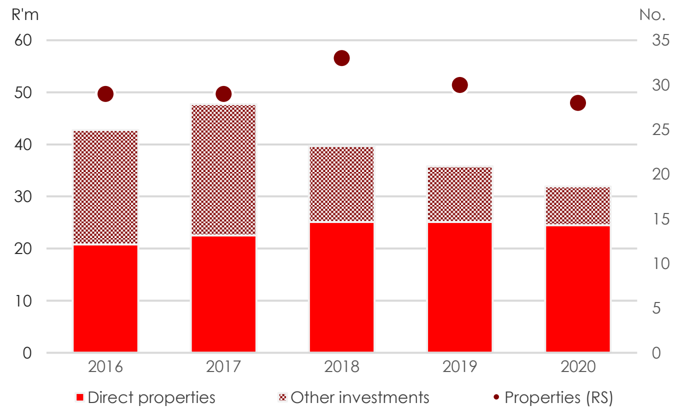
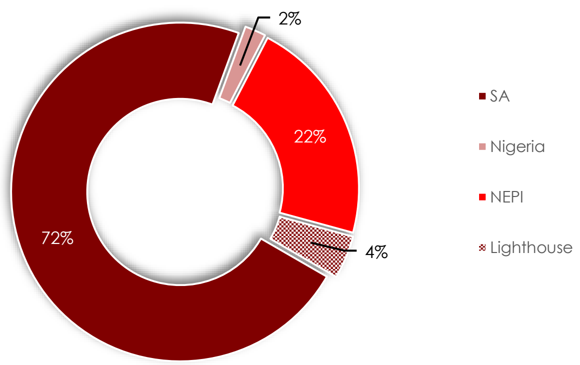


Figure 2: Portfolio split, 2020*



*Unless otherwise stated, the periods shown in the charts and tables represent fiscal years (e.g. 2020 represents FY20).

The continued moderation in the overall portfolio value has been driven by attrition of the securities portfolio, against the more stable direct property base. With respect to the properties, more conservative earnings assumptions built into the most recent independent valuations in the wake of COVID-19 resulted in moderate loss of value in FY20 (c.5%).

Despite the short weighted average lease expiry profile, GCR expects relative stability in the value of the domestic property portfolio over the outlook period, on the back of resilient earnings expectations. With respect to securities, the offshore investment exposures are in flux, as Resilient traded some of its NEPI shares for a higher stake in Lighthouse (40% as of August 2020), and liquidated the NEPI scrip received in *lieu* of a cash dividend in 1H FY20. Overall, the progressive value attrition increases the scale disparity relative to leading South African funds and detracts somewhat from the portfolio quality assessment.

Resilient's domestic portfolio remains underpinned by defensively positioned properties that continue to outperform industry trends. The provincial diversification of its portfolio also protects the REIT from supply-side pressure of overrented space in the country's major metropolitan areas. These advantages are somewhat counterbalanced by the high concentration by property. Resilient's domestic portfolio is underpinned by strongly performing nationals, with each of the top ten tenants expected to contribute between 2%-10% of contractual rentals.

Exposure to distressed lessees is low, with the Edcon contribution to rental income to be reduced further in the short-term. The tenant mix is also viewed as defensive, with a focus on non-discretionary anchors and strong discretionary brands. In view of the sustained demand for space in Resilient's centres, COVID-19 dynamics and the recessionary operating climate are not expected to have a lasting impact on occupancies or tenant retention. In this regard, GCR expects the REIT to sustain low vacancies through the cycle. The lumpiness in the lease expiry profile is viewed as a defensive response to the highly uncertain operating climate, meant to ensure the quality of earnings.

Figure 3: Vacancy profile (by rental), 2020

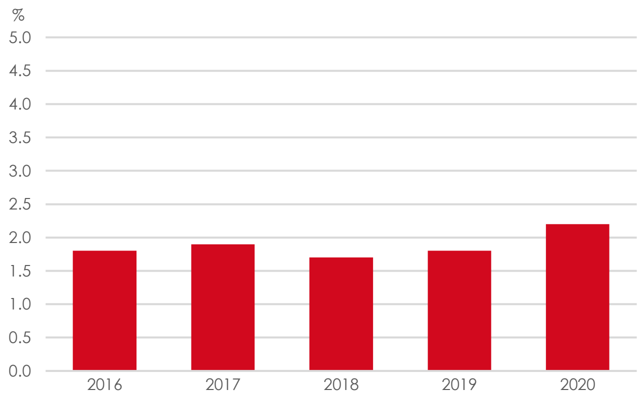
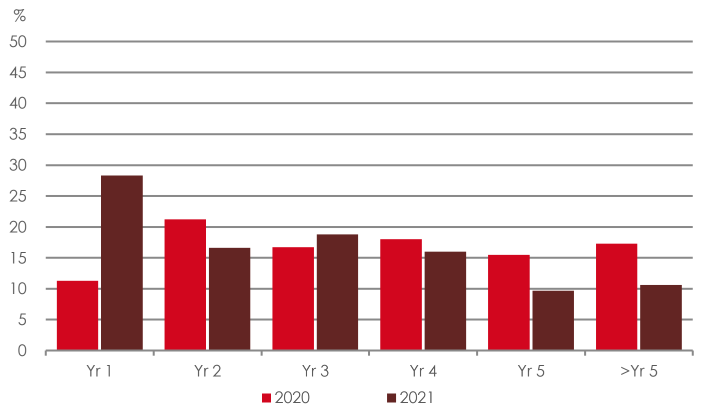
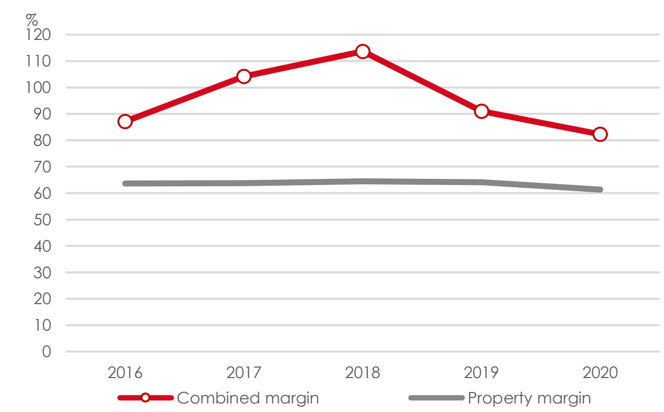


Figure 4: SA lease expiries (by rental), 2020



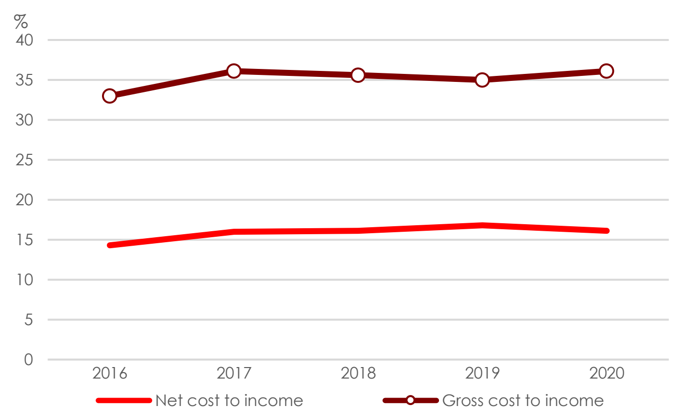
Cognisance is taken of sustained cost rigour, with the net property expense ratio continuing to trend within a narrow range. That said, South Africa's inherently high all-in occupancy rate is expected to continue to place pressure on margins. In GCR's view, retailers will look to trade high escalations for flat or lower rentals in the face of double-digit municipal and utility cost inflation. As such, the discounts afforded to tenants are not likely to be clawed back in the short-term, as we expect landlords to prioritise tenant sustainability over the outlook period.

Figure 5: Margin progression*



*Represents cash earnings relative to contractual rentals.

Figure 6: Cost rigour



In addition, offshore cash earnings could be curtailed by, *inter alia*; investees' lower distributable income, decisions to cut pay-out ratios, withhold distributions, or pay out scrip in *lieu* of cash. Accordingly, we expect the all-in cash operating margin to ease to a new low in the short term, before resetting within the 80-85% range thereafter. Material earnings pressure that persists beyond the short-term due to (*inter alia*) weaker than expected organic performance of the offshore investments, in particular, could negatively impact the portfolio quality assessment.

With respect to cash flows, comfort is taken from the rebound in collections, which are trending above 90% of contractual rental income (before discounts) in 1H FY21. Arrears and impairments remain low, despite sharp YoY inflections. We have also considered agreements reached with most tenants, and that trading activity has largely normalised barring tenants facing significant restrictions (e.g. cinemas). There is no development risk, with capital commitments less than 0.5% of portfolio value, and any redevelopment plans shelved over the outlook period.

Management and governance

Management and governance are currently viewed to be neutral to the rating assessment.

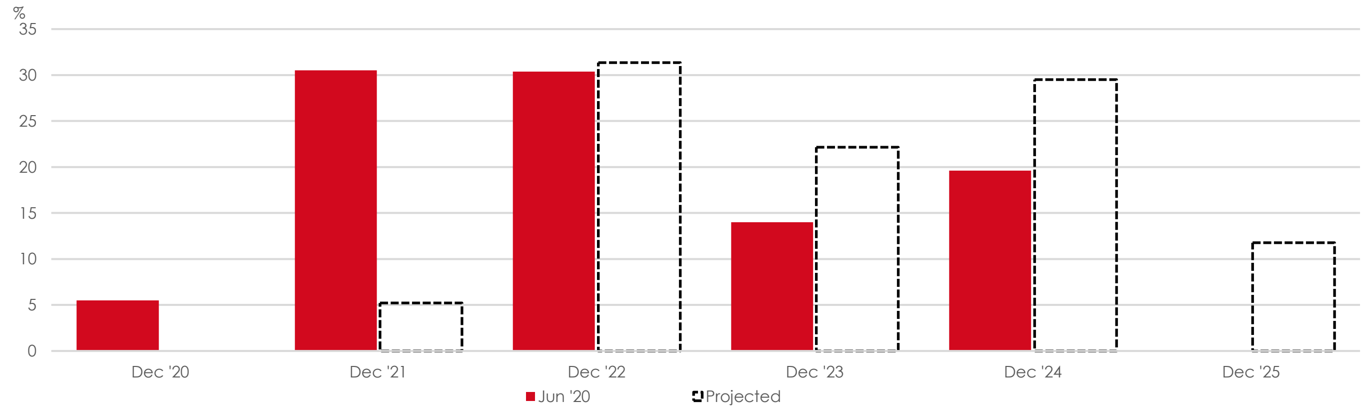
Financial Profile

The financial profile is anchored by the REIT's conservative funding philosophy relative to peers and its proactive overall treasury management

Leverage and capital structure

The leverage assessment remains positive, on the back of a prudent funding philosophy and demonstrably strong overall treasury management. Specifically, the all-in debt exposure has been managed down by termination of all cross-currency swaps, the aforementioned moratorium on redevelopments, and continued recycling of capital into growth opportunities. Proactive refinancing continues to support a reasonable debt expiry profile, with GCR expecting the two-year expiries to be managed at/below 40% of debt outstanding. The REIT also continues to demonstrate reasonably strong access to capital, selectively participating in the debt capital markets at a time when corporates are being increasingly crowded out amidst considerable uncertainty.

Figure 7: Debt maturity profile*



*Excludes GCR stresses for (*inter alia*) capital commitments, synthetic debt exposures and distributions payable. The projected profile assumes no debt repayments or additional drawdowns, and projects refinancing of short-term debt expiries.

Despite the attrition of the indirect portfolio's value in particular, Resilient's net LTV was c.35% (inclusive of planned capex), with the metric expected to trend between 30.0% - 37.5% over the outlook period. While earnings are expected to be distorted in the short-term, GCR expects interest cover to normalise between 2.5x - 3.75x. Beyond the current COVID-19 related uncertainty, material pressure on values or earnings would weaken our leverage assessment.

Figure 8: Loan to value progression

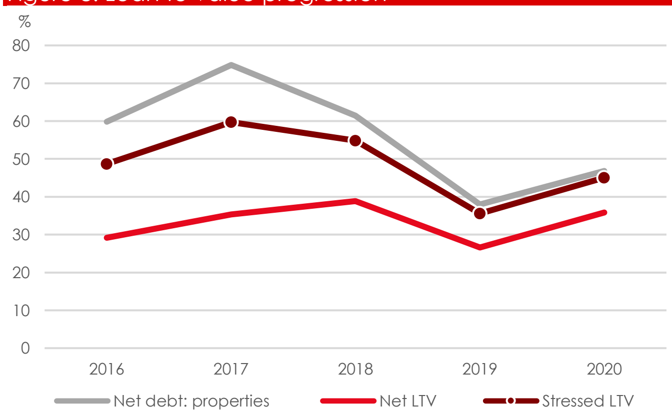
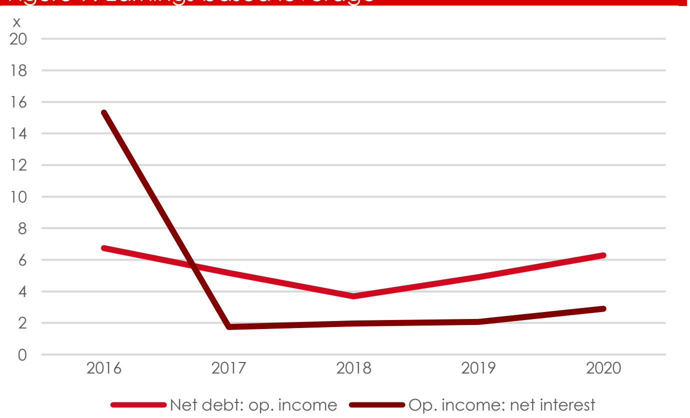


Figure 9: Earnings based leverage



Looking further ahead, the increased Lighthouse shareholding (40% of issued capital) presents mixed fortunes for Resilient. Specifically, although Lighthouse's strategy is geared towards more developed economies relative to Resilient's other exposures, this is counterbalanced by its small scale, comparatively shorter track record, high exposure to listed securities, as well as investee Hammerson's ongoing restructuring (after its recent recapitalisation). Although

GCR has noted Lighthouse's low leverage (September 2020: 21%), it is our view that debt could rise in the medium-term to fund acquisition-led growth. In this regard, Resilient will be expected to enhance its geographically diverse earnings base while still adhering to a conservative funding profile over the outlook period.

Liquidity

Well-established relationships with key banking counterparties and prudent treasury policies underpin the REIT's sound liquidity profile. Resilient does reflect much higher concentration to two main funders relative to peers of similar scale and geographic positioning. That said, the REIT continues to sustain well-balanced debt expiries, as well as reasonable secured headroom across all its facilities. Together with low capex requirements, this is supportive12 months' liquidity coverage of at least 1.25x over the outlook period.

Table 1: Facility profile (R'm)

Funder/territory	June '19			June '20		
	Facility	Drawn	Security	Facility	Drawn	Security
Nedbank	1,529	1,555	2,206	1,385	1,252	2,294
RMB	3,550	2,368	8,191	3,550	3,572	7,884
Standard Bank	3,958	2,843	8,550	4,108	3,578	8,551
Liberty Financial Solutions	815	815	2,212	810	814	1,940
Nigeria*	635	635	1,297	783	783	1,310
DMTN (unsecured)°	-	1,977	-	-	1,253	-
Total	**10,487**	**10,194**	**22,455**	**10,636**	**11,251**	**21,979**

*Includes minorities' interest of R306m (FY19: R248m).
°Represents listed issuances under the REIT's R5bn DMTN programme.

While the property portfolio encumbrance is high, the securities portfolio remains unencumbered. Covenant risk is well managed, supporting reasonably sound access to funding and flexibility to access further unsecured lending. Lately, interest coverage covenant definitions were broadened to cater for the highly uncertain operating landscape (both locally and abroad). Looking ahead, GCR expects this proactive engagement with funders to be sustained for the fund to sustain a stable funding profile. Although most corporates have been largely crowded out of the capital markets due to limited liquidity and pricing distortions, there is demonstrated appetite for Resilient's debt instruments. Although management is not expected to make recourse to equity funding in the short-term, the decision to maintain a 100% pay-out ratio is supportive of sustained shareholder support, in GCR's view.

Comparative Profile

Peer analysis and group support

The peer analysis is neutral to the ratings. Group support is not applicable to the ratings, as Resilient is not a subsidiary of a larger group or operating holding company.

Rating Adjustment Factors

Structural adjustments

As Resilient is assessed as a group, no structural adjustments were made to the anchor credit evaluator in arriving at the final ratings.

Instrument ratings

No adjustments for instrument ratings are applicable.

Risk Score Summary

Rating components & factors	Risk Score
Operating environment	**14.00**
Country risk score	7.50
Sector risk score	6.50
Business profile	**1.50**
Portfolio quality	1.50
Management & governance	0.00
Financial profile	**0.50**
Leverage & capital structure	0.50
Liquidity	0.00
Comparative profile	**0.00**
Peer comparative	0.00
Group support	0.00
Government support	0.00
Total risk score	**16.00**

Glossary

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.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Committed Facility	A line of credit extended to a borrower that is guaranteed to be available for a specified period. The lender is obliged to lend the predetermined amount for the defined period under the terms of the agreement.
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.
Coverage	The scope of the protection provided under a contract of insurance.
Currency Risk	The potential for losses arising from adverse movements in exchange rates.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Facility	The grant of availability of money at some future date in return for a fee.
Hedge	A form of risk management aimed at mitigating financial loss or other adverse circumstances. May include taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
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 Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
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.
Lease	Conveyance of land, buildings, equipment or other assets from one person (lessor) to another (lessee) for a specific period of time for monetary or other consideration, usually in the form of rent.
Lessee	The party that enjoys temporary use of a corporeal thing.
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.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Performing	An obligation that performs according to its contractual obligations.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Refinancing	The issue of new debt to replace maturing debt. New debt may be provided by existing or new lenders, with a new set of terms in place.
REIT	Real Estate Investment Trust. A company that owns, operates or finances income-producing real estate.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term	Current; ordinarily less than one year.
Swap	An exchange of payment streams between two parties for their mutual benefit. Swaps can involve an exchange of debt obligations, interest payments or currencies, with a commitment to re-exchange them at a specified time.
Vacancy	In commercial property, usually expressed as a percentage of unoccupied floor space in relation to the GLA.
Valuation	An assessment of the property value, with the value being compared to similar properties in the area.
Yield	Percentage return on an investment or security, usually calculated at an annual rate.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings 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 Resilient REIT Limited. 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.

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

- The 2020 annual financial statements (plus four years of audited comparative numbers)
- Results presentations and market/trading updates
- Audited 2020 financial results (plus four years of comparative, audited financials)
- The latest market updates in respect of trading, leverage, and liquidity management
- The latest investees' results and trading updates