The Pakistan Credit Rating Agency Limited

# Rating Report

## TPL REIT Fund I

**Report Contents**



**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 23-Dec-2021 | RFR 3+ | - | Stable | Preliminary | - |

**Rating Rationale and Key Rating Drivers**

TPL REIT Fund I (or the "Fund") is a perpetual, closed-end, shariah-compliant hybrid Scheme proposed to be launched by TPL REIT Management Company Limited. The REIT Scheme has been registered with SECP. The Fund is being set up to achieve regular and stable returns through investments in a diversified portfolio of sustainable developments and yielding assets in the real estate sector in Pakistan. The Fund would be listed on the stock exchange within three years of financial close. The REIT Fund size is proposed to be PKR 80bln (USD 500mln), of which the initial fund size would be up to PKR 18.75bln. The RMC is seeking to raise 60% of the targeted fund from foreign investors, 30% from domestic investors and the rest from its strategic investor, TPL Properties Ltd. Foreign funds would be routed in Pakistan through one or more feeder funds established in acceptable off shore jurisdictions which will allow foreign investors to invest in REIT through a regulated tax-efficient vehicle. The land has already been acquired for the projects and all relevant NOCs of Technology Park and One Hoshang have been obtained. The assigned rating captures the risk profile of the three projects which will be financed through the initial fundraising. The rating may be impacted by the risk characteristics of future projects. The investments raised under the Fund in the first round will be used to finance three real estate projects; i) Technology Park: This would be the first kind of technology park in Pakistan with high-end technology infrastructure, accompanied by a 42 key business hotel ii) Mangrove: Master planned community including mid-rise residential apartment towers, retail space, offices and hospitality asset located at the waterfront and iii) One Hoshang: Pakistan's one of a kind premium end residential apartment tower and showrooms with world-class amenities. All projects will be located at prime locations in Karachi and will be developed by following international safety, sustainability, and environmental standards and shall be Gold LEED Certified. The total area that would be covered under the scheme is 13,375,000 sq. ft. The total cost of three projects would be financed by a mix of equity, debt, pool of funds, and customer advances against the sale of developed inventory.

The rating would remain dependent on the sustainability of the RMC, successful fundraising, achievement of milestones, and listing of the Fund. Successful completion of each project and generation of expected return would remain critical for rating.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | TPL REIT Fund I |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | REIT Fund Rating Rating |
| **Applicable Criteria** | Criteria \| Rating Modifiers(Jun-21),Methodology \| REIT Fund Rating(Oct-21) |
| **Related Research** | Sector Study \| Real Estate(May-21) |
| **Rating Analysts** | Muhammad Junaid \| muhammad.junaid@pacra.com \| +92-42-35869504 |

## Profile

**Operations** TPL REIT Fund I ("The Fund") is a perpetual, closed-ended, and shariah-compliant hybrid fund. The REIT will initially be incorporated as a private fund and will be listed within three years as required by the REIT Regulations, 2015. The objective of the fund is to achieve regular and stable returns through investments in a diversified portfolio of sustainable developments and yielding assets in the real estate sector in Pakistan. The investments would be through direct investment and/or separate special purpose vehicles that will be controlled and at least 75% owned by the Fund. The fund will create Special Purpose Vehicles (SPVs) for each project to trace their cashflows and ensure their heterogeneity.

**Portfolio Mix** The fund is well-diversified at the property level and segment level. At the property level, the fund will invest in three projects simultaneously; therefore, it will not be dependent on a single project. At the segment level, the projects are diversified into i) Technology Park (commercial office & business hotel) ii) Mangrove (waterfront mid-rise community) and iii) One Hoshang (luxury residences). At the geographic level, the Fund is concentrated in Karachi.

## Economic & Industry Risk

**Economic Overview** The real estate industry is strongly correlated with overall economic conditions. Macroeconomic indicators like GDP, manufacturing activity, interest rate environment and favorable policies exhibit a favorable correlation with the real estate demand and, in turn, prices. The macroeconomic indicators are mixed in Pakistan. On one hand, there has been a post-pandemic upturn in the economic activity and an upward revision in the GDP estimates. However, there is uncertainty due to the current account deficit and stalled IMF program. The vaccination drive has picked up pace that would mitigate the risk of any significant disruption to the economic activity going forward. Further, the government's focus on the real estate and construction sector has shown significant improvement recently with the announcement of several incentives packages for the construction industry. This, coupled with the low-interest rate environment in the country, has ignited strong growth in the sector.

**Industry Dynamics** PACRA analyzes the real estate industry in the context of the local economy and regulatory environment. REITs are a relatively new entrant in Pakistan's market with 10 RMC licenses granted by SECP to date. Only one REIT is listed on the Pakistan Stock Exchange (PSX). The COVID-19 pandemic had a negative impact on commercial properties, especially retail and office building. Arif Habib Dolmen REIT is the only major player in the market with a fund size of ~PKR 52bln, the total market size is ~PKR 54bln. TPL REIT Fund I would be the second-largest player and the first hybrid fund in the industry with an initial fund size of PKR 18.75bln, aiming to reach the target fund size of PKR 80bln.

## Asset Quality Risk

**Market Position** The properties falling under the TPL REIT Fund I, would have a position in view of which risk of material variation in salability and occupancy level would be low. The competitiveness would be judged on the provision of quality of services, maintenance services, and provision of amenities. Furthermore, the development of REIT Fund's properties based on international safety, sustainability, and environmental standards would further enhance the market positioning of the property. In addition to this, the design of properties approved by world-acclaimed international and local third-party partners is also strengthening the market position.

**Project Risk** Timely completion, relative size, and salability carry due importance in project risk. The projects falling under TPL REIT Fund I, are yet to begin development which would subject it to the project risk. Two of the initial projects are at the advanced stage of design and several regulatory approvals have been obtained. The project risk is of paramount importance in developmental/hybrid REITS as the value of the REIT is primarily dependent upon the timely completion of the project.

**Tenancy Risk** The projects, once complete, will be subjected to tenancy risk. Being a hybrid REIT fund, TPL REIT would also be subjected to this risk. The risk deriving factors would be tenancy agreements, vacancy rates, and profile, and diversity of tenant base. In this regard role of the property manager would carry due weightage which is TPL Property Management (Pvt) Limited.

**Legal Risk** The land acquired for projects is clear from any lien mark, stay orders against the transfer of the legal title, availability of complete documentation, and approvals obtained from relevant authorities for real estate development.

**Third-Party Service Provider Risk** TPL - RMC is working with several third-party service providers. There is a risk that the third-party service providers fail to deliver or the quality is substandard. In the case of TPL REIT, TPL Properties Limited would be the development advisor, TPL Properties has good experience in property development. While TPL Property Management would be the property manager in respect of rental assets. The valuer appointed for the properties would be Colliers International Pakistan Limited, which is on the list of approved valuers maintained by the Pakistan Bank's Association. This ensures the independence of the valuer. The auditor of the TPL REIT is EY Ford Rhodes who falls under category "A" on the panel of approved auditors maintained by SBP. The Fund Administrator of TPL REIT is APEX, an international leading fund administrator. Digital Custodian Company has been engaged as the Trustee TPL REIT.

**Event Risk** There is an event risk of unexpected cash outflows. Third-party guarantees or insurance arrangements can mitigate this risk.

## Financial Risk

**Financing Arrangements** TPL RMC is planning to raise financing from investors after the regulatory approvals. The Company is targeting up to PKR 18.75bln in the initial fundraising. Out of PKR 18.75bln, TPL Properties will invest up to PKR 7.5bln as a strategic investor and the rest will be raised from local investors. The RMC shall avail borrowing from financial institutions either at the Fund or SPV level (as necessary). All borrowing shall be availed with the approval of the REIT Manager's Board of Directors and the Trustee, or the Board of Directors of the SPV, as applicable.

**Cashflows & Coverages** TPL RMC plans to meet the capital requirement of the projects from advances against the off-plan sale of inventory, in addition to REIT funds. There is a risk that the quantum and stability of the cash flows are not according to the expectations. The REIT Fund proposes to distribute at least 90% of its profits (excluding unrealized gain) as dividends to its unitholders. The Fund may retain minimal liquidity that it would invest surplus funds in liquid assets approved by the investment committee. Liquid assets may include Government securities, money market funds, or deposits with commercial banks having at least AA long-term rating.

**Capital Structure** TPL RMC plans to borrow PKR 4.4bln to finance the projects. This borrowing will be in addition to the initial REIT fundraising of PKR 18.75bln. The debt raise will affect REIT's ability to adapt to the economic changes or sustain shocks in business.

## Management Review

**REIT Manager** TPL REIT Management Company Limited (TPL-RMC) is a public limited company, regulated by the SECP. TPL-RMC was incorporated in 2018 to capitalize on the emerging REITs market in Pakistan. TPL-RMC holds the license to undertake REIT Management Services. Currently, the RMC is generating income from investment in mutual funds. As for as the RMC management fee is concerned, the RMC would be charging a yearly management fee @1.5% of NAV and a performance fee @ 15% of the change in NAV from the REIT fund.

The Pakistan Credit Rating Agency Limited

| TPL REIT Management Limited | Jun-21 | Jun-20 | Jun-19 |
|---|---|---|---|
| Public Limited | 12M | 12M | 12M |
| **A BALANCE SHEET** | | | |
| 1 Earning Assets | 417 | 54 | 50 |
| 2 Non-Earning Assets | 3 | 0 | 0 |
| **3 Total Assets** | 420 | 54 | 50 |
| 4 Total Borrowing | - | - | - |
| 5 Other Liabilities | 10 | 0 | 0 |
| **6 Total Liabilities** | 10 | 0 | 0 |
| **7 Shareholders' Equity** | 410 | 54 | 50 |
| **B INCOME STATEMENT** | | | |
| 1 Investment Income | 8 | 5 | 1 |
| 2 Operating Expenses | (1) | (1) | (1) |
| **3 Net Investment Income** | 7 | 5 | (0) |
| 4 Other Income | - | 0 | - |
| 5 Total Income | 7 | 5 | (0) |
| 6 Other Expenses | - | - | (0) |
| 7 Total Finance Cost | - | - | - |
| **8 Profit Or (Loss) Before Taxation** | 7 | 5 | (0) |
| 9 Taxation | (1) | (1) | - |
| **10 Profit After Tax** | 6 | 4 | (0) |
| **C RATIO ANALYSIS** | | | |
| **1 Investment Performance** | | | |
| i. Investment Income / Average AUMs | N/A | N/A | N/A |
| ii. ROE | 2.7% | 7.4% | -0.5% |
| iii. ROA | 2.6% | 7.4% | -0.5% |
| **2 Financial Sustainability** | | | |
| i. Coverages | | | |
| *a. Total Borrowing / EBITDA* | N/A | N/A | N/A |
| *b. EBITDA / Finance Cost* | N/A | N/A | N/A |
| ii. Capitalization | | | |
| *a. Total Borrowing / (Total Borrowing + Shareholders' Equity)* | 0.0% | 0.0% | 0.0% |

## REIT Fund Rating (RFR)

An independent opinion on investment quality of fund and prospects of successful implementation of underlying real estate projects

| Scale | Definition |
|---|---|
| RFR1 | **Exceptionally Strong.** Highest investment quality of fund; exceptionally strong prospects of successful implementation of real estate projects |
| RFR2++<br>RFR2+<br>RFR2 | **Very strong.** High investment quality of fund; very strong prospects of successful implementation of real estate projects |
| RFR3++<br>RFR3+<br>RFR3 | **Strong.** Good investment quality of fund; strong prospects of successful implementation of real estate projects |
| RFR4++<br>RFR4+<br>RFR4 | **Adequate.** Adequate investment quality of fund; average prospects of successful implementation of real estate projects |
| RFR5 | **Weak.** Weak investment quality of fund; low prospects of successful implementation of real estate projects |

**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

## Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

**Rating Team Statements**
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

**Conduct of Business**
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
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(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

**Independence & Conflict of interest**
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

**Monitoring and review**
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
**Probability of Default**
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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