

The Pakistan Credit Rating Agency Limited



Real Estate Investment Trust (REIT) Manager Rating

Specialized Rating Methodology

Table of Contents

Introduction	2
Profile	5
Ownership Risk	5
Governance Risk	6
Management Risk	7
Investment and Portfolio Management Risk	9
Customer Relationship Risk	11
Investment Performance Risk	11

Summary

This methodology outlines PACRA's approach to assigning REIT Manager Rating, an independent opinion on the quality of a REIT Manager's investment and operations management. PACRA's opinion is based on evaluation of the following factors: i) Profile, ii) Ownership, iii) Governance, iv) Management, v) Investment Risk & Portfolio Management, vi) Customer Relationship, and vii) Investment Performance. PACRA also compares the standing of the REIT Management Company with peers in its relative universe.

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1. Introduction

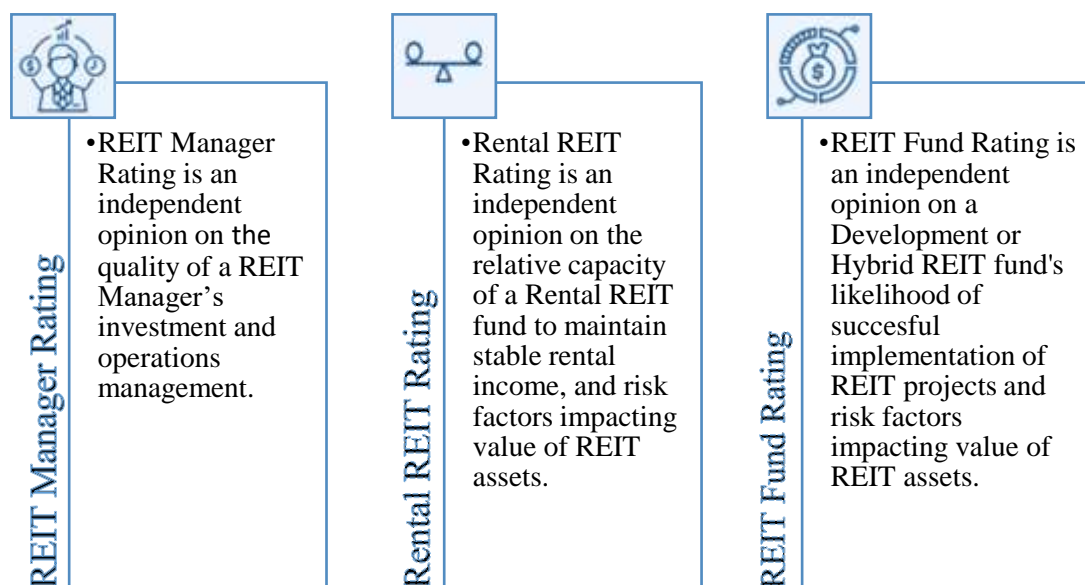
- **Overview:** Pooled investment, Close-end funds
- **REIT Industry Structure:** Distinction between RMC and REIT Funds
- **Scope:** Opinion on the quality of a REIT Manager's investment and operations management
- **Regulatory Framework:** Real Estate Investment Trust Regulations, 2015 and Listing on PSX
- **Rating Framework:** Qualitative and quantitative factors, all factors assessed on standalone and relative basis.
- **Rating Scale:** RM1 to RM5

1.1 Overview: Real Estate Investment Trusts (REITs) are investment vehicles designed to mobilize resources from a large pool of investors and, in turn, provide them access to income-generating real estate assets. A REIT is structured like a traditional closed-end mutual fund, however, instead of stocks and bonds, a REIT investor owns real estate backed units that sell like any other units/listed security, enabling the unitholder to invest directly in real estate. Returns for the investors are in the form of either rental income distributed through dividends or capital gains through price appreciation of the underlying assets reflected in the unit price. REITs generally distribute majority of their profits (over 90% in Pakistan) to their unitholders to receive favorable tax treatment under Pakistan's tax laws. REITs enable investors to have a direct exposure with low individual investments to a relatively illiquid asset class with sizeable initial capital requirement.

1.2 REIT Industry Structure: The REIT industry has two distinct elements: REIT Management Company (RMC) and REIT funds. REIT funds can be structured as three different models – Rental, Developmental or Hybrid REIT funds. These are briefly described below:

- RMC – a public limited company licensed to undertake REIT management services
- Rental REIT funds – established with the objective of making investment in industrial, commercial or residential real estate for generating rental income
- Developmental REIT funds – established with the objective of development, construction, refurbishment, rehabilitation, management and/or operation of real estate for industrial, commercial, residential purpose or a combination of these
- Hybrid REIT funds – comprising developmental component as well as rental component

1.3 Scope: PACRA has developed separate methodologies to capture the distinct rating considerations attached to these elements of the REIT industry, depicted in the following diagram. **This methodology outlines PACRA's rating considerations for REIT Manager Rating.**



1.4 Regulatory Framework: REITs are regulated by the Securities and Exchange Commission of Pakistan (SECP), which has issued a comprehensive set of regulations (REIT Regulations 2015, hereon referred to as "the Regulations"). The Regulations address all aspects of REIT registration, operations, and roles and responsibilities of all parties including the RMC. REITs

can be formed under Public and Private Partnership model (referred to as PPP REIT schemes) or otherwise directly or through Special Purpose Vehicles (referred to as non-PPP REIT schemes). As per the Regulations, a non-PPP REIT scheme must be listed on the PSX within three years after its first financial close while in case of PPP REITs, it should be listed no later than after the first year of its commercial operations date. Some salient features of the Regulations are listed in the table below:

Minimum ownership requirement by strategic investor/RMC:	
<i>In case of single strategic investor</i>	25% of fund size
<i>In case of multiple strategic investors</i>	5% of fund size
Permitted borrowing without approval of unitholders	25% of fund size
Application fee for REIT scheme	PKR 0.5 million
Annual Monitoring Fee to SECP (Rental REIT)	0.1% of fund size
Annual Monitoring Fee to SECP (Developmental REIT)	0.2% of fund size
<i>Fee for Hybrid REIT will be a combination of Developmental and Rental components, proportionately</i>	

1.5 Draft Amendments in Regulatory Framework: In end-September 2022, the SECP introduced draft amendments in REIT Regulations 2015¹ which are open for stakeholder comments at the time of this document’s publication. The proposed amendments are aimed at introducing new REIT products and simplifying the registration and approval processes to encourage new entrants and improve industry competitiveness. Following are some of the proposed reforms along with their intended implications:

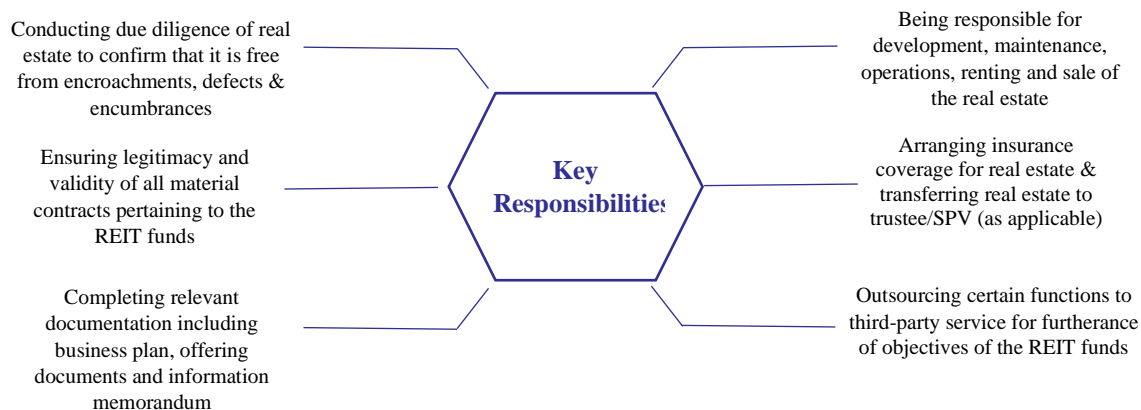
	Current	Proposed
Enhancing the scope of REIT Assets	<ul style="list-style-type: none"> Allowed real estate segments: <ul style="list-style-type: none"> Non-PPP scheme – residential, industrial and commercial real assets; PPP scheme – infrastructure 	Addition of the following real estate segments: Agriculture, Healthcare, Transport, Power, Energy, Telecommunication, water and sanitation, social, cultural and commercial segment
Types of REIT Scheme	<ul style="list-style-type: none"> Rental Developmental Hybrid 	Addition of: “Investment based REIT scheme” with: <ul style="list-style-type: none"> Investment in multiple completed real estate units like shops, hotel rooms, offices etc. Source of return for unit holders would be revenues generated from rental income
Changes in process for launch of REIT Scheme	<ul style="list-style-type: none"> Name reservation Permission to form RMC License to perform RMC services Appointment of trustee and approval of trust deed Registration of the REIT Scheme Issuance of units to private investors Approval of offering document Issuance of units to the public 	<ul style="list-style-type: none"> Various approval-based steps changed to reporting-based Total number of approvals reduced from 7 to 4 More responsibility placed with RMC and trustee for various steps
Lock-in period	<ul style="list-style-type: none"> RMC/strategic investor required to hold at least 25% of the initial size of the REIT Fund throughout the life of REIT Scheme. RMC/strategic investor can transfer 10% of the holding to 	<ul style="list-style-type: none"> RMC/strategic investor required to hold at least 25% of size of REIT Fund till revocation of fund or listing of schemes which ever is earlier During the lock in period, RMC and Strategic investors can sell their

¹Review of Land Scape & Revamping Framework Real Estate Investment Trusts (REITs): <https://www.secp.gov.pk/document/review-of-land-scape-revamping-framework-real-estate-investment-trusts-reits/?wpdmdl=45436&refresh=633a6f121fdbc1664773906>
 Draft Amendments to REIT Regulations 2015: <https://www.secp.gov.pk/document/notification-amendments-in-real-estate-investment-trust-regulations-2015/?wpdmdl=45823&refresh=633a6f12271e61664773906>

	<p>another strategic investors subject to approval of SECP</p> <ul style="list-style-type: none"> Requirements for SECP approval to sell remaining holding after lock-in period 	<p>shareholding to other strategic investors with approval of SECP.</p> <ul style="list-style-type: none"> Subsequent to lock in period, no approval is required.
Valuation	<ul style="list-style-type: none"> Requirement of two valuations at the time of acquisition Requirement to value real estate once in every half year, and in case of PPP REIT, at least once in every financial year Valuation methodologies specified by SECP 	<ul style="list-style-type: none"> Mandatory requirement of two valuations at the time of acquisition abolished, at discretion of trustee Valuation to be done on annual basis Valuer given liberty to decide valuation methodology, while following requirements specified in relevant annexure of Regulations
Transfer of ongoing real estate project to REIT	<ul style="list-style-type: none"> No mention 	<ul style="list-style-type: none"> Ongoing developmental projects can be transferred to the REIT structure subject to fulfilment of specified conditions

1.6 Roles and Responsibilities of an RMC: RMCs provide REIT Management Services to all three types of REITs. REITs invests in different segments within the real estate industry such as office buildings, residential properties, industrial estate, apartments, malls, hotels and other commercial buildings and mega structures.

Some key responsibilities of RMCs, as per the Regulations, are given below:



1.7 RMC Rating Framework: PACRA follows a comprehensive approach when assigning REIT Manager Rating, comprising both qualitative and quantitative analyses. The factors considered during evaluation include: i) Profile, ii) Ownership, iii) Governance, iv) Management, v) Investment Risk and Portfolio Management, vi) Customer Relationship, and vii) Investment Performance. By this, it is easy to understand the perspective of the RMC shareholder, board and the management team; since an RMC design has to be reflection of the objectives conceived by the shareholding group. PACRA attempts to analyze an RMC not only on a standalone basis but also in the relative universe.

1.8 Rating Scale: REIT Manager Rating scale ranges from RM1 (REIT Manager meets or exceed the overall REIT management industry best practices and highest benchmarks) to RM5 (REIT Manager does not meet the minimum REIT management industry standards and benchmarks). Symbols ranging from RM2 to RM4 will be appended by ‘++’ and ‘+’ for ranking in the same category.

2. Profile

- **Background:**
Evolution and past strategy
- **Market Share:**
Analysis of size in terms of market share and competitive position
- **Fund Mix:** Portfolio of REIT funds

2.1 Background: PACRA reviews the background of the RMC to understand its evolution from where it started to where it currently stands. PACRA looks at the progress of the RMC from its historical past and the number of REIT funds under the management of the RMC. The progress of the RMC helps PACRA in determining its ability to successfully manage REIT funds. PACRA considers RMC experience in the industry and views favorably RMCs that have established several years' track record, navigating through market cycles, developing sound processes and well nurtured expertise to offer REIT management services.

2.2 Market Share: Size provides sustainability to an RMC and longevity to its operations. Thus, analysis of REIT funds under management and the product base relative to the industry, is central to PACRA's assessment. The aim is to assess the RMC's ability to work with clients and to provide services well-suited to their needs. To gauge this, PACRA assesses the market share of an RMC and its growth over a period of time.

2.3 Fund Mix: PACRA considers that apart from sheer size, a good RMC has a well-diversified portfolio of REIT funds. PACRA looks at diversification at two levels: a) AUMs represented by the top fund, and b) AUMs represented by single property. Concentration in either of these is not considered favorable.

3. Ownership

- **Ownership Structure:**
Identification of man at the last mile
- **Stability:** Succession planning at shareholder level
- **Business Acumen:**
Knowledge, skills and experience of key shareholders
- **Financial Strength:**
Willingness and ability of key shareholders to provide extra-ordinary financial support

3.1 Ownership Structure: The assessment of ownership begins by looking at the legal status of the RMC i.e., whether it is listed or unlisted. PACRA then moves to an in-depth study of the shareholding mix in order to disentangle structure of ownership. Key factors that are considered for this purpose, inter-alia, include: i) shareholding structure which includes whether the individual(s) own the RMC directly or indirectly, ii) foreign or local shareholders, iii) whether the RMC is owned by a single group or through a combination of entities and individuals, and iv) whether it is part of a group or a standalone RMC. All these deliberations are done to identify the man at the last mile. PACRA further considers how an RMC is actually run, as, at times, entities are run as family concerns despite being legally structured as companies.

***Complex shareholding/ownership structures:** In cases where an RMC has a complex ownership structure, there are unique challenges in evaluating the decision-making process, lines of hierarchy and financial obligations and liabilities. In analyzing these RMC's, the fundamental issue is to explore the underlying reason or motivation for the complexity of the structure.*

***RMCs which are owned by private individuals and families:** On the one hand, the concentration of equity ownership might indicate that the majority shareholders have a strong vested interest in creating long-term value and closely monitoring management behavior. On the other hand, a potential concern in such cases is that the owners might rely heavily on extracting funds from the RMC as source of income or to fund other business activities, potentially undermining the financial stability of the RMC.*

3.2 Stability: In order to analyze the stability of ownership, a particularly important factor to be taken into account is succession planning. A very important part of our background analytical work is an attempt to assess whether, and under right of succession, the RMC's prospects would be supported and by whom. This is particularly relevant in case of family-owned businesses and joint ventures, whose failures could have a contagious effect on the sustainability of the RMC. A stable ownership with clarity in succession, perhaps major stakes residing with one family or group, is considered positive for ratings.

3.3 Business Acumen: PACRA gauges the owners'/major shareholder business acumen. Having a strong business acumen set has been critical for sustainable success. PACRA analyzes

business acumen through two primary areas: i) industry-specific working knowledge, and ii) strategic thinking capability. Meanwhile, a deep and applicable understanding of the system is critical in order to determine how a business achieves its goals and objectives. The scope includes the assessment and understanding of how the shareholders of the RMC deliberate over and successfully make the right business decisions. Conformity to the Fit and Proper Criteria as per the Regulations is also confirmed.

3.4 Financial Strength: PACRA evaluates the availability of financial resources with the RMC owner since the Regulations stipulate minimum paid up capital of PKR 50mln for RMCs. Moreover, if the RMC is the strategic investor for certain REITs, it is required to hold at minimum 25% units of initial size of the fund at all times. Thus, the owner presents the first source of risk for the RMC. If the owner is unable to arrange the required equity, it may not be able to set up the RMC. PACRA also analyzes the ability and willingness of the major shareholders to support the RMC both on a continuing basis, and support in times of crisis. Here, PACRA gives due importance to: i) behavior of the major shareholders to provide timely and comprehensive support in times of need in the past, ii) prospective view of key shareholders, in case such need arises, iii) other businesses of shareholders, and iv) the level of commitment of the major shareholder with the RMC in providing capital support. In case of no explicit commitment, PACRA attempts to form a view on availability of likely support. Support, in this context, refers strictly to financial support, rather than operational support. The scope for looking at other business of shareholders includes overall profiling of the key shareholders in the context of identifying the resources they have, outside the RMC. If, in a group structure, the financial strength of the key shareholder is deemed to be weaker than that of the RMC, this may bode negatively for the RMC's standalone rating given the possibility that the RMC may at some point of time be bound to extend financial support to its weaker parent.

Information Required on Ownership:

- Shareholding pattern
- Details of strategic investor, major shareholders' other businesses
- Shareholders' financial information
- Past pattern of support provided by the shareholders

4. Governance

- **Board Structure:** Composition of board in terms of size, independence and committees
- **Members Profile:** Relevance and diversity of board members' skills, knowledge and experience
- **Board Effectiveness:** Extent to which board properly discharges its responsibilities
- **Transparency:** Quality and extent of financial and non-financial information disclosure to stake holders

4.1 Board Structure: This comprises assessment of board on various criteria including overall size, presence of independent members, and duration of board members' association with the RMC, overall skill mixes and structure of board committees. Size of the board may vary as per the scope and complexity of the operations of the RMC. While a very small board is not considered good, similarly, reaching a decision in an effective and efficient manner may not be possible in case of a very large board. A healthy composition of board includes the presence of independent/non-executive members having limited relationship with the shareholding group of the RMC. Meanwhile, same individual holding chairman and CEO positions is considered weak governance practice. The chairman is expected to have a non-executive role. Compliance with the code of corporate governance is also examined. PACRA also examines the independence of governance from major shareholders. Lastly, PACRA evaluates number of board committees, their structure, and how these committees provide support to the board. A board with higher number of members should have higher number of committees in place to assist in performing its role.

4.2 Members' Profile: PACRA collects information regarding profile and experience of each board member. This helps in forming an opinion about overall quality of the board. Moreover, diversification in terms of knowledge background and experience is considered positive. However, a fair number of board members should have related experience. In the eyes of PACRA members having sufficient knowledge and professional experience of the Real Estate Industry are viewed positively.

4.3 Board Effectiveness: In PACRA’s view, the role of the board is to work with management in steering the RMC to its performance objectives and to provide critical and impartial oversight of management performance. PACRA analyzes the type and extent of information shared with board members, and quality of discussions taking place at board and committee levels. Effective oversight requires frequent sharing of detailed information covering various aspects of business and market development. Meanwhile, PACRA also reviews the number of board meetings held during the year as these should be justified with the number of issues/matters arising. Board members’ attendance and participation in meetings is important, and is gauged by viewing board meeting minutes.

4.4 Transparency: Quality of governance framework is also assessed by the procedures designed by the board to ensure transparent disclosures of financial and other information. This can be achieved through: i) ensuring independence of the audit committee, ii) strengthening the quality of internal audit function, which may be in-house or outsourced, and iii) improving quality of external audit by engaging auditors which are included in the State Bank of Pakistan’s panel of auditors and/or have a satisfactory QCR rating.

***Accounting Quality:** PACRA reviews the quality of an RMC’s accounting policies as reflected in its notes to accounts, auditors’ comments and other disclosures which are part of its financial statements. Adherence to accounting standards is assessed, particularly for unlisted concerns.*

Information Required on Governance:

- Size and composition of board
- Details of board committees including TORs
- Profile of board members
- Information packs used by the board
- Minutes of board meetings
- Internal auditor detail (if outsourced)
- External auditor detail

5. Management

- **Organizational Structure:**
Alignment of organogram with RMC size, nature of business and requirements
- **Management Team:**
Relevance and diversity of skills, knowledge and experience of top management
- **Management Effectiveness:** Extent to which top management properly discharges duties and role of technology infrastructure therein
- **Control Environment:**
Robustness of systems and processes

5.1 Organizational Structure: PACRA’s analysis of the organizational structure focuses on how the RMC is organized keeping in view the scope of operations and diversity of the REIT funds. PACRA believes that departments should be structured in an RMC keeping in view segregation of duties and importance of the functions to be performed, e.g., risk function has to be separate and independent. Each functional area is also covered during the analysis including Internal Audit, Information & Technology, Risk Management, Portfolio Management, Research, Sales and Distribution, Marketing, and compliance, etc.

5.2 Management Team: PACRA’s evaluation of human resources is based on an objective criterion that focuses on the back ground of management and staff, both individually and collectively. Assessment is based on the years of relevant work experience, prior track record and tenure with the RMC. Loss of key personnel, particularly members of senior management and senior portfolio managers, can have potentially adverse effects on performance of REIT funds under management and overall standing of the RMC relative to peers. Hence, HR turnover is reviewed to determine the stability of critical staff, with particular focus on key departments. In addition, RMC’s human resource policies are also reviewed to gauge RMC’s emphasis on retaining and recruiting vital staff and ensuring their redundancy in the structure.

4.1.1 Since the RMC is responsible for setting up of the REIT, developing the business plan and implementing it, it is extremely important that its management team have the relevant business and financial acumen and experience to deliver their roles effectively. Here, PACRA would prefer an RMC which is part of a group with experience and expertise in real estate development and management. Senior individuals with expertise in real estate related legalities

is also important to ensure that due diligence of the real estate is conducted proficiently in terms of completeness and authenticity of documentation, clarity on legal status, and transferability of real estate.

5.3 Management Effectiveness: Optimum deployment and delivery of management services requires adequate skills and operating systems. Skills and systems if deployed correctly boosts management effectiveness. Skills and systems could be internal or can be arranged by entering into a contract with a third party. PACRA analysis is based on a thorough review of management systems with the perspective of its effectiveness and adequacy. PACRA places high value on MIS and system generated MIS are considered superior. A key measure of management effectiveness is its track record of delivering on past projections and sticking to strategies.

4.1.2 Oversight of Third-Party Service Providers: Existence of documented policies and processes established by the RMC for availing services by third-party service providers would be viewed positively. In particular, PACRA assesses how due diligence of service providers is conducted by RMC, onboarding processes and mechanisms in place to monitor the quality of services being provided by the third-parties as per the underlying Service Level Agreements (SLAs). Controls surrounding these processes are considered crucial as the performance of the REIT is not only dependent upon the management of the RMC but also upon the quality of the services provided by the third parties. Since ultimate responsibility of outsourced functions rests with the RMC. PACRA evaluates whether an adequate mechanism exists for the identification and mitigation of service providers' related risks. Here, PACRA gives due credit to the existence of comprehensive contingency plans developed under the guidance of the RMC's Board to prevent potential disruption in operations due to negligence or underperformance of the service providers.

MIS: System generated – real-time based – MIS reports add more efficiency in decision making whether related to operational, financial or strategic issues. PACRA evaluates the quality and frequency of the MIS reports used by the management team to ascertain that decision-making within the RMC is information-based.

5.4 Control Environment: An analysis of the overall Compliance and Internal Control framework (including Internal Audit procedures) of the RMC helps in identifying the procedures, control centers and reporting lines, in order to manage conflicts of interest, meet fiduciary responsibility, and to verify the accuracy of financial and accounting information prepared for unitholders and other stakeholders. This analysis would assess the strength of the overall compliance and control environment beyond regulatory requirements. Well-documented and comprehensive internal policies and a structured internal control program are viewed as positive factors for the rating. The compliance function is evaluated on an enterprise-wide basis. More value would be given to the independence of the compliance function and it's integrated into the overall systems of the RMC.

4.1.3 Managing Conflicts of Interest: It is possible that the key owner/strategic investor of the REIT holds multiple real estate properties which it may choose to not place under the REIT. This would effectively mean competing real estate interests, potentially impact the impartiality of the key owner. Since the key owner has a high minority stake (possibly even majority stake), and may also be part of the Board/management team, this can threaten the interests of unitholders. Other conflicting interests may arise if an RMC outsources key functions to affiliates or associated companies. The Regulations limit such risks to some extent by requiring certain functions, including the trustee, valuer and advisor/consultant to be independent. However, other roles such as those of property manager or developmental advisor may still result in risk of self-dealing if transactions are not conducting on arms-length basis. Here, PACRA would place emphasis on the RMC's policy on avoiding such conflicts and assess how the RMC ensures robust controls around related party transactions. There may also be conflicts of interest on the RMCs part if compensation arrangements are not well thought out. If the

management fee of the RMC is tied to value of underlying real estate assets, this can potentially impact decision making by the RMC. It is highly unlikely that the RMC would want to sell a highly valued asset in such case even if the sale may result in a substantial capital gain for the REIT. Therefore, it is preferred that the management fee be linked to operating income/profits rather than value of underlying assets.

Operational Risk: *Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. An analysis of the RMC's Disaster Recovery (DR) procedures, infrastructure security and monitoring of third-party activities helps to determine the viability of the operational control environment against unanticipated business disruptions, personnel slippage and inadvertent data entry errors. In addition, PACRA evaluates capacity to promote ethics and monitor enforcement thereof.*

Information Required on Management:

- Latest organogram
- Details of management committees
- Business Plans of REIT funds under Management
- Profile of senior management
- Redundancy pattern
- MIS reports
- Minutes of management committees' meetings
- Financial institution's policies and SOPs

6. Investment and Portfolio Management Risk

- **Investment Risk Management Framework:** Quality of policies and systems for Risk Management
- **Investment Decision Making:** Composition and role of Investment Committee
- **Investment Research & Analysis:** Importance of research & analysis while decision making.

6.1 Investment Risk Management Framework: A strong risk management framework and monitoring culture are pivotal to effective investment and portfolio management. Evaluating the overall risk management framework of the RMC enables to determine how various risks are identified, monitored and mitigated across the RMC. The efficiency of controls and risk management within an RMC is instrumental in mitigating risks arising from operational and investment management activities. The analysis also considers role of the Board in formulating risk management policies, the independence of the risk management function, and the key risk indicators and IT systems employed by the RMC to monitor risk. At the same time, the involvement of senior management in the overall risk management function is assessed to understand organization's emphasis on risk and its overall risk culture.

4.1.4 Type of Risks: Investment Risk Management permeates the entire investment management process, and consists of two pillars a) macro-economic risks, b) portfolio risks. Macro-economic risks pertain to the operating environment of the industry and overall economy. Portfolio risks are related to REIT funds under the management of the RMC. PACRA reviews coverage and appropriateness of risk indicators used by the RMC for both macroeconomic and portfolio level risks, the capacity of the RMC to measure such indicators and monitor exposures against explicit and meaningful limits. The extent of risk indicators used by the RMC depends on the scope of activities and nature of REIT funds under the management of the RMC. Reconciliation between expected and actual risk levels is equally important and requires regular comparisons, analysis of discrepancies and corrections. Key risks to which an RMC is exposed during its investment processes and portfolio management are summarized below:

- **Economic & Industry Risk:** These are macroeconomic and industry specific factors. The real estate industry is strongly correlated with overall economic conditions. Macro-economic indicators, which impact real estate includes GDP growth, manufacturing activity, interest rate environment and government policies. Meanwhile, PACRA analyzes the real estate industry in context of the local economy, regulatory environment and trends impacting the industry.

- **Asset Quality Risk:** This includes, market position (demand and consumer interest relative to other properties), project risk (completion of projects of Developmental and Hybrid REITs), tenancy risk (tenancy agreements, profile and concentration of tenant base, and vacancy rates), legal risk (any ongoing or potential legal disputes), third-party service provider risk (risks arising due to quality of services provided by third-party contractors) and event risk (risk arising due to unforeseen events).
- **Financial Risk:** Here, PACRA analysis availability of liquid resources for completion of projects, management of ongoing cash-flow needs, marketability of the underlying properties, insurance arrangements and debt burden to ascertain level of risk.

4.1.4.1 PACRA considers the underlying protocols developed by the RMC to mitigate and avoid these risks. PACRA considers it positively if the RMC has well-structured enterprise risk management processes, thoroughly designed standard operating procedures and internal controls systems covering the above stated risks. Similarly, business plans for underlying funds are analyzed. For newly launched funds, PACRA's analysis is based upon the adequacy and achievability of the business plan. PACRA analyzes whether the business plan adequately covers legal, financial, and business aspects, contingency planning and exit strategies. For operational funds, PACRA also compares the stated objectives in the business plans with the actual results achieved by the managed funds.

6.2 Investment Decision Making: PACRA assesses how investment/divestment decisions are formulated, reasoned and analyzed. From this perspective, the composition of Investment Committee, experience of its members, frequency of meetings, independence from other functions and review of investment committee packages are reviewed to determine the overall effectiveness of decision-making process. Investment Committee and its functions are an integral part of the decision-making process, as the Investment Committee is the primary point of reference for any investment decisions made and implemented. PACRA reviews the quality of IC composition by reviewing the profile of individual IC members in order to gauge the collective investment acumen of the IC. Meanwhile, dominance of any particular member is carefully scrutinized through review of Investment Committee minutes. Meanwhile, effectiveness of the IC is also gauged by studying adherence to the stated investment objectives and philosophy to ensure that it is discharging its responsibilities in the best possible manner and in the best interest of the unitholders.

6.3 Investment Research and Analysis: Strong investment research and analytical frameworks are critical for prudent investment management. In the absence of formal data pertaining to Pakistan's real estate sector, it is crucial that the RMC has a well-structured, adequately staffed and capable in-house research function to gather data required for investment decision making. The experience and educational profile of the research team are considered. A mix of different skill set in the team is considered good when it is supervised by a strong head of the department/function. Ultimately, the quality of the research would dictate how effectively the RMC monitors the real estate value, market position, changes in economic, and regulatory environment and legal issues, in addition to any other risk factors which may impact the operations and performance of the REIT. The degree of independence enjoyed by the research staff in its operational activities and investment recommendations, both from the fund management team and from the reference shareholder, is an important determinant in assessing its effectiveness in the investment management chain.

Information Required on Investment Risk & Portfolio Management:

- Investment policy and guidelines
- Risk policy/manual
- Details of risk management systems
- Details of investment committee (incl. members profile and ToRs)
- Details of research function

7. Customer Relationship

- **Investor Services:** Relationship management system, capacity and quality
- **Investor Reporting:** Quality, accuracy and frequency of information sharing with investors
- **Distribution and Sales Network:** Distribution arrangements and strength of sales channels

7.1 Investor Services: RMC is responsible for regular reporting to its unitholders and the regulator. PACRA examines the investor services platform of an RMC for evaluating overall service quality and resource availability for investors education and facilitation. Examining client relationships focuses on the RMC ability to manage relations through determination of investment objectives and a thorough understanding of constraints, and then to day-to-day relationships. PACRA evaluates the RMC capacity to provide appropriate responses tailored to unitholders' requests, as well as keeping abreast of applicable regulations. Criteria are, inter alia, staffing, technical knowledge of sales people, systems such as Client Relationship Management (CRM tool), value-added services and access to information. The platform offered to unitholders, if any, from the stand-point of its adequacy and robustness is also evaluated.

7.2 Investor Reporting: Much of the information provided to investors is communicated through regular reporting, which PACRA examines in light of its comprehensiveness, clarity, consistency, accuracy and timing. This capacity to adapt reports to meet varied investor requirements is also examined. Beyond mere reporting, PACRA believes that all RMC should offer performance presentations and performance attribution reports to their clients on a widespread and timely basis. PACRA, therefore, looks at accuracy of performance attribution and consistency with the investment process. PACRA also reviews the resources and the procedures used in the production of reports, particularly with respect to data accuracy.

7.3 Distribution and Sales Network: PACRA examines the distribution and sales network of an RMC. Particular focus is given to RMC marketing strategies, well-structured sales team and association with other players in the real estate industry. At the same time, RMC emphasis on brand management, strength of sales team, training routines for sales team and related performance reviews is also incorporated in analysis.

Information Required on Customer Relationship:

- Details of value-added services
- Frequency, mode and information of client reporting
- Complaint management policy and systems
- Details of Sales and distribution channels

8. Investment Performance

- **REIT Funds Under Management:** Growth trend of REIT funds in line with business plan
- **Performance:** Consistency in performance of the RMC
- **Financial Sustainability:** Standalone and relative financial position as depicted by balance sheet and income statement

8.1 REIT Funds Under Management: PACRA looks at the growth trend in the AUMs. This is then compared to industry trends and peer performance over the period. Movement in AUMs is also assessed in light of the overall economic environment during the period. Segment-wise composition of AUMs is analyzed to detect significant changes in trends and possible underlying risks.

8.2 Performance: Achieving competitive investment results to sustain and improve REIT funds is the principal objective of an RMC. Over the long run, poor performance leads to poor reputation and makes holding on to REIT Funds challenging. This lowers the income and leads to deterioration in profitability and ultimately the standing of the RMC. PACRA believes that in long run, the REIT funds of an RMC with noted strengths will usually be superior or at par with peers. Given the low number of players currently operating in the REIT industry and lack of availability of formal data pertaining to the real estate sector in general, performance benchmarking is expected to be a challenge in the short-term and could be made across asset classes. However, the growth momentum of the industry, supported by favorable government policies, is encouraging and more performance related data gathered over time is expected to allow for building sophisticated datasets and indices for comparative analyses.

8.3 Financial Sustainability: PACRA looks at financial position of the RMC with an objective to assess sustainability. For this, both balance sheet analysis and profit analysis are undertaken. Several aspects of the RMC's income statement are considered: revenue and diversification of revenue stream: revenue from management fee and other income, expense trends, concentration by REIT funds and industry segments. More than 50% revenue contribution by one REIT fund or industry segment may not be considered positively. All these deliberations are done to assess whether the RMC is financially stable to maintain its operations in the long run and its payment capacity in case any liability comes due. The return on equity is analyzed in conjunction with peer to make a view as to the unitholder's satisfaction with the investment. PACRA also considers if there are insurance arrangements to cover the loss occurring due to errors and omissions.

Information Required on Investment Performance:

- Details of Insurance policies acquired
- Analysis on growth trends of REIT funds under management
- Financial statements
- Financial projections

REIT Manager Rating Scale				
An independent opinion on a REIT Manager's quality of investment and operations management.				
Scale	Definition			
RM1	Very high quality of investment and operations management.			
RM2++ RM2+ RM2	High quality of investment and operations management.			
RM3++ RM3+ RM3	Good quality of investment and operations management.			
RM4++ RM4+ RM4	Adequate quality of investment and operations management.			
RM5	Weak quality of investment and operations management.			
<p>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'.</p>	<p>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.</p>	<p>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.</p>	<p>Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.</p>	<p>Harmonization A change in rating due to revision in applicable methodology or underlying scale.</p>
<p>Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.</p>				

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