The Pakistan Credit Rating Agency

Rental Real Estate Investment Trust (REIT) Fund Rating

Assessment Framework

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Summary

This methodology outlines PACRA's approach to assigning a Rental REIT Fund Rating, an independent opinion on the capacity of a Rental REIT Fund to maintain stable rental income, and risk factors impacting the value of REIT assets over the foreseeable future.

It is important to understand that Rental REIT Fund Rating differs fundamentally from the traditional credit rating, which reflects an entity/issuer's ability to meet its financial obligations. PACRA's opinion is based on evaluation of the following factors: i) Profile, ii) Economic and Industry Risk, iii) Asset Quality, iv) Financial Risk, and v) Management Review.

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Introduction

Overview

Real Estate Investment Trusts (REITs) are investment vehicles designed to mobilize resources from a large pool of investors and, in turn, provide them with 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 or listed securities, enabling the investor to invest directly in real estate. Returns for the investors come either from rental income distributed through dividends or capital gains through price appreciation of the underlying assets, as reflected in the unit price. REITs generally distribute the majority of their profits (over 90% in Pakistan) to their investors to receive favorable tax treatment under Pakistan's tax laws. REITs enable investors to have direct exposure to a relatively illiquid asset class with low individual investment requirements and a sizeable initial capital requirement.

REIT Industry Structure

A REIT Scheme can execute its project through two structures. The Regulations place specific obligations on the RMC under the second one, and PACRA considers the RMC's adherence to them in its assessment.

- **Direct Investment Structure:** The REIT Scheme invests directly in the REIT Project.
- **Special Purpose Vehicle (SPV) Structure:** The REIT Scheme invests in an SPV, which executes the REIT Project. The RMC manages the SPV under an SPV Management Services Agreement, and the Regulations set conditions on the REIT Scheme's ownership of the SPV and on its governance and operations.

Types of REITs

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

- **RMC:** a public limited company licensed to undertake REIT management services.
- **Rental REIT schemes:** established with the objective of making investment in industrial, commercial or residential real estate for generating rental income.
- **Developmental REIT schemes:** 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 schemes:** comprising developmental component as well as rental component.

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 Rental REIT Funds.

Regulatory Framework

REITs are regulated by the Securities and Exchange Commission of Pakistan (SECP), which has issued a comprehensive set of regulations (REIT Regulations 2022, hereinafter referred to as "the Regulations"). The Regulations address all aspects of REIT registration, operations, and the roles and responsibilities of all parties, including the RMC. Where applicable, PACRA also considers the Shariah Governance Regulations, 2023, which apply to REIT Schemes and RMCs offering Shariah-compliant products. REITs can be formed under a 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 Developmental REIT scheme or Hybrid REIT scheme with a developmental component should be listed three years from the date of transfer of real estate/shares of SPV, whereas other types of REIT schemes should be listed one year from the date of transfer of real estate/shares of SPV. Some salient features of the Regulations are listed in the table below:

Minimum ownership requirement by accredited investor/RMC:	
In case of single strategic investor	25% Units
In case of multiple strategic investors	5% Units
Application for permission to form an RMC	PKR 0.25 million
Application for license to undertake or carry out REIT Management Services.	PKR 1 million
Application for the renewal of license to carry out an activity or function.	Nil
Launch REIT scheme	PKR 0.5 million
Annual Monitoring Fee paid quarterly to SECP (Rental REIT)	0.1% of fund size
Annual Monitoring Fee paid quarterly to SECP (Developmental REIT)	0.2% of fund size
Annual Monitoring Fee paid quarterly to SECP (Hybrid REIT)	0.15% of fund size

Rental REIT Fund Rating Framework

PACRA follows a comprehensive framework when assigning Rental REIT Fund Rating, comprising both qualitative and quantitative analyses. The factors considered during evaluation include: i) Profile, ii) Economic and Industry Risk, iii) Asset Quality, iv) Financial Risk, and v) Management Review. PACRA attempts to analyze a REIT not only on a standalone basis but also in the relative universe, where applicable.

Rating Scale

Rental REIT Fund Rating scale ranges from AAA (rr) (indicating fund having exceptionally strong capacity to maintain stable rental income and risk factors impacting value of REIT assets are negligible over the foreseeable future) to B (rr) (indicating fund having weak capacity to maintain stable rental income and risk factors impacting value of REIT assets are very high). The scale is appended with "+" and "-" signs to denote the relative status within each category except "AAA (rr)" and B (rr)".

Profile

Portfolio Mix

Rental REITs hold completed, rent-generating assets in industrial, commercial or residential real estate segments. PACRA looks at the composition of the REIT fund's portfolio and degree of diversification in terms of the number of properties and underlying real estate segments. A fund with a single underlying property or multiple properties within a single real estate segment would generally be considered riskier due to a higher risk of disruption. This does not entail that a fund specializing in a certain real estate segment would necessarily be at a disadvantage, nor does it imply that simply having a higher number of properties would assure greater stability in rental income and appreciation in asset value. In the case of multiple properties, PACRA assesses diversification at segment and geographic level. Meanwhile, the individual asset quality of each property is assessed as per the criteria outlined in Section 3 of this methodology and factored accordingly into the rating opinion.

Economy and 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 Government policies exhibit a strong correlation with real estate demand and, in turn, prices. It is also viewed by investors as a viable investment venue. In a growing economy, with low interest rates, capital availability becomes high, resulting in higher purchasing power that creates interest for investors. Therefore, more commercial real estate projects are likely to be initiated. Interest rates can have a dual impact. In addition to capital access, high interest rates may end up negatively impacting demand for REITs as investors opt for safer investment options such as bank deposits or government securities. Meanwhile, population demographics, urbanization rate, and political stability are other important factors when analyzing real estate trends. Budgetary allocation by the government for infrastructure development also plays an important role in the development and growth of the industry, as investors are attracted and encouraged to invest through various schemes and incentives.

Conversely, in times of low economic growth, REIT returns may suffer as property prices stagnate and the market becomes illiquid. The rental portion may also get impacted due to the likelihood of low occupancy and inability to increase or recover full rental payments. In such conditions, the negotiating power of property owners over tenants is also likely to be compromised. PACRA closely monitors economic conditions for indicators of negative movement in the economy and factors the same in its rating assessment.

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 financial market. However, progressive regulatory reforms in recent years have encouraged several new entrants. At the time of this document's publication, 41 RMCs have obtained licenses to provide REIT management services. These numbers reflect the addition of 3 RMCs in 10MCY26[1], as REITs remain a tax-friendly investment avenue, given that 90% of their profits are distributed.

[1] Number of RMCs taken from SECP List for NBFCs and SFAs as on August 31, 2026

The real estate and construction sector is recovering from a prolonged slowdown caused by high interest rates, elevated inflation, and a heavy tax burden on property transactions. The Federal Budget FY27 introduced relief measures, including lower taxes on property purchase and transfer and the removal of federal excise duty on property transactions. Together with expanded housing initiatives and higher development spending, these measures have supported construction activity. However, the policy rate remains elevated, and developers continue to face high costs of land, energy and construction inputs. PACRA monitors prevailing economic, regulatory and industry trends and duly incorporates them in its opinion.

Asset Quality

Market Position

Market position is determined from the perspective of consumer interest for a particular property and is driven by a variety of factors including property type, location, infrastructure dynamics and physical state. Market position ultimately drives the occupancy/salability of a property across changing market dynamics and economic shocks.

- **Type of Property:** Different types of properties exhibit varying degrees of business risk. PACRA expects demand for shopping malls and hotels to be highly sensitive to economic cycles, while demand for schools, hospitals, residential and office space is expected to remain more stable even in an economic downturn, hence providing more comfort to the rating. PACRA recognizes that such relationships may not always hold or be as straightforward. For example, demand for industrial properties like factories and manufacturing plants may show a mixed trend, depending on the demand-supply dynamics of the particular industry and its sensitivity to economic conditions. Investors and customers are becoming increasingly conscious about Environmental, Social and Governance (ESG) risks pertaining to Real Estate sector and projects. E&S risks become more important from a rental REIT perspective as preference for "Green" buildings is gaining traction. These could impact the demand and eventual returns of the project. PACRA considers these risks in its evaluation to assess their impact on the final rating.
- **Geographic Location:** Strategically located properties with close proximity to residential and commercial areas are viewed positively. PACRA analyzes the ongoing and planned development in the area to form a view on demand prospects. The presence of substitute properties or the threat of new entrants can impact market position.
- **Infrastructural Dynamics:** Connectivity to well-developed transportation networks for accessibility and availability of utilities (power, gas, water, etc.) and parking space is considered favorable.
- **Physical State:** Forming an opinion on the quality of construction and physical condition of a developing property may be a challenge. However, once it is complete, PACRA assesses its age, physical state, amenities and maintenance on an ongoing basis to estimate its useful life and prospects for income generation through renting and/or ultimate sale.

Tenancy Risk

Once a property has been developed, a Hybrid REIT scheme may choose to rent out a portion or all of it. In such cases, it is crucial for PACRA to assess the underlying tenancy agreements, vacancy rates, and profile and diversity of tenant base.

- **Tenancy Agreements:** Longer-term tenancy agreements, with prescribed rental increment clauses, are viewed favorably since they mitigate the risk of unexpected vacancies and provide stable cash flows. PACRA examines average tenure of the agreements, expiry and opt out clauses, and backup plans if a major tenant leaves unexpectedly.

- **Vacancy Rates:** Higher vacancy rates relative to the industry can be an important indicator of challenges in property management or marketing. PACRA opines whether this is a temporary or one-off occurrence or whether a trend is developing.
- **Tenant Base:** Concentration of revenue among top 5 and top 10 tenants is considered. Less than 10% exposure to the top tenant is considered desirable. High-profile tenants, evergreen tenants or tenants with good credit ratings generally offer more comfort to the rating due to their financial strength and payment ability.

Legal Risk

PACRA evaluates the protocols in place for evaluation of legal risk, as legal disputes pertaining to property can potentially cause huge losses or even lead to closure of projects or suspension of income. PACRA expects due diligence to be conducted pertaining to the legal status of the property, ensuring the property is clear from any lien marks or stay orders against the transfer of the legal title, availability of complete documentation and approvals have been obtained from relevant authorities for real estate development.

Third-Party Service Provider Risk

An RMC may outsource certain functions related to third parties through Service Level Agreements (SLAs). PACRA considers the quality and terms of engagement for these parties, while control mechanisms to monitor their performance and the comprehensiveness of related contingency planning are also evaluated. This is important to prevent potential disruption in operations due to negligence or underperformance by service providers, which can impact the completion and quality of the property. Some key parties that are scrutinized during this analysis include: Valuer, Development Advisor/Property Manager and External Auditor.

- **Valuer:** The Valuer is appointed by the RMC (with consent of the Trustee) for valuation of REIT assets. PACRA assesses the independence of the Valuer, its listing position on the panel of valuers maintained by Pakistan Banks' Association (PBA), and experience in the field since the valuation of the property is a key determinant of ultimate sale and returns to investors.
- **Development Advisor/Property Manager:** For Developmental REITs, a development advisor is appointed by the RMC for planning, design, costing, scheduling, contract preparation, coordination and supervision. Meanwhile, a Property Manager may be appointed for Hybrid REITs for managing and maintaining the rental component. Experience, track record, and market reputation of the designated personnel/entities are considered to determine their ability to ensure timely completion, maintenance, and upkeep of the property. PACRA reviews the degree of oversight and supervision along with related MIS shared. Similarly, project management software and tools deployed and Standard Operating Procedures (SOPs) followed are examined.
- **REIT Auditor:** Assessing the quality of the REIT auditor is crucial to establish the integrity of its financial statements and reporting. PACRA reviews whether the external auditor is on the panel of approved auditors maintained by the State Bank of Pakistan and/or has a satisfactory QCR rating to form its opinion.

Event Risk

Incorporating the risk of unforeseen events that can cause a disaster into a rating opinion is challenging, given their unpredictable nature. However, their potential impact makes them a consideration. These events may be external (economic changes, regulatory changes, litigation, or natural disasters such as earthquakes, landslides, or flooding) or internally driven (unrelated diversification or strategic restructuring) and can lead to sudden and material shocks to rental income. PACRA evaluates any third-party guarantees or insurance arrangements in place to mitigate such risks. PACRA also applies its analytical judgment in assessing the likelihood of such occurrences and potential impact,

insofar as may be possible, and assesses the REIT fund's track record, expertise of RMC and level of financial discipline to incorporate the same into its ratings.

Financial Risk

Cash Flows

Properties with a strong market position (in terms of location, amenities, and physical state) and financially strong, diversified tenant profiles are likely to generate more stable cash flows. Longer tenure of rent agreements and regular rent renewal clauses also favorably impact the stability of cash flows. Given the liquidity constraints posed by high dividend distribution requirements to maintain tax-free status, it is crucial for PACRA to assess the REIT's ability to raise cash, internally or through a strategic investor. Special consideration is given to the existence of liquid assets, available borrowing lines, and access to capital markets to sustain ongoing operations. This includes proper maintenance and upkeep of the properties, related services and amenities, and covering unexpected costs (e.g., financial penalties or fines from legal authorities or third parties). The quality and market position of properties in the REIT's portfolio factor are key determinants of occupancy and, hence, affect rental income and the value of REIT assets.

Coverages

Key cash flow measures used by PACRA include a REIT's Funds from Operations (FFO) and Adjusted Funds from Operations (AFFO). AFFO accounts for the impact of ongoing maintenance expenses, capital expenditures, and any rent increases and advances received from tenants. PACRA analyzes the adequacy of coverage provided by cash flows to outstanding costs, including debt principal and interest payments

Capital Structure

PACRA considers capital structure to determine a REIT's reliance on external financing. While there is no absolute ceiling for borrowing stipulated by the Regulations, from a rating perspective, REITs with conservative leveraging are viewed favorably. This is because higher borrowing and debt repayment lead to strained cash resources, which impacts the REIT's ability to adapt to changing economic conditions or sustain shocks in business. Ultimately, financial flexibility becomes limited, as do returns to investors due to pressure on performance and profits.

Management Review

The ability of a REIT scheme to meet its investment objectives and adhere to stated policies depends on the RMC's expertise and quality of support systems. Therefore, an assessment of the RMC's qualifications, experience, capabilities and track record are an integral part of the rating process. The assessment of management quality may also provide a basis of how the scheme might respond to future opportunities or stress situations under different market conditions.

RMC Rating

Opinion on quality of the RMC is directly derived from the RMC Rating, the criteria for which is detailed in PACRA's REIT Manager Rating methodology. During the evaluation process, PACRA reviews the policies and procedures developed by the management to meet its investment objectives and assesses the efficacy of the investment

management process, supporting organizational structure, internal controls, risk management, and reporting systems.

Analysis of arrangements with and quality of third-party services providers is conducted. Adequacy of the resources and appropriate segregation of duties to prevent conflict of interest is considered positively. Further, the profile of the RMC management team is assessed in terms of relevant experience and track record. A key measure of management effectiveness is its track record of delivering on past projections and sticking to strategies defined in its business plan. Investment process and quality of underlying research are also key considerations.

To determine the REIT fund's level of risk tolerance and confirming harmony in fund's stated objectives and the REIT manager's investment philosophy in future course of action, discussions with the RMC regarding investment strategy and outlook on business and industry are held. The framework deployed to ensure compliance with regulatory requirements and its actual effectiveness would likewise be an important consideration.

Rental REIT Fund Rating

Opinion on the relative capacity of a Rental REIT fund to maintain stable rental income and risk factors impacting value of REIT assets.

Scale	Long-Term Rating
AAA (rr)	Exceptionally strong capacity to maintain stable rental income. Risk factors impacting value of REIT assets are considered negligible over the foreseeable future.
AA+ (rr) **AA (rr)** **AA- (rr)**	Very strong capacity to maintain stable rental income. Risk factors impacting value of REIT assets are modest over the foreseeable future.
A+ (rr) **A (rr)** **A- (rr)**	Strong capacity to maintain stable rental income. Risk factors impacting value of REIT assets are modest over the foreseeable future.
BBB+ (rr) **BBB (rr)** **BBB- (rr)**	Adequate capacity to maintain stable rental income. Risk factors impacting value of REIT assets are modest over the foreseeable future.
BB+ (rr) **BB (rr)** **BB- (rr)**	Inadequate capacity to maintain stable rental income. Risk factors impacting value of REIT assets are high.
B (rr)	Weak capacity to maintain stable rental income. Risk factors impacting value of REIT assets are very high.

Rating Modifiers | Rating Actions

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) 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 surveil the opinion due to lack of requisite information.

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

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. Rating actions may include "maintain", "upgrade", or "downgrade".

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