



GCR affirms Delta Property Fund Limited's rating of BBB+(ZA); Outlook Stable.

Johannesburg, 15 Aug 2014 — Global Credit Ratings has today affirmed the national scale issuer ratings assigned to Delta Property Fund Limited of BBB+_(ZA) and A2_(ZA) in the long term and short term respectively, with the outlook accorded as Stable.

RATING RATIONALE

Global Credit Ratings has affirmed the above credit ratings of Delta Property Fund Limited (“Delta”) based on the following key criteria:

Leveraging management’s strong B-BBEE credentials and extensive experience within the niche sovereign property space, Delta more than trebled its scale in 12 months, with properties and investments (including a strategic stake in Ascension Property Fund, “Ascension”) valued at R7.3bn at FYE14, from R2.1bn at its November 2012 listing. Following the decision to shelve the mooted merger with Ascension and Rebosis Property Fund (“Rebosis”), Delta recently acquired a 33% stake in its affiliate Delta International for R417m, which was funded through the DMTN programme and plain vanilla debt facilities.

Government entities occupied 56% of GLA and contributed 64% of rentals as of FYE14 (FYE13: 69%; 75%). Although the robust credit profile of this tenant grouping mitigates concentration risk, the relationship is premised on Delta maintaining its strong empowerment credentials and a greater regulatory burden. The fund reflects a long term lease profile, with average escalations of 8% at FYE14 (FYE13: 8.4%). Vacancies also remain low at 4.6% (FYE13: 4.4%), with property enhancements to be staggered to limit their impact on income generation and gearing. Management is of the view that Delta’s weighted mean rentals (around R90/m², from R94/m² in F13) are sustainable, attributing the headroom over industry averages to claw backs for rates and taxes structured into pricing for government leases. This is borne out to an extent by the fact that margins are largely aligned with those of funds dominated by single-tenanted assets. However, the EBITDA margin (of 71% in F14; F13: 76%, against an F12 high of 82%) continues to decline as government tenancies are diluted, implying superior returns on state contracts.

The rapid growth saw debt rise to R3.5bn at FYE14 (FYE13: R866m), with a further R2.3bn raised from unitholders. As such, the LTV closed FYE14 at a high of 48%, from 41% previously, at the top end of the gearing benchmark for ‘BBB’ band rated funds, while debt to EBITDA remained elevated due to the earnings drag of new acquisitions (744%; FYE13: 819%). Gearing metrics are nonetheless expected to moderate in the medium term as the portfolio is bedded down, with the net LTV easing to 38% by FYE15. Delta’s liquidity and funding flexibility are deemed to be constrained, as investments are wholly encumbered and it currently has limited untapped facilities. Despite overcollateralisation on standing facilities of nearly 2x and ready access to capital markets via the DMTN programme, the fairly high LTV limits its ability to take on further debt in the absence of new equity capital.



Upward rating pressure would mainly emanate from the proven ability to extract value from recent acquisitions. Moreover, the fund would need to manage the LTV ratio to below 40%, in line with other 'A' band rated funds. However, LTVs persistently above the 45% level would be indicative of excessive gearing. In this respect, continuing to leverage the balance sheet to fund new acquisitions or equity investments would exert downward rating pressure unless coupled with new unitholder capital. Any negative developments in the relationship with the Department of Public Works, or non-payment from government could negatively impact earnings and credit protection metrics.

NATIONAL SCALE RATINGS HISTORY

Initial rating (Jul/2013)

Long term: BBB⁺_(ZA); Short term: A2_(ZA)

Outlook: Stable

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH

GCR's Global Master Criteria for Rating Corporate Entities, updated August 2013

GCR's Criteria for Rating Property Funds; updated July 2014

Delta Property Fund Limited ("Delta") Rating Report, 2013

Delta R362m Senior Secured Notes; New Issuance report, December 2013

RATING LIMITATIONS AND DISCLAIMERS

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SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

Delta Property Fund 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 credit rating/s has been disclosed to Delta Property Fund Limited with no contestation of the rating.

The information received from Delta Property Fund Limited and other reliable third parties to accord the credit rating(s) included the 2014 audited financial statements (plus four years of comparative numbers), the projected 2015 income statement, portfolio performance metrics and 2015 income forecasts by property, approved capex projections for 2015, corporate governance and enterprise risk framework, industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties. In addition, information specific to the rated entity and/or industry was also received.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS REPORT

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Gearing	With regard to corporate analysis, gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
Gross lettable area	Or GLA. This is the amount of floor space available to be rented in a commercial property.

EBITDA	Earnings before interest, taxes, depreciation and amortisation is useful for comparing the income of companies with different asset structures as it calculated before excluding non-cash expenses related to assets.
Income Statement	A summary of all the expenditure and income of a company over a set period.
Liquidity Risk	The risk that a company may not be able to take or meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets.
Loan to value	Or LTV. A ratio used to assess lending risk, usually calculated by expressing the principal balance on a mortgage as a percentage of the market or carrying value of investment properties.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.

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