GCR RATINGS

GCR affirms Vukile Property Fund Limited's rating of A(ZA); Outlook Positive

Johannesburg, 15 March 2017 — Global Credit Ratings has today affirmed the national scale issuer ratings assigned to Vukile Property Fund Limited of $A_{(ZA)}$ and $A1_{(ZA)}$ in the long term and short term respectively; with the outlook accorded as Positive.

SUMMARY RATING RATIONALE

Global Credit Ratings ("GCR") has accorded the above credit ratings to Vukile Property Fund Limited ("Vukile") based on the following key criteria:

Vukile's refocused investment strategy has seen it transition into a predominantly retail-oriented fund, geared at improving the overall quality and size of the portfolio. Post finalisation of the forthcoming transaction with GemGrow Properties Ltd ("GemGrow"), Vukile's total property investments are expected to be valued at c.R14.7bn at year-end FY17 (FY13: R7.7bn). The GemGrow transaction will see Vukile acquire all 14 of the ex-Synergy retail assets for R2.5bn via an asset swap agreement, thus taking Vukile's direct retail weighting to c.86% of the total portfolio (FY16: 67%), from around 48% four years ago.

In the interim, the fund's focus is on optimising the existing portfolio by recycling existing capital sources into yield enhancing upgrades and developments, with two retail centres expected to be completed in 2017. GCR also notes management's intention to further diversify earnings offshore, which should provide an effective Rand hedge through the cycle.

Tenant quality is fairly high, with 'A' grade lessees' contributing c.65% of GLA, whilst the lease maturity profile is well-dispersed, with at least 44% of in-force rental contracts expiring in FY20 and beyond. The vacancy rate increased to 5% in 1H F17 (FY16: 3.9%), although is expected to moderate going forward as certain office assets are anticipated to be traded out of the portfolio.

The 32% increase in rental income to R2.1bn achieved in FY16 was mainly driven by acquisitions. While growth moderated to an annualised 4% in 1H FY17, the completion of planned developments and higher average base rentals off the back of the enlarged retail portfolio of direct assets is expected to provide revenue uplift in FY18. Medium term margins are expected to be relatively resilient, backed by robust in-force escalations and cost control initiatives.

The cumulative R5.3bn in cash raised from shareholders since FY13 and dividend reinvestments have kept gearing metrics conservative. Vukile's LTV ratio reduced to a low of 28% at 1H FY17, which is well below management's upper target threshold of 35% and aligns to levels reported by highly rated REITs. Debt to operating income metrics also registered at a review low of 308% at 1H FY17 (FY16: 424%) on the back of sizeable debt repayments. Note is taken of the large debt maturities over the next 24 months, although potential refinancing risk is mitigated by the low LTV, sufficient unutilised facilities and the discretionary cash balance of R871m reported at 1H FY17.

Vukile's ability to successfully bed down new assets and sustain high quality cash flows and grow earnings in line with the articulated retail strategy could provide ratings uplift. Moreover, the lengthening of the debt maturity profile would also be positively viewed. On the contrary, downward rating pressure could arise from a notable slowdown in the retail sector, thereby weakening the fund's performance benchmarks, and/or a material increase in gearing.

NATIONAL SCALE RATINGS HISTORY		
Initial rating (February 2012)		
Long term: $A_{(ZA)}$ Short term: $A1_{(ZA)}$		
Outlook: Stable		
Last rating (February 2016)		
Long term: $A_{(ZA)}$ Short term: $A1_{(ZA)}$		
Outlook: Stable		

ANALYTICAL CONTACTS

Primary Analyst		
Sheri Few		
Senior Analyst		
(011) 784-1771		
few@globalratings.net		
Committee Chairperson		
Eyal Shevel		
Sector Head: Corporate ratings		
(011) 784-1771		
shevel@globalratings.net		

APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Criteria for rating corporate entities, updated February 2017

Criteria for rating property funds, updated February 2017

Vukile rating reports (2012-2016)

RATING LIMITATIONS AND DISCLAIMERS

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