FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms NEPI Rockcastle Plc at 'BBB'. Outlook Stable.

Thu 30 Apr, 2020 - 2:39 PM ET

Fitch Ratings - Stockholm - 30 Apr 2020: Fitch Ratings has affirmed real estate company NEPI Rockcastle plc's Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB' with a Stable Outlook. Fitch has also affirmed the senior unsecured 'BBB' rating of bonds issued by NE Property B.V., which are guaranteed by NEPI Rockcastle plc.

The ratings reflect the group's large EUR6.3 billion portfolio (including developments), mainly of regionally dominant shopping centres, and its significant financial headroom that will provide flexibility in handling the economic impact of lockdown measures due to the coronavirus pandemic. Properties are located in Romania (38% of market value at end-December 2019), Poland (23%) and other CEE countries.

Shopping centres in Lithuania that reopened in April 2020 and centres in Poland that will re-open on 4 May 2020 will, if maintained, aid their retail tenants, although the impact from potential tenant defaults and on NEPI's rental income when re-leasing takes place is less certain. Fitch forecasts NEPI's leverage to remain below the negative rating sensitivity at 8x in 2020, despite its assumptions for a three-month loss of 2020 rent from non-trading tenants, followed by a slow recovery in 2021.

KEY RATING DRIVERS

Weakened Retail Prospects: Government-introduced social distancing measures are curtailing retail activity in jurisdictions where NEPI's assets are located. In most countries, non-essential shops have been closed and only food stores, pharmacies and parapharmacies can operate. Fitch believes that prolonged closures will pressure retail tenants and some of them may not survive, despite governments' offered aid. Even when trading restrictions are lifted, the general economic downturn may cause the rebound in retailers' sales to pre-crisis levels to take longer than expected. Fitch believes that this bleak prospect will result in weaker demand for retail space, leading to higher vacancies and lower rents.

Pressure on Tenants: NEPI's regionally dominant shopping centres host only a limited share of tenants who are exempt from shop opening restrictions. Nonetheless, at above 20% of total retail rent, as estimated by Fitch, this is a good foundation. The remaining rent is due from tenants whose shops are currently closed. These non-trading tenants are more likely to suffer from liquidity issues and potential tenant defaults, despite forms of government support in some countries. NEPI's large share of larger tenants, who are more likely to have the financial flexibility to better cope with a loss of revenue, will support its rental collection.

Operational Metrics under Pressure: NEPI had a strong performance in 2019. Occupancy rate was 98% at end-2019, and NEPI had a moderate 12% occupancy cost ratio and like-for-like net operating income growth at 6.2%, which is unlikely to be maintained in 2020. Only 8% of rents are due to re-set in 2020, compared to 18% in 2021. Weaker prospects for retail during the period of a weak economic recovery following the lockdown measures may put pressure on NEPI's operating metrics in the short- to medium-term.

We expect retail landlords, including NEPI, to concentrate on preserving occupancy to maintain retail vitality at its shopping centres and to be able to sustain footfall and tenant sales. This may come at the expense of delayed or even falling rents. Tenants with euro-denominated rents in countries such as Romania, Poland or Hungary will be under additional pressure as rents become less affordable if the recent weakness in local currencies remains.

Financial Metrics Headroom: Fitch forecasts net debt/EBITDA to remain below 7x at end-2020, despite factoring in a three-month rent loss from non-trading retail tenants. This is well within Fitch's negative rating sensitivity of 8.0x. In 2021 and 2022 leverage is projected to recover and stay around 5.5x. Actual leverage will vary depending on the length and severity of the lockdown restrictions, the resilience of the tenant base, and the scope of measures to preserve cash such as curtailing capex, reducing non-essential operating expenses and adjusting dividends. NEPI's 2019 EBITDA net interest cover is healthy at 8.1x.

DERIVATION SUMMARY

NEPI's property portfolio of EUR6.3 billion (including developments) across nine countries in CEE is larger and more geographically diversified than that of fellow CEE peers such as Atrium European Real Estate Limited's (BBB/Stable) EUR2.4 billion portfolio and the EUR2.4 billion office-focused portfolio held by Globalworth Real Estate Investments Limited (BBB-/Stable).

NEPI's conservative financial profile is demonstrated by its low Fitch-calculated loan-to-value of 34%. Its end-2019 net debt/EBITDA at 5.6x is due in part to its higher-income-yielding assets. The resulting financial profile is stronger than Atrium's and Globalworth's. However, the majority of Atrium's assets are located in countries rated 'A-' and above, whereas the lower average country risk rating of NEPI's exposure is more similar to that of Globalworth.

Western European peers such as Hammerson plc (BBB/Stable) or British Land Company PLC (The) (A-/Stable) have assets located in the more mature Western European markets where income yields are tighter, and their resultant financial metrics are therefore not directly comparable with CEE entities.

KEY ASSUMPTIONS

Our Rating Approach for Fitch's Rating Case During the Coronavirus Crisis is:

2020 Rental Income: For retail property companies Fitch is modelling a standard 25% loss of rental income, representing the three months of lost rent from April to June 2020. This is reduced to around 14% based on Fitch's estimate of the share of retail tenants that are open for trading and the rents from the group's less-affected office and industrial tenants.

In subsequent years, rental income may be lower because of several factors, including the resilience of the tenant mix, which takes into account whether tenants will recover some sales or whether they have permanently lost sales; retailers that are vulnerable to insolvency; property companies with high exposure to lease expiries in 2021 and 2022 that may see lower rents due to weaker market conditions; and retail portfolios with a high occupancy cost ratio and high rents that are more vulnerable to the weaker retailer environment.

Including portfolio rotation and developments coming on-stream in 2020, Fitch has assumed around a net 1% increase in NEPI's 2021 rents compared with its unaffected 2019 income.

Dividends: Many companies have announced the cancellation of the latest (quarterly) dividend payment. This conserves cash. Unconstrained by its REIT status, NEPI has flexibility related to its dividend pay-out. Fitch has assumed over EUR200 million in dividends in 2020.

Capex: For liquidity and practical purposes, most property companies' capex has been, or will be, curtailed, and development projects deferred. Fitch has assumed a lower capex of around EUR140 million in 2020 for NEPI, although the company has significant flexibility to reduce this figure further.

Disposals: No disposals are forecasted for NEPI in 2020.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Continuing the expansion and positive geographical diversification of the portfolio, while maintaining similar occupancy rates, current conservative financial profile, and like-for-like rental growth

- Proportional increase to higher-rated countries in the portfolio, either through expansion or through ratings upgrades

- Net debt/EBITDA below 7.0x on a sustained basis

- Average debt maturity no shorter than five years

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Material expansion into new or existing non-investment-grade countries

- Significant deterioration of operating metrics on a sustained basis, such as higher vacancies

- Increase in leverage with such metrics as loan-to-value (adjusted net debt/investment properties) consistently exceeding 45% or net debt/EBITDA surpassing 8.0x on a sustained basis

- A liquidity score below 1.25x on a sustained basis

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Comfortable Liquidity: At end-2019, NEPI had a EUR209 million cash balance and EUR575 million of available revolving credit facilities, but EUR10 million of debt due in 2020. During 1Q20, NEPI repaid EUR198 million of notes due in February 2021, leaving EUR250 million of debt maturing in 2021. The remaining maturities are comfortably covered by readily available cash and committed available bank lines.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
NEPI Rockcastle plc	LT IDR	BBB	Affirmed
• senior unsecured	LT	BBB	Affirmed
NE Property B.V.			
• senior unsecured	LT	BBB	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

NE Property B.V.	EU Issued
NEPI Rockcastle plc	EU Issued

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