RATING ACTION COMMENTARY

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

Tue 17 Nov, 2020 - 12:00 PM ET

Fitch Ratings - Stockholm - 17 Nov 2020: Fitch Ratings has affirmed real estate company NEPI Rockcastle plc's Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB'. The Outlook is Stable. Fitch has also affirmed the senior unsecured' rating of the bonds issued by NE Property B.V., which are guaranteed by NEPI Rockcastle plc, at 'BBB'.

NEPI's ratings are underpinned by its EUR5.8 billion (including developments, but excluding sold Romanian office assets) portfolio of mainly regionally dominant shopping centres spread across nine CEE countries, including Romania (35% of market value), Poland (25%) and Hungary (10%). NEPI's financial profile is robust for its rating with Fitch forecasting that net debt to EBITDA may fall to 6x in the year to December 2021 (FY21). As at 1H20, it had a Fitch-adjusted loan-to-value (LTV) ratio of 38% (Fitch's calculation excludes development property). These strengths are partly offset by large exposure to lower rated countries, albeit with diversification across them.

A surge in the number of new COVID-19 cases in CEE countries has led to tightening restrictions in several of the countries where NEPI operates. The impact on tenants' sales and ultimately NEPI's rents is still uncertain but we expect it to be manageable and less adverse than western European peers. NEPI is well-positioned to withstand a second wave of lockdown provisions due to its conservative financial position and actions taken to conserve the company's liquidity following the first wave, reducing capex and non-essential costs. A second wave will nonetheless hit retailers whose financial profiles have been weakened by poor trading.

KEY RATING DRIVERS

New Corona Restrictions: In Czech Republic and Poland non-essential stores have been closed again. Restaurant and leisure tenants have also been restricted in Poland, Slovakia, Lithuania, Hungary and the most affected regions in Romania. NEPI estimates that the new restrictions impact tenants representing only 23% of its leased space, leaving the remaining 77% fully operating at present.

The new restrictions will put further pressure on tenants' already weakened financial profiles, which in turn may negatively impact NEPI's occupancy rate and rents which have remained fairly stable so far. This will also affect NEPI's rent collection for the period, particularly if the Polish government's earlier decision to suspend the rent obligations of closed stores tenants remains in place.

Good Rent Collection: NEPI has managed its rent collection by granting rent relief to struggling tenants, switching to monthly rent invoicing and allowing some rents to be deferred up to 60 days. Rent relief granted to tenants during 1H20 amounted to EUR48 million (including government-mandated relief). In total, including rent deferrals and non-payments, 28% of contractual rent remained uncollected at end-1H20 out of which 17% corresponds to the relief granted. This corresponds to a 72% collected contractual rents (unadjusted for granted concessions), the rate, which is higher than UK peers but below Nordic peers where more state support was offered to tenants.

In exchange for rent relief or easing of payment conditions, NEPI obtained various concessions such as lease extensions or improved terms. By mid-September NEPI had agreed terms of rental agreements with tenants representing 78% of gross rental income.

Footfall and Tenant Sales: Prior to the latest round of store restrictions (starting in October and November), September footfall recovered to 79% compared with the same period last year. Like other places in Europe, tenant sales have generally been higher than footfall as consumers spent more on each visit. In August, tenant sales were materially higher at 89%. The recovery of tenant sales will be key for the health of NEPI's retail tenants and rental levels in 2021. Further restrictions on trading may lead to setbacks and a slower recovery until an effective vaccine is in place. The occupancy rate declined to 96% in August 2020 (YE19: 98%).

NEPI's short weighted average lease length of four years corresponds to a CEE-market standard and presents the risk of tenant lease expiries or rents re-setting at lower rental

levels. Exposure to fashion retailers poses the risk of potential weaker tenants during an economic downturn.

Agreement on Office Sale: A new agreement for the delayed sale of NEPI's Romanian office portfolio was signed in August and proceeds have now been received. The sale will support NEPI's conservative financial profile and provide additional liquidity. The transaction value was EUR307 million (net proceeds were EUR294 million).

Robust Financial Profile: Leverage will be primarily driven by how rental levels and occupancy rates develops in 2021 considering NEPI's conservative approach to investments and willingness to adapt its cash dividends. Assuming that capex remains at 2020's lower level, we forecast NEPI's financial position to remain robust for its rating, with net debt to EBITDA falling to 6.0x in FY21 and remaining below 6x in FY22.

Should trading restrictions worsen, NEPI has the flexibility to spend less and to adjust cash dividends accordingly, which leaves room for additional investment should conditions improve. In our rating case we have assumed a three-month loss of rent for non-trading tenants in 2020, followed by a slow recovery in 2021. Despite lower collection of rent, NEPI's interest cover ratio remained strong at 4.3x in FY20.

Uncertainties Prevent Upgrade: NEPI meets various rating sensitivities for an upgrade but these are balanced by the huge pandemic-related uncertainties on retail operations and the potential for retailer insolvencies turning prospective rental value declines into lower rents for landlords. However, NEPI has entered this period of uncertainty with considerable financial headroom.

DERIVATION SUMMARY

NEPI's portfolio of EUR5.9 billion (including developments), spread across nine countries in Central and Eastern Europe, is larger and more geographically diversified than that of fellow CEE peers such as Atrium European Real Estate Limited's (BBB/Stable) EUR2.5 billion portfolio and the EUR2.8 billion office-focused portfolio held by Globalworth Real Estate Investments Limited (BBB-/Stable). Compared with Atrium's portfolio focussed on capital city centre shopping centres, NEPI's regional portfolio is more focussed on secondary cities.

NEPI's conservative financial profile is demonstrated by its low FY19 net debt to EBITDA at 5.6x. This is partly due to its higher income-yielding assets (net initial yield: 6.7% versus

Atrium at 6.2%, which would be lower excluding non-core Russia). Fitch-calculated LTV was 34%. The resulting financial profile is better than Atrium and Globalworth. 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 more resembles that of Globalworth.

Western European peers like Hammerson plc (IDR: BBB/Negative) or The British Land Company plc (IDR: A-/Stable) have assets located in the more mature Western European markets where income yields are tighter, thus their financial metrics are not directly comparable with CEE entities.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Given the second wave of the COVID-19 pandemic and related tightening of social distancing measures (including non-essential shop closures in some countries), FY21 rents include no continued adverse effects on rent other than (i) a 5% decrease of rents being renewal; a decrease in occupancy to 93%, and one month of lost rent in FY21 (adjusted for an amount reflecting NEPI's share of essential stores).

- In FY20 lower rent is matched by lower cash dividends (including another year's scrip), so after a free cashflow outflow, incremental debt is carried into FY21.

- Capex is a mixture of non-income yielding reinvestment (EUR50 million per year) and continued development spend. Rent from completed and signed pre-let projects is included in FY21 rents.

RATING SENSITIVITIES

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

- 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 upgrades

- Net debt to 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 to 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

Strong Liquidity: At end-June 2020 (1H20), NEPI had EUR109 million readily available cash (EUR138 million reported cash less around EUR29 million which Fitch considers not readily available for debt repayment) and EUR195 million of availability under its revolving credit facility (RCF).

In July 2020, NEPI issued EUR500 million unsecured bonds. The proceeds were used to repay RCF outstandings, increasing the undrawn available amount to EUR575 million. Cash balances have been further strengthened by EUR294 million of proceeds from the disposal of its Romanian office portfolio. This is compared with EUR28 million debt due in the next 12 months. In our liquidity calculations we have not included the EUR150 million RCF, which expires in December 2020

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

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

RATING ACTIONS

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

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APPLICABLE CRITERIA

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

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 26 Jun 2020)

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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