FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms NEPI Rockcastle at 'BBB+', Outlook Stable

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Fitch Ratings - Warsaw - 30 Oct 2023: Fitch Ratings has affirmed NEPI Rockcastle N.V.'s (NEPI) Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB+'. The Outlook on the IDR is Stable. Fitch has also affirmed the senior unsecured rating of the bonds issued by NE Property B.V., which are guaranteed by NEPI, at 'BBB+'.

The affirmation reflects the continued solid operating performance of NEPI's retail assets, despite the challenging economic environment impacting consumers' discretionary spending. This is evidenced by high occupancy, growing footfall and tenants' sales and decreasing tenants' occupancy costs ratios despite CPI-linked rent indexation in 1Q23. This positions NEPI's portfolio to withstand pressure if inflation-adjusted retail sales growth slows in the coming months.

The ratings also reflect NEPI's moderate leverage with end-2022 net debt/EBITDA at 6.4x and ample net interest coverage of 8.0x, which we forecast to remain above 4.5x until end-2026, despite higher interest rates increasing the group's average cost of debt. Fitch calculates that NEPI's liquidity remains adequate and covers the repayment of EUR499 million bonds maturing in November 2024.

KEY RATING DRIVERS

Representative Acquisitions in Poland: In December 2022, NEPI acquired Forum Gdansk, a shopping centre with 63,500 sqm of gross leasable area (GLA) in the Tricity metropolitan area (population 750,000) for EUR250 million, including EUR50 million unsecured vendor financing. Forum's passing rent was EUR17.2 million at end-2022. In December NEPI also acquired Copernicus Shopping Centre (48,000 sqm GLA) in Torun (197,000) for EUR127 million. Copernicus's passing rent was EUR9.1 million.

Both assets had occupancy of over 96% (end-2022) and the tenant line-up includes H&M, Reserved, CCC, Auchan or Eurospar. Forum benefits also from a broader Inditex offer and a Helios cinema. Similar to NEPI's other shopping centres, these assets are green certified (BREEAM Excellent and BREEAM Very Good, respectively).

Leasing activity: NEPI signed 534 leases in 1H23 (2022: 1,047) covering 123,600 sqm or 5.7% of total GLA (2022: 230,000 sqm/11%). This included 228 new leases (2.6% GLA), which helped maintain retail vacancies at 2.5% (by rent). The average rental uplift on renewals and re-letting was 7.5% (2022: 8.7%) on top of indexed passing rents, which was a blend of a 7.3% (5.7%) uplift on like-for-like units and a 9.3% (24.8%) increase resulting from asset management initiatives (such as re-sizing and merging of units).

Strong NOI Growth: NEPI's reported net operating income (NOI) increased by 23% in 1H23 to EUR241 million (1H22: EUR196 million). Excluding the acquisitions and full consolidation of Ploiesti Shopping City, since September 2022, NOI growth was 15%. This was helped by CPI rent indexation (over 7% in 1H23), rental uplifts on renewals, lower administrative and higher recoveries of property expenses, despite a 31% increase in property operating expenses driven by utility prices and labour costs.

Growing Tenants' Sales and Footfall: Tenants' sales in NEPI's like-for-like portfolio were 16% higher in 1H23 than 1H22 (sales in 1H22 were 8% higher than in 1H19) due to a 9.8% increase in footfall combined with an 8% inflation-driven increase in the average shopping basket value. The most dynamic growth in rents of 29% was recorded in tenants from health & beauty (12% of the portfolio's total tenants' share by turnover) and the previously lagging entertainment segment (3%). Fashion tenants' (42%) recorded a 13% increase.

Higher tenants' sales improved the occupancy cost ratio to 12.9% (1H22: 13.2% and close to 1H19's level of 13.4%; excluding hypermarkets). However, this varies between countries with tenants in Hungary affected by the weaker forint versus the euro in which rents are paid.

Low Tenant Concentration, Short WAULT: NEPI's top 10 tenants (25% of rent) comprise LPP (5%) and Inditex (4%) fashion brands including the first Lefties store in CEE, which opened in Promenada Craiova (PC). They are followed by Carrefour (4%), Auchan (3%) and other well-known international and regional retailers. The weighted average lease term to earliest-break (WAULT) of 3.0 years reflects typical lease terms of three to five years. Fitch believes that the short WAULT requires active leasing and property management, especially in 2024 and 2025 when 18% and 20% of rents expire or tenants have a break option, respectively.

Moderate Leverage: NEPI's end-2022 net debt/EBITDA was 6.4x (2021: 5.7x) and would be around 6.0x pro-forma for a full-year rent contribution from assets acquired in 4Q22. Fitch forecasts net leverage to decrease to 5.4x in 2023 due to limited cash dividend, rent indexation and new rent from PC. During 2024-2026, Fitch expects leverage to remain below 6.0x despite the continued capex programme.

We expect net interest cover to reduce to 4.9x in 2026 from 6.4x in 2023 as existing fixed or hedged debt is refinanced in the current interest rate environment. The Fitch-calculated end-2022 loan-to-value was 38%.

Growth by Development: NEPI's development activity concentrates on the less-saturated Romanian retail property market. At end-1H23, two key projects were the mixed-use extension of Promenada Mall (around 58,000 sqm of new space, total capex of EUR220 million) in Bucharest and construction of PC, a new shopping centre (around 54,000 sqm) and retail park (10,000 sqm) in Craiova (population of 230,000) with total capex of EUR136 million. PC was opened in October 2023 with 99% of the shopping centre's GLA leased and 85% for the retail park.

As at end-1H23, NEPI's total development capex to complete was around EUR230 million. Projects under permitting and pre-leasing assume adding over 100,000 sqm of retail GLA in Bulgaria and Romania with EUR246 million of capex to be spent.

Serenada/Krokus Dispute Resolution: In November 2022, NEPI agreed to settle a dispute related to its discontinued acquisition of two shopping centres in Krakow (Poland) in 2017. As a result, NEPI paid EUR16 million to the owners of the properties. This payment and subsequent reversal of EUR21 million provision were excluded from Fitch's recurring cash-flow EBITDA.

DERIVATION SUMMARY

NEPI's peers include Globe Trade Centre S.A. (GTC, BB+/Rating Watch Negative) with its EUR2.0 billion portfolio, which benefits from diversification across asset classes with offices (64% of market value) and retail (36%), and Globalworth Real Estate Investments Limited (BBB-/Negative), whose office-focused portfolio was valued at EUR2.8 billion. NEPI's country risk exposure is the most similar to GTC's with a presence in nine countries predominantly rated 'BBB+' or below (59% of NEPI's assets' market value). Globalworth's portfolio is almost equally split between Poland (A-/Stable) and Romania (BBB-/Stable). The smaller (EUR1.0 billion), all-retail portfolio of AKROPOLIS GROUP, UAB (BB+/Stable) is 60% in Lithuania (A/Stable), the rest in Latvia (A-/Positive).

NEPI's end-2022 net debt/EBITDA at 6.4x is lower than GTC's leverage of around 10x and Globalworth's of about 8.5x helped by planned disposal proceeds.

NEPI has a net initial yield (NIY; this measures annualised net rents to investment property asset values) of 7.0% (end-1H23). Globalworth's lower NIY of 5.2% at end-2022 was affected by 14% vacancy. The remaining CEE peers do not disclose directly comparable NIY data. Fitch believes the quality of Globalworth and GTC's portfolios is broadly similar to that of NEPI.

Akropolis and Serbia-focused Balkans Real Estate B.V. (BB(EXP)/Stable), which has a portfolio spread across retail and office, have conservative financial profiles with net debt/EBITDA forecast at below 4.5x and around 6x, respectively. However, their ratings are constrained by a concentration on a limited number of assets, restricting asset, tenant and geographical diversification.

KEY ASSUMPTIONS

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

- Like-for-like passing rent increase of 6% in 2023, compared with annualised rent for 2022. Rent increase of 3.6% in 2024 and over 2% in 2025-2026, due to indexation and rental uplifts of renewed leases

- No acquisitions or material asset disposals assumed

- Over EUR820 million of development capex between 2023 and 2026, including EUR50 million a year spent on non-income-yielding reinvestments. Property development capex yields blended 8.5%

- EUR68 million cash dividend in 2023 (after scrip). Cash dividends at 90% of funds from operations in 2024-2026

- New debt refinanced with a 1.75% spread above reference rate (FY23: 3.0%, FY24: 3.0%, FY25: 2.7%)

RATING SENSITIVITIES

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

Given the retail-focused portfolio and mix of CEE countries, Fitch does not expect an upgrade of NEPI to the 'A' rating category.

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

- Material expansion in new or existing non-investment-grade countries, either through expansion or through downgrades.

- 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 40% or net debt/EBITDA surpassing 7.0x on a sustained basis.

- A liquidity score below 1.25x on a sustained basis.

LIQUIDITY AND DEBT STRUCTURE

Adequate Liquidity: At end-1H23, NEPI had EUR321 million of readily available cash (excluding restricted EUR26 million held on the secured loans' related reserve accounts) and access to EUR620 million of available revolving credit facilities (RCF). This is ample to cover EUR72 million debt repayment until end-1H24. However, this liquidity headroom would be lower if we included debt maturities to November 2024 when EUR499 million of bonds fall due and a EUR200 million RCF cannot effectively support this refinancing as it currently matures in December 2024.

Fitch calculates that the liquidity score for the 17 months from 1H23 to end-November 2024 Is 1.0x (calculated as readily available cash + undrawn portion of committed facilities + free cash flow, divided by the upcoming (usually 12-month) debt maturities). We continue to monitor NEPI's progress in accessing new funding.

NEPI's debt is predominantly unsecured. At end-June 2023, after procuring EUR199 million of mortgage loan secured on two shopping centres in Romania, NEPI's unencumbered investment property pool was valued at EUR5.4 billion (83% of total income-producing assets, by value). The funds were used to repay RCFs drawn to finance acquisitions in Poland in December 2022. The group's unencumbered income-producing investment properties/unsecured debt ratio was 2.5x at end-June 2023.

ISSUER PROFILE

NEPI is a retail-focused property company with an income-producing portfolio of regionally dominant shopping centres spread over nine CEE countries, valued at EUR6.4 billion at end-June 2023.

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 is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
NEPI Rockcastle N.V.	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+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Rating Criteria (pub. 28 Oct 2022) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 12 May 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 14 Oct 2023) (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), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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NE Property B.V.	EU Issued, UK Endorsed
NEPI Rockcastle N.V.	EU Issued, UK Endorsed

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