FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Emirates REIT (CEIC) PLC's IDR 'BB-'/Stable; Senior Secured 'BB+(EXP)'

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Fitch Ratings - London - 05 Dec 2024: Fitch Ratings has assigned Emirates REIT (CEIC) PLC a Long-Term Issuer Default Rating (IDR) of 'BB-' with a Stable Outlook and an expected senior secured rating of 'BB+(EXP)' with a Recovery Rating of 'RR2'.

The ratings reflect Emirates REIT's asset, tenant and location concentration. The group's Index Tower in the Dubai International Financial Centre (DIFC) constitutes over 60% of its portfolio value, with the largest school property accounting for another 10%. Its total eight main clusters of investment properties, totalling USD0.9 billion, are in key Dubai locations. The top 10 tenants represent 35% of the group's rental income.

New management is focused on successfully letting the portfolio, increasing rents and lengthening the average lease length to earliest-break (WALB) on lease renewals. The undersupply of prime offices relative to rising demand in the central Dubai office market is conducive to optimising occupancy and rental levels.

KEY RATING DRIVERS

Improvement in Office Leasing Fundamentals: Emirate REIT's new operations-focused management aims to improve the portfolio's leasing activity by increasing occupancy rates and securing higher rents from lease renewals that reflect Dubai's limited near-term prime office supply. It also aims to extend weighted average lease lengths on an earliest-break basis (WALB). Some of its offices are starting from a low base of post-pandemic short-dated leases on lower rents.

In Index Tower, the difference between existing AED/sq ft rents and market rents achieved on some 2023 and 2024 re-leasing is over 30%. Additionally, the tenant retention rate for 2023 and the year-to-date is 75%-80%, indicating tenant preference for this prime location. These improved fundamentals also benefit property valuations.

Dubai Office Supply & Demand: Tenants' demand for quality office space is outstripping supply, as evident in the market's high occupancy rates of 93%-95%. At these near-full levels, expected to continue to at least end-2026, landlords should see improved rents and lease terms. Fitch anticipates developers and free zones to initiate new office projects like Immerse Tower in DIFC, DMCC, and TECOM, but these will have a two-to-three year construction period. Scarcity of supply in prime office will lead to higher rents in non-prime buildings and locations, increasing their rents and property values.

Lower Group Rental Income: Following its disposals of Trident Grand Mall in July 2024 for USD20 million and Office Park in October 2024 for USD190 million, Emirates REIT's net rental income (NRI) reduces by USD14 million compared with 2023's figures. Despite the reduced asset base, the same NRI gain during 2023-2025 - primarily driven by Index Tower's occupancy and rental levels on reviews and renewals - will result in group EBITDA remaining at around USD50 million in 2025.

Schools Important Rental Contributor: The group's portfolio features a mix of rents, lease durations and tenant types. Its three schools represent a third of the group's 2024 rental income (pro-forma for disposals), dominated by the well-established GEMS World Academy in Al Barsha, South Dubai, and Lycee Francais in Al Quoz. These two schools have long-dated leases with periodic uplifts in rents, expiring post-2040. These assets' rents are determined based on school profitability rather than per square foot area.

Shorter Leases in Offices: Unlike the defensive income stream from schools, half of Emirates REIT's Index Tower's office space features three- to five-year leases. It also has shorter leases for smaller space requirements catering to smaller entities and even shorter leases with premium rent for flexible service-type office space. Given the importance of the DIFC status, tenant retention at Index Tower has been high, exceeding 75%-80% in both 2023 and 2024.

Concentration Risk Post-Disposals: The recent disposal of assets, as part of the group's 2022 debt restructuring conditions, has resulted in asset concentrations. Index Tower represents over 60% of the group's investment property value (pro-forma USD0.9 billion at end-1H24 values), followed by GEMS at 10%. Similarly, the group's top 10 tenants contribute a high 35% of total rental income.

Adverse Impact of Concentrations: Such concentrations can expose the group to volatile results. This was evident post-2018 when the delayed Gate Avenue passageway link to DIFC caused a drop in occupancy at Index Tower, negatively affecting rental values. Additionally, ceased rent payments by the Jebel Ali school in May 2022, which represented over 15% of the group's 2018 rental income, adversely affected group profits.

Rental Income to Rise: Pro-forma for the 2024 asset disposals, the group's portfolio is valued at USD0.9 billion, generating USD60 million in net rental income. The latter is set to increase to USD70 million in 2025, primarily driven by rental income growth from Index Tower, as well as increased rents from its European Business Centre and the addition of The LOFT III's refurbished office space. Emirates REIT's cost base is also set to benefit from less asset management fees to Equitativa and less void costs as occupancy rates increase.

Improved Financial Profile: The planned secured USD205 million sukuk will refinance Emirates REIT's December 2022 sukuk financing. We expect this to significantly improve its interest cover to around 2.5x at end-2025, from 0.9x at end-2023, due to the less punitive profit rates of the new sukuk. We forecast the group's net debt/EBITDA will be low at under 4.5x and its loan-to-value (LTV) at around 25% at end-2025. Cash dividends may resume in 2025 as the refinancing of the existing sukuk with the planned new debt will improve cash flow.

DERIVATION SUMMARY

Fitch's publicly-rated peers for Emirates REIT's rental income-producing investment property portfolio include the anchor rental income-focused entities within Emaar Properties PJSC (BBB/Stable) and conglomerate Majid Al Futtaim Holding LLC (MAF; BBB/Stable). For Emaar, this includes the 37 malls of Emaar Malls Management (EMM) dominated by Dubai Malls, which contributed 85% of EMM's rental income. For MAF, the key asset and the single-largest contributor to the group is Mall of the Emirates. Aldar owns the 2.5 million sq ft Yas Mall, the third-largest mall in UAE. Within Emirates REIT, Index Tower is a large profit contributor to the group. UAE peers include the Saudi Arabian retail landlord Arabian Centres Company (BB+/Negative) trading as Cenomi Centres, which currently operates 22 assets with significant related-party activities.

The rating approach to the investment-grade groups Emaar and MAF is to apply little debt capacity (net debt/EBITDA) to their property and residential development activities, and to measure the remaining group debt against the stable profits derived from investment property rents. Acknowledging the high net initial yield (NIY) of these assets, their net debt/EBITDA is around 5x-6x (EMM: below 1x in 2023; MAFP: 5.4x in 2023). This compares with Emirates REIT's leverage, pro-forma for 2024 disposals, of around 4x.

Fitch does not necessarily rate property companies based on size, as big portfolios do not protect them from default. However, smaller companies face geographic, asset and tenant concentrations that can constrain their ratings. This can also lead to debt maturity concentrations that require active treasury management. These characteristics, some present in Emirates REIT, limit its IDR to the 'BB' rating category.

KEY ASSUMPTIONS

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

- Index Tower's net property income to rise to USD29.8 million in 2024 and USD36.7 million in 2025 from USD22 million in 2023, driven by improvement in this asset's rental income, occupancy and WALB

- Office rents at Index Tower averaging a blended AED320 sq ft/USD86 sq ft for 2024 (including 1H24 actuals) at 88% occupancy, rising to AED390 sq ft/USD105 sq ft at 90% occupancy for 2025. This is followed by largely flat office rents to 2027

-A marked increase in 93%-occupied European Business Centre office rental income for 2024, as confirmed in 1H24 results. LOFT I & II also to see increase in rents and occupancy in 2024. A refurbished LOFT III comes on-stream in 3Q25

- EBITDA improves as Equitativa's asset management fees reduce with the smaller asset base, and void costs fall with increased occupancy. This will drive EBITDA margin higher to 72% in 2024, from 65% in 2023

- Head leases rents are treated as operating costs, whereas IFRS treats them as interest expense

- Cash dividends resume in 2025 (24% of funds from operations (FFO), rising thereafter to 50%), after ceased punitive profit share improves FFO to USD30 million in 2025 (2024: minimal)

- Capex averaging USD4 million per year

- No acquisitions

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Largest single asset at more than 70% of the portfolio value

- Office WALB decreasing to less than 2.5 years, combined with vulnerability to falling rental values

- Net debt/EBITDA at more than 8x

- Net interest cover lower than 1.5x

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Meaningful improvement in asset concentration risk

- Office WALB above three years, coupled with high occupancy and rental stability

- Net debt/EBITDA at less than 6x

- Net interest cover higher than 2.0x

LIQUIDITY AND DEBT STRUCTURE

Emirates REIT's liquidity consisted of USD22.5million cash at end-1H24. The cash balance was boosted by the AED74 million (USD20 million) Trident Grand Mall disposal proceeds, which partly reduced outstanding sukuk to USD305 million, and by the Office Parks disposal proceeds AED720 million (USD196 million), which repaid associated debt and reduced the sukuk further to around USD200 million.

The existing sukuk matures in December 2025 and the Islamic financing (USD50 million) matures in March 2033. The profit share on the existing sukuk had risen to 11%, incentivising Emirates REIT to refinance the December 2022 restructured debt. The planned four-year USD205 million sukuk will refinance the existing sukuk with the collateral of Index Tower. The Islamic financing is secured by the GEMS school.

Emirates REIT plans to retain minimum liquidity, primarily in cash, of USD15 million.

DATE OF RELEVANT COMMITTEE

22 November 2024

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

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			RECOVERY	PRIOR
Emirates REIT (CEIC) PLC	LT IDR	BB- Rating Outlook Stable	New Rating		WD
senior secured	LT	BB+(EXP)	Expected Rating	RR2	

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Diego Della Maggiore
Director
Primary Rating Analyst
+44 20 3530 1797
diego.dellamaggiore@fitchratings.com
Fitch Ratings Ltd
30 North Colonnade, Canary Wharf London E14 5GN

John Hatton
Managing Director
Secondary Rating Analyst
+44 20 3530 1061
john.hatton@fitchratings.com

Alex Griffiths, FCA
Managing Director
Committee Chairperson
+44 20 3530 1709
alex.griffiths@fitchratings.com

MEDIA CONTACTS

Tahmina Pinnington-Mannan
London
+44 20 3530 1128
tahmina.pinnington-mannan@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Sukuk Rating Criteria (pub. 13 Jun 2022)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 03 Mar 2023)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 21 Jun 2024)

Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 02 Aug 2024) (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

ENDORSEMENT STATUS

Emirates REIT (CEIC) PLC	-
Emirates REIT Sukuk III Limited	-

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