FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Emirates REIT to 'C' on Distressed Debt Exchange

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Fitch Ratings - London - 24 May 2021: Fitch Ratings has downgraded Emirates REIT's Long-Term Issuer Default Rating (IDR) to 'C' from 'B+' and the senior unsecured sukuk trust certificates, issued through Emirates REIT Sukuk Limited, to 'C'/RR4/35% from 'BB-'/RR3/57%.

The downgrade follows the company's announced proposal to offer existing unsecured sukuk noteholders a new secured sukuk debt instrument with changed terms and conditions.

Under the proposed transaction, the current USD400 million unsecured sukuk notes would be exchanged for secured notes maturing in December 2024, two years longer than the current notes' maturity. The existing sukuk's 5.125% rate will be maintained, but first-year distributions (totaling USD10.2 million) will accrue and be paid at the sukuk's maturity. Under Fitch's Distressed Debt Exchange (DDE) criteria, the proposed transaction would be a material reduction in terms for lenders and is therefore viewed as a DDE.

Feedback

Should the exchange be approved and executed, upon completion of the DDE Fitch will downgrade Emirates REIT's IDR to 'RD' (Restricted Default) and re-rate it based on business prospects and the new capital structure. If the transaction does not go ahead, Fitch will re-rate the company reflecting its constrained liquidity profile and end-2022 refinance risk.

KEY RATING DRIVERS

Proposed Offer: Emirates REIT has offered the existing noteholders of its USD400 million unsecured sukuk that matures in December 2022 a new sukuk, which will have first-ranking security over company properties valued at around USD280 million (December 2020 value). The new notes will mature in December 2024. Distributions for the current debt are due in June and December 2021 at a rate of 5.125% rate, but under the proposed sukuk, first distribution (totaling USD10.2 million) will accrue and be paid at maturity. There will also be an additional payment, based on the coupon rate, ofUSD10.2 million at maturity.

Fitch views the transaction as a DDE under its Corporate Ratings Criteria, primarily due to the cash coupon payments being deferred for the first year and paid at maturity and the extension of the maturity date by two years. Should bondholders vote against the proposal, Fitch believes the company has sufficient liquidity to meet the June 2021 sukuk distribution of USD10.2 million.

Continued Market Weakness: An oversupply of office space in Dubai has adversely affected rents for several years, while the effects of Covid-19, which brought lockdowns, business closures and the departure of workers, has put additional stresses on the economy and real estate market. The UAE economy contracted more than 10% in 2020, and while economic growth of more than 2% is forecast in 2021, many weak businesses, particularly SMEs, may still be looking to cut costs, consolidate space, or potentially close.

Dubai's population declined more than 8% in 2020. Many expatriates, who make up as much as 90% of the population, will have left if they lost jobs as residency permit are normally tied to employment.

Feedback

Rental Income Stressed: Most of the company's office tenants (52% of 2020 rent) remained open during the lockdown and continued to pay rent, while the small retail portfolio, (around 12% of rental income), was largely shut. To help some tenants, especially small companies, Emirates REIT extended some leases early and granted rent-free concessions, albeit on a case-by-case basis. EBITDA declined by more than 10% in 2020. However, the company re-leased a number of large offices with key tenants.

Dubai has one of the highest vaccination rates globally and economic growth is expected, but residual economic and market stress mean rental income increases will be challenging. Emirates REIT's overall lease length is a long 9.3 years, but excluding the long school leases, the average lease maturity is only around two years. This exposes the company to market volatility.

Education Sector Weakness: Dubai's private education sector suffers from overcapacity and a limited ability to increase revenues since the government froze school fees in 2018. With more than 8% population contraction in Dubai in 2020, the student base has fallen. Two of the company's schools, GEMS and Lycée Français Jean Mermoz, have continued to pay full rents, but Jebel Ali School, which generates more than 10% of the company's rent, ceased paying rent in 2019, despite remaining operational.

In 2018, the British Columbia Canadian School, which occupied Emirates REIT's School in DIP, defaulted on its rental payments and remains vacant. Emirates REIT continues to pursue legal proceedings against both school operators.

Occupancy Remains Low: Occupancy marginally fell to 67% by October 2020, before climbing back to 69% by YE20. This remains the lowest among rated EMEA real estate companies. Infrastructure improvements and re-configuration have affected the occupancy rates of several assets, including company's largest property, the 80-storey Index Tower (occupancy 53%), but even as these improvements complete, the weakened and oversupplied market will affect the pace of growth in occupancy. Tenants are likely to demand rent concessions, which will weaken cash flows.

High Leverage Forecast to Persist: With EBITDA contracting more than 10%, YE20 net debt/EBITDA increased to more than 16x (YE19: 14x), which is high for an office REIT. Despite signs of recovery, materially reducing this leverage will be difficult given market and operational challenges. Emirates REIT has taken measure to preserve cash flows, suspending cash dividends in 2020 and reducing management fees by 20% through 2021, but these measures are unlikely to reduce cash flow leverage. The portfolio valuation decreased by around 25% in FY20.

DERIVATION SUMMARY

Emirates REIT's occupancy, size and EBITDA margins are materially lower than other rated EMEA peers. The company's high cash flow leverage of around 16x at end-2020 is also among the highest in EMEA commercial real estate. Turkish retail real estate company Ronesans Gayrimenkul Yatirim A.S. (RGY; B/Negative) had proportionally consolidated net debt/EBITDA of 16x in 2020, which is largely driven by significant foreign currency exposure as debt is denominated in US dollars or euros, while rents are in the highly volatile Turkish lira. RGY's occupancy rates remain around 95%.

Office property companies have been more stable during the pandemic, while retail real estate companies have suffered more as their shopping centres were closed during government-imposed lockdowns when many companies collected no rent. Nearly all of Emirates REIT's office and school tenants (apart from the School at DIP and Jebel Ali) continued to pay rent during the lockdown with only the retail tenants (about 12% of rent) temporarily stopping rental payments.

KEY ASSUMPTIONS

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

A lower rate of occupancy growth across portfolio compared with management's expectations.

The Jebel Ali School resuming payments in 2021.

The school at DIP starting operations in 2021 with a slow ramp up of operations.

No cash dividends distribution assumed for 2020, but partially resuming thereafter

No acquisitions within our forecast period.

RATING SENSITIVITIES

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

Evidence of an ability to fully refinance the outstanding senior unsecured sukuk due in December 2022.

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

Implementation of the proposed transaction, which constitutes a DDE, would lead to a downgrade of the IDR to 'RD'

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

Limited Liquidity: Liquidity continues to be under 1.0x. Available cash at end-2020 was USD13.7 million (2019: USD48 million), which is less than short-term debt of USD17 million. The company expects its liquidity position to improve by half-year owing to asset disposals and rental generation, but liquidity will remain very tight.

The company has two existing secured Islamic bank facilities, which are mortgaged against about USD256 million of investment properties and cashflows assigned of USD127 million. The company has an unencumbered asset ratio of just over 1.1x. The loans, which have a weighted average cost of around 5.75%, mature in five and six years.

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

Emirates REIT has an ESG Relevance Score of '4' for Management Strategy reflecting concerns over management fees, which are based on the REIT's asset values, irrespective of lower cash rents received, which together with rent non-recoverables, create a financial burden and an EBITDA margin that is lower than peers. Management has reduced the fee by 20% until the end of 2021 and the fall in asset values has reduced the impact. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Emirates REIT has an ESG Relevance Score of '4' for Financial Transparency due to limited public disclosure. The company reports in line with the rules and regulations of the Dubai Financial Services Authority (DFSA) and the Dubai International Financial

Centre (DIFC). This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

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			RECOVERY	PRIOR
Emirates REIT	LT IDR	C	Downgrade		B+ Rating Outlook Negative
Emirates REIT Sukuk					
• senior unsecured	LT	C	Downgrade	RR4	BB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Sukuk Rating Criteria (pub. 15 Feb 2021)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 30 Apr 2021)

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

Emirates REIT	UK Issued, EU Endorsed
Emirates REIT Sukuk	UK Issued, EU Endorsed

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