Moody's Investors Service

Credit Opinion: Hyprop Investments Limited

Global Credit Research - 05 Jun 2013

South Africa

Ratings

Category	Moody's Rating
Outlook	Stable
NSR LT Issuer Rating -Dom Curr	A3.za
NSR ST Issuer Rating -Dom Curr	P-2.za

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Key Indicators

Hyprop Investments Limited[1][2][3]	2012	2011	2010	2009	2008
Total Revenue (Rand mil)	**1,730**	**1,302**	**925**	**793**	**689**
Recurring EBITDA (Rand mil)	**1,444**	**1,071**	**726**	**652**	**588**
Recurring EBITDA% Total Revenue	**83.5%**	**82.3%**	**78.5%**	**82.2%**	**85.3%**
Net Debt / Recurring EBITDA (X)	**3.5x**	**5.0x**	**2.0x**	**2.1x**	**1.4x**
Recurring EBITDA / Fixed Charge (X)	**3.4x**	**4.3x**	**5.3x**	**5.1x**	**6.8x**
Gross Assets (Rand mil)	**21,526**	**20,188**	**11,449**	**10,778**	**9,458**
Secured Debt % Gross Assets	**19.1%**	**27.4%**	**13.0%**	**14.4%**	**9.5%**
Total Debt + Pfd Equity % Gross Assets	**24.1%**	**27.4%**	**13.0%**	**14.4%**	**9.5%**

[1] All ratios are calculated using Moody's Standard Adjustments. [2] Source: Moody's Financial Metrics. [3] Year end 31 December.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- High-quality retail portfolio with historically low vacancy rates

- Low leverage and coverage metrics

- Smaller scale and greater income concentration risk than similarly rated real estate peers

- Execution risk associated with Rosebank Mall redevelopment project

Corporate Profile

Hyprop Investments Limited ("Hyprop" or "the Fund"), was established in 1988 and is the third-largest property fund listed on the Johannesburg Stock Exchange (JSE) in South Africa by total assets (ZAR21.5 billion or $2.5 billion, at year-end December 2012). Hyprop is currently structured as a property loan stock (PLS) and operates like a real estate investment trust (REIT), investing in and holding commercial properties in a tax-efficient manner for investors. Hyprop has announced that it will be changing its year end to June and converting to a REIT under the new South African REIT regime. Its activities include direct investments in predominately retail property assets and, to a lesser extent, investments in the listed securities of other commercial property investment companies. The Fund's head office is in Johannesburg, South Africa.

As of 31 December 2012, the Fund's investment in South Africa consisted of 16 properties valued at ZAR18.6 billion ($2.2 billion), together with an investment of ZAR2.4 billion ($283 million) in Sycom and Atterbury Africa. For the financial year end (FYE) to 31 December 2012, consolidated revenues amounted to ZAR1.73 billion ($204 million) with EBITDA of ZAR1.44 billion ($170 million), according to our standard definitions and adjustments.

Rating Rationale

Hyprop's A3.za/P-2.za national scale rating is supported by the high quality retail portfolio, which benefits from active management producing solid, recurring retail income, supported by low vacancies (2.5% as of 31 December 2012) and well-positioned retail assets. The rating is underpinned by a significantly increased portfolio of properties due to the acquisition of Attfund Retail properties on 1 September 2011.

The ratings incorporate relatively strong credit metrics (according to our standard definitions and adjustments) as measured by total debt-to-gross assets of 24.1% and high fixed-charge cover of 3.4x, at the end of December 2012. The ratings also factor in Hyprop's conservative approach to development risk.

At the same time, the ratings assigned also factor (1) the moderate size of the portfolio and smaller scale of operations relative to local peers, as measured by total assets; (2) 95% property-exposure to the South African retail property sector, as well as high geographic concentration in the Gauteng province (59% of the total portfolio value); (3) execution risk associated with the refurbishment of Rosebank Mall; and (4) 79% secured debt in its capital structure (reduced to 67% after December year end) and the moderate yet high percentage of gross assets that are encumbered of 78.1% as a percentage of gross assets (reduced to 68.5% after December year end). All figures are as of year-end December 2012.

DETAILED RATING CONSIDERATIONS

LARGEST LISTED RETAIL FOCUSED FUND IN SOUTH AFRICA

95% of Hyprop's property assets under management portfolio are retail properties. The property portfolio includes 11 shopping centres (of which eight are 100% owned and three partially owned through co-ownership agreements) and five office properties. Group management is internal, with 214 staff overseeing 766,843 m² of lettable area. As of 31 December 2012, the Fund's investment in South Africa consisted of 16 properties valued at ZAR18.6 billion ($2.2 billion), together with an investment of ZAR2.3 billion ($271 million) in Sycom Property Fund Limited (33.9% shareholding), which is in the process of being exchanged for a 100% stake in Somerset Mall from Sycom Property Fund, subject to required approvals.

Hyprop's entire property portfolio is independently valued on a semi-annual basis for all properties, which is more frequent compared to it local peer group. The valuations are performed using the discounted cash flow method and was last carried out in December 2012. The portfolio value increases by 6.3% on a like for like basis on the prior year given low vacancies and good income growth, however valuations on its office properties (3% of property assets) did decline by 7.7% as a result of higher vacancies and weaker income growth.

PRIME, WELL LOCATED ASSETS WITH GOOD TENANT PROFILE

We view Hyprop's asset quality as excellent, supported by the number of the Fund's prime quality shopping centres located in key retail nodes. At year-end December 2012, Hyprop had around 2150 tenants, with the top 10 tenants contributing 28% of annual rental income (41% of gross lettable area (GLA)). The Fund's largest tenant is Massmart, contributing 4% of total annual rental income. Hyprop has a large amount of high-quality tenants, comprising 65% "A" quality tenants, 21% "B" quality tenants and 14% "C" quality tenants (by GLA). Tenant classifications are as follows: "A" quality - large national tenants, large listed tenants, government and major franchisees; "B" quality - national tenants, smaller listed tenants, franchisees and medium to large sized professional firms; and "C" quality - smaller tenants.

SCALE AND CONCENTRATION RISK CONSTRAIN THE RATING

Hyprop's scale, as measured by the number and value of its property assets, is relatively small compared with similarly rated peers both in South Africa and globally, which limits diversification. We view Hyprop's diversification as limited in terms of (1) the relatively small number of properties under management (16 properties); (2) predominant focus on retail property sector (95% of GLA); and (3) geographic concentration in three major metropolitan areas across South Africa, namely Johannesburg (40% of GLA), Pretoria (19% of GLA) and Cape Town (41% of GLA), with the bulk of its property exposure in the Gauteng region (59% of total portfolio value). Hyprop's exposure into Africa through a joint venture with Atterbury Africa is positive from a diversification view but is still relatively small (ZAR111 million) relative to the Hyprop's total portfolio.

STRATEGIC FOCUS ON INCOME GROWTH ACROSS HIGH-QUALTIY RETAIL ASSETS IN PRIME LOCATIONS

Management's strategy is to invest in sizable shopping centres in the major metropolitan areas: Johannesburg, Cape Town and Pretoria, with a primary focus of growing income. Hyprop's investment in shopping centres is focused on those that are dominant in their catchment area, where the vast majority of tenants' revenues are generated locally, making the centres more resilient to downturns in consumer spending and supportive of stable, long-term occupancy rates, rental income and values. The success of this strategy is demonstrated by the maintenance of a high overall occupancy rate over the past few years, currently 97.5% across the retail portfolio (excluding Rosebank Mall) despite general economic weakness in South Africa.

CASH GENERATION SUSTAINED BY HIGH OCCUPANCY RATES AND LONG LEASES

The stability of Hyprop's cash flow and earnings is credit positive and is due in large part to the Fund's relatively high occupancy rates, currently 97.5%. In addition, rental income is underpinned by medium- to long-term tenancy agreements, with a weighted average lease expiry (WALE) across the portfolio of 3.9 years. In South Africa, commercial property leases contain annual rent escalation clauses, which in Hyprop's portfolio, currently ranges from 8%-9%, providing rental growth and inflation protection. For year-end 31 December 2012, 71% of Hyprop's reported revenues of ZAR2.0 billion ($236 million) comprised contractual rental income and 22% municipal service charge recoveries (Hyprop pays all utility costs and then recoups them from tenants).

Hyprop's EBITDA margin of 83.5% (according to our standard definitions and adjustments) is relatively high compared with that of global peers, as well as higher than that of local peers Growthpoint and Redefine but slightly lower than Capital Property Fund. We anticipate Hyprop's EBITDA margins coming under pressure from (1) increased difficulty of recovering the above inflationary increases in utilities (electricity, rates and municipal levies) from tenants; (2) upward pressure on vacancies, notably from the office/commercial sector and from the expected redevelopment of Rosebank Mall; and (3) lower rental growth on new lettings.

EXECUTION RISK ASSOCIATED WITH REDEVELOPMENT OF ROSEBANK MALL AND EXPANSION INTO AFRICA

The Fund's approach to new developments is conservative, focusing on expanding and rejuvenating the existing portfolio. A moderately sized development and/or redevelopment pipeline can help grow the Fund and improve portfolio quality, which are credit positives. However this needs to be managed in the context of exposing the Fund to potential volatile cash flows and/or mistiming the market demand. Management is embarking on a ZAR920 million ($108 million) refurbishment and enlargement project of Rosebank Mall, which will increase the gross lettable area from 36,000 m2 to 62,000 m2. The estimated time of completion is September 2014. While Hyprop's management has proven experience with previous refurbishment/expansion projects this will be the largest to date and will introduce a level of execution risk. We take comfort that Hyprop has received committed rental offers for over 90% of the Rosebank Mall's GLA, removing a large portion of the future cash flow risk. At 31 December 2012, Hyprop's development pipeline equated to ZAR2.0 billion ($236 million), representing 9.4% of gross assets, which includes the carrying value of Rosebank Mall plus the expected capital expenditure for development.

In addition, Hyprop has indicated its intention to diversify its property exposure into Africa, which will broaden the Fund's geographic footprint outside of South Africa and be yield enhancing. Hyprop holds a 37.5% interest in Atterbury Africa and has committed up to ZAR750 million ($88 million) over the next 5 years to invest into Africa. Expansion is likely to expose the business to higher risk, which will need to be monitored as this part of the business grows. The initial investment of ZAR111 million ($13 million) is relatively small and as a result will not have a material effect on the overall Fund's performance in the short to medium term.

RELATIVELY LOW LEVERAGE AND COVERAGE CREDIT METRICS

At FYE 2012 Hyprop's leverage, as measured by adjusted total debt/gross assets and net Debt / EBITDA was relatively low at 24.1% and 3.5x respectively, allowing the Fund some flexibility to pursue debt funded acquisitions and/or withstand potential moderate declines in property values. The board has determined that leverage, as defined by net debt/property assets (24.1% as of 31 December 2012), can be increased to levels between 30%-40%, mainly through corporate activity and developments although its memorandum of incorporation currently allows leverage of up to 55%.

South African property companies have traditionally financed their assets with secured bank loans. Hyprop has followed the same approach. However, since the rating was assigned Hyprop have successfully reduced its secured debt exposure from 100% to 79% while the level of encumbered assets stabilized to 78.1% of its gross assets as of 31 December 2012 but has subsequently reduced to 68.5%. The Fund's ratio of secured debt/gross assets at 31 December 2012 was 19.1%, which falls in the Baa range in the rating grid and unencumbered assets of 21.9% falls in the B rating range.

Liquidity Profile

Hyprop's liquidity is deemed sufficient to meet its near-term obligations, supported by (1) unutilised committed liquidity facilities of ZAR2.0 billion ($236 million); and (2) stable internal cash flow generation. However, there is a need for debt refinancing and additional funding requirements to meet its development capex plans to ensure a sound liquidity profile over the next 12 to 18 months. The Fund's current credit facilities are provided by a variety of domestic banks and are subject to covenants and material adverse change clauses. At present, there is good headroom in the covenants and Hyprop has in the past successfully managed to renegotiate its bank facilities.

Rating Outlook

The stable outlook on the rating reflects our view that Hyprop will at least maintain its current operating profile in terms of occupancy and renewal rates and EBITDA margin, even if faced with a more severe economic downturn.

What Could Change the Rating - Down

Downward pressure on the ratings or outlook could result from (1) Hyprop's failure to maintain an adequate liquidity profile; (2) a debt-financed acquisition or change in capital structure, such that leverage in terms of adjusted total debt/gross assets is trending above 30% or fixed-charge coverage trends below 3.0x on a sustainable basis; or (3) unexpected operating difficulties that negatively affect operational performance or cash flows. All metrics are according to our standard definitions and analytic adjustments.

What Could Change the Rating - Up

Although unlikely in the near term, upward pressure on the rating or outlook could develop with a longer track-record as a rated entity, demonstrating prudent financial and operating policies and if the Fund continues to exhibit stable to growing size and geographic footprint with stable to improving operating margins, while maintaining overall strong liquidity profile and ample headroom on its covenants. Quantitatively, given Hyprop's smaller size compared with its two larger domestic peers, Growthpoint Properties Limited (Baa3/A2.za stable) and Redefine Properties Limited (A3.za stable), upward pressure could build if the Fund were to maintain leverage - as measured by adjusted total debt/gross assets - below 25% on a sustainable basis.

Other Considerations

As a PLS, Hyprop's capital structure is composed of linked units that are traded on the JSE. These are ordinary shares linked to unsecured, unsubordinated variable rate debentures in the ratio of one ordinary share of 1 cent indivisibly linked to one debenture of 493 cents each. Debenture interest is variable and is paid as a distribution from net operating profits after tax. If there are no profits, no debenture interest payment is made. The linked securities enable PLS to distribute 100% of their income as debenture interest to their unit holders, thereby being a pure flow-through from a taxation perspective, with the effective income tax rate at company level being reduced to close to zero. This structure is comparable to the REIT structure in other countries.

We consider the linked units as equity in our analysis because all PLS companies in South Africa issue linked securities and, in the case of Hyprop, issuing any other form of share capital is not economically viable, and the Fund has no intention to do so as all net operating profits are paid as variable interest to the debenture holders.

The new South African REIT framework came into effect from 1 May 2013. In order for Hyprop to benefit from having REIT status and the associated benefits it has announced it will be changing its year end from December to June. This is credit positive for Hyprop as it will benefit from tax certainty, simplified financial reporting, bring structures into line with global best practices, provide for increased regulatory oversight and improve liquidity flexibility. See our sector comment: REIT Legislation Is Credit Positive for South African Property Investment Companies, published 2 April 2013. Furthermore, Hyprop net asset value will increase from the removal of the ZAR2.3 billion ($271 million) (17.5% of total net assets as of 31 December 2012) deferred tax liability from the balance sheet, which will no longer be required to be provisioned for under the new REIT regime.

MAPPING TO THE RATING METHODOLOGY

The principal methodology used in rating Hyprop was our "Approach for REITs and Other Commercial Property Firms", published 30 July 2010. Based on the most recent published accounts, at financial year end 2012, Hyprop's overall performance measurements from the rating grid indicate a rating outcome of Baa2. Moody's assigned national scale issuer rating of A3.za would map to a global scale rating in the range of Baa3 or Ba1 which is one to two notches different from the grid implied rating. The key reason for the rating difference is due to the Fund's relatively small scale combined with income concentration risk and financial flexibility to accommodate higher leverage.

Rating Factors

Hyprop Investments Limited[1][2][3]

REITs / REOCs	Aaa-Aa	A	Baa	Ba	B	Caa	Ca
Factor 1: Liquidity & Funding							
a) Liquidity Coverage				X			
b) Upcoming Debt Maturities				X			
c) FFO Payout				98.7%			
d) Amount of Unencumbered Assets					21.9%		
Factor 2: Leverage & Capital Structure							
a) Debt + Preferred / Gross Assets		24.1%					
b) Net Debt / EBITDA	3.5x						
c) Secured Debt / Gross Assets			19.1%				
d) Access to Capital				X			
Factor 3: Market Position & Asset Quality							
a) Franchise / Brand Name			Good				
b) Gross Assets (USD Billion)			$2.5				
c) Diversity - location/tenant/industry/economic					Limited		
d) Development / Gross Assets			9.4%				
e) Asset Quality		Excellent					
Factor 4: Cash Flow & Earnings							
a) EBITDA / Revenues	83.5%						
b) EBITDA Margin Volatility			3.0%				
c) Fixed Charge Cover		3.4x					
d) JV / Fund Business % Revenues	0.0%						
Rating:							
a) Indicated Global Rating from Grid			Baa2				
b) Actual Global Rating Assigned			Not Public				

[1] Based on year end 31 December 2012. [2] All ratios are calculated using Moody's Standard Adjustments. [3] Source: Moody's Financial Metrics.

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