Credit rating report | South African Corporate | September 2021

Dipula Income fund Limited

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Dipula Income Fund Limited	Long Term Issuer Short Term Issuer	National National	BBB(ZA) A3(ZA)	Stable

Strengths

- Granular portfolio with minimal concentration by assets or tenants,
- Defensive assets in convenient locations

Weaknesses

- Limited geographic diversification outside South Africa
- Exposure to the struggling office sector

Rating Rationale

The stable outlook on the ratings reflects GCR's expectations that Dipula's credit risk metrics will remain within the current rating thresholds. The REIT has performed better than initially anticipated and we expect a fairly resilient earnings performance to ensue despite the ongoing challenges faced by the South African property sector.

Although the REIT's vacancy rate increased to 7.6% in 1H FY21 (FY20: 6.9%) led by its office exposure, collections through the 12-month period to April 2021 were strong, with an average of 98% of billings. As a result, operating profit at 1H FY21 was reported in line with the pre-COVID-19 level observed in 1H FY20. Whilst the operating environment remains uncertain, with the resurgence of infection rates bound to pressurise earnings as certain tenants are yet again faced with restricted trading conditions, GCR is of the view that the REIT will continue to report relatively sound performance metrics. To this end, whilst the portfolio is retail oriented (64% of revenue), it defensively focuses on convenience, rural and township centres that are mostly occupied by large national tenants, which performed well through periods of lockdown. Nevertheless, the relatively small size of its property portfolio, as well as its geographic concentration to South Africa does constrain our assessment.

To support its funding profile and ensure necessary cash resources are available to withstand the COVID-19 disruptions, Dipula deferred the payment of its dividend for FY20. The unpaid dividend was temporarily utilised to reduce outstanding revolving facilities, which helped reduce the LTV ratio to 35.7% at 1H FY21 (FY20: 38.9%). Dipula received a temporary dispensation to withhold the FY20 dividend, and its board is considering various options to balance its obligations to shareholders with the need to sustain financial flexibility. If a decision is taken to pay out the distribution in cash, the LTV ratio could rise to around 40%. Net debt to EBITDA registered at 4.0x at 1H FY21 (FY20: 4.5x), while interest coverage was stronger at 3.1x (FY20: 2.6x). Despite uncertainty about the dividend payment[1], credit protection metrics are likely to continue being reported within the range supportive of the rating.

Liquidity coverage remains adequate, underpinned by available facilities of R340m, minimal short term debt maturities and limited capex plans. As a result, the uses-vs-sources coverage was unchanged at 1.2x. The REIT is currently in negotiations to extend the term on upcoming maturities, which would further improve its debt maturity profile. GCR notes that Dipula managed to dispose of some non-core assets despite the constrained environment during the review

[1] The market was advised in a pre-close call on 30 August 2021 that the FY20 dividend would not be paid despite the REIT status being maintained.

period, however, highly conservative assumptions were made in respect of assets held for sale at the interim reporting period as the market remains weak. A high proportion of encumbered properties, coupled with the potential for limited covenant headroom should a cash dividend be paid, further constrain the assessment.

Outlook Statement

The Stable Outlook reflects GCR's view that Dipula should continue to display earnings resilience and that credit protection metrics will be consistent with expectations for the rating level. The outlook is also anchored around GCR's assumptions that the LTV ratio is expected to trend in the 35% to 40% range and strong interest cover above 2.5x be maintained over the rating horizon.

Rating Triggers

Negative rating movement could arise if there is a sustained increase in the LTV ratio above 40%, which results in concerns about Dipula's covenant compliance cushion; and/or if liquidity coverage deteriorates below 1.0x. A deterioration in performance metrics could also result in GCR lowering the ratings, whether due to internal factors or as a result of weakening in the operating environment.

Positive rating action is unlikely until the operating environment improves. However, if Dipula finalises facility negotiations and there is a meaningful reduction in debt, or if there is a marked improvement in earnings and property performance metrics, this would be positively considered.

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Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Real Estate Investment Trusts and Other Commercial Property Companies, May 2019
GCR Rating Scales Symbols and Definitions, May 2019
GCR's Country Risk Score report, August 2021
GCR's SA Corporate Sector Risk Score report, April 2021

Ratings History

Dipula Income Fund Limited					
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long Term Issuer	Initial	National	BBB(ZA)	Stable Outlook	Sept 2014
Short Term Issuer		National	A3(ZA)		
Long Term Issuer	Last	National	BBB(ZA)	Negative Outlook	Sept 2020
Short Term Issuer		National	A3(ZA)		

Analytical Entity: Dipula Income Fund Limited

Dipula Income Fund Limited ("Dipula" or "the REIT") is an internally managed property fund, with all its assets in South Africa. The REIT was initially founded as Dipula Property Fund with a R300m portfolio in 2005 and was subsequently renamed to Dipula Income Fund and listed on the JSE in 2011 after a merger with Mergence Africa Property Fund. Over the years, the portfolio was expanded primarily through acquisitions, recently venturing into residential property holdings to supplement its primary exposure to the retail, office and industrial sectors. Dipula remains one of the few listed corporates to maintain a dual share structure and to have full internal management of its property portfolio.

Operating Environment

The country and sector risk assessments are tied to the South African property sector, where all the REIT's assets are located.

Country risk

The country risk score of '7.0' is based on the REIT's exposure to the South African operating environment, where 100% of its assets are located. The score reflects the mounting challenges facing the economy amidst a prolonged pandemic that has continued to blunt recovery prospects. A sharp contraction in GDP growth, lower GDP per capita, worsening fiscal position, rising unemployment and social inequality all contribute to a broadly negative overlay on prospects. The assessment is somewhat supported by fairly stable institutional scores based on the World Bank Governance Indicators & World Economic Forum Global Competitiveness Index which are in the middle of the range, but better then regional peers. As with many global countries, South Africa implemented various financial stimulus packages to soften the devastating impact of the pandemic to the worst affected areas. Some of these relief measures have been extended into 2021 and are likely to place added stress to the fiscus.

Government faces an uphill task in its drive to arrest the rise in unemployment and create sustainable new jobs over the medium to longer term given the limited headroom in the fiscus. This is exacerbated by the vulnerable financial positions of many State-Owned Entities which continue to require large amounts of capital support amidst a diminishing capability to do so. Overall, downside risks dominate the outlook horizon for the South African country risk score. While the pandemic's impact has been felt around the globe, the severity has been more pronounced in South Africa given its pre-existing economic frailties. South Africa is facing an uphill task to make up the lost ground with the government fast approaching unsustainable debt levels.

Sector risk

GCR considers the property sector to evidence moderate risk characteristics, supported by below average cyclicality, assets that generate strong income through the cycle, and sustained demand for well-positioned properties. Despite these inherent advantages, the South African property sector has stagnated somewhat over the past 24 months. Even prior to COVID-19 the industry was reporting rising vacancies and lower rental reversions, placing pressure on asset valuations. In the listed property space, much lower share prices (well below reported NAV) due to depressed equity markets, as well as repricing on the debt capital market, led to a deterioration in access to capital. COVID-19 exacerbated many of these challenges. Assumptions regarding the stability of income were challenged as many tenants withheld rentals due to them not being able to trade, which required property owners to withhold distributions to investors.

While collection rates have recovered across the property sector, those properties exposed to tenants in the hospitality and entertainment sectors remain under severe pressure. Vacancies remain a major challenge, with many tenants downsizing or going out of business during the pandemic. The disruption to the industry caused by the shift towards working from home adds further uncertainty to the industry. GCR would thus expect property sector earnings to remain weak over the short to medium term, with the longer-term trajectory to be dependent on how property owners adjust the usage of their properties to meet the requirements of tenants and customers.

Details of the latest updates to discrete country and sector risk scores are outlined in GCR's Risk Score reports, available via the following link: https://gcrratings.com/risk-scores/.

Business Profile

Dipula's portfolio proved defensive through periods of lockdown, but the portfolio quality is constrained by the small scale and exposure to smaller office and industrial properties.

Portfolio quality

Dipula's strategically located convenience, rural and township centres continue to perform well through the various stages of COVID-19 lockdowns. Thus, the value of its property portfolio increased by 1.0% over the 12-month period to 1H FY21, bucking the market trend that has seen devaluations across most property sectors. Dipula's defensive characteristics are underpinned by the high proportion of space occupied by large national tenants (71%), as a result of which average collections have recovered to around 98% since the initial hard lockdown in April 2020, with only c.R57m in rental relief granted by 1H FY21. The portfolio has also benefited from the shift in shopping trends to favour open-air community centres over regional malls.

Figure 1: Portfolio progression

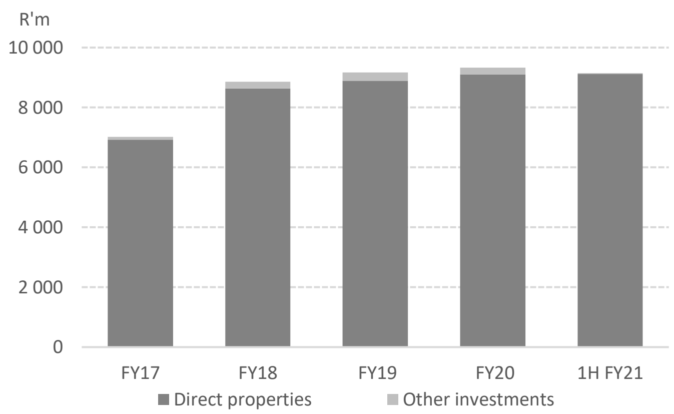
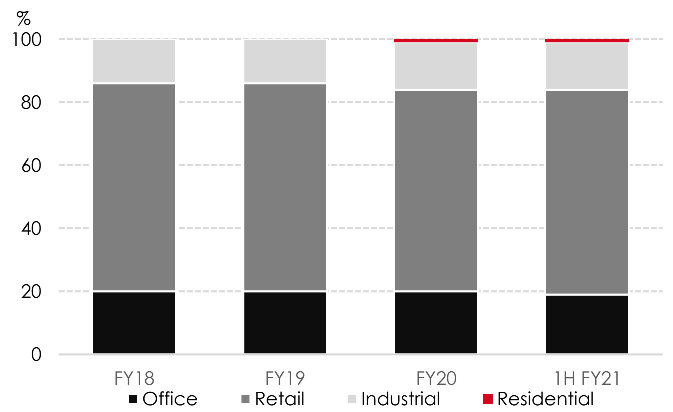


Figure 2: Direct portfolio composition by valuation



Nevertheless, Dipula's relatively small property portfolio continues to constrain the rating somewhat, as does its exposure to generally smaller office and industrial properties. Positively, concentration risk is low, with 189 properties across all nine South African provinces, and the single largest property accounting for 4% of property value, while the top ten make up just 30%. The REIT recently entered the residential property sector through the acquisition of a majority stake in Palm Springs, a residential complex in the fast-growing Cosmo City, albeit this segment only contributes 2% of rental income. An additional R153m in acquisitions is anticipated to be finalised in the coming months, while properties valued at R78m were held for sale.

Table 1: Portfolio review 1H FY21

	Retail	Industrial	Office	Total*
Property fair value (R'm)	5,544	1,401	1,833	9,041
Gross Lettable Area (m^2)	447,395	335,931	132,620	926,648
Contribution to rental income (%)	64	15	19	100
Weighted average escalation (%)	7.1	7.6	7.4	7.1
Tenant retention (%)	74	83	78	77
WALE (years)	2.7	3.8	1.4	2.8
Average rental collections (%)°	99	96	98	98

*Includes land (valued at R20m) as well as residential properties where relevant.
°Reflects the period from April 2020 to April 2021.

Vacancies continued to progress upwards, led by the struggling office sector which reported the largest increase to 11.6% at 1H FY21 from 7.2% previously, followed by retail and industrial properties which had vacancy rates of 9.9% and 3.2% respectively. Resultantly, the overall portfolio's vacancy rate increased to 7.6% (1H FY20: 5.8%). Nevertheless, Dipula concluded several new leases with competitive escalations of 7.7% and a weighted average lease expiry of 3.4 years, albeit a negative reversion rate of 4.8% was evidenced on lease renewals. Portfolio fundamentals are not expected to improve significantly in the short to medium, as any new letting activity will potentially be coupled with reversionary pressure. Dipula's relatively short-dated lease expiry profile is likely to come under pressure as additional leases come up for renewal, which reported a shorter weighted average lease expiry ("WALE") of 2.5 years. This will be further weighed down by the growing residential portfolio where tenants typically sign up for one-year leases.

Figure 3: Vacancy profile (by GLA)

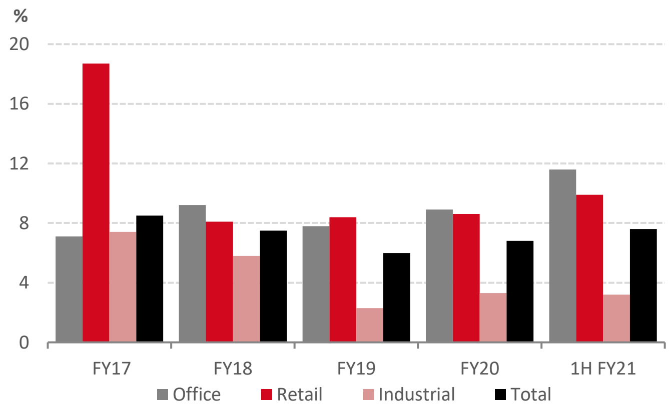
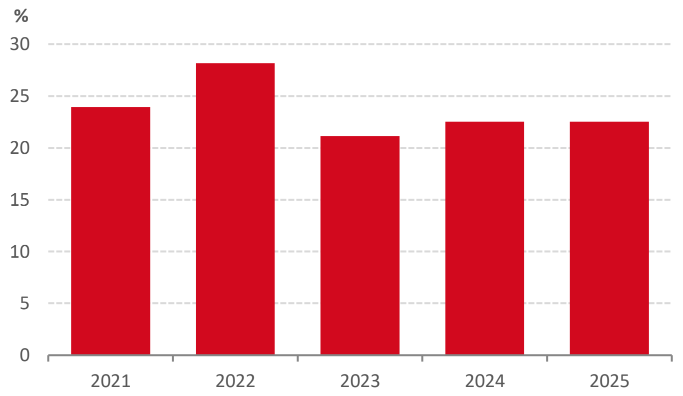


Figure 4: Lease expiries (by rental), 1H FY21



Rigorous cost management is evident in the moderate 1.6% increase in property expenses to R219m, while the REIT's cost to income ratio was in line with the previous period at 36.7% (1H FY20: 36.3%). As a result, the operating profit margin of 63.2% was comparable to the pre-pandemic level and is expected to be maintained at the upper end of the 60%-65% range over the medium term.

Management and governance

Management and governance factors were deemed to be neutral to the ratings assessment.

Financial Profile

The financial profile improved due to the withholding of the FY20 dividend, although metrics remain within a narrow range supportive of the rating.

Leverage and capital structure

Dipula deferred the payment of its R447m dividend for FY20 to shareholders, but instead used the cash to reduce the outstanding exposure on the REIT's revolving credit facilities. This was necessitated by the need to ensure that cash resources were available amidst the prevailing uncertainty in the market due to COVID-19 related disruptions. The REIT received a dispensation to withhold the FY20 dividend, while the board considers various options to balance its obligations to shareholders with the need to maintain financial flexibility. Subsequently, management advised in a pre-close call on 30 August 2021 that the FY20 dividend will not be paid.

Figure 5: Leverage metrics progression

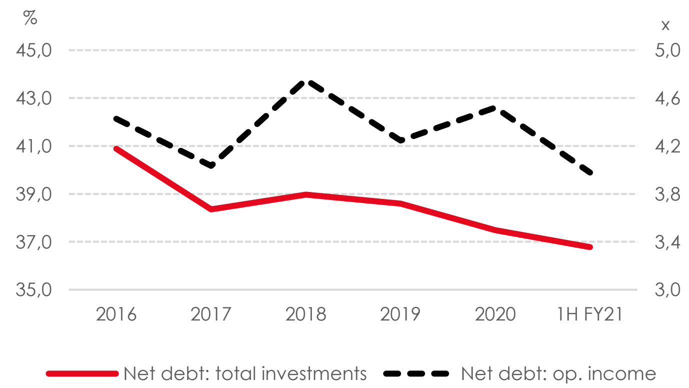
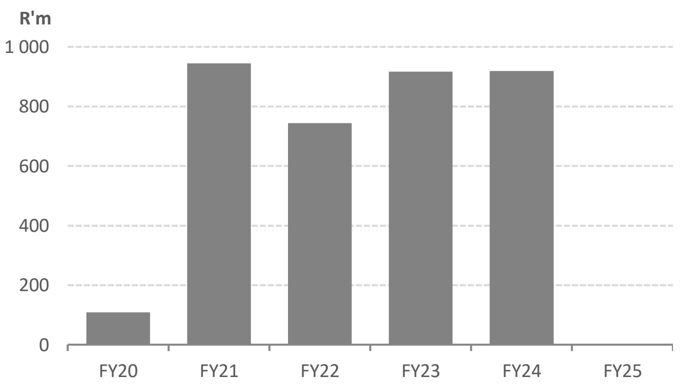


Figure 6: Debt maturity profile, 1H FY21



As a consequence of the withheld distribution, the LTV ratio improved to 35.7% at 1H FY21 (FY20: 38.9%), whereas GCR estimates that the LTV could rise to c.40% if the distribution is paid out in cash, as this would require the REIT to draw down on its funding facilities. Net debt to EBITDA also improved to 4.0x (FY20: 4.5x) while the interest cover ratio registered at 3.1x (FY20: 2.6x). The improved credit protection metrics are comfortably within the REIT's required covenants of an LTV ratio below 45% and an interest cover of at least 2.0x. GCR expects leverage metrics to continue being reported in the historically observed narrow ranges, which will continue to support the existing rating. Furthermore, GCR is cognisant that Dipula is at advanced stages of negotiations with its funders to increase the conservative LTV covenant limits to a level aligned with the rest of the market.

Dipula has limited funding sources, with credit lines solely from The Standard Bank of South Africa and Nedbank. The REIT has plans to dilute this concentration by introducing new funders as part of its upcoming acquisitions. Although a R2bn DMTN programme was established in 2015, no issuances have been made under the programme as bank funding has generally been sufficient and is available on favourable terms. Debt maturities are relatively well spread, and the weighted average debt maturity of 2.2 years is in line with most REITs in the market. GCR expects Dipula to reach an agreement with its funders to term out debt maturities, which will further improve the debt profile. Management's strategic initiatives for growth of the portfolio will likely result in additional strain on the leverage profile, albeit this may be mitigated by the successful disposal of assets to limit debt uptake.

Liquidity

Dipula's liquidity profile is supported by available unutilised facilities of R340m, together with minimal upcoming debt maturities and capex plans. In addition, GCR's highly conservative assumptions regarding assets held for sale made a minor contribution to liquidity sources, on the back of the successful disposal of some non-core assets during the constrained period leading up to February 2021. Although the REIT withheld the FY20 distribution, dividends are expected to constitute the biggest cash outlay over the coming 12-month period. Consequently, GCR estimates an unchanged liquidity coverage of 1.2x. Dipula has a high proportion of encumbered properties, which when coupled with the potential for limited covenant headroom should a cash dividend be paid, further constrain the liquidity assessment.

Comparative Profile

Peer analysis and group support

The peer analysis is neutral to the ratings and group support is not applicable to the assessment.

Rating Adjustment Factors

Structural adjustments

No adjustments were made to the Anchor Credit Evaluator in arriving at the ratings.

Instrument ratings

No adjustments for instrument ratings are applicable.

Risk Score Summary

Rating components & factors	Risk scores
Operating environment	**13.00**
Country risk score	7.00
Sector risk score	6.00
Business profile	**(1.00)**
Portfolio quality	(1.00)
Management and governance	0.00
Financial profile	**(2.00)**
Leverage and capital structure	(1.00)
Liquidity	(1.00)
Comparative profile	**0.00**
Group support	0.00
Peer analysis	0.00
Total Score	**10.00**

Glossary

Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
Committed Facility	A line of credit extended to a borrower that is guaranteed to be available for a specified period. The lender is obliged to lend the predetermined amount for the defined period under the terms of the agreement.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Facility	The grant of availability of money at some future date in return for a fee.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Issuer	The party indebted or the person making repayments for its borrowings.
Lease	Conveyance of land, buildings, equipment or other assets from one person (lessor) to another (lessee) for a specific period of time for monetary or other consideration, usually in the form of rent.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Portfolio	A collection of investments held by an institutional investor. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Horizon	The rating outlook period
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Refinancing	The issue of new debt to replace maturing debt. New debt may be provided by existing or new lenders, with a new set of terms in place.
REIT	Real Estate Investment Trust. A company that owns, operates or finances income-producing real estate.
Short Term	Current; ordinarily less than one year.
Vacancy	In commercial property, usually expressed as a percentage of unoccupied floor space in relation to the GLA.
Valuation	An assessment of the property value, with the value being compared to similar properties in the area.
WALE	Weighted average lease expiry.
Yield	Percentage return on an investment or security, usually calculated at an annual rate.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to Dipula Income Fund Limited. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Dipula Income Fund Limited participated in the rating process *via* face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from to Dipula Income Fund Limited and other reliable third parties to accord the credit ratings included:

- The 2020 annual financial statements (plus four years of audited comparative numbers)
- The 2020 integrated report
- Unaudited interim results at February 2021
- Results presentations and market/trading updates
- A breakdown of utilised and available debt facilities at February 2021