Credit Rating Announcement

GCR downgrades Hospitality Property Fund Limited's ratings to $BBB_{(ZA)}/A3_{(ZA)}$ as industry pressure rises; Negative Watch maintained

Rating Action

Johannesburg, 28 August 2020 – GCR Ratings ("GCR") has downgraded Hospitality Property Fund Limited's ("HPF" or "the REIT") national scale long and short-term issuer ratings to $BBB_{(ZA)}/A3_{(ZA)}$ from $A-_{(ZA)}/A2_{(ZA)}$ respectively. Concurrently, the ratings assigned to the Senior Secured Notes issued by HPF have been downgraded to $A+_{(ZA)(EL)}$ from $AA_{(ZA)(EL)}$. The Outlook on all the ratings has been maintained on Rating Watch Negative.

Rated Entity / Issue	Rating class	Rating scale	Rating*	Outlook / Watch
Hospitality Property Fund Limited	Long Term Issuer	National	$BBB_{(ZA)}$	Rating Watch Negative
	Short Term Issuer	National	$A3_{(ZA)}$	
Senior Secured HPF11 Notes	Long Term Issue	National	$A+_{(ZA)(EL)}$	Rating Watch Negative
Senior Secured HPF12 Notes	Long Term Issue	National	$A+_{(ZA)(EL)}$	Rating Watch Negative
Senior Secured HPF13 Notes	Long Term Issue	National	$A+_{(ZA)(EL)}$	Rating Watch Negative

*The Senior Secured Note ratings are based on an estimate of the expected loss in the event of an issuer default and are a function of the estimated probability of default of the issuer and the potential losses that may be incurred. As such, these ratings carry an "(EL)" suffix.

Rating Rationale

The downgrade to HPF reflects the extremely uncertain operating environment, with all hospitality related companies having seen their income drastically reduced due to the government efforts to curtail the COVID-19 pandemic.

Since the beginning of the COVID-19 shutdown at the end of March 2020 and during the lockdown period, HPF has seen its income plunge by over 90%. Almost all of the REIT's properties were closed during the initial period of the lockdown and even though restrictions were eased in June and July 2020, the REIT indicated that a large portion of its portfolio remains closed and the overall occupancy level is below 20%. Although restrictions on local travel and tourism have been eased, demand for room nights is expected to remain very weak over the next 6 months. There remains great uncertainty whether tourism will recover, and to what extent it will recover going into the critical summer season and further into 2021. This will be dependent on the timing of the removal of international travel restrictions and perceived control over the COVID-19 pandemic, as tourist activity forms a substantial part of the revenue base. Recognising that income could fall by 75% in FY21 and only recover gradually through FY22, HPF wrote down the value of its properties by R2.5bn to R10bn at FY20 (a 17% reduction from the pre-write down value).

HPF's conservative funding profile has proved critically robust in alleviating the pressure. Thus, although the LTV ratio recorded a significant increase to 26% at FY20 (FY19:16%), driven by the portfolio write-down, it remains well below the industry average. Moreover, GCR takes comfort from the significant headroom to debt covenants, with the lowest at 40%. However, with operating income likely to plunge in FY21, net interest cover is likely to be very low or negative. To this end, HPF has been proactive in engaging with its funders and has obtained waivers in respect of the interest cover ratio for the September measurement period and have started negotiating to get waivers for March 2021 as well. We expect that the LTV will increase going forward, driven by the dual need to raise debt to maintain operations and the continued pressure on property values.

Liquidity concerns are also ameliorated by the long-dated debt maturity profile. HPF has no short-term debt and its next maturity (R250m) is only in August 2021 and thereafter in August 2022 (R500m). The company has taken strong measures to conserve cash, with a moratorium on all capex spend. Nevertheless, the company will rely on the ongoing support of funders for liquidity if the operating environment does not rapidly and significantly improve.

GCR considers it appropriate to incorporate a negative peer adjustor to capture HFP's exposure to the severe disruption to the hospitality industry, compared to traditional property market sectors. As long as this anomalous situation persists, operating income is likely to be severely constrained, and credit risk factors will remain elevated. The peer adjustor will be reviewed once market dynamics have returned to normal. GCR also takes note of the increased shareholding by Tsogo Sun Hotels in HPF, with the insulation provided by the REIT structure legislation disqualifying the group assessment approach. Further changes to the REIT's incorporation and/or holding structure will be assessed to determine any ratings impact.

Secured Notes lowered in line with issuer credit ratings

The rating of the Senior Secured Notes is dependent on the estimated recoveries from the stressed portfolio of properties, in the event of an issuer default and enforcement in a fire-sale scenario as modelled by GCR. Although the aggregate property value declined as mentioned above, the recovery calculation is based on the assumption that the debt in issue is the maximum potential amount at the covenant LTV of 45%. The modelled recovery rate of 90.5% qualifies for the national scale equivalent of two international scale notches uplift from the issuer rating, associated with 'Excellent' recovery prospects. The fund currently has significant headroom to the covenant, with the LTV reported at 25.6% at FY20. GCR took further comfort from the recoveries potentially qualifying for the same level of uplift in a stress tested scenario, where the recovered property value was further reduced to reflect elevated asset risks.

Outlook Statement

The Rating Watch Negative reflects the elevated credit risks arising from the significant disruption to HPF's operating performance as a result of the collapse in travel due to the COVID-19 crisis. GCR expects a significant decline in earnings, albeit ongoing liquidity support from funders has been factored in. The REIT's funding requirements in support of a recovery to full trading are expected to result in the LTV potentially rising above 30%, exacerbated by ongoing pressure on property values. GCR will continue to monitor the REIT''s performance and review the ratings after the interim results are published.

Rating Triggers

GCR could take Negative rating action if there are further material write-downs in property values, resulting in deteriorating leverage metrics or if there is a material deterioration in liquidity coverage. Upward rating migration could follow a return to historical trading volumes after the lifting of COVID-19 related restrictions.

The negative rating action on the Senior Secured Notes may not be the same as the action on the issuer rating, if property write-downs result in a material reduction in the estimated recovery rate.

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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
Criteria for Rating Secured Bonds, November 2018
GCR's Country Risk Score report, published May 2020
GCR's SA Sector Risk Score report, published July 2020
Credit Spotlight: Issuer Credit Ratings, Issue Credit Ratings and Expected Loss Ratings, published June 2020
GCR places South African commercial property on Negative Trend, published August 2020

Ratings history

Hospitality Property Fund Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long term Issuer	Initial	National	BBB-(ZA)	Stable Outlook	Nov 2012
Short Term Issuer	Initial	National	A3(ZA)		
Long term Issuer	Last	National	A-(ZA)	Rating Watch Negative	Mar 2020
Short Term Issuer	Last	National	A2(ZA)		

Stock Code	Review	Rating scale	Rating*	Outlook/Watch	Date
HPF11	Initial	National	AA-(ZA)	Stable Outlook	Feb 2018
	Last	National	AA(ZA)(EL)	Rating Watch Negative	Mar 2020
HPF12	Initial	National	AA(ZA)	Stable Outlook	April 2019
	Last	National	AA(ZA)(EL)	Rating Watch Negative	Mar 2020
HPF13	Initial	National	AA(ZA)(EL)	Stable Outlook	Dec 2019
	Last	National	AA(ZA)(EL)	Rating Watch Negative	Mar 2020

* Structured bond ratings are based on an estimate of the expected loss in the event of an issuer default and are a function of the estimated probability of default of the issuer and the potential losses that may be incurred. As such, the ratings carry an 'EL' suffix. The expected loss ratings assigned to the notes issued therefore differs from the 'BBB(ZA)' long-term senior unsecured credit rating of the issuer. The ratings are derived by applying a notching approach, starting from the issuer long term rating. Should the issuer rating or the estimated recovery rate calculated by GCR change, the ratings assigned to the Senior Secured Notes may also change. Prior to the publication of GCR's Rating Scales, Symbols and Definitions in May 2019, structured bond ratings did not carry the 'EL' suffix. For a full explanation see the research piece title Credit Spotlight: Issuer Credit Ratings, Issue Credit Ratings and Expected Loss Ratings, published in June 2020.

Risk Score Summary

Risk scores	Hospitality Property Fund Limited
Operating environment	**13.00**
Country risk score	7.00
Sector risk score	6.00
Business profile	**(2.50)**
Portfolio quality	(2.50)
Management and governance	0.00
Financial profile	**0.50**
Leverage and Capital Structure	1.00
Liquidity	(0.50)
Comparative profile	**(1.00)**
Group support	0.00
Peer analysis	(1.00)
Total Score	**10.00**

Glossary

Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Bond	A long-term debt instrument issued by either a company, institution or the government to raise funds.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Concentrations	A high degree of positive correlation between factors or excessive exposure to a single factor that share similar demographics or financial instrument or specific sector or specific industry or specific markets.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Debt Service Ratio	A measure of a company's ability to service its interest and principal redemption costs, expressed as the ratio of earnings or cash flows over a period to the sum of interest and principal payments over the same timeframe.
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
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.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
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.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
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 individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
REIT	Real Estate Investment Trust. A company that owns, operates or finances income-producing real estate.
Renewal	The re-establishment of the in-force status of a policy, the term of which has expired or will expire unless it is renewed.
Rent	Payment from a lessee to the lessor for the temporary use of an asset.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Weighted Average	An average resulting from the multiplication of each component by a factor reflecting its importance or, relative size to a pool of assets or liabilities.

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 Hospitality Property 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.

Hospitality Property 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 Hospitality Property Fund Limited and other reliable third parties to accord the credit ratings included:

- The 2020 audited annual financial statements (plus four years of audited comparative numbers)
- Results presentations
- A breakdown of debt facilities available and related counterparties at 31 July 2020
- SENS announcements
- Covenant compliance certificates
- Occupancy and rental income data