GCR RATINGS

Credit Rating Announcement

GCR downgrades Hospitality Property Fund Limited's ratings to BBB-(ZA) due to a protracted industry downturn amidst the ongoing COVID-19 uncertainties; Negative Outlook

Rating Action

Johannesburg, 8 February 2021 – GCR Ratings ("GCR") has downgraded Hospitality Property Fund Limited's ("HPF" or "the fund") national scale long-term issuer rating to BBB-(ZA) from BBB(ZA) and maintained the short-term rating of A3(ZA). Concurrently, the long-term issue ratings assigned to the Senior Secured Notes issued by HPF have also been downgraded to A(ZA)(EL) from A+(ZA)(EL). The Outlook on all the ratings is Negative.

Rated Entity / Issue	Rating class	Rating scale	Rating*	Outlook / Watch
Hospitality Property Fund Limited	Long Term Issuer	National	BBB-(ZA)	Negative
	Short Term Issuer	National	A3(ZA)	
Senior Secured HPF11 Notes	Long Term Issue	National	A(ZA)(EL)	Negative
Senior Secured HPF12 Notes	Long Term Issue	National	A(ZA)(EL)	Negative
Senior Secured HPF13 Notes	Long Term Issue	National	A(ZA)(EL)	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 review of HPF's issuer ratings follows the buyout of its minority shareholders by Tsogo Sun Hotels Limited ("TSH" or "the group"). Subsequently, HPF has been delisted from the JSE and is therefore no longer classified as a REIT. In the absence of any insulation provided by the REIT status, GCR has revised the rating criteria applicable to the fund and now utilises the Criteria for Rating Corporate Entities, with the analytical entity being TSH. This is because without any outside shareholders or the REIT status, GCR considers HPF to be a core operating entity of TSH, being the direct owner of most of the group's hotel properties and having a very high level of operational integration. As such, HPF's rating is equalised to the wider group.

GCR's assessment of TSH reflects the severe disruption to the hospitality industry that has been experienced since March 2020 due to the COVID-19 pandemic. Given the ongoing disruptions and uncertainties, a full recovery is likely to be slow and could only start to show by 4Q 2021, whilst GCR considers the longer-term outlook to remain constrained. The market uncertainty is counterbalanced by the leading market position enjoyed by TSH, as well as its strong banking relationships that have provided funding support through the downturn.

As a result of the collapse in both business and leisure travel, occupancy levels have fallen to unprecedented lows and most of the hotel portfolio was closed for a large part of FY21, resulting in the ongoing operating losses. With the easing of lockdown restrictions from June 2020 some hotels were reopened, which helped revenue generation somewhat. However, the resurgence of infection rates and reinstatement of stricter lockdown levels locally in December 2020 cut the hospitality industry's revival short and led to some of the forward-bookings for 2021 being cancelled/deferred.

TSH has introduced cost containment measures across the group including reducing the payroll burden through operational restructuring and temporary layoff of staff. However, without sufficient bed nights, the group remains in a loss-making position. Positively, the cost base has been fundamentally lowered and TSH expects to reach breakeven at a lower occupancy level, whilst there should be some enhancement to margins once conditions in the hospitality industry start to improve.

The group was moderately geared prior to the COVID-19 crisis, with R4.5bn in debt at FY20 (FY19: R3.4bn) including USD denominated debt facilities, and an additional R1.0bn in lease liabilities. Nevertheless, TSH's credit protection metrics deteriorated because of unfavourable foreign exchange movements and the poor earnings performance. EBITDA and cash flow coverage of debt remains negative, while GCR estimates a moderate ratio of net debt to fixed assets of 32.6% at FY20, albeit having risen from 22.4% at FY19. This increase also reflects the c.R1.7bn fair value write down to properties and impairments at FY20, necessitated by much lower projections of income over the short to medium term as a result of the lockdown. No further impairments have been made since FY20.

Funding lines for HPF and TSH are independently secured against specific assets and only consolidated at group level for reporting purposes. Most of the outstanding debt is rand denominated and ringfenced at HPF level, while TSH is separately funded through a combination of local and offshore secured debt. Given the earnings disruptions, lenders approved covenant waivers up to March 2021, replacing the existing covenant limits with temporary minimum liquidity amounts and a maximum loss over a 12-month rolling period for TSH. The group is in constant communication with lenders, which has helped to sustain their support and the conclusion of negotiations to refinance upcoming USD maturities with 5-year facilities. GCR notes the inherent risk of not having any hedges in place for the USD denominated debt, albeit this is partly mitigated by the high asset value of the underlying security, and the potential to settle these debt facilities through the sale of foreign assets in the medium term.

The liquidity assessment is supported by the absence of short-term debt maturities, the suspension of dividend payments and the limitation on capital expenditure to necessary repairs only. At December 2020, TSH and HPF had R1.9bn in available cash and unutilised facilities, enabling the group to comfortably exceed the minimum liquidity requirements of R500m at TSH level and R125m at HPF level that were introduced with the covenant waiver. Even after incorporating stressed operating cash flow assumptions, GCR estimates a uses versus sources liquidity coverage of between 1.5 and 2.0x over the coming 12 months.

GCR views TSH's position as one of the largest South African hotel groups to be a rating strength. Its footprint is spread across all nine provinces in South African, and the group offers luxury, full service and economy hotels. This includes a mix of internally managed and external brands. The provision of rooms across multiple price points with highly recognisable and established brands, together with the relatively diverse portfolio of assets, serves to somewhat offset the single line of business risk and support an intermediate business profile. As over 90% of its hotel assets are located in South Africa, the group's ownership of several hotels in the rest of Africa and the UAE does not provide sufficient diversification benefit away from the South African operating environment.

<u>Secured Notes ratings downgraded in line with the national scale long-term issuer credit ratings</u>

The ratings of the Senior Secured Notes issued by HPF is dependent on the estimated recoveries from the stressed portfolio of secured properties, in the event of an issuer default and enforcement in a fire-sale scenario as modelled by GCR. The aggregate value of outstanding secured debt is assumed to be the maximum possible amount at the covenant LTV of 45%. The stressed amount recovered from the sale of properties was negatively impacted by the prolonged period of minimal to zero occupancy at the hotels during 2020. The modelled recovery rate therefore declined to 86.7% from 90.5% previously and is now commensurate with 'Superior' recovery prospects. Nonetheless, the recovery rate still qualifies the Senior Secured Notes for a rating uplift equivalent to four national scale notches from the issuer rating. Additional comfort was taken from the fund currently having significant headroom to the covenant limit, reporting an LTV of 26.0% at 1H FY21. Any changes to the value of the security portfolio may potentially impact the estimated recovery rate and lead to a revision of the ratings.

Outlook Statement

The Negative Outlook reflects the elevated credit risks arising from the significant ongoing disruptions to the hospitality industry because of COVID-19, and uncertain outlook on TSH's operating performance. Accordingly, GCR expects earnings to remain depressed and the group to continue reporting operating losses, with a gradual recovery dependent on the rollout of vaccines locally and the return of both local and international consumers' confidence in the hospitality industry. Liquidity support from funders is expected to be sustained.

Rating Triggers

GCR could take negative rating action if the COVID-19 pandemic persists through most of 2021 and the volumes in the hospitality industry remain around historical lows. This would likely transpire in continued operating losses and further material write-downs in property values, resulting in deteriorating leverage metrics. The ratings could also be downgraded if GCR perceives funding support from key financial institutions to materially weaken.

Upward rating migration is only possible post the COVID-19 pandemic if there is a return to historical trading volumes and profitability recovers.

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 Corporate Entities, May 2019
Criteria for Rating Secured Bonds, November 2018
GCR's Country Risk Score report, published November 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

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	BBB(ZA)	Rating Watch Negative	Aug 2020
Short Term Issuer	Last	National	A3(ZA)		

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

Rating factors & components	Risk Score
Operating environment	**11.00**
Country risk score	7.00
Sector risk score	4.00
Business profile	**1.00**
Competitive position	1.00
Management and governance	0.00
Financial profile	**(2.50)**
Earnings	(2.00)
Leverage and cash flow	(1.50)
Liquidity	1.00
Comparative profile	**0.00**
Group support	0.00
Peer analysis	0.00
Total Score	**9.50**

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.
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.
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 and Tsogo Sun Hotels 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 Tsogo sun Hotels Limited and other reliable third parties to accord the credit ratings included:

- The Tsogo Sun Hotels 2020 audited annual financial statements
- Tsogo Sun Hotels September 2020 Interim results
- Results presentations
- A breakdown of debt facilities available at 31 December 2020
- SENS announcements
- Covenant compliance certificates
- Occupancy and rental income data for the secured Hospitality Property Fund portfolio