24 November 2020

Corporates

Budapesti Ingatlan Nyrt. Hungary, Real Estate

B+ STABLE

Corporate profile

Budapesti Ingatlan Hasznosítási és Fejlesztési Nyrt. (BIF), founded in 1994, lets, develops and manages properties (buy and hold), and develops residential projects for sale. As of 31 December 2018, BIF is classified as a Regulated Real Estate Investment Company (REIT/SZIT in Hungary).

Key metrics

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020F**	**2021F**
Scope-adjusted EBITDA/interest cover (x)	8.7x	12.0x	8.0x	3.9x
Scope-adjusted debt (SaD)/EBITDA	0.0x	0.5x	3.7x	9.5x
Scope-adjusted loan/value ratio	0%	3%	20%	31%

Rating rationale

Scope Ratings has today affirmed its B+/Stable issuer rating on Budapesti Ingatlan Nyrt. Scope also affirms the BB- rating for the senior unsecured debt category.

The rating affirmation is driven by BIF's solid credit metrics, including a relatively high Scope-adjusted EBITDA interest cover ratio (11x in 2019) and low leverage below 20% as of June 2020. In the last twelve months, the company has acquired some assets to expand its portfolio, including two office buildings and a former hotel building that is going to be converted into office space. It plans to invest approx. HUF 30bn in the next two years. The company's core office property portfolio has produced relatively stable net rental income, despite the impact of the Covid-19 outbreak on the economy. BIF has not reported a significant effect on its rent collections, having negotiated a rental rescheduling plan with the tenants of its two hotel buildings. Occupancy has remained relatively high (87% in October 2020) but is 6pp lower than in October 2019. We expect occupancy to increase to levels closer to 90% in the next few months, based on healthy demand from existing tenants that want to increase the area they occupy, according to BIF.

The rating continues to be constrained by the company's small size and market share, with total assets of around HUF 60bn (approx. EUR 170m) as of June 2020. This results in a lack of economies of scale, which leads to greater sensitivity to unforeseen shocks and volatile cash flow. BIF's development activities expose the company to the industry's inherent cyclicality. Further rating constraints are weak geographical and tenant diversification, exposure to small to medium-size Hungarian companies, and a very short weighted average unexpired lease term (WAULT) of 2.5 years as of October 2020, which provides only limited visibility on future cash flows. Cluster risk arises from the relatively short lease on Vigadó Palace, with a lease end in September 2021. The Hungarian Ministry of Agriculture – the sole tenant in the building – is expected to exercise its option and extend the lease.

Ratings & Outlook

Corporate ratings	B+/Stable
Senior unsecured rating	BB-

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Related Methodology

Corporate Rating Methodology, February 2020

Rating Methodology European Real Estate Corporates January 2020

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Outlook and rating-change drivers

The Outlook for BIF is Stable and incorporates the lease extension of BIF's anchor tenant (expiring in H2 2021). Despite the forecasted increase in the company's indebtedness, we anticipate Scope-adjusted EBITDA interest cover above 1.7x and Scope-adjusted loan/value ratio remaining below 40%.

A positive action would require BIF to significantly improve its business risk profile while keeping the Scope-adjusted loan/value ratio at around 50%. This could be achieved by the company substantially growing in size, leading to a less concentrated portfolio.

A negative rating action is possible if leverage increases significantly, indicated by a Scope-adjusted loan/value ratio of above 60%. Leverage could increase if property values in the portfolio significantly drop due to a sudden shock in the Hungarian market or new property acquisitions via external financing and a lower equity share contribution.

Rating drivers

Positive rating drivers	Negative rating drivers
• Exposed to second-tier investment market with healthy demand from tenants • High occupancy rate (87% as at October 2020) but visibility beyond 2022 is limited • Stable profitability, with Scope-adjusted (Sa) EBITDA margin of above 40% • High debt protection (Sa EBITDA interest cover of greater than 10x) and very low leverage (Sa loan/value ratio of around 20% as at June 2020) • Adequate liquidity, including available undrawn credit lines of about HUF 1.5bn	• Small property company exposed to greater sensitivity to unforeseen shocks and cash flow volatility • Small market shares in an increasingly competitive environment • Exposure to development activities leads to volatile cash flow pattern, partially mitigated by stable recurring rental income • Cluster risk in 2022 resulting from a short WAULT (2.5 years) • Limited tenant diversification and exposure to small to middle-sized Hungarian companies, partially mitigated by credit quality of the main tenant (Hungarian Ministry of Agriculture) • Weak diversification across geographies with a portfolio solely focused on Budapest • Negative discretionary cash flow due to portfolio expansion in 2020 and 2021

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improving business risk profile, growing significantly in size, less concentrated portfolio, while keeping the Scope-adjusted loan/value ratio at around 50%	• Leverage increases significantly, indicated by a Scope-adjusted loan/value ratio of more than 60%

Financial overview

			Scope estimates	
Scope credit ratios	**2018**	**2019**	**2020E**	**2021E**
SaEBITDA/interest cover (x)	8.7x	12.0x	8.0x	3.9x
Scope-adjusted debt (SaD)/EBITDA	0.0x	0.5x	3.7x	9.5x
Scope-adjusted Loan/value ratio (%)	0%	3%	20%	31%
Scope-adjusted EBITDA in HUF m	**2018**	**2019**	**2020E**	**2021E**
EBITDA	2,096.1	2,467.5	4,191.6	2,175.1
Operating lease payment in respective year	0.0	0.0	0.0	0.0
Other	0.0	0.0	-1,097.0	0.0
Scope-adjusted EBITDA	2,096.1	2,467.5	3,094.6	2,175.1
Scope-adjusted funds from operations in HUF m	**2018**	**2019**	**2020E**	**2021E**
Scope-adjusted EBITDA	2,096.1	2,467.5	3,094.6	2,175.1
less: (net) cash interest as per cashflow statement	-240.4	-205.8	-385.6	-560.6
less: cash tax paid as per cashflow statement	-16.6	-13.3	-8.0	-3.2
Others (provisions, impairments)	2.8	4.0	0.0	0.0
Scope funds from operations	1,842.1	2,252.4	2,701.1	1,611.3
Scope-adjusted debt in HUF m	**2018**	**2019**	**2020E**	**2021E**
Reported gross financial debt	9,923.1	16,133.8	21,192.3	40,032.5
add: finance leases	0.0	0.0	0.0	0.0
less: cash, cash equivalents	-9,850.8	-14,937.8	-9,613.8	-19,290.2
Scope-adjusted debt	72.3	1,196.0	11,578.5	20,742.4

Business risk profile: B

Industry risk: BB-

Industry risk remains unchanged. We have assigned a blended industry risk of BB-, given BIF's activities, which comprise the leasing and management of commercial real estate buildings, as well as the development of residential projects. This exposes the company to the highly cyclical real estate industry, especially regarding its development activities, which tend to increase cash flow volatility. Industry risk for BIF is therefore modest.

Small property company exposed to sudden shocks and the real estate cycle

BIF's limited size, with about HUF 60.4bn (EUR 0.2bn) of total assets as of June 2020, is a negative rating driver since it implies enhanced sensitivity to unforeseen shocks, greater cash flow volatility, limited economies of scale and higher key person risk. In the last twelve months, the company has acquired some assets for its portfolio (more than 25,000 sqm of additional space), including two office buildings and a former hotel building that is going to be converted into office space. The company plans to invest approx. HUF 30bn in the next two years, mainly focused on brownfield development. Main projects include the redevelopment and upgrade of the following properties: Városmajor, Bajcsy, and the newly acquired Tower building (part of the Üllloi Street building complex). Despite these investments, we expect BIF to remain relatively small.

Small market shares in an increasingly competitive environment

Notwithstanding the company's focus on Budapest and the recent additions to its office portfolio, BIF has no significant share in the city's real estate market (market share of approx. 1.5% for the office segment). Development activity in Budapest (around 570,000 sqm of new office space under construction[1]) will expose the company's property portfolio to intense market competition.

Weak diversification across geographies with portfolio solely focused on Budapest

BIF focuses on investing in the Budapest real estate market, with 100% of its portfolio distributed across the city's districts. The company does not intend to increase its geographical outreach beyond Budapest. This is because it defines itself as a market specialist and recognises the risk inherent in expansion without good market knowledge or networks in other geographies. While this strategy seems prudent given the limited size of the company, it also fully exposes BIF to the macroeconomic environment of one market.

While International funds' interest in the Hungarian real estate market is growing and the transaction volume reached a record EUR 1.8bn in 2019, Hungarian buyers still dominate the investment market (66% of total transactions of 2019). The Budapest real estate has a relatively low level of liquidity compared to other European locations. If the economy cools and/or interest rates rise, investors are likely to focus on tier-one markets and safe havens like London, Paris or the seven major German cities. This could eventually lead to substantial downward pressure on property values, an increase in leverage, the reduced availability of external financing, and limited recovery expectations for debt investors.

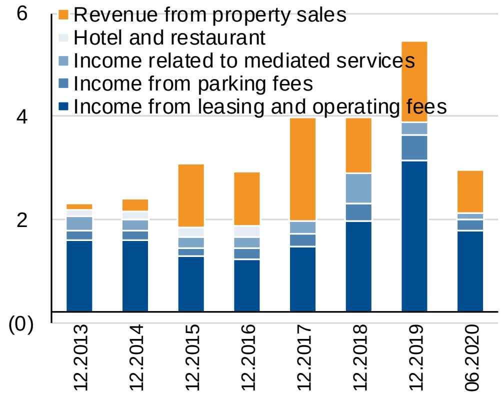
Limited tenant diversification and exposure to SMEs, mitigated by credit quality of main tenant

The company continues to be exposed to high tenant concentration with a considerable net rental income contribution from its main tenant, the Hungarian Ministry for Agriculture. The top 10 tenants represent 69% of total rental income as of October 2020. However, associated risk is partially mitigated by the main tenant's credit quality. Mostly local, small to medium-sized companies make up the remainder of BIF's tenants. Small-sized companies are particularly vulnerable to worsening macroeconomic conditions and unforeseen shocks, which we expect to directly translate into softer demand and defaults from these tenants. The company is also exposed to some hotel operators, which represent approx. 12% of rental income as of October 2020. Of HUF 114.8m in future due payments, approx. HUF 98m corresponds to rental payments from the two hotel operators. BIF has negotiated a rescheduling plan with both tenants for the payment of

[1] https://www.jll.hu/content/dam/jll-com/documents/pdf/research/Hungary_Research_Budapest_City_Report_H1_2020.pdf

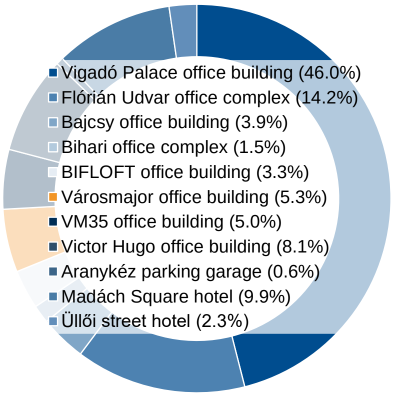
the deferred rents. The presence of bank guarantees or cash deposits for at least 98% of the leases partially mitigates the risk of a single tenant default, which could impair rental cash flow. Such guarantees amount to an equivalent of three months' rent. In addition, there have been no significant impairments in recent years, as evidenced by overdue receivables of 0.7% of the total rent as of October 2020.

Figure 1: Distribution of revenues by type of use



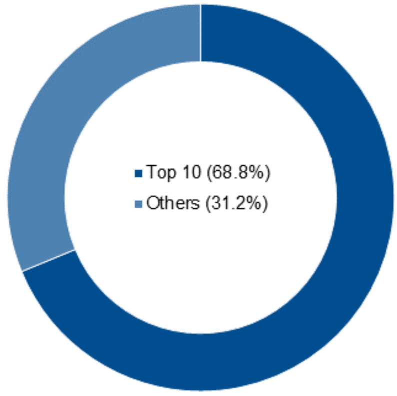
Source: BIF, Scope

Figure 2: Distribution of NRI[2] by property



Source: BIF, Scope

Figure 3: Tenant diversification by rental income



Source: BIF, Scope

Relatively high occupancy rate but exposed to re-letting risk due to short WAULT

The high occupancy rate of BIF's core office property portfolio has produced relatively stable net rental income since 2013. Occupancy was 87% in October 2020, down 6pp compared to the previous year, due to lower occupancy in one of the properties, Florian Udvar, for which two leases (approx. 20% of the rental area) expired at the end of 2019. The company expects to increase occupancy levels in the property closer to 75% (10pp above the current level), This is because one existing tenant in the property will expand its current rental space and take over a further 10% of the total rental area in the office complex. Despite high occupancy, the relatively short WAULT of 2.5 years as at October 2020[3] provides only limited visibility on future cash flows and exposes the properties to re-letting risk in 2022. Cluster risk arises from the relatively short lease on Vigadó Palace, with a lease end in September 2021. The Hungarian Ministry of Agriculture – the single tenant in the building – is expected to exercise its option and extend its lease in Vigadó Palace.

Buildings with a short WAULT tend to have a high turnover of tenants, higher costs associated with re-letting and require more asset management. However, BIF has demonstrated its ability to keep high occupancy in the buildings, having established long-term relationships with tenants. For example, as the development of the Major Udvar property has started in 2020, some major tenants have been reallocated to a neighbouring building – Városmajor 35.

Stable profitability but exposed to development activities in the portfolio

BIF's profitability, as measured by its Scope-adjusted EBITDA margin, stood between 40% and 50% in the last few years. We expect the EBITDA margin to remain above 40%, with some upside potential once the properties currently in development come into operation. The margin is exposed to some volatility risk, because of: i) the company's concentrated tenant base; ii) the short WAULT; and iii) BIF's exposure to development activities. Whilst BIF's development activities have significantly contributed to revenues in

[2] Net rental income
[3] Assuming a six month notice period in the case of open-ended leases.

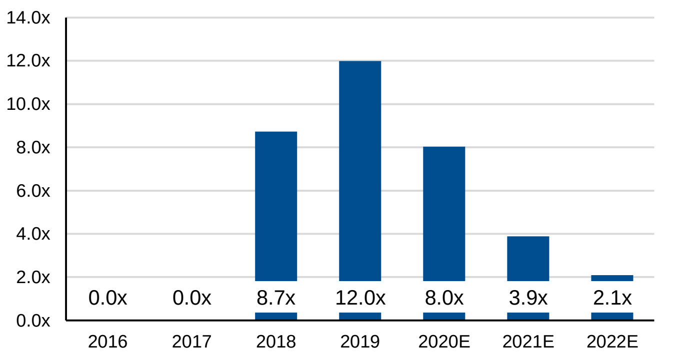
the past, they also lead to greater cash flow volatility. In 2020, the company sold part of its residential development project, with the aim of focussing on the development of its office buildings.

Financial risk profile: BB+

Strong debt protection metrics driven by predominately equity-financed portfolio growth

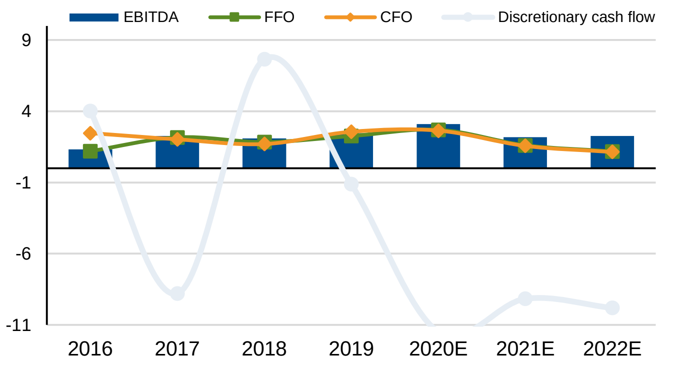
BIF's debt protection, as measured by its Scope-adjusted EBITDA interest cover, stood at above 10x in 2019 and benefitted from the company's low level of debt. In 2020, the company refinanced part of its outstanding debt. Following this transaction, all of BIF's debt is subject to a fixed interest rate, resulting in better visibility on financial costs. We anticipate declining debt protection in the years to come, as a result of the higher leverage component in the company's balance sheet after the bond placement. However, we forecast that EBITDA interest cover will remain above 1.7x. in the next few years.

Figure 4: Scope-adjusted EBITDA interest cover (x)



Source: Scope estimates

Figure 5: Cash flows (HUF bn)

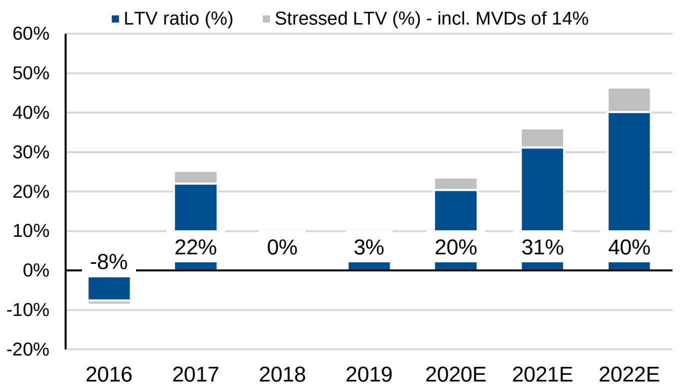


Source: Scope estimates

Negative free operating cash flow driven by portfolio expansion

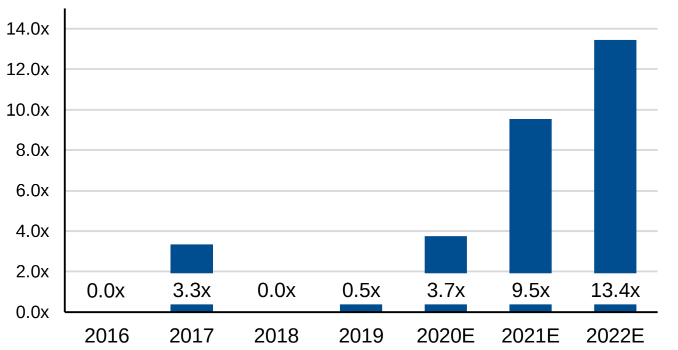
We forecast relatively stable and positive funds from operations (FFO) and cash flow from operations (CFO) in the next few years, due to BIF's solid recurring rental income, subject to some lease terminations in the short run. Free operating cash flow has been more volatile and we expect it to turn negative from 2019 on, driven by the portfolio expansion planned for the 2020-2021 period, which is expected to bear fruit from 2022 on.

Figure 6: Scope-adjusted loan/value ratio (%)



MVDs = Market value declines
Source: Scope estimates

Figure 7: SaD/EBITDA (x)



Source: Scope estimates

Low leverage reflects predominately equity-financed portfolio growth

BIF has relatively low indebtedness. In 2020, the company refinanced part of its outstanding debt with the Magyar Fejlesztési Bank (MFB), as well as the floating rate credit agreement with Takarékbank, as part of the Hungarian National Bank's Funding for Growth Scheme. As of June 2020, BIF's total debt stood at HUF 19.0bn and its net debt at HUF 10.1bn. The refinancing has extended the average maturity of the company's debt to 13 years. BIF's financial debt is solely denominated in HUF. Foreign exchange risk is non-existent as of now because 95% of revenues are generated in HUF.

In accordance with the Hungarian REIT regulation, the maximum loan/value ratio is set at 65%. BIF aims to keep its loan/value ratio below 50% according to management. We forecast that the loan/value ratio will increase to around 40% in the coming years, considering the HUF 20.0bn bond. We believe BIF has sufficient financial headroom to execute its planned portfolio expansion.

Adequate liquidity

We consider liquidity to be adequate. In detail:

In HUF	2019	2020E
Short-term debt (t-1)	0.8bn	0.5bn
Unrestricted cash (t-1)	9.8bn	14.9bn
Open committed credit lines (t-1)	20.0bn	12.4bn
Free operating cash flow (t)[4]	2.6bn	-9.0bn
Coverage	**42.1x**	**35.8x**

BIF's liquidity is adequate, supported by approximately HUF 10bn in cash balances as of June 2020, as well as available open credit lines for HUF 1.5bn provided by the Takarékbank. This credit line can be used to finance future real estate developments. All financial debt is long term (13 years on average), leading to low refinancing risk in the coming years. The company also has reserves of around HUF 8.5bn (treasury shares) and an unencumbered asset position of HUF 34.5bn as of October 2020, all of which provides indirect security for the HUF 20bn senior unsecured bond to be issued (we expect the unencumbered asset ratio to remain above 1.7x after the bond issuance).

Long-term and short-term debt instrument ratings

Senior unsecured debt: BB-

BIF plans to issue a HUF 20bn senior unsecured corporate bond under the MNB Bond Funding for Growth Scheme. The planned bond has a fixed coupon (to be paid on an annual basis) with a tenor of ten years, and 100% redemption at maturity. Proceeds from the bond are earmarked to co-finance investments of around HUF 30bn in the next few years, mainly to develop existing properties.

Our recovery analysis is based on a hypothetical default scenario in 2022 and on BIF's liquidation value, considering its planned investments in the next few years. We expect an 'above average' recovery for BIF's senior unsecured debt (HUF 20bn). However, we have not added two potential notches of uplift to the issuer rating due to risk and the possibility that senior secured debt will increase in the path to default (volatility of capital structure and share of senior unsecured debt). We have therefore affirmed the debt class rating of BB-.

[4] We exclude discretionary expansion capex from our liquidity calculation because such investments are only made if external financing is available.

Appendix I: Peer comparison (as at last reporting date)

	BIF Nyrt. [5]	SkyGreen Buildings Kft. [6]	Wingholding Zrt.	Globe Trade Centre S.A.
	B+/Stable/--	B+/Stable/--	B+/Stable/--	BBB-/Stable/--
Last reporting date	30.06.2020	31.12.2019	31.12.2019	30 June 2020
Business risk profile				
Scope-adjusted assets (EUR m)	148	188.6	1,500	2,290
Portfolio yield	7.3%	-	6.8%	6.9%[7]
Gross lettable area (thousand sq m)	89	49	600	746
No. of residential units	na	na	na	na
No. of countries active in	1	1	3	6
Top 3 tenants (%)	-	50%	34%	14%
Top 10 tenants (%)	69%	84%	44%	26%
Office (share by net rental income)	51%	85%	85%	65%
Retail (share by NRI)	0%	6%	10%	35%
Residential (share by NRI)	0%	0%	0%	na
Hotel (share by NRI)	12%	0%	0%	na
Logistics (share by NRI)	0%	0%	5%	na
Others (share by NRI)	38%	9%	0%	na
Property location	'B'	'B'	'B'	'B'
EPRA occupancy rate (%)	87%	80%	88%	94%
WAULT (years)	2.5	2.9	5.7	3.0
Tenant sales growth (%)	na	na	na	na
Like-for-like rent growth (%)	na	na	na	-16%
Occupancy cost ratio (%)	na	na	na	na
SaEBITDA margin[8]	41%	79%	37%	90%
EPRA cost ratio (incl. vacancy)	na	na	na	na
EPRA cost ratio (excl. vacancy)	na	na	na	na
Financial risk profile				
SaEBITDA interest cover (x)	9.7x	2.8x	4.6x	3.2x
Scope-adjusted loan/value ratio (%)	18%	31%	63%	48%
SaD/SaEBITDA (x)	10.6x	10.9x	13.9x	9.7x
Weighted average cost of debt (%)	-	2.0%	2.4%	2.6%
Unencumbered asset ratio (%)	177%	na	220%	581%
Weighted average maturity (years)	13	7	na	3.6

Sources: Public information, Scope

[5] NRI, occupancy and WAULT information as of October 2020
[6] NRI, occupancy and WAULT information as of September 2020
[7] As at end-December 2019
[8] For the last 12 months to the reporting date

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