RATING REPORT

Globe Residency REIT (GRR)

REPORT DATE:
December 20, 2022

RATING ANALYST:

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Rating Category	Latest Rating REIT FUND RATING
Rating	RFR2 (dr)
Rating Date	December 20, 2022
Outlook	Stable
Rating Action	Initial

COMPANY INFORMATION	
Registered in 2021	**External auditors:** A.F. Ferguson PWC
Development REIT	
Key Shareholders (with stake 5% or more):	
Javedan Corporation (100%)	

APPLICABLE METHODOLOGY(IES)
Real Estate Investment Trust (REIT) Fund- July 2022 https://docs.vis.com.pk/docs/REITMethodology-Final-Dec2021(Final).pdf

Globe Residency REIT (GRR)

OVERVIEW OF THE INSTITUTION

Globe Residency REIT (GRR) is a closed-end development REIT and was established under the Trust Deed dated December, 24, 2021. The approval of REIT registration took place on December 14, 2021.

The REIT is governed by Real Estate Investment Trust Regulations, 2015, promulgated and amended from time to time by SECP.

The REIT's land property has been acquired by Javedan Corporation Limited (JCL), whereby the effective date of transfer from JCL was April 01, 2022.

RATING RATIONALE

Globe Residency REIT (GRR) scheme having a size of Rs. 2.8b was launched in April'2022 funded through Rs. 1.4b equity (unitholders) and Rs. 1.4b borrowings from a commercial bank. At end-June'22, all REIT units are held by Javedan Corporation Limited (JCL). In August'22, JCL has issued a public notice of disposing of upto 100% units of GRR through PSX after obtaining all regulatory approvals in the following manner:

- Upto 10% of the units offered to general public,
- Upto 5% of the units offered to Real Estate Consultants engaged in marketing and sale of GRR project
- Upto 85% of the units offered to all ordinary shareholders of JCL

Post sale of the units, pattern of shareholding of the REIT fund is expected to change. However, as a Strategic Investor (SI), JCL will continue to hold at least 25% of the units of the fund in accordance with REIT Regulations 2022.

The scheme is launched as a Limited-life (period of five years), Closed-end, Rated, Privately Placed (planned to be listed in the ongoing year), Developmental RET Scheme. Purpose of the scheme is to acquire and construct 'Globe Residency Apartments' project comprising land parcels in Naya Nazimabad, Karachi from JCL and generate income for unit holders. Investment Policy of the scheme stipulates that it shall primarily invest in real estate; however during the REIT life, surplus funds may be invested in with 'AA' rated Shariah Compliant Banks, other Islamic Financial Institutions and Islamic money market funds or investment in other avenues in accordance with and as allowed under the REIT Regulations. As per information memorandum, the REIT fund anticipates to generate pre-tax Internal Rate of Return (IRR) of around 30.7% on the project and investor IRR of 33.7%.

About the Project

The total area acquired from JCL comprises 40,500 square yards divided into five land parcels/flat sites, nine towers with total number of 1,344 apartments.

Total cost of the project has been estimated at Rs. 20.4b, 58% of which encompasses construction cost to execute the project. 86% of the project cost will be financed through customer advances over the life of the fund while remaining will be financed through a mix of equity, borrowing, and Musharaka Investment. The business model of the REIT has built contingencies to the tune of 10% of the total construction cost providing comfort to this extent in any cost escalations during the life of the REIT. Given inflationary environment, project remains exposed to cost overrun risk however, assigned ratings take into account the ability to pass on the cost escalation to the end price.

Meezan Bank and GRR have entered into a Musharaka Agreement in August'2022 to jointly develop and sell apartment towers (three towers a FL-05, total 408 apartments) at the GRR site.

Meezan Bank has acquired 50% of the investment in these three towers where both parties will equally contribute to the construction costs. The grey structure of these towers is expected to be completed in 18 months, after which they will be available to be sold. Meezan Bank will offer mortgage financing to consumers who wish to purchase apartments in these designated towers. Timely construction of the same and consequent transfer of legal ownership to end consumers is considered important.

As per the Information memorandum of the REIT Fund, total completion time for construction and sales of all apartments is targeted as **four years**. However, with sales collection extending till year 5 in accordance to the modular approach used, the life of the REIT Fund is estimated at **five years** subsequent to which the REIT project will extinguish and liquidation proceeds will be distributed to the REIT unitholders.

Business Risk

Operating Environment- The real-estate industry is generally aligned with macroeconomic trends such as rising GDP and higher incomes, generating greater demand for residential, commercial and industrial space. Real Estate Activities contributed 5.6% in the total GDP of Pakistan in 2022 registering a growth of 3.7% year-on-year. With global economy contracting in the ongoing year, the impact of flooding in major regions of Pakistan has further reduced the estimates for GDP growth amidst consistently high levels of inflation. Furthermore, prevailing uncertainty on current account deficit and stalled IMF program has further slowed down economic growth in the country. In view of the aforementioned, VIS expects general slowdown in the economy in the medium-term with diminishing spending capacity amidst rising inflationary pressures. However, given the housing shortage and government incentives on housing sector together with relatively lower returns in other investment avenues, real estate investment through REIT funds may provide investors an alternative investment avenue yielding comparatively higher returns. over medium to long term.

Market Position-Being one of the pioneers in launching REITS (rental and developmental), market position of the sponsors remains sound. They remain one of the two leading players in this segment although many are planned to enter this space. Furthermore, the success with rental REIT executed by the sponsors along with their real estate development experience in development of Naya Nazimabad, also provides competitive advantage.

Property Location and Quality- The land parcels are situated inside the gated 'Naya Nazimabad' (NN) launched by Javedan Corporation in 2011 which currently has around 1,200 constructed houses and around 400 under construction. Located on Manghopir Road in the northern part of Karachi, Deh Manghopir; NN is accessible from Qalandria Chawk via Sakhi Hasan and North Nazimabad. It is just 2 km from Sakhi Hasan; 5 km from Hyderi Market and Water Pump and 8 km from NIPA Chowrangi. The site is also adequately served by public transport. The Bus Rapid Transit 'BRT' Green-line, which is a 17.8 km busway in Karachi, is almost at the completion of its construction and will have 21 stations. It is expected to be functional by next year. Furthermore, the surrounding areas of the project offers wide range of amenities to its residents. Amenities play a major role while choosing a property and enhance the desirability of real estate. Quality of amenities planned and in place is expected to bode well for future sales in line with the target market. The saleability of the project is supported by its location with vacancy levels projected to be low.

Counterparty Credit Risk- VIS assess counterparty risk based on the model followed by the REIT in terms of property-offtake. For GRR, contracts for the apartments will be based on installments and revenue recognition against the same will be realized over time as project completes. With apartment units being sold to a diversified customer base from varying backgrounds, credit risk is considered manageable. Furthermore, in view of planned selling of apartments through a partnership with Meezan Bank (house financing scheme) also mitigates cash flow risk. As of Jun 30, 2022, 90% of all dues had been collected.

Legal Risk- The land acquired for this project has been transferred in the name of the trustee (CDC) of the REIT fund as per the executed Conveyance Deed. All other necessary approvals from relevant authorities have been obtained.

Target Market & affordability- As per management, the target market is the middle class segment of the society comprising educated professionals, mid-level employees, and emerging, small/medium scale entrepreneurs, overseas Pakistanis and internally migrating families. The project primarily comprise sales of apartments of various sizes which provides a diverse product base to the target market to choose from.

Project Implementation Risk- One of the key rating factors for a Development REIT which may impact return to the investors is contingent on timely completion of the project. The apartments under GRR were launched by JCL in November'21. At end-September'22, around 50% of the apartments have been sold. Total land has been acquired at a consideration of Rs. 3.24b financed through Rs. 1.4b equity (REIT fun), Rs. 1.14b debt, and the remaining Rs. 700m as payable over the course of three years which at all times will be subordinate to payments of all regulatory and business obligations of GRR subject to availability of cash flows. Given the project team that has been engaged and supervision exercised, chances of delays in project implementation remain low. As per the latest progress report, completion of project remains fairly in line with the project timelines. Completion of the project in stipulated timelines is considered important to maintain the ratings.

Management Risk

Ratings draw comfort from sound operational track record along with financial soundness of all the parties involved in the execution of the REIT fund as tabulated below:

REIT Management Company	Arif Habib Dolmen REIT Management Limited (RMC). GRR is being managed by a REIT Management Company that is jointly owned by Arif Habib Group of Companies and Dolmen Group. The Arif Habib Group possesses diverse experience in real-estate development, fertilizers, securities & commodities brokerage, corporate advisory, asset management, cement, steel, dairy and

	wind power sectors. The Dolmen Group owns and manages the largest portfolio of shopping malls in Pakistan. The RMC will charge Project management fee of 1% of the REIT fund which will be payable quarterly in arrears. In totality, the PMF is estimated at around 15% of the REIT's total Profit before tax. The RMC's financial risk profile has depicted improvement since preceding year, as illustrated by improvement in efficiency ratio , which improved from 100% in FY22 to 52% in FY21. The improvement in efficiency ratio was mainly a result of 127% uptick in management fee. Apart from 23% increase in management fee on DCR, the RMC also started booking income under the 3 newly launched developmental REITs.
Trustee	Central Depository Company (CDC)
Development Advisor	Arch Vision- Architectural Design and Planning Arif Habib Development and Engineering Consultants (Private) Limited- Project Management entailing procurement of materials, sales, marketing, collection, contract preparation, coordination and supervision of the Project.
Valuers	MYK Associates Private Limited
Legal Counsel	Ahmed & Qazi Advocates and Legal Consultants
Contractors	Abaseen Construction Company Ltd. (ACCL) Principal Builders (Pvt.) Limited AHCL Construction (Pvt.) Limited Karizma Construction And R.F Associates
External Auditors	A.F. Ferguson PWC

Financial Risk

Stability of Cash Flows

In addition to equity and debt financing through REIT fund, expenses related to construction and other expenses are expected to be financed through customer advances over the life of the fund. As such cash flow sensitivity to any variability in execution of sales plan and realization of collection proceeds remains relatively high. However, impact of variability in sales plan depicts modest sensitivity to investor returns over the rating horizon. Meeting projected targets is considered essential from a ratings perspective.

Leverage and Capital Structure

At end June'22, the Company has borrowed Rs. 1.4b for the commencement of REIT operations as depicted in the financing mix above. The long-term loan is a term finance facility availed from Bank Alfalah Limited at a profit rate of 6MK+1.25%. The loan is repayable in six equal half-yearly installments starting from September 30, 2023 indicating tenure of 4 years (inclusive one year grace period). Going forward, management does not envisage any debt drawdown to meet cash flow requirements and major financing will be executed through customers advances. Timeline projected improvement in capitalization profile is considered a key rating sensitivity. Dividend payout policy of the scheme is to distribute 100% of earnings every year to unitholders, hence, reducing leverage levels through timely payment of obligations and meeting performance obligations is considered important, going forward.

Globe Residency REIT **Appendix I**

Financial Summary	
BALANCE SHEET	**FY22A (Apr-June)**
Investment Property	2,301.4
Contract cost assets (including current portion)	28.3
Contract assets/unbilled revenue	916.2
Receivables and deposits	318.7
Advance for development expenditure	324.5
Cash and Bank balances	160.1
Total Assets	**4,049.8**
Long term loan	1,400.0
Outstanding land consideration (including current portion)	700.0
Contract Liabilities/Unearned revenue	66.0
Accrued expenses and other liabilities	299.4
Total Liabilities	**2,465.4**
Paid-up Capital	1,400.0
Equity	**1,584.4**
INCOME STATEMENT	**FY22A (Apr-June)**
Revenue from contracts with customers	2,564.5
Gross Profit	507.6
Net Operating income	417.0
Profit Before Taxation	412.2
Profit for the year	342.4
CASH FLOW	**FY22A (Apr-June)**
Funds from Operations (FFO)	407.8
Gross Margin	20%
Net Margin	13%
Current Ratio	7.1
Geating	0.9

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

Development & Hybrid REIT Fund Rating Scale - Appendix II

RFR1*

Successful implementation of REIT project is highly likely. Risk factors impacting value of REIT assets are negligible over the foreseeable future.

RFR2++, RFR2+, RFR2

Successful implementation of REIT project is very likely. Risk factors impacting value of REIT assets are modest over the foreseeable future.

RFR3++, RFR3+, RFR3

Successful implementation of REIT project is likely. Risk factors impacting value of REIT assets may vary with possible changes in the economy over the foreseeable future.

RFR4++, RFR4+, RFR4

Material risk to successful implementation of REIT project. Risk factors impacting value of REIT assets are sensitive to changes in the economy over the foreseeable future.

RFR5++, RFR5+, RFR5

Highest risk to successful implementation of REIT project. Risk factors impacting value of REIT assets are capable of fluctuating widely if changes occur in the economy.

**RFR-REIT Fund Rating*

The REIT rating scale of 'RFR1' to 'RFR5' is appended by the letter (dr) to denote Developmental Rental REIT ratings and (hr) to denote Hybrid REIT rating.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Globe Residency REIT
Sector	Construction
Type of Relationship	Solicited
Purpose of Rating	Development REIT
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: DEVELOPMENT REIT		
20/12/2022	RFR2 (dr)		Stable	Initial

Instrument Structure	
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence	Mr. Razi Haider- CFO AHDRMC (September 14, 2022) Mr. Muhammad Ejaz- CEO AHDRMC (September 14, 2022) Mr. Adnan Rizvi- EVP Head of Investments (September 14, 2022)