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Delta Property Fund Limited

South Africa Corporate Analysis **August 2014**

Security class	Rating scale	Rating	Rating outlook	Review date
Long term	National	BBB+$_{(ZA)}$	Stable	07/2015
Short term	National	A2$_{(ZA)}$	Stable	07/2015

Financial data:

(US$'m Comparative)

	28/02/13	28/02/14
R/US$ (avg.)	8.37	9.88
R/US$ (close)	8.84	10.80
Total assets	253.6	698.0
Total debt	98.0	296.1
Total capital°	140.7	353.0
Cash & equiv.	6.4	7.6
Turnover	16.7	66.2
EBITDA	12.6	47.1
NPAT	(2.1)	38.9
Op. cash flow	(0.9)	23.6
Market cap.	US$337.3m	
Market share*	n.a	

° Includes subordinated debentures.
* As at 20/08/2014 @ R10.63/US$.

Rating history:

Initial rating (07/2013)
Long-term: BBB+$_{(ZA)}$
Short-term: A2$_{(ZA)}$
Rating outlook: Stable

Related methodologies/research:

Criteria for rating corporate entities, updated August 2013

Criteria for rating property funds, updated July 2014

Delta Property Fund Limited ("Delta, or the fund") rating report, 2013

Delta R362m Senior Secured Notes; New Issuance report, December 2013

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Summary rating rationale

The ratings are based on the following key factors:

- Leveraging management's strong B-BBEE credentials and extensive experience within the niche sovereign property space, Delta more than trebled its scale in 12 months, with investments (including the since disposed of stake in Ascension Property Fund, "Ascension") valued at R7.3bn at FYE14, from R2.1bn at its November 2012 listing.
- Government entities occupied 56% of GLA and contributed 68% of rentals as of FYE14 (FYE13: 69%; 75%). Although the robust credit profile of these tenants mitigates concentration risk, the relationship is premised on Delta maintaining its strong empowerment credentials.
- Following the decision to shelve the mooted merger with Ascension and Rebosis Property Fund ("Rebosis"), Delta acquired a 33% stake in an offshoot fund (newly JSE-listed Delta International) for R417m.
- The fund reflects a long term lease profile, with average escalations of 8% at FYE14 (FYE13: 8.4%). Vacancies remain low at 4.6% (FYE13: 4.4%), while property enhancements will be well-paced to limit their impact on income generation and gearing.
- Delta maintains that its weighted mean rentals (around R90/m^2, from R94/m^2 in F13) are sustainable, attributing the headroom over industry averages to claw backs for rates and taxes structured into pricing for government leases. This is borne out to an extent by the fact that margins are largely aligned with those of funds dominated by single-tenanted assets. However, the EBITDA margin (of 71% in F14; F13: 76%, against an F12 high of 82%) continues to decline as government tenancies are diluted, implying superior returns on state contracts.
- The rapid growth saw debt rise to R3.5bn at FYE14 (FYE13: R866m), with a further R2.3bn raised from unitholders. As such, the LTV spiked to 48% (FYE13: 41%), nearing the top end of the gearing benchmark for 'BBB' band rated funds, while debt to EBITDA remained elevated due to the earnings drag of new acquisitions (744%; FYE13: 819%). Gearing metrics are expected to trend down in the medium term as the portfolio is bedded down, with the net LTV to ease to 38% by FYE15.
- Delta's liquidity and funding flexibility are deemed to be constrained, as investments are wholly encumbered. Despite overcollateralisation on standing facilities of nearly 2x and ready access to capital markets via the DMTN programme, the fairly high LTV limits its ability to take on further debt in the absence of new equity capital.

Factors that could trigger a rating action may include

Positive change: Proven ability to extract value from recent acquisitions. Moreover, the fund would need to reduce the LTV ratio to below 40%, in line with other 'A' band rated funds.

Negative change: LTV ratios persistently above the 45% level would be indicative of excessive gearing. In this respect, continuing to leverage the balance sheet to fund new acquisitions or equity investments would exert downward rating pressure unless coupled with new equity. Any negative developments in the relationship with the Department of Public Works, or non-payment from government, could negatively impact earnings and credit protection metrics.

Business profile and recent developments

Formed in March 2009 (as Tuffsan 89 Investment Holding (Proprietary) Limited, "Tuffsan") Delta was listed on the JSE in November 2012 as a property loan stock ("PLS") company. It was granted REIT status in March 2014, and is in the process of conversion, which should be complete by October. The fund has strategically positioned itself in the sovereign commercial property space, leveraging its strong empowerment credentials. It also has a proven track record in terms of delivery in this niche segment, and has developed dedicated internal processes to handle the administratively intensive government and parastatal leases and collections. Nevertheless, it has diversified within a fairly short time frame, on the back of aggressive growth. In this respect, the fund is targeting a 60:40 split between its exposure to state tenanted assets and all its other investments, including equities. This will enable it to capitalise on its niche market expertise, while positioning itself as a medium-scale player within the private property space. Although it may not necessarily secure long term leases at the same rates garnered from state contracts, the reduced administrative burden and shorter cash conversion cycle will stand the fund in good stead. Key beneficial linked unitholders are summarised below:

Table 1: Linked unitholder summary (FYE14)	%
Major beneficial unitholders (> 5%)	**44.08**
Government Employees Pension Fund	14.93
Coronation Fund Managers	12.69
STANLIB	11.46
Nedbank Group	5.00
Non-public	**47.64**
Directors & associates	8.56
Government Employees Pension Fund	14.93
Government Fund Managers	12.69
Coronation Fund Managers	11.46

Delta's overarching strategy hinges on its ability to acquire strategically positioned, income generating assets mainly targeted at state and quasi-government institutions as well as parastatals. Its manager therefore leverages established relationships within the office space to secure properties at favourable yields in business nodes that draw such tenancies. These acquisitions are further improved by securing long term lease contracts and through continual enhancements in order to maintain high quality standards throughout the portfolio. To also capture private sector demand, the fund ensures that its properties are defensive, through their location and the quality of property management. This has contributed to the diversification in the fund's tenancy profile which has accompanied its increased scale. In view of its rapid growth, however, it remains to be seen if the pace of property enhancements will not elevate funding pressure, given the sizeable fixed capital spend that may be necessary going forward.

Table 2: Investment property: value movements (R'm)	F13	F14
Opening balance	**362**	**2,070**
Acquisitions	1,591	4,478
Acquisitions related to bus. combinations	14	-
Unrealised gains	64	264
Pre-acquisition property net income & expenses	(6)	-
Capex & tenant installations	46	42
Total	**2,070**	**6,853**
Straight line rental income accrual	49	112
Closing balance	**2,119**	**6,966**

During F14 alone, Delta concluded the acquisition of 57 yield enhancing properties from a range of vendors, developers as well as public and private property funds at an aggregate consideration of R4.5bn, bringing the fund's value up to R7.3bn, from just R2.1bn at its listing in 2012. The fund's GLA also trebled to 621,442m^2 in the 12 months to February 2014. The F14 deals were timed in a manner that helped to minimise procurement costs and allowed them to secure cost effective financing, with the largest series of transactions aggregated at a cost of R1bn. The rapid growth saw some moderation in the average value per property to R91m, from R106m at FYE13. This however, remains well ahead of the mean valuation per asset at inception of around R50m, and is still in line with internal targets in terms of asset scale.

In F14, Delta acquired a strategic interest in Ascension, with a view to a possible takeover. This subsequently resulted in a co-operation agreement between Delta and Rebosis, partly attributable to the latter having a similar view towards Ascension and as a mutually agreed solution to their competing interests. All three parties, however, decided to shelve the proposed merger indefinitely, which saw Delta sell its Ascension shares to Rebosis for R349m in June 2014. The cash was allocated to the fund's costlier facilities to reduce its all-in cost of financing. According to management, the timing of the merger (which would have resulted in a R16bn fund) was not expedient, especially as Delta was also working towards the listing of a pan-African fund on the JSE. In this respect, it acquired a 33% interest in Delta International Property Fund ("Delta International") for US$39m (R417m). This was funded through the DMTN programme and plain vanilla debt facilities.

The international fund, whose primary listing is in Bermuda, is expected have a 7.8% US$-forward yield, providing a strategic Rand-hedge to the broader group's local interests. Delta International evolved from Delta, and was built on the management team's experience in private equity and real estate on the continent. Delta's executives sit on its board, while Greg Booyens, who previously served as the Finance Executive for Delta's asset manager, has been appointed CFO. The international fund currently has 4 assets in Morocco and Mozambique, and intends to target dominant office, retail and strategically positioned hospitality assets in selected African countries. Delta International plans to raise up to US$300m in 6 months to fund new acquisitions, and Delta would require around R535m to follow its rights.

Table 3: Post FYE14 acquisitions	Sector	Cost R'm	GLA 000's m^2	Effective date	Acquisition yield
Thembisa Mega mart	Retail	240	14.1	Sep-14	9.1
OMC Durban	Office	291	44.7	Sep-14	11.0
The Marine	Office	196	24.5	Sep-14	11.0
Servamus	Office	119	13.7	Apr-14	10.9

On the local front, Delta purchased assets at a total consideration of nearly R850m post balance sheet date, of which Servamus has since been transferred. Having attained the desired critical mass well ahead of its inception target (of reaching a critical mass of R7bn by FYE17), management intends to bed down its local portfolio over the medium term. As such, the acquisition drive is expected to taper off, and this should see gearing levels moderate from the FYE14 highs.

Corporate governance

In F14, Delta internalised its property manager Motseng Property Services ("MPS"), to improve oversight of its assets, develop closer relationships with tenants, and also as a cost containment measure. Its affiliate MPI Property Asset Management ("MPI") serves as the fund's asset manager, and is responsible for the compensation of its directors from the fees received from Delta. MPI is a level 1 B-BBEE contributor, which underpins Delta's strong credentials in the sovereign property space. In this regard, Delta has maintained level 2 contributor status in terms of the Property Charter's B-BBEE criteria.

Table 4: Corporate governance summary

Description	Findings
Directors - Executive	2
- Non-executive	4 independent; 2 non-independent.
Frequency of meetings	Eight in F14. Ad hoc meetings where necessary.
Separation of the chairman	Chairman is separate from the Chief Executive.
Board committees	Audit, Risk & Compliance; Remuneration & Nomination; Investment; Transformation, Social, Ethics & Sustainability. Committees are chaired by independents.
Internal control/compliance	Yes, reports to Audit committee. Grant Thornton currently serves as the fund's internal auditor.
External auditors	BDO South Africa Inc. An unqualified, clean audit opinion was issued for F14.

The executives have a long track record in commercial real estate, while the chairman lends extensive fiduciary experience to the board. As the chair is not independent, however, the board has appointed a lead independent with a proven track record in negotiating and administering BEE transactions, private equity, as well as project management. The board helped to anchor strategy execution leading up to Delta's listing, and underpinned the strong acquisitive drive that has seen the fund expand its scale and notably enhance its portfolio's profile. All board members are subject to retirement by rotation at least once in each 3-year cycle, and may be re-elected by unitholders as per the Memorandum of Incorporation.

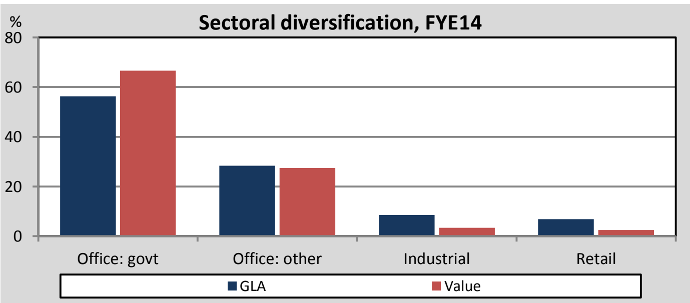
Property portfolio

The strong growth achieved in F14 reduced concentration by property, with the top 10 assets accounting for 41% of the portfolio's carrying value at year end, from a high of 85% at FYE13. The portfolio has become fairly granular, with the largest asset (Forum Building), representing around 7% of the total GLA and carrying value (FYE13: 20%; 21%). With the strong acquisitive phase drawing to a close, the fund's property profile should evidence some stability going forward, maintaining the fundamentals reflected at FYE14. Delta has a long term view towards its assets, and excepting instances where a client acquires a property or when a building that is not a strategic fit is purchased a part of a portfolio, does not anticipate having to make disposals. Single tenanted properties (assets with 90% of GLA let to one client), comprised 66% of total value (FYE13: 47%). These ease the fund's already high administrative burden somewhat. The associated triple net leases also mean that tenants are responsible for maintenance, insurance and real estate taxes (the latter relates only to non-government clients) in addition to rentals and utilities.

At FYE14, 46 of the fund's 77 properties were anchored by the national Department of Public Works ("DPW"), representing a number of government departments, while SARS anchored an additional 4 buildings. The balance represents comparatively smaller assets anchored by A or B-grade private sector tenants. The overall rental rates eased during F14, reflecting the pressure in the overall market. Dilution also fed through from some of the properties acquired, by virtue of their geographic location, sectoral designation and scale. The disparity between the rates and rental escalation of government and non-government contracts is also noted. This has previously been raised as a source of concern by GCR, as it could prejudice renewal reversions, and would imply material write-downs if the tenancy shifted more towards private-sector clients. According to management, the headroom over industry averages (for similar positioned and graded assets) is mainly attributable to rates and tax claw backs structured into pricing for government leases. As such, it deems the weighted average rentals (of around R90/m^2, from R94/m^2 in F13) as sustainable, particularly given the long dated government leases (averaging 8 years). This is borne out to an extent by the fact that margins are largely aligned with those of funds dominated by single-tenanted assets. However, overall margins have progressively declined as government tenancies have been diluted, implying superior returns on such leases. Delta's state leases are vetted by the Auditor General, and stand up to scrutiny at this level. The DPW is estimated to have a backlog of around 1,300 out of 3,000 leases that have expired or are yet to be regularised. This implies a strong contract pipeline for Delta and other funds that meet the empowerment criteria and have the requisite experience in the sector.

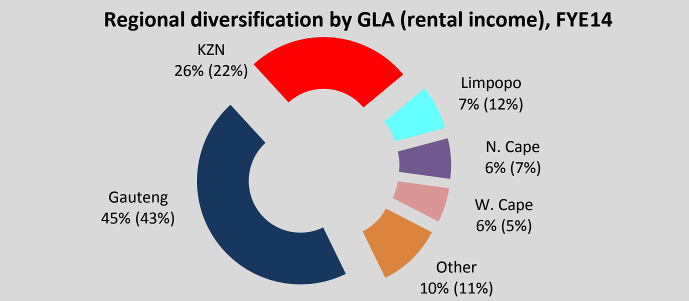
Table 5: Average rentals	Rand/m^2			Weighted avg. escalation (%)		
	FYE13	May-13	FYE14	FYE13	May-13	FYE14
Office – government	87	112	105	8.4	8.7	8.4
Office – other	76	78	84	7.9	7.9	7.0
Industrial	80	70	81	8.0	8.0	7.5
Retail	n.a	45	29	n.a	8.1	8.5
Total	**94**	**94**	**90**	**8.5**	**8.5**	**7.5**

The property portfolio remains dominated by B-graded buildings, which comprised a higher 79% of the total at FYE14 (FYE13: 59%), with the balance constituted of A-grade buildings. In spite of the largely B-grade building profile, 83% of GLA is occupied by A-grade tenants (large national government clients, listed corporates as well as major franchisees), which contributed 88% of rental income as at FYE14. The robust credit risk profile of Delta's key tenant is a critical concentration risk mitigant. It is, however, premised on Delta maintaining its strong empowerment credentials, and subjects it to further regulatory scrutiny in comparison to players that solely target private sector tenants.

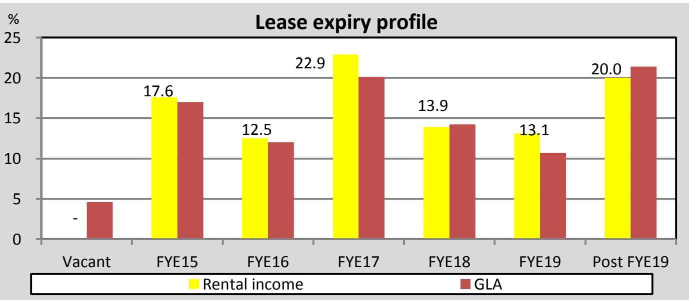


While the assets procured are predominantly government office space, Delta has a burgeoning private sector office exposure as well as a small retail and industrial sector representation. Specifically, government office tenants accounted for 64% of rentals (after straight line rental adjustments), from 75% previously. Other office tenancies represented 27% of rental income (FYE13: 20%), and 28% of the carrying value, with a modest split between retail and industrial. The sectoral profile is not expected to change materially going forward, although the fund may progressively raise its industrial exposure.

A higher 45% of Delta's GLA (and 43% of rental income) derived from assets in Gauteng at FYE14 (FYE13: 39%; 35%). Nonetheless, recent acquisitions have increased its foothold in other provinces, particularly Limpopo and KZN. The latter will be enhanced further once post-year end acquisitions transfer. The fund does not actively manage geographic exposure, and in view of the much higher demand for office space (and consequently greater availability) within KZN and Gauteng, these provinces will continue to dominate.



The lease expiry profile remains well diversified, with 21% of rental income and 20% of GLA extending beyond FYE19. Leases for up to 25% of Delta's GLA were renewed in F14, achieving an 8% overall escalation, with tenors of 3-5 years. While the private sector leases tend to be shorter, they provide the fund with a chance to benefit from a potential market upturn on renewal. Vacancy rates remain well managed, and were reported at a low 4.6% at FYE14 (FYE13: 4.4%).



The high vacancy rates reported for certain buildings are mainly attributed to planned or ongoing enhancements. Specifically, around R20m is to be spent on Presidia (which reported a vacancy rate of 51% at FYE14, driving a R62m write down) to enhance its retail space, air-conditioning and for certain client-specific enhancements. Its vacancy rate had moderated to 26% by July 2014. Other high vacancies related to small properties (less than 7,000m^2) that are either being fitted out for tenants or have since been let. Delta normally begins renewal negotiations at least 9 months before lease expiry to mitigate the risk of having to incur the opportunity cost of vacant space.

Operating environment

The domestic economy continued to weaken in 2013, with real GDP growth slowing to 1.9% (2012: 2.5%), against a 2.8% projection. Pressures have largely stemmed from worsening labour unrest during the year, which directly affected several key sectors. The 2013 strikes were resolved with above inflation wage increases, while the 2014 platinum strike was only finalised after 6 months. As such, mining production declined by 24.7% quarter on quarter in 1Q 2014, driving a 0.6% decline in GDP. Inflationary pressures from necessities such as food and fuel, and administered costs such as electricity and rates, raised consumer indebtedness and curtailed disposable income. Accordingly, while consumer confidence showed resilience in 2012 and 1H 2013, there were clear signs of deterioration towards the end of 2013. With continued Rand depreciation exacerbating inflationary pressures, the Reserve Bank has so far effected two interest rate movements in 2014, raising the repo rate by a cumulative 75b.p. by the end of July.

Against this backdrop, office space has come under increased pressure, with the average vacancy rate reported at a 9-year high of 11.3% in 2Q 2014 (2013: 11.2%), according to SAPOA. With the exodus from inner city space exacerbated by oversupply and new developments, vacancies in this sub-segment are highest, at 16.7%, compared to decentralised nodes, whose vacancy rate averaged 9.7% in 2Q 2014. Cost rationalisation by large corporates and SME liquidations in the highly uncertain economic environment continue to reduce demand for office (as well as industrial) space. At the same time, fairly low construction costs and efforts to reduce energy use through greener buildings has led to a tenant-driven boom in key business nodes. Several large corporates are constructing purpose built office and industrial space, with the latter trend driven by the need to optimise supply chains to rein in costs.

SAPOA places new office developments at around 4% of available space. Although this falls below the level of activity seen in 2006-2008, it is largely concentrated, with 75% of the construction in 10 nodes and a third in Sandton alone. As such, rentals are under pressure, and as of 2Q 2014, are estimated to have eased by 2% YOY. Given the current oversupply, ongoing developments are expected to continue to drive higher vacancies in peripheral nodes, even for high quality properties, placing further strain on rental rates in these areas. While well-positioned prime space continues to report above inflation escalations and positive reversions, secondary-grade space reflects high vacancies, a trend that will persist until mining and industrial output normalise. Delta continues to benefit from the positioning of most of its assets, especially in decentralised nodes where state departments and parastatals drive demand for office space. These areas have also not seen new development activity at the levels reflected in nodes such as Sandton, and thus register strong (but declining) rental rates and positive reversions.

Financial performance

A 4-year financial review pertaining to company numbers is appended to this report, whilst consolidated numbers are presented from F13. Historical information prior to F13 relates to Tuffsan, the legal entity that housed Delta's properties prior to its listing. The following commentary therefore relates to Delta's consolidated financials, unless otherwise stated.

Rental income nearly quadrupled to R654m in F14, exceeding Delta's R600m forecast. This was a function of stronger yields secured on certain acquisitions and the expediency of some of the asset transfers. Nonetheless, the majority of the assets procured did not make a full year's contribution to revenue in F14. Properties with a carrying value of R3.5bn at year end only transferred in 2H F14, while Servamus was transferred in April. As such, the lagged effect on rental income is likely to drive strong top line growth in F15. The base portfolio (20 assets held at FYE13) reported rental income of R227m in F13, from R113m previously. However, 19 of these properties were transferred during 2H F13, contributing only 4 months' income in that year. As such, meaningful comparisons in terms of underlying growth can only be drawn from F15.

Property operating expenses equated to a moderately higher 23% of F14 revenue, from 20% previously, despite the enhanced scale, representing exogenous pressures as tenants' all-in costs of occupancy continue to rise. These costs consumed a higher 26% of Delta's contractual rentals (stripped of straight line rental adjustments), from 24% in F13. Although well-contained, overheads equated to a slightly higher 7% of rental income in F14, despite a reclassification of property management fees as operating expenses. Positively, debtors costs equated to a low 1% of receivables and a negligible proportion of rentals. Cost inflation emanating from higher utility costs, rates and taxes is likely to lead to progressive margin compression in the medium term. While the EBITDA margin eased further to 71% in F14 (F13: 76%), it translated to much stronger EBITDA of R465m (F13: R106m). The margin is strong relative to other listed funds with similar fundamentals, although it has fallen well behind a high of 82% reported on a much smaller portfolio in F12. While the positive impact of lagged earnings will feed through in F15, it is unlikely that margins will change materially, given the shift in sectoral composition.

Delta's weighted average cost of financing eased to 7.5% in F14 (F13: 8.9%), and as such, despite the sharp rise in debt, operating income more comfortably covered the elevated finance charge (3.2x, from 2.1x previously). The debt serviceability metric was more aligned with strongly rated REITs, coming in ahead of the 2.5x threshold for 'A' band rated funds. Although the decision to fix 70% of the fund's interest rate exposure saw the weighted average cost of funding increase to 7.9% post year end, the more conservative stance is considered prudent in view of rising interest rates. The settlement of costlier facilities using the Ascension shares' cash proceeds should also support an improvement in the overall cost of debt for F15.

Having incurred once-off restructuring and listing costs amounting to R42m in F13, the fund reported antecedent interest related to linked units (R35m) and a R10m break fee due from Ascension (in respect of a legal claim arising from their original agreement) in F14. Unrealised gains of R261m (F13: R29m) were underpinned by revaluation surpluses on investment properties, with a comparatively modest R3m loss logged on other investments. After accounting for a R289m distribution to linked unitholders (F13: R39m), Delta reported a R328m pretax profit in F14. This related to capital and other unrealised gains, as cash profits continue to be distributed to unitholders in line with REIT requirements. Delta incurred a R6m non-deductible tax charge (related to new debt raised to fund the Ascension share purchase) during the year, as well as a R62m deferred tax credit.

Cash generated by operations registered at a robust R413m in F14 (F13: R48m), and was closely aligned with EBITDA after adjusting for anomalous capital items. REITs typically do not register material working capital pressure. Although Delta reported a spike in its working capital absorption, this was transitional and mainly related to accrued revenues. After accounting for a R145m net interest outlay, the fund reported a R233m operating cash flow, which was largely disbursed to linked unitholders. With respect to capex, Delta reported capital commitments amounting to R182m at FYE14, which will largely be debt funded. A sizeable portion of this expenditure (R153m) relates to the parking development for CMH Building in Durban, an additional floor for Liberty Towers (R39m) and enhancements to Forum Building.

A total of R6.2bn was spent on property acquisitions (plus a modest portion spent on enhancements) in the 2 years to FYE14, with a further R336m paid for listed equities. The aggressive growth to date has been strongly supported by linked unitholders, from whom a total of R3.4bn was raised over the 2 years. In F14, R1bn was garnered from a rights issue, while additional linked units were issued as part settlement for property purchases. Having launched a R2bn DMTN programme in F14, the fund has nonetheless remained largely reliant on its banking counterparties, from whom a total of R2bn was raised during the year. As cash earnings are distributed, REITs do not normally reflect much liquidity on their balance sheets. In keeping with this, a net cash inflow of R25m (F13: R27m) was reported, bringing the total balance to R82m at FYE14.

Gearing and liquidity profile

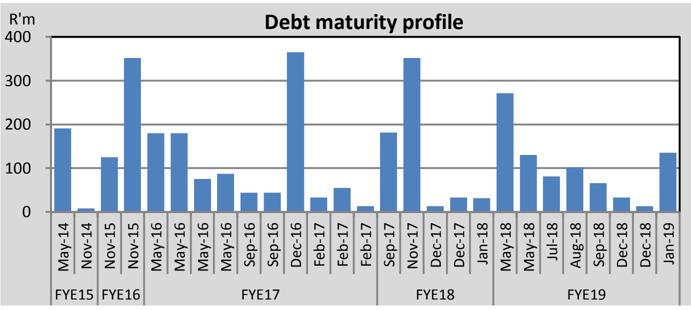
The balance sheet is underlined by investment properties, whose carrying value was notably enhanced by strategic acquisitions, and rose to R7bn at FYE14, from R2.2bn previously. Revaluation surpluses remain muted given the fund's fairly short track record. Although directors' valuations are completed each year, a third of the entire portfolio is valued independently. This is in line with JSE requirements and industry best practices. Listed equity and trade receivables make up most of the remainder, and in instances a fair portion is made up of loans or advances extended to vendors.

Linked unitholders' funds have risen substantially on the back of capital raising efforts since the listing, registering at R3.8bn at FYE14 (FYE13: R1.2bn). Conversion to an all-equity structure is anticipated within the next 18 months, in line with REIT requirements. Delta made increased recourse to interest-bearing debt in 2H F14, which rose to R3.2bn at FYE14 (FYE13: R866m). A further R267m relates to interest free, current loans from vendors, secured by a second covering mortgage bond. Debt at FYE14 exceeded original budgets by R1.1bn, and accordingly, the gross LTV ratio spiked to 48% (44% excluding vendor loans, against a projected 43%), while the fund's net LTV rose to 46%, from 38% at FYE13. This is at the upper end of GCR's threshold for 'BBB' rated funds, and exceeded one of the treasury's targets to maintain the LTV below 40%, with a 45% cap in relation to certain transactions. The net LTV is thus expected to moderate to 38% by FYE15, with some benefit accruing from the transfer of properties recently acquired and the Delta International investment.

Table 6: Debt profile by source: FYE14 (R'm)°	Facility	Draw down (FYE14)	Facility LTV (%)	Draw down (FYE13)
Nedbank	2,082	1,993	44.8	837
Standard Bank	955	609	37.6	-
Sanlam	39	40	26.3	-
Grindrod	-	-	n.a	30
DMTN	552	556	44.7	-
Total	**3,628**	**3,198**	**47.3***	**866**

°Reflects interest bearing liabilities only, and excludes obligations due to vendors.
*Based on existing bank facilities.

It is currently uncertain, however, how much additional debt will be raised during F15 and F16. Even with Delta's acquisition pipeline tapering off, it would require around R535m to follow its Delta International rights, a further R730m for pipeline transactions, and will likely finance capex through bank facilities. In this respect, should the net LTV ratio persist within the 45%-50% range, this would place downward pressure on the ratings. Albeit having moderated to 726% (FYE13: 765%), net debt to EBITDA remains well above the GCR comfort level for highly rated funds of 400%. Note is nonetheless taken of the earnings drag of recent acquisitive activity. In this respect, the F14 acquisitions (including Servamus) reflected a forward net debt to EBITDA of around 390%, while the entire portfolio of investment properties on the balance sheet would register a net debt to EBITDA of around 435% following a full 12-month contribution to earnings. Some comfort is also drawn from the long-term tenor of Delta's leases, which imply greater certainty of future cash flows and therefore a comparatively higher tolerance for the high earnings based gearing metrics. Assuming no further property acquisitions through to FYE16, earnings based gearing would be expected to moderate to comfortable levels over the medium term.



Delta brought Sanlam and Standard Bank into its pool of funders, and secured enhanced facilities from Nedbank amounting to R2.1bn. Standard Bank facilities amounted to R1bn (including a R340m bridging facility), while term finance from Sanlam totalled R39m at FYE14. The Nedbank facilities were secured by investment properties worth R4.5bn at FYE14, while the Standard Bank facilities were secured by assets worth a further R1.6bn. In December 2013, Delta raised R362m from floating rate notes secured by assets worth R810m (as of FYE14). The notes, which carry a limited Nedbank guarantee, are rated A+$_{(ZA)}$ by GCR. As part of the covenants relating to the transaction, the LTV on the secured portfolio is capped at 50%, while Delta's interest cover should not fall below 2x. The debt maturity profile is fairly well managed, with management targeting a cap on maturities in one year of not more than 25%.

As earnings are fully distributed, liquidity for REITs is underpinned by unused credit lines, as well as the ability to raise capital from the capital market or from private sources. While Delta's investments are fully encumbered, collateralisation of nearly 2x on its bank facilities implies scope for these to be increased. It is noted, however, that highly rated funds normally reflect much more flexibility in this respect, with higher overcollateralisation than that reflected on Delta's credit lines. In this respect, Delta is currently working on securing extended local facilities from its bankers to provide flexibility with respect to the financing of properties set to transfer in September. Commercial paper issuances under the DMTN programme enhance the fund's liquidity, and are meant to be backed by committed revolving credit facilities from both Nedbank and Standard Bank amounting to nearly R500m. Given its fairly elevated gearing metrics, the fund's scope to raise further debt is somewhat constrained, unless recourse is also made to linked unitholders.

Outlook

The property sector has become increasingly challenging, with the impact of constrained GDP growth curtailing demand for space (especially in the office segment) amidst a spate of development activity. Demand for space from the public sector is nonetheless expected to remain sound, with the DPW working to clear a backlog of expired leases. Delta is fairly well positioned to draw benefits from this, having attained critical mass from an aggressive growth phase. Plans going forward are to bed down these acquisitions and to maintain a Rand hedge through the stake in affiliate Delta International. Growth has, however, seen gearing metrics exceed levels associated with 'A' rated REITs. This restricts its funding flexibility, and coupled with the limited untapped facilities, is a key factor constraining upward rating migration. The fund's gearing ratios are projected to moderate in the medium term, although this hinges on a commitment to take a temporary hiatus from acquisitions. Delta expects to generate strong cash flows from its assets in F15, with associated scale economies set to provide some insulation from rising costs. Nonetheless, administered and operating expenses continue to rise sharply across the industry, and as such, margins are likely to moderate further going forward.

The fund's rating is underpinned by the high national scale credit risk profile of the state (its primary tenant), which ameliorates the related concentration risk. This advantage is, however, predicated on the maintenance of favourable relations with government. Delta's enhanced scale places its operating performance metrics largely in line with a number of highly rated REITs within the GCR ratings universe, although its fairly limited track record serves to constrain the rating somewhat.

Delta Property Fund Limited

(R in millions except as noted)

INCOME STATEMENT Year ended: 28 February	Company 2010	Company 2011	Company 2012	Company 2013	Group† 2013	Group† 2014
Rental income	1.6	33.7	60.5	129.9	139.9	654.0
EBITDA	**(0.4)**	**25.6**	**49.8**	**98.5**	**105.8**	**465.7**
Depreciation and amortisation	0.0	0.0	0.0	0.0	(0.1)	(1.1)
Operating income	**(0.4)**	**25.6**	**49.8**	**98.5**	**105.7**	**464.6**
Income from investments	0.0	0.0	0.0	0.0	0.0	2.2
Income from operations and investments	**(0.4)**	**25.6**	**49.8**	**98.5**	**105.7**	**466.7**
Net finance charge	0.0	(23.8)	(26.4)	(44.2)	(49.6)	(145.2)
Foreign exchange and fair value movements	132.7	(19.6)	33.3	37.6	29.2	261.3
Antecedent interest and other capital items	0.0	0.0	0.0	(41.7)	(41.7)	35.3
Distribution to linked debenture holders	0.0	0.0	0.0	(39.1)	(39.1)	(289.3)
NPBT	**132.4**	**(17.8)**	**56.7**	**11.3**	**4.6**	**328.7**
Taxation charge	(18.7)	3.2	(16.9)	(20.6)	(21.9)	56.0
NPAT	**113.6**	**(14.6)**	**39.7**	**(9.4)**	**(17.3)**	**384.7**
CASH FLOW STATEMENT						
Cash generated by operations	**(0.4)**	**18.8**	**30.3**	**42.6**	**47.5**	**412.5**
Utilised to increase working capital	(0.3)	4.0	(0.2)	(8.5)	(7.5)	(34.7)
Net interest paid	0.0	(23.8)	(26.4)	(47.3)	(47.4)	(145.2)
Taxation paid	0.0	(0.4)	(0.3)	(0.2)	(0.2)	0.4
Cash flow from operations	**(0.7)**	**(1.5)**	**3.4**	**(13.4)**	**(7.6)**	**233.0**
Discretionary cash flow from operations	**(0.7)**	**(1.5)**	**3.4**	**(13.4)**	**(7.6)**	**233.0**
Distribution to unitholders	0.0	0.0	0.0	0.0	0.0	(200.6)
Retained cash flow	**(0.7)**	**(1.5)**	**3.4**	**(13.4)**	**(7.6)**	**32.4**
Net expansionary capex*	(184.9)	(1.9)	(7.1)	(1,439.8)	(1,636.9)	(4,524.0)
Investments and other	0.3	(23.4)	(51.6)	(172.4)	42.5	(335.7)
Proceeds on sale of assets/investments	0.0	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.0	1,121.9	1,121.9	2,254.5
Cash movement: (increase)/decrease	(0.8)	0.3	(29.2)	(24.0)	(27.1)	(25.4)
Borrowings: increase/(decrease)	186.1	26.5	84.4	527.7	507.2	2,598.1
Net increase/(decrease) in debt	**185.2**	**26.8**	**55.2**	**503.7**	**480.1**	**2,572.7**
BALANCE SHEET						
Ordinary share capital	**113.6**	**99.0**	**138.8**	**1,061.6**	**1,053.7**	**3,317.9**
Debenture capital	0.0	0.0	0.0	189.7	189.7	493.9
Total linked unitholders' funds	**113.6**	**99.0**	**138.8**	**1,251.3**	**1,243.4**	**3,811.9**
Short term debt	0.0	22.7	29.3	34.0	34.0	483.2
Long term debt	186.1	203.2	289.8	832.5	832.5	2,981.3
Total interest-bearing debt°	**186.1**	**225.8**	**319.1**	**866.4**	**866.4**	**3,464.5**
Distributions payable	0.0	0.0	0.0	0.0	0.0	0.0
Interest-free liabilities	20.6	18.8	36.1	124.8	131.8	262.0
Total equity + liabilities	**320.3**	**343.6**	**494.0**	**2,242.5**	**2,241.5**	**7,538.4**
Fixed assets	0.0	0.0	0.0	0.0	0.3	8.1
Properties	**317.6**	**313.2**	**362.4**	**1,897.0**	**2,119.1**	**6,965.7**
Investments and advances	(0.3)	23.1	75.0	253.1	25.9	360.5
Cash and cash equivalent	0.8	0.5	29.7	53.8	56.8	82.2
Other current assets	2.1	6.9	26.9	38.6	39.4	121.8
Total assets	**320.3**	**343.6**	**494.0**	**2,242.5**	**2,241.5**	**7,538.4**
RATIOS						
Cash flow:						
Operating cash flow: total debt (%)	neg	neg	1.1	neg	neg	6.7
Discretionary cash flow: net debt (%)	neg	neg	1.2	neg	neg	6.9
Profitability:						
Turnover growth (%)	n.a	1,952.0	78.3	108.4	7.7	367.3
EBITDA: revenues (%)	neg	76.0	82.3	75.9	75.6	71.2
Operating profit margin (%)	(26.3)	76.0	82.3	75.9	75.5	71.0
EBITDA: average total assets (%)	neg	7.7	12.3	n.a	n.a	9.7
Return on equity (%)	200.0	neg	33.4	4.9	2.1	39.0
Properties under development: total properties (%)	0.0	0.0	0.0	0.0	0.0	0.0
Coverage:						
Operating income : gross interest (x)	neg	1.1	1.6	1.8	1.9	3.1
Operating income : net interest (x)	9.2	1.1	1.9	2.2	2.1	3.2
Activity and liquidity:						
Days receivable outstanding (days)	240.6	48.6	101.9	92.0	101.7	41.5
Current ratio (:1)	1.2	1.9	6.2	1.2	1.1	1.5
Capitalisation:						
Total debt : equity (%)	163.8	228.1	230.0	69.2	69.7	90.9
Net debt : equity (%)	163.0	227.6	208.6	64.9	65.1	88.7
Total debt : EBITDA (%)	n.a	881.2	640.9	879.2	819.1	744.0
Net debt : EBITDA (%)	n.a	879.2	581.2	824.7	765.4	726.3
Loan to value						
Total debt : properties (%)	58.6	72.1	88.1	45.7	40.9	49.7
Net debt : properties (%)	58.3	72.0	79.9	42.8	38.2	48.6
Total debt : properties & investments (%)	58.6	67.2	73.0	40.8	40.9	47.5
Net debt : properties & investments (%)	58.4	67.0	66.2	38.3	38.2	46.3

†Historical information prior to F13 relates to Tuffsan, and is shown mainly for illustrative purposes. Group numbers are shown from F13, in line with the change in corporate structure.

°Inclusive of vendor loans.

*Inclusive of maintenance capex/spend on enhancements to investment properties.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS REPORT

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Bond	A bond is a legal contract in which a borrower such as a government, company or institution issues a certificate by which it promises to pay a lender a specific rate of interest for a fixed duration and then redeem the contract at face value on maturity.
Cash Equivalent	An asset that is easily and quickly convertible to cash such that holding it is equivalent to holding cash. A Treasury Bill is considered cash equivalent.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash Flow Statement	The cash flow statement shows the cash flows associated with the operating, investing and financing activities of a company, combining to explain the net movement in cash holdings.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
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.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Current Ratio	A measure of a company's ability to meet its short-term liabilities and is calculated by dividing current assets by current liabilities. Current assets are made up of cash and cash equivalents ('near cash'), accounts receivable and inventory, while current liabilities are the sum of short-term loans and accounts payable.
Debentures	Debenture is also referred to as a Bond or Note. See Bond.
EBITDA	Earnings before interest, taxes, depreciation and amortisation is useful for comparing the income of companies with different asset structures as it calculated before excluding non-cash expenses related to assets.
Fair Value	The fair value of a security, an asset or a company is the rational view of its worth. It may be different from cost or market value.
Fixed Assets	Assets of a company that will be used or held for longer than a year. They include tangible assets, such as land and equipment, stake in subsidiaries and other investments, as well as intangible assets such as goodwill, information technology or a company's logo and brand.
Gearing	With regard to corporate analysis, gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds, EBITDA or by the value of investments.
Gross lettable area	Or GLA. This is the amount of floor space available to be rented in a commercial property.
Impairment	Reduction in the value of an asset because the asset is no longer expected to generate the same benefits, as determined by the company through periodic assessments.
Income Statement	A summary of all the expenditure and income of a company over a set period.
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 Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Interest Rate Risk	The potential for losses or reduced income arising from adverse movements in interest rates.
JSE	JSE Limited (previously the JSE Securities Exchange and the Johannesburg Stock Exchange) is a licenced exchange under the Securities Services Act of 2004 (South Africa).
Liquidation	Liquidation is the process by which a company is wound up and its assets distributed. It can be either compulsory or voluntary. It can also refer to the selling of securities or the closing out of a long or short market position.
Liquidity Risk	The risk that a company may not be able to take or meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets.
Loan to value	A ratio used to assess lending risk, usually calculated by expressing the principal balance on a mortgage as a percentage of the market or carrying value of investment properties.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Operating Margin	Operating margin is operating profit expressed as a percentage of a company's sales over a given period.
Operating Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
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.
Prepayment	Any unscheduled or early repayment of the principal of a mortgage/loan.
Repo Rate	In South Africa the repo rate refers to the rate at which the South African Reserve Bank lends money to banking institution. The money is lent through a repurchase agreement. .
Repurchase Agreement	In a repurchase agreement, or repo, one party sells assets or securities to another and agrees to repurchase them later at a set price on a specified date.

Retained Earnings	Earnings not paid out as dividends by a company. Retained earnings are typically reinvested back into the business and are an important component of shareholders' equity.
Rights Issue	One of the ways that a company can raise additional funds is to issue new shares. These must be first offered to current shareholders and a rights issue allows a shareholder to buy shares in proportion to the number already held.
Revaluation surplus	Unrealised gains or formal upward adjustments to assets such as property or plant and equipment.
Secured Debt	Debt backed with or secured by collateral to reduce lending risk and thus the interest rate charged.
Stock Exchange	A market with a trading-floor or a screen-based system where members buy and sell securities.
Tenor	The time from the value date until the expiry date of an instrument, typically a loan or option.
Vanilla bond	A bond with no unusual features, paying a fixed rate of interest and redeemable in full on maturity.
Working Capital	Working capital usually refers to net working capital and is the resource that a company uses to finance day-to-day operations. It is calculated by deducting current liabilities from current assets.

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SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

Delta 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 credit rating/s has been disclosed to Delta Property Fund Limited with no contestation of the rating.

The information received from Delta Property Fund Limited and other reliable third parties to accord the credit rating included the 2014 audited financial statements (plus four years of comparative numbers), the projected 2015 income statement, portfolio performance metrics and 2015 income forecasts by property, approved capex projections for 2015, corporate governance and enterprise risk framework, industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties. In addition, information specific to the rated entity and/or industry was also received.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.