September 16, 2021

Mindspace Business Parks REIT: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	-	-	[ICRA]AAA(Stable), reaffirmed
Total	-	-	

**Instrument details are provided in Annexure-1*

Rationale

The rating continues to favourably factors in the large and diversified portfolio of assets housed under Mindspace Business Parks REIT (Mindspace REIT). The asset portfolio of the REIT has office space measuring 31.2 million square feet (mn sqft) of leasable area, which includes completed area of 23.8 mn sqft, under construction area of 1.8 mn sqft and 5.6 mn sq.ft. of planned area for future development. The portfolio assets are diversified across geographies such as Mumbai Region, Pune, Hyderabad and Chennai and have a diversified tenant mix comprising of leading multi-national and Indian corporates, wherein the top-10 tenants contribute 38.6% to the gross contracted rentals. While the completed area enjoys healthy committed occupancy (84.4% as on June 30, 2021), ICRA notes that the committed occupancy has declined from 92.0% as on March 31, 2020 on the back of the Covid-19 pandemic. Collection efficiency, however, remained healthy with more than 99% of the total contracted rentals being collected in Q1FY2021. The demand prospects of the portfolio are adequate, as reflected in the leasing of 1.5 mn sqft area in Q4FY2021, of which 72% was leased to new tenants. The leasing for Q1FY2022 was 1.2 mn. sq. ft. However, sustained weakness on account of possible structural changes in working model induced by Covid-19 pandemic may impact the incremental leasing and the realisation of mark-to-market potential. ICRA notes that tenant leases contributing to 18.5% of the gross contracted rentals will be due for expiry over the next three years and any prolonged impact of the Covid-19 situation on incremental leasing may increase vacancy in the portfolio. The risk is partially mitigated by the strong tenant profile and the lower-than-market rentals, which increase the tenant stickiness.

The rating draws comfort from the low external borrowings at consolidated level with net debt at Rs. 3,692 crore as on June 30, 2021. Thus, the portfolio has a low leverage with loan to asset value (LTV) of 14.9% which provides financial flexibility to Mindspace REIT to fund future organic as well as inorganic growth. However, the debt at REIT level has been taken in the form of Non-Convertible Debentures (NCDs) and Market Linked Debentures (MLDs) with bullet repayments at the end of maturity exposing the company to refinancing risk. The residual debt is at the level of SPVs and are primarily in the form of lease rental discounting (LRD) loans, which are amortising in nature. ICRA expects the incremental capex to be funded by additional borrowings.

The rating also considers the impact of future acquisitions that may be undertaken by Mindspace REIT on the leverage metrics. The current leverage is low at 14.9%; however, planned capex and aggressive acquisition plans can increase the leverage and reduce the financial flexibility. ICRA will continue to monitor the future asset acquisitions and their consequent impact on the leverage. Comfort, however, continues to be drawn from the proven track record and the experienced management of the REIT sponsor K Raheja Corp Group (KRC), as well as the REIT manager K Raheja Corp Investment Managers LLP (KRCIML).

ICRA believes that Mindspace REIT's credit profile will be supported by the REIT regulations that restrict the extent of under construction assets in the portfolio to less than 20% of the asset value and the leverage to less than 49% of the asset value. The overall credit profile is expected to remain stable on the back of the large and stable operational portfolio, the anticipated growth from assets currently under development and the low leverage at the consolidated level.

Key rating drivers and their description

Credit strengths

Well diversified and large portfolio of assets with strong tenant profile – The asset portfolio under the REIT includes some of the major business parks located in Mumbai Region, Hyderabad, Pune and Chennai. The asset portfolio of the REIT has office space measuring 31.2 million square feet (mn sqft) of leasable area, which includes completed area of 23.8 mn sqft, under construction area of 1.8 mn sqft and 5.6 mn sq.ft. of planned area for future development. The overall committed occupancy level of the portfolio remains healthy, at 84.4%, supported by long-term lease agreements and a good track record of tenant stickiness owing to competitive rentals in most of the assets. The tenant profile in the REIT portfolio remains strong and diversified with leading multinational and Indian corporates - the top-10 tenants generate around 38.6% of Mindspace REIT's gross contracted rentals. Some of the key tenants in the portfolio are Accenture, Qualcomm, Barclays, BA Continuum, Schlumberger, Cognizant, and Amazon.

Healthy track record of sponsor and REIT manager – The REIT manager and sponsor are part of KRC, which has considerable experience in the development and management of commercial real estate. KRC is one of India's leading group in real estate development and retail business, with experience of over four decades in developing and operating assets across commercial, hospitality, retail, malls and residential segments. As of March 31, 2021, KRC has developed properties across various businesses, including 30.6 mn sqft of commercial projects, five operational malls, 3,000+ operational hotel keys and residential projects across five cities in India. In addition, the Group operates 270+ retail outlets across India.

Low leverage and strong debt coverage – The rating draws comfort from the low external borrowings at consolidated level with net debt at Rs. 3,692 crore as on June 30, 2021. Thus, the portfolio has a low leverage with loan to asset value (LTV) of 14.9% which provides financial flexibility to Mindspace REIT to fund future organic as well as inorganic growth. The incremental debt drawdown for the under-construction assets will increase the debt to some extent by FY2022 end. Low initial leverage provides financial flexibility to fund the future construction and acquisitions.

Restrictions on leverage level and under-construction portfolio – The REIT regulations restrict the extent of under construction assets in the portfolio to less than 20% of the asset value and the leverage to less than 49% of the asset value.

Credit challenges

Exposure to refinance risk – The debt at REIT level has been taken in the form of Non-Convertible Debentures (NCDs) and Market Linked Debentures (MLDs) with bullet repayments at the end of maturity exposing the company to high refinancing risk. ICRA also expects the incremental capex to be funded by additional borrowings. High financial flexibility, however, provides some comfort.

Vulnerability of commercial real estate sector to Covid-19 induced demand moderation – While the completed area enjoys healthy committed occupancy (84.4% as on June 30, 2021), ICRA notes that the committed occupancy has declined from 92.0% as on March 31, 2020 on the back of the Covid-19 pandemic. Collection efficiency, however, remained healthy with more than 99% of the total contracted rentals being collected in Q1FY2021. Going forward, sustained adoption of work-from-home may impact the incremental leasing and the realisation of mark-to-market potential for the REIT assets. ICRA notes that tenant leases contributing to 18.5% of the gross contracted rentals will be due for expiry over the next three years and any prolonged impact of the Covid-19 situation may increase tenant vacancy. However, the risk is partially mitigated by the strong tenant profile and the lower-than-market rentals, which increase the tenant stickiness. The demand prospects of the portfolio are adequate, as reflected in the leasing of 1.5 mn sqft area in Q4FY2021, of which 72% was leased to new tenants. The leasing for Q1FY2022 was 1.2 mn. sq. ft.

Possible increase in leverage levels – Expected initial leverage after REIT formation is estimated to be low. However, in case of any aggressive acquisition plans, the leverage may increase, thus impacting the consolidated debt coverage indicators. However, regulatory restriction on leverage will mitigate the risk to some extent.

Liquidity position: Superior

The liquidity position of the REIT will be supported by the stable rental income from the underlying assets and the low operational expenditure in the leasing business. Healthy fund flow from operations will be adequate to cover the debt servicing obligations. The average monthly principal and interest obligations in FY2022 are estimated at Rs. 44 crore, while the average monthly net operating income is expected to be upwards of Rs. 110 crore. Additionally, the REIT has cash, bank balances and DSRA of Rs. 337 crore as on June 30, 2021. Further, the REIT maintains an overdraft limit of Rs. 737 crore post listing, which enhances the liquidity profile. The LTV is expected to remain comfortable, in the range of 15-17%, providing significant debt headroom for construction activities and future acquisition.

Rating sensitivities

Positive factors – Not applicable

Negative factors –

- Higher-than-anticipated borrowing or a decline in the net operating income that increases the Net Debt/NOI to above 4.5x
- Inability to increase the occupancy from the current level
- Significant time and cost overruns in the under-construction assets as well as a delay in incremental lease tie-ups

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Real Estate Investment Trusts
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the financials of Mindspace REIT and its subsidiaries (as mentioned in Annexure-2)

About the company

Mindspace REIT is a Real Estate Investment Trust listed in India under the SEBI Real Estate Investment Trust Regulations, 2014. It is incorporated as a registered Trust and listed through a public issue of units. The sponsor of Mindspace REIT is the K Raheja Corp Group, which has contributed shares in eight SPVs to the REIT in lieu of units in the latter. Mindspace REIT primarily hold interests in rental yielding commercial real estate assets (Grade-A office portfolio). The REIT also houses a facility management division in one of the SPVs. The asset portfolio of the REIT has a total leasable area of 31.2 mn sqft, including a completed area of 23.8 mn sqft, an under-construction area of 1.8 mn sqft and 5.6 mn sqft of planned area for future development. The REIT may also acquire additional assets in future as per its investment criteria to further grow the portfolio inorganically.

Key financial indicators (audited)

MBPR Consolidated Financials	FY2020#	FY2021*
Operating Income (Rs. crore)	1766.0	1138
PAT (Rs. crore)	513.9	335
OPBDIT/OI (%)	62.9%	74.4%
PAT/OI (%)	29.1%	29.4%
Total Outside Liabilities/Tangible Net Worth (times)	3.9	0.3
Total Debt/OPBDIT (times)	6.6	4.5
Interest Coverage (times)	2.2	4.9

 # - consolidated pre-REIT numbers for the portfolio as per the offer document

**Audited results for 8 months (Aug-Mar)*

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
Source: Annual Report and Company, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of July 15, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019
					September 16, 2021	28-Aug-2020	25-July-2020	-	-
1	Issuer Rating	Long Term	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	Provisional [ICRA]AAA (Stable)	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
-	-

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details – Not Applicable

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

Company Name	Ownership	Consolidation Approach
Intime Properties Limited	89%	Full Consolidation
Sundew Properties Limited	89%	Full Consolidation
K. Raheja IT Park (Hyderabad) Limited	89%	Full Consolidation
Mindspace Business Parks Private Limited	100%	Full Consolidation
Gigaplex Estates Private Limited	100%	Full Consolidation
Avacado Properties & Trading (India) Private Limited	100%	Full Consolidation
KRC Infrastructure and Projects Private Limited	100%	Full Consolidation
Horizonview Properties Private Limited	100%	Full Consolidation

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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