Embassy Office Parks REIT

December 02, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Issuer rating	0.00	CARE AAA (Is); Stable [Triple A (Issuer Rating); Outlook: Stable]	Assigned

Details of instruments/facilities in Annexure-1.
The issuer rating is subject to the entity maintaining a net debt/gross asset value less than 35%.

Detailed rationale and key rating drivers

The Issuer rating assigned to Embassy Office Parks REIT (EOPR or Embassy REIT) positively factors in its diversified asset portfolio of commercial office space, hospitality, and renewable energy assets spread across Bengaluru, Mumbai, Pune, and the National Capital Region (NCR). The properties of EOPR are occupied by marquee clients, resulting in strong collection efficiency. There has been a decline in the occupancy levels for Embassy REIT and it stood at 87% as on September 30, 2022, as against 88.5% as on September 30, 2021. The COVID-19 pandemic and the reduced marketability of the special economic zone (SEZ) area impacted the occupancy level. Nevertheless, CARE Ratings Limited (CARE Ratings) takes note of the fact that most of the leases expired or expiring were yielding rentals significantly lower than the current market rates, and therefore, EOPR is likely to benefit from the mark-to-market (MTM) opportunity as and when the vacant spaces backfill. EOPR's ability to improve the occupancy levels and realise MTM gains will be a rating monitorable.

Since its launch, EOPR has demonstrated strong financial risk management, characterised by low loan-to-value (LTV), comfortable debt/earnings before interest, taxes, depreciation, and amortisation (EBIDTA), and debt-service coverage ratio (DSCR) levels. CARE Ratings also takes note of EOPR entering into a non-binding offer letter with the Embassy sponsor to acquire two assets. While CARE Ratings believes that the debt protection metrics are likely to remain strong, the funding pattern for the acquisition(s) will be closely monitored.

The restrictions under the Securities and Exchange Board of India (SEBI) regulations, which limit the share of under-construction assets to less than 20% and net debt/gross asset value (GAV) to <49%, enhance credit protection.

These strengths far outweigh the refinancing risk associated with the non-convertible debenture (NCD) and term loan repayments at EOPR and its subsidiaries, respectively. Nevertheless, Embassy REIT has demonstrated raising of debt at competitive rates to refinance the Series I NCD of ₹3,650 crore (plus interest accrued). EOPR is also exposed to the execution and marketing risks associated with upcoming projects and the cyclicality of the real estate and hospitality sectors.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade
Not applicable

Negative factors – Factors that could lead to negative rating action/downgrade:

- Net debt/GAV of more than 35%.
- Consolidated net debt/EBIDTA[2] of more than 5.5x.

Detailed description of the key rating drivers

Key rating strengths

Fairly diversified asset portfolio of Embassy REIT: EOPR's asset portfolio consists of commercial office space across four cities, hospitality, and a captive solar plant of 100 MW capacity. As on September 30, 2022, EOPR had 43.2 million sq ft (msf) of commercial space area, of which 33.4 msf is completed and 87% is occupied, 7.1 msf of under-construction space, while 2.7 msf is proposed development. The commercial space is diversified in Bengaluru, Mumbai, Pune, and the NCR region. EOPR also has completed hotels with an inventory of 1,096 keys and under-construction hotels of 518 keys in Bengaluru, apart from a

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications
[2] For the calculation of debt/EBIDTA, EBIDTA is calculated as defined in NCD documents. As per which, EBIDTA also include 50% of EBIDTA of Golflinks Software Park P Limited plus fitout rentals plus rental support income.

100-MW solar park located in Ballari, Karnataka. The commercial office space portfolio contributes nearly 90% of the REIT's total revenue. Diversification in asset class and geographies mitigates the micro-market and industry-specific issues to a certain extent.

Healthy occupancy level of commercial assets and recovery in the hospitality segment: The occupancy levels of commercial office spaces remained healthy at 87% as on September 30, 2022, although moderated from 88.5% as on September 30, 2021, due to the impact of COVID-19. Moreover, the majority of the vacant space lies in the SEZ. Areas in the SEZ are inherently witnessing delayed leasing. Embassy REIT is in the process of converting some of its SEZ space into non-SEZ, which will enhance its marketability. Moreover, the passage of the proposed Development of Enterprises and Services Hub (DESH) bill by the Government of India (GoI) may also aid the leasing progress in the SEZ. As such, another 1.65 msf of the area is due for expiry in H2FY23-FY24 (refer to the period from April 1 to March 31), which may impact the occupancy levels in the near term. Nevertheless, as informed by the management, there has been an increase in enquiries, and the occupancy may improve in the medium to long term. For H1FY23, EOPR has signed over 3.4msf of leases which is ~70% of the FY23 guidance given by management. Furthermore, most of the leases expired or expiring were old leases generating lower than the current market rates, providing reasonable MTM opportunity to Embassy REIT. The assets of EOPR are occupied by tenants with strong credit profiles, with almost half of the gross leasable area leased out to Fortune 500 companies. The rental collection efficiency was strong at above 99% despite COVID-19. The satisfactory weighted average lease expiry (WALE) of seven years provides revenue visibility for the longer term. While the hospitality assets have been impacted severely by COVID-19, there is a gradual recovery in occupancy. As such, its contribution overall to EOPR is insignificant.

Strong debt protection metrics of Embassy REIT: The debt protection metrics of EOPR, marked by an LTV of 26% and net debt to EBIDTA of less than 5.0x, remained comfortable, giving it headroom to raise additional debt to fund future growth plans. CARE Ratings also takes note of the non-binding offer letter entered with the Embassy sponsor to acquire two assets, viz, Embassy Splendid Techzone, Chennai, and Embassy Hub, Bengaluru. CARE Ratings expects the above metrics to remain largely unchanged after the acquisition.

<u>Key rating weaknesses</u>

Execution risk associated with projects undertaken: EOPR plans to incur a capex of ₹3,659 crore, on a consolidated basis, over the next two to three years, which is likely to be majorly funded with debt. While the execution risk will persist to timely complete the project, comfort is drawn from the successful track record of EOPR in executing such projects. As per CARE Ratings' estimates, the net debt/GAV and net debt/EBIDTA are expected to remain below 30% and 5.5x in the near to medium term.

High refinancing risk: The debt raised by Embassy REIT and its subsidiaries are to be repaid in a bullet payment at the end of three to five years, exposing it to high refinancing risk. However, such risks are mitigated to an extent given the high financial flexibility arising from the low LTV, which provides ample headroom to raise additional debt and equity-raising possibilities. CARE Ratings also takes note of the demonstrated track record of EOPR refinancing several debts itself as well as of its subsidiaries, including refinancing of the relatively high-cost Series-I NCD in November 2021.

Liquidity: Strong

The liquidity of EOPR is superior owing to the strong debt coverage indicators, aided by minimal interim principal payments. While the bullet repayment exposes it to high refinancing risk, EOPR's low debt/GAV allows ample headroom to raise additional debt, including raising LRD loans in SPVs from banks for refinancing of NCDs. All the NCD instruments have multiple call options before the final maturity, which enables them to refinance the NCDs prior to the due date. Regulations allowing participation from pension funds, insurance companies, and now foreign portfolio investments (FPIs) have provided access to a larger investor base. Further restrictions imposed under REIT regulations in terms of undertaking under-construction projects limit the cash outflow towards the capex. At the consolidated level, EOPR had cash and cash equivalents of ₹123 crore as on September 30, 2022.

Analytical approach

The analysis of Embassy REIT is carried out on a consolidated basis, which includes its subsidiaries and associates mentioned in Annexure-6. The consolidated approach is taken due to the strong operational, financial, and managerial linkages between the entities.

Applicable criteria

[Policy on default recognition](#)
[Consolidation](#)
[Financial Ratios – Non financial Sector](#)
[Issuer Rating](#)
[Liquidity Analysis of Non-financial sector entities](#)
[Rating Outlook and Credit Watch](#)
[Rating methodology for Debt backed by lease rentals](#)
[Real Estate Investment Trusts (REITs)](#)
[Policy on Withdrawal of Ratings](#)

About the company

EOPR is India's first publicly listed real estate investment trust (REIT) sponsored by Blackstone (BRE Mauritius) and Embassy Property Development Pvt Ltd. As on September 30, 2022, Embassy REIT has a 43.2 msf portfolio of eight infrastructure-like office parks and four city centre office buildings in the cities of Bengaluru, Pune, Mumbai, and the NCR.

Embassy REIT's portfolio comprises 33.4 msf completed operating area, with an occupancy of 87% as on September 30, 2022. The portfolio also comprises a 1,096-key operational business hotel, a 518-key under-construction hotel, and a 100-MW solar park supplying renewable energy to park occupiers.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	Sep 30, 2022 (UA)
TOI	2,448	3,050	1,744
PBILDT	1,939	2,386	1,325
PAT	698	888	307
Overall gearing (times)	0.56	0.67	NA
Interest coverage (times)	3.00	2.88	2.78

A: Audited; UA: Un-audited; NA: Not available.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Issuer Rating-Issuer Ratings	-	-	-	-	0.00	CARE AAA (Is); Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1.	Issuer Rating-Issuer Ratings	LT*	0.00	CARE AAA (Is); Stable	-	-	-	-

*Long term

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Not applicable

Annexure-4: Complexity level of the various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1.	Issuer Rating- Issuer Ratings	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Annexure-6: List of entities consolidated

Sr. No.	Entity Name	Shareholding Percentage
1.	Sarla Infrastructure P Ltd.	100%
2.	Vikas Telecom Private Limited	100%
3.	Indian Express News Papers (Mumbai) P Limited	100%
4.	Quadron Business Park Private Limited	100%
5.	Qubix Business Park Private Limited	100%
6.	Earnest Towers Private Limited	100%
7.	Vikhroli Corporate Park Private Limited	100%
8.	Galaxy Square Private Limited	100%
9.	Oxygen Business Park Private Limited	100%
10.	Embassy Pune Techzone Private Limited	100%
11.	Manyata Promoters Private Limited (MPPL)	100%
11.	Embassy Energy Private Limited	20% (balance 80% by MPPL)
12.	Umbel Properties Private Limited	100%
13.	Golflinks Software Park Private Limited	50%

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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