Rating Action Release 16 FEB 2021

Scope assigns BB/Stable issuer rating to Futureal Development Holding Kft.

The ratings are primarily driven by the company's robust market position but are constrained by increasing leverage and inherent development risks.

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope has assigned an issuer rating of BB/Stable to the issuing entity Futureal Development Holding Kft. and an issuer rating of BB/Stable to the holding company and guarantor of the contemplated senior unsecured bond Futureal Holding B.V. Scope has also assigned a long-term debt rating on senior unsecured debt of BB.

Rating rationale

Scope rates Futureal's business risk at BB. This includes a blended industry risk of B+ to reflect the company's core activity of real estate development as well as the dynamic growth of its commercial investment property portfolio, which generates recurring revenues. Competitive positioning (rated BB+) is supported by Futureal's strong market position as Hungary's largest commercial real estate developer with a long track record, high visibility and an excellent industry network among banks and construction companies. The absolute size of Futureal's commercial portfolio is, however, still limited at this point since the vast majority of previous developments have been sold. The company aims to create an approx. EUR 1bn commercial portfolio via its own develop-to-hold projects in the next two years. Futureal has properties/projects in Hungary, the UK and Poland. Nevertheless, Scope sees diversification as a rating constraint since the lion's share of anticipated rental revenue will be concentrated around Budapest. Despite a substantial increase in the company's project pipeline, Scope highlights a strong dependency on the Budapest retail and office markets for now.

Asset quality is mixed in Scope's view. Futureal owns and is building brand new properties in good locations, predominantly in the inner city of Budapest (retail and office) and has already won over high-quality tenants as part of its pre-letting activities. At the same time, Scope sees the risk of elevated price volatility for the asset classes of retail and office in the near to medium term, accompanied by limited fungibility. This is would be particularly relevant for unfinished projects in a potential market downturn. Scope expects a Scope-adjusted EBITDA margin of over 80% in the next two years, as higher recurring rental revenues lift profitability once more projects are finished. The transition from a typical developer to a commercial property owner is still subject to execution risks. Consequently, Scope's assessment does not include the full benefit of substantially higher future margins at this point.

Futureal's financial risk profile, assessed at BB-, is supported by an anticipated increase in recurring and more granular revenue. It is constrained by the remaining execution risks posed by the company's transition to a commercial real estate owner. In the short term (2021 and 2022), Scope expects a temporary slump in interest cover to 1.2x-1.7x, based on much higher financial debt, the rating agency's weighted average debt assumption and the gradual ramp-up of rental revenues. In the medium term (2023 and beyond), Scope expects interest cover to move towards 2.0x.

A delay in construction or the start of project operations may result in prolonged interest payments at potentially higher rates. The company's cash generation has been volatile in the past, due to its develop-to-sell business model, with negative free operating cash flow driven by the expansion of the business. Scope expects free operating cash flow to remain negative for several business years as a result of the current expansion. Nevertheless, a considerable part of capex is of a discretionary nature, since projects may be postponed, renegotiated or cancelled in the event of a severe market downturn. Scope would assume some sunk costs in such a case but no further substantial cash outflows once a project had been stopped. In addition, Scope has lowered expected revenues due to the negative impact of Covid-19. Scope has also stressed costs in its financial forecast.

Outlook and rating-change drivers

The Outlook is Stable and reflects Scope's view that Futureal will be able to grow its recurring revenue base by successfully completing its develop-to-hold projects on time and on budget. As a consequence, Scope assumes an increasing Scope-adjusted loan/value ratio of 50%-60% and Scope-adjusted EBITDA interest cover of above 1.0x from recurring revenues only, not taking potential asset sales into account.

A positive action would require the company to reduce leverage, as measured by its Scope-adjusted loan/value ratio, to below 50% on a sustained basis while achieving Scope-adjusted interest coverage from recurring rental income at least in line with Scope's financial base case.

A negative rating action is possible if either Futureal's Scope-adjusted loan/value ratio increases to more than 60% on a sustained basis or Scope-adjusted interest coverage from recurring revenues lags Scope's base case expectations. This could be triggered by a slump in market prices/rents or weak rent collection rates as the result of a prolonged crisis in the retail sector.

Long-term and short-term debt instrument ratings

Futureal contemplates to issue a new 10-year senior unsecured bond (HUF equivalent of EUR 150m) with a fixed coupon under the MNB's Bond Funding for Growth Scheme. The contemplated bond will be amortizing annually by 10% from end of year seven and will feature a bullet repayment of 70% at maturity. Scope's base case assumptions incorporated a successful placement of the above-mentioned bond in Q1 2021.

The proceeds are earmarked for the financing of investments into real estate development and investment projects, acquisitions (acquisition of real estate directly or indirectly through the acquisition of legal entities, acquisition of companies, including management companies, and of immaterial goods, etc.), working capital as well as refinancing of outstanding loans (including senior loans, shareholder loans, etc.). Bond proceeds shall be used in line with the Issuer's Green Financing Framework being in accordance with the Green Bond Principles issued by the International Capital Markets Association.

Scope's recovery analysis is based on a hypothetical default scenario at year-end 2022. It shows a high sensitivity to attainable prices in a distressed sales scenario as well as very high sensitivity to the volume of senior secured bank debt at the time of hypothetical default. Given the structural subordination of senior unsecured creditors of the rated entity below current and future secured debt at property SPV level in the agency's default scenario. This translates into a BB rating for senior unsecured debt.

Stress testing

- No stress testing was performed.

Cash flow analysis

- Scope performed its standard cash flow forecasting for the company.

Methodology

The methodology/ies used for this rating(s) and/or rating outlook(s): Corporate Rating Methodology 26 Feb 2020; European Real Estate Corporates 15 Jan 2021 are available on https://www.scoperatings.com/#!methodology/list.

Information on the meaning of each rating category, including definitions of default and recoveries can be viewed in the “Rating Definitions - Credit Ratings and Ancillary Services” published on https://www.scoperatings.com/#!governance-and-policies/rating-scale. Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope’s definitions of default and rating notations can be found at https://www.scoperatings.com/#governance-and-policies/rating-scale. Guidance and information on how Environmental, Social or Governance factors (ESG factor) are incorporated into the rating can be found in the respective sections of the methodologies or guidance documents provided on https://www.scoperatings.com/#!methodology/list.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The rated entity and/or its agents participated in the rating process.

The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity and Scope internal sources.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope’s ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the rating or outlook action, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0

The credit rating and/or outlook is UK endorsed.

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Potential conflicts

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