



GRADING METHODOLOGY

REAL ESTATE PROJECT GRADING

An independent opinion on execution prospects of a real estate project as per plan and ability to transfer as per terms

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PAKISTAN CREDIT RATING AGENCY

1. SCOPE

- Real Estate – an important sector in local economy
- Methodology applicable on Real Estate Projects

1.1 The real estate is considered an important sector in Pakistan. One important factor which could discourage lenders, and investors (intermediary investors as well end-users) is the credibility of developers and the reliability of completing projects on time and without cost overruns. This factor assumes greater significance in the backdrop of a number of failures in the past relating to property development and housing schemes. What could provide a degree of comfort to lenders and investors? This factor has prompted PACRA to launch a system of grading real estate projects. PACRA grading, an independent opinion, aims to serve as a tool for identifying risks associated with the concerned project. The grading of real estate projects is designed to opine on the execution prospects of a real estate project as per plan and ability to transfer as per terms. Where needed, PACRA may engage an external consultant to have a more detailed technical insight into the project whose grading assignment is under process.

1.2 The grading is expected to facilitate the overall growth of the real estate sector by providing developers with incentives to conform to their promise.

1.3 A graded project enhances the confidence of the end users and provides comfort to lenders of these projects, thereby facilitating the flow of institutional funds to the project/project owner. Besides benefiting the sector participants and end-users (investors/customers), the grading is designed to provide objective opinions as inputs in the pricing and credit decisions of banks/financial institutions. The grading is not a recommendation to lend/do business/invest with a certain project.

Following broad factors are looked at while reaching at a project grading opinion:

Project Grading - Key Factors	
Project Management Systems	Evaluation of the management systems used to execute and monitor the project.
Business Risk	Evaluate the risks emanating from the project and developers choice of market and project.
Performance Risk	Evaluate the performance of construction-related activities for the project.
Project Financing Risk	Looks at the components of project financing and their time-lines to estimate whether the required funds would be available for on-time delivery.

Following is detailed list of factors PACRA sees while analyzing a project:

Project Management Systems		
Sr. No.	Factors	Definitions
1	Project Planning and Management System	Evaluate the usage of software and MIS tools used to aid the planning and monitoring of project activities
2	Pre-commencement Activities	Evaluates the planning function with regards to comprehensiveness before the commencement of project construction
3	Regulatory Approvals	System for seeking approvals once the design phase has been completed
4	Title management system	Evaluation of the system for ensuring land titles are valid and as per requirements
5	Provisioning for Utilities	Evaluate the methods for ensuring utility connections
6	Contractor and Supplier Selection	Process for selecting contractors and suppliers
7	Approval Process for activities	How completed activities are verified and ensured
8	Coordination Mechanism	Formal and informal communication; coordination of project activities involving different partners
9	Reporting Quality	Frequency of reports, details listed, including;
10	Project Manager	Experience of project manager and his ability to provide input to stakeholders on various activities
11	PM Team	Evaluate the depth of project management team and the setup for segregation of duties
12	On-site Supervision	Site supervision system of the developer
13	Resource availability	Availability of resources (manpower, machinery, procurement) for construction
14	Resource Utilization	Utilization of resources on site

Business Risk		
Sr. No.	Factors	Definitions
A)	Project specific data	
1	Type of Project	Relates to the ultimate usage of the constructed entity, which impacts its marketability
2	Target Market	What is the target market for the developer's project/s
3	Location risk	Dynamics of the local market, based on which city the project is located in and its accessibility with respect to usage
4	Project Concept risk	Whether the concept of the project (<i>design, utility and scale</i>) is expected to aid or hamper sales
5	Pricing of Project	Whether pricing corresponds to the target market
6	Key Selling Point (KSP)	If sufficiently differentiated from substitutes in the local market
7	Current Stage of Construction	Percentage completion achieved at the time of grading
8	Viability of sales plan	Whether the time-lines and price points in the sales plan are achievable and whether they will be communicated to the target market in time
9	Regulatory Risk	Risk of intervention from a regulatory body based on project design elements and/or political risk
B)	Exogenous factors	
10	Economic Cycle	Impact of economic cycle, through construction + sales period
11	Brand Recognition	Ability of the developer to attract buyers based on previous history and reputation in the market.
12	Developer structure	Incorporation and structuring of the developer's business

Project Performance Risk		
Sr. No.	Factors	Definitions
A) Timeliness		
1	Viability of Master-plan	To judge whether the project as conceived is viable for implementation
2	Master-plan Compliance	Stability of master plan and level of compliance with it
3	Project Priority	Priority of project within the portfolio of the developer
4	Status of Current Delays	Delays in construction activities completed so far
5	Origin of Delay	Ascertain why the delays were experienced. The earlier the delays are in the lifecycle of the project, the more likelihood that they may be recouped later.
6	Time Recovery Measures	Presence of and effectiveness of time recovery measures in the contracts with construction partners
7	Parallel Execution Capacity	Evaluate whether the developers and the contractors for the project have ability to execute multiple activities at the same time
8	Financial Penalties	Penalty on developer from the customer and penalty on contractors from the developer
B) Quality of Execution		
9	QC Structure	Evaluate the QC function implemented by the developer for the said project
10	Independence of QC	Evaluate the degree of independence of quality control mechanism
11	Workflow	Evaluate the placement of QC staff in overall project management
12	Environmental Impact	Assessment of environmental impact of project – usually through mandated EIA (Environmental impact assessment Report)
13	Quality of Delivered Activities	Evaluate quality of constructed structure

Project Financing Risk		
Sr. No.	Factors	Definitions
1	Project Financial Feasibility	Can the project be completed (as per its design and construction schedule) in the specified costs
2	Financial Policies	Transparency and trustworthiness of financial statements including market value assessment and balance sheets
3	Capacity to Pour- in more Equity	Evaluate whether the developer can contribute more equity into the said project from other projects
4	Coverage of cost till Completion	Percentage of outstanding costs covered through equity, advances and Credit lines
5	Project Breakeven	Calculate break-even point with respect to sales/rentals
6	Sales Plan	When would the project be 100% sold
7	Project Leveraging	To reflect flexibility towards taking on bridge financing
8	Project Encumbrance	Whether any liens exist for the land of the project
9	Profile of buyers	Payment history and/or credit rating and profile of buyers of the project
10	Liquidity	Assess the liquid assets of the developer (including cash, unused portion of bank lines, mutual funds or stock investments)(treatment of property?)

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PROJECT GRADING SCALE & DEFINITIONS

Project grading reflects opinion on execution prospects of a real estate project as per plan and ability to transfer as per terms.

SCALE	DEFINITION
PG1	<p>Very strong project</p> <p>Highest prospects of successful implementation of real estate project and transfer as per terms. The project risk factors are very low.</p>
PG2+ PG2	<p>Strong project</p> <p>High prospects of successful implementation of the real estate project and transfer as per terms. The project risk factors are low.</p>
PG3+ PG	<p>Good project</p> <p>Good prospects of successful implementation of the real estate project and transfer as per terms. The project risk factors are moderate.</p>
PG4+ PG4	<p>Adequate project</p> <p>Adequate prospects of successful implementation of the real estate project and transfer as per terms. The project risk factors are relatively high.</p>
PG5	<p>Weak project</p> <p>Weak prospects of implementation of the real estate project and transfer as per terms. The project risk factors are very high.</p>

Outlook (Stable, Positive, Negative, Developing)

Indicates the potential and direction of a grading over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a grading change. ‘Stable’ outlook means a grading is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Grading Watch

Alerts to the possibility of a grading change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a grading change is inevitable. Grading Watch may carry designation – Positive (grading may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

Withdrawn

A grading is withdrawn on a) termination of grading mandate, b) cessation of underlying entity/project, or c) it is not possible to update an opinion due to lack of requisite information.

Surveillance

PACRA attempts to keep its grading under surveillance through quarterly information solicitation about project. However, it remains limited to progress report on development and relevant financials.

Disclaimer: PACRA's project grading is not a recommendation to purchase, sell or hold investment in a project, in as much as it does not comment on the project's market price or suitability for a particular investor.