The Pakistan Credit Rating Agency

Real Estate Investment Trust (REIT) Fund Rating

Assessment Framework

Table of Contents

Introduction 2
Profile 3
Economy and Industry Risk 4
Asset Quality 5
Financial Risk 7
Management Review 8

Summary

This methodology outlines PACRA's approach to assigning REIT Fund Rating, an independent opinion on the likelihood of successful implementation of a REIT project and risk factors impacting the value of REIT assets. REIT Fund Rating is assigned to: i) Developmental REIT funds and ii) Hybrid REIT funds.

It is important to understand that REIT Fund Rating differs fundamentally from the traditional credit rating, which reflects an entity/issuer's ability to meet its financial obligations. PACRA's REIT Fund Rating opinion is based on evaluation of the following factors: i) Profile, ii) Economic and Industry Risk, iii) Asset Quality, iv) Financial Risk, and v) Management Review. In addition to standalone analysis of these factors, PACRA also considers the relative positioning of the REIT fund in its operating industry to arrive at the final rating.

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Introduction

Overview

Real Estate Investment Trusts (REITs) are investment vehicles designed to mobilize resources from a large pool of investors and, in turn, provide them with access to income-generating real estate assets. A REIT is structured like a traditional closed-end mutual fund; however, instead of stocks and bonds, a REIT investor owns real estate-backed units that sell like any other units or listed securities, enabling the investor to invest directly in real estate. Returns for the investors come either from rental income distributed through dividends or capital gains through price appreciation of the underlying assets, as reflected in the unit price. REITs generally distribute the majority of their profits (over 90% in Pakistan) to their investors to receive favorable tax treatment under Pakistan's tax laws. REITs enable investors to have direct exposure to a relatively illiquid asset class with low individual investment requirements and a sizeable initial capital requirement.

REIT Industry Structure

A REIT Scheme can execute its project through two structures. The Regulations place specific obligations on the RMC under the second one, and PACRA considers the RMC's adherence to them in its assessment.

- **Direct Investment Structure:** The REIT Scheme invests directly in the REIT Project.
- **Special Purpose Vehicle (SPV) Structure:** The REIT Scheme invests in an SPV, which executes the REIT Project. The RMC manages the SPV under an SPV Management Services Agreement, and the Regulations set conditions on the REIT Scheme's ownership of the SPV and on its governance and operations.

Types of REITs

The REIT industry has two distinct elements: REIT Management Company (RMC) and REIT schemes. REIT schemes can be structured as three different models – Rental, Developmental or Hybrid REIT schemes. These are briefly described below:

- **RMC:** a public limited company licensed to undertake REIT management services.
- **Rental REIT schemes:** established with the objective of making investments in industrial, commercial or residential real estate for generating rental income.
- **Developmental REIT schemes:** established with the objective of development, construction, refurbishment, rehabilitation, management and/or operation of real estate for industrial, commercial, residential purposes or a combination of these.
- **Hybrid REIT schemes:** comprising developmental component as well as rental component.

Scope

PACRA has developed separate methodologies to capture the distinct rating considerations attached to these elements of the REIT industry, depicted in the following diagram. This methodology outlines PACRA's rating considerations for REIT Fund Rating of Developmental and Hybrid REIT schemes.

Regulatory Framework

REITs are regulated by the Securities and Exchange Commission of Pakistan (SECP), which has issued a comprehensive set of regulations (REIT Regulations 2022, hereinafter referred to as "the Regulations"). The Regulations address all aspects of REIT registration, operations, and the roles and responsibilities of all parties, including the RMC. Where applicable, PACRA also considers the Shariah Governance Regulations, 2023, which apply to REIT Schemes and RMCs offering Shariah-compliant products. REITs can be formed under a Public and Private Partnership model (referred to as PPP REIT schemes) or otherwise directly or through Special Purpose Vehicles (referred to as non-PPP REIT schemes). As per the Regulations, a Developmental REIT scheme or Hybrid REIT scheme with a developmental component should be listed three years from the date of transfer of real estate/shares of SPV, whereas other types of REIT schemes should be listed one year from the date of transfer of real estate/shares of SPV. Some salient features of the Regulations are listed in the table below:

Minimum ownership requirement by accredited investor/RMC:	
In case of single strategic investor	25% Units
In case of multiple strategic investors	5% Units
Application for permission to form an RMC	PKR 0.25 million
Application for license to undertake or carry out REIT Management Services.	PKR 1 million
Application for the renewal of license to carry out an activity or function.	Nil
Launch REIT scheme	PKR 0.5 million
Annual Monitoring Fee paid quarterly to SECP (Rental REIT)	0.1% of fund size
Annual Monitoring Fee paid quarterly to SECP (Developmental REIT)	0.2% of fund size
Annual Monitoring Fee paid quarterly to SECP (Hybrid REIT)	0.15% of fund size

REIT Fund Rating Framework

PACRA follows a comprehensive framework when assigning REIT Fund Rating, comprising both qualitative and quantitative analyses. The factors considered during evaluation include: i) Profile, ii) Economic and Industry Risk, iii) Asset Quality, iv) Financial Risk, and v) Management Review. PACRA attempts to analyze a REIT not only on a standalone basis but also in the relative universe.

Rating Scale

REIT Fund Rating scale ranges from RFR1 (indicating an exceptionally strong likelihood of successful implementation of REIT projects and negligible risk factors impacting the value of REIT assets) to RFR5 (indicating weak likelihood of successful implementation of REIT projects and possibility of wide fluctuations in the value of REIT assets if changes occur in the economy).

Profile

Operations

PACRA initiates its assessment by determining whether the REIT fund is developmental or hybrid. This helps PACRA develop an understanding of the scope and complexity of operations to ascertain the types and magnitude of

associated risks. REITs that do not wish to acquire fully developed property usually opt for the hybrid structure, as this offers maximum flexibility. After acquiring land or partially developed real estate and developing it, the fund may choose to retain some portion for leasing/renting out while selling the rest for capital gains. Compared to Developmental REIT schemes, Hybrid REIT schemes offer an additional safety cushion of being able to generate rental income from the underlying property if unable to sell within planned timelines or at the target price.

Portfolio Mix

PACRA looks at the composition of the REIT scheme's portfolio and the degree of diversification therein. A scheme with a single underlying property would generally be considered riskier compared to a scheme with multiple underlying properties as the risk of disruption in returns is likely to be higher in case of the former. This does not entail that a scheme specializing in a certain real estate segment would necessarily be at a disadvantage, nor does it imply that simply having a higher number of properties would safeguard the scheme from low or unstable returns. When there are multiple properties, PACRA assesses diversification at the segment and geographic level. Meanwhile, individual asset quality of each property is assessed as per the criteria outlined in Section 3 of this methodology and factored proportionately into the rating opinion.

Economy and Industry Risk

Economic Overview

The real estate industry is strongly correlated with overall economic conditions. Macroeconomic indicators like GDP, manufacturing activity, interest rate environment, and Government policies exhibit a strong correlation with real estate demand and, in turn, prices. It is also viewed by investors as a viable investment venue. In a growing economy, with low interest rates, capital availability becomes high, resulting in higher purchasing power that creates interest for investors. Therefore, more commercial real estate projects are likely to be initiated. Interest rates can have a dual impact. In addition to capital access, high interest rates may end up negatively impacting demand for REITs as investors opt for safer investment options such as bank deposits or government securities. Meanwhile, population demographics, urbanization rate, and political stability are other important factors when analyzing real estate trends. Budgetary allocation by the government for infrastructure development also plays an important role in the development and growth of the industry, as investors are attracted and encouraged to invest through various schemes and incentives.

Conversely, in times of low economic growth, REIT returns may suffer as property prices stagnate and the market becomes illiquid. The rental portion may also get impacted due to the likelihood of low occupancy and inability to increase or recover full rental payments. In such conditions, the negotiating power of property owners over tenants is also likely to be compromised. PACRA closely monitors economic conditions for indicators of negative movement in the economy and factors the same in its rating assessment.

Industry Dynamics

PACRA analyzes the real estate industry in the context of the local economy and regulatory environment. REITs are a relatively new entrant in Pakistan's financial market. However, progressive regulatory reforms in recent years have encouraged several new entrants. At the time of this document's publication, 41 RMCs have obtained licenses to

provide REIT management services. These numbers reflect the addition of 3 RMCs in 10MCY26[1], as REITs remain a tax-friendly investment avenue, given that 90% of their profits are distributed.

The real estate and construction sector is recovering from a prolonged slowdown caused by high interest rates, elevated inflation, and a heavy tax burden on property transactions. The Federal Budget FY27 introduced relief measures, including lower taxes on property purchase and transfer and the removal of federal excise duty on property transactions. Together with expanded housing initiatives and higher development spending, these measures have supported construction activity. However, the policy rate remains elevated, and developers continue to face high costs of land, energy and construction inputs. PACRA monitors prevailing economic, regulatory and industry trends and duly incorporates them in its opinion.

Asset Quality

Market Position

Market position is determined from the perspective of consumer interest for a particular property and is driven by a variety of factors including property type, location, infrastructure dynamics and physical state. Market position ultimately drives the occupancy/salability of a property across changing market dynamics and economic shocks.

- **Type of Property:** Different types of properties exhibit varying degrees of business risk. PACRA expects demand for shopping malls and hotels to be highly sensitive to economic cycles, while demand for schools, hospitals, residential and office space is expected to remain more stable even in an economic downturn, hence providing more comfort to the rating. PACRA recognizes that such relationships may not always hold or be as straightforward. For example, demand for industrial properties like factories and manufacturing plants may show a mixed trend, depending on the demand-supply dynamics of the particular industry and its sensitivity to economic conditions. Investors and customers are becoming increasingly conscious about Environmental, Social, and Governance (ESG) risks pertaining to the real estate sector and projects. E&S risks become more important from a rental REIT perspective as preference for "Green" buildings is gaining traction. These could impact the demand and eventual returns of the project. PACRA considers these risks in its evaluation to assess their impact on the final rating.
- **Geographic Location:** Strategically located properties with close proximity to residential and commercial areas are viewed positively. PACRA analyzes the ongoing and planned development in the area to form a view on demand prospects. Presence of substitute properties or threat of new entrants can impact market position.
- **Infrastructural Dynamics:** Connectivity to well-developed transportation networks for accessibility and availability of utilities (power, gas, water, etc.) and parking space is considered favorable.
- **Physical State:** Forming an opinion on the quality of construction and physical condition of a developing property may be a challenge. However, once it is complete, PACRA assesses its age, physical state, amenities and maintenance on an ongoing basis to estimate its useful life and prospects for income generation through renting and/or ultimate sale.

[1] Number of RMCs taken from SECP List for NBFCs and SFAs as on August 31, 2026

Project Risk

Project risk is a key consideration for Developmental and Hybrid REIT schemes as the value of the REIT is primarily dependent upon timely completion of the project. The degree of project risk may vary depending on whether the underlying property is yet to be developed (i.e., only land is acquired) or is partially developed. Such projects are generally sizeable and may take a long time to complete. In this regard, PACRA assesses the following:

- **Completion Risk:** Completion of the project in adherence to planned timelines without cost overruns in line with the processes and milestones identified in the business plan is of utmost importance.
- **Relative Size:** If the property is being expanded/renovated under an existing REIT scheme, then its relative size compared with the overall size of the REIT scheme would indicate the project priority and magnitude of associated risks within the overall rating opinion.
- **Salability:** Risk of sale of the property at the target price is crucial. PACRA assesses whether target pricing corresponds with the target market and if any unique selling point (USP) exists to give a competitive edge to ensure successful sale. PACRA further reviews the plans in place delineating the course of action in the event that the REIT scheme is unable to sell the property in a timely manner or at the target price. Any formal sales agreements are evaluated. PACRA also analyzes the sales and advances from customers to establish trends and how these will impact various aspects of the REIT scheme going forward. In case of decreasing demand, PACRA explores the underlying reasons to incorporate the risk of salability of the property into its opinion

Tenancy Risk

Once a property has been developed, a Hybrid REIT scheme may choose to rent out a portion or all of it. In such cases, it is crucial for PACRA to assess the underlying tenancy agreements, vacancy rates, and profile and diversity of tenant base.

- **Tenancy Agreements:** Longer-term tenancy agreements, with prescribed rental increment clauses, are viewed favorably since they mitigate the risk of unexpected vacancies and provide stable cash flows. PACRA examines average tenure of the agreements, expiry and opt-out clauses, and backup plans if a major tenant leaves unexpectedly.
- **Vacancy Rates:** Higher vacancy rates relative to the industry can be an important indicator of challenges in property management or marketing. PACRA opines whether this is a temporary or one-off occurrence or whether a trend is developing.
- **Tenant Base:** Concentration of revenue among top 5 and top 10 tenants is considered. Less than 10% exposure to the top tenant is considered desirable. High-profile tenants, evergreen tenants, or tenants with good credit ratings generally offer more comfort to the rating due to their financial strength and payment ability.

Legal Risk

PACRA evaluates the protocols in place for evaluation of legal risk, as legal disputes pertaining to property can potentially cause huge losses or even lead to closure of projects or suspension of income. PACRA expects due diligence to be conducted pertaining to the legal status of the property, ensuring the property is clear of any lien mark or stay orders against the transfer of the legal title, and that complete documentation and approvals are obtained from relevant authorities for real estate development.

Third-Party Service Provider Risk

An RMC may outsource certain functions related to third parties through Service Level Agreements (SLAs). PACRA considers the quality and terms of engagement for these parties, while control mechanisms to monitor their performance and the comprehensiveness of related contingency planning are also evaluated. This is important to prevent potential disruption in operations due to negligence or underperformance by service providers, which can impact the completion and quality of the property. Some key parties that are scrutinized during this analysis include: Valuer, Development Advisor/Property Manager, and External Auditor.

- **Valuer:** The Valuer is appointed by the RMC (with consent of the Trustee) for valuation of REIT assets. PACRA assesses the independence of the Valuer, its listing position on the panel of valuers maintained by Pakistan Banks' Association (PBA), and experience in the field since the valuation of the property is a key determinant of ultimate sale and returns to investors.
- **Development Advisor/Property Manager:** For Developmental REITs, a development advisor is appointed by the RMC for planning, design, costing, scheduling, contract preparation, coordination and supervision. Meanwhile, a Property Manager may be appointed for Hybrid REITs for managing and maintaining the rental component. Experience, track record, and market reputation of the designated personnel/entities are considered to determine their ability to ensure timely completion, maintenance, and upkeep of the property. PACRA reviews the degree of oversight and supervision along with related MIS shared. Similarly, project management software and tools deployed and Standard Operating Procedures (SOPs) followed are examined.
- **REIT Auditor:** Assessing the quality of the REIT auditor is crucial to establish the integrity of its financial statements and reporting. PACRA reviews whether the external auditor is on the panel of approved auditors maintained by the State Bank of Pakistan and/or has a satisfactory QCR rating to form its opinion.

Financial Risk

Financing Arrangements

Developmental and Hybrid REITs need to develop a property fully before being able to generate any income from it. This means that the adequacy of financing arrangements to manage capital expenditures and cover cost overruns, while ensuring timely completion in line with the construction schedule, is crucial. The REIT's ability to raise cash, whether through the strategic investor or externally, is analyzed. PACRA assesses whether the strategic investor has equity arrangements in place, and their credit profile is also considered. The existence of liquid assets, available borrowing lines, and access to capital markets to finance project completion and cover incurrence of unexpected costs (e.g., financial penalties or fines from legal authorities or third parties) would be given special consideration. In case of borrowing in currency other than PKR, PACRA also takes into account the exchange rate risk. For an operational REIT scheme, the quality of the developed property is factored in as an important potential cash source, as a highly demanded property in an attractive location is likely to be easier to dispose of in a timely manner to support cash needs. However, PACRA also considers that disposing of high-yield assets may ultimately end up diminishing returns to investors.

Cash Flows and Coverages

High-end properties (in terms of location, amenities, and physical state) are likely to generate higher cash flows when they are ultimately sold or rented out, and hence, yield higher returns. For the rental component of Hybrid REIT funds, a longer tenure of rent agreements, regular rent renewal clauses, and a well-diversified tenant base are likely to result in more stable cash flows. PACRA assesses how the REIT manages cash flows given the liquidity constraints posed

by high dividend distribution requirements to maintain tax-free status. Key cash flow measures used by PACRA include a REIT's Funds from Operations (FFO) and Adjusted Funds from Operations (AFFO). AFFO accounts for the impact of ongoing maintenance expenses, gain or loss on sale of property, capital expenditure, and any rent increases. PACRA further analyzes the adequacy of coverage provided by cash flows to outstanding costs, including debt principal and interest payments.

Capital Structure

PACRA considers capital structure to determine a REIT's reliance on external financing. While there is no absolute ceiling for borrowing stipulated by the Regulations, from a rating perspective, REITs with conservative leveraging are viewed favorably. This is because higher borrowing and debt repayment lead to strained cash resources, which impacts the REIT's ability to adapt to changing economic conditions or sustain shocks in business. Ultimately, financial flexibility becomes limited, as do returns to investors due to pressure on performance and profits.

Management Review

The ability of a REIT scheme to meet its investment objectives and adhere to stated policies depends on the RMC's expertise and quality of support systems. Therefore, an assessment of the RMC's qualifications, experience, capabilities, and track record is an integral part of the rating process. The assessment of management quality may also provide a basis for how the scheme might respond to future opportunities or stress situations under different market conditions.

RMC Rating

Opinion on the quality of the RMC is directly derived from the RMC Rating, the criteria for which are detailed in PACRA's REIT Manager Rating methodology. During the evaluation process, PACRA reviews the policies and procedures developed by the management to meet its investment objectives and assesses the efficacy of the investment management process, supporting organizational structure, internal controls, risk management, and reporting systems.

Analysis of arrangements with and quality of third-party service providers is conducted. The adequacy of the resources and appropriate segregation of duties to prevent conflict of interest is considered positively. Further, the profile of the RMC management team is assessed in terms of relevant experience and track record. A key measure of management effectiveness is its track record of delivering on past projections and sticking to strategies defined in its business plan. Investment process and quality of underlying research are also key considerations.

To determine the REIT scheme's level of risk tolerance and confirm harmony between the scheme's stated objectives and the REIT manager's investment philosophy in the future course of action, discussions with the RMC regarding investment strategy and outlook on business and industry are held. The framework deployed to ensure compliance with regulatory requirements and its actual effectiveness would likewise be an important consideration.

REIT Fund Rating (RFR)

An independent opinion on a Development or Hybrid REIT fund's likelihood of successful implementation of REIT projects and risk factors impacting value of REIT assets.

Scale	Long-Term Rating
RFR1	Exceptionally Strong likelihood of successful implementation of REIT project. Risk factors impacting value of REIT assets are negligible over the foreseeable future.
RFR2++ **RFR2+** **RFR2**	Very Strong likelihood of successful implementation of REIT project. Risk factors impacting the value of REIT assets are modest over the foreseeable future.
RFR3++ **RFR3+** **RFR3**	Strong likelihood of successful implementation of REIT project. Risk factors impacting value of REIT assets may vary with possible changes in the economy over the foreseeable future.
RFR4++ **RFR4+** **RFR4**	Adequate likelihood of successful implementation of REIT project. Risk factors impacting value of REIT assets are sensitive to changes in the economy over the foreseeable future.
RFR5	Weak quality likelihood of successful implementation of REIT project. Risk factors impacting value of REIT assets are capable of fluctuating widely if changes occur in the economy.

Rating Modifiers | Rating Actions

Outlook (Stable, Positive, Negative, Developing)

Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business / financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating 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'.

Rating Watch

Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension

It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn

A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

Harmonization

A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening. Rating actions may include "maintain", "upgrade", or "downgrade".

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