Futureal Development Holding Kft.
Hungary, Real Estate

BB NEGATIVE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	negative	1.1x	1.1x	1.3x
Scope-adjusted debt (SaD)/EBITDA	negative	61.2x	27.3x	20.3x
Scope-adjusted loan/value ratio	25%	43%	47%	52%

Rating rationale

The rating is driven by Futureal's solid competitive positioning, gradual ramp-up of recurring rental income and successful execution of its develop-to-hold pipeline, with the latter contributing to reduce the exposure to development risks. The long dated and fixed-rate debt maturity profile delays the impact of rising interest rates.

The rating is constrained by the high concentration around the Budapest metropolitan area (hosting 82% of the portfolio's value as at end-June 2022) and increased leverage driven by mostly debt-financed growth. A further constraint comes from Futureal's interest cover, just above 1.0x, which suggests limited headroom in case of cash flow volatility. In addition, the negative cash flow generation implies reliance on external financing, although mitigated by the company's ability to cut back or delay discretionary capital expenditures.

Outlook and rating-change drivers

The Outlook is Negative and reflects Scope's concerns about Futureal's EBITDA interest cover around 1x in the current deteriorating market environment, leaving little headroom in case of slower than expected rental of projects, loss of tenants given the challenging business environment, or delays and cost overruns in its ongoing developments. Scope's base case assumes the company will be able to grow its recurring revenue base by successfully completing develop-to-hold projects on time and on budget while keeping its LTV ratio under control. Scope assumes that the LTV ratio will climb above 50% from its current level of 42% but will remain between 50%-55% and that Scope-adjusted EBITDA interest cover will remain between 1.0x and 1.5x, not taking potential asset sales into account.

A positive rating action back to Stable would require the company to demonstrate a stable interest coverage above 1x, in the upper end of Scope's base case. A positive rating action with an upgrade is remote at this point. It would require the company to reduce leverage, as measured by its LTV ratio, to below 50% on a sustained basis while achieving Scope-adjusted interest coverage from recurring rental income of around 2.0x. In addition, Scope would expect significant diversification in terms of geographies and tenant base to mitigate potential cash flow volatility.

A downgrade could occur if Futureal's LTV ratio approached 60% or if Scope-adjusted interest coverage dropped below 1.0x. This could be triggered by a slump in market prices/rents or delayed up-letting of new properties.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
4 November 2022	Outlook change	BB/Negative
3 December 2021	Affirmation	BB/Stable
1 September 2021	Affirmation	BB/Stable
16 February 2021	New	BB/Stable

Ratings & Outlook

Issuer	BB/Negative
Senior unsecured debt	BB

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Related Methodologies/ Research

Corporate Rating Methodology; July 2022

European Real Estate Methodology; January 2022

ESG considerations for the credit ratings of real estate corporates; April 2021

European real estate; October 2022

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Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Sizeable non-speculative develop-to-hold pipeline, limiting development risks while supporting growth prospects • High-quality commercial property portfolio, limiting vulnerability to deteriorating economic conditions • Moderately diversified portfolio across different asset classes with slightly different demand patterns/outlooks	• Increase in leverage and reduced debt protection driven by largely debt-financed portfolio growth, partially mitigated by the gradual ramp-up of relatively predictable rental income • Limited recurring cash flows against resources needed for growth, suggesting reliance on external financing • High cluster risk posed by heavy concentration around Budapest metropolitan area • Rising development and labour costs put pressure on profitability/yield on cost

Positive rating-change drivers	Negative rating-change drivers
• Significant improvement of the business risk profile through increased diversification in terms of geographies and tenant-portfolio mix • Scope-adjusted LTV ratio below 50% on a sustained basis	• Scope-adjusted LTV ratio above 60% on a sustained basis • Weaker-than-expected buildup of recurring rental revenue

Corporate profile

Futureal (Futureal Holding B.V. together with its subsidiaries) is one of the largest commercial property developers and investors in Central Europe, active in the office, retail and logistics asset classes. The company's core market is in Hungary (mainly the Budapest metropolitan area), with a further presence in Poland and the UK. Futureal has shifted its strategic focus from a develop-to-sell to a develop or buy-to-hold model, aiming to build up a diversified property portfolio and expand its geographical footprint. Futureal's activities revolve around three main business brands: Futureal Development, HelloParks and Futureal Investment Partners.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	14.3x	negative	1.1x	1.1x	1.3x	1.3x
SaD/EBITDA	3.0x	negative	61.2x	27.3x	20.3x	18.8x
Scope-adjusted loan/value ratio	18%	25%	43%	47%	52%	54%
Scope-adjusted EBITDA in EUR k						
EBITDA	31,786	-393	5,364	18,282	31,898	38,139
Other items	0	0	0	0	0	0
Scope-adjusted EBITDA	**31,786**	**-393**	**5,364**	**18,282**	**31,898**	**38,139**
Funds from operations inScope-adjusted EBITDA in EUR k						
Scope-adjusted EBITDA	31,786	-393	5,364	18,282	31,898	38,139
less: (net) cash interest paid	-2,221	-7,893	-4,772	-16,143	-23,749	-29,275
less: cash tax paid per cash flow statement	-849	-401	-2,080	0	-815	-886
Change in provisions	327	229	2,206	0	0	0
Funds from operations (FFO)	**29,043**	**-8,458**	**717**	**2,139**	**7,334**	**7,978**
Free operating cash flow Scope-adjusted EBITDA in EUR k						
Funds from operations	29,043	-8,458	717	2,139	7,334	7,978
Change in working capital	-15,958	100,354	-13,025	11,566	-1,298	-7,113
Non-operating cash flow	-55,426	-60,239	-18,578	0	0	0
less: capital expenditure (net)	14,813	-62,881	-187,445	-202,903	-132,482	-68,797
less: other cash flow from investing	-24,113	-5,281	-8,782	0	0	0
Free operating cash flow	**-51,641**	**-36,504**	**-227,113**	**-189,198**	**-126,446**	**-67,932**
Net cash interest paid in Scope-adjusted EBITDA in EUR k						
Net cash interest per cash flow statement	-2,221	-7,893	-4,772	-16,143	-23,749	-29,275
add: interest component, operating leases	0	0	0	0	0	0
Net cash interest paid	**-2,221**	**-7,893**	**-4,772**	**-16,143**	**-23,749**	**-29,275**
Scope-adjusted debt in Scope-adjusted EBITDA in EUR k						
Reported gross financial debt	146,252	193,557	618,400	772,403	799,194	803,469
less: cash and cash equivalents	-67,735	-88,562	-345,952	-293,867	-173,661	-106,342
add: non-accessible cash	18,016	31,599	55,690	20,869	20,869	20,869
Scope-adjusted debt (SaD)	**96,533**	**136,594**	**328,138**	**499,405**	**646,403**	**717,996**

Futureal Development Holding Kft.

Hungary, Real Estate

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Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend

Green leaf (ESG factor: credit-positive)

Red leaf (ESG factor: credit-negative)

Grey leaf (ESG factor: credit-neutral)

In regard to sustainability, Futureal aims to follow common ESG principles by minimising waste generation, energy consumption and harmful emissions during the implementation and operation of development projects/standing assets. In addition, Futureal was one of the founding members of the Hungarian Green Building Council and committed (over 10 years ago) to only develop commercial buildings meeting the minimum certification of BREEAM 'Very Good'. Furthermore, the group introduced a green bond framework in February 2021, under which proceeds from green bonds/loans will be directed towards existing or future buildings to reduce their carbon footprint and improve the company's environmental performance.

However, the company does not prepare an extra-financial performance report, nor has it defined quantitative/timebound ESG targets/KPIs.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BB

Industry risk profile: BB-

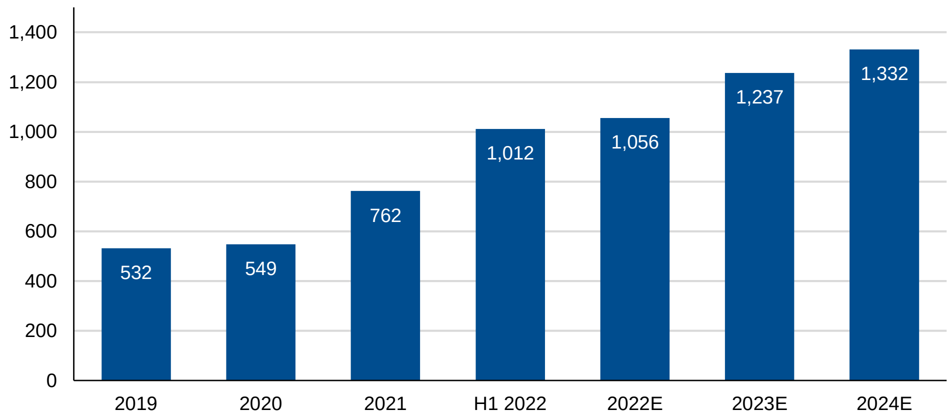
Futureal is primarily exposed to commercial real estate through development and rental activities, whose contribution has been volatile during the last three years. Consistent with the company's strategic shift towards a develop-to-hold and/or buy-to-hold model, the contribution of rental income has grown considerably to 64% of total revenue in 2021 (up from 14% the previous year). Consequently, the blended industry risk assessment of BB- reflects shrinking exposure to development activities in conjunction with the execution of the project pipeline (13% of gross asset value as of end-December 2021 – down from 45% the year before).

Market-leading commercial real estate company in the Budapest metropolitan area

Futureal is a relatively small real estate company in the European context but it remains among the largest commercial property developers and investors in the CEE region, especially in its home market of Budapest. Futureal has grown significantly in recent years, with Scope-adjusted total assets standing at EUR 1.0bn as of end-June 2022 (up 33% from end-December 2021).

We anticipate continued growth going forward, with total assets reaching around EUR 1.1bn by end-December 2022 and EUR 1.2bn by YE2023. Our growth assumption is supported by the sizeable development pipeline (over 1.2m sq m of potential GLA) and a continued focus on value-add and opportunistic investments.

Figure 1: Scope-adjusted total assets (EUR m)



Sources: Futureal, Scope estimates

Moderate market shares

The Hungarian real estate market is fairly fragmented, with dominant market shares mainly observable within specific segments. In light of this fact, we deem Futureal's market shares in its core-market of Budapest to be moderate, estimated at around 2%, 4% and 6% for the office, industrial and retail (shopping centres) segments respectively.

In view of Futureal's in-place portfolio and robust development pipeline, the company is well positioned to retain its current market positions in the retail and office segments, and gain leadership status in the industrial segment (joining the top three behind CTP and Prologis in the short term, assuming no deviation in the pipeline's execution).

Improving geographical focus, but still heavy concentration in Budapest metropolitan area

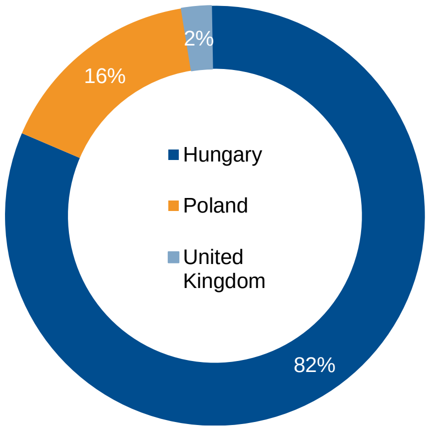
Futureal's properties are predominantly located in the Budapest area, which hosts 82% of the portfolio value as of end-June 2022 (2021: 85%). All ongoing/planned development projects are also located in Budapest. Given the cyclical nature of Futureal's activities, low geographical diversification bears the risk of inherent volatility in the commercial real estate market and missed opportunities in other locations with better growth prospects. In addition, it represents a cluster risk for the company's cash flow as the company engages in rather large-scale projects (e.g. Budapest One, Corvin Innovation Campus).

Nonetheless, the company has notably broadened its presence in Poland after completing several acquisitions in 2021 (Manhattan and Bemowo shopping centres, Wratislavia Tower office building and two logistics plots with up to 70,000 sq m of potential GLA). Over the next couple of years, Futureal aims to further expand its geographical footprint and build up its portfolio through further acquisitions. Long-term ambitions to expand into the Czech Republic and the Netherlands are to be preceded by an initial focus on the UK, with planned investments in the residential segment (not intended to be fully funded by Futureal).

… mitigated by wide diversification across asset classes

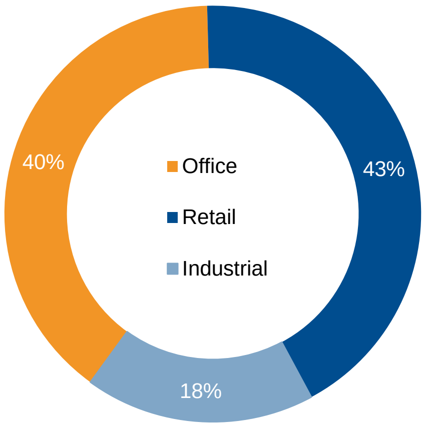
Within the commercial real estate segment, Futureal's standing portfolio covers three property segments – retail (40% of GLA, including planned GLA until end-2022), office (31%) and industrial (30%), which have slightly different demand patterns. We acknowledge Futureal's improving diversification in regard to asset classes, which helps reduce sensitivity to cash flow volatility should one segment become more affected than another.

Figure 2: Geographical diversification (by portfolio fair value as of end-June 2022)



Sources: Futureal, Scope

Figure 3: Asset class diversification (by portfolio fair value as of end-June 2022)

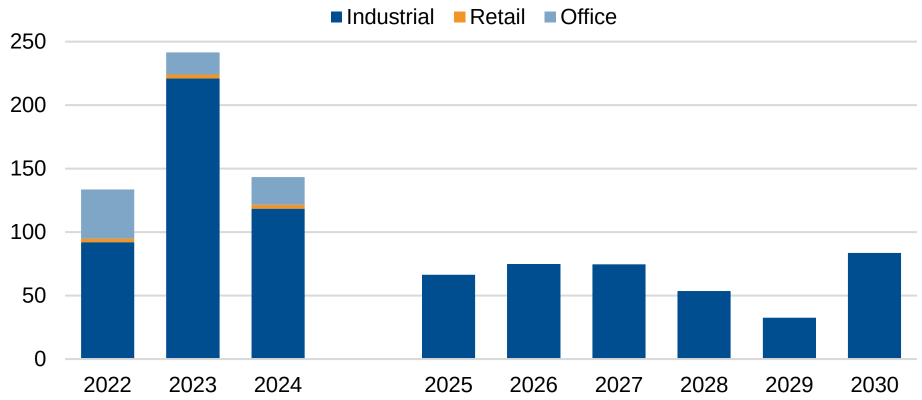


Sources: Futureal, Scope

Project pipeline primarily centred on logistics properties

Futureal's industrial branch (led by HelloParks and its team of 65 professionals) aspires to gain market leadership in Hungary. The share of industrial and logistics in the portfolio is therefore expected to ramp up steadily, accounting for a large portion of the development pipeline with a potential of around 950,000 sq m of GLA. With this new focus, Futureal aims to capitalise on strong occupant demand for new industrial space (especially urban last-mile facilities) and good rental growth prospects, largely supported by: (i) a favourable balance of supply and demand; (ii) the growth of e-commerce and (iii) occupants' willingness to optimise supply chains; and (iv) Hungary's ambition to become a major European hub/platform for electric vehicle batteries/parts.

Figure 4: Project pipeline ('000s sq m)



Sources: Futureal, Scope

The quality and granularity of the tenant base is becoming an increasingly important consideration as economic and market conditions worsen, making tenant defaults and delayed payments more likely.

Moderate concentration of the tenant portfolio

Despite an improvement in the tenant mix along with the portfolio build-up, Futureal's tenant base (more than 60 tenants) still shows moderate concentration, with the top three tenants accounting for 18% of annual rental income and the top 10 accounting for around 40%.

… mitigated by the quality and sector diversification of tenants

The overall quality of Futureal's tenant portfolio is good, with top-tier occupants (such as BT Group, Oracle, Vodafone, Inditex and Carrefour) outweighing small and medium-sized tenants with weaker/unknown credit quality. This largely reduces exposure to potential tenant defaults, delayed payments and rent impairments, from which the company has been well protected thus far (as evidenced by just one rent write-off of EUR 18k in the last five years).

Moreover, many tenants are in industries that benefit from relatively low cyclicality (accounting for more than 30% of annual rental revenue), which reduces the risk of cash flow deterioration during economic downturns.

High-quality commercial property portfolio

Futureal has a good standing in the Hungarian commercial real estate market, as evidenced by multinational companies (e.g. IBM, Nokia, Vodafone, BT Group) trusting it to address their real estate needs. Futureal's properties are more likely to meet occupants' demand for high sustainability standards, flexible and adaptable workspaces, technology integration, good transport links and other factors important for attracting and retaining skilled staff.

Overall, the quality of Futureal's properties is considered high/good, which is underpinned by: (i) inner city locations with direct transport links; (ii) modern properties with an economic age of below five years on average; (iii) a high level of BREEAM certification achieved on several assets; and (iv) appealing properties with unique attributes/iconic design. Although investors'/buyers' appetite for sizeable acquisitions is understandably low at present, the quality positioning of Futureal's portfolio supports assets' liquidity to some extent and limits potential haircuts on property values.

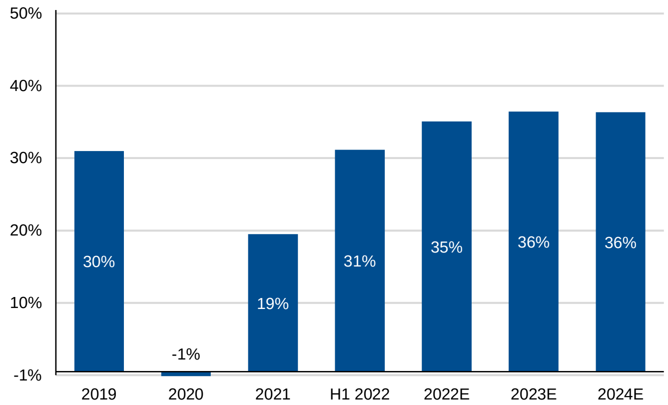
Stable key portfolio performance indicators

As of end-June 2022, KPIs for the standing portfolio show relatively good levels considering a vast majority of assets were recently brought to market. Leasing activity was nevertheless slower in 2021 and H1 2022, having been undermined by greater hesitancy among potential occupants given an unsupportive macroeconomic outlook and shifting work habits[2]. As of end-June 2022, the occupancy rate of the standing portfolio stood at 81% (including the first two HelloParks logistics buildings at 100% occupancy, Etele Plaza at 97% and Budapest One phase 1 at 99.5%). The WAULT of the portfolio stood at nearly six years (10.2 years for Etele Plaza and about 6.0 years for logistics), which provides a good level of visibility in terms of future rental income.

Improving profitability benefitting from the gradual ramp-up of rental income

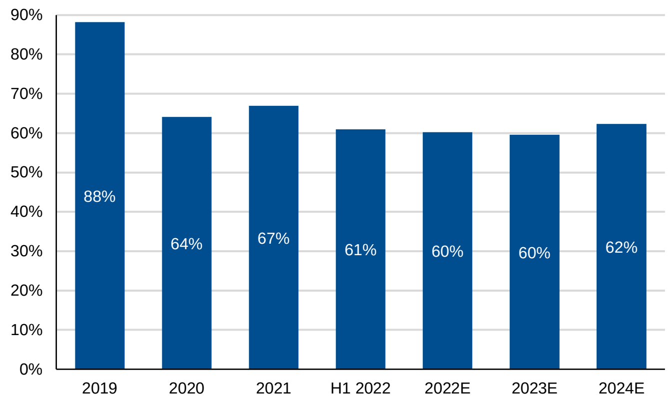
Given the relatively limited historical dataset currently under consolidation and the strategic repositioning towards a develop-to-hold/buy-to-hold model rather than develop-to-sell, Futureal's operating profitability has been highly volatile and largely affected by the lumpiness of large-scale projects. Consequently, profitability as measured by the Scope-adjusted EBITDA margin stood at 31% for the six months to end-June 2022 (compared to 19% in full-year 2021), yet it does not truly reflect the core profitability achieved from rental activities.

Figure 5: Scope-adjusted EBITDA margin



Sources: Futureal, Scope estimates

Figure 6: EBITDA margin from rental activities[3]



Sources: Futureal, Scope estimates

… still impacted by cost overruns in the short term

On a standalone basis, the EBITDA margin of the rental segment[3] stood at 67% and 61% in 2021 and H1 2022 respectively. The decline in H1 2022 was mainly driven by higher services charges in conjunction with the ramp-up of rental operations. With upcoming projects to be leased out, we expect profitability from rental operations to remain around 60% in the short-term, before reaching a normalised margin of about 65%-70% once the shift towards buy-and-hold is completed.

We anticipate profitability to range between 30%-40% in the short-term, benefiting from the gradual ramp-up of rental revenues in conjunction with pipeline execution and leasing activity take-up. However, profitability will remain susceptible to cost overruns and rising operating expenses, which might not be immediately or fully passed on to tenants.

Financial risk profile: BB-

Largely debt-financed portfolio growth has led to a sharp increase in leverage

Leverage, as measured by the Scope-adjusted LTV ratio, rose to 43% as at end-December 2021 (up from 25% in FY 2020). This is largely attributable to the company's increased indebtedness subsequent to the bond issuances in 2021 (raising a total of HUF 121bn). Nonetheless, current leverage (42% as of end-June 2022) still provides some headroom against potential market value declines or a slowdown in occupiers' demand.

We anticipate the LTV ratio will trend upwards and remain between 45%-55% going forward, primarily driven by: (i) additional financings required to fund non-discretionary

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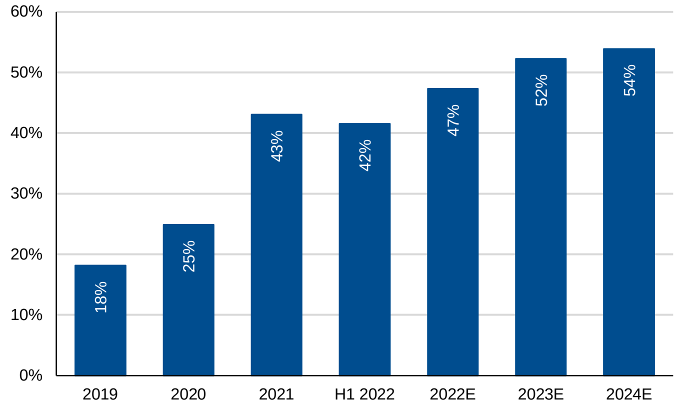
[2] Substitution risk for office spaces has increased, and demand could permanently/largely shift to a hybrid model between physical and virtual home offices. A study by JLL of employees' work habits and expectations for the working environment has established that average office working days stand at 2.3 days a week (likely to rise to 2.6 days) in Germany, 3.1 days in France, 2.9 days in Italy and 2.5 days in Spain, undermining medium-term demand for office space in Europe's major economies.
[3] Defined as (rental income + service revenue – direct cost of rental and operation / rental income + service revenue)

investments; (ii) positive changes in the portfolio's fair value, benefitting from firm rental values thanks to high-quality assets and execution of the development pipeline; and (iii) improved cash flow generation from rental properties, gradually reducing the reliance on external financings.

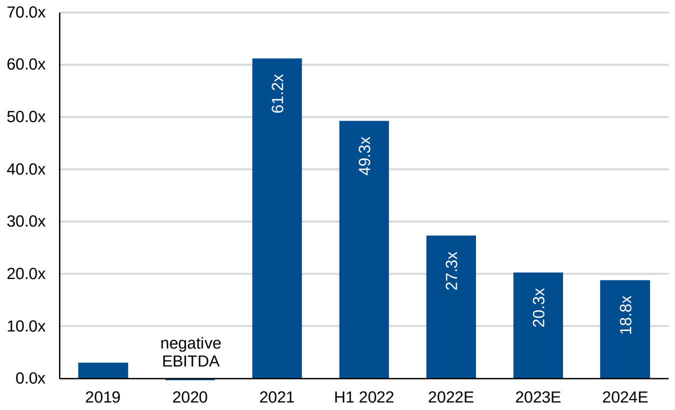
Despite the anticipated increase in leverage, Futureal's access to external financing (on a secured and unsecured basis) remains good, supported by the pool of unencumbered assets (mostly logistics properties) and some headroom to refinance assets financed at below a 40% LTV ratio.

Figure 7: Scope-adjusted LTV ratio (%)



Sources: Futureal, Scope estimates

Figure 8: SaD/EBITDA (x)



Sources: Futureal, Scope estimates

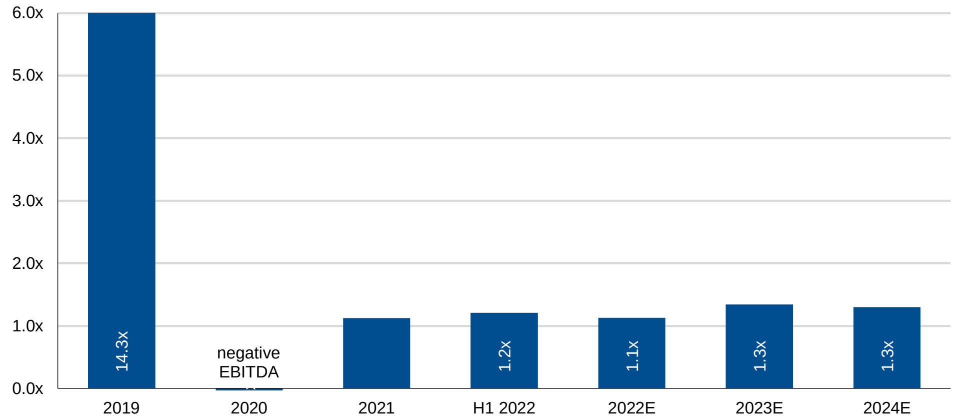
Debt protection constrained by high degree of indebtedness

Debt protection weakened significantly from pre-2020 levels, with Scope-adjusted EBITDA/interest down to 1.2x at end-June 2022. This was largely driven by: (i) dynamic and mostly debt-financed portfolio growth (combining own developments and opportunistic acquisitions); (ii) the 2021 bond offerings and tap issue in late January 2022; and (iii) a slower build-up of rental activities, induced by extended development periods (large-scale projects).

… although it is sufficient to serve interest payments

Futureal's current interest cover suggests limited headroom against the risk of cash flow volatility, which is particularly heightened by rising interest rates and uncertainties surrounding the demand for commercial space (wait-and-see approach of companies). However, this level is sufficient to cover current and future interest payments and is further supported by Futureal's prudent liquidity management and risk policy. In addition, the risks arising from development activities are largely mitigated by a non-speculative approach towards new projects, in which the company only starts once occupant demand/interest is present.

Figure 9: Scope-adjusted EBITDA/interest cover (x)



Sources: Futureal, Scope estimates

Going forward, we expect interest cover to remain between 1.0x and 1.5x, taking into consideration: (i) the gradual ramp-up of rental income, consistent with pipeline execution and leasing take-up; (ii) good protection from rising interest rates, with over 90% fixed-rate debt locked for prolonged terms; (iii) financing of ongoing developments secured with favourable terms (average cost of 2.7%), with further availability under existing loan limits (around 30% undrawn as at end-June 2022); (iv) cash flow generation that will remain stretched in the short term, implying additional financings need (at higher cost) to fund growth plans.

Adequate liquidity

Futureal's liquidity assessment is adequate.

BalanceScope-adjusted EBITDA in EUR k	2022E	2023E	2024E
Unrestricted cash (t-1)	290.3	272.9	152.8
Open committed credit lines (t-1)	0.0	0.0	0.0
Free operating cash flow	-189.2	-126.4	-67.9
Short-term debt (t-1)	14.7	23.2	20.7
Coverage	**>200%**	**>200%**	**>200%**

In view of the issuer's good relationships with established banks and its sound track record in the capital markets, we consider liquidity/refinancing risk to be manageable. Hence, we expect liquidity to remain adequate in the short term, owing largely to the lack of major upcoming debt maturities.

Supplementary rating drivers: +/- 0 notches

Financial policy: neutral

Futureal does not have a declared target leverage ratio at present. However, management aims to keep leverage under control (i.e. below 60%) by assessing the impact of new projects/potential investments prior to reaching a decision, with further consideration of the timing and financing structure (debt-to-equity ratio). We acknowledge the numerous capital injections realised by the ultimate beneficiaries in the past, contributing to fund expansion while maintaining a sound balance sheet. The company is not subject to any financial covenants at the holding company level (Futureal Holding B.V.) but such covenants exist at the project level (typical maximum project LTV ratio covenant of 70%). In past fiscal years, the company has commonly distributed dividends, and it intends to continue doing so in a way that agrees with the company's financial situation, and without impairing the company's financial structure/debt repayment capacity.

Parent support: neutral

Futureal Holding B.V., parent company and guarantor for the bond liabilities of Futureal Development Holding Kft., is ultimately owned by Gábor and Péter Futó. The owners have a long track record of injecting equity into the company, particularly during economic downturns (e.g. the global financial crisis and European sovereign debt crisis) and more recently between 2018 and 2020 to support restructuring. The owners remain supportive of that eventuality going forward.

Although we are confident about the owners' willingness to support Futureal in case of financial distress, we are not incorporating a rating uplift given the absence of explicit/contractual forms of financial support.

Long-term debt ratings

Senior unsecured debt rating: BB

As at H1 2022, Futureal has two senior unsecured bonds outstanding issued under the Hungarian National Bank's Bond Funding for Growth Programme: a HUF 63.05bn bond with a fixed coupon of 4% maturing in 2031 and a HUF 57.95bn bond with a fixed coupon of 3.5% maturing in 2036. Scope's recovery analysis is based on a hypothetical default scenario at year-end 2024E, showing an average recovery for the senior unsecured bonds. Scope's analysis shows high sensitivity to attainable prices in a distressed sales scenario and high sensitivity to the volume of senior secured bank debt at the time of a hypothetical default. Senior unsecured debt at the issuer level, affirmed at BB, benefits from a relatively high unencumbered asset ratio of around 160%, providing a large pool of collateral to debt holders.

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