BRC Ratings

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Colombia

Rating report

PARTICIPATORY SECURITIES PROGRAM PATRIMONIO AUTÓNOMO ESTRATEGIAS INMOBILIARIAS (PEI) managed by PEI Asset Management S.A.S

This English version is provided on request and reflects the translation from the original one provided only in Spanish by BRC Ratings – S&P Global S.A. Sociedad Calificadora de Valores on March 21, 2024, under the title "Programa de Títulos Participativos Patrimonio Autónomo Estrategias Inmobiliarias (PEI) Administrado por PEI Asset Management S.A.S.". *In case of any discrepancy between this English version and the original in Spanish, the Spanish version shall apply.*

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PARTICIPATORY SECURITIES PROGRAM PATRIMONIO AUTÓNOMO ESTRATEGIAS INMOBILIARIAS (PEI) managed by PEI Asset Management S.A.S

PERIODIC REVIEW			
Real Estate Participation Securities		**i AAA Rating**	
Figures as of December 31, 2023:		Rating history:	
Total value of the Program:	COP 8.5 trillion	Periodic review Mar./23:	i AAA
Total placed value:	COP 3.7 trillion	Periodic review Mar./22:	i AAA
Group of assets that make up the PEI:	164	Periodic review Mar./21:	i AAA
		Initial rating Dec./06:	i AA+
Annual profitability for 2023:	13.76% AER		

Introduction

Unlike a debt instrument, the securitization of participatory securities backed by real estate does not commit to the payment of capital or interest, hence there is a particular scale for this type of instrument (i-rating). This type of issuance is made through investment vehicles that develop, buy and manage real estate assets and lease the space to tenants who subsequently pay rent. Once the expenses and obligations of the vehicle are covered, 100% of its distributable cash flow is distributed among its investors as returns. Additionally, the return of these vehicles includes the value of the commercial appreciation of the properties.

The rating of real estate securities is an evaluation of the probability that the vehicle can generate the projected returns and recover the investors' capital in the long term. In this way, the analysis focuses on the factors that determine the financial and operational stability of the vehicle, mainly, the lease flows, the valuation of the properties and the ability of the administrator and other related parties to comply with the guidelines of the placement prospectus.

I. OVERVIEW

- We affirmed the rating of i AAA real estate participation securities of the Participatory Securities Program Patrimonio Autónomo Estrategias Inmobiliarias (PEI) managed by PEI Asset Management S.A.S.
- The decision stems from the portfolio's ability to meet the estimated profitability and recover the capital invested in the long term, even throughout stress scenarios that may impact the distributable cash flow in the short term.
- The rating also incorporates adequate diversification and quality of assets that support real estate securities; this is reflected in stable cash flow growth and constant asset appreciation.

II. RATING ACTION:

Bogota, March 21, 2024. The Technical Committee of BRC Ratings – S&P Global S.A., affirmed in periodic review the rating of real estate participation securities of i AAA to the Participatory Securities Program Autonomous Heritage Real Estate Strategies (PEI) managed by PEI Asset Management S.A.S.

III. RATING RATIONALE:

The rating scale of the participatory securities evaluates two factors. First, the probability of generating the projected returns. In this particular case, the return is made up of both the distributed cash flow, after covering operations and financial obligations, and the appreciation of the assets. It is important to note that the appraisals are made by independent companies, and the vehicle's policy is that none of these carry out the analysis for more than three consecutive years.

We expect that, in the short term, cash flow profitability will be pressured by the vehicle's financial expense but will maintain the recovery trend observed in 2023. However, this effect is compensated by the appreciation of the assets, since these are of high quality in the market and the PEI (Patrimonio Estrategias Inmobiliarias) carries out constant maintenance that is reflected in the annual appraisals. In this way, we estimate that the profitability of the vehicle can meet the administrator's objective (CPI +6.7% to 6.9%) in the long term. In addition, we project a recovery of the equity dividend yield to levels above 4% starting in 2026 (1.1% at the end of 2023), driven by the rental escalation strategy and the optimization of the vehicle operating expenses.

The second factor considered by the rating of securities is the ability to recover the capital invested by the investor. This recovery time changes for the last tranches issued, because, as the number of titles of the vehicle increases, the nominal cash flow received by each one is lower, especially in scenarios that put pressure on the distributable cash flow. Despite this, due to the indexation of contracts to inflation, real income and asset valuation would maintain a stable trend that would allow investors to recover their capital in the next 10 to 15 years. These factors, along with the vehicle's real estate results, are consistent with the 'i AAA' rating. This is also based on the quality of assets and the geographic and category diversification of the portfolio.

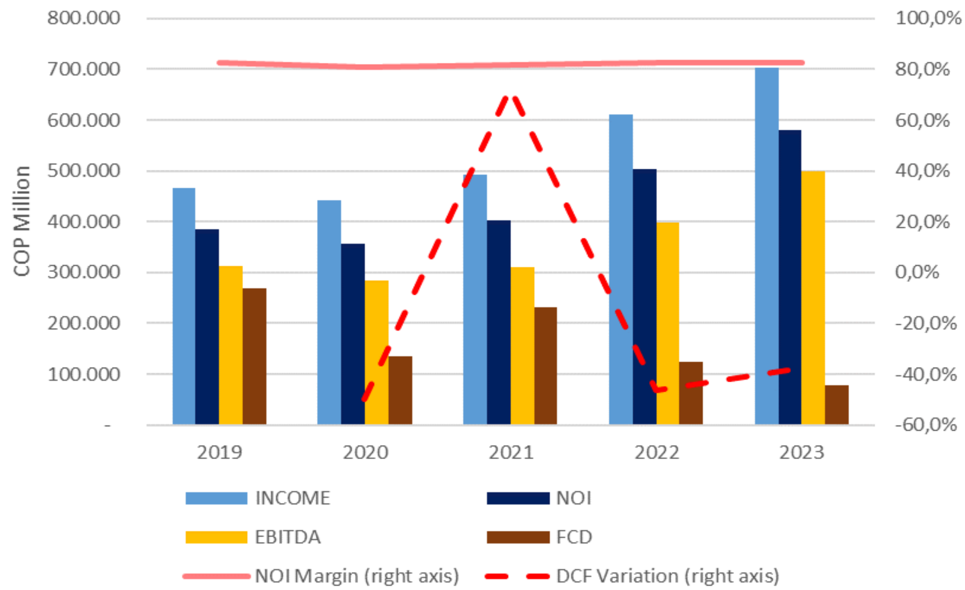
It is important to keep in mind that participatory securities are not a credit obligation, so the PEI is not obliged to comply with any amount or percentage of distribution at the end of each year. Furthermore, the prospectus clarifies that the projected returns are not guaranteed but will depend on the behaviour of the real estate market and the assets in the portfolio. Therefore, the estimated profitability can be changed without violating the prospectus as we have observed in previous years.

In 2023, the vehicle's operating results improved compared to the end of 2022. Net Operating Income (NOI) grew 15.5% and EBITDA 24.9% which are historical maximum levels since the beginning of PEI's operations. These variations were the result of the improvement in vacancy rates and the absorption of the CPI observed in recent years in lease contracts. Physical vacancy closed at 4.3% in 2023, lower than that of 2022 of 5.7%, and in line with the PEI's target range around 5%. However, economic vacancy remains above this range, as it rose to 6.0% in 2023 from 7.6% in 2022. This is results from having vacant assets with high rental values.

At the same time, the behaviour of the cap rate reflects the capacity to generate operating cash by the assets that make up the portfolio; this remained above 6.57% throughout 2023, consistently recovering the level from 2019. This reflects the institutional strength of the manager, the adequate diversification of its portfolio and a long-term investment horizon. We believe that these characteristics would allow PEI to have sufficient foundations to face adverse situations in the future.

Even with the good results recorded in 2023, the cash flow distributable to the investor decreased by 37.4% (see Chart 1). Explained by the level of PEI indebtedness in recent years and the indexation of 80.9% of the obligations at variable rates. This generated an increase of 62.3% in financial expenses.

Chart 1
PEI financial figures (in COP million)



Source: PEI. Made by BRC.

In our view, cash flow profitability in 2024 will reach levels close to 1.9%, even without recovering pre-pandemic distribution capacity. Despite this, we estimate that the total profitability of the vehicle to be around 12%. This, because the valuation of the assets that includes the CPI adjustments on the lease contracts and their maintenance by the PEI as the manager.

This result would not affect the vehicle's ability to meet its estimated profitability in the long term. We project a gradual recovery in cash flow in 2024 and 2025 that would offset the decline in recent years. However, a greater deterioration in macroeconomic factors that impact the portfolio's cash generation, debt levels higher than those recorded in 2023, a more aggressive expansion of non-stabilized assets or unfavourable results in the valuation of assets could modify our outlook and, hence, the rating.

Asset Portfolio

The portfolio of real estate assets has maintained a high quality, as a result of the robust process that the PEI follows when making its investments and the high degree of knowledge of the real estate market in

Colombia. Throughout 2023, the administrator finished the first relevant divestment in the history of the vehicle. It was to the sale of a warehouse in Yumbo for a value of $8.8 billion Colombian pesos (COP) (97% of the book value). According to the addendums made to the prospectus last year, these resources could be used for prepayment of debt or an extraordinary distribution to investors.

We do not foresee new asset acquisitions in the short term, so the composition of the portfolio should remain stable in 2024 and 2025. We will monitor possible divestitures, redevelopments or reconversions of assets and their impact on the operational and financial results of the vehicle in the medium and long term.

Currently, geographical diversification measured from rental fees has not had significant changes compared to a year earlier. Bogotá remains the city with the highest participation (48%). The cities that follow are Cali, Medellín and Barranquilla with concentrations between 6% and 14%. We consider that such diversification is appropriate and allows PEI to hedge against economic volatility in some regions of the country.

We highlight the fragmentation of PEI tenants, whose established limit is 20% of annual income. Davivienda, which is the largest tenant, remains at levels between 7% and 8% of income, reducing its participation from 10% in 2021. The rest of the tenants do not exceed 4%. Nutresa became part of the most representative tenants in the portfolio, compared to the previous year with a participation of 3%.

Assets under management are mainly classified into four business lines: trade, corporate, logistics and specialized. The composition by business line (according to the value of the properties) as of December 2023 is within the limits established by asset type of 70%. We highlight the concentration in corporate and commercial assets, which represent on average 78% of the total value of the portfolio, as they are the sectors with the greatest volatility in their historical vacancy. Therefore, persistent high inflation conditions or low economic growth could impact the rental income line in these sectors through vacancy. We include the above within our scenarios in the profitability projections. If we observe a greater concentration in riskier segments, we could lower the rating, as long as this results in greater risk of the capacity to generate returns per distributed cash.

Portfolio Management

PEI bases its acquisitions on a detailed study of the conditions of the property, its possibilities of use and its expectation of the evolution of its value. The high quality of the assets and the constant maintenance work carried out by the vehicle on them has allowed the valuation to partially compensate for the variations in distributable cash flow in recent years. For example, the valuation profitability in 2023 was 12.50% (higher than the 9.28% CPI). The intrinsic value of the assets remains resilient in real terms, which reflects the strength of the portfolio and its adequate management.

In 2023, PEI executed COP44.33 billion allocated to capital expenditures (capex), an increase of 18.3% compared to 2022. By 2024, we expect this item to be approximately COP36 billion, after the completion of the installation of covers on logistics assets and other adaptations the previous year.

Economic vacancy closed 2023 at 6.0%, an improvement of 160 bps from the previous year. Physical vacancy was below the target level of 5% at 4.3%. In the last year, the difference between these has reduced to approximately 2.1%, annual average, from 2.9% in 2022. This behaviour reflects the effect of rent staggering and the placement of assets with higher rental rates.

Regarding the evolution of the net portfolio (current portfolio minus accounting provisions), we observe stable behaviour from 2022 to 2023. Last year it represented 0.5% of total revenues, with an increase of 8 basis points (bps) from 2022. We project stable behaviour in the portfolio considering the quality of tenants in the portfolio, added to the administrator's stabilization strategy with grace periods and subsequent escalation in rents.

The aforementioned EBITDA result is also explained by the reductions in the modified administration fees in the prospectus for the second half of 2023. This, with the objective of anchoring these expenses to the operating and financial results of the vehicle. We consider that these changes favour distributable cash flow through optimization of expenses and generate incentives to deleverage the vehicle, especially in scenarios of volatile operating results.

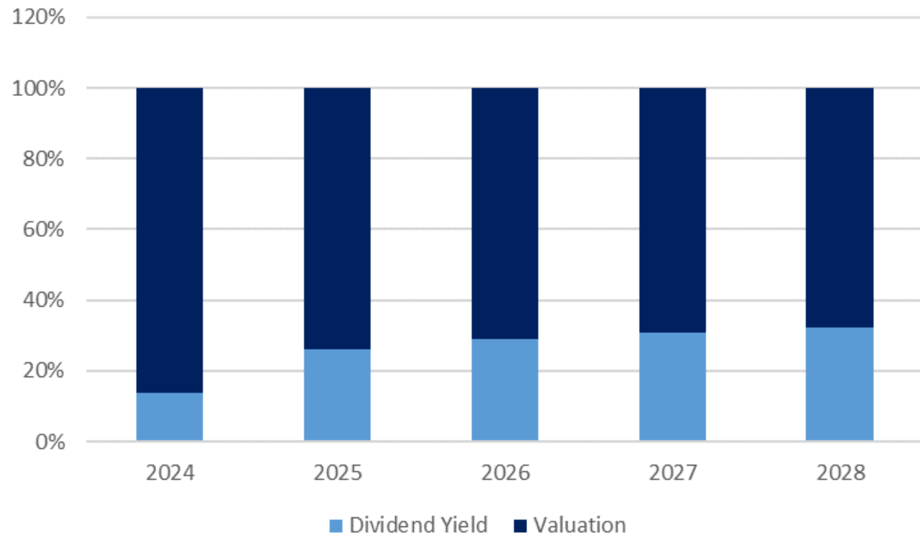
Profitability:

PEI continues to adjust its 10-year base profitability projections. For this review PEI estimates lower profitability compared to that projected in the last review of CPI + 6.7 to 6.9% from CPI + 6.9% to 7.1%. These estimates remain above peers and the market.

It is important to consider that the debt strategy to finance PEI acquisitions has impacted the vehicle's cash flow profitability, so it rose to 1.1% in 2023 from 3.5% in 2022 and 4.8% in 2021. This result exceeded our projection for 2023. We estimate a Dividend yield around 1.9% at the end of 2024, with a gradual recovery to levels above 4% in 2026.

Despite this, the total profitability of the vehicle in high inflation scenarios, such as that observed in recent years, is compensated by the boost in valuation implied by the adjustment to the CPI of the lease contracts. In 2023, the valuation profitability was 12.5% (higher than inflation for the year), and the consolidated annual return was 13.76%. Our projections indicate that the vehicle would be able to maintain its profitability above the CPI+ 6.7% to 6.9% benchmark in the long term. This, once the recovery of the Dividend Yield (see Chart 2) is included, thus increasing its representativeness in the annual profitability of the vehicle.

Chart 2
Profitability projections due to valuation and Dividend yield



Made by: BRC

IV. FACTORS TO MODIFY THE RATING:

What can lead us to affirm the rating

- The generation of stable distributable returns and the conservation of investors' capital.
- Compliance with both the acquisition plan and its financial projections.
- The constant valuation of assets above the observed CPI.

What could lead us to downgrade the rating

- The deterioration of the PEI's cash flow, due to any factor associated with the decrease in income or the growth of expenses, that consistently affects the distribution of returns to the holders of the participating securities.
- Debt levels higher than the established limits.
- A constant increase in the volatility of the cash flow generated by the portfolio, accompanied by a reduction in the Dividend Yield paid to investors.

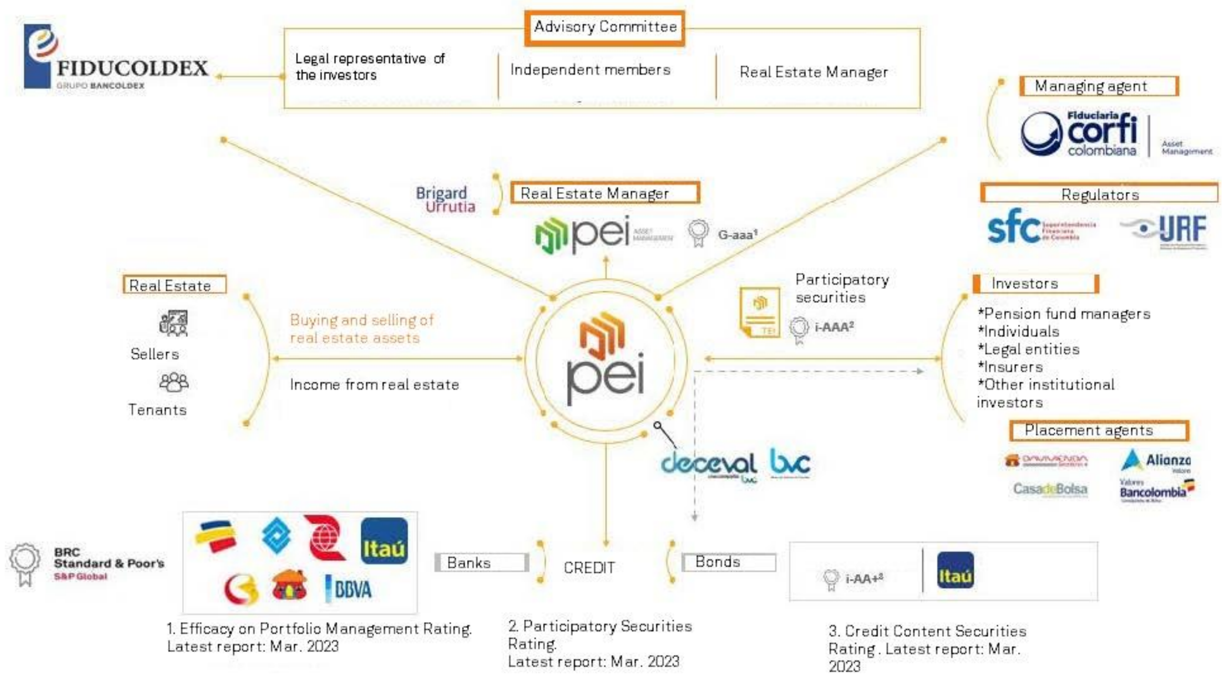
V. DEFINITION AND STRUCTURE OF THE SECURITIZATION

The attainment of resources for the constitution of Patrimonio Estrategias Inmobiliarias begins with the issuance of securities backed by the rights and obligations of the promise of purchase and sale contracts of the real estate assets previously signed with the owners of the assets. The autonomous patrimony only purchases properties that are already leased (otherwise, it must have the approval of the Advisory Committee), a condition that seeks to guarantee the stability of income once the investment in the asset has been made.

The purchase and sale contracts are executed with the resources from the issue, and the assets become the property of the autonomous patrimony. These properties constitute the investment portfolio that makes up the PEI, and are managed by a professional operator, who is in charge of all the maintenance processes and the operation of the facilities (security, cleaning, administration, among others).

With the ownership of the assets, the autonomous patrimony receives as its main income the rents from the aforementioned properties, which will become --after paying all the costs and expenses of issuance, administration and operation-- the main part of the distributable returns that, in turn, together with the appreciation or devaluation of assets, will determine the profitability of investors.

Chart 3
Securitization scheme



Source: PEI

VI. CONTINGENCIES:

According to information from the issuer, it did not have legal processes that could affect its financial position as of December 2022.

VII. ADDITIONAL INFORMATION

Type of rating	Real Estate Participation Securities
Minute number	2518
Date of the Committee	March 21, 2024
Type of Review	Periodic review
Administrator	PEI Asset Management S.A.S.
Members of the Committee	María Carolina Barón Buitrago
	María Soledad Mosquera
	Patricia Calvo

Rating history

Periodic review March/23: i AAA
Periodic review March/22: i AAA
Initial rating December/06: i AA+

The technical visit for the rating process was carried out with sufficient time due to the availability of the issuer and the delivery of the information was fulfilled in the foreseen times and in accordance with the requirements of BRC Ratings – S&P Global S.A. SCV.

BRC Ratings – S&P Global S.A. SCV does not perform auditing; therefore, the entity's management takes full responsibility for the integrity and veracity of all the information provided and that has served as the basis for the preparation of this report. On the other hand, BBRC Ratings – S&P Global S.A. SCV reviewed the available public information and compared it with the information provided by the entity.

The financial information included in this report is based on the audited financial statements of the last three years and unaudited financial statements as of December 2023.

If you have any question regarding the indicators included in this document, you can consult the glossary at www.brc.com.co

To see the definitions of our ratings, visit www.brc.com.co or click here.

VIII. MEMBERS OF THE TECHNICAL COMMITTEE:

The resumes of the members of the Technical Rating Committee are available on our website www.brc.com.co