Spotlight: VGP N.V.

Part Developer and Part Investment Property Investor

Property Portfolio Profile (End-December 2021)

Asset Class:	Industrial and Logistics Parks
Portfolio Size (JVs at 100%):	VGP: EUR2.0bn JVs: EUR3.5bn
Geographies:	Continental Europe
Weighted Average Yield:	VGP Portfolio: 4.6% JVs Portfolio: 4.3%
Vacancy Rate:	VGP: 0.7% JVs: 0.6%
Weighted Average Lease:	VGP: 9.3 years JVs: 7.6 years

Source: Fitch Ratings, VGP N.V.

Related Research

VGP N.V. (September 2022)

SELP Finance (December 2021)

AXA Logistics Europe Master S.C.A. (November 2021)

EMEA Real Estate Updated Base Case (August 2022)

Real Estate and Property – Long-Term Climate Vulnerability Scores (June 2022)

Analysts

John Hatton
+44 20 3530 1061
john.hatton@fitchratings.com

Fredric Liljestrand
+46 8 551 09 441
fredric.liljestrand@fitchratings.com

Property Development for Bespoke JVs

VGP N.V. (BBB-/Stable) sources land across continental Europe to develop industrial and logistic parks which, pre-let and developed, are transferred to bespoke debt- and equity-funded joint ventures (JVs) with Allianz Real Estate as a co-equity investor. Cash proceeds to VGP substantially repay its cost-to-build outlay. VGP retains a 50% stake in the JVs.

Although a property developer, VGP has a record of consistent internal discipline to manage development risks, as well as an increasing backbone of recurring incomes (cash dividends, fees and subordinated fundings' interest income) from the JVs, to create a stable investment-grade financial profile.

Development Risk Mitigations

VGP's inherent development risk mitigants include an in-house team sourcing land and managing development costs; development profit (above build-to-cost, typically above 20%-30%) headroom; land acquisition is mainly incurred with tenant pre-lets in place (end-2021 under construction developments: 85% pre-let); and completed assets are transferred at value to established, pre-funded JVs. In Germany (58% of the group's portfolio), developers can only source quality permitted land, which is granted once a tenant, its local employment and trade tax-paying credentials are established by the local authorities.

Developments are pre-agreed and screened with the JV partner as suitable for each geography-specific JV to buy on completion. To date, no completed buildings have been rejected by Allianz under these agreements.

Between May 2016 and end-December 2021, VGP transferred EUR2.1 billion of assets (cost plus valuation increase), of which, VGP received 87% of this asset value sold in cash – remunerating in full its land acquisition and building cost-to-build outlays – and retained a 50% equity stake in the property investment JVs. If this asset class's valuation yields were to widen by 50bp-60bp, from the current averaged 4.4% valuation yield to 5.0% (a 12% decrease in value) affecting the end-2021 development programme, Fitch calculates that VGP would still get its cost-to-build outlay repaid from JV monetisations.

Furthermore, from a debt creditor's perspective, the completed developments are rental-income producing.

Backbone of Recurring Income from JVs

VGP's own income statement's rents are less meaningful, as they are an accounting rent of the completed asset held for a transitionary time before they are sold on to the JVs. More recurring and durable are the asset management and facilities management fees VGP receives from the JVs as well as income from construction loans and shareholder loans, which supports its investment-grade profile. In FY21, JVs totalled EUR3.5 billion (at 100%) of investment property, and paid VGP a EUR20.6 million second-time cash dividend (FY20: EUR6.9 million). FY23 and FY24 dividend capacity is around EUR40 million.

Fitch uses VGP's committed annualised rental income figures to compile a 'fail-safe' financial profile for it (ie if there were no more JV monetisations and VGP had to complete property developments for itself to hold).

Substantially pre-let, with a weighted average lease length of 9.6 years and a range of net initial yields (NIY) of around 4.5%-5.0%, VGP's financial profile compares well with peers such as Tritax EuroBox plc (BBB-/Stable), and AXA Logistics Europe Master S.C.A (BBB+/Stable) which both have little development activity, and SELP Financial SARL (BBB/Stable) and the UK entity SEGRO PLC (A-/Stable), both of which are part-developer property investors.

Sector Fundamentals

Despite uncertainties about real estate as an asset class, given interest rate changes, Fitch is not expecting a big change in logistics and heavy-industrial unit fundamentals because of underlying demand (ecommerce, enhanced distribution, onshoring trends) for these units and limited supply in main markets, including scarcity of land.

Furthermore, in an inflationary environment, many of these leases have annual CPI indexation.

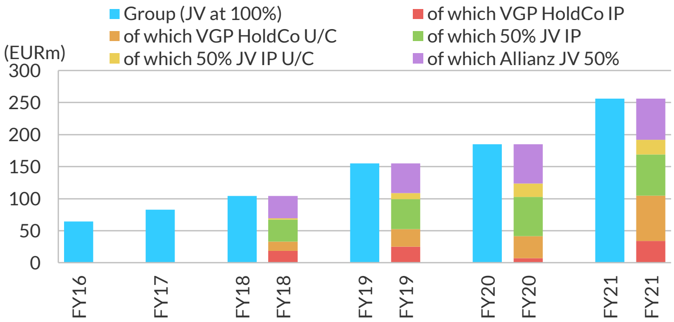
Partly reflecting an inability to second guess future capital values, Fitch has focussed its analysis on the longevity of rental income relative to long-term debt and interest rate fixing, as measured in net debt/rental-derived EBITDA. This also reflects VGP's focus on its annualised committed rents and completed portfolio's end-2021 99% occupancy rate.

Committed Annualised Rental Income

Each year-end's committed annualised rental income is "the annualised rental income generated or to be generated by signed lease agreements of which the start date is already in effect or will be in effect in the future".

The EUR256.1 million (JV at 100%) at end-2021 includes existing and prospective rental income to be funded on VGP's balance sheet, and existing completed assets within the JVs. It quantifies the rent roll figure.

Committed Annualised Rental Income



Source: Fitch Ratings, VGP. IP = Investment Property U/C = Under Construction

Using these pre-let rental gross rental income (GRI) figures, Fitch has compiled two financial profiles for VGP:

VGP as Holdco Financial Profile

This profile shows VGP as a holding company (VGP as Holdco), adding the capex needed to achieve the relevant pre-let rental figure, assuming no more transfers of completed buildings to the JVs take place, to the company's end-2021 net debt.

This profile is most relevant to VGP's bondholders, as the rental income in its actual income statement is transitionary (reflecting its part-year investment properties and held-for-sale assets, as they transition to the JVs).

VGP as Holdco

(EURm)	FY21	FY20
Summary income statement		
Net rental income (NRI) – annualised rent	126.6	60.5
JV asset, facilities and development fees	21.3	14.7
Administration expenses[a]	-12.7	-6.1
Operating profit	135.2	69.2
Interest income from JVs and associates	12.3	9.3
Dividend capacity from JVs[b]	32.7	26.0
Add back depreciation	2.4	2.1
EBITDA: JV dividend capacity	182.7	106.6
Alternative: Use actual dividends from JVs	20.6	6.9
EBITDA: Actual cash dividends from JVs	170.6	87.5
Interest expense[c]	-61.7	-32.4
Summary balance sheet		
VGP opening net debt	1,162.8	546.7
Capex spend to achieve annualised rent	600.7	379.0
VGP closing net debt	1,763.5	925.7
VGP opening Investment Property (IP) and Held for Sale (H4S)	2,354.4	1,022.5
Capex spend to achieve annualised rent	600.7	379.0
VGP closing IP and H4S	2,955.1	1,401.5
of which development land	434.6	297.1
Financial ratios using dividend capacity		
Gross interest cover ratio (x)	3.0x	3.3
Net debt/EBITDA (x)	9.7	8.7
Financial ratios using actual cash dividends from JVs		
Gross interest cover ratio (x)	2.8	2.7
Net debt/EBITDA (x)	10.3	10.6
Loan-to-value (excluding development land and JV equity stakes; including 40% (FY20: 20%) gain on incremental capex spent) (%)	67%	78

[a] Fitch assumes administration expenses at 10% of NRI
[b] Dividend capacity from JVs taken from JVs' EBITDA
[c] Interest expense at an average 3.5% cost of debt, including 40% revaluation uplift on incremental capex spend
Source: Fitch Ratings, VGP N.V.

To this financial profile of backbone rental income, Fitch has added the actual recurring fees from the JVs, VGP's second cash dividend of EUR20.6 million in FY21 and, for comparative purposes, the JVs' profit before tax implied dividend capacity.

These show the backbone of recurring income streams to VGP relative to its cost base, including:

- Annual committed rental income (equivalent to an annualised gross rental income figure): EUR256.1 million in 2021 and exclude amounts related to the JVs' existing investment properties.
- JV fees: many of these are recurring in nature as VGP and its JVs have increased in size. They include asset management fees based on each JV's net asset value, facilities management and letting fees, construction loan remuneration, tax-efficient interest receivable on shareholder loans and cash dividends from JVs.
- Administration expenses: VGP has its own in-house construction team, whereas other property companies outsource this activity and capitalise it in their balance sheets; therefore, Fitch has excluded this cost from VGP's pro forma profile.
- VGP has also started making discretionary contributions to a charitable foundation (FY21: EUR5 million, FY20: EUR4 million). Fitch has put these amounts alongside discretionary dividends to shareholders.
- EBITDA: The resultant EBITDA is recurring and rent-derived.
- Investment property and net debt: Fitch has added the capex required to achieve the annualised rental income to VGP's YE21 net debt. Conservatively, Fitch has added an assumed 40% valuation increase above cost, even though the development programme shows a much higher capital gain.
- VGP as Holdco net debt/EBITDA: Using dividend capacity from the JVs, cashflow leverage was 9.7x (FY21: 8.6x). This high leverage reflects on-balance-sheet funding from 2021's heavy capex, few 2021 monetisations to JVs and the sizeable VGP-funded Munich JV. Adjusting this ratio for 1H22 JV monetisations and VGP's receipts, the ratio improves to 9.0x, consistent with VGP's rating sensitivities to maintain its investment-grade rating.
- At below 7x for VGP's upgrade to 'BBB' and above 9x for a downgrade to 'BB+', it captures the company's different mix of income streams, size and concentrations. This compares with Tritax EuroBox's rating sensitivities for 9.5x (upgrade to 'BBB') and 10.5x (downgrade to 'BB+'), and SELP, which undertakes development activities and whose downgrade rating sensitivity to 'BBB-' is above 10x.
- Interest coverage: VGP's interest cover (about 3x) has less headroom than peers' as its legacy cost of euro-denominated debt is 3.5% (compared with peers at 2%). This is set to improve with the total EUR1 billion January 2022 bond issuance at blended 2% coupons.

VGP's Proportionally Consolidated Financial Profile

Based on the same analytical approach of VGP as a Holdco, the proportionally consolidated profile adds its 50% of the JVs' rents, investment property and debt. This financial profile is more familiar to investors and serves as a good reality check, but includes VGP's share of JV debt that is secured and has no recourse to VGP, and the JVs are leveraged at 50%-60% loan-to-value (LTV).

This synthetic profile and its resultant 10.5x net debt/EBITDA are comparable to rated peers, more so non-developers Tritax EuroBox and AXA LEM, both of which have a similar NIY, but are of different sizes.

VGP's Real Profit Model – Transfers to JVs

The main profit driver for VGP is the capital gains realised on completion (whose valuations are assessed by third parties) when these income-producing units are transferred to the JVs.

Fitch regards this profit stream as a benefit for VGP's equity stakeholders. Fitch does not view it as an investment-grade rating activity because property values are uncertain (property company management do not control the main component of valuation yields, which is interest rates), rents may vary, completion times may vary (particularly if there is no funded purchaser), development risk has to be actively managed and the speculative holding cost of non-income-producing land can seriously affect this profit stream (and has almost been the downfall of industrial developers).

JVs at 100% - Profile of Closings

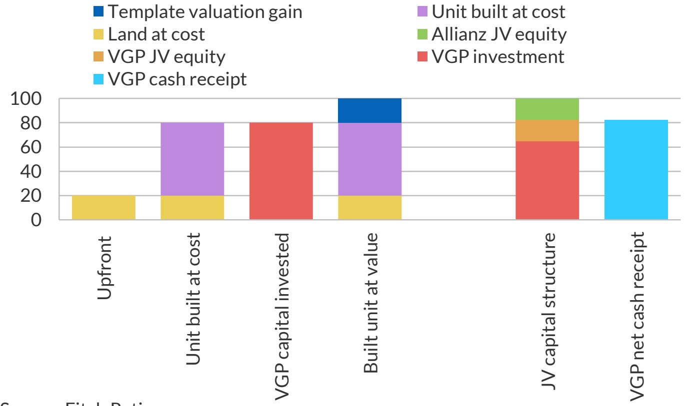
Date of closings	Headline amounts sold into the JV (EURm)	End-period investment properties (EURm)	
VGP European Logistics JV (JV I) at 100%			
May 2016	500		
October 2016	80	end-2016	496
May 2017	173	end-2017	715
May 2018	400	end-2018	1,162
April 2019	203		
November 2019	232	end-2019	1,662
October 2020	166	end-2020	1,917
June 2021	68	end-2021	2,300
July 2022	81		
VGP European Logistics 2 S.a.r.l JV (JV II)			
July 2019	175	end-2019	145
November 2020	258	end-2020	403
		end-2021	451
March 2022	364	end-Jun 2022	757
July 2022	24		
Munich JV			
June 2020	187		--
December 2020	55	end-2020	419
		end-2021	551
Logistics Park Moerdijk (LPM)			
November 2020	--	end-2020	81
	--	end-2021	105
Replicate VGP European Logistics JV (JV IIb) at 100%			
Planned Nov 2022	1,000		

Source: Fitch Ratings, VGP N.V.

VGP's regular monetisations into the debt-funded, co-investor Allianz JVs alleviate many of these risks, together with VGP's internal discipline on land purchase. Fitch has analysed VGP's development programme in detail, to ensure that its risk profile is consistent with the rating.

The following graphic shows a representative 20%-30% capital gain on the construction of a unit in an industrial park, and a JV's repayment of VGP's capital outlay. The end-2021 development programme has a higher capital gain than the above range.

Template Development Outlays



Source: Fitch Ratings

VGP's Proportionally Consolidated Financial Profile

	FY21 VGP	FY21 JV at 50%	To achieve annualised rent	FY21 total annualised rent	FY20 total annualised rent
Summary income statement					
Gross rental income (GRI)		62.4		192.1	123.9
Property operating expense[a]		-7.1		-17.3	-10.9
Net rental income (NRI) – annualised rent		55.3		174.8	113.0
JV asset and facilities fee income	21.3			21.3	14.7
Administration expenses[b]				-17.5	-11.3
Interest income from JVs and associates	12.3			12.3	9.3
JV cash dividends	20.6			20.6	6.9
EBITDA		55.3		211.5	132.6
Interest expense[c]				-87.5	-58.8
Summary balance sheet					
Investment properties and held for sale assets	2,354.4,	1,746.8	+600.7	4,701.9	2,846.6
Net debt	1,385.0	515.4	+600.7	2,501.1	1,410.9
Net asset value	3,882.7	858.1	[d]240.3	4,981.1	2,958.3
EBITDA interest cover ratio (x)				2.4	2.3
Net debt/EBITDA (x)				10.5	10.6
LTV (excluding development land and JV equity stakes; including 40% (FY20: 20%) gain on incremental capex spent) (%)				51	56

[a] Property operating expense to achieve a representative almost 90% NRI margin
[b] Illustrative reversal of VGP development programme team's costs, but Fitch assumes administration expenses at 10% NRI
[c] Interest expense at an average of 3.5% cost of debt
[d] Including 40% revaluation uplift on incremental capex spend
Source: Fitch Ratings, VGP N.V.

The *Summary Cash Flow from Disposal of VGP Assets into JVs* table contains the actual historic data, showing that when EUR2.1 billion of assets have been transferred into the JVs, VGP has received 87% of the assets' value in cash (most of which is revalued when transfer from VGP's balance sheet). Given the template 20%-30% valuation gain - whereas the end-2021 development programme's is higher - VGP repays its capital for that asset and re-invests it in further expansion.

To date, no assets developed by VGP have been rejected by Allianz for the JVs. The JVs can only invest in completed pre-let assets or, if not yet completed, they are transferred to the JVs with VGP funding the units' construction through arms' length remunerated construction loans. Allianz wants income-yielding industrial and logistics assets.

The Munich JV was different to the above JVs in that VGP initially funded a large portion of the capital for this entity upfront – covering the development stage – and, since mid-2020, Allianz has been rebalancing its contribution to a 50:50 proportion (with a minimum EUR73 million contribution planned for November 2022). Furthermore, because the assets are completed and income-producing, if secured debt is raised against the assets, VGP will receive its share of this re-gearing of the balance sheet planned for 2023. This will enhance the above VGP financial profiles.

Current Development Programme

The development programme includes a number of large projects, most of which include land already acquired as at end-2021.

Summary Development Programme at End-2021

	Total lettable area when complete (rounded) (sq m)	Included in annualised committed rental income (EURm) [1]	Estimated end-value ranges of completed parks (EURm)
More than EUR200m:			
VGP Park München, Germany	314,000	25.6	
VGP Park Giessen am Alten Flughafen, Germany	212,000	Not disclosed	
VGP Park Nijmegen, Netherlands	319,000 87,000	3.6 4.0	
VGP Park Nurnberg, Germany	159,000	Not disclosed	
VGP Park Magdeburg, Germany	294,000	8.0	
VGP Park Laatzen, Germany	139,000	10.1	
Around or below EUR200m			
VGP Park Bratislava, Slovakia	296,000 102,000	4.8 --	
VGP Park BUD Aerozone Kft., Hungary	A24,000	3.0	
VGP Park San Fernando de Henares, Spain	117,000	7.2	
VGP Park Ceske Budejovice, Czech Republic	131,000	0.4	

[1] As disclosed in the 2021 Annual Report
Source: Fitch Ratings, VGP N.V.

Summary Cash Flow from Disposal of VGP Assets into JVs

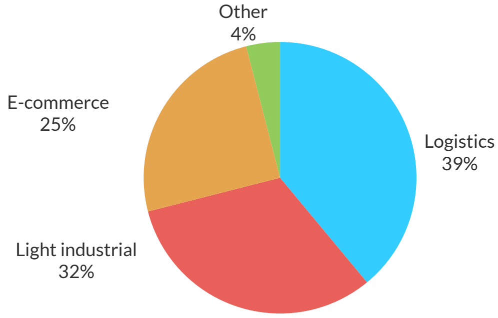
(EURm, rounded)	Six-year total	FY21	FY20	FY19	FY18	FY17	FY16
Investment properties transferred at value	2,102	55	609	476	255	174	534
Cash shareholder loans advanced	-1,343	-42	-373	-337	-256	-113	-223
Cash shareholder loans repaid	1,229	40	313	286	338	101	151
Cash shareholder loans interest	included in shareholder loans repaid above						
Realised valuation gain on sale (value in JV)	270	12	167	35	34	0	21
Sub-total: cash received (from bank funding and Allianz equity) before VGP Equity into JV	2,259	65	717	459	372	162	483
Cash equity by VGP into the JV (net)	-427	-12	-192	-74	-50	-24	-77
Cash received after VGP equity into JV	1,832	54	525	386	288	138	386
as % of investment property transferred in	87	99	86	81	126	79	79

Source: Fitch Ratings, derived from the main items in VGP's annual accounts "Cash flow from disposal of subsidiaries and investment properties"

The KraussMaffei Technologies buildings at Munich and Laatzen VGP Parks yield high rents by sq m as they are higher quality than traditional industrial units, reflecting the higher building costs.

The typical tenants span manufacturing operations as well as logistics and third-party logistics tenants together with e-commerce-related operations (retailers' distribution centres such as Zolando at Giessen).

Tenant Portfolio Breakdown (JVs at 100%)



Source: Fitch Raitngs

End-2021 Top 10 Tenants (JVs at 100%)

Tenant (Fitch rating)	Rental income (%)	Industry type
KraussMaffei Technologies (part of China National Chemical Corporation Limited; A/Stable)	10.9	Manufacturing (plastics coverings)
Amazon.com Inc (AA-/Positive)	6.1	Retail logistics
Zalando	5.5	Retail logistics
Rhenus Logistics	3.8	Logistics
Drylock Technologies	2.5	Manufacturing
BMW Group	1.9	Auto manu.
Siemens	1.8	Manufacturing
MediaMarktSaturn	1.8	Retailer logistics
CATL	1.5	Engineering
4PX	1.3	Logistics
Total Top 10	37.0	

Source: Fitch Ratings, VGP with JVs at 100%

The units are built to VGP's standards and are not bespoke to tenants, which means that when buildings are re-leased or a tenant fails and leaves a unit vacant, the building is ready to be re-let.

Sector Demand – Land Constrained

A common problem for many industrial and logistic park developers is the scarcity of good quality land. This stems from constraints on land availability in countries such as Germany, Czech Republic and Slovakia, and from inherently limited land availability in other countries, such as Spain (in Madrid and Barcelona, where only brownfields are available).

VGP's management is cautious about markets where land availability is less constrained and oversupply and participants' speculative-builds can alter the risk profile. The widespread rising acquisition prices of greenfield land is fuelling the rise in the value of logistic assets and their rents.

VGP looks for land near cities with more than 100,000 inhabitants (tenants need access to the workforce), on transport arteries (good locations), with electricity and power connectivity, ability to operate 24/7 and good transport access. Alongside smaller last-mile units' plots, VGP has also amassed sites for sizeable, co-ordinated, multi-tenanted industrial and logistics parks. Some sites will have big box assets which are greater than 10,000sqm.

VGP has a disciplined approach to land acquisition, requiring land bought with construction permits and, on a portfolio basis, a minimum of 80% pre-lets.

Key Person Risk – The Allianz Event

The Allianz JVs have the following unusual clause within shareholder agreements, which Fitch has labelled 'Allianz Events':

"If Jan Van Geet, as CEO of the Group, would no longer devote sufficient time to the development of the portfolio of the Joint Venture, Allianz can, upon notice thereof, stop the acquisition process of the proposed income-generating assets, until Jan Van Geet has been replaced to the satisfaction of Allianz.

"If at any time during the term of the Joint Venture Agreement, the participation that Jan Van Geet, directly or indirectly, holds in the Company [VGP N.V.] falls below 25% of the total outstanding Shares (other than due to the dilution of his participation as a result of capital increases or similar transactions at the level of the Company in which he would not participate), then Allianz is entitled to terminate all the management agreements with immediate effect and to terminate the JV Agreement."

Fitch largely views these provisions as a legacy from when VGP was a smaller company and the chief executive was a keyperson risk. Today, the management team has become wider, though Jan Van Geet continues to be an informative and involved chief executive as well as a large shareholder (YE21: 40.85% ownership).

Concerning the management fees, VGP has confirmed that, upon an Allianz Event, it would continue to be the asset manager for the JVs and can charge fees. That contract cannot be terminated by Allianz, but only by the management of the JV, which includes VGP's vote. Equally, if unanimous board approval to change the dividend policy cannot be reached, full dividends have to be paid.

This provision does not exist in the planned successor to VGP European Logistics JV (JV I) labelled JV Ib. The clause is less applicable to the full JV I or the Munich JV, but does apply to VGP European Logistics 2 S.a.r.l JV (JV II).

Even if the clause is triggered in full, VGP has said it would continue to have a minimum 50% stake in the JVs, act as asset manager for the JVs and receive relevant JV income streams. Fitch's analysis of VGP As Holdco shows the company's likely financial profile should the unlikely Allianz Event take place and further JV transfers cease.

Logistics-Sector Property Portfolio Factors ■ Concern ■ Medium ■ Good

Company	Investment property portfolio value	Geographical spread (% of portfolio by rent or value)	Vacancy rate (%)	Average lease length (years)	Top tenant concentrations and top tenant (%)	Sector concentrations (%)	Acquisition or development strategy	Asset type (%)	Average asset age (years)	Net initial yield (%)	Topped-up net initial yield (%)
AXA Logistics Europe Master S.C.A	EUR4.1bn	By value: France: 25 Germany: 24 Italy: 14 Netherlands: 10	3.0	5.4	Top 10: 40	Logistics	Acquisition	Big box: 100	10	Dec 20: 4.2	n.a.
			■	■	■				■		
SEGRO PLC (at share)	GBP16.7bn	By value: UK: 66 France: 10 Germany: 9 Italy: 7 Poland: 4	3.2	7.2	Top 20: 31 Amazon: 5	Transport and logistics: 21 Manufacturing: 16 TMT: 11 Wholesale Dist.: 10 Post & Parcel: 9	Both	UK urban: 54 UK big box: 9 Cont Europe urban: 12 Cont Europe big box: 21	Not available	3.0	3.3
			■	■	■				■		
SELP Finance SARL	EUR6.9bn	By value: Germany: 28 Italy: 19 Poland: 18 France: 18 Netherlands: 5	1.8	5.7	Top 10: 27	Transport and logistics: 33 Retail: 17 Manufacturing: 17 Wholesale Dist: 12 Post & Parcel: 3	Both	Big box: 100	8.2	3.4	3.9
			■	■	■				■		
Tritax EuroBox plc	EUR1.3bn End-Sept 2021	By rent (Dec 2021): Germany: 48 Italy: 15 Spain: 12 Belgium: 11 Poland: 5	3.3	9.3	75	Omnichannel retail: 28 Third-party logistics: 21 Online retail: 23 Manufacturing: 9	Acquisition	Big box: 100	4.7	3.7	3.9
			■	■	■				■		
VGP SA JVs at 100%	EUR5.8bn	By value: Germany: 53 Czech: 12 Spain: 10 Netherlands: 7	0.7	VGP: 9.6 JVs: 7.1	Top 10: 40 Krauss Maffei: 11 Amazon: 6	Logistics: 39 Light Ind: 32 Ecommerce: 24	Development	Big box: n.a Ind: n.a Manufacturing: n.a.	Likely very young	Weighted Average Yield: VGP: 4.6 JVs: 4.3	n.a.
			■	■	■				■		

Note: All data as of December 2021 unless otherwise stated
Source: Fitch Ratings, companies' disclosures