Corporate Governance and Credit Rating Services Inc.

25 August 2017

Credit Rating

Rating (National): Long Term

(TR) AA

Outlook:

Stable

Rating (National): Short Term

(TR) A1+

Outlook:

Stable

İş Gayrimenkul Yatırım Ortaklığı A.Ş.
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İŞ GAYRİMENKUL YATIRIM ORTAKLIĞI A.Ş. (ISGYO)

Rating Summary

İş Gayrimenkul Yatırım Ortaklığı Anonim Şirketi ("the Company") was founded on August 6, 1999 by conversion of İş Gayrimenkul Yatırım ve Proje Değerlendirme Anonim Şirketi to a real estate investment trust following the taking over of all assets and liabilities of İş Gayrimenkul Yatırım ve Proje Değerlendirme Anonim Şirketi and Merkez Gayrimenkul Yatırım ve Proje Değerlendirme Anonim Şirketi, which were both established in 1998 and operating separately. The main shareholder of the Company is Türkiye İş Bankası Anonim Şirketi ("İş Bank").

The Company is a capital market institution, which can invest in real estate, real estate backed capital market instruments, real estate projects, real estate backed rights and capital market instruments and engage in other activities that are allowed in the Capital Markets Board (CMB) regulations, within the framework of principles and procedures set forth in Capital Markets Board regulations on real estate investment trusts. The Company's operating principles, portfolio investment policies and management restrictions are based on compliance with CMB regulations and relevant legislation.

Following our comparative analysis of the sector and examination of financial/operational risks carried by the Company, as well as its domestic market position, IS GYO received a (National) rating of AA.

Previous rating	Long-term	(TR) AA
	Short-term	(TR) A1+

Outlook

47% of the Company's real estate portfolio is composed of office buildings, 18% of shopping centers, 30% of projects, 4% is land and 1% is hotel. 47% of IS GYO's 2016 revenue is rental income (including right of construction). The majority of the total rental income is from Tuzla Technology and Operation Center, IS Towers and Kanyon shopping mall. Currency distribution of the rental income calculated on the basis of lease agreements for 2016 is as 21% in US Dollars, 4% in Euros and 75% in Turkish Liras. Buying order advances account for 34% of total foreign liabilities. The high level of advances seen on the balance sheet is the key indicator of confidence in the Company. Since these advances correspond to the sale price of the houses which will be built, advance sales of planned units can be achieved without generating cash outflow. Thus, resource costs are managed effectively by low-cost funding.

The course of the exchange rates and interest rates determine the performance of the real estate sector, in which the Company operates. Turkey's young population's demographic structure and investment and residential preferences for real estate investments, plus the demand for additional housing created by the immigration from neighboring countries lead to a demand-oriented potential in the construction sector. Real estate is expected to be the leading sector contributing to economic growth also in the coming period. Nevertheless, increase on construction costs due to the depreciation of the TL against exchange rates may affect the performance of the sector.

Considering these factors, the Company’s outlook is considered to be Stable.

Economic Outlook

The global growth forecast for 2017 is revised as 3.5% from 3.3% in the June 2017 interim global economic outlook report released by the Organization for Economic Co-operation and Development (OECD). The reason for the foreseeable improvement is the increase in confidence in the markets, visible signs of recovery from low levels in trade and investment, as well as the global growth effects of economic recovery in commodity producers. The same report also points to an increase in demand for high-tech products and an increase in capital renewal investments, as well as upward risks. It is stated in the report that despite the relative increase in employment, the labor market has not yet recovered and the pressure on wages is ongoing. Attention is drawn to the risks arising from the high and growing credit volume, the rising housing prices and the high interest rate ranges.

The International Monetary Fund (IMF) kept the global growth forecast for 2017 at 3.5% in the July 2017 Global Economic Outlook Report. None the less, despite a cautious optimism, the report refers also to fundamental uncertainties and the global risks that persist. A main uncertainty is the Trump administration's increasing protectionism that will affect the trade relations not only with China but also the global trade regime, including the European Union. Moreover, in addition to the uncertainty in the Brexit process, the upcoming elections in Germany and the Netherlands, continuation of the Greek debt crisis and the fact that the banking sector maintains its fragility as seen in the case of Italy are indicating that downside risks are still retained.

According to the statement released by the TSI (Turkish Statistical Institute), the Turkish economy, grew by 5% in the first quarter of 2017. Government incentives proposed in the first quarter to provide economic support, in other words, effective use of fiscal policies to prevent economic stagnation, has been determining in accelerating growth. Zeroing of the Special Consumption Tax (SCT) on white goods and the VAT cut in furniture have encouraged household consumption and hence growth in the first quarter. In addition, the start of loan disbursement within the scope of the Credit Guarantee Fund (CGF) also contributed significantly to the upsurge in growth. The constitutional amendment, which took place after the referendum in April 2017, radical and massive legal amendments on the agenda, despite the partial elimination of domestic political uncertainties and the presidential election set for 2019, are showing that the uncertainty factor will be effective for a while. In addition to the above, the possible effects of our neighbors Syria and Iraq-based regional developments on Turkey, along with the Increased tension between the Gulf states and Qatar and Iran on the one hand, and the cooling relations with the EU on the other point to increasing risks for Turkey.

In spite of these risks, the World Bank's June 2017 European and Central Asia regional report highlighted that Turkey recovered from shocks experienced in 2016 faster than expected and growth forecasts for 2017, 2018 and 2019 were revised upwards by 3.5%, 3.9% and 4.1% respectively. Inflation started to shadow forth more and more in 2017; as of July, the annual increase in CPI was 9.79%, the weighted average annual increase was 9.44%, while the year-on-month PPI increase was 15.45% and the weighted average increase was 10.94%. On the other hand, it is also observed that the jump in credit-deposit ratios to 143 percent levels resulted with banks increasing their annual interest payments on TL-denominated deposit accounts up to 15 percent in order to meet their cash needs. In addition, activation of the CGF as a growth-oriented stimulant in a country with ongoing need for foreign financing due to current account deficit is argued to cause funding costs to move upwards.

Company Overview

İş Bank owned İş Gayrimenkul Yatırım Ortaklığı was originally founded on August 6, 1999 as a result of the merger of two real companies: İş Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş. and Merkez Gayrimenkul Yatırım ve Proje Değerlendirme A.Ş. The Company has completed its initial public offering in the same year and began trading on BIST.

The Company shares are traded under “ISGYO” code at BIST Outright Purchases and Sales Market (Among Qualified Investors) - Collective and Structured Products Market and IS GYO is a constituent of BIST 100 (XU100), BIST All Shares (XUTUM), BIST 100-30 (XYUZO), BIST Real Estate Investment Trusts (XGMYO), BIST Dividend 25 (XTM25), BIST Dividend (XTMTU), BIST Financials (XUMAL), BIST Corporate Governance (XKURY) and BIST Sustainability (XUSRD) indices.

As of December 31, 2016, the Company represents approximately 5.4% of the real estate investment trusts with a market value of TL 1,326 million. Approximately 46% of the Company's portfolio investments are based on offices, 17% are shopping centers & hypermarkets, 4% are land, 30% are projects and 3% are money and capital markets instruments.

IS GYO’s capital structure as of the date of our report is as follows:

Capital Structure		
Shareholder	**Share (TL)**	**Stake Held (%)**
Türkiye İş Bankası A.Ş.	403,081,659.20	44.11
Anadolu Hayat Emeklilik A.Ş.	64,952,937.61	7.11
Other	445,715,403.19	48.78
Total	**913,750,000.00**	**100.00**

The division of tasks in the IS GYO Board is as follows:

ISGYO Board of Directors	
Name	**Duty**
ÖMER KARAKUŞ	Chairman
SÜLEYMAN H. ÖZCAN	Vice-chairman
AYSEL TACER	Member
D. SEVDİL YILDIRIM	Independent Member
HALUK BÜYÜKBAŞ	Independent Member
NİHAT UZUNOĞLU	Independent Member
METE ULUYURT	Member
MURAT DOĞAN	Member
SAKİNE İLGEN DOKUYUCU	Member

The Company decided to start the merger talks with TSKB REIC. However, at the meeting of Board of Directors dated July 18, 2017, it was decided to;

- Cancel the merger transaction with TSKB REIC by taking over all assets and liabilities of TSKB REIC, because of effective and technical reasons arising from the fact that the merger could not be completed in the period of time determined in the regulation in case of taking as basis the financials and their footnotes dated December 31, 2016.
- Terminate the Merger Agreement signed with TSKB REIC.
- Withdraw the application made to CMB regarding the merger.

Consolidated Balance Sheet and Income Statement of IS GYO (TL)

Key Balance Sheet and Income Statement Items (TL '000')	2016	2015
Current Assets	322,950	459,875
Cash and Cash Equivalents	127,262	123,908
Trade Receivables	28,770	21,821
Fixed Assets	4,564,070	3,665,325
Investment Property	3,714,669	3,291,629
Total Assets	4,887,020	4,125,201
Short Term Liabilities	188,453	556,007
Long Term Liabilities	1,537,221	778,558
Equity	3,161,346	2,790,635
Total Liabilities	4,887,020	4,125,201
Total Financial Liabilities	1,054,661	710,590
Income	404,533	222,012
Gross Profit	194,804	159,921
General Administrative and Marketing & Sales Distribution Expenses (-)	-37,119	-36,497
Net Income-Loss from Other Operations	336,772	468,787
Operating Profit	494,457	592,210
Net Profit for the Year	420,511	555,933

Ratio Analysis

Key Financial Ratios	2016	2015
Return on Equity (Pre-tax Profit / Shareholders' Equity)	0.13	0.20
Net Profit / Total Assets	0.09	0.13
Asset Profitability (EBIT / Total Assets)	0.10	0.14
Ekonomic Profitability (EBIT / Total Liabilities)	0.29	0.44
Net Profit / Net Revenue	1.04	2.50
Liquid Assets / Total Liabilities	0.07	0.09
Cash Ratio (Liquid Assets / STL)	0.68	0.22
Short Term Receivables / Total Assets	0.01	0.01
Interest Coverage (EBIT / Net Financial Gain - Loss)	6.63	16.33
Receivables Turnover Rate (Net Revenue / Trade Receivables)	14.06	10.17
Net Foreign Currency Position / Total Assets	-0.04	-0.08
Net Foreign Currency Position / Equity	-0.07	-0.11
Financial Leverage (Shareholders' Equity / Total Debt)	1.83	2.09
Short Term Liabilities / Total Liabilities	0.04	0.13
Fixed Assets / Total Debt	2.64	2.75
Total Financial Debt / Total Assets	0.22	0.17
Tangible Fixed Assets + Investment Properties / Total Assets	0.77	0.80

2016 sales revenues increased by 82% compared to 2015 thanks to the Ege Perla project deliveries and Sirkeci Building sale. The net profit of the Company decreased by 24.4% in 2016 compared to the previous year and was realized as TL 420.5 million. Gross profit increased by 21.8% to TL 194.8 million. In 2016, the rental income of the Company increased by 41.3% compared to the previous year and this increase was largely due to the increase in rents obtained from the Tuzla Technology and Operation Center. On the other hand, the departure of the company Şişecam from Tower 3 in September caused Tower revenues in Istanbul to decline. As a result of the Company's management creating an appropriate liquidity risk management for short, medium and long term funding and liquidity requirements, 13% of total financial liabilities are shorter than 1 year. The Company has a foreign exchange position corresponding to TL 212 million (USD 48.9 million + EUR 10.8 million). The Company's net debt is TL 927 million, up 58% from TL 586 million at the end of 2015. We think the debt is manageable with the Company's cash generating capacity and foreign exchange based income from certain assets.

Corporate Governance

The Company has provided substantial compliance with the Capital Markets Board's (CMB) Corporate Governance Principles and has implemented all of the necessary policies and measures. Management and internal control mechanisms have been created effectively and are in operation. All of the corporate governance risks are identified and managed actively. The rights of shareholders and stakeholders are respected in a fair manner and public disclosure and transparency is at superior levels. Structure and operation of the board of directors is in the category of best practice. There are almost no weaknesses in these areas.

Methodology

SAHA's credit rating methodology is composed of quantitative and qualitative sections to affect the final note with specific weights. Quantitative analysis components consist of company's performance compared to the sector, analysis of the financial risks, and the assessment of cash flow projections. Comparative performance analysis of the sector determines the position of the company concerned in comparison with the sector firms' recent financial performances. Financial risk analysis covers the evaluation of the company's financial ratios on the basis of objective criteria. Liquidity, leverage, asset quality, profitability, volatility and concentration are treated as sub-headings in this analysis. Finally, scenario analysis tackles the company's future base and stress scenario projections subject to scrutiny in the context of the firm's financing tool and assesses the risks of fulfillment of obligations.

Qualitative analysis covers operational issues such as sector and company risks as well as administrative risks in the context of corporate governance practices. Sector analysis evaluates the nature and rate of growth of the sector, its competitive structure, structural analysis of customers and creditors, and sensitivity of the sector to risks at home and abroad. Company analysis discusses market share and efficiency, growth trend, cost structure, service quality, organizational stability, access to domestic and foreign funding sources, off-balance sheet liabilities, accounting practices, and parent / subsidiary company relationships.

Corporate governance plays an important role in our methodology. The importance of corporate governance and transparency outshines once again in the current global financial crisis we witness. Our methodology consist of four main sections; shareholders, public disclosure and transparency, stakeholders, and board of directors. The corporate governance methodology of SAHA can be accessed at www,saharating,com.

Rating Definitions

Our long term credit rating results start from AAA showing the highest quality and continue all the way to the lowest rating of D (default). Plus (+) and minus (-) signs are used to make a more detailed distinction between the categories of AA and CCC.

Companies and securities rated with long-term AAA, AA, A, BBB and short-term A1 +, A1, A2, A3 categories should be considered “investment worthy” by the market.

Short Term	Long Term	Rating Definitions
(TR) A1+	(TR) AAA (TR) AA+ (TR) AA (TR) AA-	The highest credit quality. Ability to meet financial obligations is extremely high. If securities; carries a little more risk than the risk-free government bonds.
(TR) A1	(TR) A+ (TR) A	Credit quality is very high. Very high ability to fulfill financial obligations. Sudden changes at the company and economic and financial conditions may increase investment risk, but not at a significant level.
(TR) A2	(TR) A- (TR) BBB+	High ability to fulfill financial obligations, but may be affected by adverse economic conditions and changes.
(TR) A3	(TR) BBB (TR) BBB-	Sufficient financial ability to fulfill its obligations, but carries more risk in adverse economic conditions and changes. If securities; has adequate protection parameters, but issuer’s capacity to fulfill its obligations may weaken due to adverse economic conditions and changes.

Companies and securities rated with long-term BB, B, CCC, and short-term B, C categories should be considered “speculative” by the market.

(TR) B	(TR) BB+ (TR) BB (TR) BB-	Carries minimum level of speculative features. Not in danger in the short term, but face to face with negative financial and economic conditions. If securities; under the investment level, but on-time payment exist, or under less danger than other speculative securities. However, if the issuer’s capacity to fulfill its obligations weakens, serious uncertainties may appear.
(TR) C	(TR) B+ (TR) B (TR) B-	Currently has the capacity to fulfill financial obligations, but highly sensitive to adverse economic and financial conditions. If securities; there is a risk of on-time payment. Financial protection factors can show high fluctuations according to the status of the economy, the sector, and the issuer.
(TR) C	(TR) CCC+ (TR) CCC (TR) CCC-	Well below the category of investment. In danger, and economic, sectoral and financial conditions should have a positive development to fulfill its financial obligations. If securities; there are serious uncertainties about the timely payment of principal and interest.
(TR) D	(TR) D	Event of default. Company cannot meet its financial obligations or cannot pay the principal and/or interest of the relevant securities.

Disclaimer

This Credit Rating Report has been prepared by Saha Kurumsal Yönetim ve Kredi Derecelendirme A.Ş. (SAHA Corporate Governance and Credit Rating Services, Inc.) in collaboration with IS GYO A.Ş. and is based on information disclosed to public by IS GYO A.Ş.

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