

Major risk factors and internal control and risk management systems

In 2015, the board of directors of Vastned Retail Belgium once again focused attention on the risk factors with which Vastned Retail Belgium must contend.

The constant evolutions in the real estate and financial markets require a continuous monitoring of the strategic, operational and financial risks, as well as of the financial reporting and compliance risks in order to safeguard the results and the financial situation of Vastned Retail Belgium.

Strategic risks and management

These risks are largely determined by the strategic choices made by Vastned Retail Belgium to limit its vulnerability to external factors. The size of these risks is determined by the strategic choices such as the choice of type of real estate and the time of investment and divestment.

Type of real estate

Vastned Retail Belgium has mainly chosen to invest in retail properties, with a focus on premium city high streets shops (prime retail properties located on the best shopping streets in the major cities of Antwerp, Brussels, Ghent and Bruges) and high street shops (city centre shops on top locations). Non-high street shops (high-end retail parks and retail warehouses on top locations) also belong to the portfolio. Furthermore, the company tries to spread as well as possible the geographic locations of its properties.

The real estate patrimony of Vastned Retail Belgium is valued on a quarterly basis by independent property experts. These property experts have the necessary qualifications and significant market experience. The fair value of the buildings, as estimated by them, is entered under the section "Investment properties" in the assets side of the statutory and consolidated balance sheet. Fluctuations in fair values are entered under the section "Changes in fair value of investment properties" in the consolidated and statutory income statements and these can have either a positive or negative effect on the net result. The values

established by the experts represent the market value of the buildings. Consequently, fluctuations in the market value of the property are reflected in the net assets of Vastned Retail Belgium, as published on a quarterly basis. Vastned Retail Belgium is exposed to the fluctuation in fair value of its portfolio, as estimated by the independent assessments.

As at 31 December 2015, a 1% hypothetical negative adjustment of the yield used by property experts for the valuation of the real estate portfolio of the company (yield or capitalisation rate) would reduce the investment value of the real estate by € 59 million or 17%. As a result, the debt ratio of the company would increase by 6% to 34% (in this regard, also see the "Sensitivity analysis" in the Property report).

Time of investment and divestment

Based on the knowledge of economic and real estate cycles, one tries to anticipate as accurately as possible the downward and upward movements of the markets. The normally expected course of the economic cycles can be assessed to the best of one's ability based on economic indicators. The investment market and particularly, the rental market for commercial real estate respond with a certain amount of delay to the volatility of the economic climate. Clear periods of economic boom lead to higher market prices which may, at a later date, be subject to sharp negative adjustments. During this period of economic boom, Vastned Retail Belgium will pursue a fairly moderate policy on investments

so as to reduce the risk of making ill-timed investments. In periods of economic recession, the value and occupancy rate of buildings usually decline. However, once the economy picks up again, a more active investment policy is followed in anticipation of the increasing value of buildings and a more active rental market. In this regard, due care is taken to prevent the debt ratio of the company from rising above the permitted levels.

Operating risks and management

These risks arise out of daily transactions and (external) events executed within the strategic framework such as investment risks, rental risks, cost control risks, risks relating to a deteriorating condition of buildings and the risk of major works, debtor's risks and legal and tax risks.

Investment risks

The main risks inherent in investing in real estate are related to future negative changes in fair value of investment properties caused primarily by increasing vacancy, unpaid rents, decline in rents when concluding new lease agreements or extending existing lease agreements, and soil contamination.

At Vastned Retail Belgium, internal control measures are taken to reduce the risk of making incorrect investment decisions. For example, the risk profile is always carefully assessed based on market research, an estimate of future yields, a screening of existing tenants, a study of environmental and permit requirements, an analysis of tax risks, etc.

Pursuant to article 49, §1 of the Act of 12 May 2014 on regulated real estate companies an independent property expert values each acquisition or divestment of property. For each divestment, the assessment value determined by the independent property expert is an important guiding principle for the transaction value.

Vastned Retail Belgium also carefully ensures that the eventual guarantees offered during the transaction remain limited, in terms of both duration and value.

For each acquisition, Vastned Retail Belgium also carries out a technical, commercial, administrative, legal, accounting and tax "due diligence" based on continuous analysis procedures and usually with the assistance of external, specialised consultants.

Rental risks

These risks are related to the nature and location of the real estate property, the extent to which it must compete with nearby buildings, the intended target audience and users, the quality of the real estate property, the quality of the tenant and the lease agreement. Vastned Retail Belgium continuously records the development of these factors. Based on the above criteria, a risk profile is allocated to each property, which is regularly evaluated (based on the company's own local knowledge and data from external parties and/or valuers). Depending on the risk profile, a certain yield must be realised over a certain period, which is compared to the expected yield according to the internal yield model. On the basis of this, an analysis is drawn up of the objects in which additional investments should be made, where the tenant mix must be adapted and which properties are eligible for sale. Vacancy and the vacancy risk are also analysed each month, for which the expiry dates of the lease agreements are taken into account. The company strives to maintain a balanced distribution of the duration of the lease agreements in compliance with rules defined in the applicable leasing legislation. This allows future lease terminations and agreement revisions to be anticipated in good time.

As at 31 December 2015, the share of the buildings let to H&M (Hennes & Mauritz) amounted to 21,5% of the consolidated assets of Vastned Retail Belgium. The FSMA granted Vastned Retail Belgium a derogation from the limitation to 20% in accordance with article 30 §3 and §4 of the RREC Act. This article prohibits RRECs from investing more than 20% of their assets in one single property entity.

In the light of this granted derogation, the debt ratio may not amount to more than 33%, in accordance with the provisions of article 30 §4 of the RREC Act. The debt ratio of Vastned Retail Belgium amounted to 28% as at 31 December 2015. The aforementioned derogation was obtained for 2 years, until October 2017.

Cost control risks

There is a risk of the net yield on real estate properties being negatively influenced by high operating costs or investments. Within Vastned Retail Belgium, several internal control measures are implemented that reduce this risk, including regular comparison of maintenance budgets with the actual reality and approval procedures at the time of entering into maintenance and investment commitments. These approval procedures entail, depending on the amount, one or more offers being requested from various contractors. During this process, the asset management department of Vastned Retail Belgium makes a comparison of price, quality and timing of the works. Depending on the size of the amount quoted for the works to be carried out, there are various levels of approval within the company.

Debtor's risks

Vastned Retail Belgium follows clear procedures for screening tenants when new lease agreements are concluded. Deposits or bank guarantees are also always required when entering into lease agreements. A rental deposit or bank guarantee of six months' rent is provided for in the standard lease agreement used by Vastned Retail Belgium for the rental of its properties. As at 31 December 2015, the actual weighted average duration of the rental deposits and bank guarantees was approximately 5 months (or about € 8 million).

In addition, there are internal control procedures in place to ensure timely recovery of lease receivables and adequate follow-up of rent arrears. Rents are payable in advance on a monthly or quarterly basis. The financial and asset management pays close attention to limiting rent arrears. As at 31 December 2015, the number of days of outstanding customers' credit was only 3 days.

Legal and tax risks

- **Contracts and corporate reorganisations**

Before concluding contracts with third parties and depending on their complexity, these are reviewed by external consultants, to reduce the risk of financial loss and damage being caused to the company's reputation due to inadequate contracts. Vastned Retail Belgium is insured against liability arising from its activities or its investments under a third party liability insurance

policy covering bodily injury up to an amount of € 12,4 million and material damage (other than that caused by fire and explosion) of up to € 0,6 million. Furthermore, the directors and members of the management committee are insured for directors' liability, covering losses up to an amount of € 35 million.

Corporate reorganisations, in which Vastned Retail Belgium is involved (merger, demerger, partial demerger, contribution in kind, etc.), are always subject to "due diligence" activities, guided by external consultants to minimise the risk of legal and financial errors.

- **Insurance**

The risk that buildings are destroyed by fire, storm, water damage and consequential damage arising from the same is insured by Vastned Retail Belgium for a total reconstruction value of € 120 million (€ 63 million premium city high street shops, € 23 million high street shops and € 34 million non-high street shops) compared to a fair value of € 347 million as at 31 December 2015 (€ 199 million premium city high street shops, € 60 million high street shops and € 88 million non-high street shops). Cover amounting to 36 months of rent is also provided for vacancies in the buildings due to these events.

- **Taxation**

Taxation plays an important role in the area of real estate investments (VAT, registration fees, exit tax, split acquisitions, property tax, etc.). These tax risks are continuously assessed and where necessary, the assistance of external consultants is used.

- **Risk relating to regulatory and administrative procedures**

The changes in regulations on urban planning and environmental protection can have an adverse effect on the long-term operation of a building by Vastned Retail Belgium. The strict enforcement and observance of urban planning regulations by municipal governments can negatively influence the attractiveness of the building. For example, a reduction in the dimensions of a building imposed as part of thorough renovation can also affect its fair value.

The exit tax, which is due by companies acquired by the RREC via merger, is calculated while taking Circular Letter Ci.RH.423/567.729 of

23 December 2004 into account. The way in which this circular letter is interpreted or applied in practice can always vary. This "actual tax value", as the circular letter refers to it, is calculated by deducting registration fees or VAT, and differs from the fair value of the property as recorded on the company's balance sheet in accordance with IAS 40.

Finally, the introduction of new or more stringent standards for soil contamination or energy consumption can have a major impact on the costs required to continue operating the property.



▲ Antwerp, Schuttershofstraat 30b / Armediuivelstraat 2

Financial risks and management

The major financial risks are the financing risk, the liquidity risk and the interest-rate risk and the risks associated with banking counterparties.

Financing risk

The real estate portfolio can be financed partly with shareholders' equity and partly with borrowed capital. A relative increase in borrowed capital with respect to shareholders' equity can result in a higher yield (known as "leverage"), but can also imply an increased risk. In case of disappointing yields from real estate and a decrease in fair value of investment properties, a high degree of leverage can give rise to the risk of no longer being able to meet interest rate and repayment obligations of borrowed capital and other payment obligations. In such a case, it is not possible to obtain financing with new borrowed capital or this can only be obtained under very unfavourable terms. To continue meeting payment obligations, real estate must then be sold, which entails the risk that this sale cannot be carried out under the most favourable conditions. The value development of the retail portfolio is largely determined by developments in the real estate market. For financing real estate, Vastned Retail Belgium always strives for a balance between shareholders' equity and borrowed capital.

Vastned Retail Belgium also strives to secure access to the capital market by providing transparent information and maintaining regular contacts with bankers and current or potential shareholders and by increasing the liquidity of the share.

Finally, with respect to long-term financing, it aims for a balanced spread of refinancing dates and a weighted average duration between 3,5 and 5 years. This may be temporarily derogated from if specific market conditions require this. The average remaining duration of the long-term credit agreements as at 31 December 2015 was 3,2 years.

The bank credit agreements of Vastned Retail Belgium are subject to compliance with financial ratios, which are primarily related to the consolidated financial debt level of Vastned Retail Belgium or its financial interest charges. These ratios limit the amount that could still be borrowed by Vastned Retail Belgium. These ratios were respected as at 31 December 2015. If Vastned Retail Belgium were no longer to respect these ratios, the financing agreements of Vastned Retail Belgium can be cancelled, renegotiated, terminated or prematurely repaid.

Vastned Retail Belgium is limited in its borrowing capacity by the maximum debt ratio permitted by the regulations on regulated real estate companies. Within the legally defined limits of the 65% ratio, the theoretical additional debt capacity of Vastned Retail Belgium amounted to approximately € 365 million in case of an unchanged valuation of the existing real estate portfolio. As at 31 December 2015 the debt ratio amounted to 28%.

Liquidity risk

Vastned Retail Belgium must generate sufficient cash flow to meet its day-to-day payment obligations. On the one hand, this risk is limited by the measures mentioned under operational risks, which reduces the risk of loss of cash flow due to e.g. vacancy or bankruptcies of tenants. On the other hand Vastned Retail Belgium has to dispose of sufficient credit margin to absorb fluctuations in liquidity needs. For this purpose cash flow prognoses are made. In addition, Vastned Retail Belgium has provided for a sufficient credit margin with its bankers to absorb fluctuations in liquidity requirements. In order to avail itself of this credit margin, the covenants of credit facilities must be complied with on a continuous basis.

As at 31 December 2015, Vastned Retail Belgium had non-withdrawn credit lines of € 42 million available for its operations and dividend payment.

Interest rate risk

As a result of financing with borrowed capital, the yield is also dependent on interest rate developments. In order to reduce this risk, when composing the loan portfolio, the company aims for a ratio of one-third short-term borrowed capital (with a variable interest rate) and two-thirds long-term borrowed capital (with a fixed interest rate). Depending on the developments in interest rates, derogation from this may occur. Additionally, the company tries, with respect to the long-term borrowed capital, to achieve a balanced spread of the dates of review of the interest rates and duration of minimum 3 years.

As at 31 December 2015, 94% of the credit lines of the company were financing with a fixed interest rate or are fixed by interest rate swaps. 6% of the credit facilities had a variable interest rate. The fixed interest rates are fixed for a remaining average duration of 3,3 years.

Risk associated with banking counterparties

The conclusion of a financing contract or investment in a hedging instrument with a financial institution gives rise to a counterparty risk if this institution remains in default. In order to limit this counterparty risk, Vastned Retail Belgium takes the assistance of various reference banks in the market to ensure a certain diversification of its sources of financing and its interest rate hedges, with particular attention for the price-quality ratio of the services provided.

Vastned Retail Belgium maintains business relations with 5 banks:

- banks providing financing are: ING Belgium nv, BNP Paribas Fortis nv, Bayerische Landesbank, Belfius Bank nv and KBC Bank nv
- banks which are counterparties for the interest rate hedges are: BNP Paribas Fortis nv, ING Belgium nv and KBC Bank nv.

Vastned Retail Belgium regularly reviews the list of its banking relationships and the extent of its exposure to each of these. In the current economic climate, it is possible that one or more of the banking counterparties of Vastned Retail Belgium can remain in default. The financial model of Vastned Retail Belgium is based on a structural debt burden, which implies that its cash position at a financial institution is usually quite limited. As at 31 December 2015, this cash position amounted to € 0,3 million.

Financial reporting risks and management

The financial reporting risk is the risk that the company's financial reports contain material inaccuracies, in which case stakeholders would receive incorrect information regarding the operational and financial results of the company, as well as the risk that the deadline imposed by the regulations for financial reporting is not honoured. This can result in damage to the company's reputation, and stakeholders could make investment decisions which are not based on the right information, which in turn could result in claims being filed against the company.

Each quarter, a complete closing and consolidation of the accounts is prepared and published. To optimise the financial reporting process, the finance department always draws up a schedule with deadlines for all the tasks to be completed. Subsequently, the financial team prepares the quarterly figures and balance sheets quarterly figures are always analysed in detail and checked internally.

To reduce the risk of errors in the financial reporting, these figures are discussed within the management committee and their accuracy and completeness checked via analyses of rental income, operational costs, vacancy, rental activities, the evolution of the value of the buildings, outstanding debtors, etc. Comparisons with forecasts and budgets are discussed. After this, the management committee presents the financial statements to the audit committee each quarter, along with a comparison of annual figures, budget, and explanations for derogations. In addition, the half-yearly and annual figures are always checked by the statutory auditor.

Compliance risks and management

This includes the risk of an inadequate level of compliance with relevant laws and regulations and the risk of employees not acting with integrity. Vastned Retail Belgium limits this risk by screening its employees at the time of recruitment, by creating awareness among them regarding this risk and by ensuring that they have sufficient knowledge of the changes in the relevant laws and regulations, assisted in this regard by external legal advisers. To ensure a corporate culture of integrity, Vastned Retail Belgium has in the past defined an internal code of conduct and whistleblowing rules. Moreover, the company has instituted adequate internal control mechanisms based on the four-eyes principle. These mechanisms are designed to limit the risk of dishonest behaviour.

Article 17, §4 of the RREC Act stipulates that the public RREC *“must take the necessary measures to be able at all times to access an appropriate independent compliance function so as to ensure compliance by the public RREC, its directors, effective leader, employees and agents with the laws relating to the integrity of the business of a public RREC”*. Article 6 of the Royal Decree on RREC stipulates that the public RREC *“must take the necessary measures to be able*

to permanently access an appropriate independent compliance function. The compliance function is appropriate when it ensures with reasonable certainty compliance by the public RREC, its directors, effective leader, employees and agents with the laws relating to the integrity of the business of a public RREC”.

The “independent compliance function” can be understood as an independent function within the company focused on examining and promoting compliance by the company with the rules relating to the integrity of its business activities. The rules concern those resulting from the company’s policy, the status of the company and other legal and regulatory provisions. In other words, this concerns an element of corporate culture, with an emphasis on honesty and integrity and adherence to high ethical standards in business. In addition, both the company and its employees must behave with integrity, i.e. honestly, reliably and in a trustworthy manner.

Inge Tas, member of the management committee and cfo, is appointed head of the independent compliance function.



▲ Ghent, Volderstraat 15

Risks associated with the status of public regulated real estate company

Since 27 October 2014, the company has the status of public regulated real estate company. As a public regulated real estate company, Vastned Retail Belgium is governed by the provisions of the Act of 12 May 2014 on regulated real estate companies and the Royal Decree of 13 July 2014 on regulated real estate companies.

As a public RREC Vastned Retail Belgium is exposed to the risk of future changes in the law governing RREC. In addition, there is also the risk of losing the status of public RREC. In that case, Vastned Retail Belgium would lose the advantage of the favourable tax system⁴ applicable to RRECs.

Furthermore, the loss of this status would generally be seen as an event whereby the loans that Vastned Retail Belgium has taken out become due immediately.

Retaining the status of public RREC has the constant attention of the board of directors and the management committee. As such, the distribution requirement and funding limits are calculated or determined periodically and on an ad-hoc basis when refinancing, investing and preparing the dividend proposal.

4 Results (rental income and capital gains from sales less operating expenses and financial charges) are exempt from corporation tax as far as the public RREC is concerned; only disallowed expenses and abnormal benefits are taxed. It can also be subjected to the special secret commissions tax on commissions and remunerations paid that are not properly documented in individual pay sheets and a summary statement.