S&P Global Ratings

RatingsDirect®

Research Update:

Starhill Global REIT Outlook Revised To Negative On Likely Weaker Leverage; 'BBB+' Rating Affirmed

Primary Credit Analyst:
Yijing Ng, Singapore (65) 6216-1170; yijing.ng@spglobal.com

Secondary Contact:
Kah Ling Chan, Singapore (65) 6239-6336; kahling.chan@spglobal.com

Table Of Contents

Research Update:

Starhill Global REIT Outlook Revised To Negative On Likely Weaker Leverage; 'BBB+' Rating Affirmed

Rating Action Overview

- On March 19, 2019, S&P Global Ratings revised the rating outlook on Singapore-based Starhill Global Real Estate Investment Trust (SGREIT) to negative from stable. We also affirmed the 'BBB+' issuer credit rating on the trust and the 'BBB+' issue rating on its guaranteed senior unsecured notes.
- We expect SGREIT's leverage ratio to deteriorate to below our downgrade trigger because of an asset-enhancement initiative (AEI) concerning its Starhill Gallery in Malaysia.
- Material delays or cost overruns, or underperformance at SGREIT's other assets that result in a drop in net property income, could also lead credit metrics to remain sub-par.
- We affirmed the rating because we anticipate secured occupancy and higher rents on lease renewal following the AEI's completion in 2021, leading the leverage ratios to recover by 2023.

Rating Action Rationale

We revised the outlook in view of the AEI and to reflect the possibility that we could lower the rating by one notch over the next 18 to 24 months if: (1) the performance of SGREIT's other assets are weaker than our current expectations; or (2) material delays or cost overruns in the AEI result in a key measure of leverage remaining less than 9%, a level that could trigger a downgrade.

We affirmed the rating because we anticipate that SGREIT's ratio of funds from operations (FFO) to debt will recover after the AEI on Starhill Gallery is substantially completed in June 2021. This reflects the secured occupancy and higher rents on lease renewal, which we believe will lead the ratio to rise above 9% in fiscal 2023.

We anticipate that SGREIT's ratio of FFO to debt will fall to the low end of the 8% range over the next few years. This leverage measure is weaker than our previous estimate of 9.2%-9.6% for fiscal 2020. The rental rebates given to the Starhill Gallery tenant during the two-year AEI period will be a drag on the FFO. The higher borrowings and associated interest costs to fund the AEI also weigh on our revised FFO-to-debt projections.

Mitigating factors that should offset the deteriorating credit metrics include certainty over occupancy after the AEI. Starhill Gallery is on a master lease with Katagreen Development Sdn. Bhd. Katagreen is an indirect wholly owned subsidiary of YTL Corp. Bhd., the sponsor of SGREIT. The master lease expires in June 2019. The lease renewal has been secured with Katagreen for 19.5 years with a "positive rental reversion" (or higher rents) in fiscal 2023 after the AEI. The renewed lease has a rental step-up every three years. SGREIT's other Malaysia asset Lot 10 has also had its master lease with Katagreen secured for nine years (assuming the option to renew is exercised after six years), with positive rental reversion and rental step-ups every three years.

Over the longer term, the AEI should enhance SGREIT's asset quality and contribute more resilient recurring income. Over the AEI period, we expect positive rental reversions in SGREIT's Singapore retail assets to temper the effect of rental rebates.

We estimate that the ratio of FFO to debt will progressively improve to the high end of the 8% category in fiscal 2022, and stay above 9% thereafter. Even at the weakest point, the ratio should stay above 8%. These factors support our positive comparative rating adjustment to the rating.

The AEI on Starhill Gallery seeks to capitalize on the expected increase footfall with the new MRT (or subway) station at Bukit Bintang area. SGREIT estimates the AEI will cost Singapore dollar (S$) 58.1 million (about US$43 million) and last for two years from July 2019 to June 2021. The trust expects to fully fund the AEI by borrowings.

Outlook

The negative outlook on SGREIT reflects our expectation that the trust's financial leverage will be stretched over the next 18 to 24 months, beyond the threshold for the 'BBB+' rating.

The negative outlook also reflects the possibility that we may downgrade SGREIT over the next 18 to 24 months if its business underperforms our expectations, and if the Starhill Gallery AEI does not provide the budgeted returns.

Downside scenario

If the ratio of FFO to debt looks likely to remain sub-par without management taking corrective action, we could lower the rating to 'BBB'. Indications would be if the FFO-to-debt ratio no longer looks likely to recover to 9% or if the debt-to-capital ratio exceeds and remains materially above 35%.

We could also lower the rating in the next 18 to 24 months if: (1) SGREIT is unable to replace the loss of a key tenant within a reasonable timeframe on favorable lease terms; or (2) the performance of the Singapore property market is markedly weaker than our expectations, resulting in increased volatility in profitability and cash flows.

Upside scenario

We could return the rating to a stable if SGREIT is likely to return its credit metrics to levels that are consistent with a 'BBB+' rating.

Company Description

SGREIT is Singapore-based REIT, with properties across Singapore, Malaysia, China, Australia, and Japan. Its portfolio comprises primarily retail properties, which contribute about 85%-90% to gross rental income. The remaining contribution comes from office buildings.

There are currently 10 assets in the trust's portfolio, valued at about S$3.1 billion as of June 30, 2018.

Our Base-Case Scenario

Our base-case scenario assumptions include:

- Singapore's economy will grow 2.5%-2.7% over the next two years. This translates into broadly stable operating conditions for Singapore REITs.
- Positive rental reversions for SGREIT's Singapore retail assets, with bottoming-out of the retail sector on the back of limited new supply.
- SGREIT's revenue to be flat in 2019 and thereafter decline 1.7% in 2020 due to the rental rebates during the AEI. Revenue to grow a marginal 0.9% in 2021 with positive rental reversion in Singapore and Australia assets.
- The REIT's portfolio occupancy is likely to be over 95% in fiscal 2020 and 2021.
- EBITDA margin to dip in fiscal 2020 and 2021 to 67%-68%, slightly slower than historical trends, due to rental rebates.
- SGREIT's capital expenditure to be S$10 million in 2019. Capital expenditure to be higher in 2020 and 2021 due to the AEI, at S$42 million and S$18 million, respectively.

Based on these assumptions, we arrive at the following credit measures:

- SGREIT's ratio of FFO to debt to be 9.0% in 2019, and 8.2%-8.3% in 2020 and 2021.
- Its ratio of debt to total assets to be 36%-37% in 2019, and 37%-38% in 2020 and 2021.

Liquidity

We assess SGREIT's liquidity as adequate because the REIT's sources of liquidity are more than 1.2x its liquidity uses over the 12 months ending Dec. 31, 2019. We expect sources of liquidity to exceed uses even if EBITDA decreases by 10%.

We believe SGREIT has sound banking relationships, with a diverse pool of lenders. It has satisfactory standing in the capital markets, as demonstrated by successful bond issuances under its medium-term notes (MTN) program.

Principal liquidity sources include:

- Cash and cash equivalents of S$62 million as of Dec. 31, 2018.
- Consolidated cash FFO of about S$100 million in the 12 months to Dec. 31, 2019.

Principal liquidity uses include:

- Capital expenditure of about S$21 million in the 12 months to Dec. 31, 2019.
- Cash dividends of about S$100 million during the same period.
- Debt maturities of S$7 million revolving credit facility.

Covenants

We believe SGREIT has adequate headroom in the financial covenants on its bank loans over the next 12 months. Major covenants include interest coverage of at least 1.5x and ratio of debt to assets of less than 45%.

Issue Rating--Subordination Risk Analysis

Capital structure

As of Dec. 31, 2018, SGREIT's capital structure consists of S$1.1 billion of debt, 28% out of which is secured debt. The REIT's funding is well diversified between bank facilities and MTN programs.

Analytical conclusions

We rate SGREIT's S$2 billion program 'BBB+', the same level as the issuer credit rating. We do not view SGREIT's capital structure as having any material structural or contractual subordination risks. As of Dec. 31, 2018, SGREIT's ratio of secured debt to total assets is 10%.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Negative/--

Business risk: Strong
- Country risk: Low
- Industry risk: Low
- Competitive position: Strong

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: bbb

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

Related Criteria

- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Starhill Global Real Estate Investment Trust		
Issuer Credit Rating	BBB+/Negative/--	BBB+/Stable/--
Starhill Global Reit MTN Pte Ltd.		
Senior Unsecured	BBB+	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.