Research Update:

Starhill Global REIT Downgraded To 'BBB' On Reduced Cash Flow Adequacy Ratios; Outlook Stable

August 29, 2019

Rating Action Overview

- Starhill Global Real Estate Investment Trust (SGREIT) is facing pressure in rent reversions in its key Singapore assets amid weakened economic conditions.
- We now expect SGREIT's ratio of funds from operations (FFO) to debt to decline to 7.6%-7.8% in fiscals 2020 and 2021, ending June 30, which breaches our 8% downward rating trigger.
- On Aug. 29, 2019, S&P Global Ratings lowered its long-term issuer credit rating on SGREIT to 'BBB' from 'BBB+'. The outlook is stable. At the same time, we lowered the issue rating on the company's guaranteed senior unsecured notes to 'BBB' from 'BBB+'.
- The stable outlook reflects our view that the REIT's cash flow adequacy ratios have stabilized at lower levels, given the good quality and location of its assets, and sound occupancy.

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Rating Action Rationale

We lowered the rating on SGREIT as weaker operating performance and rent reversions will keep the company's cash flow adequacy ratios below our downgrade trigger over the next 24 months.

We now project SGREIT's ratio of FFO to debt to be at 7.6%-7.8% through fiscal 2021, below our downgrade trigger of 8%. This is lower than the 8.2%-8.3% we previously projected. We anticipate EBITDA to average about Singapore dollar (S$) 133 million in fiscals 2020 and 2021, compared with close to S$140 million previously. FFO is likely to average S$91 million over the period, compared with about S$98 million previously.

Rental pressure will persist amid gloomier economic conditions. Particularly, SGREIT's key retail assets in Singapore's prime Orchard Road shopping belt cater to the higher-end market. These Singapore retail assets accounted for 50% of SGREIT's portfolio gross rent and 51% of net property income for fiscal 2019. We expect more downside pressure to discretionary spending in these urban malls given subdued consumer sentiment. This is likely to be unfavorable when rentals come up for renewal (referred to as rental reversions).

SGREIT's Ngee Ann City's master tenant's rent review in June 2019 resulted in rents remaining flat. This was below the low-to-mid single digit increase in rent that we had anticipated. That asset is important to SGREIT, given Toshin Development Singapore Pte. Ltd., the master lessee, accounted for 22.9% of SGREIT's portfolio gross rent as of June 30, 2019. The master lease has a three-yearly rental review, and achieved a positive 5.5% rental reversion (or higher rents) in the previous 2016 review. The flat rental reflects the weakened operating conditions, and resulted in a downward revision of our projected rents in the next three years.

Eroded consumer sentiment also led to lower rentals upon renewal elsewhere in the company's portfolio (such as at Wisma Atria) despite slightly improving occupancy rates. Finally, contributions from SGREIT's Australia assets were weighed down by the depreciation of the Australian dollar against the Singapore dollar.

We believe such economic challenges are enduring; Singapore's Ministry of Trade and Industry's GDP forecast is now at 0%-1%, much lower than our own forecast. Our economic team currently expects 2.3% GDP growth in 2019 and 2.4% in 2020, compared with 2.8% in 2019 and 2.7% in 2020 six months ago. Toshin's flat rental reversion will also limit rent reversion upside for other malls in the Orchard Road shopping belt, including Wisma Atria. This also contributed to the downward revision of our base case.

Rental rebates agreed by SGREIT to the master tenant during the asset enhancement initiative (AEI) at its Starhill Gallery mall in Malaysia will weigh down rental performance at these assets for the duration of the AEI. That initiative will take 24 months and we now expect it to be completed only in fiscal 2022 due to delays in approvals. We project net property income for SGREIT's two Malaysia assets to average S$18.7 million, compared with about S$27 million before the SGREIT announced the AEI, due to rental rebates.

Reduced EBITDA and FFO are taking place amid likely higher debt levels through fiscal 2021. We project SGREIT's total debt to reach close to S$1.2 billion by the end of fiscal 2021 as it expects to spend S$58 million on the Malaysian AEI. That compares with debt of about S$1.13 billion as of June 30, 2019.

SGREIT's FFO-to-debt ratio is unlikely to recover to close to 9%--levels we would consider commensurate with a higher rating--until 2023 at the earliest. We estimate that the company's FFO would need to reach about S$105 million (compared with our projection of about S$91 million in fiscal 2020) for this to happen. This will require the completion of Starhill Gallery AEI, which we now expect to be by September 2021. It will also require a much improved rental environment, which we see as unlikely over the next two years at least.

Outlook

The stable outlook reflects our view that the REIT's cash flow adequacy ratios will remain steady over the next 24 months, given the good quality and location of its assets and sound occupancy. The stable outlook also factors our expectation that SGREIT will not fund further material AEIs or acquisitions with debt.

Downside scenario

We may lower the rating if SGREIT's leverage weakens, such that the ratio of FFO to debt declines below 7.0% on a sustained basis.

This may happen if: (1) SGREIT is unable to replace the loss of a key tenant within a reasonable timeframe on favorable lease terms; (2) the performance of the Singapore property market is markedly weaker than our expectation, leading to a revenue and EBITDA decline exceeding 10% from our base case; or (3) SGREIT undertakes major debt-funded acquisitions and AEIs.

Upside scenario

While unlikely over the near term, we may raise the rating if SGREIT adopts more conservative financial policies that result in stronger credit metrics. An indication would be the ratio of FFO to debt improving above 9.0% on a sustained basis. We estimate this will require revenue and EBITDA growing in the high single digits, which we believe is unlikely in the current operating environment. We could also consider an upgrade if SGREIT substantially diversifies its portfolio and tenant base and significantly increases its scale.

Company Description

SGREIT is a Singapore-based REIT, with properties in Singapore, Malaysia, China, Australia, and Japan. Its portfolio comprises primarily retail properties, which contribute 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$3.06 billion as of June 30, 2019.

Our Base-Case Scenario

Our base-case scenario assumptions include:

- Singapore's GDP to average 2.3%-2.4% over the next two years. We expect the softening GDP growth since the beginning of 2019 to dampen consumer sentiment and discretionary spending. This is likely to limit upside potential in rental reversions of SGREIT's high-end retail assets in Singapore.
- Projected flat to marginally positive rental reversions for SGREIT's Singapore retail assets, amid economic headwinds. Limited new retail supply will help to prevent deterioration of rental rates.
- SGREIT's revenue to decline about 3% in fiscal 2020, mainly due to rental rebates during Starhill Gallery's AEI. Revenue to grow a marginal 1% in fiscal 2021 with slightly positive rental reversions in Singapore and Australian assets. This is to improve to 3%-4% in fiscal 2022 post-AEI.
- The REIT's portfolio occupancy to be above 95% in fiscals 2020 and 2021.
- Adjusted EBITDA margin to decline to 66%-67% in fiscals 2020 and 2021, mainly due to rental rebates for Starhill Gallery.
- Capital expenditure of S$37 million in fiscal 2020 and S$31 million in fiscal 2021. Of these amounts, about S$58 million will go toward the Starhill Gallery AEI.
- Cash distributions to unitholders to remain S$97 million-S$98 million annually for fiscals 2020 and 2021, despite weaker operating performance. Management fees will be partially paid in units, rather than cash, to mitigate disruptions from the Starhill Gallery AEI for the next two years.

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

- FFO-to-debt ratio of 7.8% in fiscal 2020, and 7.6%-7.7% in fiscal 2021.
- Debt-to-total-asset ratio of 37%-38% in fiscal 2020, and 38%-39% in fiscal 2021.

Liquidity

We assess SGREIT's liquidity as adequate because the REIT's sources of liquidity are about 1.8x its liquidity uses over the 12 months ending June 30, 2020. 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. The REIT has an extended record of refinancing maturing debt at favorable rates, given the quality of its mall portfolio. It also has a well-scattered debt maturity profile, giving it a good ability to absorb high impact, low probability events.

Principal liquidity sources include:

- Cash and cash equivalents of S$72.9 million as of June 30, 2019.
- Cash flow from operations of S$99 million-S$100 million in the 12 months to June 30, 2020.
- Committed undrawn bank lines of about S$310 million, maturing in more than 12 months.

Principal liquidity uses include:

- Short-term debt maturities of S$128 million.
- Capital expenditure of about S$37 million in the 12 months to June 30, 2020.
- Cash dividends of S$97 million-S$98 million during the same period.

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%. We project both EBITDA interest coverage and FFO-interest coverage to exceed 3.0x through fiscal 2021, allowing SGREIT to keep substantial buffer against a decline in profits and cash flows. We also project the ratio of debt to assets to average about 38% through fiscal 2021.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 30, 2019, SGREIT's capital structure consists of S$1.1 billion of debt. The REIT's funding is well-diversified between bank facilities and MTN programs.

About 27% of total debt, or S$305 million, is secured debt. A further 0.8%, or S$8.5 million, pertains to an outstanding Japanese yen bond for which bondholders have a statutory preferred right.

Analytical conclusions

We rate SGREIT's notes under its S$2 billion MTN 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 June 30, 2019, SGREIT's ratio of secured debt to total assets is about 10%.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/--

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: Neutral (no impact)

Stand-alone credit profile: bbb

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded

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