Research Update:

Frasers Centrepoint Trust Ratings Affirmed With Stable Outlook Reflecting Improved Portfolio; Off CreditWatch

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Rating Action Overview

- We believe Frasers Centrepoint Trust's (FCT) proposed acquisition of the remainder of AsiaRetail Fund Ltd. (ARF, previously known as PGIM Real Estate AsiaRetail Fund Ltd.) will significantly improve the scale and competitive position of its retail asset portfolio.
- In our view, these factors can offset FCT's tolerance for higher leverage. To achieve this, we expect satisfactory completion of FCT's proposed corporate actions, including the acquisition, equity fund raising, and an asset disposal.
- On Sept. 9, 2020, S&P Global Ratings affirmed its 'BBB' long-term issuer credit ratings on FCT and the 'BBB' issue ratings on the outstanding senior unsecured notes that the Singapore-based REIT guarantees. We removed the ratings from CreditWatch, where they were placed with negative implications on April 13, 2020.
- The stable outlook reflects our view that FCT's enlarged asset base and improved resilience will help it endure weaker leverage than historically.

Rating Action Rationale

We affirmed the ratings and removed them from CreditWatch because we believe FCT's proposed acquisition of ARF will enhance its portfolio quality and offset the increase in leverage post the corporate actions. We see a very high likelihood of the actions materializing, considering the trust's record and its fully underwritten equity fund-raising exercise.

We expect FCT's portfolio quality will improve significantly after the acquisition. The REIT's competitive position will strengthen as its retail market share will increase, consolidating its position as the second-largest retail REIT in Singapore. FCT could also better position its malls in key suburban and transportation hubs after completion of ARF acquisition. We believe these factors would improve FCT's negotiation power and ability to attract and retain tenants. In the niche suburban retail market, the REIT will hold 10.2% market share, up from 5.4%, a close second to CapitaLand Mall Trust's 10.6%.

FCT's portfolio of suburban malls has recovered quickly from the COVID-19 hit, in line with our expectations. This is because the malls have a largely nondiscretionary tenant mix. The assets' close proximity to densely-populated residential areas also aided the recovery because they benefitted from continued work-from-home arrangements. According to FCT, overall tenant sales in its malls have recovered to close to 2019 levels in July 2020.

In our view, the ARF portfolio is complementary to FCT's business strategy and will reduce asset concentration risk. The acquired retail assets will improve FCT's presence most prominently in the eastern parts of Singapore. Moreover, the location of these assets has little overlap with FCT's existing portfolio.

In our view, the asset quality of the ARF portfolio is similar to FCT's existing portfolio. Like FCT's existing retail assets, the ARF retail assets are located near transport nodes and densely populated residential areas, and benefit from high shopper traffic.

We believe FCT's concentration risk will reduce considerably with the expanded portfolio. The REIT's top two assets, Causeway Point and Northpoint City North Wing, contributed about 75% of reported net property income (NPI) for fiscal 2019 (ended Sept. 30, 2019). We estimate this share will reduce to 35%-40% post the corporate actions.

FCT's strengthened business position may allow it to tolerate a higher leverage profile. We forecast FCT's ratio of funds from operations (FFO) to debt will weaken to 7%-8% in fiscal 2021, from above 12% in fiscal 2018, before its acquisition of stakes in ARF and Waterway Point (a mall in northeast Singapore in which FCT acquired a 40% stake in fiscal 2019). Our revised forecast is also lower than the mid-to-high 8% we had expected when we put FCT on CreditWatch on April 13, 2020.

The weaker ratio forecast is despite the proposed acquisition of ARF being supported by a sizable equity fund raising. This is due to the consolidation of ARF's debt post the proposed corporate actions. We believe FCT's enhanced business position will improve its resilience to future income volatility, allowing it to tolerate a higher leverage.

Weakened economic outlook and acceleration of online shopping will increase headwinds for FCT, in our view. We continue to expect that the REIT will face negative rental reversions (or reduction in rental rates on renewal of contracts) and weaker occupancies over the next six to 12 months. That's because COVID-19 has weakened Singapore's economic prospects and hit consumer spending.

In addition, COVID-19 could accelerate an ongoing structural shift in consumer preference away from brick-and-mortar retail to online. While FCT continues to engage shoppers through omni-channel platforms to drive mall visitation and sales, its effectiveness remains to be seen.

Outlook

The stable outlook on FCT reflects our view that the REIT's competitive position and scale of operations will improve, assuming the proposed acquisitions are successful.

We expect FCT to successfully integrate and manage the enlarged asset base. We also anticipate the REIT will capture favorable retail spending prospects from its predominantly suburban retail focus.

Upside scenario

Upward rating momentum is dependent on FCT adhering to a more conservative financial stance such that its ratio of FFO to debt strengthens to above 9% on a sustained basis. Upward rating movement would also be contingent on the REIT's asset base continuing to have strong credit quality.

Downside scenario

We could lower the rating on FCT if debt-funded acquisitions or developments, or further unexpected adverse rental losses from COVID-19, results in its ratio of FFO to debt falling below 7%.

We could also downgrade FCT if: (1) the performance of the REIT's enlarged asset base is worse than our base case; or (2) the Singapore retail property market weakens much more than our expectation, leading to a sustained deterioration of the trust's portfolio quality.

Company Description

FCT is a Singapore-based REIT managed by Frasers Centrepoint Asset Management Ltd. It was established in June 2006.

FCT has six wholly owned suburban retail assets in Singapore. In fiscal 2019, the REIT bought a 40% stake in Waterway Point, a mall in Singapore's northeast, from its sponsor Frasers Property Ltd. In the same year, FCT bought an 18.8% stake in ARF. It increased the stake to 24.82% following share redemptions by other shareholders, and raised it further to 36.89% after acquiring an additional 12.07% stake in July 2020. On Sept. 3, 2020, FCT announced a proposed acquisition of the remaining 63.11% of ARF from its sponsor.

ARF owns five suburban retail malls as well as an office property in Singapore, and a retail mall in Malaysia. FCT will, however, not acquire the Malaysia retail mall. FCT also holds a 31.15% stake in Malaysia's Hektar REIT.

Our Base-Case Scenario

Assumptions

We assume that the proposed transaction will be successful, including the acquisition of ARF, equity fund raising, and asset disposal. We also assume that the tax authorities will approve the tax-transparency status of the acquired assets, and that the debt within the enlarged REIT will rank equally.

Liquidity

In our view, FCT's liquidity is expected to remain adequate. The REIT has demonstrated its ability to access debt capital markets even during a period of economic stress, completing a Singapore dollar (S$) 200 million bond issuance in May 2020. We believe the balance sheet will be larger post-transaction, and this will assist FCT in accessing sources of liquidity.

Issue Ratings--Subordination Risk Analysis

We rate the outstanding S$190 million senior unsecured notes drawn down from FCT's guaranteed S$1 billion multicurrency medium-term notes program and the company's guaranteed S$200 million senior unsecured notes issued in May 2020 at 'BBB', the same level as the issuer credit rating.

We expect that post-transaction, the weighted average maturity of debt will be managed to ensure that it remains above three years.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/--

Business risk: Strong

- Country risk: Very 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 Ratings Analysis: Neutral (No impact)

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
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Frasers Centrepoint Trust		
Issuer Credit Rating	BBB/Stable/--	BBB/Watch Neg/--
FCT MTN Pte. Ltd.		
Senior Unsecured	BBB	BBB/Watch Neg