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Summary:

Viva Industrial REIT

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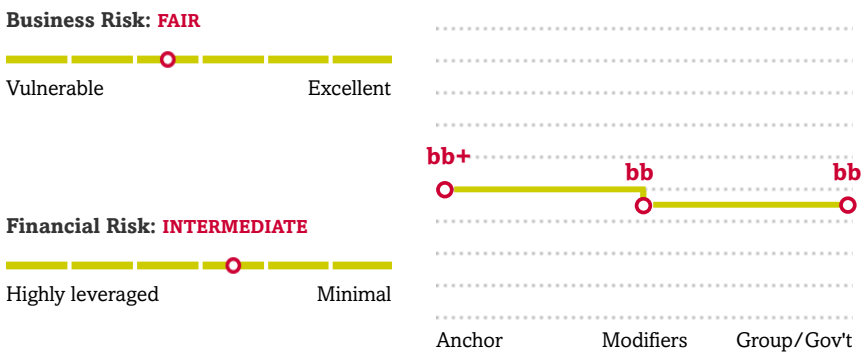
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Summary:

Viva Industrial REIT



CORPORATE CREDIT RATING
BB/Stable/--

Rationale

Business Risk: Fair	Financial Risk: Intermediate
• Significant reliance on rental support. • Higher asset and counterparty concentration than the industry. • Subdued industrial property market in Singapore.	• Limited financial flexibility due to MAS' leverage limit. • Aggressive debt-funded acquisition appetite. • Adequate liquidity.

Outlook: Stable

The stable outlook reflects our expectation that Viva Industrial REIT will operate close to the top of its financial policy of 40% leverage over the next 12-18 months. Our stable outlook also hinges on steady rental support over the period. We expect Viva's balance sheet to remain stable after factoring the remaining capital outlays related to asset enhancement initiatives (AEI) at Viva Business Park (VBP), one of the REIT's two largest assets by area and valuation. However, the capital structure may weaken if the company completes debt-funded acquisitions.

Downside scenario

We may lower the rating if Viva's debt-funded spending exceeds our expectation, substantially weakening its balance sheet. A ratio of funds from operations (FFO) to debt that is persistently below 7% could indicate such weakness. Downgrade pressure may also arise if Viva's occupancy levels decline materially and impair its profitability. A disruption to the rental support could also immediately stress the company's leverage.

Upside scenario

The rating upside is limited for Viva over the next 12 months, in our view. However, we may raise the rating if the REIT meaningfully enhances the portfolio occupancy and profitability while expanding and diversifying its portfolio. An upgrade also hinges on Viva demonstrating a record of financial discipline. Evidence of a more conservative financial policy would be an FFO-to-debt ratio of more than 10% and leverage below 40% on a sustained basis, and excluding rental support.

Our Base-Case Scenario

Assumptions

- Real GDP growth in Singapore will likely be 2.1% in 2016 and 2.4% in 2017, respectively.
- Singapore's industrial property sector to remain subdued over the next 12 months, with rental rates increasing moderately in the single-digit percentage range.
- Revenue growth of about 23% in 2016 due to incremental income from the AEIs at VBP, and additional revenue from the Ubi, Pioneer, and Home-Fix acquisitions. Revenue growth of about 5% in 2017 from the full-year contribution from Pioneer, and moderate occupancy improvements.
- Portfolio occupancy to increase to 89% in 2016, from 84.5% in 2015 and 78% in 2014, due to take rates of the new AEIs and the addition of fully occupied acquisitions. We expect occupancy to stay relatively flat in 2017.
- Total non-discretionary capital expenditure (capex) of about Singapore dollar (S$) 70 million in 2016 on AEI and acquisitions. The debt and equity proceeds from the December 2015 offering will help to fund this spending.
- EBITDA, including rental support, will be S$70 million–S$75 million in 2016 and 2017.

Key Metrics

	2015A	2016E	2017E
FFO/Debt* (%)	8.7	9.0-11.0	9.5-11.5
EBITDA interest coverage* (x)	3.7	3.5-4.0	3.5-4.0
Debt/Assets (%)*	39.8	About 40	About 40

*S&P Global Ratings-fully adjusted figures. A--Actual. E--Estimate. FFO--Funds from operations. EBITDA includes about S$13 million rental support

Business Risk: Fair

Viva's significant reliance on rental support and high concentration of counterparties are key risks to the business. We expect rental support to contribute about 20% of the EBITDA this year, with about S$10 million from the single property of UE Bizhub EAST. The expiry of this support could lower profitability if Viva is not able to raise occupancies and rents at the property. However, the completion of nearby mass transit, expected in 2017, should help mitigate this risk.

UE Bizhub EAST and Viva Business Park comprise about 60% of the portfolio's about S$1.2 billion valuation. This concentration has improved over the past year from 85% with the addition of three new properties. However, it is still higher than peers'. Meaningful counterparty concentration also exists, with the top 10 customers accounting for over 45% of rental income.

Although the rental support and asset concentration compare unfavorably to peers, Viva has diversified its portfolio and improved occupancies over the past year. Viva has added the 11 Ubi Road, Home-Fix Building, and 30 Pioneer Road properties recently, all with 100% occupancy. This, as well as improvements at other properties have increased

the portfolio occupancy to high 80% from high 70%.

Financial Risk: Intermediate

Viva's risk tolerance and aggressive growth appetite are the primary constraints, in our view. We project Viva's leverage (debt-to-asset ratio) to average at around 40% over the next few years. This is at the high end for Singapore-listed REITs, and allows limited financial flexibility relative to the 45% limit set by Monetary Authority of Singapore (MAS).

Viva's acquisitions over the past year have been relatively small and manageable. We expect the REIT to continue to pursue additional acquisitions. These could pressure the company's already limited financial flexibility if they are financed with debt. We believe this is a risk because equity raising may be protracted and depend on market conditions. Maintaining limited headroom under the 45% limit could create difficulties for Viva if the market enters unforeseen adverse conditions.

We project Viva's FFO-to-debt ratio, adjusted for rental support to remain above 9.5% for the next couple years. We expect this ratio to be supported by additional leasing of converted white space at VBP following the completion of the AEI, the addition of new properties, and the improvement in occupancies at other existing locations. We would view maintenance of credit ratios at these levels, including acquisitions, as positive and evidence of a more conservative financial policy.

Liquidity: Adequate

We view Viva's liquidity as adequate. We expect the trust's ratio of liquidity sources to uses to be about 1.2x-1.3x over the next 12 months. Even if EBITDA declines by 15%, we expect Viva's liquidity sources to exceed liquidity uses and the company to maintain sufficient covenant headroom.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash balance of S$13.3 million as of June 30, 2016. • Unused committed revolving credit facility of S$15 million as of June 30, 2016. • Cash FFO that we estimate at S$45 million-S$55 million over the next 12 months.	• Cash dividends of S$45 million-S$60 million in the next 12 months. • Committed capital spending of S$10 million-S$15 million during this time, assuming no acquisitions.

Other Credit Considerations

We estimate that Viva's leverage will be close to, or higher than, 40% over the next 12-24 months as the company continues to grow through acquisitions. This ratio is at the top of the REIT's financial policy. Viva's ratio of FFO-to-debt could also decline below our expectation of around 10%. Our negative financial policy modifier captures such event risk. Viva has shown success in acquiring properties and expanding its portfolio, however we believe this

limits financial flexibility to absorb unforeseen market weakness.

Ratings Score Snapshot

Corporate Credit Rating

BB/Stable/--

Business risk: Fair

- **Country risk:** Low
- **Industry risk:** Very low
- **Competitive position:** Fair

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bb+

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Negative (-1 notch)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bb

- **Entity status within group:** Core (no impact)

Recovery Analysis

Key Analytical Factors

- The issue rating on Viva's unsecured medium-term notes is 'BB+', one notch above the corporate credit rating. The recovery rating on these notes is '2', supported by our discounted asset valuation, but constrained by the significant amount of senior secured debt ahead of the issue. Our recovery prospects are at the higher half of the 70%-90% range.
- Our hypothetical default scenario contemplates a deep recession that negatively affects corporations and financial institutions. As tenants vacate or shrink their office space needs, Viva's rental revenue stream deteriorates to a point where the cash flows cannot meet fixed obligations, and the company fully uses up its liquidity leading to a payment default in 2021. This would be aggravated by fast moving changes in the market and difficulty disposing of non-core assets due to the weaker economic environment. We estimate that net operating income would need to decline by over 30% for an extended period to reach a default point.
- We evaluate recovery prospects for Viva using a real estate valuation methodology where we apply a distressed cap rate to a stressed net operating income, given the likelihood that assets would be sold in the event of payment default. We also assume that debt maturities are refinanced at higher rates on the path to default.

Simulated Default Assumptions

- Year of default: 2021
- Net operating income decline: 30%
- Blended cap rate: 6.63%
- Claims at the property level: 5%
- Revolver draw: 85%
- Jurisdiction: Singapore

Simplified Waterfall

- Gross enterprise value at default: S$660 million
- Administrative costs: S$35 million
- Net value available to creditors: S$625 million
- Secured debt claims: S$408 million
- Unsecured debt claims: S$103 million
- --Recovery expectation: 70%-90% (upper half of the range)

*All debt amounts include six months' prepetition interest

Related Criteria And Research

Related Criteria

- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments - January 20, 2016
- Criteria - Corporates - Recovery: Revised Revolver Usage Assumptions For Recovery Analysis In Corporate Ratings - November 20, 2014
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - June 01, 2016
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- Legal Criteria: Guarantee Criteria--Structured Finance - May 07, 2013
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings - October 24, 2013
- Criteria - Corporates - Recovery: Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt - August 10, 2009

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Real Estate Industry - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue - April 15, 2008
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	**bb+**	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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