

Media Release:

# Shin-Li Number One Real Estate Investment Trust Assigned 'twA-(prelim)/twA-2(prelim)' Ratings; Outlook Stable

September 26, 2023

## Rating Action Overview

- Shin-Li No.1 REIT is scheduled to be set up in the fourth quarter of 2023, with a portfolio of only three properties in Taiwan. The planned asset size is around NT\$6.61 billion.
- We view the REIT's business risk profile is largely constrained by its limited market position that only comprises three properties with ages of more than 20 years, as well as its asset, property type and tenant concentration risks. However, the risks are partly offset by the good or niche locations of the three properties.
- We expect the REIT to raise debt immediately after it is formally established, but we believe that the REIT's conservative debt leverage policy will keep the ratio of debt to capital below 25%. Accordingly, we estimate the REIT's ratio of debt to EBITDA is likely to be around 8x in 2023 and 2024.
- We are assigning our 'twA- (prelim)' long-term and 'twA-2 (prelim)' short-term issuer credit ratings to Shin-Li No.1 REIT. The final ratings on Shin-Li No.1 REIT will be subject to the successful listing of the REIT and our review on the final documents after the trust's establishment.
- The rating outlook is stable supported by the REIT's stable rental income and its conservative property expansion plan, which should keep the ratio of debt to EBITDA below 9.5x over the next two years.

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## Rating Action Rationale

We view the REIT's market position is limited, given its much smaller scale than that of its peers. Shin-Li No. 1 REIT's portfolio comprises only three properties, with a market value of around new Taiwan dollar (NT\$) 5 billion, which would make it one of the smallest REITs in Taiwan. In addition, the three properties are all over 20 years old, albeit with constant maintenance. The three entrusted properties of Shin-Li No.1 REIT are:

1. Qingcheng Street No.1--a mall with a wide variety of restaurants and beverage outlets located adjacent to the intersection of the mass rapid transit lines in the center of Taipei city,
2. Taichung Nova--a shopping mall specifically selling electronics such as computers, communications and consumer products, whose location is near the famous commercial district, Calligraphy Greenway in Taichung city, and

3. Beitou Market--a retail property with tenants including a gym, cosmetic store, and hypermarket, located in the northern part of Taipei City and surrounded by a residential area.

The REIT's portfolio also includes some offshore REIT investments targeting the Singapore and Japan market.

**The REIT's asset, property type, and tenant concentration risks are high.** With only three properties and five tenants in the REIT's portfolio that are all concentrated on a single retail industry, we believe the REIT has limited bargaining power in its tenant selection, especially considering that the properties are all over 20 years old. While our base case assumes that all properties under the REIT should remain fully occupied over the next two years, unfavorable market conditions during the current economic downturn or future industry disruption could lead to some volatility in rental income.

**Satisfactory or niche locations of its properties is a key positive rating factor.** In our view, the REIT's satisfactory property locations should be able to support the business development of the tenants to consistently deliver their rental payments. Our view is underpinned by the traffic hub that can attract the nearby residents and office workers to Qingcheng Street No.1, the well-known Calligraphy Greenway that can bring sufficient shopping flow to Taichung Nova, and the surrounding residential area as the sustainable consumption driver for Beitou Market.

**Rental income is likely to show lower volatility.** The REIT's rental income is mostly backed by long-term and fix-charge rental contracts, instead of a revenue-based model that may fluctuate in tandem with the tenant's operating performance. The only exception is Taiwan Carrefour which operates in Beitou Market; however, we believe the hypermarket's stable revenue track record and relatively small proportion of Beitou Market's total rental income could mitigate the potential impact on total revenue fluctuation. We also consider the likelihood for the early termination of any rental contracts to be limited over the next two to three years, supported by the tenants' long-term operating history, established market reputation and franchise. This, along with no expiration of rental contracts until 2027, leads us to forecast the REIT will maintain 100% occupancy that provides stable rental income over the next two years.

**Conservative financial policy to underpin the REIT's low debt leverage.** We see Shin-Li No.1 REIT maintaining its conservative financial policy, with a debt to asset ratio of less than 25%, due to its conservative business plan and the related regulations governing REITs in Taiwan. The REIT plans to borrow around NT\$1.6 billion via a three-year bank loan and aims to invest this in Beitou Market and part of Qingcheng Street No.1 soon after the trust is established. Contrary to most local REITs peers that may have property expansion plans either via debt funding or equity raising, the property manager of Shin-Li No.1 REIT is more likely to perform a passive management role and has no appetite to actively procure or dispose of any properties over the next few years, in our view. As a result, the REIT's ratio of debt to EBIDTA will be around 8x over the next two years. We believe the trust's comprehensive refinancing plan under its well-established and solid relationship with local banks helps to offset the refinancing risk of its bank loan, despite the REIT's weighted average maturity will be less than three years.

## Outlook

The stable rating outlook on Shin-Li No. 1 REIT reflects our expectation that the REIT could generate stable rental income over the next two years. This is supported by long-term and fixed-charge rental contracts that represent more than 85% of the trust's total rental income, with no early termination of the rental contracts expected during this period. The outlook also reflects our expectation that the REIT's ratio of debt to EBITDA could remain at about 8x, with the ratio of debt to capital remaining below 25% due to the trust manager's conservative business plan.

### Downward scenario

We may lower the rating if the trust's debt-to-EBITDA ratio increases close to 9.5x. Such deterioration could result from high tenant turnover or sharply decreasing rental income due to severely adverse macroeconomic or market developments. These could be associated with a slump in local consumption or the loss of customers to brick-and-mortar stores amid mounting competitive pressure from e-commerce.

### Upward scenario

The likelihood to an upgrade over the next one to two years is low, in our view, considering Shin-Li No.1 REIT's property portfolio exhibits almost no upside potential for rental income over the next two years. We may, however, raise the rating if the trust could keep the ratio of debt to EBITDA sustainably below 4.5x while maintaining its financial policy to keep the debt-to-capital ratio no higher than 25%. This could happen if the REIT significantly raises its rental income due to the tenant's stronger revenue than we currently expect, or the fund significantly expands its property portfolio to lower the concentration risk.

## Our Base-Case Scenario

- Taiwan's real GDP to grow 0.5% in 2023, 3.0% in 2024 and 2.6% in 2025.
- In addition to the paid-in-capital of around NT\$5 billion, the trust will borrow around NT\$1.6 billion to mainly fund the three different properties that are most engaged with the long-term fix-rate rental contracts with limited tenants. The remaining funds will be used to invest in off-shore REITs.
- We forecast Shin-Li No.1 REIT's revenue to marginally grow by less than 0.5% in 2024 and 2025, primarily reflecting the fixed rental of the most rental contracts with its tenants, with the only exception of the floating rental of one tenant based on a 1%-3% inflation rate.
- All of the properties in the trust's portfolio will remain fully occupied over the next two years.
- The estimated yield of the off-shore REITs investment of 5%.
- Interest rate on the loan of around 2%.
- Property maintenance fee and associated operating costs are either based on engineer reports or transaction documents.
- There is no additional asset acquisition plan in the coming two years.
- NT\$59.725 million in tenants' deposit, a haircut on cash and short-term investments for surplus cash, with the haircut ratio on the cash and equivalent cash at around 28%.
- 100% dividend payout.

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

- EBITDA margin of 84%-87% in 2023 and 2024.
- Ratio of adjusted debt to EBITDA of around 8x in 2023 and 2024.
- Ratio of debt to capital of 20%-23% in 2023 and 2024.

## Liquidity

The short-term credit rating is 'twA-2'. We view that Shin-Li No.1 REIT has strong liquidity to meet its needs up to 2026. We estimate the ratio of liquidity sources to uses will be above 1.0x-1.5x through 2026. The liquidity assessment incorporates our view that liquidity sources will continue to exceed uses even if the trust's EBITDA were to decline by 15%.

The liquidity assessment also reflects our view that the trust has generally prudent risk management, as indicated by its low financial leverage target. The liquidity profile also reflects our view that Shin-Li No.1 REIT has a sound business relationship with banks and a generally high standing in Taiwan's credit market based on the trust's low interest rates on its bank loans. We believe the REIT's unpledged properties can help to obtain extra liquidity source, if needed. There is no financial covenant on the trust's borrowing.

Principal Liquidity Sources:

- Cash and short-term investments of NT\$156.4 million at the end of 2022, (net of the tenant-provided deposit as the penalty if the lease contract is terminated early).
- Cash funds from operation of NT\$145 million-NT\$155 million annually.

Principal Liquidity Uses:

- Distribution to unitholders of NT\$145 million-NT\$155 million annually in the coming three years.

## Environmental, Social, And Governance

ESG factors have an overall neutral influence on our credit rating analysis of Shin-Li No.1 REIT. Social factors are a largely neutral consideration for the real estate sector. The trust's property portfolio is somewhat concentrated in retail assets in Taipei and Taichung city, which are quite vulnerable to pandemic-related mobility restrictions. However, rental performance remained quite stable even during the COVID-19 pandemic, thanks to the REIT's mostly fix-charge rental contracts. Additionally, we believe the associated social risk for the REIT should gradually wane along with the reopening of Taiwan's border since the late 2022, which could bring the trust's operations back on track over the next two years.

Environmental factors are predominantly a neutral consideration in our credit rating analysis of the real estate sector, especially for operators, given their low exposure to construction activity. Governance factor are likewise a neutral consideration in our credit rating analysis. To be specific, regulations governing the operations of Taiwan REITs, such as stipulated risk tolerance, eligible investments, and adequate control from stated trust deeds, largely constrain any operational deviation for these trusts.

## Rating Score Snapshot

Issuer Credit Rating: twA- (prelim)/Stable/twA-2 (prelim)

Note: All scores are in comparison with global obligors.

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Low
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: twa-

Modifiers

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

## Related Criteria & Research

### Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology - June 8, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry - February 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Principles Of Credit Ratings - February 16, 2011

### Related Research

- Taiwan Ratings' Ratings Definitions – November 11, 2021

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## Ratings List

### New Ratings; Outlook Assigned

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#### Shin-Li Number One Real Estate Investment Trust

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Preliminary Issuer Credit Ratings

twA-(prelim)/Stable/twA-2(prelim)

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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.taiwanratings.com](http://www.taiwanratings.com) for further information.

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