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https://www.moodys.com/research/Moodys-assigns-first-time-A2-issuer-rating-to-Wharf-REIC--PR_376013

Rating Action: **Moody's assigns first-time A2 issuer rating to Wharf REIC; outlook stable**

Global Credit Research - 20 Dec 2017

Hong Kong, December 20, 2017 -- Moody's Investors Service has assigned a first-time A2 issuer rating to Wharf Real Estate Investment Company Limited (WREIC).

At the same time, Moody's has assigned a provisional (P)A2 senior unsecured rating to the new USD3 billion guaranteed medium-term note (MTN) program of Wharf REIC Finance (BVI) Limited, a wholly-owned subsidiary of WREIC. The MTN program is unconditionally and irrevocably guaranteed by WREIC.

The outlook on the ratings above is stable.

RATINGS RATIONALE

"The A2 issuer rating reflects WREIC's sizeable and good quality assets, as well as the diversity of its asset types located in prime commercial locations in Hong Kong," says Stephanie Lau, a Moody's Vice President and Senior Analyst.

At 30 June 2017, WREIC mainly owned six assets totaling about 11 million sq. ft. in gross floor area in prime retail malls, offices, and hotels.

WREIC's scale in terms of rental revenue and valuation is large when compared with other commercial property owners in Hong Kong (Aa2 stable). Its investment properties were valued at HKD245.4 billion (USD32.0 billion) at 30 June 2017.

Its gross revenue for the 12 months ended 30 June 2017 totaled HKD17.6 billion (USD2.3 billion), a level similar to that reported by A2-rated local property peers, such as Hong Kong Land Company Limited (A2 stable), Swire Properties Limited (A2 stable), and Link Real Estate Investment Trust (A2 stable).

WREIC's two key assets — Harbour City and Times Square — are mixed-use integrated complexes and contributed around 75% of the company's total gross revenue for the 12 months to 30 June 2017.

These assets are located in Hong Kong's prime shopping districts of Tsim Sha Tsui and Causeway Bay, capturing substantial retail consumption from local consumers and tourists.

"The A2 issuer rating also considers WREIC's strong management ability in tenancy management, which provides good visibility in terms of revenue and profit," adds Lau, who is also Moody's Lead Analyst for WREIC.

WREIC demonstrates strong tenancy management, as evidenced by its track record of positive rental growth and high occupancy levels throughout the economic cycles.

The company's particular strength in retail leasing is demonstrated by its retail rental compound annual growth rate of 17% for Harbour City during 2006-2016, and 13% for Times Square in the same period.

In addition, WREIC has recorded overall retail and office occupancy rates of at least 95% and 91%, respectively, since 2007.

The A2 issuer rating also takes into account Moody's expectation that WREIC will maintain a sustainable business strategy and prudent financial management.

WREIC was created in November 2017 through the spin-off of six Hong Kong investment property assets of The Wharf (Holdings) Limited. WREIC is principally engaged in commercial property investment in Hong Kong. Moody's expects this business will generate stable cash flow, with limited execution risk.

WREIC has also inherited some legacy development projects in China (A1 stable), with a total saleable value of around HKD5-HKD6 billion, which it will likely dispose of over the next 12-24 months. With no plans for further property development in China, any remaining development risk should decline over time.

Given the large scale of WREIC's asset base and revenues, Moody's expects that the company's business profile will remain very stable over the next 12-18 months.

Based on WREIC's pro forma historical financial information from the operations of its six assets between 2014 and 2016, its debt leverage — as measured by debt/EBITDA — was stable at 3.2x-3.8x during the period.

Moody's expects that WREIC will adopt a prudent approach to growth and maintain its debt leverage around historical levels. Consequently, WREIC's debt leverage — as measured by adjusted debt/EBITDA and EBITDA/interest coverage — should register around 3.5x-4.0x and 6.5x-7.0x respectively over the next 12-18 months. These levels are consistent with other large-scale stable real estate investment trusts at the single-A rating level in Hong Kong and Singapore (Aaa stable).

The A2 issuer rating is constrained by WREIC's revenue and asset concentration in its two key assets in Hong Kong. The company is susceptible to potential economic fluctuations in Hong Kong, despite its demonstrated resilience during the 2014-2017 economic cycles.

Nevertheless, this asset and revenue concentration risk is somewhat mitigated by the company's diversified asset types and broad tenant base.

In addition to Harbour City and Times Square, WREIC owns quality properties, including the office buildings, Crawford House and Wheelock House, in the Central business district, and Plaza Hollywood, a major regional shopping mall in Kowloon East. The company also generates income from three hotels in Harbour City, and will receive contributions from The Murray, a new hotel in Central, opening in early 2018.

The broad tenant base of Harbour City and Times Square's retail segments also mitigate concentration risk. Both properties boast a diversified retail tenant mix, in terms of rental, area and total sales contribution.

WREIC's liquidity position is adequate for the next 12-18 months, based on:

(1) Its strong annual net cash flow from operations of HKD7.5-HKD8.0 billion by Moody's estimate;

(2) Low capital expenditures estimated by Moody's at HKD2.5-HKD3.0 billion and mostly related to construction costs on its China development projects and The Murray;

(3) Its target dividends of 65% of realized recurring profit in Hong Kong attributable to shareholders; and

(4) Moody's expectation that the company will retain its good access to funding from banks and the capital markets and will be able to refinance its bridging loans for the settlement of inter-company loans, including through medium-term notes of 3-5 years maturity.

The stable ratings outlook reflects Moody's expectation that WREIC will maintain: (1) its quality asset portfolio; (2) predictable and strong rental revenues and high occupancy levels for its key assets; and (3) stable debt leverage at levels supporting its A2 rating.

Upward ratings pressure could emerge, if the company can: (1) diversify in terms of geographies and asset types, without increasing business and financial risk; (2) reduce concentration risk in revenue contributions from its key assets; (3) increase the duration of its lease coverage to increase its buffer against a potential economic downturn; and (4) improve its credit metrics, such that adjusted debt/EBITDA falls below 2.5x on a sustained basis.

On the other hand, the ratings could face downward pressure, if WREIC aggressively accelerates its property development activities, undertakes property acquisitions, or material capital distributions, leading to a material deterioration in its liquidity position or credit metrics.

Financial indicators that Moody's would consider for a ratings downgrade include adjusted debt/EBITDA above 4.5x-5.0x or debt/total assets exceeding 25%-30% on a consistent basis.

In addition, any material change in the ownership of WREIC by its key shareholder would be negative for the ratings.

The principal methodology used in these ratings was Global Rating Methodology for REITs and Other Commercial Property Firms published in July 2010. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Listed on the Hong Kong Stock Exchange on 23 November 2017, Wharf Real Estate Investment Company Limited (WREIC) was created through the spin-off of six Hong Kong investment property assets of The Wharf (Holdings) Limited.

WREIC holds a portfolio consisting six quality commercial properties in Hong Kong, totaling an aggregate gross floor area of 11.7m sq. ft, with a market capitalization of around HKD148 billion as of 4 December 2017. Its key shareholder, Wheelock Group, owns a 62% stake in the company.

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