Asia Credit Research

Earnings Review: CapitaLand Commercial Trust ("CCT")

Issuer Profile:
Neutral (3)

Ticker: **CCTSP**

Background

Listed on the SGX in 2004, CapitaLand Commercial Trust ("CCT") is Singapore's first listed commercial REIT. With SGD11.1bn in deposited properties as at 1 April 2019, it is also one of the largest. CCT comprises eight prime properties in Singapore, an office building in Frankfurt, Germany and an 11.0%-stake in MRCB-Quill REIT listed in Malaysia. CCT is 30.1%-owned by CapitaLand Ltd ("CAPL").

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Recommendation

- Underlying portfolio performance is strong, despite softness at specific properties. CCT is expected to continue to benefit from the recovery of the Singapore office market. We retain our Neutral (3) Issuer Profile.
- When comparing against the CapitaLand Mall Trust ("CAPITA") curve (which we deemed to be fully valued), we think CCTSP 3.327% '25s looks interesting as it is trading 24bps wider than CAPITA 3.2% '25s for a 5 months short tenor. We hold CAPITA at one notch higher at Positive (2) Issuer Profile. We think the other parts of the CCTSP curve looks somewhat fair, as they offer ~10-15bps pick up over CAPITA curve.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
CCTSP 2.96% '21s	13/08/2021	35.2%	2.78%	83bps
CCTSP 3.17% '24	05/03/2024	35.2%	2.99%	99bps
CCTSP 3.327% '25	21/03/2025	35.2%	3.21%	116bps
CAPITA 3.08% '21	20/02/2021	34.2%	2.63%	69bps
CAPITA 3.75% '24	02/08/2024	34.2%	2.91%	88bps
CAPITA 3.2% '25	21/08/2025	34.2%	3.01%	92bps

Indicative prices as at 22 April 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Lower y/y growth:** Gross revenue and net property income ("NPI") grew by 3.5% y/y and 3.4% y/y to SGD99.8mn and SGD79.8mn respectively. Both of which were due to Asia Square Tower 2 ("AST2") (completed in Nov 2017) which saw occupancy rate increase to 98.1% from 90.8% in 1Q2018 and Gallileo (completed in Jun 2018), though partially offset by the divestment of Twenty Anson (in Aug 2018). On a q/q basis, results were flattish - gross revenue and NPI increased by 0.74% q/q and 0.67% q/q respectively. What stood out to us was the slowing albeit positive y/y growth relative to the past one year. Specifically, CCT recorded the following y/y growth in gross revenue – 4Q2018:+14.8%, 3Q2018:+35.6%, 2Q2018:+12.0% and 1Q2018:+7.7% and the following y/y figures for NPI – 4Q2018:+16.6%, 3Q2018:+37.3%, 2Q2018:+12.5% and 1Q2018:+10.5%. That said, there are inorganic growth opportunities which CCT can pursue, such as the Duo office and retail development (valued at >SGD1.5bn). Separately, CCT has a long-term target of having 10-20% of total deposited properties in other developed markets beyond Singapore, which translates to an estimated ~SGD2bn in possible overseas acquisitions. Overall, CCT's revenue and NPI are reasonably diversified over 5 properties. AST2, the largest contributor, makes up 28% of CCT's revenue and NPI.

- **Good portfolio statistics:** Portfolio committed occupancy was 99.1% up from 97.3% in 1Q2018, largely on the back of stronger occupancy rate at AST2. WALE is healthy at 5.7 years, with a balance 13% of total leases (9% of which is in office and 4% in retail) by net lettable area expiring in 2019. Narrowing down to office leases specifically, 18% (out of the 29%) of total office leases expiring in 2019 (based on monthly gross rental income) have already been committed and rental reversions for most of the office leases signed were reported to be positive. Leasing momentum is steady, given the limited new supply coming onstream.

- **Temporary weakness at some properties**: In 1Q2019, gross revenue from CapitaGreen was down by 1.7% y/y due to negative rent reversions while NPI fell by 5.2% y/y largely as a result of higher marketing expenses. Six Battery Road also saw gross revenue fall by 3.4% y/y while NPI decline by 3.6% y/y as occupancy rate fall from 99.8% a year ago to 97.6%.
    i) CapitaGreen has 0.4% of leases expiring and the average rent of those expiring leases is SGD12.57 psf per month ("pm") for 1H2019. Given the high base leases that the property was under, we think negative rent reversion is likely. That said, in 2H2019, we see 3.6% of leases expiring at SGD10.59 psf pm. This is below market rent of SGD11.15 psf pm. Therefore we are not expecting negative rent reversion to persist throughout the year for CapitaGreen.
    ii) Six Battery Road has 0.2% of leases expiring at SGD9.15 psf pm in 1H2019 and 1.0% of leases at SGD11.60 psf pm for 2H2019. As such, negative rent reversion may be possible at Six Battery Road in 2H2019.

  Given that the average rent of leases expiring in 2019 for CCT is SGD10.44 psf pm, we think an overall positive rent reversion will be the likely case though gross revenue for individual quarters may fluctuate due to timing of leases expiring.

- **Manageable credit metrics:** Aggregate leverage inched up slightly to 35.2% from 34.9% in 4Q2018, largely due to a SGD9.0mn debt drawdown for CapitaSpring. All-in average cost of debt fell slightly to 2.5% from 2.6% while average term to maturity is 3.6 years, down from 3.9 years in the previous quarter. Reported interest coverage is healthy at 5.8x. Refinancing risk is minimal as CCT only has a JPY bond with an outstanding amount of SGD148mn which it has sufficient bank facilities to refinance coming due in 2019 (4% of total borrowings). Majority of CCT's assets (77.4%) are unencumbered except for CapitaGreen and Gallileo. Looking forward, CCT has a balance development cost of SGD229.5mn for CapitaSpring that will be funded by debt which will be incurred progressively up till 2021. We expected aggregate leverage to climb to ~36.2% as a result.

- **Developments at CCT's properties:**
    i) **CapitaSpring** will be a 51-storey integrated development at Market Street, comprising Grade A office, serviced residence with 299 rooms managed by Ascott, ancillary retail and a food centre. An interactive marketing showsuite will be launched in 2Q2019. We expect CapitaSpring to do well in the market given the lack of office supply. As at 31 March 2019, committed occupancy rate is ~24%. JP Morgan will be relocating over from Capital Tower. CCT has a call option exercisable within five years after the development obtained TOP (expected to be 1H2021) for the balance 55% of CapitaSpring's commercial component which is does not currently own.
    ii) **Bugis Junction** was returned to the State for the agreed compensation sum of SGD40.7mn on 1 April 2019. CCT has since signed a one-year master lease with the State for Bugis Village with a projected net income of SGD1.0mn. ~84% of tenants at Bugis Village have committed to extend their leases as at 1 April 2019.
    iii) **21 Collyer Quay** is occupied by HSBC who has extended leases by another year from end-April 2019 to end-April 2020 at a 35% higher rate.
    iv) **Capital Tower** launched flexible spaces and new community activities.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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