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ISSUER COMMENT

AIMS AMP Capital Industrial REIT Ventures into Green Field Development

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On 26 July, Singapore-based AIMS AMP Capital Industrial REIT (AIMSAMPIReit, Ba2 stable) said it intends to redevelop 20 Gul Way, an industrial property in Jurong Industrial Estate, Singapore, into a five storey ramp up warehouse facility.

With this move, the company joins the league of major players within the Singapore Real Estate Investment Trusts (S-REITs) sector that have ventured into property development in the hope of achieving higher yields amidst rising property prices.

These projects, however, could lead to property development risks and pressure key credit metrics temporarily due to additional debt taken up to fund projects. But, various efforts have been made by the AIMSAMPIReit to mitigate these risks.

According to the Monetary Authority of Singapore (MAS) property funds guidelines for the S-REITs, the total contract value of property development activities undertaken must be restricted to 10% of its total value of deposited properties.

As of June 30, 2011, AIMSAMPIReit had reported total assets of approximately SGD863 million and expects the contract value of the property development to cost about SGD137 million. This will bring total development cost to approximately 16% of its total assets, thus breaching the limit set by the MAS.

As a result of the MAS restriction, the company intends to redevelop the property in two separate phases over the next two-and-a-half to three years. It will obtain a temporary occupation permit for the first phase of development with income generated, before commencing on the second phase.

Phase 1 is estimated to cost about SGD79 million and is expected to be completed within 15 months of the commencement of the design and construction works.

Property development in general, entails risks such as potential cost overruns, construction delays, counterparty risks, as well as uncertainty of occupancy rates upon completion.

In order to mitigate such risks, AIMSAMPIReit has entered into a design and construction agreement with Indeco Engineers Pte Ltd, a wholly-owned subsidiary of CWT Limited. CWT is listed on the Singapore Stock Exchange.

Under the agreement, AIMSAMPIReit will not be liable for any cost overruns, and will instead be compensated for any loss in rental income if the project is delayed by the contractor.

Further, the company will be signing a pre-committed master lease agreement with CWT Limited for the entire 1.2 million square feet of gross floor area for a total of four to five years, with annual rent escalation of 2% per annum. This provides medium-term visibility to operating income and minimizes operating risk for the property.

AIMSAMPIReit has also secured a new four-year secured term loan of SGD150 million, which extends beyond the construction period, to fund the redevelopment of the site.

Assuming the project is fully debt funded, reported Debt/Total Assets for the trust is estimated to increase to 41.5% from the 31.9% as at 31 March 2011. The increased leverage can be incorporated in its current Ba2 rating, however, it could limit any immediate upside. On the other hand, a debt/equity mix could also be employed in order to keep leverage below its targeted level of 40%.

AIMSAMPIReit's interest coverage and debt/EBITDA ratios are expected to weaken over the development period due to loss of rental income from the existing property and the additional debt taken up to fund the project.

In addition, the trust remains exposed to counterparty risks for the transaction.

On the other hand, estimated valuation of the property upon completion will be SGD214 million, bringing the total portfolio value to SGD1.03 billion from the current book value of SGD850 million.

AIMSAMPIReit joins several other S-REITs, such as CapitaCommercial Trust (Baa1, stable), CapitaMall Trust (A2, stable) and K-REIT (Baa3, stable) which had earlier announced their plans to venture into property development.

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