ASX Release

27 August 2018

MIRVAC RECEIVES FITCH A- STABLE CREDIT RATING

Mirvac Group (Mirvac) [ASX: MGR] today announces that it has been assigned an A- Stable rating from Fitch.

This is the first time that Fitch has assigned a rating to Mirvac.

Mirvac's Chief Financial Officer, Shane Gannon, said, "The A- Stable credit rating from Fitch is further demonstration of the resilience of Mirvac's diversified business model and strong balance sheet."

The Fitch ratings announcement is appended.

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27 Aug 2018 | New Rating

Fitch Assigns First-Time 'A-' Rating to Mirvac; Outlook Stable

Fitch Ratings-Sydney-27 August 2018: Fitch Ratings has assigned Mirvac Group (Mirvac), which comprises Mirvac Limited, Mirvac Property Trust and Mirvac Group Finance Limited, a Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'A-'. The Outlook is Stable. Fitch has also assigned a senior unsecured rating of 'A-' to all senior unsecured debt issued or guaranteed by Mirvac, including debt issued by Mirvac Group Finance. A full list of rating actions follows at the end of this commentary.

Mirvac is one of Australia's largest integrated real-estate groups, with an investment-property portfolio across office, industrial and retail premises mainly located in Sydney and Melbourne. The company also has a well-established development business that focuses on residential properties and delivering the company's asset pipeline for inclusion in its investment portfolio.

Mirvac's rating reflects the strength of its investment-property portfolio and the strong recurring revenues it generates, which Fitch expects to continue. The quality of its investment-property portfolio was enhanced over recent years following a strategic decision to concentrate on the Sydney and Melbourne markets - which the company sees as the drivers of Australian economic growth - and, in particular, on high density and above-average income areas in its retail portfolio. This has helped Mirvac to consistently maintain occupancy rates of over 96% across its portfolio since the financial year ended 30 June 2013 (FY13), as well as consistently achieve positive leasing spreads.

Nevertheless, Mirvac's exposure to the more volatile and capital-intensive residential-development sector constrains its credit profile. Fitch expects the company's net debt/recurring operating EBITDA to increase to around 7x in FY19, before improving to below 6x in FY20 and FY21 (FY18: 5.7x), and its net debt/investment properties (LTV) to increase to around 35% in FY19 and then remain at around 30% (FY18: 29%) over the same period. This reflects Mirvac's development cash flows as its current development pipeline is completed and begins to contribute recurring revenue. However, Fitch expects these metrics to be higher throughout the cycle - but within our rating guidelines - as Mirvac's allocation of invested capital to its development business is expected to remain between 10% and 15% until FY22, below its 20% target, as a result of the additions to its investment portfolio and as the company begins its next development cycle.

KEY RATING DRIVERS

Stable Rental Income Underscores Rating: Mirvac has good visibility over future investment cash flows, driven by weighted-average lease expiries at around seven years in both its office and industrial portfolios, and around four years in its retail portfolio - with no more than 10% to 12% of leases expiring in any given year. We expect demand for Mirvac's properties to remain strong. The company's leasing spreads across its portfolio have ranged from 2% to 5% since FY14 and it has already let 84% of its active development pipeline, while its retail properties continue to deliver above-average three-year comparable total sales, specialty sales and foot-traffic growth.

Attractive Investment-Property Portfolio: Mirvac has one of the largest REIT portfolios in Australia across the office, industrial and retail sectors, with over AUD10 billion in invested capital that generated around AUD500 million in recurring EBITDA in FY18. The portfolio is mainly concentrated in Australia's two largest cities, Sydney and Melbourne - which the company sees as the drivers of Australian economic growth. The quality of the portfolio is reflected by historically high occupancy levels, which have remained above 96% on a total portfolio basis since FY13 and reached 97.5% in office, 100% in industrial and above 99% in retail at FYE18.

Mirvac's retail assets are unique, in an Australian context, demonstrated by the company's focus on inner urban areas. Mirvac's properties have outperformed those of its Australian peers, when measured across like-for-like income growth, occupancy and leasing spreads, following the company's strategic re-weighting of its portfolio towards more resilient and experiential stores, such as food and beverage and entertainment, and away from department stores, together with a focus on high traffic locations with superior demographics. The strength of its performance is also highlighted by the challenges that a number of Australian retailers are facing.

Residential Development Risk Exposure: Fitch believes that Mirvac's residential-development business increases the company's overall business risk given the long cash-conversion cycle between outflows to acquire land for construction, and inflows only occurring upon settlement. However, the cash-flow visibility created by Mirvac's minimum presale requirements, as well as disciplined land restocking, helps mitigate this risk - at FYE18, Mirvac had AUD2.2 billion in pre-sold residential revenue and around 28,000 lots under control, supporting over 13,000 potential lot settlements over the next four years, and no settlement risk issues.

Mirvac seeks to control its risk exposure through its maximum allocation of 20% of its total invested capital to the development business - at FYE18, the proportion was 14% and we expect it to decline over the next few years as the company's office pipeline is completed and pre-sold residential revenue is realised. Fitch also believes that Mirvac's leading position and long history in the Australian residential-development market reduces the impact of market cyclicality on the business, as the company's scale and access to recurring cash flows from its investment portfolio afford it greater flexibility in managing the business to market conditions.

Development Business Increases Leverage: Mirvac's exposure to its more capital-intensive development business leads to a higher leverage than its international peers, while its strategic focus on generating target margins through the cycle and managing its business to market conditions can lead to leverage peaking at higher levels for longer. Fitch forecasts LTV will increase to around 35% in FY19 from around 30% at FYE18 and leverage will also rise, to 7x from 5.7x, as it begins its land restocking and completes its active developments. We expect the metrics to return to around 30% and 6x, respectively, from FY20 as its current development pipeline is completed and begins generating cash.

DERIVATION SUMMARY

Mirvac's 'A-' IDR reflects the strength of its investment-property portfolio, which is diversified across the office, industrial and retail sectors, and positions it well against similarly rated international peers Simon Property Group, Inc. (A/Stable), The British Land Company PLC (A-/Stable) and Unibail-Rodamco SE (A/Rating Watch Negative).

Simon Property's rating also reflects its strong property portfolio, which benefits from international diversification, despite its concentration in the retail sector. The one-notch difference is due to Mirvac's weaker financial profile, reflecting its exposure to residential development, compared with Simon Property's, whose development exposure is limited to additions to its investment portfolio.

Mirvac's exposure to residential development also explains its weaker financial profile compared with British Land. However, Mirvac's stronger property portfolio resulting from its larger scale and diversification across sectors and locations throughout Australia, compared with British Land's portfolio concentration in London, results in both companies being rated at the same level.

Unibail's property portfolio, however, is stronger than Mirvac's as it benefits from both its larger scale and stronger geographical diversification (with its exposure mainly in large densely populated areas, including Paris, London, New York City and Los Angeles), despite its concentration in the retail sector. Nevertheless, Mirvac's better financial profile, particularly given Unibail's elevated leverage as a result of the acquisition of Westfield Corporation (Fitch has stated that Unibail's rating will be downgraded by one notch to 'A-' upon completion of the transaction), mitigates the strength of its property portfolio and underscores the two issuers' ratings being at a similar level following Unibail's anticipated downgrade.

Within the Asia-Pacific region, Mirvac's investment portfolio is comparable with that higher-rated Chinese peer Sun Hung Kai Properties Limited (A/Stable) due to the quality of Mirvac's assets and low rental income risk even though Sun Hung Kai has a larger scale. Mirvac's weaker financial profile underscores the one-notch rating differential and reflects the underlying difference in the strategic focus of their respective residential-development businesses - with Sun Hung Kai focusing on asset turnover, allowing it to be self-funding; however, its exposure to this business risk caps its rating at 'A'.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- EBITDA margin to range between 28% and 33% from FY19 to FY22
- Capex of AUD598 million in FY19 and AUD362 million from FY20 to FY22
- Inventory restocking to begin in FY19 as pre-sold residential revenue is realised
- Distrbution payout ratio to be around 80% of operating profit after tax (excluding unrealised revaluations)

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
- Recurring EBITDA/cash interest expense increasing to above 4.5x on a sustained basis (FY18: 3.2x).
- Net debt/investment property valuation falling to below 20% on a sustained basis (FY18: 29%).
- Net debt/recurring EBITDA falling to below 4.5x (FY18: 5.7x).

Developments that May, Individually or Collectively, Lead to Negative Rating Action
- Recurring EBITDA/cash interest expense falling to below 2.5x on a sustained basis.

- Net debt/investment property valuation rising to above 40% on a sustained basis and a deviation from managing this ratio conservatively through the cycle.
- Net debt/recurring EBITDA rising to above 7.5x on a sustained basis.

LIQUIDITY

Well-Managed Funding Structure: Mirvac has a minimum liquidity target of the higher of AUD300 million or 12 months of debt maturities, consisting of cash and undrawn committed facilities. At FYE18, Mirvac had AUD221 million of cash and AUD685 million of undrawn committed facilities. The company's formalised debt and liquidity-management policies allow it to effectively match its assets and liabilities, while ensuring it has sufficient liquidity to meet its commitments as and when they fall due - the difference between its portfolio's weighted-average lease expiries (5.6 years) and its weighted-average debt tenor (6.8 years) is around one year.

FULL LIST OF RATING ACTIONS

Mirvac Group
- Long-Term Foreign-Currency Issuer Default Rating assigned at 'A-'; Outlook Stable
- Senior unsecured rating assigned at 'A-'

Mirvac Group Finance Limited
- Senior unsecured rating assigned at 'A-' for the following programmes and senior unsecured bonds guaranteed by Mirvac:
- EUR2 billion medium-term note programme dated 6 September 2017
- Commercial paper and medium-term note programme dated 23 August 2016
- AUD250 million 3.5% senior unsecured notes due 18 September 2023 (ISIN: AU3CB0239507)
- AUD200 million 5.75% senior unsecured notes due 18 September 2020 (ISIN: AU3CB0214534)
- USD400 million 3.625% senior unsecured notes due 18 March 2027 (ISIN: XS1688567251)

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)
Sector Navigators (pub. 23 Mar 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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Endorsement Policy

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