RATING METHODOLOGY

DEBT SECURITIES/SUKUK ISSUED BY MALAYSIAN REAL ESTATE INVESTMENT TRUSTS (M-REITS)

OVERVIEW

The rating methodology on Malaysian real estate investment trusts (M-REITs) will focus on the asset quality as well as operating strength of the pool of properties in the portfolio, the factors that will impact the performance of the property market, and the evaluation of the property managers appointed to manage the M-REITs together with the support from sponsors, if any. The rating approach will also assess the M-REIT's financial performance with an emphasis on their liquidity and funding position in relation to their abilities to service interest payments and repay principal obligations on debt securities issued. This is pertinent from a credit perspective as REITs are often required to have high dividend distribution and, hence, have limited cash retention.

Since the launch of the first M-REIT in August 2005, the domestic REIT sector has continued to evolve in terms of asset size and diversity.MARC Ratings will assess the prospects of the industries that influence demand for the assets in the portfolio. In addition to commercial properties, the M-REIT sector includes industrial, retail, hotel, hospital, and plantation assets. As at end-May 2025, there are 19 M-REITs listed on Bursa Malaysia, of which five are based on Islamic Shariah principles, with a total asset size of about RM79.0 billion. MARC Ratings will also focus on the regulatory framework governing M-REITs, including the tax structure as well as gearing limits in relation to the ability of M-REITs to undertake growth strategies as well as honour debt obligations.

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The rating factors are summarised as follows:

- Asset quality – risk profile of each asset under the portfolio, type of properties, location, accessibility, market value of each asset, property tenure (whether freehold/leasehold), age
- Operating strength – rental stability and sustainability, tenant composition, lease structure and tenancy terms, asset and geographic diversity
- Management of the REIT – track record, external and internal growth policies, fee structure, governance and policies, presence of sponsor(s), quality of property contribution from sponsor(s) (if any)
- Financial analysis – profitability, liquidity and funding, capital structure, financial flexibility

ASSET QUALITY

MARC Ratings will assess the risk profile of each asset in the M-REIT portfolio by focusing on the macroeconomic and microeconomic factors that will impactthe performance of the asset. For the evaluation of macroeconomic factors, this will include examining property market cycles, the supply and demand dynamics in the areas where the properties are located, the economic growth outlook,and the interest rate environment.

MARC Ratings will examine the location of the property in terms of maturity and accessibility. Properties located in or near strong economic growth areas are viewed to have a more competitive edge than those in areas where diminished prospects for growth are envisaged. Highly populated areas which usually have more stable economic activity will be viewed more positively compared to areas with a population of lower density. Other factors that will determine the strength of demand, such as government efforts to lure potential industries and/or creation of economic zones through the provision of tax and other incentives, will also be considered.

MARC Ratings takes into consideration that different classes of assets have different levels of risk. For instance, should economic policies favour more service-oriented enterprises, interest in commercial properties could increase and, conversely, if factors such as relocation to lower-wage countries gather pace, demand for industrial properties could wane. As another example,hospital assets, which are perceived to have a higher degree of risk given its specialised nature relative to commercial assets, may restrict opportunities for it to be converted for alternate uses.

Other considerations for assessment include the acquisition price of the assets, redevelopment potential, tenure of the property (freehold/leasehold), and the number of years remaining on the lease if the property has leasehold status. In addition, its size, age and condition will provide an indication on refurbishment and upgrading requirements and, hence, potential for yield accretion will be assessed. Newer and more recently completed properties are assumed to be superior in attracting tenants as the buildings are of higher quality in their classes and may be a better fit with current market demand. If the collateral properties are properly maintained and renovated, they may be able to maintain their competitiveness, regardless ofage.In assessing the performance of the M-REIT, MARC Ratings views asset quality as crucial for tenant retention, as well as improving occupancy levels and marketability. As part ofits assessment, MARC Ratings will also seek the latest valuation report on each of the properties in the M-REIT portfolio from qualified valuers, and conduct on-site inspections of the main assets.

OPERATING STRENGTH

MARC Ratings will evaluate the ability of the properties to generate sustainable and stable rental streams relative to the portfolio's debt obligations. The size of the M-REIT's portfolio as well as its market positioning will be considered, as M-REITs with larger portfolios may have greater flexibility to sell non-performing properties, if needed. The portfolio's diversity in terms of asset usage, as well as geographic and tenant mix, are factors that would support its operating stability. In general, MARC Ratings considers a geographically diversified portfolio to be more favourably inclined to generate sustainable cash flow. However, should an M-REIT be less diversified, it can still be susceptible to similar risk factors. Despite this, in some cases where M-REIT portfolios have assets concentrated in a single high-density area with thriving economic activities, such as having commercial properties in the Kuala Lumpur city centre, this will not be seen as detrimental to the evaluation of the portfolio as MARC Ratings will assess the competitiveness of the properties. In this case, the concentration of properties in the Kuala Lumpur city centre is viewed to pose less risk given the higher scale of economic activity and the level of connectivity that exceeds other regions in Malaysia.

Given that different property types have varying degrees of risk, the composition of the portfolio in terms of revenue contribution will be assessed. A fairly diversified revenue base will be seen as contributing to greater stability of the portfolio's operating cash flow.

In evaluating the operating strength of the M-REIT portfolio, tenant mix is an important indicator ofthe performance of the portfolio going forward. In this regard, MARC Ratings will evaluate the quality of tenants by assessing the creditworthiness of these tenants, the diversity of the major tenants, the percentage of rental space occupied by major tenants and the nature of the tenancy agreements in terms of average length of tenancy, number of future renewal periods, rental step-up clauses, and termination clauses, among others. Assessment on the lease structure will also be carried out, of which triple net leases and long-term fixed rate leases will be viewed more favourably. MARC Ratings will also look at the degree of single-asset exposure to see how vulnerable rental stability can be. If the number of tenants is limited, the assessment will place emphasis on the creditworthiness of key tenants instead, by analysing details of leases and the importance of the collateral properties to the tenants. MARC Ratings will also examine historical tenancy statistics, i.e. the rental ageing analysis, default rates and eviction statistics, and evaluate management policies that are in place to minimise these risks.

MANAGEMENT OF THE REIT

Given that the composition of M-REIT portfolios is expected to be continuously changing over the long term, MARC Ratings will examine the caliber and track record of the M-REIT portfolio manager to ascertain its business direction moving forward. Assessment will be made on both the M-REIT manager's external and internal growth policies.

For its external growth policies, MARC Ratings will evaluate the M-REIT's management strategy in relation to its ability to execute yield-accretive plans by growing the portfolio through divestments and subsequent investments in revenue-generating properties. The manager's past and current investment criteria, which is crucial in determining the prospects for the M-REIT, will also be assessed. The management's risk appetite in relation to its acquisition and divestments as well as the terms of its compensation package will be considered. Where a pattern of frequent asset sales to generate short-term capital gains is detected, MARC Ratings may be inclined to view such actions less favourably and as contributing to earnings fluctuations. MARC Ratings will ascertain if the investment plans are in line with the M-REIT's vision and assess its track record of successful implementation to date. Additionally, management with strong property sourcing capabilities or those that have been able to create a "brand" for its chain of properties will be viewed more favourably.

For its internal growth policies, the M-REIT manager's role in carrying out effective risk management will be assessed by examining the internal policies on managing tenant risk, including policies on tenant selection, policies on the execution of asset enhancement initiatives (AEI) to improve asset value through refurbishment, as well as policies pertaining to the maintenance of the properties under its portfolio. In addition, the manager's ability to provide timely valuation reports on all of the M-REIT's properties, and other reports as required by regulatory authorities, will be taken into consideration.

Sponsor

A sponsor of an M-REIT is usually the company or group that originally owned the real estate properties initially injected into the M-REIT. The sponsor provides the initial assets or properties that go into the M-REIT when it is first created. Sponsors are often property developers or large real estate companies.

In Malaysia, the sponsor usually continues to support the M-REIT after it is established, by actively contributing to its growth. This is done by, among others:

- Selling more properties to the M-REIT
- Giving the M-REIT access to new developments
- Providing management expertise
- Enabling the leverage of sharedbranding.

The sponsor often holds a significant ownership stake in the M-REIT, therefore they have an interest in its long-term success. With the presence of a sponsor with a strong profile, the credit assessment on the M-REIT would be better supported.

However, MARC Ratings will also look into the governance policies the M-REIT manager has put in place to ensure all regulatory requirements pertaining to related party transactions or potential conflicts of interest are adhered to. The level of the M-REIT manager's dependence on or independence from its sponsor will also be taken into consideration to assess the M-REIT manager's property sourcing capabilities; limited abilitiesmay result in the acquisition of inferior properties.

FINANCIAL ANALYSIS

MARC Ratings will analyse the financial performance of the M-REIT by focusing on key financial ratios, bearing in mind that the distribution of a significant portion of earnings is an intrinsic characteristic of an M-REIT.

Profitability

Among the profitability measures that will be assessed are as follows:

- Growth in net operating income (NOI)
- Operating margins
- Dividend payout ratio
- Expenses/ Operating Income
- Return on Assets

A trend analysis of these measures will indicate the ability of the M-REIT to operate within the parameters of its stated objectives and help identify contributing factors to the strength and weakness of its performance. The dividend payout will provide insights on the M-REIT's financial policy on balancing income distribution to unitholders and payment to creditors with its cash retention capacity to fund future growth of its business. To gauge the M-REIT's performance going forward, MARC Ratings will take into account the M-REIT's financial projections and its management plans.

Cash flow coverage

Cash flow coverage ratios are important measures to assess the extent to which M-REIT's financial obligations are covered by its operating cash flow. Among the key cash flow protection measures analysed are as follows:

- Cash Flow from Operations (CFO)/Interest Coverage
- CFO/Debt payments
- EBITDA/Interest
- Debt Service Cover Ratio (DSCR)

MARC Ratings will also carry out sensitivity tests to assess the sustainability and stability of the future cash flow projections by varying the occupancy levels, rental rates, interest payments and other inputs. Where there may be assets in the pool which are encumbered, MARC Ratings will seek to exclude the cash flow generated from the assets to obtain the M-REIT's actual free cash flow position.

Capital structure

MARC Ratings will examine the M-REIT's capital structure by focusing on the following key leverage ratios:

- Total debt/Capital
- Short-term debt/Capital
- Long-term debt/Capital
- Debt/Market value
- Debt/EBITDA
- Overcollateralisation
- Composition of fixed vs floating borrowings

The M-REIT's gearing level will be compared with its internal policy as well as to the prevailing limit set by the regulatory body — the statutory debt limit is 50% of an asset's value. MARC Ratings will assess the ability of the M-REIT to manage its capital prudently while balancing its need for growth by borrowing against the assets.

MARC Ratings will also examine the collateral cover of the assets (overcollateralization, or"OC") to determine the available buffer against debt should the value of the assets deteriorate.MARC Ratings will also examine the collateral cover of the assets (overcollateralisation, or "OC") to determine the available buffer against debt should the value of the assets deteriorate. This is calculated by taking the total valuation of assets under the portfolio and dividing this by the borrowings taken by the M-REIT. The minimum OC of 1.69x is viewed to provide reasonable buffer for full recovery of the principal.

The composition of the M-REIT's exposure to fixed vs floating borrowings will also be taken into consideration to assess its sensitivity to interest rate movements. Additionally, the debt maturity profile will be examined, particularly the structure of its repayment schedule.Where lumpy maturities exist, MARC Ratings will assess the ability of the M-REIT to refinance the debt on a timely basis with particular concern. In assessing refinancing risk, MARC Ratings will seek to understand the debt characteristics of the M-REIT and its ability to maintain available unencumbered assets to be secured as collateral to provide new financing. A large portion of unencumbered assets is viewed as credit positive as this suggests higher financial flexibility of an M-REIT. Securitisation transactions also involve the collection of cash in accounts or other types of high-quality assets in collection accounts to provide a buffer for bondholders/sukukholders.

Financial flexibility

MARC Ratings will examine the M-REIT's financial flexibility by assessing its available banking lines. MARC Ratings will also assess whether adequate banking lines are available to the M-REIT in relation to debt repayment and acquisition plans.

Additionally, the M-REIT's demonstrated ability to access to capital in the past, based on its success in increasing its capital through either the public or private markets, will contribute positively to the credit assessment.

Where the M-REIT will need to initiate asset sales for repayment, MARC Ratings will assess the time frame needed.

SUMMARY

Key rating factors under this methodology are as follows:

Factor	Remarks
Asset quality	Risk profile of assets under portfolio, location, asset classes, property market trend
Operating strength	Size of portfolio, ability to generate stable revenue, portfolio diversification, tenant mix, lease structure
Management	Track record and experience, business direction – external and internal growth policies, governance policies Presence of sponsor
Profitability	Growth in NOI, operating margins, dividend payout ratio
Cash flow coverage	CFO interest coverage, CFO debt payment coverage, DSCR, degree of unencumbered assets
Capital structure	Debt/capital, Overcollateralization, composition of fixed vs floating borrowings, debt maturity profile, refinancing riskDebt/capital, overcollateralisation, composition of fixed vs floating borrowings, debt maturity profile, refinancing risk
Financial flexibility	Adequate banking lines, access to capital

This methodology should be read in conjunction with MARC Ratings' "Corporate Debt Ratings" methodology which is available on MARC's corporate website at www.marc.com.my.

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