

Singapore REITs

State of the industry

SINGAPORE | REAL ESTATE (REIT) | UPDATE

29 May 2015

Summary

- We remain overweight on S-REITs even though we acknowledge valuations are catching up.
- Sector outperformance vs STI to slow; stick to REITs operating within resilient industries/geographical regions.
- Fundamental growth drivers for our top picks remain intact.
- Impending rise in 10y bond yields to lead to compressing spreads, but S-REITs still offer better spreads vs US and Japan peers. S-REITs also offer better exposure to more diversified sectors and geographical regions vs HK-REITs.
- Headwinds remain across the sectors such as looming huge supply of commercial space, lacklustre general retail sales and slow rebound in tourist arrivals.

Top ideas

- **Croesus Retail Trust (Buy).** Pro-growth Abenomics/growth in Japanese consumer confidence and wages to boost consumption spending.
- **Soilbuild Business Space REIT (Buy).** Secular trend of decentralisation of commercial activities outside of the City – Business Parks to rule.
- **Capitaland Retail China Trust (Accumulate).** China's move towards a consumption-driven economy to drive spending power of Chinese consumers.
- **First REIT (Accumulate).** Indonesian health care reforms in progress, ramping up hospital network at the most opportune time.
- **Cache Logistics Trust (Accumulate).** Portfolio of quality warehouses, positioned to capitalise on Singapore's status as the regional logistics hub.
- **Fraser Centrepoint Trust (Accumulate).** Resilient heartland malls with little upcoming supply competition.

Key takeaways from 1Q CY15 results

- **Commercial: Office rental index still going up, underpinning Commercial Reits' rental reversions, but growth is slowing.** Grade A office rents grew 1.8% q-q vs the 5.1% q-q change in 1Q14.
- **Industrial: Risk involved in sale and leaseback transactions.** The vendor tends to have the intention of not renewing the lease upon expiry. In such an instance, the vendor has the intention of using the proceeds from the sale to develop its own property and subsequently move into it. This creates a tenancy risk for the REIT when the leaseback period expires.
- **Retail: General local retail sales remain sluggish.** Excluding motor vehicles, retail sales for March fell 3.2% y-y. Strong mall operators were still able to grow shopper traffic q-q. Malls in certain suburban areas where recent supply is huge, are starting to get hit with slower rental reversions. These include the Jurong East and Raffles City/Marina Square areas.
- **Hospitality: Weak tourist numbers and corporate demand weighed on earnings.** Absence of biennial events such as the Singapore Airshow in February and weak tourism numbers affected RevPAR numbers for hotels. Weaker demand from corporate clients for serviced apartments also weighed on earnings.

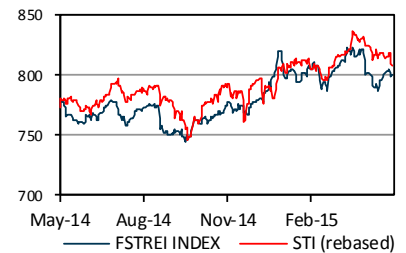
Outlook for the sector

- **Commercial: Looming surge in supply increases bargaining power of tenants.** 3.6 million sq ft of new office space in 2016 vs average annual net demand of 1.2 million sq ft. (last 10 years) Given the huge oncoming supply of office space in 2016, we expect the office rental index to slow even further towards the end of the year. Tenants will be mindful of the huge oncoming supply and negotiate for lower rates. On the other hand, landlords will be trying to lock in tenants on longer leases to avoid lease expiries in 2016-2018 as the market works off the

INDEX PERFORMANCE (%)

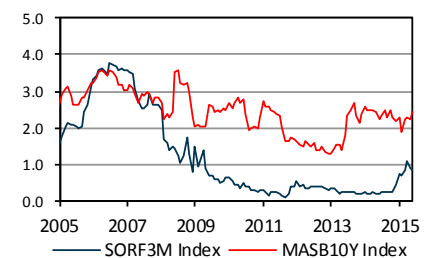
	1M TH	3M TH	1YR
FSTREIRETURN	(0.7)	0.8	9.6
STIRETURN	(15)	19	7.7

FSTREI VS. STI



Source: Bloomberg, PSR

3-month SOR (%) & 10-year SGS (%)



Source: Bloomberg, PSR

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excess supply of office space then. Bargaining power is increasingly shifting in tenants' favour as we move closer to 2016.

- **Industrial: Large supply of industrial space coming on-stream in 2015 and 2016.** 2.1 million sqm for the remaining three-quarters of 2015, and 2.5 million sqm in 2016. This will add to the existing stock of 43.19 million sqm (as of 1Q CY15), and is higher than the average supply of around 1.5 million sqm in the past three years. (Source: JTC)
- **Retail:** We expect retail sales to remain sluggish. Interest rate hike expectations have pushed 3m Sibor in March to its highest levels in 8 years. This could have caused consumers to tighten purse strings on other discretionary spending as higher mortgage repayments eat into disposable income. Lacklustre tourist arrivals are not expected to be catalyst sources as well.
- **Hospitality:** We expect tourist numbers to register higher y-y numbers towards the later part of the year due to the low base effect created last year and the aggressive S\$20m marketing campaign by STB. We do not, however, expect a huge increase in total yearly tourist numbers from last year due to a lack of significant attraction openings this year, as well as the continual strengthening of the SGD against the IDR. Indonesians are our biggest tourist group by nationality.

REITS Table (By Sector and YTD Performance)

Source: Bloomberg (Updated: 27 May 2015)

Commercial	Mkt. Cap (\$\$mn)	Price (\$\$)	P/NAV (x)	yield (%)	YTD (%)	RECOMMENDATION
FRASERS COMMERCIAL TRUST	1067	1.565	0.99	6.1	10.6	
MAPLETREE COMMERCIAL TRUST	3223	1.525	1.23	5.2	8.2	
QUE COMMERCIAL REIT	721	0.825	0.75	6.9	2.5	
KEPPEL REIT	3793	1.190	0.85	5.7	-2.5	
CAPITALAND COMMERCIAL TRUST	4791	1.625	0.94	5.2	-7.4	
SUNTEC REIT	4519	1.800	0.85	5.0	-8.2	
IREIT GLOBAL	341	0.810	1.11	7.9	-9.0	

Retail	Mkt. Cap (\$\$mn)	Price (\$\$)	P/NAV (x)	yield (%)	YTD (%)	RECOMMENDATION
MAPLETREE GREATER CHINA COMM	2910	1.065	1.01	6.4	12.1	
FRASERS CENTREPOINT TRUST	1915	2.09	1.13	5.7	10.3	ACCUMULATE (TP \$2.14)
CAPITALAND RETAIL CHINA TRUST	1481	1.765	1.07	5.5	9.3	ACCUMULATE (TP \$1.90)
CAPITALAND MALL TRUST	7689	2.22	1.21	4.8	8.8	
STARHILL GLOBAL REIT	1863	0.865	0.94	5.8	8.1	
LIPPO MALLS INDONESIA RETAIL	991	0.365	0.86	10.0	7.4	
CROESUS RETAIL TRUST	492	0.950	1.17	11.4	2.7	BUY (TP \$1.08)
SPH REIT	2664	1.055	1.13	5.3	1.4	
FORTUNE REIT	HKD14678m	HKD7.81	0.66	5.3	0.6	

Industrial	Mkt. Cap (\$\$mn)	Price (\$\$)	P/NAV (x)	yield (%)	YTD (%)	RECOMMENDATION
KEPPEL DC REIT	945	1.070	1.22	6.0	9.7	
SOILBUILD BUSINESS SPACE REIT	790	0.850	1.06	7.8	7.6	BUY (TP \$1.00)
MAPLETREE INDUSTRIAL TRUST	2778	1.590	1.20	6.7	7.1	
ASCENDAS INDIA TRUST	808	0.875	1.46	5.6	6.7	
VIVA INDUSTRIAL TRUST	521	0.835	1.12	9.1	5.0	
AIMS AMP CAPITAL INDUSTRIAL	935	1.480	0.96	7.9	4.6	
CAMBRIDGE INDUSTRIAL TRUST	909	0.710	1.04	6.9	4.4	
ASCENDAS REAL ESTATE INV TRT	5967	2.48	1.19	5.9	4.2	
CACHE LOGISTICS TRUST	908	1.160	1.19	7.4	0.0	ACCUMULATE (TP \$1.31)
MAPLETREE LOGISTICS TRUST	2932	1.185	1.16	6.2	0.0	
SABANA SHARIAH COMP IND REIT	627	0.860	0.79	8.3	-8.5	

Healthcare	Mkt. Cap (\$\$mn)	Price (\$\$)	P/NAV (x)	yield (%)	YTD (%)	RECOMMENDATION
FIRST REAL ESTATE INVT TRUST	1069	1.440	1.48	5.7	14.7	ACCUMULATE (TP \$1.55)
RELIGARE HEALTH TRUST	822	1.035	1.16	7.0	3.5	
PARKWAYLIFE REAL ESTATE	1416	2.34	1.37	5.5	-1.7	

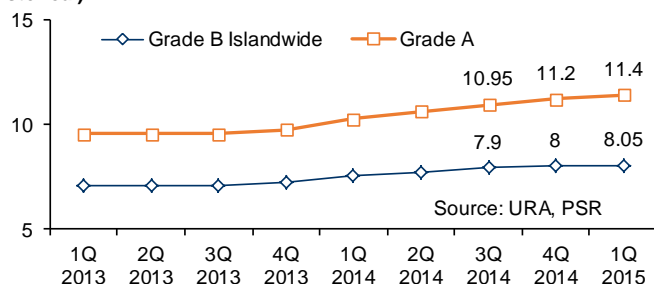
Residential	Mkt. Cap (\$\$mn)	Price (\$\$)	P/NAV (x)	yield (%)	YTD (%)	RECOMMENDATION
SAIZEN REIT	247	0.870	0.80	7.1	1.2	

Hospitality	Mkt. Cap (\$\$mn)	Price (\$\$)	P/NAV (x)	yield (%)	YTD (%)	RECOMMENDATION
QUE HOSPITALITY TRUST	1261	0.950	1.05	6.8	5.0	
ASCENDAS HOSPITALITY TRUST	792	0.710	1.03	7.2	4.4	
ASCOTT RESIDENCE TRUST	1979	1.285	0.95	6.6	1.2	
CDL HOSPITALITY TRUST	1692	1.720	1.06	6.7	-1.1	
FAR EAST HOSPITALITY TRUST	1416	0.795	0.82	5.4	-2.5	
FRASERS HOSPITALITY TRUST	1036	0.860	1.03	4.3	-3.4	
FSSTI INDEX					1.6	
FST REIT INDEX					2.6	

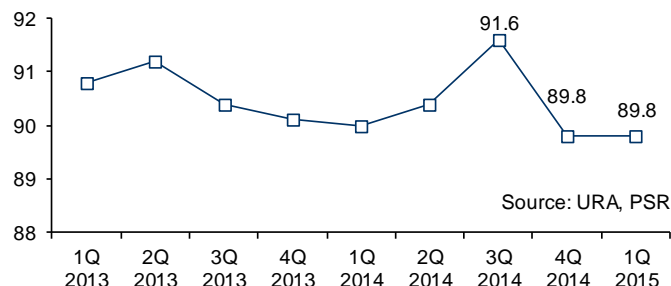
Commercial REITs

Status

Commercial Office Rental Index: Grade A and Grade B Islandwide (2y historical)



Occupancy Rate of Private & Public Sector Office Space % (Whole Island)



Periods	Average annual net supply	Average annual net demand
2005 – 2014 (through 10-year property market cycles)	0.8m sq ft	1.0m sq ft
2010 – 2014 (five years period post GFC)	1.0m sq ft	1.2m sq ft
2015 – 2019 (gross supply)	1.0m sq ft	N.A.

Source: Capitaland Commercial Trust 1Q15 Results Presentation

Outlook

- **Large supply of office space in 2016 to limit rental growth.** 3.6m sq ft of new office space, primarily in the Marina Bay area is substantially more than average annual net demand of 1.2m sq ft for the past five years.
- **CBD office rental growth could be subdued until 2018 as the market works off excess supply.** Average net demand for office space over the past 10 years is 1m sq ft. Though average annual net supply for next 5 years is 1m sq ft, the sudden flood in supply in a single year (2016) would prove hard to work off. We think CBD office rental growth could be subdued until 2018.
- **Slowing demand to further weigh on rents.** Tech companies have largely made up for the slack in CBD office space demand from financial institutions in recent years. Lately, however, we are seeing an increasing number of companies move out of CBD offices into more suburban business parks. Daimler and Google (reportedly in negotiations) are two recent examples. We highlighted this secular trend of businesses decentralising from city area in our Soilbuild REIT initiation.

Strategy

- Explore REITs with exposure to outside central CBD regions. **(Fraser's Commercial Trust: Not-rated)**

Healthcare REITs

Outlook

- **Weak CPI may weigh on Parkway Life REIT (PLIFE)'s Singapore property rental reversions.** Parkway Life's Singapore properties have rental reversions pegged to either CPI (CPI+1%) or percentage of revenue. Strong positive Singapore CPI numbers over the past few years, especially in 2011 and 2012 have driven rental reversions for PLIFE. Rental growth could slow this year given the negative CPI numbers for January to April.
- **Japanese nursing homes remain in tight supply.** PLIFE's management has guided that quality nursing homes in Japan remain in short supply amid strong demand from the ageing population. This could drive rental reversions for PLIFE's portfolio of nursing homes in Japan.
- **Positive on Indonesia healthcare reforms.** We remain bullish on the Indonesian healthcare sector as President Jokowi rolls out universal healthcare coverage. We expect further acquisitions to boost First REIT's DPU growth this year.

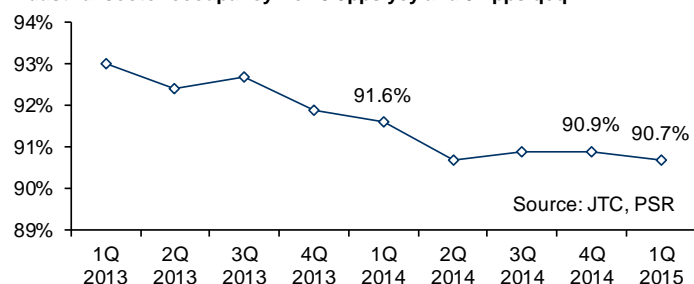
Strategy

- Ongoing healthcare reforms in Indonesia to drive First REITs' expansion plans in Indonesia. **(First REIT: Accumulate)**
- Explore REITs that are exposed to healthcare sectors where the macro picture is supportive. For instance, REITs expanding hospital networks in countries which have a clear lack of hospital beds eg. Indonesia and India. **(Religare Health Trust: Non-Rated)**

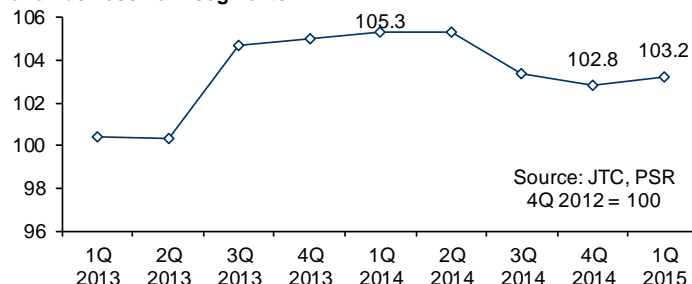
Industrial REITs

Status

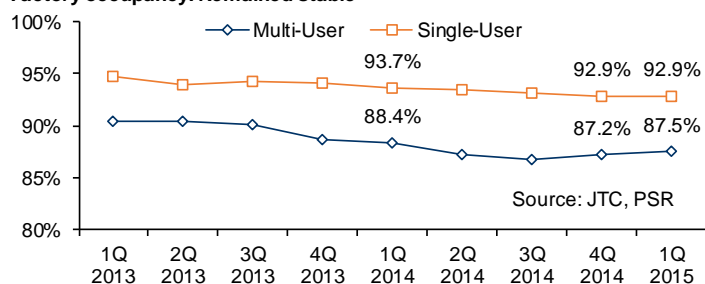
Industrial sector occupancy: Fell 0.9pps yoy and 0.2pps qoq



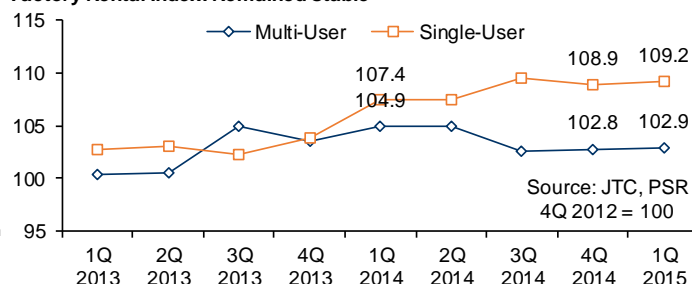
Industrial sector Rental Index: Rebounded 0.4% qoq, led by Warehouse and Business Park segments



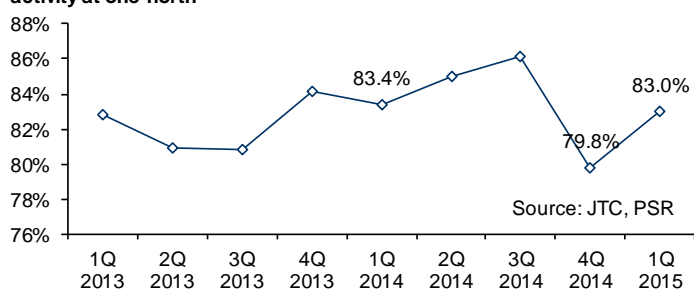
Factory occupancy: Remained stable



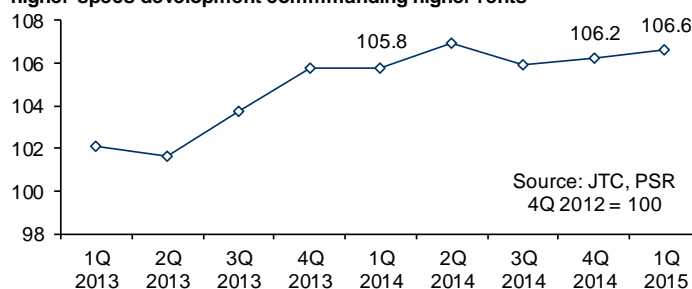
Factory Rental Index: Remained stable



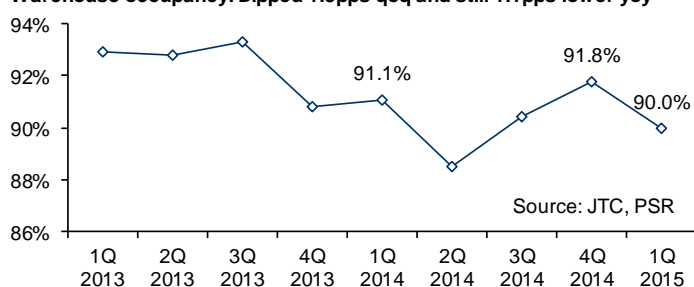
Business Park occupancy: Up 3.2pps qoq, contributed by healthy leasing activity at one-north



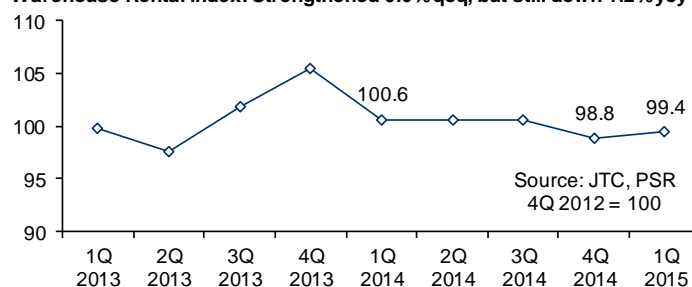
Business Park Rental Index: Strengthened 0.4% qoq, due to newer and higher-specs development commanding higher rents



Warehouse occupancy: Dipped 1.8pps qoq and still 1.1pps lower yoy



Warehouse Rental Index: Strengthened 0.6% qoq, but still down 1.2% yoy



Outlook

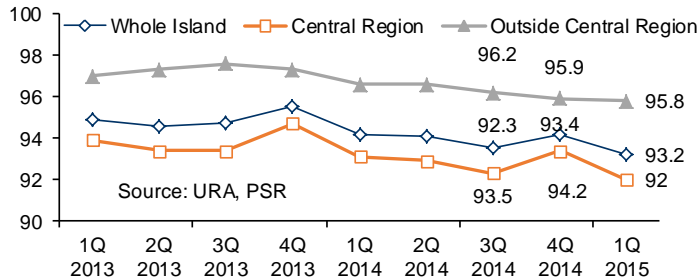
- **Downward pressure on rents for factory space expected.** Pressure coming from the supply-side as there will be substantial completion of factory space of 3.07 million sqm in 2015 and 2016.
- **Demand for Business Park to remain healthy.** Rental and occupancy to remain stable with potential for higher rents, with less supply.
- **1.18 million sqm of Warehouse supply but... c.73.5% is pre-committed.** Thus there is limited oversupply risk.
- **Keen competition among landlords to secure qualifying tenants.** This will be exacerbated by supply pressure.

Strategy

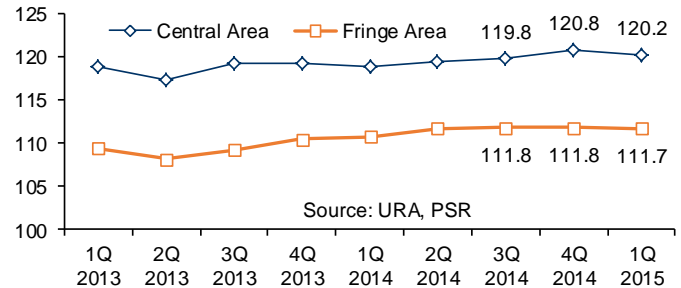
- Add exposure to REITs with **Business Park spaces** in the portfolio. **(Soilbuild REIT: BUY)**
- Be **selective on Warehouse REIT**: Choose a portfolio of warehouses with good locations (near to ports and airports) and superior design (modern ramp-up type vs. legacy cargo-lift type). **(Cache: Accumulate)**
- Explore REITs that will have **DPU growth through BTS projects** in the pipeline. **(Cache: Accumulate; Mapletree Industrial Trust: Not-rated)**

Retail REITs Status

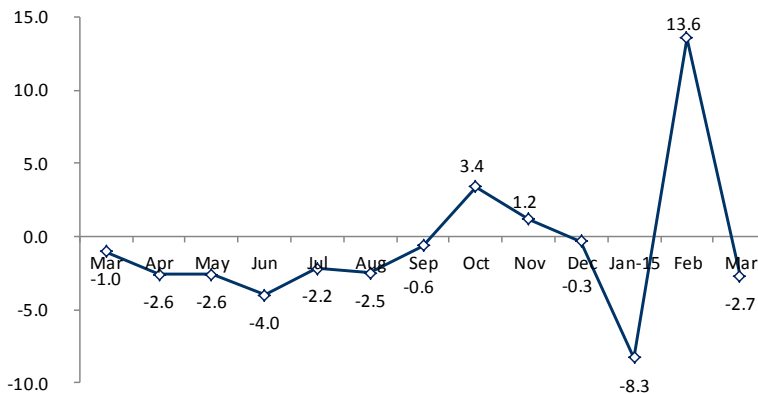
Occupancy Rate of Private & Public Sector Retail Space (%)



Rental Index of Private Sector Retail Space



Singapore Retail Sales (ex Motor Vehicles) y-y growth (%)



Retail sales growth resumed the sluggish trend after the February bump due to CNY effect

Source: Singstat, PSR

Outlook

- **Weak tourist numbers negatively affect high-street portfolio.** We expect tourist numbers to register higher y-y numbers towards the later part of the year due to the low base effect created last year. STB's aggressive S\$20m marketing campaign and major sporting events in the later part of the year, such as the SEA games and WTA tennis championships would provide some support. We do not, however, expect a huge increase in total yearly tourist numbers from last year due to a lack of significant attraction openings this year, as well as the continual strengthening of the SGD against the IDR. Indonesians are our biggest tourist group by nationality.
- **Retail sales to remain flat y-y.** We do not expect retail sales to pick up significantly this year. Interest rate hike expectations have pushed 3m Sibor in March to its highest levels in 8 years. This could cause consumers to tighten purse strings on other discretionary spending. Low inflation and low unemployment could also provide some support.

Strategy

- Maintain **exposure on resilient heartland malls in Singapore**, especially those with little upcoming competing supply (**Frasers Centrepoint Trust: Accumulate**)
- Capitalise on countries with growing middle class affluence/consumer spending power such as China and Japan (**CapitaLand Retail China Trust: Accumulate, Croesus Retail Trust, BUY**)

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