Singapore REITs

Industrial sub-sector: Possibility of rents bottoming this year

SINGAPORE | REAL ESTATE (REIT) | UPDATE

- Lower yoy sector-wide occupancy and rental; qoq improvement in occupancy
- Sector's Rental Index has fallen below 2012 levels, with rental reversions likely to maintain at negative high single-digit to negative low double-digit
- Multiple-User Factory and Warehouse rental reversions maintained at negative double-digit from previous quarter and likely to be maintained in 2017
- Factory space was the hardest hit in 4Q 2016 with an onslaught of new supply
- Supply pressure in 2017 for Warehouse space is going to be worse than 2016
- Expect reversions for Business Parks to be flat
- We believe rents could bottom in 2017, but emphasize that negative rental reversions to persist
- Upgrade Industrial sub-sector to "**Equal Weight**" on optimism of bottoming of rents
- Maintaining our "**Underweight**" view on the overall S-REITs sector

What is the news?

- JTC recently released its Quarterly Market Report of Industrial Properties for 4Q 2016.

Summary of Rental & Occupancy rate, as at 4Q 2016

		3Q 2016	4Q 2016	%qoq	%yoy
Rental	All Industrial	94.3	93.8	(0.5)	(6.8)
	Multiple-User Factory	92.2	91.7	(0.5)	(7.7)
	Single-User Factory	101.8	100.9	(0.9)	(6.6)
	Business Park	104.2	105.4	1.2	0.5
	Warehouse	91.2	91.0	(0.2)	(6.4)
Occupancy	All Industrial	89.1%	89.5%	0.4	(1.1)
	Multiple-User Factory	87.1%	87.3%	0.2	0.1
	Single-User Factory	90.6%	90.9%	0.3	(1.4)
	Business Park	81.1%	83.0%	1.9	(1.1)
	Warehouse	89.1%	89.7%	0.6	(1.7)

Source: JTC, Phillip Securities Research (Singapore)

Key takeaways from the quarter

- **Reversions were generally negative, again only a minority bucked the trend**
  Generally negative reversions across the Industrial REITs, as the oversupply condition persists with muted demand. Exceptions of positive *portfolio weighted average* rental reversions during the quarter came from **Ascendas REIT (A-REIT)** (+3%) and **Mapletree Industrial Trust (MINT)** (+2.1%). **Keppel DC REIT (KDCREIT)** renewed a major lease in one of its Singapore properties for five-years, at approximately 3% higher rent than the preceding rate.
- **Certain portfolios revalued downwards**
  In our previous report (11 November 2016) for the Industrial sub-sector, we had cautioned on portfolio revaluation losses. With the *exception* of **Viva Industrial Trust (VIT)**, all the other industrial REITs that ended their fiscal year in December 2016 recorded fair value losses to investment properties.
- **Possible bottoming of rents, but still a tenants' market**
  We observed that *asking rents* being posted by leasing agents had stabilised during the quarter. Our channel check suggests that there is still a fair amount of leasing activity on the ground and that rents may be bottoming. This was corroborated by one of the REIT CEOs during the results briefing who opined that we are close to the bottom for Industrial rents. We do however draw a distinction between rent level and rental reversions. We still are expecting softness for the sector, with aggregate reversions to be at least in the high negative single-digit region for 2017.

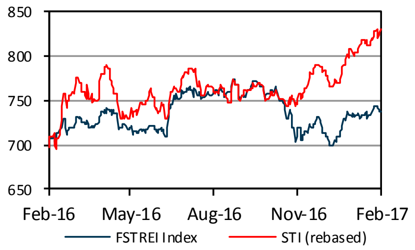
20 February 2017

Underweight

INDEX PERFORMANCE (%)

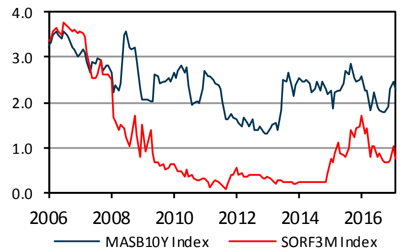
	1MTH	3MTH	1YR
FSTREI RETURN	2.6	5.9	12.5
STI RETURN	3.0	11.4	21.7

FSTREI VS. STI



Source: Bloomberg, PSR

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



Source: Bloomberg, PSR

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Investment Actions

We have downgraded our view on the overall S-REITs sector to "**Underweight**" in our most recent S-REIT sector report (6 February 2017). In this update report, we upgrade the Industrial sub-sector to "**Equal Weight**" on optimism of the bottoming of Industrial rents this year.

Industrial REITs under our coverage

	Rating	Target Price (S$)	Last Close Price (S$)
Cache Logistics Trust	Reduce	0.730	0.810
Keppel DC REIT	Neutral	1.150	1.175
Mapletree Industrial Trust	Accumulate	1.740	1.660
Soilbuild Business Space REIT	Neutral	0.680	0.650

Source: Phillip Securities Research (Singapore)

Cache Logistics Trust (Cache) – High gearing of 43.1% is the key idiosyncratic impediment to inorganic growth

- "Reduce" rating from our results report on 25 January
- Limited scope for organic growth in gross revenue due to oversupply, mitigated by only 4.9% expiry by gross rental income in FY17
- In the absence of any capital distribution from the divestment of Changi Districentre 3 in January 2017, we are expecting lower year-on-year (yoy) DPU in all four quarters of FY17e
- We forecast 6.44/6.91 cents distribution per unit (DPU) for FY17e/FY18e, which is 13.0%/6.6% lower than consensus expectation of 7.4/7.4 cents

Keppel DC REIT (KDCREIT) – Expecting 30% yoy higher gross revenue in FY17 driven by two acquisitions completed in FY16 and one in January 2017

- "Neutral" rating from our results report on 24 January
- Completed the acquisition three data centres in Cardiff, Wales; Milan, Italy and Singapore
- However, the three acquisitions came at a cost – increasing unitholder base following the 274-for-1,000 Preferential Offering in November 2016
- Hedging policy in place to hedge two-years ahead for expected foreign currency denominated income does not detract from the fact that there is country risk and currency risk exposure
- We forecast 6.39/6.19 cents DPU for FY17e/FY18e, which is 11.3%/16.4% lower than consensus expectation of 7.2/7.4 cents

Mapletree Industrial Trust (MINT) – Firepower to acquire: 29.4% gearing is one of the lowest within the S-REIT universe

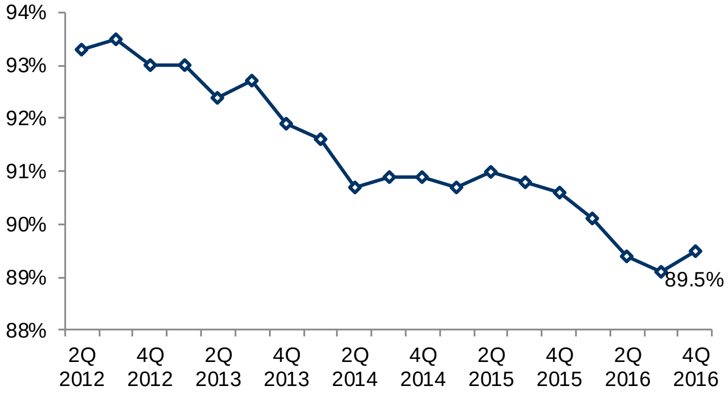
- "Accumulate" rating from our results report on 25 January
- Phase One of Hewlett-Packard build-to-suit (BTS) is already contributing, Phase Two to contribute by 2Q CY17
- We are mindful of the 31% of leases expiring in FY18 in an oversupply landscape; about half of the leases expiring in FY18 come from the Flatted Factories segment
- We forecast 11.22/11.34 cents DPU for FY17e/FY18e, which is broadly in line with consensus expectation of 11.0/11.9 cents

Soilbuild Business Space REIT (SBREIT) – Tough year ahead to backfill Loyang Way property

- "Neutral" rating from our results report on 25 January
- Acquisition of Bukit Batok Connection to just offset the negative effect of the Loyang Way vacancy; Loyang Way property size is 5.2% by portfolio value
- DPU to be weighed down by higher unit base arising from the 1-for-10 Preferential Offering in September 2016
- We are expecting lower yoy DPU in all four quarters of FY17e
- We forecast 5.47/4.87 cents DPU for FY17e/FY18e; this is 4.0%/11.5% lower than consensus expectation of 5.7/5.5 cents

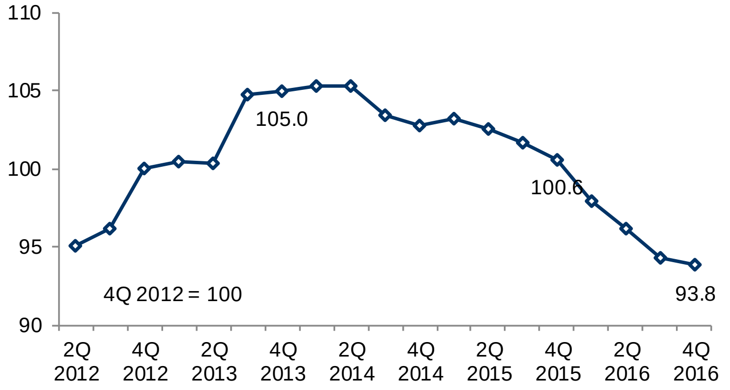
4Q 2016 JTC market data: Occupancy and Rental Index

Figure 1. Industrial sector occupancy



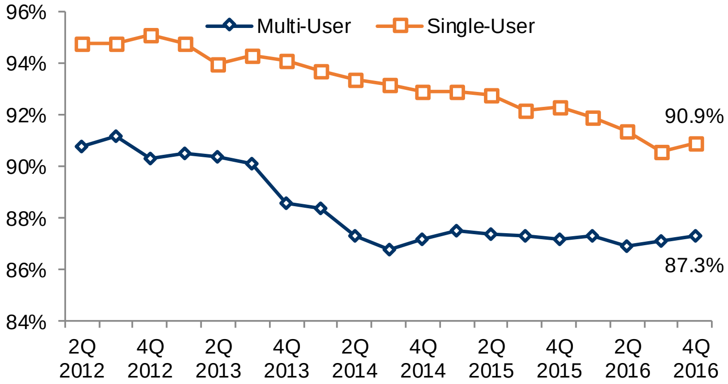
Source: JTC, Phillip Securities Research (Singapore)

Figure 2. Industrial sector Rental Index



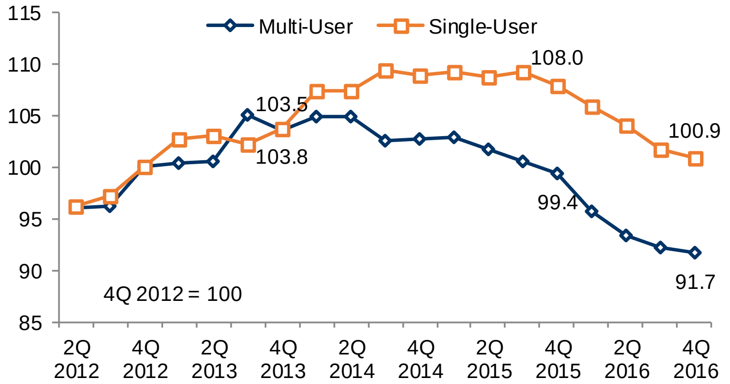
Source: JTC, Phillip Securities Research (Singapore)

Figure 3. Factory occupancy



Source: JTC, Phillip Securities Research (Singapore)

Figure 4. Factory Rental Index

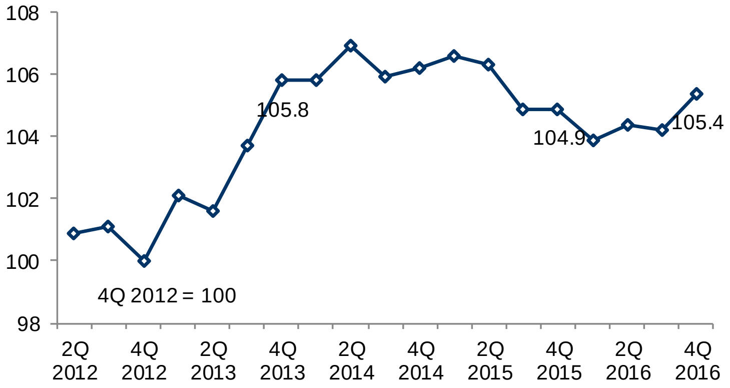


Source: JTC, Phillip Securities Research (Singapore)

Figure 5. Business Park occupancy

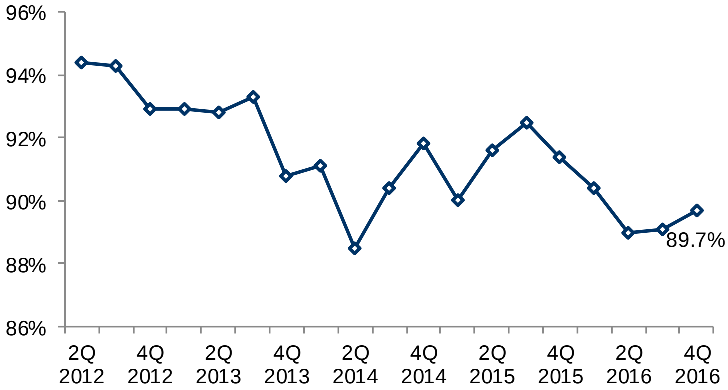
Source: JTC, Phillip Securities Research (Singapore)

Figure 6. Business Park Rental Index



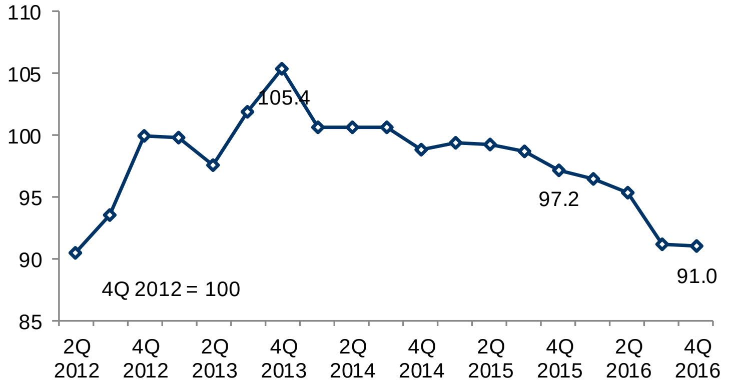
Source: JTC, Phillip Securities Research (Singapore)

Figure 7. Warehouse occupancy



Source: JTC, Phillip Securities Research (Singapore)

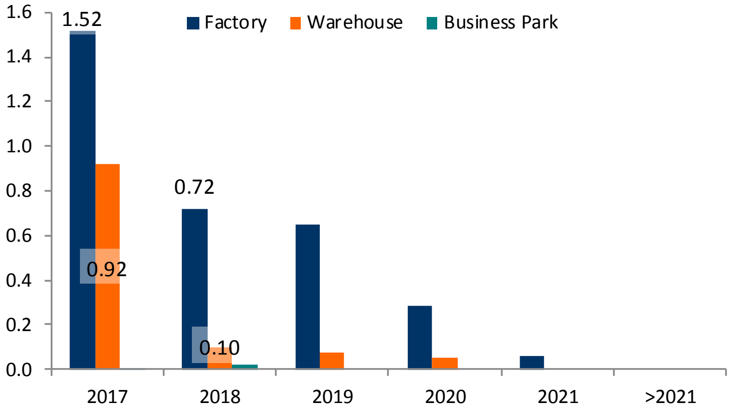
Figure 8. Warehouse Rental Index



Source: JTC, Phillip Securities Research (Singapore)

4Q 2016 JTC market data: Supply pipeline

Figure 9. Supply pipeline profile, as at 4Q 2016 (mn sqm)



Source: JTC, Phillip Securities Research (Singapore)

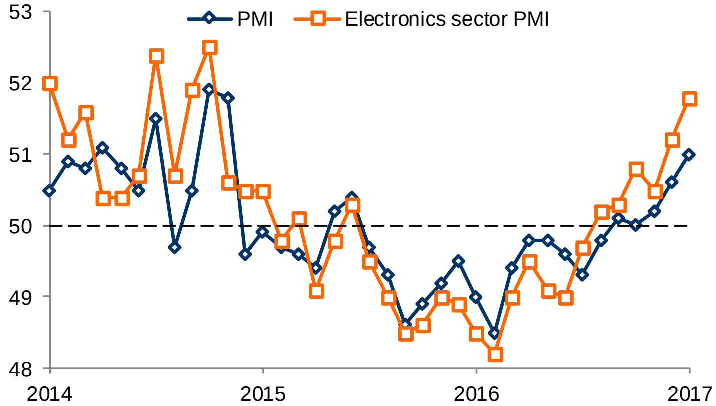
Supply Pipeline as a percentage of existing stock, as at 4Q 2016

(%)	2017	2018	2019	2020	2021	>2021
Factory	4.4	2.1	1.9	0.8	0.2	-
Warehouse	9.7	1.0	0.8	0.5	-	-
Business Park	0.2	1.2	-	-	-	-
Industrial sector	**5.3**	**1.8**	**1.6**	**0.7**	**0.1**	**0.0**

Source: JTC, Phillip Securities Research (Singapore)

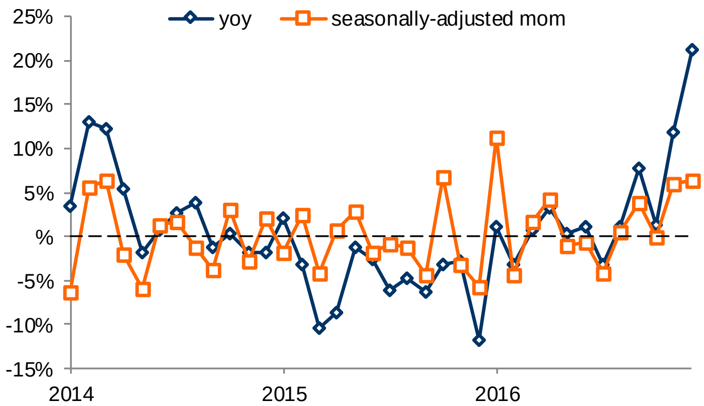
Manufacturing Indicators

Figure 10. Purchasing Managers' Index (PMI), January 2017



Source: Bloomberg, SIPMM, Phillip Securities Research (Singapore)

Figure 11. Industrial Production Index, December 2016



Source: Bloomberg, EDB, Phillip Securities Research (Singapore)

How do we view this?

- **Uptick in Industrial activity, in line with global PMIs**
  We highlighted the first signs of the uptick in industrial activity in our previous report (11 November 2016). For the month of September 2016, the Purchasing Manager's Index (PMI) had its first expansionary month (50.1) in the year and Industrial Production had an encouraging 6.7% yoy growth.
  Singapore's PMI has been in expansionary mode since late-2016 to January 2017. This is in line with expansionary global PMIs such as Eurozone, USA, China and Japan. Singapore Industrial Production Index in December 2016 was 21.3% higher yoy and 6.4% higher on a seasonally-adjusted month-on-month (mom) basis. We are optimistic on a recovery for the PMI and Industrial Production Index, but not before moderating downwards to a more sustainable level. While this could signal the start of higher demand for Industrial space, upcoming new supply is still higher than historical supply, and demand now is lower than historical demand.
- **Continued pressure due to mismatch in supply and demand**
  The net increase in Industrial space in 2016 was 1.82mn sqm, bringing existing stock to 46.28mn sqm as at 4Q 2016. JTC estimates about 2.4mn sqm of industrial space to come on-stream in 2017. The additional space coming on stream is significantly higher

than the average annual supply of around 1.8mn sqm in the past three years. Historical average demand over the past three years was 1.3mn sqm.

- **4Q aggregate reversions extending to double-digits did not come as a surprise**
  4Q 2016 Rental Index (93.8) is lower than three years ago in 4Q 2013 (105.0), and below the levels last seen in 2012. What this means is that lease renewals signed in 4Q 2016 were at lower rents compared to three years ago, and implying negative reversions of -10.7% in aggregate. This does not come as a surprise as we had already flagged in our previous report (11 November 2016) our expectations for aggregate reversions to reach negative double-digit territory into 2017.
- **Onslaught of Factory space in 2017: Multiple-User Factory space likely to be the laggard for the sub-sector in occupancy recovery**
  In our previous report (11 November 2016), we opined that Factory space would be the hardest hit in 4Q 2016. This did materialise as evident from Multiple-User and Single-User Factory space having the highest negative change in the Rental Index on both quarter-on-quarter (qoq) and yoy basis (refer to table on Page 1).
  Planned supply of Factory space of 1.52mn sqm for 2017 is about 49% more than the net new supply of 1.02mn sq mn in 2016. Of which planned supply of 548,000 sqm of Multiple-User Factory space in 2017 is 133% more than the net new supply of 235,000 sqm in 2016. Rental Index for Multiple-User in 4Q 2016 (91.7) was 11.4% lower compared to three years ago in 4Q 2013 (103.5). We are of the view that rental reversions in 2017 for Multiple-User Factory space will likely continue to be negative low double-digit. Our previous view was for negative double-digit negative reversions up to mid-teens.
- **Supply pressure in 2017 for Warehouse is going to be worse than 2016**
  Warehouse Rental Index in 4Q 2016 (91.0) was also lower than three years ago in 4Q 2013 (105.4). This implies that Warehouse lease renewals done in 4Q 2016 were on negative reversion terms of about -14%. Negative reversions in 4Q 2016 was more pronounced because the peak Rental Index of 105.4 was exactly three years ago in 4Q 2013.
  Total planned supply for 2017 is 923,000 sqm, which is 58% higher than the net new supply of 584,000 sqm in 2016. Planned supply for 2017 represents 9.7% additional space to existing stock as of 4Q 2016, compared to the 6.6% that was added during 2016. We are expecting negative low double-digit rental reversions in 2017.
- **Limited new supply for Business Park, expect flat reversions**
  New supply of Business Park space is limited in 2017 and 2018, with only 0.2% and 1.2% increase respectively, over current existing stock. There is currently no new supply planned from 2019 onwards. We are expecting Rental Index to remain stable qoq, but reversions to be flat in 2017. Our previous view was for flat reversions with a negative bias.

Strategic top-down view

- **Equal Weight on the Industrial S-REITs sub-sector on optimism of bottoming of rents**
  We expect the demand-supply imbalance to persist into 2017. Although this would exert downward pressure on rent, we already see some stabilisation of *asking rents* and this could indicate the possible bottoming of rents. However, we emphasize the distinction between negative rental reversions and bottoming of rents. We expect to still see negative reversions in 2017.

Tactical bottom-up view

- **MINT is our top pick for the Industrial S-REITs sub-sector**
  Management has demonstrated the ability to grow the portfolio organically with the BTS project and ongoing asset enhancement project (AEI) at Kallang Basin 4 Cluster, while simultaneously managing capital structure.

  MINT's gearing of 29.4% is one of the lowest within the S-REIT universe. Weighted average debt maturity of the REIT is 3.2 years, with 2.8%/17.0% of debt maturing in FY17/FY18 respectively. 67.0% of debt is hedged on fixed rate and the interest cover ratio is a healthy 7.8x, compared to the sub-sector average of 5.3x.

PhillipCapital

Commentary for quarterly and full year results across the Industrial REITs sub-sector

Summary of quarterly results

	Gross revenue (S$ mn)			Net property income (S$ mn)			Distributable income (S$ mn)			DPU (cents)		
Y/E Mar	**3Q17**	**3Q16**	**yoy (%)**	**3Q17**	**3Q16**	**yoy (%)**	**3Q17**	**3Q16**	**yoy (%)**	**3Q17**	**3Q16**	**yoy (%)**
AIMS AMP Capital Industrial REIT	30.4	32.5	(6.7)	19.8	21.1	(6.0)	17.7	18.1	(2.3)	2.77	2.85	(2.8)
Ascendas REIT	208.6	193.8	7.6	155.0	142.2	9.0	115.1	96.6	19.2	3.993	3.946	1.2
Mapletree Industrial Trust	84.5	83.3	1.4	63.4	61.9	2.5	51.1	50.3	1.6	2.83	2.82	0.4
Mapletree Logistics Trust	95.5	88.9	7.4	79.9	74.1	7.7	46.8	46.2	1.4	1.87	1.87	0.0
Y/E Dec	**4Q16**	**4Q15**	**yoy (%)**	**4Q16**	**4Q15**	**yoy (%)**	**4Q16**	**4Q15**	**yoy (%)**	**4Q16**	**4Q15**	**yoy (%)**
Cache Logistics Trust	28.0	23.1	21.2	22.1	18.8	17.5	16.6	16.8	(1.3)	1.847	2.140	(13.7)
Cambridge Industrial Trust	27.8	28.5	(2.5)	19.7	21.6	(8.8)	13.0	14.8	(12.0)	0.996	1.139	(12.6)
Keppel DC REIT	26.8	24.8	8.4	24.9	21.8	14.2	14.8	14.5	2.0	1.31	1.64	(20.1)
Sabana Shari'ah Compliant REIT	22.5	24.6	(8.2)	13.9	16.3	(14.7)	9.3	11.0	(16.1)	0.88	1.50	(41.3)
Soilbuild Business Space REIT	21.7	20.4	6.1	18.9	17.5	8.0	16.4	15.1	8.4	1.570	1.614	(2.7)
Viva Industrial Trust	25.6	19.7	29.8	18.1	13.7	31.7	15.9	12.5	27.9	1.760	1.634	7.7

Source: Various REITs, Phillip Securities Research (Singapore)

- **Gross revenue growth driven by both inorganic and organic growth**
  Inorganic growth in gross revenue was due to acquisitions at **A-REIT**, **Mapletree Logistics Trust (MLT)**, **Cache**, **KDCREIT** and **VIT**. Organic growth in gross revenue was due to completion of Phase One of the Hewlett-Packard BTS project at **MINT** and the Mapletree Logistics Hub – Toh Guan coming back on line upon completion of the asset enhancement initiative (AEI) for **MLT**.
- **DPU impacted by dilution from larger Unitholder base**
  Yoy decline in DPU for **AIMS AMP Capital Industrial REIT (AAREIT)** and **Cambridge Industrial Trust (CIT)** was in line with the yoy decline in distributable income. For a few of the REITs, distributable income was decimated at the yoy reported DPU level due to equity fund raising through Rights Issue (**Sabana Shari'ah Compliant REIT (SSREIT)**), Preferential Offering (**SBREIT**, **KDCREIT**, **VIT**), Private Placement (**Cache**, **VIT**).

Summary of full year results

	Gross revenue (S$ mn)			Net property income (S$ mn)			Distributable income (S$ mn)			DPU (cents)		
Y/E Dec	**FY16**	**FY15**	**yoy (%)**	**FY16**	**FY15**	**yoy (%)**	**FY16**	**FY15**	**yoy (%)**	**FY16**	**FY15**	**yoy (%)**
Cache Logistics Trust	111.3	89.7	24.0	88.0	76.2	15.6	69.3	68.0	2.0	7.73	8.50	(9.1)
Cambridge Industrial Trust	112.1	112.2	(0.1)	82.3	86.2	(4.5)	54.5	61.8	(11.9)	4.17	4.79	(12.9)
Keppel DC REIT	99.1	102.5	(3.2)	90.9	86.9	4.7	61.0	57.4	6.3	6.14	6.51	(5.7)
Sabana Shari'ah Compliant REIT	91.8	100.8	(8.9)	56.9	71.6	(20.5)	36.9	50.1	(26.3)	4.17	5.99	(30.4)
Soilbuild Business Space REIT	81.1	79.3	2.3	70.7	67.8	4.3	60.3	57.9	4.1	6.09	6.49	(6.1)
Viva Industrial Trust	95.1	74.0	28.6	68.5	50.8	34.7	60.9	47.5	28.3	6.96	7.00	(0.6)

Source: Various REITs, Phillip Securities Research (Singapore)

- **Gross revenue growth driven by inorganic growth**
  Gross revenue for **Cache** and **VIT** grew substantially due to acquisitions. Higher gross revenue for **Cache** was from acquisition of six properties in Australia, and contribution from the DHL Supply Chain Advanced Regional Centre (DSC ARC). Higher gross revenue for **VIT** was from Viva Business Park (VBP) and other properties (19 Tai Seng Avenue, Home-Fix Building, 11 Ubi Road and 30 Pioneer Road).
  Reasons for lower gross revenue for the other REITs include downsizing by client, conversions of master-lease properties to multi-tenancies, negative rental reversions and divestment.
- **DPU impacted by dilution from larger Unitholder base**
  Full year reported DPU was lower yoy across the board. Lower DPU for **CIT** was in line with the lower distributable income. For the rest of the REITs, distributable income was decimated at the DPU level due to equity fund raising through Rights Issue (**SSREIT**), Preferential Offering (**SBREIT**, **KDCREIT**, **VIT**) and Private Placement (**Cache**, **VIT**).

Review of Performance Measures of Industrial S-REITs

Average occupancy of 92.5% among the Industrial S-REITs was higher than the JTC sector-wide occupancy of 89.5%.

Summary of Performance Measures, as at end of December 2016

	Occupancy (%)	WALE by GRI (years)	WALE by NLA (years)	Gearing (%)	WADM (years)	WACD (%)	Interest coverage (x)
AIMS AMP Capital Industrial REIT	94.0	2.5		34.6	2.1	3.7	5.1
Ascendas REIT	90.2	3.7		31.8	3.9	3.0	5.6
Cache Logistics Trust	96.4	3.8	3.9	43.1	2.8	3.6	4.0
Cambridge Industrial Trust	94.7	3.7		37.5	3.1	3.7	3.6
Keppel DC REIT	94.4		9.6	28.3	3.2	2.3	9.4
Mapletree Industrial Trust	92.1	3.2		29.4	3.2	2.6	7.8
Mapletree Logistics Trust	96.1		4.1	38.7	3.5	2.3	5.7
Sabana Shari'ah Compliant REIT	87.2	2.6		43.2	1.9	4.2	3.1
Soilbuild Business Space REIT	89.6	3.4		37.6	2.8	3.4	4.8
Viva Industrial Trust	89.8	3.1		37.2	3.2	4.0	4.2
Average	**92.5**	**3.3**	**5.9**	**36.1**	**3.0**	**3.3**	**5.3**

Source: Various REITs, Phillip Securities Research (Singapore)

WALE: Weighted Average Lease Expiry; WADM: Weighted Average Debt Maturity; WACD: Weighted Average Cost of Debt

GRI: Gross rental income; NLA: Net leasable area

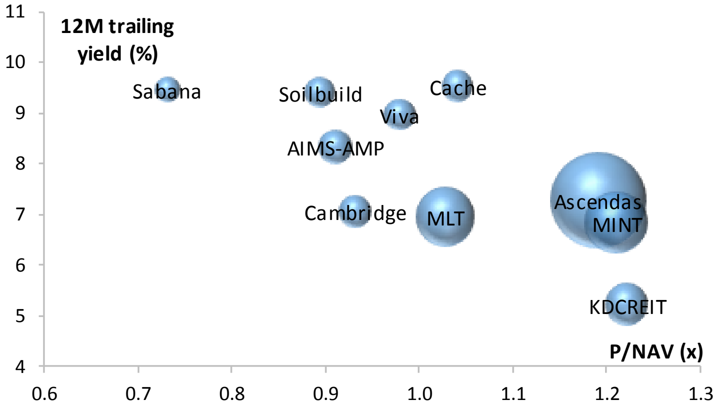
Peer relative valuation

Industrial S-REITs peer relative data (arranged by Mkt. Cap.)

	Mkt. Cap. (S$ mn)	Price (S$)	Trailing P/NAV (x)	12M trailing yield (%)
Ascendas REIT	7,148	2.48	1.19	7.3
Mapletree Industrial Trust	2,983	1.655	1.21	6.8
Mapletree Logistics Trust	2,650	1.060	1.03	7.0
Keppel DC REIT	1,311	1.165	1.22	5.2
AIMS AMP Capital Industrial REIT	859	1.345	0.91	8.3
Cambridge Industrial Trust	770	0.590	0.93	7.1
Viva Industrial Trust	745	0.775	0.98	9.0
Cache Logistics Trust	729	0.810	1.04	9.5
Soilbuild Business Space REIT	674	0.645	0.89	9.4
Sabana Shari'ah Compliant REIT	463	0.440	0.73	9.5
Average			**1.02**	**7.9**

Source: Bloomberg (Updated: 17 February 2017), Phillip Securities Research (Singapore)

Figure 12. 12M trailing yield (%) vs. P/NAV (x)



Source: Bloomberg (Updated: 17 February 2017), Phillip Securities Research (Singapore)

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