Favourable S-REITs Yield Spreads Against 10-Year SGS

Led by deteriorating fundamentals and the one-month lock down in Singapore, S-REITs saw another bout of sell-off on 03 April 2020. The recent market movement indicates that investors are bracing for further potential dividend cuts.

On average, S-REITs have already declined by 39% from the peak as of 03 April 2020. At this level, the trailing- 12-month yield stands at 6.60%. Valuation-wise, most S-REITs are now trading at around 0.75 times price-to-book value (P/B) compared to 1.17 times pre-crisis period. Comparing pre-crisis and post-crisis book values, the market has already priced-in about 35% cut in assets valuations of S-REITs.

To put things into perspective, S-REITs distributions per unit (“DPU”) was down 20% and were trading at around 0.44 times P/B during the lowest point of the Global Financial Crisis (“GFC”) in 2008. The lower P/B multiple was a result of wider sell-off, owing to higher level of borrowings in the balance sheets at higher interest costs for S-REITs during that time. At the bottom of the market, S-REITs dividend yields averaged about 5.75% while the Singapore 10-year government bond was yielding 2.25%.

Assuming current S-REITs’ prices continue to trade down to GFC’s level of 0.44 times P/B (representing another 41.3% fall), the historic trailing- 12-month yield of 6.60% would increase correspondingly to about 9.3%. However, such a scenario assumes no further deductions to DPU and may not be reflective of the reality.

On a forward-looking basis, S-REITs are likely to taper down DPU in adjustment to this challenging landscape. At current valuations, market seems to have priced in a 20 percent deduction in future DPU for S-REITs, which would yield 6.65%.

In our worst case scenario, we assume a 50% cut in DPU and S-REITs would yield 4.16% compared to the Singapore 10-year government bond yield of 1.04%. The Singapore 10-year government bond yield has come down from 1.75% in January.

Justifiably, the yield spreads of S-REITs against the Singapore 10-year government bond for base case (20% DPU cut) and worst case (50% DPU cut) now is 5.63% and 3.14% respectively. Compared to the yield spread of 3.5% during the GFC, the yield spreads are much more attractive. Inherently, this also means that S-REITs are currently offering rather compelling value to any long-term investor.

		Dividend Yield (%)				Base Case	Worst Case	P/B		
	Price Movement (3/4 vs 31/1)	3/4/2020	31/1/2020	Projected DPU cut 20%	Projected DPU cut 50%	Div Yield (%) with DPU cut 20%	Div Yield (%) with DPU cut 50%	1/4/2020	31/1/2020	Global Financial Crisis
Average		**6.6**	**4.41**			**6.65**	**4.16**	0.75	1.17	
Diversified REITs	-39%	8.61	5.51	6.13	3.83	10.04	6.28	0.54	0.91	na
Healthcare REITs	-18%	5.75	4.73	4.46	2.78	5.42	3.39	1.28	1.57	0.53
Hotel & Resort REITs	-46%	11.11	5.72	6.68	4.17	12.37	7.73	0.48	0.89	0.3
Industrial REITs	-24%	5.21	5.32	5.28	3.3	6.94	4.34	1.07	0.84	0.5
Office REITs	-34%	6.15	3.87	4.15	2.59	6.29	3.93	0.7	1.06	0.37
Real Estate Operating Companies	-33%	2.02	3.81	4.05	2.53	6.05	3.78	0.96	0.99	na
Retail REITs	-39%	6.8	4.52	5.03	3.14	8.24	5.15	0.71	1.16	0.5
Specialised REITs	2.7%	3.26	5.17	4.03	2.52	3.92	2.45	2.03	1.97	na

Source: Phillip Capital Management

Important Information