

Singapore

Flash Note

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DBS Group Research . Equity

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Singapore office

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Where is the cap rate expansion?

- Manulife Centre potentially sold, at mid-2% yield based on net property income
- Potential transaction is a continuation of sale of fringe CBD office properties at "tight" yields
- Office REITs with better located properties are trading at a discount to these physical market transactions
- Maintain Overweight on office REITs – CapitaLand Commercial Trust (CCT; BUY, TP S\$2.12) is our top pick

What's New

Chelsfield exploring the purchase of Manulife Centre for c.S\$550m

- According to Business Times, British property group, Chelsfield, is conducting due diligence on Manulife Centre on Bras Basah Road and is looking to purchase the building for around S\$550m.
- This translates to around S\$2,300 per square foot (psf) on net lettable area (NLA) of c.242,000 square feet (sqft), and based on our estimate, at a NPI yield at around the mid-2% level assuming average passing rents of S\$6-7 psf/mth
- Manulife Centre is currently owned through a 60:40 partnership between Alpha Asia Macro Trends Fund (AAMTF) II and City Developments (CDL).
- The building was originally sold in late 2015 by CDL for S\$487.5m to the JV. With the addition of Central Mall and 7 & 9 Tampines Centre, an office fund worth S\$1.1bn was created.
- Manulife Centre is an 11-storey office building with retail units on the ground floor and was completed in 1989. The property is located close to the Bencoolen and Bras Basah MRT stations. Manulife Centre is a 999-year leasehold property, however the property was sold as a 99-year

leasehold into the JV. Currently, there are another 93 years left on the lease.

- Based on a Business Times article, there is potential for asset enhancement works to enhance the property's income. This could include removing excess car park lots to increase NLA and expanding the retail use from ground floor to the second and third levels. In addition, with anchor tenant, Manulife which occupies c.100,000 sqft, vacating the building at the end of the year, there is potential to increase rents to around S\$7 psf.

Our thoughts

- The potential sale of Manulife Centre at a mid-2% NPI yield is a continuation of the trend of fringe CBD office properties being sold on tight yields and defies some investor expectations that Singapore office cap rates should expand in a rising interest rate environment.
- Recent fringe CBD office transactions include the disposal by CapitaLand Commercial Trust (CCT) of Twenty Anson to AEW on a 2.7% NPI yield as well as a 50% interest One George Street and Wilkie Edge on 3.2% and 3.4% exit yields respectively.
- We believe these transactions highlight the desirability of Singapore office properties as an attractive investment class by global investors contrary to equity investors who have marked down office REITs. Office REITs currently trade below book value which we believe is unjustified given that the better located Grade A office buildings owned by the REITs are being valued by the REITs using a 3.6-4.10% cap rate.
- In addition, in our view, prospects of a multi-year recovery in office rents given easing supply pressures over the next 3-4 years should translate to office REITs trading at least at book value if not a premium. Evidence of the strong recovery in

rents is the reported 4.1% q-o-q increase in Grade A rents to c.S\$10 psf/mth in June, up from lows of S\$8.95 psf/mth in 1H17. This faster than expected increase in rents also provides upside risk to our DPU estimates.

With evidence that office values in Singapore are holding up if not increasing, and rents are on an upward trend, we maintain our overweight stance on office REITs with **CCT (BUY, TP of S\$2.12)** as our top pick.

Office Peer Comp as at 9 July 2018

REIT	FYE	Last Price (\$)	Rec	12-mth Target Price (\$)	Mkt Cap (\$'m)	Total Return (%)	FY17/18F	Yield FY18F/19F	FY19/20F	FY17/18F	P/Bk FY18F/19F	FY19/20F
Office												
CCT	Dec	1.730	BUY	2.12	6,475	28%	5.0%	5.0%	5.1%	0.97	0.98	0.98
FCOT	Sep	1.370	BUY	1.65	1,210	27%	7.2%	7.0%	7.0%	0.86	0.89	0.90
KREIT	Dec	1.110	BUY	1.41	3,783	32%	5.1%	5.0%	5.1%	0.79	0.80	0.81
OUECT	Dec	0.675	HOLD	0.73	1,044	15%	6.9%	6.9%	6.9%	0.74	0.75	0.75

5.5%	5.4%	5.5%	0.87	0.88	0.89
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Source: Bloomberg Finance L.P., DBS Bank

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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