

Singapore Industry Focus

US Office SREITs

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DBS Group Research . Equity

20 Mar 2020

Attractive American heroes

- The spread of Covid-19 to North America and Europe that could bring about a potential recession has caused US Office SREITs' share prices to halve; now trading at 0.5x-0.7x P/NAV with 11% to 16% yield
- Limited near-term downside risks supported by low lease expiries in FY2020, no major break clauses and long WALE
- Covid-19 impact may slow down leasing activities and potential acquisitions
- With limited history, occupancy fell to c.80% during GFC. Based on our ballpark estimates, a 20% cut in NPI implies 8% to 12% yield at current prices

US Office SREITs trading at 0.5x-0.7x P/NAV. Following the recent development of the Covid-19 spreading to North America and Europe that could tip these economies into a recession, the share price of US Office SREITs has taken a big hit, falling off a cliff by 47%-50% from its peak only in Jan 2020. At current prices, US Office SREITs are now trading at 11% to 16% yield and 0.5x to 0.7x P/NAV.

Limited near-term downside risks supported by low lease expiries in FY2020 of below 8% and long WALE. We think the downside risks is limited in the near term as US Office REITs have a long WALE of 4-6 years and the leases expiring in FY2020 are below 8%. Also, at current prices, we believe US Office SREITs have priced in a potential recession. While information is limited, we gather that occupancies fell close to 80% during the GFC vs. the current range of 94%-96%. Based on our ballpark estimates, if we lower FY2020F NPI by 20% on current prices, US Office SREITs would trade at 8%-12% yield. Gearing levels among US Office REITs range between 34% and 38% as at Dec 2019.

Covid-19 impact may slow down leasing activities and potential acquisitions in the near term. From our channel checks with US Office REITs, while leasing interests have been good in 1Q20 (Manulife US REIT (MUST) executed 138k sqft of leases with average tenures of 7.8 years and reversions of +8.1%), US Office REITs expect leasing activities and potential acquisitions to slow down due to movement restrictions and work-from-home arrangements. However, the near-term risks are still limited as expiring leases in FY2020 range between 4% and 8% and there are no major break/pre-termination clauses.

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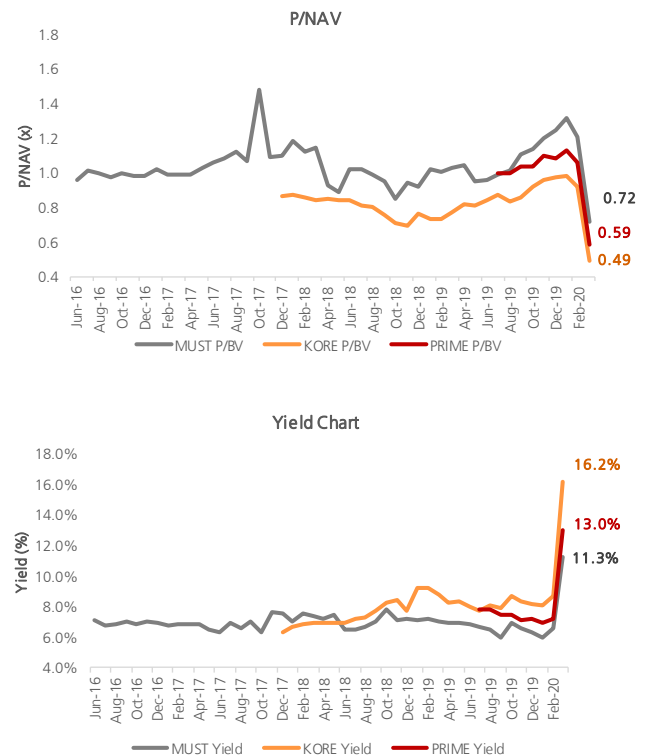
STOCKS

	Price US\$	Mkt Cap US\$m	12-mth Target Price US\$	Performance (%)		Rating
				3 mth	12 mth	
Manulife US Real Estate Inv	0.565	886	1.15	(45.2)	(34.0)	BUY
Prime US REIT	0.53	490	1.05	(44.8)	N.A	BUY
Keppel Pacific Oak US REIT	0.395	369	0.90	(49.0)	(42.8)	BUY

Source: DBS Bank, Bloomberg Finance L.P.

Closing price as of 19 Mar 2020

US Office SREITs P/NAV and yield chart



Source: DBS Bank



Live more, Bank less

Attractive American heroes

Following the recent development of the Covid-19 spreading to North America and Europe that could tip these economies into a potential recession, the share price of US Office SREITs has taken a big hit, the share price of US Office SREITs has taken a big hit, falling off a cliff by 47%-50% from its peak only in Jan 2020. At current prices, US Office SREITs are now trading at 11% to 16% yield and 0.5x to 0.7x P/NAV.

I believe the question in everyone's mind is "would there be risks to their dividend yield?"

- We believe the downside risks are limited in the near term as US Office REITs have a long WALE of 4-6 years and leases expiring in FY2020 are below 8%.
- In addition, at current prices, we believe the US Office SREITs have priced in a potential recession. While information is limited, we understand that occupancies fell close to 80% during the GFC vs. the current range of 94%-96%. Based on our ballpark estimates, if we lower FY2020F NPI by 20% on current prices, US Office SREITs would trade at 8%-12% yield.
- Gearing levels among US Office REITs range between 34% and 38% as at Dec 2019.

Covid-19 impact

Manulife US REIT (MUST) announced today that it has signed a new lease with a new tenant for 53k sqft at the Plaza, Secaucus with positive rental reversion for a tenure of 12 years despite the Covid-19 outbreak in the US. YTD, MUST has executed 138k sqft of leases (2.9% of portfolio NLA) with long tenures averaging 7.8 years and rental reversions of +8.1%. As such expiring leases in FY20 has dropped further to less than 4% of

GRI from 5% as at Dec 2019, and committed occupancy increased to 96.4% vs. 95.8% as at Dec 2019. This attests to the resilience of its portfolio.

Following our channel checks with the US Office REITs,

- **Leases expiring in FY20 is below 8%.** All three US office REITs have said that lease renewals in 1Q2020 is done and leases expiring in FY2020 remain low, ranging from 4% to 8% of GRI/CRI.
- **Leasing interests remain strong but leasing activities likely to slow down in the near term.** we understand that while leasing interests remain strong especially for well-located, Trophy / Class A office properties, the US Office REITs do expect some slowdown in leasing activities, especially when social distancing and some form of 'lockdown' are being practised to curb the spread of Covid-19, leading to restrictions for touring office buildings, and most companies in the US have now activated work-from-home arrangements.
- **No major break clause.** All three US Office REITs have indicated that the majority of the leases have no break clauses or pre-termination clauses.
- **No rental rebates at the moment.** There were questions whether tenants have requested for rental rebates. We understand that at the moment, there are no rental rebates. However, Keppel Pacific Oak US REIT (KORE) said that the tenants are likely to be covered by business interruption insurance and could claim if the conditions of business interruptions are met.
- **Delays in potential acquisitions.** Given the existing situation, US Office REITs could expect delays for any potential acquisitions.

Snapshot comparison of US Office SREITs

	MUST	Prime	KORE
AUM (US\$m) *	2,095	1,425	1,257
No of properties *	9	12	13
NLA (sqft) *	4,666,477	3,888,605	4,701,627
Committed occupancy *	95.8%	96.3%	93.6%
WALE *	5.9	5.1	4.2
Lease expiries - 2020	5.2%	6.9%	7.1%
Lease expiries - 2021	7.2%	8.4%	13.5%
Built-in average annual rental escalations *	2.0%	2.9%	2.6%
Gearing	37.7%	33.7%	36.9%
All-in average Cost of Debt	3.4%	3.3%	3.7%
Average Term to maturity (years)	2.8	5.2	2.9

* including Park Tower for Prime US REIT

Source: DBS Bank, Companies

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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 share price catalysts within this time frame)

**Share price appreciation + dividends*

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