Singapore Industry Focus

Singapore REITs

Refer to important disclosures at the end of this report

DBS Group Research . Equity   7 Jul 2020

The next chapter

- Broadening rally expected in 2H20 as investors' confidence returns aided by "lower-for-longer" rates.
- Employing a rotational strategy amongst the industrial S-REITs to capture alpha.
- Commercial properties with dominant characteristics set to ride past structural headwinds.
- Acquisition momentum to fuel next leg up

Broadening S-REIT rally as economy remains on the mend. With various landlords and government incentives rolling off in the coming months, we expect the economy to deteriorate first, before recovering gradually. That said, we have noted a broadening of the S-REIT rally as investors position ahead of a recovery. The next data-point we see boosting investors' confidence is the phased return of office workers to CBD, which will boost office and selected retail S-REITs. Per our report, Singapore Office REITs: Grab it while it lasts, investors should focus on the positive implications of a possible supply crunch in 2H20-2020 rather than structural demand changes which will unravel over 3-5 years. Over time, we see resilience in being positioned in Grade A office (**KREIT, CCT**) and decentralised office space (**MCT**). In the retail space, we maintain our preference for the suburban over tourist-focused malls as discretionary spending will likely remain subdued amidst the weak economic outlook as per Singapore Retail REITs: Near the end of a storm report. We see value in the retail landlords **CMT** and **FCT** to play catch-up given prices are 16-20% below that at start of 2020.

A differentiated strategy in the industrial S-REITs to capture alpha. Amongst the top performers YTD, we continue to like the industrial S-REITs aided by structural tailwinds (riding on greater adoption of e-commerce and office decentralisation trends). We however employ a differentiated strategy, with a focus on **A-REIT** and **FLT** which we believe will play catch-up given their higher absolute yields of 5.0% and 6.5% respectively. We also see a yield compression in the mid-cap industrial S-REITs (Singapore Industrial S-REITs: Making up lost ground) as economic recovery gathers pace in the medium term. We like **ALLT** and **SBREIT** for their quality portfolio and value-accretive pipeline of assets.

Returning to the virtuous acquisition growth cycle. S-REITs are trading at 1.15x P/NAV and FY20/21F yield of 5.5%/6.3%, implying a growth rate of c.15%. Spreads are attractive to remain vested and while growth in 2021 is at a robust 80bps (or 15%) owing to one-offs in 2020, we see upside upon a resumption of acquisition activities in 2H20. We see possibilities in selected S-REITs in the industrial and retail subsectors positioned to leverage on their sponsors' pipeline and support growth distributions.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
Ascendas REIT	3.28	8,525	3.45	22.9	5.1	BUY
CapitaLand Commercial Trust	1.81	5,021	1.95	29.3	(21.3)	BUY
Mapletree Commercial Trust	1.98	4,712	2.25	25.3	(4.9)	BUY
Keppel REIT	1.12	2,728	1.35	19.8	(11.8)	BUY
CapitaLand Mall Trust	2.09	5,540	2.40	29.0	(23.7)	BUY
Frasers Centrepoint Trust	2.46	1,979	2.95	39.0	(9.9)	BUY
Frasers Logistics & Commercial Trust	1.21	2,971	1.40	46.7	(4.7)	BUY
ARA LOGOS Logistics Trust	0.58	449	0.70	22.3	(27.2)	BUY
Soilbuild Business Space Reit	0.41	368	0.50	28.6	(34.6)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 6 Jul 2020

Broadening rally in 2H20

A liquidity driven but broadening rally in recent months. While the strong liquidity have boosted share prices and brought the S-REITs Index (FSTREI Index) to c.11% of its peak in 2020 (vs -20% for the Straits Times Index [STI]), we note that the industrial S-REIT (-7.1% year-to-date [YTD]) sector remains the key relative outperformer given its relative resilient earnings followed by healthcare S-REITs (-13.2%), and office S-REITs (-16.4% YTD).

The subsectors that have been materially affected by the COVID-19 pandemic, namely the retail (-22.5% YTD) and hospitality S-REITs (-21.3% YTD) remain more than 20% below their prices at the start of the year.

We do, however, note a broadening rally seen in the S-REITs in recent months, buoyed by increasing positive data-points as the economy reopens progressively. We also observed that the retail S-REITs have been relative outperformers in the months of May'20 and Jun'20, overtaking the performance of Industrial S-REITs. The gradual loosening of restrictions, allowing retailers to restart operations (even cinemas from 13 July 2020) is positive for retail landlords, implying lower need for further rental reliefs going forward.

Broadening rally to continue into 2H20. Looking ahead, we believe that the continued phased reopening of the economy will result in more confidence seeping back into the sector. While industrial subsectors will likely remain the core sector amongst investors, we see the following trends emerging (i) broadening of the rally seen in the S-REITs to the other subsectors of office and retail S-REITs, (ii) closing of the mid-cap and large-cap valuations within the industrial space, and (iii) the return in the pace of accretive acquisitions, driving upside to valuations for the S-REITs.

With most of the other S-REIT subsectors trading between their 10-year -0.5 and -1 standard deviation (SD), we see the ability to revert to historical mean as the economy recovers.

Performance of S-REITs by subsectors and vs STI/Developers

	Jan	Feb	Mar	Apr	May	Jun	2020 YTD
	% chg	% chg	% chg	% chg	% chg	% chg	% chg
Office	-0.8%	-7.6%	-19.9%	5.9%	5.0%	0.9%	-16.4%
Retail	0.9%	-6.5%	-26.7%	1.8%	10.2%	6.4%	-22.5%
Industrial	2.5%	-1.4%	-23.6%	9.9%	8.1%	3.3%	-7.1%
Hospitality	-2.4%	-5.0%	-18.9%	10.9%	-0.5%	2.7%	-21.3%
Healthcare	4.7%	-3.6%	-18.7%	8.9%	8.4%	-10.0%	-13.2%
Others:							
Office (US)	4.0%	-7.0%	-29.4%	10.0%	13.8%	-0.6%	-19.0%
Office (EUR)	1.7%	-5.0%	-30.2%	13.7%	13.2%	-0.3%	-17.0%
Retail (Others)	-3.4%	-4.3%	-20.7%	9.5%	0.2%	5.9%	-19.7%
FSTREI	2.0%	-5.2%	-19.7%	5.9%	8.3%	-0.4%	-11.3%
FSSTI	-4.1%	-4.8%	-17.9%	3.1%	-2.6%	2.0%	-23.2%
STI Index	-2.1%	-4.5%	-16.0%	1.8%	-2.5%	2.5%	-20.1%

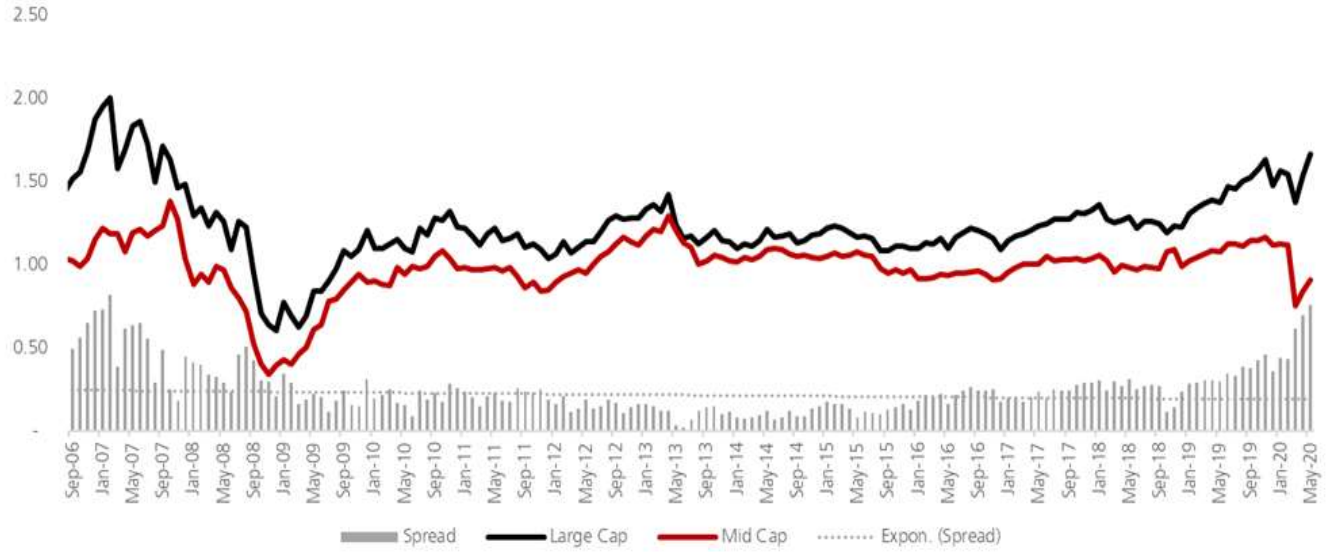
Source: Bloomberg Finance L.P., DBS Bank

Valuation ranges and historical P/NAV

	Last close	% form1 year high	% from YTD high	% from start of 2020	P/NAV	+1 SD	Mean	- 0.5 SD	-1 SD
Office									
CCT	1.8	-18%	-14%	-11%	0.96	1.12	0.90	0.90	0.68
KREIT	1.1	-18%	-14%	-15%	0.78	1.06	0.83	0.83	0.60
MCT	2.0	-17%	-16%	-17%	1.13	1.31	1.16	1.17	1.02
Suntec	1.5	-26%	-21%	-21%	0.68	1.00	0.81	0.81	0.62
OUECT	0.4	-29%	-27%	-29%	0.65	0.84	0.77	0.77	0.70
		-20%	-17%	-17%	0.94	1.11	0.93	0.93	0.74
Retail									
CMT	1.96	-26%	-22%	-20%	0.98	1.49	1.24	1.24	0.99
FCT	2.35	-18%	-18%	-16%	1.08	1.31	1.11	1.11	0.91
LREIT	0.69	-20%	-20%	-20%	0.80	1.00	1.00	0.93	0.86
SPH REIT	0.87	-24%	-18%	-19%	1.11	1.13	1.08	1.08	1.03
SGREIT	0.51	-37%	-31%	-30%	0.62	0.94	0.80	0.80	0.65
		-24%	-21%	-20%	1.01	1.33	1.14	1.14	0.95
Retail Overseas									
CRCT	1.26	-22%	-19%	-22%	0.84	1.18	1.00	1.00	0.81
MAGIC	0.94	-36%	-21%	-19%	0.64	0.98	0.89	0.89	0.80
SASSEUR	0.74	-16%	-8%	-16%	0.77	1.20	1.03	0.90	0.80
		-29%	-18%	-20%	0.75	1.12	0.97	0.93	0.80
Hotels									
ART	0.99	-28%	-26%	-26%	0.82	1.01	0.92	0.92	0.83
CDREIT	1.01	-40%	-35%	-38%	0.70	1.26	1.10	1.10	0.94
FEHT	0.50	-33%	-27%	-33%	0.60	0.95	0.81	0.81	0.67
FHT	0.46	-41%	-34%	-36%	0.66	1.03	0.97	0.97	0.91
		-33%	-29%	-31%	0.77	1.06	0.95	0.95	0.84
Industrials									
a-itrust	1.34	-26%	-19%	-14%	1.38	1.46	1.30	1.30	1.14
A-REIT	3.17	-4%	1%	7%	1.48	1.36	1.24	1.24	1.12
ALLT	0.56	-30%	-21%	-22%	0.93	1.22	1.13	1.13	1.04
EREIT	0.39	-29%	-29%	-27%	0.99	1.13	0.97	0.97	0.81
MINT	2.95	-1%	-1%	-26%	1.77	1.41	1.28	1.28	1.15
MLT	1.94	-5%	-5%	11%	1.69	1.27	1.14	1.14	1.01
SBREIT	0.39	-36%	-23%	-25%	0.68	1.03	0.96	0.96	0.89
KDCREIT	2.55	-1%	-1%	23%	2.19	1.64	1.40	1.40	1.16
AIMS	1.22	-18%	-16%	-15%	1.02	1.07	0.95	0.95	0.83
FLT	1.26	0%	2%	3%	1.28	1.30	1.19	1.19	1.08
		-6%	-4%	0%	1.58	1.36	1.22	1.22	1.08
Healthcare									
P-Life	3.43	-7%	-4%	3%	1.75	1.56	1.39	1.39	1.22
US Office									
KORE	0.68	-14%	-14%	-13%	0.89	0.91	0.83	0.83	0.75
MUST	0.75	-29%	-29%	-25%	0.97	1.17	1.05	1.05	0.93
Prime	0.78	-23%	-23%	-19%	0.90	1.14	1.06	1.06	0.98
		-19%	-19%	-16%	0.95	1.10	1.00	1.00	0.90
S-REIT					1.15	1.28	1.12	1.12	0.97

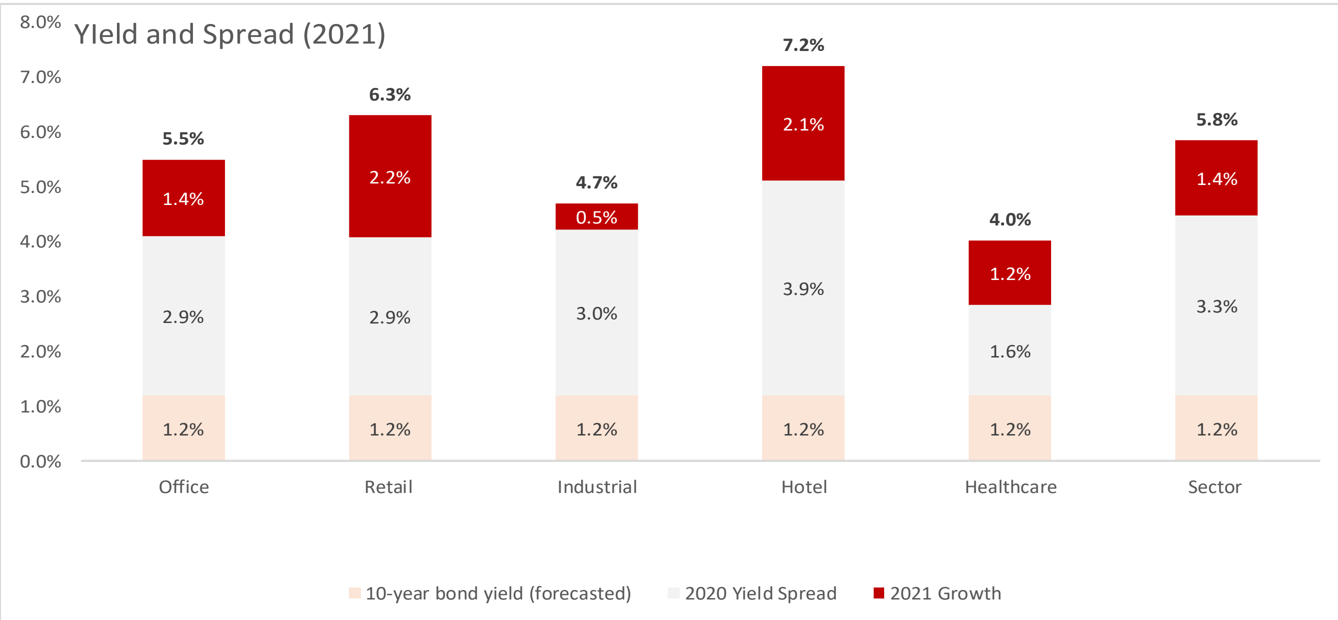
Source: Bloomberg Finance L.P., DBS Bank

Second-largest price-to-book spread between large-cap and mid-cap REITs since FY06



Source: Bloomberg Finance L.P., Company, DBS Bank

Yields and Spreads



Source: Bloomberg Finance L.P., DBS Bank

Navigating the real economic test

New way of commuting; faster adoption of e-commerce trends are expected post COVID-19. With various landlords and the government incentives in the coming months, the crux is if companies (tenants, retailers) can get back up on their own two feet post disruption brought about by the COVID-19 pandemic. We expect changes in workers' commuting, leisure, working and lifestyle preferences in the future, which will have an impact on how investors allocate capital to the various sectors over time. At the top of everyone's minds is how potential changes to the way workers commute to work (or telecommute) consume and travel will have an impact on the future landscape for the various real estate classes going forward.

Industrial S-REITs (+ near/medium term). Notwithstanding the best-performing subsector YTD, we remain firm believers in the industrial S-REIT subsector that will emerge stronger post COVID-19, buoyed by the acceleration of structural growth trends. While assistance rendered to tenants is likely to be expensed by landlords in the upcoming results in 2QCY20, the impact across the sector remains manageable at c.3%-5% of revenues.

Focusing on COVID-19-resilient exposures. The COVID-19 pandemic has brought forth some structural changes in the economy and led to acceleration of certain trends. The widespread outbreak has made the biomedical and healthcare sector more crucial than before. The continued drive to digitalise the economy will boost the technology and infocomm sector, and the rise of e-commerce should benefit the logistics and distribution sector. We believe that the consumer goods sector will continue to be a mainstay and stay relatively stable, and so will the government sector and non-profit organisations.

However, the depressed oil prices and projected economic slowdown will pose a challenge for those in the oil and gas, commodity and marine sectors. Lockdowns of nations to curb the spread of COVID-19 have weighed negatively on international travel and tourism, and put pressure on the aerospace sector.

We compared the exposure of industrial REITs to tenants in the various sectors and noticed that the exposure among the large-cap and mid-cap REITs are actually very similar. The proportions of their exposures to the fast-growing sectors and declining sectors are on par.

It may be too generic to access each REIT's earning risks according to tenant industry as there will be winners and losers in every sector. However, we believe that this gives us a very good sense of their tenant diversification. Among them, a large-cap industrial REIT and MLT have the highest exposures to the commodity, marine and aerospace industries, accounting for c.21% and c.10% of their tenants respectively. This is further highlighted in Singapore Industrial S-REITs: Making up lost ground.

Breakdown of Industrial S-REITs by tenant industry subsectors

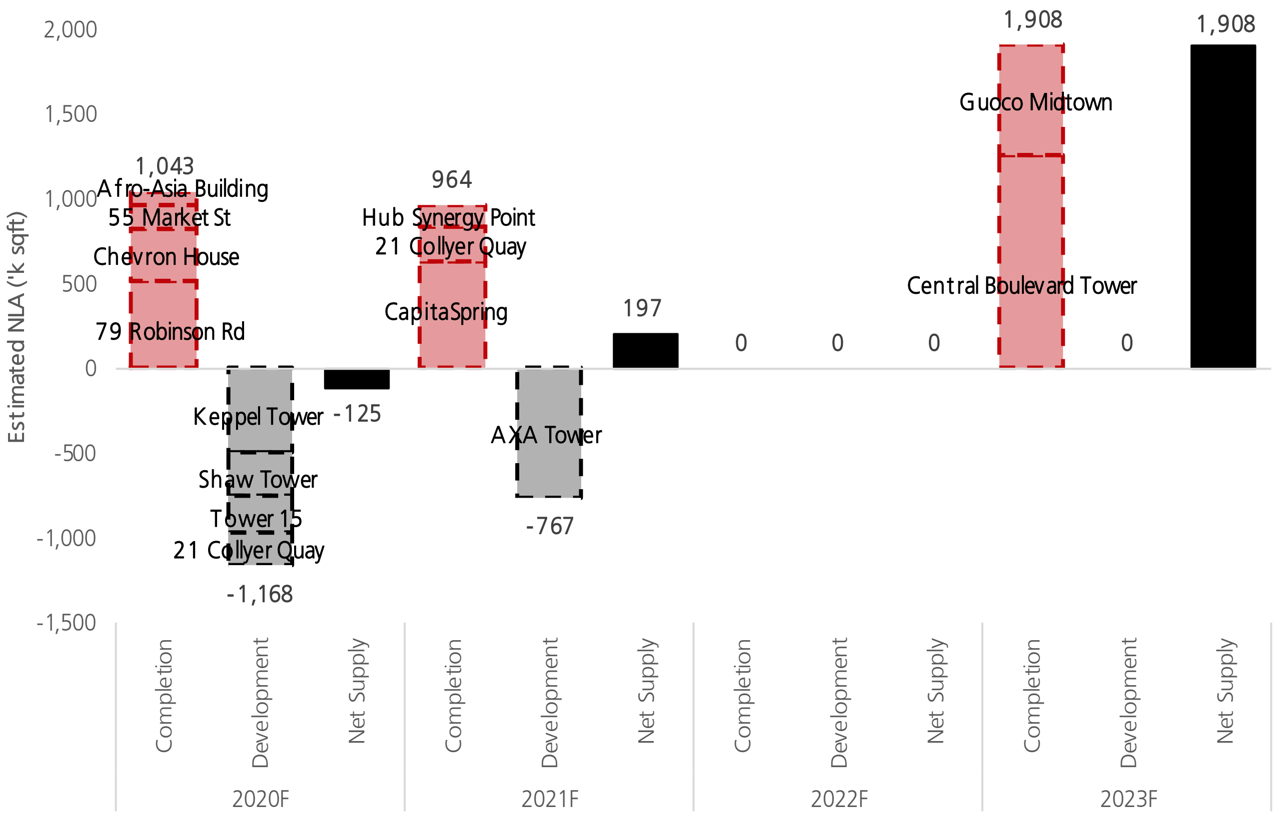
Industrial REITs	Technology, Infocomm	Biomedical, Healthcare	Consumer goods	Logistics, Distribution	Government, NPO	Oil & Gas, Commodities, Marine, Aerospace	Others
Large-cap average	**34%**	**5%**	**21%**	**15%**	**4%**	**9%**	**26%**
AREIT	25%	13%	4%	18%	6%	3%	30%
MLT	16%	3%	40%	-	-	10%	31%
FLT	7%	2%	30%	26%	6%	4%	25%
KDCREIT	92%	-	-	-	-	-	8%
Mid-cap average	**32%**	**5%**	**16%**	**18%**	**12%**	**4%**	**30%**
AIT	67%	3%	6%	7%	-	1%	16%
EREIT	24%	4%	2%	28%	-	3%	39%
AAREIT	19%	15%	20%	28%	-	-	18%
ALLT	4%	1%	54%	-	-	2%	40%
ECWREIT	49%	-	-	36%	-	-	16%
SBREIT	21%	1%	4%	2%	12%	7%	53%
SSREIT	36%	9%	9%	8%	-	9%	30%

Source: Companies, DBS Bank

Office – the jury is still out (-ve near term /+ve medium term). We keep an eye out on potential shifts in occupier demand as firms embrace flexible working arrangements for their employees, as the impact on office demand in the central business district (CBD) will only unravel in the longer term <Singapore Office REITs: Grab it while it lasts>. The near-term office outlook remains stable, buoyed by the lack of upcoming supply over 2020-2022, thereby supporting office S-REITs portfolio occupancies. Coupled with ample spreads between expiring and market transaction levels, we believe that downside risks for office REITs are likely to be manageable.

We believe it is too early to turn cautious on potential structural demand shifts with the adoption of work-from-home ("WFH") practices. While flexible working policies will be core, we do not see a 180-degree pivot towards WFH but a balance will be sought. In fact, we see Office S-REITs upping the game by offering flexible workspaces to meet their tenants' evolving needs and integrating with sustainability practices. Near-term supporting factors are (i) demand for space due to safe distancing requirements and (ii) Business Continuity Plan (BCP) needs. We expect two trends in the medium term as follows: (i) the premium grade A office space continue holding its ground, and (ii) acceleration in the decentralised office space.

Office supply completions in CBD to be delayed



Source: Companies, DBS Bank

Retail S-REITs (-ve near term/+ve medium term). While we are into phase 2 of the reopening of the economy post Circuit Breaker, the worst is over for retail S-REITs, which had to provide the highest amount of tenant assistance to their retailers. That said, since reopening, we are seeing positive signs emerging with sales momentum (especially in the food & beverage sector) approaching pre-COVID-19 levels. That said, the strong adoption post COVID-19 of online shopping and food delivery will drive more sales online. Landlords will have to remain proactive to continue to attract consumers to come to the malls to spend. Meanwhile, vacancy rates are expected to increase modestly across most portfolios.

Hotels (-ve near term/+ve medium term). The hotel sector will be the last to recover as we do not expect international travellers to come to Singapore anytime soon (earliest 2021). The recovery will be tepid if any, and the hospitality REITs will depend on their sponsors for rental income this year. Given the strong sponsor backing and the reopening of the Singapore tourism sector to staycations from 3 July 2020 onwards, we do not anticipate further downside risk for 2020 numbers. Assuming that the travel industry returns to normalcy in 2021, this sector will thus rebound the strongest.

Summary of subsector views

	Recovery post circuit break	Near Term view	Long term view	Picks
Industrial	Fast	• Industrial sector expected to remain resilient • Landlords with higher exposure to SME tenants may have to make more provisions to provide rental waivers/rebates	• Business parks and data centres expected to remain robust due to limited new supply • REITs with strong acquisition pipelines are expected to resume portfolio growth plans	AREIT, FLT, ARA LOGOS, SBREIT
Office	Fast	• Progressive return to office bodes well for the landlords • Risk of downsizing and bankruptcy due to weaker GDP outlook	• Recovery could be faster than expected given very limited upcoming net supply in the next 3 years	KREIT,MCT, CCT
Office – US	Fast	• Improved sentiment with the progressive return to office post the reopening of the US economy • Leases remain sticky due to safe distancing and moving office remains challenging	• Risk of downsizing and bankruptcy on sectors impacted by COVID-19/trade war such as retail trades, travel related and O&G • Risk of a second wave of outbreak leading to another lockdown	Prime
Retail	Moderate	• Suburban retail to do better • Gradual reopening of office to boost performance of centrally located malls. • Tourist dependent malls to likely see slowest pace of recovery	• Faster adoption of e-commerce • Low competing retail supply pipeline to mitigate downside risk in the next 3 years	FCT, CMT Lendlease Global Commercial Reit
Retail - Overseas	Moderate	• Moderate pace of recovery with traffic recovering 70-85% in the various markets • Presence of second wave threat in China	• Recovery of consumption to normalised pre-COVID-19 level, which is generally within China (c.5-6% y-o-y retail sales growth) • Faster adoption of e-commerce	-
Hotels	Moderate/slow	• Expectations for recovery earliest in 2021 • Sponsor-backed rental income to provide an income floor	• Anticipate travel recovery to approach normalisation only in 2022	ART

Source: Bloomberg Finance L.P., DBS Bank

Acquisitions to occur in 2H2020

Returning to the virtuous acquisition growth cycle. S-REITs are trading at 1.15x P/NAV and FY20/21F yields of 5.5%/6.3%, implying a growth rate of c.15%. Spreads are attractive to remain vested and while growth in 2021 is at a robust 80bps (or 15%) owing to one-offs in 2020, we see upside upon a resumption of acquisition activities in 2H20. We see possibilities in selected S-REITs in the industrial and retail subsectors positioned to leverage on their sponsors' pipeline and support growth distributions.

Pipeline from Sponsors

Sponsors:	Assets	Sector	Estimated Value (S$'m)	Est. Yield (%)	Potential platforms
CapitaLand Limited	Stakes in Raffles City Beijing	Retail	1,200	4.0%-5.0%	CRCT
	Stakes in Raffles City Shanghai	Retail	2,400	4.0%-5.0%	CRCT
	Business Park (Ascent)	Industrial	318	5.5%-6.0%	A-REIT
	Business Park (Galaxis)	Industrial	550	5.5%-6.0%	A-REIT
	Business Park (5 Science Park Drive)	Industrial	173	5.5%-6.0%	A-REIT
	5 Retail Malls (Japan)	Retail	650	5.5%	CMT
	Office properties (Japan)	Office	1,600	4.0%	CCT
	Multi-family portfolio (USA)	Hotels	1,150	6.0%	ART
Frasers Property Limited *	Northpoint City South Wing	Retail	1,050	4.5%-5.0%	FCT
	Stake in PGIM fund	Retail	1,000	4.0%-5%	FCT
	50% stake in Frasers Tower	Commercial	2,000	3.5%-4.0%	-
Mapletree Investments	Warehouses in China, Japan, Malaysia	Industrial	500-1,000	5.0%-7.0%	MLT
	Office properties in Japan	Office	400-800	4.5%-5.0%	MAGIC
	Stakes in US data centres	Industrial	1,500	6.0%-6.5%	MINT
	St James Power Station	Office	175-200	4,0%-4.5%	MCT
City Developments Limited	M Social Hotel	Hospitality	300	4.0%-5.0%	CDL HT
	Other hospitality assets	Hospitality	n.a.	N.a.	CDL HT
	UK Office Portfolio	Office	1,050	4.5%-5.0%	IPO

Source: Companies, DBS Bank

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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Sources for all charts and tables are DBS Bank unless otherwise specified.

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