Sector updates

Singapore REITs – Volatility expected given bond yields spike

Research Team

Singapore | Real Estate

The Zero Fix – Opportunities and Challenges

Investment summary

The S-REITs sector has come under some selling pressure in recent weeks given the sudden and sharp spike in sovereign bond yields. This leaves us more cautious on the sector in the near-term as sentiment over yield sensitive instruments weakens and we expect further volatility in the months ahead, with potentially more selling pressure. We observe that there has historically not been a clear correlation between the FSTREI and 10-year Singapore government bond yield. However, a sudden and sharp spike in bond yields can cause an initial negative knee-jerk reaction in the share prices of S-REITs. In the past three episodes when this happened since 2013, we have subsequently seen a 15% to 21% rebound in the sector from the trough over a 12-month period once bond yields stabilise. Hence, although the sudden surge in bond yields this year is a concern, investors should also focus on the underlying drivers such as a stronger economic outlook, which would support the recovery of the operational performance of S-REITs and drive a potential sector re-rating. In terms of valuations, given the spike in bond yields, the current forward yield spread between the FSTREI and the 10-year Singapore government bond yield has now compressed to 395 bps, which is below the 10-year average. For investors looking for exposure to the sector, we would position with a recovery basket comprising retail and hospitality REITs given that we have already seen a more meaningful rotation to value and cyclical stocks globally: **Ascott Residence Trust [BUY; FV: SGD1.24]**, **CapitaLand China Trust (CLCT SP) [BUY; FV: SGD1.58]**, **Frasers Centrepoint Trust (FCT SP) [BUY; FV: SGD2.95]**, **Mapletree Commercial Trust (MCT SP) [BUY; FV: SGD2.18]** and **Mapletree North Asia Commercial Trust (MAGIC SP) [BUY; FV: SGD1.06]**. For investors with a longer-term horizon, we would be buyers on dips of high-quality S-REITs which are expected to be beneficiaries of secular growth trends with room for solid inorganic growth opportunities. Preferred picks within what we term as our resilient basket would be: **Ascendas REIT (AREIT SP) [BUY; FV: SGD3.89]**, **Frasers Logistics & Commercial Trust (FLT SP) [BUY; FV: SGD1.62], Keppel DC REIT (KDCREIT SP) [BUY; FV: SGD3.51], Mapletree Industrial Trust (MINT SP) [FV: SGD3.51]** and **Mapletree Logistics Trust (MLT SP) [BUY; FV: SGD2.17]**. Over the next 9-12 months horizon, we would expect our recovery basket to outperform our resilient basket.

- 4Q/2H20 results largely in-line; forecasting DPU growth of 14.4% in FY21F and 8.9% in FY22F
- No clear correlation between S-REITs' performance and sovereign bond yields, but sudden and sharp spike in bond yields can cause a negative knee-jerk share price reaction
- Recovery basket likely to outperform over next 9-12 months: ART SP, CLCT SP, FCT SP, MCT SP and MAGIC SP

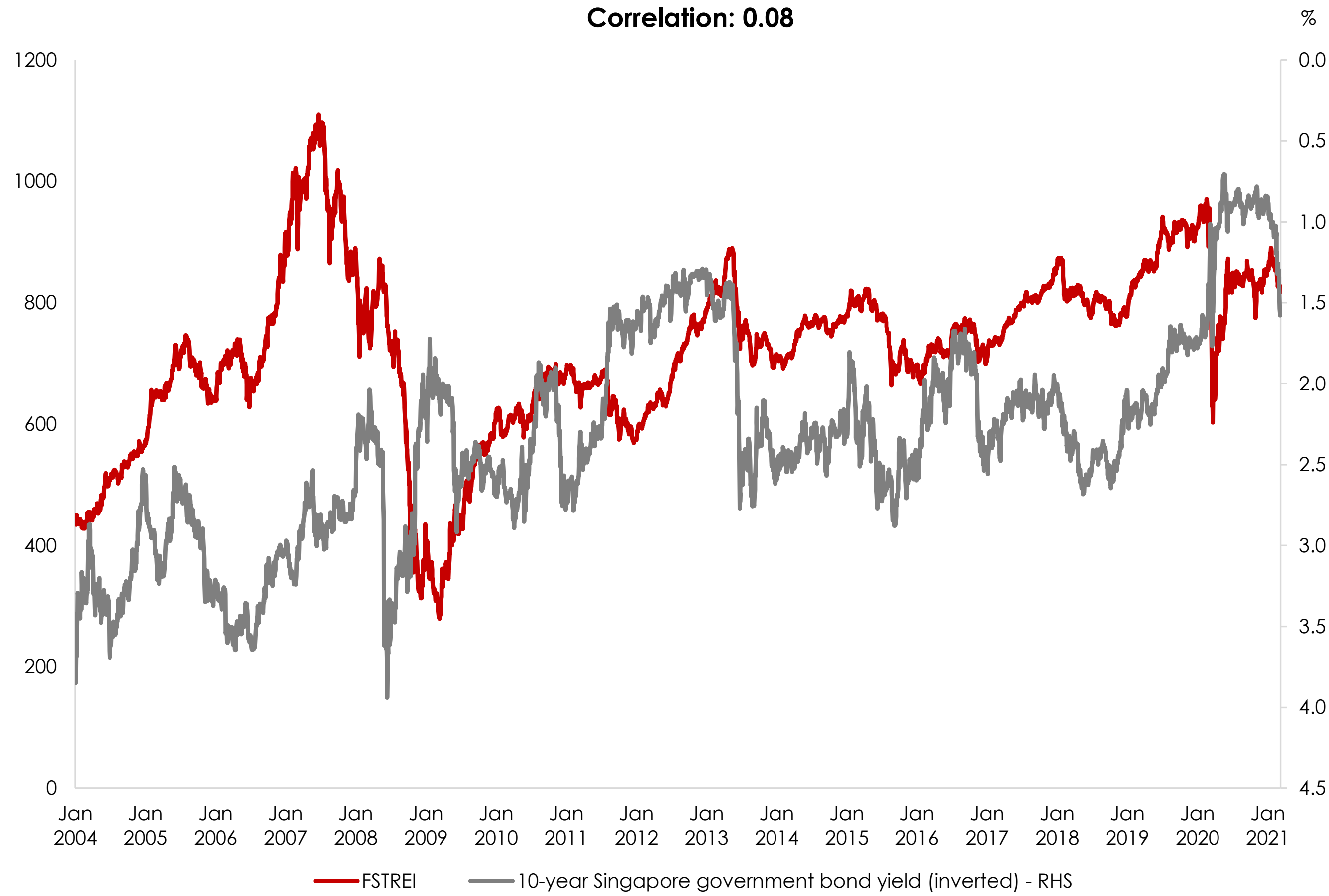
Low correlation between S-REITs' share price performance and Singapore government 10-year bond yield, but sudden spikes can bring about volatility

The S-REITs sector has come under some selling pressure in recent weeks given the sudden and sharp spike in the 10-year US Treasury yield and 10-year Singapore government bond yield, which have jumped 62 and 71 basis points (bps) year-to-date (YTD), respectively. This leaves us **more cautious on the sector in the near-term**

as sentiment over yield sensitive instruments weakens and we expect further volatility in the months ahead. From a valuation perspective, a spike in sovereign bond yields can also compress the distribution yield spread between the S-REITs sector against the 10-year Singapore government bond yield, thus making valuations look less attractive.

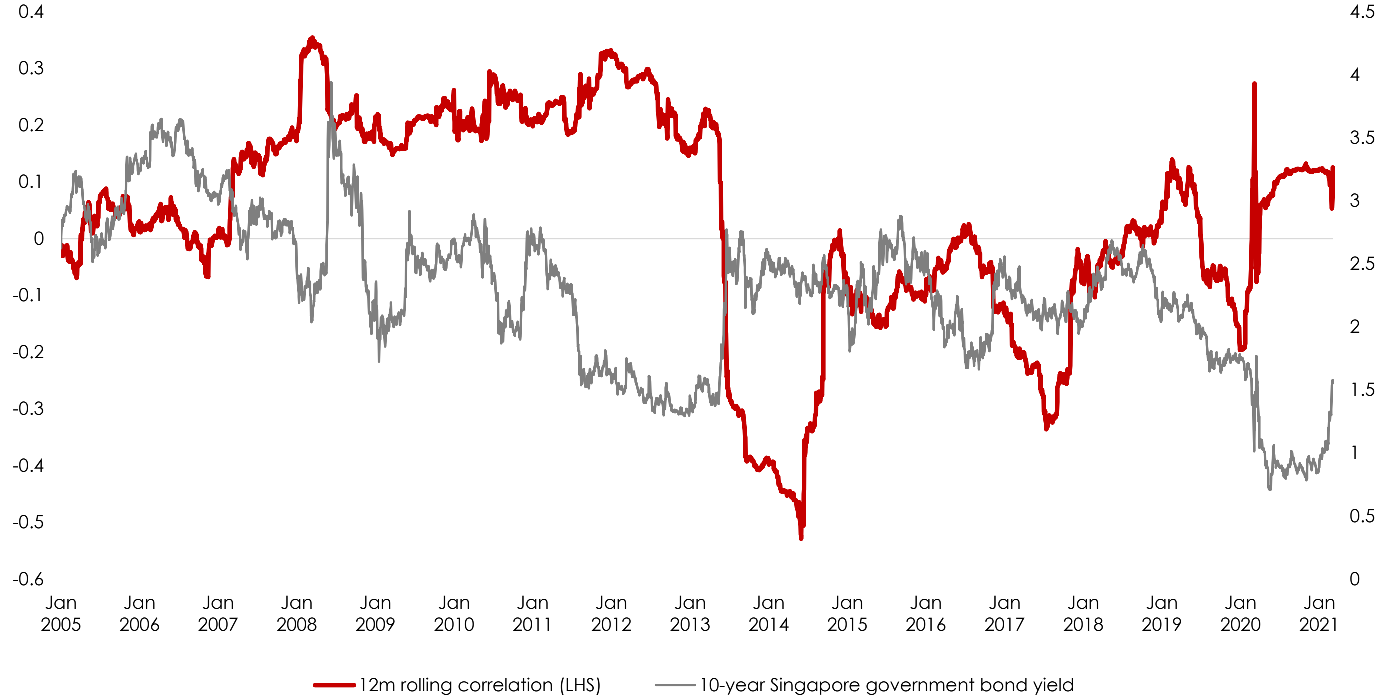
That said, based on historical data points, the **correlation between the proportionate performance of the FTSE Straits Times REIT Index (FSTREI) and change in 10-year Singapore government bond yield was low at only 0.08 from the period between the start of 2004 to 5 Mar 2021**. If we take this analysis deeper by exploring the rolling 12-month correlation between these two variables (refer to Exhibit 2), we note that the correlation was largely positive (i.e. FSTREI was appreciating when bond yields were rising and vice-versa) from the start of 2004 to mid-2013. Thereafter, we saw more episodes of the correlation being in negative territory. For example, the Bernanke taper tantrum in May 2013 resulted in a sharp spike in bond yields, with the 10-year Singapore government bond yield rocketing from 1.6% (22 May) to 2.8% (24 Jun) and the FSTREI dipped 17.7% during this span of one month. It subsequently corrected by another 4.6%, troughing in early Feb 2014 before rebounding 16.2% over the next 12 months as bond yields stabilised and the US GDP growth gathered momentum.

Exhibit 1: Trend between FSTREI and 10-year Singapore government bond yield



Source: Bloomberg, Internal estimates

Exhibit 2: Rolling 12-month correlation between FSTREI and 10-year Singapore government bond yield



Source: Bloomberg, Internal estimates

Other episodes when bond yields spiked and the rolling 12-month correlation between the FSTREI and 10-year Singapore government bond yield was in negative territory are detailed in Exhibit 3. Currently, the 10-year Singapore government bond yield has risen 71 bps YTD, while the FSTREI is down 4.0%, with the rolling 12-month correlation still in slight positive territory (0.13).

Exhibit 3: Periods when FSTREI declined when bond yields spiked

Event(s)	Date start	Level of 10-year Singapore government bond yield	FSTREI Index level	Date when FSTREI troughed	Level of 10-year Singapore government bond yield	FSTREI Index level	% change in FSTREI	Basis point change in 10-year Singapore government bond yield	Range of rolling 12-month correlation	Subsequent 12 months performance of FSTREI from trough
Bernanke taper tantrum	22-May-13	1.56%	881.18	05-Feb-14	2.41%	691.63	-21.5%	85	0.17 to -0.41	16.2%
Concerns over first Fed rate hike since 2008	16-Jan-15	1.81%	798.61	24-Aug-15	2.60%	663.64	-16.9%	80	-0.09 to -0.16	15.1%
Trump election win and reflation expectations	08-Nov-16	1.97%	739.04	23-Dec-16	2.43%	699.70	-5.3%	46	-0.05 to -0.13	21.1%

Source: Bloomberg, internal estimates
Note: Performance of FSTREI excludes distributions

We conclude that there has **historically not been a clear correlation between the FSTREI and 10-year Singapore government bond yield**. However, a **sudden and sharp spike in bond yields can cause an initial negative knee-jerk reaction in the share prices of S-REITs**. In the past three episodes when this happened since 2013, we have **subsequently seen a 15% to 21% rebound in the sector from the trough over a 12-month period once bond yields stabilise**. Hence, although the sudden surge in bond yields this year is a concern, investors should also **focus on the underlying drivers such as a stronger economic outlook, which would support the recovery of the operational performance of S-REITs and drive a potential sector re-rating**.

Forward distribution yield spread has compressed to below 10-year average levels

In terms of valuations, given the spike in bond yields, the **current forward yield spread** between the FSTREI and the 10-year Singapore government bond yield has now **compressed to 395 bps**, which is 57 bps below the start of the year and also approximately 0.4 standard deviations below the 10-year average of 420 bps. **Valuations for the sector are no longer as appealing as compared to six months ago**, and we would be **cautious over the near-term as volatility is likely to stay** and there **could be further selling pressure**. Our house projections for the 10-year US Treasury yield over the next 12 months was recently raised from 1.5% to 1.9%, and we note that the correlation between the10-year US Treasury yield and 10-year Singapore government bond yield has historically been high.

That said, we believe a **firm economic recovery from the pandemic can help to buttress the underlying operational improvement of S-REITs**, and this should **help to drive a re-rating over the medium to longer term, even as bond yields trend upwards** (assuming that the increase is not as sharp as what we have seen in recent weeks).

Exhibit 4: Yield spread between FSTREI and Singapore government 10Y bond yield

Source: Bloomberg, Internal estimates

For investors looking for exposure to the sector, we would position with a recovery basket comprising retail and hospitality REITs given that we have already seen a more meaningful rotation to value and cyclical stocks globally: **Ascott Residence Trust [BUY; FV: SGD1.24]**, **CapitaLand China Trust (CLCT SP) [BUY; FV: SGD1.58]**, **Frasers Centrepoint Trust (FCT SP) [BUY; FV: SGD2.95]**, **Mapletree Commercial Trust (MCT SP) [BUY; FV: SGD2.18]** and **Mapletree North Asia Commercial Trust (MAGIC SP) [BUY; FV: SGD1.06]**.

Exhibit 5: Recovery basket preferred picks

REIT	Ticker	Last Close (SGD)	Fair Value (SGD)	Distribution Yield FY-1	Distribution Yield FY-2	P/B FY-1 (x)	P/B FY-2 (x)	Potential Total Returns	Rating
Ascott Residence Trust	ART SP	1.05	1.24	3.9%	5.9%	0.9	1.0	22%	**BUY**
CapitaLand China Trust	CLCT SP	1.34	1.58	6.4%	7.2%	0.9	0.9	24%	**BUY**
Frasers Centrepoint Trust	FCT SP	2.39	2.95	5.2%	5.4%	1.0	1.0	29%	**BUY**
Mapletree Commercial Trust	MCT SP	2.01	2.18	4.2%	4.7%	1.2	1.2	13%	**BUY**
Mapletree North Asia Commercial Trust	MAGIC SP	0.955	1.06	6.3%	7.3%	0.7	0.7	17%	**BUY**

Source: Refinitiv, Internal estimates, as at 9 Mar 2021 closing prices
Note: FY-1 denotes current financial year; FY-2 denotes next financial year. Figures are internal forecasts.

For investors with a longer-term horizon, we would be buyers on dips of high-quality S-REITs which are expected to be beneficiaries of secular growth trends with room for solid inorganic growth opportunities. Preferred picks within what we term as our resilient basket would be: **Ascendas REIT (AREIT SP) [BUY; FV: SGD3.89]**, **Frasers Logistics & Commercial Trust (FLT SP) [BUY; FV: SGD1.62]**, **Keppel DC REIT (KDCREIT SP) [BUY; FV: SGD3.51]**, **Mapletree Industrial Trust (MINT SP) [FV: SGD3.51]** and **Mapletree Logistics Trust (MLT SP) [BUY; FV: SGD2.17]**.

Over the **next 9-12 months horizon**, we would **expect our recovery basket to outperform our resilient basket**.

Exhibit 6: Resilient basket preferred picks

REIT	Ticker	Last Close (SGD)	Fair Value (SGD)	Distribution Yield FY-1	Distribution Yield FY-2	P/B FY-1 (x)	P/B FY-2 (x)	Potential Total Returns	Rating
Ascendas REIT	AREIT SP	2.85	3.89	5.5%	5.7%	1.3	1.3	42%	**BUY**
Frasers Logistics & Commercial Trust	FLT SP	1.35	1.62	5.4%	5.5%	1.2	1.2	25%	**BUY**
Keppel DC REIT	KDCREIT SP	2.54	3.51	3.8%	3.9%	2.1	2.1	42%	**BUY**
Mapletree Industrial Trust	MINT SP	2.55	3.51	4.8%	5.2%	1.5	1.5	42%	**BUY**
Mapletree Logistics Trust	MLT SP	1.78	2.17	4.6%	4.8%	1.4	1.4	27%	**BUY**

Source: Refinitiv, Internal estimates, as at 9 Mar 2021 closing prices
Note: FY-1 denotes current financial year; FY-2 denotes next financial year. Figures are internal forecasts.

4Q/2HCY20 results an affirmation that gradual recovery is on track

Looking back at the recently concluded 4Q/2HCY20 earnings season, there were 15 S-REITs under our coverage which reported DPU figures (others only provided operational updates). Eight of these 15 reported results which met our expectations, three exceeded and the remaining four fell short. Although YoY DPU growth was -14.4% for these 15 S-REITs, or -7.0% on a market-cap weighted basis (refer to Exhibit 7), given that results were largely in-line with our expectations, we believe this is an **affirmation that the gradual recovery from the Covid-19 pandemic is on track**.

Exhibit 7: Results performance of S-REITs under coverage

	Reporting Period	Reporting Currency	NPI	YoY Chg	Dist. income	YoY Chg	DPU (cents)	YoY Chg
OFFICE								
Manulife US REIT	2H	**US$ m**	53.66	-8.2%	40.99	-5.5%	2.59	-11.3%
OUE Commercial REIT	2H	S$ m	119.4	-1.0%	75.5	-0.8%	1.43	-12.3%
Suntec REIT	4Q	S$ m	109.0	-10.4%	106.1	-19.8%	4.11	-12.8%
		S$ m	**301.6**	**-6.4%**	**237.6**	**-11.3%**	**9.07**	**-12.2%**
RETAIL								
CapitaLand Int. Comm. Trust	4Q	S$ m	191.9	36.4%	145.4	26.8%	2.63	-15.4%
CapitaLand Retail China Trust	2H	S$ m	85.20	21.9%	42.68	-22.8%	3.33	-30.2%
Frasers Centrepoint Trust	1Q	S$ m	N.A.	N.M.	N.A.	N.M.	N.A.	N.M.
Mapletree Commercial Trust	3Q	S$ m	104.4	1.1%	N.A.	N.M.	N.A.	N.M.
Mapletree NAC Trust	3Q	S$ m	75.7	49.0%	N.A.	N.M.	N.A.	N.M.
SPH REIT (1)	1Q	S$ m	N.A.	N.M.	N.A.	N.M.	1.20	-13.0%
Starhill Global REIT	1H	S$ m	65.0	-12.3%	41.43	-16.1%	1.88	-16.8%
		S$ m	**522.2**	**19.0%**	**229.5**	**4.6%**	**9.04**	**-21.5%**
INDUSTRIAL								
Ascendas REIT	2H	S$ m	388.20	7.8%	275.24	9.8%	7.42	-0.9%
ESR-REIT	2H	S$ m	84.0	-8.2%	51.3	-25.1%	1.44	-28.0%
Frasers Logistics & Comm Trust	1Q	S$ m	N.A.	N.M.	N.A.	N.M.	N.A.	N.M.
Mapletree Industrial Trust	3Q	S$ m	98.9	20.8%	77.1	11.0%	3.28	3.8%
Mapletree Logistics Trust	3Q	S$ m	124.7	14.9%	84.4	10.2%	2.07	1.0%
		S$ m	**695.9**	**8.4%**	**488.1**	**4.9%**	**14.20**	**-3.3%**
HOSPITALITY								
Ascott Residence Trust	2H	S$ m	61.04	-53.2%	61.67	-32.2%	1.99	-52.4%
CDL Hospitality Trusts	2H	S$ m	39.6	-46.2%	42.06	-28.7%	3.44	-29.2%
Far East Hospitality Trust	2H	S$ m	33.58	-38.0%	27.45	-29.9%	1.38	-30.7%
		S$ m	**134.2**	**-48.0%**	**131.2**	**-30.6%**	**6.81**	**-38.3%**
DATA CENTRE								
Keppel DC REIT	2H	S$ m	129.9	43.1%	81.9	39.1%	4.80	27.5%
		S$ m	**129.9**	**43.1%**	**81.9**	**39.1%**	**4.80**	**27.5%**
GRAND TOTAL:		**S$ m**	**1,783.9**	**1.8%**	**1,168.2**	**-2.7%**	**43.92**	**-14.4%**
MARKET-CAP WEIGHTED:				**10.3%**		**4.9%**		**-7.0%**

Source: REIT Managers, Internal estimates

(1) Period from 1 Sep 2020 to 30 Nov 2020 as SPH REIT's financial year end is on 31 Aug

Note: USDSGD exchange rate of 1.365 and 1.368 used for calculation of Office sector's YoY DPU change based on Manulife US REIT's 2H20 and 2H19 DPU in USD, respectively

Key trends and observations by sub-sector

Retail:
- Suburban malls' retail sales unsurprisingly outperformed Orchard Road/downtown malls
- Recovery nearly back to pre-Covid-19 levels for some suburban malls
- Pick up in discretionary spending such as on watches and jewellery. This was driven largely by locals indulging themselves given that they are not able to travel overseas
- Leasing environment still soft, and negative rental reversions are likely to persist for most retail S-REITs

Office:
- Slower decision making by corporates on lease negotiations
- Uncertainties remain over work from home trends
- Downsizing by financial institutions (FI) and energy-related companies to be mitigated by non-bank FI and Chinese Tech companies

Industrial/data centres:
- Industrial leasing demand saw an uptick in 4Q20 but overall environment remains challenging
- Mapletree Industrial Trust guided for continued negative rental reversions over the next 2-3 quarters
- Demand for logistics properties to remain resilient
- Data centres continue to be supported by healthy demand and supply dynamics

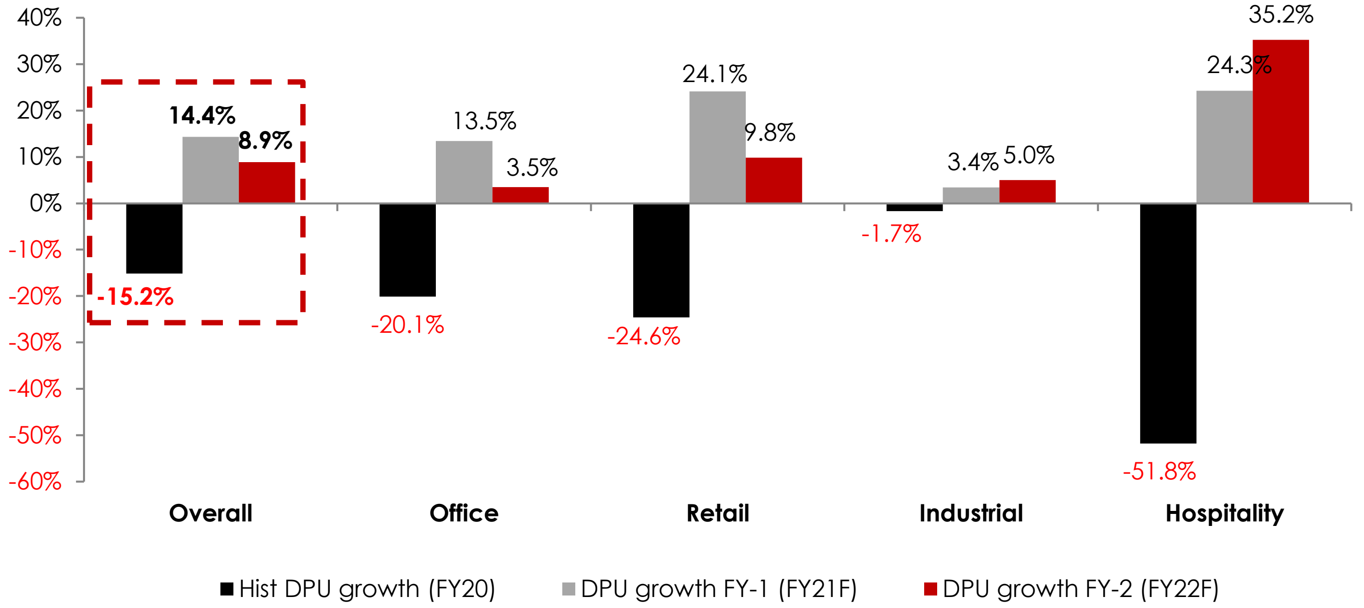
Hospitality:
- Pace of recovery likely to be uneven. Countries with larger domestic markets, more stabilised Covid-19 cases and faster roll-out of vaccinations to lead the recovery
- Sequential recovery in 4Q20 but recovery in some regions such as the US, Japan and Europe was impacted by resurgence of Covid-19 cases
- Ascott Residence Trust and CDL Hospitality Trust's FY20 DPU performances beat expectations on capital distributions, while Far East Hospitality Trust's results were in-line. Undistributed capital gains could be used to smoothen out the impact of Covid-19 and income losses in FY21

Projecting DPU growth of 14.4% in FY21F and 8.9% in FY22F, supported by a rebound in macroeconomic conditions

After taking into account the latest set of results and operational trends observed, we have fine-tuned our assumptions. We now **forecast DPU for the S-REITs under our coverage to register a market cap-weighted growth of 14.4% for the current financial year (FY21F) and 8.9% for the next financial year (FY22F)**, largely due to a lower base effect from rental concessions and restrictive border closures during 2020.

If we compare our FY21 forecasts to actual FY19 data which was before the Covid-19 pandemic hit, this results in an expected growth (market cap-weighted) of -5.5%, which is a reflection of the still uncertain and challenging operating landscape.

Exhibit 8: DPU forecasts for S-REITs under coverage by sub-sector breakdown



Source: REIT Managers, internal estimates

Note: FY-1 denotes current financial year; FY-2 denotes next financial year. Figures are internal forecasts.

ANALYST DECLARATION:

For analysts' shareholding disclosure on individual companies, please refer to the latest reports of these companies.

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