Asia Credit Research

Earnings Review: Keppel Real Estate Investment Trust ("KREIT")

Recommendation

- Though there looks to be some rental pressure affecting part of KREIT's portfolio, the overall raising office rental environment could mitigate the impact going forward. KREIT's credit profile has been stable with aggregate leverage at 38.6%. We will retain our Neutral (4) Issuer Profile.
- We remain overweight the KREITS 4.98%-perp. It offers a YTC of almost 4% for 2.5 years to first call. This is almost a 100bps pickup compared to the AREIT 4.75%-perp with similar call date and more than compensates for the slightly higher leverage.
- We have KREIT at Neutral (4) and Ascendas REIT ("AREIT") at Neutral (3).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
KREITS 4.98%-PERP	02/11/2020	38.6%	3.85%	183
AREIT 4.75%-PERP	14/10/2020	35.2%	2.91%	89

Indicative prices as at 19 April 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Issuer Profile: Neutral (4)

Ticker: **KREITS**

Background

Keppel REIT ("KREIT") is a real estate investment trust focused on mainly commercial assets. It has an AUM of SGD8.5bn. 87% of the portfolio is based in Singapore, with the balance in Australia. The Singapore assets are mainly stakes in Grade A office assets in the CBD, such as Ocean Financial Centre ("OFC", 99.9% stake), Marina Bay Financial Centre Towers 1, 2 & 3 ("MBFC",33% stake in each) and One Raffles Quay ("ORQ, 33% stake). KREIT is 46.4% owned by Keppel Corp ("KEP"), its sponsor.

Nick Wong Liang Mian, CFA
+65 6530-7348
NickWong@ocbc.com

Key Considerations

- **Softer numbers due to 275 George Street:** KREIT reported 1Q2018 results, with property income down 0.3% y/y to SGD39.7mn while NPI declined 0.6% y/y to SGD31.2mn. Performance was affected by the lower occupancy at 275 George Street (committed occupancy fell from 99.3% to 93.4% y/y) likely due to Telstra returning some space (portfolio NLA attributed fell 1.2ppt to 3.2%). This caused property income from 275 George Street to decline 26.5% to SGD3.73mn, while NPI fell harder to SGD2.82mn. That said, KREIT may have been able to obtain commitments for some of the space returned, stating that a government agency took up space in 275 George Street. This could be the reason why despite the sharp plunge in property income, occupancy at 275 George Street only dipped from 99.7% to 93.4% q/q. As such, contributions from the asset could recover in the next few quarter. Overall performance was also mitigated by improvements at Bugis Junction Towers on occupancy recovery.

- **ORQ and MBFC contributions fell:** Total return before tax fell sharply by 11.8% y/y to SGD37.1mn, driven largely by weaker contributions from associates (-10.9% y/y) and JV (-5.7% y/y) with dividend income from ORQ and MBFC falling sharply. As committed occupancy remains almost full for both ORQ (100%) as well as MBFC (99.8%), the assets could be facing negative rental reversion pressure. As KREIT no longer (effective 1Q2018) discloses rental reversion data, it can't be verified directly. As a reference, KREIT reported -4% rental reversion for 2017. Based on 2017 annual report disclosures, property income from ORQ fell 2.6% y/y while property income from MBFC fell 5.5% y/y. In our opinion, ORQ and MBFC likely faced competitive pressure due to the ramp up at Marina One (1.88mn sqft NLA), which is a neighbouring mega asset.

- **Occupancy and retention remains strong:** To be fair, KREIT holds newish, well-positioned, high quality assets. This supports demand (there will be a clearing price) and **o**ther portfolio statistics remaining strong. Committed occupancy stands at 99.4% (4Q2017: 99.7%), retention rate at 93.0% and WALE at 5.3 years. Portfolio occupancy rates for both Singapore (99.8%) and Australia (97.9%) remain higher than market averages of 94.1% (*source: CBRE 1Q2018*) and 89.6% (*source: JLL, end-Dec 2017*) respectively. Rental expiry for 2018 was reduced to just 6.2% of NLA (4Q2017: 8.3%). Given the rising office rental environment, with CBRE reporting SGD9.70 psf market Grade A office rents for 1Q2018 (versus SGD9.40 psf in 4Q2017), KREIT (and its peers) would have less incentive to renew leases ahead of expiry.

- **Credit profile remains stable**: Aggregate leverage remained stable at 38.6% (4Q2017: 38.7%) though all-in interest rate increased to 2.75% (versus 2.62% for 2017). This caused reported interest coverage to weaken to 4.1x (2017: 4.3x). KREIT has no maturities due in 2018, though it's worth noting that KREIT has sizable bank loans aggregating SGD762mn due in 2019. In our opinion, KREIT should be able to refinance its loans when it comes due given that 84% of its assets remain unencumbered.

OCBC Global Treasury	
Treasury Advisory **Corporate FX & Structured Products** Tel: 6349-1888 / 1881 **Interest Rate Derivatives** Tel: 6349-1899 **Investments & Structured Products** Tel: 6349-1886 **GT Institutional Sales** Tel: 6349-1810	**Credit Research** **Andrew Wong** +65 6530 4736 WongVKAM@ocbc.com **Nick Wong Liang Mian, CFA** +65 6530 7348 NickWong@ocbc.com **Ezien Hoo, CFA** +65 6722 2215 EzienHoo@ocbc.com **Wong Hong Wei** +65 6722 2533 wonghongwei@ocbc.com

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

Disclaimer for research report
This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "**Relevant Materials**") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "**Relevant Entity**") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID**") and the EU's Markets in Financial Instruments Regulation (600/2014) ("**MiFIR**") (together referred to as "**MiFID II**"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W