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S-REITs: Falter but not Fall

Overview

The REIT market in Singapore kicked off in 2002, with the successful listing of CapitaLand Mall Trust. In the same year, Ascendas REIT followed. By 2007, the equity price for S-REITs had gained 230% (28.6% p.a.) according to the FSTREI Index. This happened just before the 2008 Global Financial Crisis which wiped out all of the gains since 2002. Although the FSTREI Index has fallen 37.9% from its recent high on 23 March 2020, and subsequently rebounded some ~15%, we can expect more pain before things get better given the COVID-19 situation continues to develop and Singapore remains vulnerable. Within the SGD bond space, CapitaLand Mall Trust is the largest REIT bond issuer. Amid this turbulent period, we think it is reasonable to expect pockets of opportunity to pick up bullet bonds issued by quality REITs at slashed prices, though we discourage panic selling, and think that investors who have the holding power can continue to hold on to their existing high grade REIT bullet bonds so long as the fundamentals of the REITs remain intact.

Operating metrics of REITs

	Expiring leases (% of gross rental income) in 2020	Largest gross rental income by a single tenant	Total gross rental income by top 10 tenants	Exposure to F&B
CapitaLand Mall Trust	21.3%	3.2%	22.1%	31.1%
Frasers Centrepoint Trust	26.6%	3.1%	21.1%	38.2%
Mapletree Commercial Trust	17.0%	10.0%	27.1%	14.4%
CapitaLand Commercial Trust	17.0%	9.0%	37.0%	5.0%
Frasers Commercial Trust	5.5%	15.4%	50.0%	N.A.
Ascendas REIT	23.7%	4.1%	17.9%	N.A.
Mapletree Industrial Trust	17.2%	8.4%	28.5%	N.A.
Ascott Residence Trust	N.A	N.A	N.A	N.A.

Source: Company (as at 31 Dec 2019), OCBC Credit Research

- **Expiring leases in 2020 as a % of total gross rental income** can be used to determine the upper limit of the losses in gross rental income that we may see in 2020, if we assume a worst case scenario where all expiring leases will not be renewed and the REITs will not be able to replace these tenants. We think the percentages look manageable in the sense that the REITs are unlikely to default on upcoming maturity borrowings due to expiring leases.

- **Largest gross rental income by a single tenant** gives us an idea on tenant concentration and reliance on specific tenant for rental income. Broadly, we are comfortable with the numbers. Frasers Commercial Trust's largest tenant is Commonwealth of Australia, the Australia government and the lease will expire in July 2025, while Mapletree Commercial Trust's largest tenant is Google Asia Pacific Pte Ltd. In such a time, tenant strength is crucial in our view. The ability of a tenant to endure periods of operating and financial stress can translate to the REIT's strength as well.

- **Total gross rental income by top 10 tenants** is much like the preceding metric. For Frasers Commercial Trust, its other significant tenants are Rio Tinto Shared Services (8.2% of gross rental income) and Commonwealth Bank of Australia, one of the big 4 banks in Australia (6.4% of gross rental income). We are not overly concerned about these two tenants for now. For CapitaLand Commercial Trust, its largest tenant is RC Hotels (Pte) Ltd (9.0% of gross rental income) due to its 60% interest in Raffles City Shopping. Given that RC Hotels leases Fairmont, Swissotel The Stamford and the convention centre, which are the sectors directly impacted by COVID-19, we think revenue from Raffles City Shopping is likely to be lower. The majority of CapitaLand Commercial Trust's other significant tenants are banks. Overall we are expecting the hospitality and retail sector to take a more immediate hit and CapitaLand Commercial Trust's commercial properties and commercial tenants to continue to provide support for now.

- **Exposure to F&B** is important in our view because barriers to entry are somewhat low and businesses may be comparatively more vulnerable to economic disruptions and downturns. Frasers Centrepoint Trust and CapitaLand Mall Trust, being retail REITs, have the largest exposure. In Singapore, bars have to close by 26 March 2020, and F&B outlets must set up their arrangement of tables and seating to ensure separation of more than one metre between tables or different group of diners. This would significantly reduce the capacity of F&B outlets by at least 30% based on our estimation. At the point of writing, we are expecting these measures to be implemented for a one month period. We think F&B tenants are undeniably negatively impacted. While some of these tenants may choose to reduce staff and items available on their menu, we think it is too early to dismiss the possibility of some stores finding it more economical to cease operations entirely. Therefore, we think the retail REITs may have to consider rental rebates, and may also face negative rental reversion though the magnitude of both is difficult to estimate at this point.

- **Leisure & Entertainment and Education are also affected.** Entertainment venues such as cinemas and karaoke outlets in Singapore will be closed with effect from 26 March 2020. Tuition and enrichment centres will also be suspended. These are components within a mall.

Credit metrics of REITs

	Aggregate Leverage	Unencumbered Assets	Halved EBITDA/Interest	% Deposited property value can fall by before breaching 45% aggregate leverage
CapitaLand Mall Trust	32.9%	100%	2.13x	27%
Frasers Centrepoint Trust	33.2%	~77%	2.31x	26%
Mapletree Commercial Trust	33.4%	100%	2.21x	26%
CapitaLand Commercial Trust	35.1%	91%	2.17x	22%
Frasers Commercial Trust	29.0%	100%	1.89x	36%
Ascendas REIT	35.1%	92%	2.05x	22%
Mapletree Industrial Trust	34.1%	100%	3.20x	24%
Ascott Residence Trust	33.6%	70%	2.27x	25%

Source: Company (as at 31 Dec 2019), OCBC Credit Research

(SGD'mn)	1-year EBITDA	Cash and cash equivalent	Undrawn committed facilities	Debt headroom (assuming cap at 40%)	1-year Property operating expenses	1-year Interest
CapitaLand Mall Trust	506	202	~300	867	229	119
Frasers Centrepoint Trust	120	13	280	216	57	26
Mapletree Commercial Trust	332	69	Not disclosed	596	101	75
CapitaLand Commercial Trust	300	205	~150	577	91	69
Frasers Commercial Trust	72	16	363	252	43	19
Ascendas REIT	636	96	~200	572	223	155
Mapletree Industrial Trust	282	89	Not disclosed	285	87	44
Ascott Residence Trust	236	246	Not disclosed	449	262	52

Source: Company (as at 31 Dec 2019), OCBC Credit Research

- **High percentage of unencumbered assets provides comfort**. We like that the majority of the REITs have little to no encumbered assets. We think this would give the REITs flexibility and strength in their negotiation for loans from banks, given that secured borrowings can be an option.

- **Debt headroom measures** the amount of debt REITs can take on without breaching the implicit aggregate leverage limit of 40% which most REITs like to set for themselves though

Monetary Authority of Singapore's limit is 45%. We are comfortable with the headroom estimated in the table above as the amount is more than sufficient to cover their operating expenses and interest expenses for up to at least 1.5 years.

- **EBITDA/Interest is still manageable even after assuming EBITDA is halved.** Based on our estimation, the above-mentioned REITs will see halved EBITDA/Interest still well above 1x, with Mapletree Industrial Trust's at 3.2x.

- **Deposited property value has more than 20% leeway.** We estimate that deposited property values of the REITs can fall by over 20% to as much as 36% for Frasers Commercial Trust before the REITs will breach the 45% aggregate leverage limited by Monetary Authority of Singapore.

Upcoming REIT bullet bond maturities

Issue	Amount Issued (SGD'mn)	Maturity Date	Availability of committed facilities / Existing Cash
ASCHTS 3.3% '20	75	07/04/2020	Yes
AREIT 2.95% '20	100	03/08/2020	Yes
MCTSP 3.6% '20	160	24/08/2020	Undisclosed*
CAPITA 3.15% '20	100	18/12/2020	Yes
CCTSP 2.98% '21	50	14/02/2021	Yes
CAPITA 3.08% '21	350	20/02/2021	Yes
FCOTSP 2.783% '21	50	15/03/2021	Yes
MCTSP 3.2% '21	70	12/04/2021	Undisclosed*

Source: Bloomberg, OCBC Credit Research
**MCT does not disclose its available committed facilities. As at 31 Dec 2019, MCT has SGD68.8mn cash and cash equivalents on its balance sheet. MCT had also in late 2019 secured a green loan facility of SGD670mn and issued SGD250mn fixed rate notes.*

Recent REIT bullet bond Issuances

Issue	Amount Issued (SGD'mn)	Issue Date	Spread at Issue	Spread* (26-Mar-20)
SUNSP 3.355% '25	100	07/02/2019	127 bps	173 bps
CAPITA 3.15% '26	100	11/02/2019	104 bps	143 bps
MINTSP 3.58% '29	125	26/03/2019	142 bps	173 bps
MCTSP 3.05% '29	250	22/11/2019	139 bps	156 bps
SUNSP 2.95% '27	200	05/02/2020	143 bps	173 bps

Source: Bloomberg as at 26 March 2020
**Spread is based on indicative prices on Bloomberg. Given the ongoing market dislocation, actual prices may differ*

S-REITs have not tapped the SGD bond market since early Feb 2020. We noticed credit spreads have widened for the REIT bonds. This would mean that it is more expensive for these REITs to tap the market now. That said there are ways these REITs can boost their liquidity if needed.

Ways REITs can boost liquidity, if needed

- **Drawdown committed credit facilities:** REITs can tap the committed credit lines they have with banks. As at 31 Dec 2019, Frasers Commercial Trust has SGD363mn, Frasers Centrepoint Trust has SGD380mn, CapitaLand Commercial Trust has SGD100-200mn, and Ascendas REIT has a few hundred millions.

- **Seek bank loans:** REITs appear to still have access to bank loans. Announced on 22 March 2020, DBS Bank has provided an AUD212mn five-year sustainability-linked term loan to Hong Kong listed Link REIT. Concisely, Link REIT is the largest REIT in APAC. As at 30 Sep 2019, Link REIT had total liabilities-to-total assets of 17.9%, and reported EBITDA/Interest of 8.4x. Within the S-REIT space, Suntec REIT had announced on 19 March 2020 that it has obtained an AUD450mn green loan which can be used for refinancing existing borrowings, acquisitions, investments and general working capital purposes. These recent transactions boost our confidence in REITs' ability to obtain funding from banks at this time. Therefore, we think the other REITs can also seek loans from banks and even consider secured bank loans if need be.

- **Issue equity rights:** Other than going to banks for funding, REITs can tap their shareholders through rights issuance. Equity rights issuances are subjected to approval. We note that S-REITs have raised a record ~SGD6.2bn in 2019. 2019 is also the year their share prices were high and therefore such an issuance was timely and cheap for REITs. As at the time of writing on 26 March 2020, share prices of S-REITs have plunged ~29.%, taking into account the slight recovery observed. Therefore, we think it is becoming less and less economical for S-REITs to raise equity as time passes. Previously in 2007, S-REITs did raise equity to boost their liquidity. The event though resulted in S-REITs prices crashing lower.

- **Support from sponsor:** Ways sponsor can show support for its REITs include (1) REITs selling their assets back to the sponsor for cash. An example though not related to boosting REIT's liquidity but nevertheless demonstrates sponsor's support is CapitaLand purchasing Somerset Grand Cairnhill Singapore serviced residences from Ascott Residence Trust for redevelopment and subsequently selling it back to the REIT. (2) Acquiring properties from sponsor at an attractive price with the sponsor receiving equity units as a form of payment. We think the sponsor will be able to increase its stake in the REITs at a time where equity units are at arguably attractive prices given price-to-book is below one for most REITs. This act would increase the REIT's asset base and possibility its aggregate leverage ratio depending on the structure of the transaction. An example of (2) is Mapletree North Asia Commercial Trust's acquisition of two office properties in Japan from its sponsor, Mapletree Investments Pte Ltd. The transaction was funded via 30% new equity to its sponsor and 70% via a mix of debt or cash. (3) Provide loans directly to the REITs, and (4) provide support in terms of marketing or giving REITs greater access to the sponsor's network of financiers.
    - CapitaLand Ltd ("CAPL") is the sponsor for CapitaLand Mall Trust (CAPL's stake is 28.46%), CapitaLand Commercial Trust (29.41%), Ascendas REIT (19.15%) and Ascott Residence Trust (24.65%). CAPL is Singapore's leading real estate company, with SGD82.9bn assets as at 31 Dec 2019. CAPL is 51% owned by Temasek Holdings Pte Ltd. We hold CapitaLand Ltd at Neutral (3) Issuer Profile.
    - Mapletree Investment Pte Ltd ("MAPL") is the sponsor for Mapletree Commercial Trust (32.87%) and Mapletree Industrial Trust (29.35%). MAPL has total assets of SGD55.7bn.
    - Frasers Property Ltd ("FPL") is the sponsor for Frasers Centrepoint Trust (36.42%) and Frasers Commercial Trust (26.04%). As at end 2019, FPL has SGD37.6bn total assets.

- **Reduce dividends:** REITs have to pay out at least 90% of its taxable income each year to obtain tax exempt status by the Inland Revenue Authority of Singapore. This is perhaps the main reason why REITs have minimal cash on its balance sheet. REITs can consider distributing less of its taxable income and paying higher taxes. We think this is more relevant for REITs who have built up a track record of distributing more than 90%. We view reducing their distribution to just 90% and holding the balance as cash on their balance sheets as one of the lower hanging fruits. Depending on how taxable income may have fallen relative to S-REIT's equity share prices, we think optically dividend yield can possibly still be maintained despite a reduction in payout ratio.

- **Sell assets:** Strictly speaking, assets held by REITs hold value and can be liquidated if unencumbered to potential buyers such as private equity property funds. That said, we view this move as the last resort and see the likelihood of the REITs under our coverage pursuing this option as low.

Potential downside

- **Higher operating cost to comply with the more stringent measures.** For the retail REITs, patrons must practice at least one metre physical spacing and venues should not have more than one person per 16 sq m of usable space. We interpret this to mean that malls will have to allocate resources to manage human traffic and compliance with the new rules. While announced rules are specific to shopping malls, we have also observed temperature taking and step up in cleaning across all property types in Singapore. We expect these measures to translate to higher operating costs for the property owners.

- **Lockdown and/or limitation of movement are not out of the question.** The Singapore government has been actively rolling out measures to limit the spread of COVID-19, and thus far the disease appears contained. Having said that, we think it is too early to dismiss the possibility of a lockdown or a limit on the movement of people. As seen in other countries, a lockdown translates to mean that only essential businesses will continue to run and everyone has to stay at home. This would no doubt hurt the economy and REITs will not be exempted. Broadly, tenants of REITs may not be able to service their leases and REITs will receive lower income. For retail REITs, footfall can plunge to none and tenants other than the supermarkets and pharmacies may not be allowed to continue providing services. REITs themselves may have to provide rental rebates to these tenants and sponsors will also have to jump in to provide support. Should COVID-19 be a longer term issue, for office and industrial REITs, corporations may downsize or even wind up their businesses and demand for such spaces would as a result come down significantly. For hospitality REITs, we think a lockdown or a limit on the movement of people would diminish even staycations that could be their biggest source of occupancy at this point. Should a lockdown or a limit on the movement of people happen, we expect REITs to experience more pain. Amongst the REITs, Retail is the most vulnerable in our view. Hospitality REITs while vulnerable, receives part if their rents from master leases with Sponsors. Office and Industrial REITs are likely to be more resilient as compared to the other REITs.

- **Rental reduction for tenants.** iFly Singapore, located at Sentosa, announced on 24 March 2020 that it will reduce rent by 20% for all its food and beverage tenants for six consecutive months from April to September this year. Retail malls in the Retail REITs are arguably in a better situation on the location front, though we remain cautious as we see a second wave of cases albeit imported in Singapore. Furthermore, we recall pockets of weaknesses evident by the exit of a mix of home-grown household names and large international chains including SASA, DFS, MPH Bookstore, Crabtree and Evelyn, Forever 21 and Home-Fix last year (pre-COVID-19). Also, retail malls have in the recent years been welcoming activity-based tenants such as gyms, virtual reality arcades, culinary centres and craft workshops which offer group activities and foster community bonds and ultimately attract footfall. Given everyone is strongly encouraged to practice social distancing; we think the strategy pursued by malls may not only be futile, but also weigh on the performance of malls. That said, it is not all gloom and doom - we think landlords can work with tenants to develop or support their multi-platform strategy as we can expect consumers to move their consumption online.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

Overweight ("OW") – The bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral ("N") – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight ("UW") – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile

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.

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