

Gradual normalisation of REIT market expected in 2024

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AMID an economic backdrop where interest rates have peaked and the US Federal Reserve now speaks openly on how it will go about loosening its monetary policy this year, local real estate investment trusts (REITs) with exposure to the retail, tourism and industrial segments appear poised for growth, thanks to higher domestic spending and a recovering tourism industry, as well as an observable trend of rental reversions for certain industrial REIT counters.

In a span of two months, the Bursa Malaysia REIT Index climbed 5.6% from 777.11 points on Dec 12, 2023, to 814.39 points last Tuesday, a level not seen since February last year. Whether the interest rate factor has spurred buying interest in REITs remains to be seen but the fund managers and analysts with whom The Edge spoke recently readily point to rental reversions and domestic spending as apparent reasons for the uptick this time.

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As the world moves to reduce carbon emissions, the three core dimensions of energy sustainability in the forms of energy security, social equity and environmental impact mitigation are creating a trilemma for countries and policymakers

“When considering investing in a REIT, investors study the interest rate level and direction of its movement as well as the demand for rental of properties. Equally important is the demand for rental,” TA Investment Management Bhd chief investment officer Choo Swee Kee tells The Edge.



RHB's Loong: Although the pace of acquisition slowed in FY2023 following the sharp rise in valuations as asset owners placed a premium on their properties, industrial REITs should continue to record healthy rental reversions each year with a minimal risk of non-renewals (Photo by Suhaimi Yusuf/The Edge)

“A very good example would be during the Covid-19 pandemic period of [2020] to 2022 when interest rates were cut rapidly but REIT share prices still declined sharply due to concerns about demand. Given the current situation, where there is excess supply of rental properties, demand seems to be the more important factor.”

In its Jan 5 and Feb 5 notes, AmInvestment Research emphasised its “overweight” stance on the REIT sector and said it anticipated a healthy growth in retail REITs this year, driven by stable occupancy rates and positive rental reversions.

“This is underpinned by a stable labour market, modestly higher inflation rate of 2.5% to 3.5% accounting for the impact of subsidy rationalisation and service tax increase, coupled with a continued gradual recovery in tourist arrivals. Meanwhile, the hospitality segment of REITs is poised to benefit from government policies aimed at boosting tourism. The gradual influx of international tourists back to pre-pandemic levels is expected to contribute to retail sales improvement,” said the bank-backed research house.



TA's Choo: Independent owners could focus on key companies with naming rights or they could try to convert their buildings into serviced apartments, which seem to see better demand currently (Photo by Patrick Goh/The Edge)

Retail, tourism REITs seen to benefit

Some analysts have named several retail-driven REITs to be worthy of attention: Sunway REIT, Pavilion REIT, IGB REIT and YTL Hospitality REIT.

Sunway REIT, whose portfolio encompasses retail malls, offices, hotels, universities and industrial properties across Malaysia, has been highlighted for its revenue growth and improvement in net property income, which increased 10% year on year and 5% y-o-y respectively, as well as the slightly higher average occupancy rate of 82% in 4QFY2023 from 81% in the preceding quarter across its business segments. The REIT declared a gross distribution per unit (DPU) of 4.68 sen for 4QFY2023, bringing its FY2023 DPU to 9.3 sen, representing a distribution yield of 5.8%.

With expectations that the Fed will start cutting interest rates in mid-2024, by 75 basis points (bps) to 100bps, which will eventually bring the federal funds rate to a range of 4.5% to 4.75% by end-2024, AmlInvestment Research said in a Jan 31 note that its economic team had projected that the 10-year Malaysian Government Securities (MGS) yield would be lower at 3.63% in the fourth quarter of this year from the current level of 3.78%.

“From FY2024F onwards, we anticipate Sunway REIT’s distribution yield spread against 10-year MGS to widen to 2.4% compared with a pre-pandemic (2017-2019) median of 1%. [That makes] Sunway REIT appealing to yield-seeking investors,” said the research house, pointing out that the REIT was trading at a compelling FY2025 price-earnings ratio (PER) of 15 times compared with its four-year average PER of 20 times and that the FY2025F distribution yield of 6.7% was attractive compared with the current 10-year MGS yield of 3.78%.

AmlInvestment Research maintains its “buy” call on the REIT with a fair value (FV) of RM1.87. The research house also ascribed “buy” recommendations to Pavilion REIT (FV: RM1.62 per unit) and YTL Hospitality REIT (FV: RM1.11 per unit).

“For Pavilion REIT, we foresee resilient earnings, mainly underpinned by its prime asset portfolio anchored by Pavilion Kuala Lumpur and Elite Pavilion Mall, which are tourist hotspots that will benefit from the return of international tourists, while a further increase in earnings is expected from Pavilion Bukit Jalil in 2024F. We believe PBJ is positioned for a positive rental reversion in the year, supported by improving footfall traffic and occupancy rates,” it said.

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How selected REITs on Bursa Malaysia stack up

REIT	MARKET CAPITALISATION (RM MIL)	PRICE AS AT FEB 6 (RM)	CONSENSUS TARGET PRICE (RM)	UPSIDE/DOWNSIDE (%)	FORWARD PER (TIMES)	TTM PER (TIMES)	INDICATIVE DIVIDEND YIELD (%)
Sunway REIT	5,479.7	1.60	1.70	6.25	15.53	17.22	5.57
Pavilion REIT	4,821.1	1.32	1.48	12.12	15	10.41	10.45
IGB REIT	6,381.6	1.77	1.89	6.78	16.86	12.29	6.1
YTL Hospitality REIT	1,994.1	1.17	1.10	-5.98	12.72	13.73	7.49
AME REIT	681.1	1.30	1.41	8.46	NA	NA	5.78
Axis REIT	3,075.6	1.76	1.94	10.23	17.6	14.08	4.93

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Similarly, the research house favours YTL Hospitality REIT's stable recurring rental income and minimal occupancy risks to its hotel properties in Malaysia and Japan, which are secured by master lease agreements.

"Additionally, we anticipate higher FY2024F to FY2029F distributions due to the receipt of rental repayments that were deferred earlier in the pandemic years of FY2021 to FY2022," says AmInvestment Research, pointing out that the REIT already offers "an impressive FY2024F dividend yield of 10%".

MIDF Research has expressed its satisfaction with IGB REIT's FY2023 core net income of RM359.1 million, which grew 6.8% y-o-y.

"The portfolio's earnings growth has been underpinned by a recovery in shopper footfall at Mid Valley Megamall and The Gardens Mall, as well as a positive rental reversion even if the higher property operating expenses in relation to higher utility cost dragged earnings growth. The long-term prospects for IGB REIT remain promising due to the strategic location of its retail assets, which will drive rental growth in the near to long term. Meanwhile, its distribution yield is estimated at 5.5%," said the research house, which maintains its "buy" call on the REIT with a target price of RM1.86.

Understandably, not every fund manager or analyst is bullish on the REIT market. A fund manager who does not wish to be named argues that the yields of REITs can be easily outmatched by that of "a banking stock like Malayan Banking Bhd (Maybank), given the upward trajectory of the stock in the last three years amid the momentum in the banking sector".

The banking group's market capitalisation reached RM111.08 billion after its share price rose to RM9.29 last Tuesday from the RM8.26 level in March 2023.

"REITs may have a stable dividend income and an overall yield of about 5% these days. But I could get a better rate from a banking stock like Maybank which, even at its current price of RM9.32 [as at Feb 6] easily has a yield of at least 5%. In addition, the latter is liquid and can be withdrawn anytime, unlike the illiquid investment put into a REIT to await its maturity," the fund manager who does not wish to be named tells The Edge.

Meanwhile, RHB Research analyst Loong Kok Wen observes that despite the broadly seen recovery in occupancy levels across the retail segment, that of Suria KLCC and Pavilion KL are still below their 2019 levels, when both assets were nearly fully occupied. She believes that the opening of new malls such as Pavilion Damansara Heights Phase 1 and The Exchange TRX last October and November respectively, and as well as the upcoming launches of Warisan Merdeka Mall and Pavilion Damansara Heights Phase 2 (both believed to be this year) may capture some footfall from established malls.

"There is no denying that the increasing supply of malls will only amplify the already tenant-driven market in their favour considering that most malls typically offer similar flagship brands as part of their offerings," says Loong.



Vision Group's Chua: The performance of Malaysian REITs in 2024 is anticipated to be influenced by several factors, including economic recovery post-pandemic, consumer spending trends and the global investment climate (Photo by Kenny Yap/The Edge)

Some industrial REITs to consider

Over in the industrial segment, RHB's Loong sees growth potential in AME REIT, an Islamic trust with a portfolio of 34 industrial properties (factories and warehouses) and three dormitories, and Axis REIT.

To be clear, she is "neutral" on the REIT sector as she feels that it lacks any fresh catalysts to lift players' earnings this year after the recovery in rental rates in 2023. However, she opines that there continues to be growth prospects in industrial REITs given the optimism in the manufacturing sector.

S&P Global said on Feb 1 that Malaysian manufacturing picked up slightly in January compared with December last year amid signs of demand improvement. The seasonally adjusted S&P Global Malaysia Manufacturing Purchasing Managers' Index posted 49.0 in January, up from 47.9 in December and the highest since September 2022.

"Although the pace of acquisition slowed in FY2023 following the sharp rise in valuations as asset owners placed a premium on their properties, industrial REITs should continue to record healthy rental reversions each year with a minimal risk of non-renewals," says Loong.

She notes that Axis REIT's 15% higher y-o-y core profit of RM42.3 million brought its FY2023 earnings to RM146.3 million, which she says was fully in line with RHB Research's expectations and 96% of the street's estimates. Axis REIT's DPU of 2.4 sen brought its full-year DPU to 8.65 sen, compared with 9.75 sen in FY2022.

Loong has a straight-forward take on AME REIT, which had appreciated 12% over the last 12 months to close at RM1.30 last Tuesday, for its "portfolio of fully occupied and good quality assets" in Johor. The REIT was listed on the Main Board of Bursa in September 2022 at an initial public offering price of RM1.13 per unit.

“We await more news on acquisitions that can further drive inorganic growth. Inorganic growth is hard to come by because landlords are asking for high [acquisition] prices, hence lowering yield. In Selangor, some asking prices have a yield of 4.5% to 5% but industrial REITs are looking at 6% to 6.5%. The acquisitions are not justified,” she says.

Meanwhile, it is no surprise that the majority of analysts and fund managers are not excited about office portfolios given the oversupply situation. Some analysts have pointed out that the demand tends to be better for newer offices to be opened to the market given their compliance with ESG specifications, which puts pressure on landlords to lower rents in order to maintain occupancy levels.

As to what office landlords are doing to make their buildings more appealing to prospective and existing tenants, TA's Choo says owners that are part of a big group could tap their parent or sister companies to take up the empty spaces. “Independent owners could focus on key companies with naming rights or they could try to convert their buildings into serviced apartments, which seem to see better demand currently,” he adds.

Chua Zhu Lian, group managing director of Vision Group which operates an offshore variable capital company fund in Singapore, says: “The performance of Malaysian REITs in 2024 is anticipated to be influenced by several factors, including economic recovery post-pandemic, consumer spending trends and the global investment climate. However, concerns remain, particularly regarding geopolitical tensions, trade flows and potential regulatory changes impacting the property and investment landscapes. Monitoring these factors closely will be key to effectively navigating the Malaysian REIT market in 2024.”