Singapore Industry Focus

Singapore REITs

Refer to important disclosures at the end of this report

DBS Group Research . Equity

20 May 2022

Bank the winners

- SREITs seen as a "safe haven" when yield curve flattens (i.e., fear of recession),
- Acquisitions will be more targeted due to higher accretion hurdles, given higher funding costs
- Hospitality and office continue to shine despite market volatility; top picks are CICT, KREIT, ART, and CDLHT
- Stay with high-growth industrial and retail; top picks are FCT, LREIT, MINT, and FLT

Stars are still aligned for hospitality and office, despite market volatility. While the SREITs are not spared by the rising interest rate environment, it can still outperform in instances when the yield curve flattens (i.e., fear of recession sets in), which we will see in 2H22-2023. As such, despite the reopening plays having already done well YTD (+10%), we believe that the hospitality and office sectors will continue to shine on the back of improving fundamentals. Our top picks are CICT and KREIT for office plays, and ART and CDLHT for hospitality. For retail and industrial, we stay with picks with the strongest growth profile, which are FCT and LREIT for the retail sector and MINT and FLT for the industrial sector.

SREITs stepping up to reduce inflationary pressures from utility costs and interest rates. In the 1Q2022 results/update, we saw SREITs starting to refinance its near-term debt expiries, reducing to 11% and 17% in FY22 and FY23, respectively (largely industrial and hospitality). The hedged ratio increased to 77% vs. 75% as at end-2021, providing increased defence against rising interest costs. While utility costs are on the rise, we remain comforted that most SREITs are locked in with contracts ending from the latter half of 2022 onwards. This will impact industrial the least while retail may experience a lag before higher costs could be passed through.

Acquisitions likely to be selective and targeted moving forward. With cap rate spreads tightening as interest rates rise, we expect inorganic growth to turn challenging and acquisitions to be more selective and targeted moving forward. Most SREITs do not expect cap rates to widen in the near term and, if at all, will likely see it lagging interest rate movement. As such, SREITs could potentially turn to higher yield commercial assets or development projects in search of value-accretive acquisitions. Industrial players' SREIT acquisition momentum will slow the most, save for those with sponsor support and pipelines.

STI : 3,190.71

Analysts

Rachel TAN +65 6682 3713
racheltanlr@dbs.com

Derek TAN +65 6682 3716
derektan@dbs.com

Dale LAI +65 66823715
dalelai@dbs.com

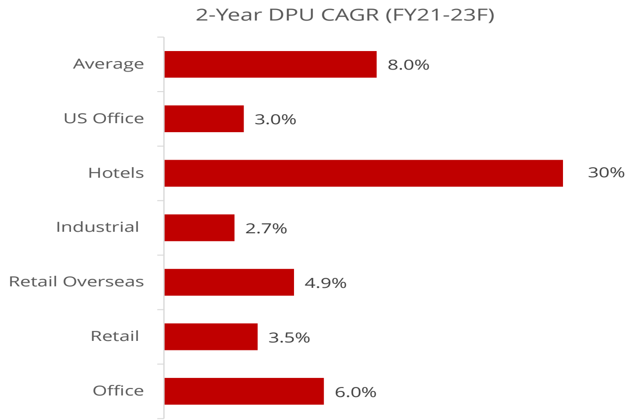
Geraldine WONG +65 6682 3719
geraldinew@dbs.com

STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
CapitaLand Integrated Commercial Trust	2.24	10,655	2.70	5.2	8.2	BUY
Keppel REIT	1.17	3,121	1.40	2.6	(2.5)	BUY
Frasers Centrepoint Trust	2.33	2,848	2.90	0.9	(1.3)	BUY
LendLease Global Commercial REIT	0.77	655	1.06	(9.5)	0.7	BUY
Ascott Residence Trust	1.14	2,689	1.40	8.6	11.8	BUY
CDL Hospitality Trusts	1.30	1,150	1.55	6.6	6.6	BUY
Mapletree Industrial Trust	2.42	4,626	3.05	(4.7)	(12.1)	BUY
Frasers Logistics & Commercial	1.35	3,580	1.75	(5.6)	(7.5)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 19 May 2022

2-year DPU CAGR led by office and hospitality



Source: DBS Bank

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ed: BM/ sa: PY, CS

Bank the winners

Stars are aligned for hospitality and office with sector-specific tailwinds.
Market volatility has been looming since the start of the year. SREITs have not been spared, with it taking a toll on SREIT performance, which was almost flattish YTD.

However, the reopening plays, such as retail, office, and hospitality, which have benefitted from the relaxation of COVID-19 measures and reopening of travel borders, have outperformed its peers despite macroeconomic concerns. Reopening plays have re-rated 11% YTD, led by hospitality (+15%), office (+10%), and retail (+9%).

For the rest of the year 2022, we believe the office and hospitality sectors will continue to shine, given expected tailwinds in the respective sectors. The office sector continues to see positive catalysts in both demand and supply. The office sector has seen strong demand from both tenant expansions and new demand from regional relocations to Singapore, which offset a potential downsizing due to the adoption of the hybrid working model. The lack of quality new supply in core CBD will drive rents up on the back of strong demand with vacancy likely to trend below 4%.

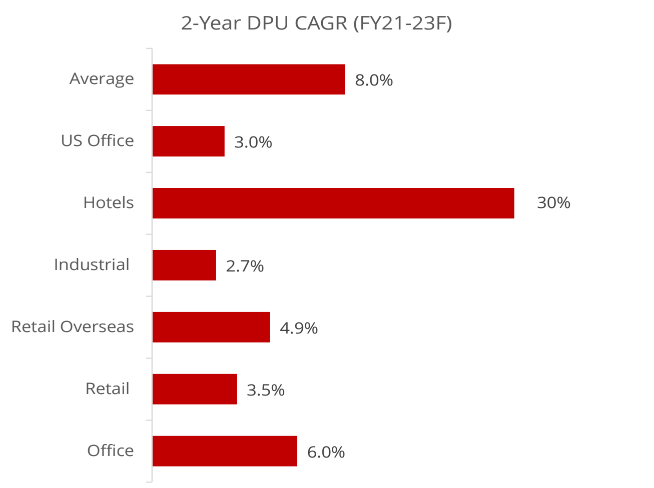
The strong pent-up demand for travel, from both the corporate and leisure segments, with the reopening of travel borders globally, will likely lead to a robust recovery well into FY23 that could offset potential macro headwinds that could hit the sector. Downside risks are limited as hospitality re-emerges from the pandemic.

The office and hospitality sectors continue to lead with two-year CAGR DPU growth at 6% and 30%, respectively, and FY23F growth at 25% and 6%, respectively (please refer the chart below). Our top picks among the two sectors are CICT and KREIT for the office sector, and ART and CDLHT for the hospitality sector.

For retail and industrial, we will stay with picks with the strongest growth profile with potential inorganic growth from either acquisition or development potential. Our top picks are FCT and LREIT for the retail sector and MINT and FLT for the industrial sector.

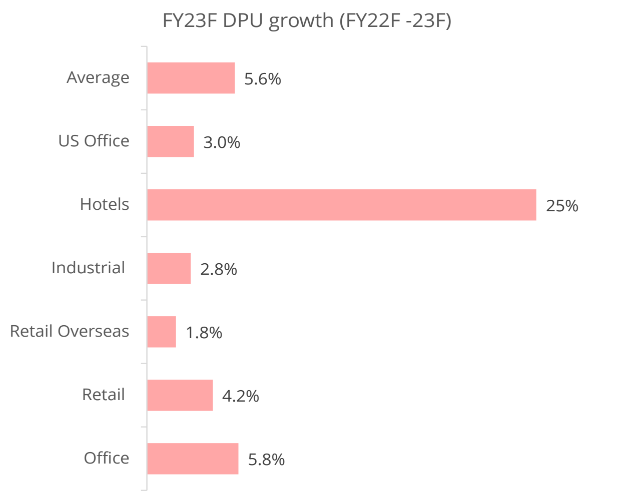
A comparison to our previous picks. We pick CDLHT to replace CLCT within our top picks, given the strong tailwinds in the hospitality sector, while CLCT has been weighed down by lockdowns in China. Despite China likely having reached the peak of its COVID-19 situation, we expect China's retail recovery to likely happen only in the latter half of the year.

2-year DPU CAGR led by office and hospitality



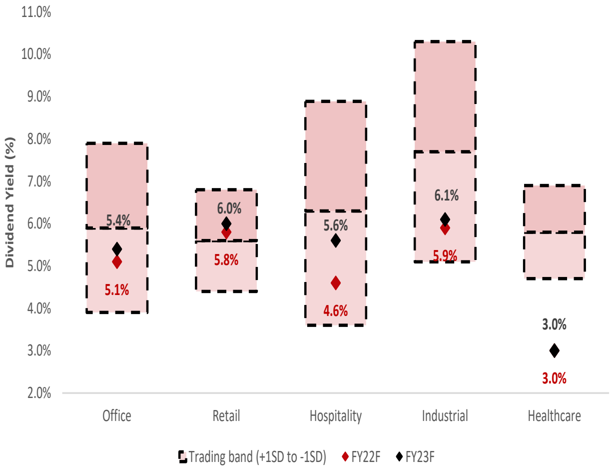
Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

FY23F DPU growth led by hospitality and office



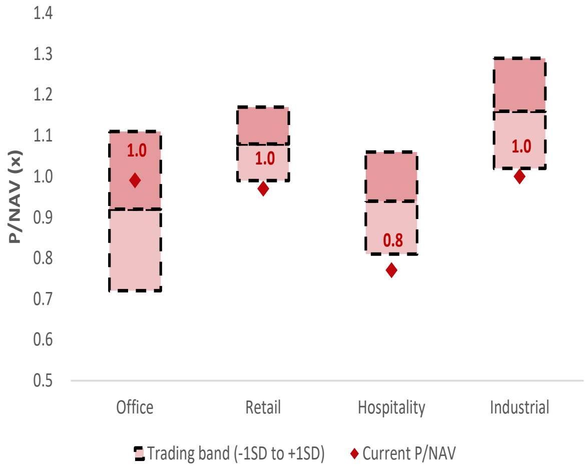
Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

Sector yield vs. historical trading band



Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

Sector P/NAV vs. historical trading band



Source: Thomson Reuters, Bloomberg Finance L.P., DBS Bank

SREITs not spared from rising interest rates, but not out. With interest rates rising and the Fed getting more hawkish with climbing inflation, SREITs are not being spared. As such, we have conducted a universal exercise to raise interest rate assumptions, and revised our valuations and target prices.

While the interest rate conditions remain fluid and US yields are likely to stay somewhat buoyant, our DBS economists expect the US 10-year yield to hit 3.40% by end-2022 and possibly moderate to 2.90% by end-2023 thereafter. The SG 10-year yield is expected to hit 2.95% by end-2022 and moderate to 2.55% by end-2023 thereafter.

Based on our DBS estimates, we revise our risk-free rate assumption to 3% from 2.5% in our SREIT universe and roll forward our DCF valuation to FY23F. The sectors that saw the most revisions in target prices are industrial, healthcare, and retail, while office was flattish and hospitality has been revised up by 6%. *Please refer to Appendix 1 for details of the revisions by SREITs.*

SREITs seen as a "safe haven" when yield curve flattens. While SREITs are typically the first to be impacted in a rising interest rate environment, in instances where the yield curve flattens (i.e., risk of recession rises), SREITs bucked the trend and outperformed historically – which is why it could be seen as a "safe haven".

While the interest rate environment could remain volatile as we keep a keen eye on CPI trends, our DBS economists continue to have a bias towards flattening in the 2Y/10Y. As such, we believe SREITs have the propensity to outperform and re-rate, despite rising interest rates.

Target price and earnings revisions

	12-mth TP	Revision FY22F DPU	FY23F DPU
Office	0%	-2%	0%
Retail	-2%	0%	0%
Overseas Retail	-1%	-3%	-1%
Hospitality	6%	1%	-1%
Industrial	-6%	-1%	-1%
Healthcare	-4%	0%	0%
European SREITs	0%	0%	0%
Overall	**-1%**	**-1%**	**0%**

Source: DBS Bank

SREITs seen as a "safe haven" and outperform when yield curve flattens

S-REIT (FSTREI Index) vs Yield Curve (Inverted, 10Y-2Y)

DBS estimates Interest rate forecasts	US Rates 3m-SOFR OIS (%)	2Y (%)	10Y (%)	10Y-2Y (bps)	SG Rates 3m SORA OIS (%)	2Y (%)	10Y (%)	10Y-2Y (bps)
Current	1.19	2.73	2.91	**18**	1	2.16	2.79	**63**
1H2022	2.25	2.80	3.50	**70**	1.5	2.25	3	**75**
2H2022	2.65	3.10	3.40	**30**	2.55	2.45	2.95	**50**
1H2023	3.25	3.00	3.05	**5**	2.55	2.35	2.65	**30**
2H2023	3.25	2.90	2.90	**-**	2.55	2.30	2.55	**25**

Source: Bloomberg Finance L.P., DBS Bank

SREITs stepping up to reduce inflationary pressures from utility costs and interest rates.

In the 1Q2022 results/business update, we saw SREITs stepping up and taking measures to reduce inflationary pressures from utility costs and interest rates. The steps taken were:

- Refinance and reduce near-term debt expiries in FY22-FY23. FY22 and FY23 debt expiries reduced to 11% and 17% from 13% and 16% as at Dec 21, respectively. While the overall reduction may seem small, a large number of the SREITs have either committed or refinanced their debt expiries in FY22 or reduced it to below 10% (except mostly industrial SREITs).
- Increase the ratio of interest rate hedging. On average, SREITs' interest rate hedging has increased to 77% from 75% as at Dec 21.
- Most have utility contracts locked in previously and expiring in the latter part of 2022. As energy prices have spiked since the Russian-Ukraine war started, SREITs have relooked at their utility contracts to ensure the rates are substantially locked in.

Fortunately, most SREITs, save for a few, have locked in utility contracts previously that are likely expiring in the latter half of the year. This will significantly minimise the utility cost impact in FY22.

The few SREITs with utility contracts expiring earlier have locked in rates for FY22, although the rates are higher.

Based on management guidance and our sensitivity, a 25bps increase in interest rates will likely have a 0.4%-2.3% impact on FY22F DPU. SREITs with a lower fixed rate hedging ratio (below 70%) and seeing a higher impact on DPU are Suntec, CDLHT, FEHT, AIMS, and Digital Core.

On utility cost guidance, utility costs typically comprise only between 1%-3% of revenue, except for hospitality, where it ranges between 3%-5%. Industrial and office sector utility costs are largely borne by the tenants. While hospitality may bear the brunt of the high costs, these could be passed on via room rates, given the strong demand and that these rates see ongoing adjustments.

Retail landlords may have to bear higher utility costs as the pass-through mechanism may have some timing issues. Nevertheless, some of these costs could be offset with the return of atrium sales and parking income.

Please refer to Appendix 2 for details on interest rates and Appendix 3 for details on utility contracts guidance.

Acquisitions likely to be selective and targeted moving forward. With cap rate spreads tightening as interest rates continue an upward trend, we expect inorganic growth to likely be challenging and acquisitions to likely be selective and targeted moving forward. Most SREITs do not expect cap rates to widen in the near term and, if at all, will likely see it lagging interest rate movement. As such, SREITs could potentially turn to higher yield commercial assets or development projects for accretion.

The industrial sector, which has seen strong inorganic growth in the past few years, could see more muted inorganic growth moving forward, given cap rates have compressed the most during the pandemic. SREITs with supportive sponsors either with pipelines or partnerships in development projects could benefit more than its peers.

SREITs refinance and reduce near-term debt expiries

	1Q2022			4Q2021		
Debt expiry	FY22	FY23	Total	FY22	FY23	Total
Office	8%	18%	26%	10%	18%	28%
Retail	4%	20%	24%	11%	17%	28%
Hospitality	24%	24%	47%	21%	21%	42%
Industrial	19%	11%	30%	18%	10%	28%
European	1%	20%	21%	7%	14%	21%
SREITs	11%	17%	28%	13%	16%	29%

Source: Company, DBS Bank

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Appendix 1: Revision of TP and estimates following adjustments to interest rates (risk free – 3%; roll forward to FY23F)

SREITs	Revised Estimates 12-mth TP	Rating	DPU – FY22F	DPU – FY23F	Old Estimates 12=mth TP	Rating	DPU – FY22F	DPU – FY23F
Office								
CICT	2.70	BUY	10.80	11.76	2.45	BUY	11.33	11.76
KREIT	1.40	BUY	6.00	6.31	1.40	BUY	6.00	6.31
Suntec	1.90	BUY	9.25	9.63	1.90	BUY	9.25	9.63
OUECT	0.45	BUY	2.60	2.63	0.50	BUY	2.60	2.63
Retail								
FCT	2.80	BUY	12.71	13.43	2.90	BUY	12.71	13.43
LREIT	1.05	BUY	4.76	5.21	1.06	BUY	4.76	5.21
SPH REIT	0.96	HOLD	5.33	5.44	0.96	HOLD	5.33	5.44
SGREIT	0.73	BUY	3.94	4.01	0.75	BUY	3.94	4.01
Retail Overseas								
CLCT	1.55	BUY	9.01	9.36	1.60	BUY	9.49	9.63
SASSEUR	1.17	BUY	7.34	7.38	1.15	BUY	7.34	7.38
Hotels								
ART	1.40	BUY	5.67	6.47	1.30	BUY	5.53	6.77
CDREIT	1.55	BUY	5.41	7.02	1.40	BUY	5.45	6.89
FEHT	0.78	BUY	2.93	3.62	0.78	BUY	2.93	3.62
Industrials								
a-itrust	1.55	BUY	8.29	9.63	1.70	BUY	8.29	9.63
A-REIT	3.65	BUY	15.96	16.23	3.65	BUY	15.96	16.23
MINT	3.05	BUY	13.90	14.60	3.35	BUY	14.30	14.60
MLT	2.05	BUY	8.90	8.99	2.35	BUY	8.80	8.90
AIMS	1.55	BUY	9.55	10.01	1.60	BUY	9.40	9.78
FLT	1.75	BUY	7.70	7.81	1.75	BUY	7.70	7.81
ECWorld	0.70	BUY	5.65	6.01	0.85	BUY	6.30	6.44
DHLT	0.95	BUY	5.22	5.30	0.95	BUY	5.22	5.30
Digital Core	1.30	BUY	4.35	4.70	1.40	BUY	4.51	4.98
Healthcare								
P-Life	5.50	BUY	14.29	14.31	5.75	BUY	14.29	14.31
European								
Cromwell	2.80	BUY	17.00	17.39	2.80	BUY	17.00	17.39
IREIT	0.70	BUY	4.69	4.68	0.70	BUY	4.69	4.68

Source: DBS Bank

Appendix 2: Gearing, cost of debt, hedging, and sensitivity to interest rate movement as at 1QCY22

SREITs (1QCY22)	Gearing*	Avg Cost of Debt	Fixed Rate (%)	Sensitivity (every 25bps increase)
Office				
CICT	41.0%	2.30%	85.0%	c.0.05 Scts or c.0.5% of FY22F DPU
KREIT	38.7%	1.81%	71.0%	c.0.07 Scts or c.1.2% of FY22F DPU
Suntec	43.3%	2.31%	51.0%	c.0.21 Scts or c.2.3% of FY22F DPU
OUECT	39.4%	3.00%	70.0%	n.a.
Retail				
FCT	33.3%	2.20%	68.0%	c.0.0845 Scts of c.0.7% of FY22F DPU
LREIT	40.7%	0.98%	90.0%	n.a.
SPH REIT	30.1%	1.66%	73.0%	n.a.
SGREIT	36.1%	3.06%	90.0%	n.a.
Retail Overseas				
CLCT	38.1%	2.64%	71.0%	c.0.07 Scts or c.0.8% of FY22F DPU
SASSEUR	26.2%	4.40%	72.0%	n.a.
Hotels				
ART	37.8%	1.60%	70.0%	c.0.07 Scts or c.1.25% of DPUs
CDREIT	39.8%	2.10%	63.5%	n.a.
FEHT	33.4%	1.70%	67.6%	n.a.
Industrials				
a-itrust	36.0%	5.40%	79.0%	n.a.
A-REIT	36.8%	2.10%	79.1%	c.0.075 Scts or c.0.5% of FY22F DPU
MINT	38.4%	2.40%	70.5%	n.a.
MLT	38.4%	2.40%	70.5%	c.0.01 Scts or 0.1% of FY22F DPU
AIMS	37.5%	2.70%	62.0%	n.a.
FLT	33.1%	1.60%	71.3%	c.0.025 Scts or c.0.33% of FY22F DPU
EC World	37.3%	4.20%	-	n.a.
Daiwa Log	32.2%	0.90%	100%	n.a.
Digital Core	26.0%	2.10%	50.0%	c.0.03 Scts or 0.7% of FY22F DPU
Healthcare				
P-Life	34.5%	0.56%	81.0%	n.a.
European				
Cromwell	38.6%	1.72%	100%	3-month Euribor still -45bps
IREIT	32.1%	1.80%	100%	n.a.

** Gearing is post announcement of acquisition; highlighted are those with < 70% fixed rate hedged*

Source: DBS Bank

Appendix 3: Impact from utility cost guidance

SREITs	Management guidance	Utility contract expiry	Estimated utility cost as a % of revenue
Office			
CICT	Based on new rates, c.4% to 5% of FY21 DPU	Utility contracts were re-contracted in early 2022 and will expire in end 2022	C.2.4% of FY21 revenue
KREIT	Based on today's rate, 1% to 2% impact for one property. AU properties can largely pass through	Utility contracts locked in with expiry in 2022, 2023, and 2024	Estimated to be c.2% of revenue
Suntec	Impact in FY22 could be partially mitigated by atrium sales and parking charges, as utility rates have been largely locked in; MCST increase expected in FY23	Utility contracts expiring in Jun 22, end-2022, and 2023	n.a.
OUECT	Minimal impact in 2022	Utility contracts expire in 2023	C.1% of revenue
Retail			
FCT	Utility cost hedging on a mall-by-mall basis	Bulk to expire in mid-2023	C.2% of revenue
LREIT	Do not expect material impact to NPI margin for FY22/FY23F for Singapore malls; Sky Complex on triple net master lease and not impacted by utility costs	Hedged one calendar year ahead	C.1.8%-2.2% of LREIT top line
SPH REIT	C.30% increase in utility costs in Singapore, which is on floating rates, and utilities in Australia, which is on fixed rates	Utility contracts locked in until Aug 22	C.1%-1.3% of revenue
SGREIT	n.a.	n.a.	n.a.
Retail Overseas			
CLCT	YTD utility costs rose about 10%	No utility hedging in place	C.3% of revenue
SASSEUR	Utility costs borne by operator and sponsor Sasseur Group	n.a.	n.a.
Hotels			
ART	Impact to be more material next year. Some contracts allow pass-through to tenants	Most of the contracts have been locked in, expiring in 2022	C.3% of revenue
CDREIT	A 10% rise in utilities will reduce NPI by c.1%-2%	Existing contracts are for between 1 to 3 years, with SG utility contracts expiring in end-2022	C.5% of revenue
FEHT	Heightened utility costs borne by master lessee	Most of the contracts have been locked in, expiring in 2022	

Source: Company, DBS Bank

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Appendix 3: Impact from utility cost guidance (cont'd)

SREITs	Management guidance	Utility contract expiry	estimated utility cost as a % of revenue
Industrials			
a-itrust	Generally passed through to tenants	n.a.	n.a.
A-REIT	Bulk recoverable from tenants	n.a.	n.a.
MINT	Expected to increase by 2x-3x, but should mitigate it by passing through as service charge increases, and in the medium term, by tapping into renewable sources	Jun 22	1% of revenue
MLT	Minimal impact from utilities, as ambient warehouses are well insulated and efficient. Some impact from its portfolio of cold storage warehouses, but exposure is small	n.a.	<1% of revenue
AIMS	Bulk of utility costs are recoverable from tenants	n.a.	n.a.
FLT	Bulk of utility costs are recoverable from tenants	n.a.	n.a.
ECWorld	All utility costs are recoverable from tenants	n.a.	n.a.
Daiwa Log	All utility costs are recoverable from tenants	n.a.	n.a.
Digital Core	All utility costs are recoverable from tenants	n.a.	n.a.
European			
Cromwell	Bulk of utility costs are recoverable from tenants	n.a.	n.a.
IREIT	Bulk of utility costs are recoverable from tenants	n.a.	n.a.

** Highlighted are those that could be impacted by higher utility costs in FY22F*

Source: Company, 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.

Please contact the primary analyst for valuation methodologies and assumptions associated with the covered companies or price targets.

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8. Judy LEE, a member of DBS Group Holdings Board of Directors, is a Director of Mapletree Logistics Trust as of 31 Mar 2022..

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DBS Regional Research Offices

HONG KONG
DBS (Hong Kong) Ltd
Contact: Dennis Lam
13th Floor One Island East,
18 Westlands Road,
Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

SINGAPORE
DBS Bank Ltd
Contact: Janice Chua
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
e-mail: groupresearch@dbs.com
Company Regn. No. 196800306E

INDONESIA
PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: indonesiaresearch@dbs.com

THAILAND
DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
Tel. 66 2 857 7831
Fax: 66 2 658 1269
e-mail: research@th.dbs.com
Company Regn. No 0105539127012
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