

# Singapore Industry Focus

## Singapore Retail REITs

Refer to important disclosures at the end of this report

DBS Group Research . Equity

23 Jun 2022

### Prized retail portfolio up for grabs

- Possible landmark transaction involving Mercatus's four dominant suburban retail malls to mark the "real estate deal of 2022"
- Singapore real estate allures international investors as a store of wealth; retail incumbents will be keen to get their hands on it
- Suburban capital values to remain resilient despite rising interest rates, ahead of expectations
- Pick [FCT](#) and [LREIT](#) to benefit if transaction materialises

**Possible landmark transaction involving Mercatus's retail mall portfolio will be keenly watched.** Mercatus is looking at possibly divesting its stakes in four suburban retail malls (AMK Hub, Jurong Point, NEX, and Swing By @ Thomson Plaza) for a reported c.\$4.0bn. We are excited by this sizable opportunity, given the lack of tight ownership of retail real estate in Singapore. With dominant attributes like being located in key transport nodes and positioned mainly in the "essential services" sector, these malls have been proven to churn out resilient cash flows during testing times, and will attract robust interest. Operational performance has rebounded in FY21 to c.96% of pre-COVID levels and should continue to head higher in FY22. Assuming a 68%-70% operational margin, we estimate FY21 yields to range between 4.3%-4.4% (pre-COVID yields were 4.6%-4.8%), which is at a similar level to recent transactions within the retail space.

**Singapore real estate's enduring allure likely to evoke strong interest amongst the local incumbents.** Singapore real estate is seen as a store of value within Asia, and thus attracts international capital. That said, we believe that this retail portfolio is likely to attract local incumbents with retail operator-backed sponsors, given that "getting it right" in retail real estate is more about managing the property well rather than getting the timing of the real estate cycle right. Given the sizable portfolio, we anticipate that listed REITs like CICT, FCT, and LREIT, working together with their respective sponsors or even developers like CDL and Far East Organisation, will be keen to get their hands on this portfolio.

**What it means for suburban retail landlords.** We see a structural trend in place for suburban retail real estate anchored by (i) the "premiumisation of retail offerings" supported by higher income growth in Singapore's population in the long term and (ii) structurally higher traffic, given a new hybrid working trend. We are seeing this already in the numbers, with FCT reporting tenant sales from Jan 22-May 22 that are, on average, 110% of pre-COVID levels. Trading at an implied cap of 4.5%, we see value in FCT and reiterate our BUY call. LREIT's recent value-accretive pivot into the suburban retail space will drive a compression in yields over time.

STI : 3,093.31

#### Analyst

Geraldine WONG +65 6682 3719  
geraldinew@dbs.com

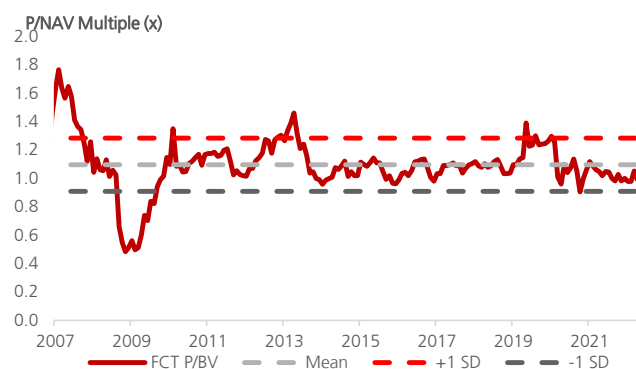
Derek TAN +65 6682 3716  
derektan@dbs.com

#### STOCKS

	Price S\$	Mkt Cap US\$m	12-mth		Rating
			Target Price S\$	Performance (%) 3 mth 12 mth	
<a href="#">CapitaLand Integrated Commercial Trust</a>	2.15	10,276	2.70	(1.4) 2.4	BUY
<a href="#">Frasers Centrepoint Trust</a>	2.23	2,738	2.90	(4.3) (7.5)	BUY

Source: DBS Bank, Bloomberg Finance L.P.  
Closing price as of 22 Jun 2022

#### FCT trading below mean P/NAV



Source: DBS Bank



Watchlist the stock on Insights Direct to receive prompt updates

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## Prized retail portfolio up for grabs

The recent news of a possible transaction involving a portfolio of suburban retail assets comprising Jurong Point, AMK Hub, a 50% stake in NEX mall, and Swing By @ Thomson Plaza is a unique opportunity for retail landlords to deepen their foothold in the Singapore suburban retail landscape.

### Who is the vendor Mercatus?

Mercatus Co-operative Limited (Mercatus) is an investor, owner, and manager of real estate with combined assets under management of over S\$10bn, owning retail and office assets in Singapore and Sydney, Australia. According to Cistri, Mercatus, part of NTUC Enterprise, is the third largest owner of retail assets in Singapore with an ownership of 5.2% (by NLA) and it has a c.9% market share in terms of suburban malls.

According to media coverage on the annual report of Mercatus, the four retail malls have a combined net lettable area (NLA) of 1.78m sqft (1.46m sqft on an effective basis) with a total valuation of S\$4.1bn as of FY21.

### Dominant malls with attractive metrics.

We are excited about the prospects of this target portfolio in terms of what's on offer for prospective investors. The assets are, in our view, "dominant malls", where the malls' location near/at key transport nodes (MRT stations and bus interchanges) and big population catchments imply strong recurring daily traffic.

We note that portfolio occupancy rates have remained resilient at over 98%-99% over FY17-21, even during the COVID-19 pandemic (FY20-1HFY21) when malls were periodically shut as the authorities imposed curbs to limit capacity in order to halt the spread of the virus.

As of FY21, the malls generated total revenue of S\$323.7m (S\$261m on an effective basis), which is 4% shy of the average revenue generated by these properties over FY17-19. Even during the COVID-19 period, revenues dipped by c.17%, highlighting its resilience, despite mandatory rebates that landlords had to offer at the time.

## Key metrics of the 4 malls owned by Mercatus

Mall	Stake	Location	Interchanges	GFA/NLA (sqft)	Key Tenants	Valuation (FY21)
	100%	Junction of Ang Mo Kio Ave 3 and 8	Ang Mo Kio MRT (NS16)	519k sqft / 320k sqft	<ul style="list-style-type: none"> <li>FairPrice Xtra</li> <li>Cathay Cineplex</li> <li>NTUC Foodfare</li> <li>Fitness First</li> <li>Malaysia Boleh!</li> </ul>	S\$846m
	100%	1 Jurong West Central 2	Boon Lay MRT (EW27) Boon Lay Bus Interchange	1,071k sqft / 750k sqft	<ul style="list-style-type: none"> <li>FairPrice Xtra</li> <li>BHG</li> <li>Golden Village</li> <li>Courts</li> <li>Popular</li> </ul>	S\$2,108m
	50%	23 Serangoon Central	Serangoon MRT (CC13/NE12)	942k sqft / 634k sqft (100% basis)	<ul style="list-style-type: none"> <li>FairPrice Xtra</li> <li>Shaw Theatres</li> <li>Isetan</li> <li>Uniqlo</li> <li>H&amp;M</li> </ul>	S\$978m (50%)
	100%	301 Upper Thomson Road	Upper Thomson MRT (TE8)	110	<ul style="list-style-type: none"> <li>Fairprice Finest</li> <li>Koufu</li> <li>Peach Garden</li> <li>Sushi Tei</li> <li>Daiso</li> </ul>	S\$203m

Source: Company, DBS Bank

### Room to yield up?

Based on an analysis of reported metrics, we note that valuations have remained fairly stable over the years. Apart from Swing By @ Thomson Plaza, which is a strata mall, the remaining three malls are valued at an average of S\$2,900psf, which has increased by an average of c.1.1% over FY17-21.

We estimate the portfolio average rent to be close to c.S\$15psf per month (ranging between S\$10psf per month and S\$16psf per month), which, we believe, has the potential to yield up over time. The average rental in FY21 is c.4% lower than the rentals achieved during the pre-COVID times of FY17-19A.

Assuming an operating margin of 68%-70%, atypical of retail assets, we estimate a FY21 yield of 4.3%-4.4%, which will be in line with recent transactions but below the average rap rate of 4.7% for the Frasers Centrepoint Trust (FCT) portfolio.

However, assuming a recovery back to pre-COVID trading conditions, we will see yields heading towards 4.6%-4.8%.

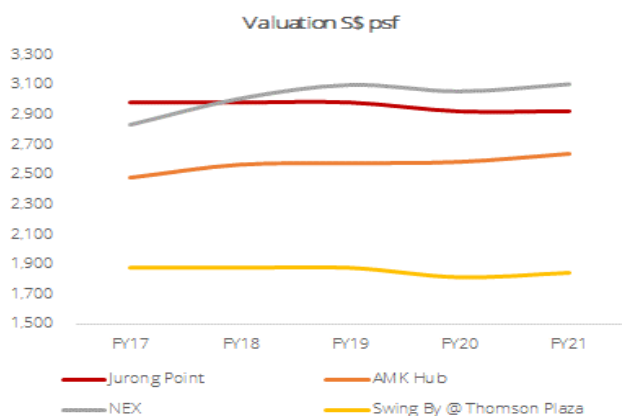
### Possible buyers

Given ample liquidity for assets and a wave of potential capital deployment into Singapore, which is seen as a safe haven investment location, we see robust interest in the sector. However, we believe this interest will likely be from local players, given that retail assets need more active management. As such, we believe that this portfolio will likely attract local incumbents (i.e., CapitaLand, FCT, Lendlease, and Far East Organisation).

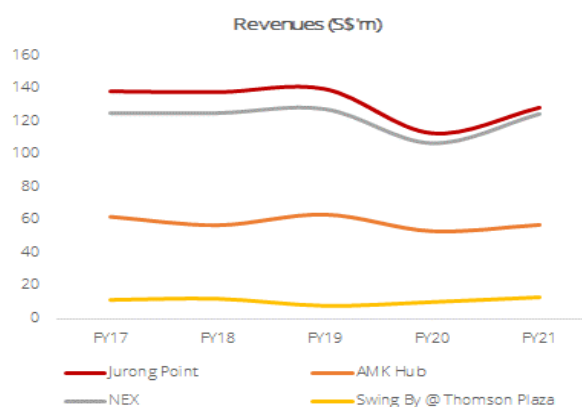
### Possible considerations

High funding costs and cost of equity will mean that the listed S-REITs will likely need to tap into their respective sponsors' balance sheets if they want to acquire this portfolio.

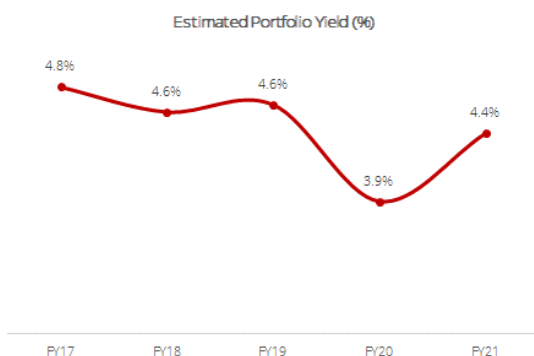
### Key operational metrics



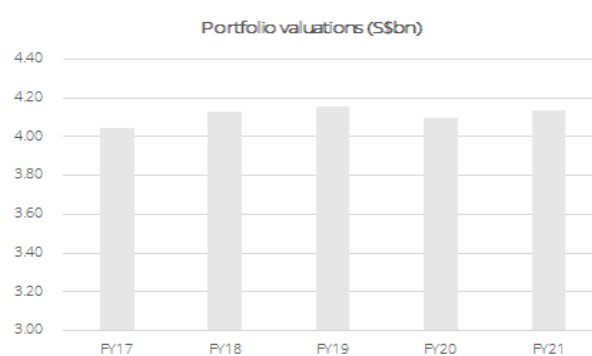
Source: Company, DBS Bank



Source: Company, DBS Bank



Source: Company, DBS Bank



Source: Company, DBS Bank

### Positive read for retail landlords

This transaction, valued at close to S\$4.0bn, will set the benchmark for retail assets in Singapore. The last major sale was back in 2017, which was the acquisition of Jurong Point by Mercatus for close to c.S\$2.2bn.

**Implied cap of FCT in the mid-4% range.** We look to FCT as a prime suburban retail peer for a potential cap rate transaction range for the portfolio. There are many cross similarities between FCT and the Mercatus portfolio, such as being large-scale, suburban, well-entrenched in deep residential catchment areas, having excellent connectivity to transportation nodes, and exposure to tenants within the essential trade sectors.

Historically, FCT’s implied cap (measured as NPI/EV) averaged c.4.9% from 2007 to present. More prominently, trading yields have compressed to below 5% since 2018 levels. We note that the yield spread against SG 10-year bonds has historically been maintained at between 2.6ppt and 2.8ppt. Since the onset of higher interest rate expectations, the cap rate has compressed further to the mid-4% range, with the yield differential coming down to 2.6%.

Further on portfolio valuation, FCT’s portfolio has generally returned to 2019 levels on the back of tenant sales recovery amongst suburban retail malls ahead of industry data, with valuers pricing in a stable 4.5% valuation cap assumption.

**New record will be set should Mercatus portfolio transaction materialise.** On our estimated NPI yield of 4.1% to 4.3%, the Mercatus deal will set a new record low for retail mall transactions on current valuations. This is a good 10-30bps below the latest precedent transaction for a similar large-sized dominant suburban mall, JEM mixed-use development. JEM was purchased in full by Lendlease Global Commercial REIT in 1Q22 at a cap of 4.4% (or 4.5% cap for the retail portion of the mixed-use development).

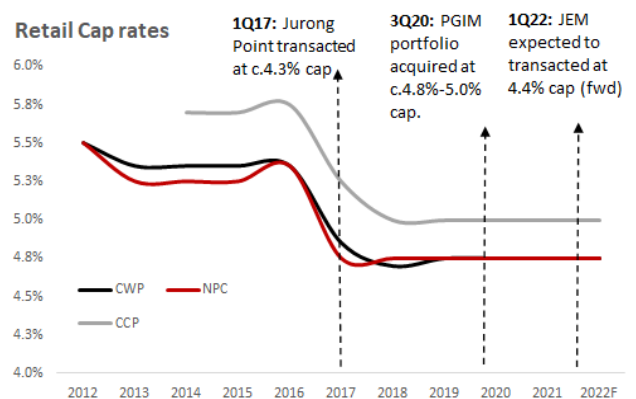
This transaction is expected to support capital values for retail malls in the suburban space, with selected malls in CICT, FCT, and LREIT to benefit. As such, we anticipate it to support valuations, implying that NAVs should remain resilient.

### Implied cap rate of FCT



Source: Company, DBS Bank

### Retail cap rates (FCT key properties)



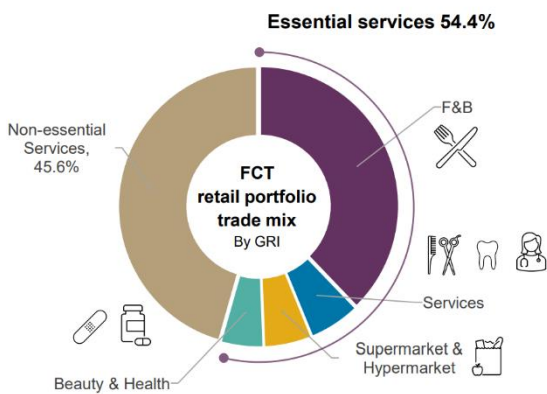
Source: Company, DBS Bank

### Retail S-REITs' resilience not appreciated

**Reliance on defensive essential spending.** With recession fears plaguing the market, investors seem very keen on suburban retail malls, which have proven its defensive traits time and time again, especially within the tightly held landscape of Singapore retail. Suburban malls typically have greater exposure to anchor tenants that are in the essential spending trade, such as supermarkets. According to Cistri, suburban malls' exposure to essential services is at about 40% of NLA, as compared to central malls, where it is at 20%-30%. On a similar note, FCT has about a 45% exposure to essential trade services by NLA and 54% by gross rental income.

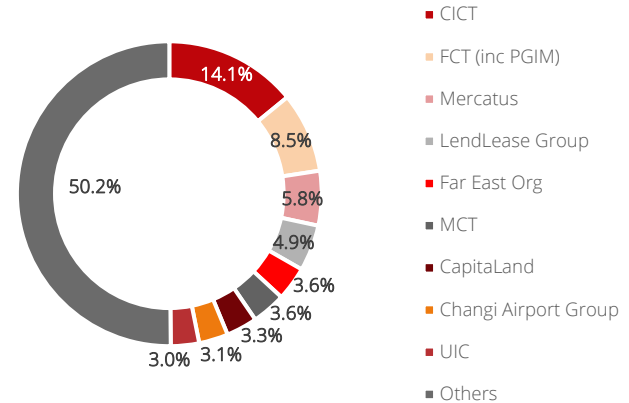
**FCT's tenant sales at 100%-110% of 2019 levels.** FCT's tenant sales have generally surpassed industry-wide tenant sales data every month since the onset of the pandemic. We note that its online capture of retail sales has tripled since the onset of the pandemic, hovering at the mid-teens range now. Physical retail sales (ex-motor and online capture) look to be in and around 90% since end-2020, while FCT's tenant sales recovery has met and exceeded 2019 levels.

#### FCT exposure by trade sectors



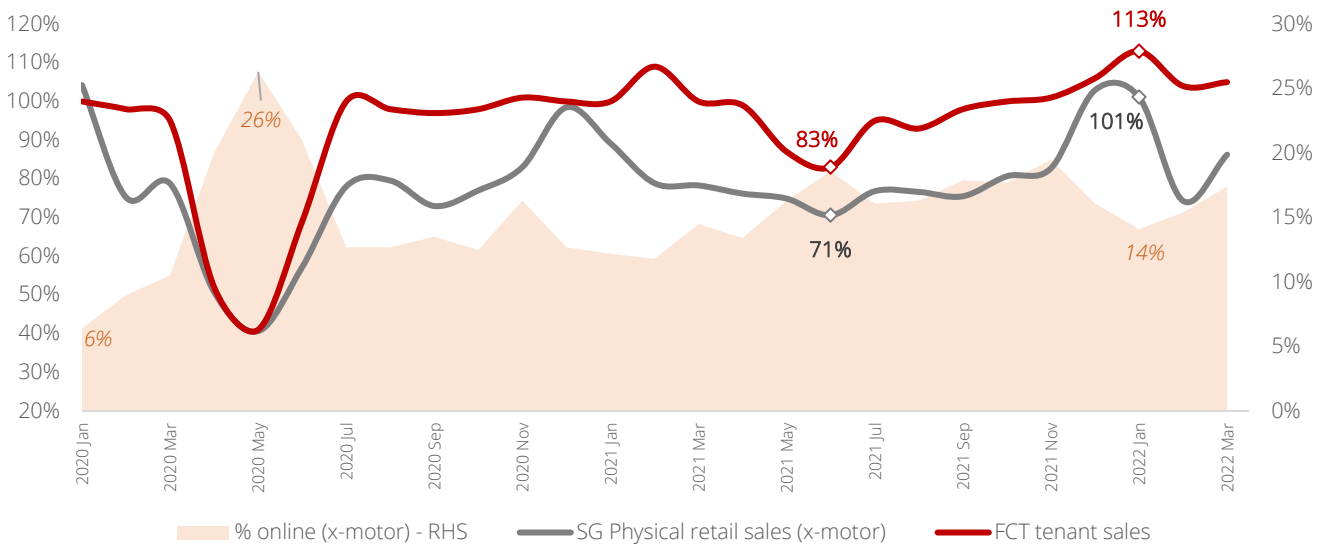
Source: FCT, DBS Bank

#### Market share of retail malls (2019)



Source: Cistri, DBS Bank

#### Tenant sales comparison (FCT vs. SG physical retail ex-motor), % 2019 levels



Source: Singstat, DBS Bank

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**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

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**DBS Regional Research Offices**

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**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: Paul Yong  
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  
Securities and Exchange Commission, Thailand