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Reviewing Malaysian REITs

Prices decline substantially in downturn

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Annual total returns (%)

	2006	2007	2008
AHP	9.32	26.42	-6.81
AHP2	21.53	17.28	-1.02
Al-Aqar KPJ		7.58	3.27
AmFirst		6.70	-0.67
AmanahRaya		14.22	-19.85
Atrium		16.03	-32.66
Axis	3.56	21.23	-32.46
Al-Hadharah		40.81	-23.18
Hektar		60.00	-42.39
QCT		0.75	-20.94
Starhill	-17.83	19.71	-14.37
Tower		71.69	-29.46
UOA	-4.52	37.14	-12.85

REIT	Discount to NAV*	Yield*
Tower	39.3%	13.77%
Starhill	39.0%	13.61%
Atrium	38.8%	12.47%
Hektar	35.2%	11.36%
Axis	32.3%	10.67%
AmanahRaya	25.6%	9.80%
AmFirst	23.8%	9.63%
QCT	23.3%	9.31%
UOA	23.0%	8.51%
Al-Aqar KPJ	7.8%	7.46%
Al-Hadharah	5.7%	5.63%

*as at Jan 19, 2009

THE Malaysian real estate investment trusts (MREITs) were launched in 2005 after REITs in general hit the stock markets in Japan, Hong Kong and Singapore. Within a year 10 REITs were launched, one repackaged with another two oldies remaining, making up 11 REITs.

Before the global financial turmoil in 2008, the MREITs performed predictably well, yielding 6% to 7% dividend returns with marginal growth in share premium.

By end-2008, along with the rest of the equities market, the MREITs took a severe beating from which they have hardly recovered.

Some salient points of the MREITs are worth noting.

● REITS share prices have declined substantially.

The MREITs today show a substantial discount to the net asset values (NAV) of the assets underlying the REITs, ranging from 23% to 39% (as shown in Table 1). The property market, in general, has not shown such drastic changes in values over 2007.

Although the asset base of the MREITs has increased, much of this is due to the injection of new and additional assets and not because of increases in asset values or appreciation in values.

The peculiar nature of this phenomenon is because of the nature of the REITs.

● On a down market, REITS show equity tendencies, on an up market, REITS show bond tendencies.

Much research has been carried out by academics as to the behaviour of REITs. The research has been inconclusive.

It will appear, from the little information and research that can be done in Malaysia, that MREITs have a tendency to behave like an equity in a down market, that is, if the stock market declines the MREITs will also follow suit, irregardless of the stability, or otherwise of the underlying asset.

However, in an upswing, the fixed nature of the income and the inability of the underlying asset to react quickly forces the MREITs to behave like a fixed-income instrument, like a bond. This phenomenon would explain why the MREITs are now selling at a discount to the NAV.

● Income to continue at current levels.

It is anticipated that the current income of the MREITs will continue at current levels and may not be affected by the general downturn. Almost all the MREITs were launched before 2007; therefore the rents underpinning their income were at 2006 and 2005 levels.

It is believed that these rents are sustainable and the majority of MREITs did not increase the rental levels to the high levels reached in 2007. Hence, the income and the dividend flow is expected to continue.

● Sale and leasebacks will continue to perform better.

Another reason the income will be sustainable is because a number of MREITs has secured guaranteed returns on a sale-and-leaseback basis. Therefore, the downturn in the market is shielded.

● Yields have increased tremendously.

The sustainable income, coupled with the decline in the net asset value, has boosted dividend yields to between 6% and 14%. Table 1 explains the dividend yield position of the MREITs in January 2009. These returns show, on average, an increase of 50% over the previous yields.

● Singapore yields even higher due to a sharper drop in REITS pricing.

The sharper corrections to the equities market and the more prominent impact of the economy has affected the Singapore REITs, pushing prices down and, thus, increasing yields. Some REITs are giving yields in excess of 25% in Singapore.

● Injection of new assets will face yield disparities.

The yield disparities have affected the injection of new assets into existing REITs. Most real estate pricings and rental incomes fall between 6% and 8% for commercial properties. When current yields are in excess of these returns, REIT sponsors will be unable to inject new assets at below the dividend yields.

● Opportunities for acquisition of better quality asset.

However, the current downturn can also provide wonderful opportunities for the acquisition of better quality assets and a more competitive pricing of the real estate.

● Refinancing.

Financing for REITs has been different from normal financing. As the requirement is for the income to be distributed, almost all the MREITs have been servicing only the interest component of the loan; there is no repayment, partially or otherwise of the loan.

This, coupled with the lower negotiated interest rates regime, has helped the MREITs to declare a higher dividend than the yields from the underlying asset.

Menara Axis in Petaling Jaya.

In a number of cases, refinancing may be soon. In view of the reduced interest rates currently being considered by the financial institutions, it might be easier to get a lower interest rate.

The MREITs appear to have weathered the financial storm well as the discounts to the net asset value is manageable and not as severe as in other countries.

Added to that is the sustainable income from the rents.

It would appear, therefore, that MREIT yields will be maintained and the downside risks are manageable.

● PEPS is the acronym for Persatuan Penilai & Perunding Harta Swasta Malaysia (Association of Valuers and Property Consultants in Private Practice Malaysia). We welcome your feedback on this article. Please email to starbiz@thestar.com.my.