

Retail and office REITs under pressure

BY LIEW JIA TENG

Over the years, Malaysian real estate investment trusts (MREITs) have been considered by many in the investing fraternity as a safe bet.

Given their consistent dividend payouts, REITs are seen as a must in any defensive portfolio as a hedge in volatile times, such as now. Furthermore, in a low interest rate environment, investors favour REITs for their dividend yields.

But the Covid-19 pandemic is an unprecedented crisis.

With the Movement Control Order (MCO) being extended for the second time to April 28, most shopping malls, hotels and offices in the country will be closed, or partially closed, for a total of 42 days.

While waiting to resume full operations, their fixed expenses such as utility fees, workers' salary and loan interest will continue to be incurred. Not to mention that most of them will have little revenue or minimal cash flow coming in, while some might even offer rental rebates to retain their tenants.

So, how will the REITs' portfolio of properties perform this year?

More importantly, will the REITs be able to deliver stable dividends and attractive yields? Are they still resilient and defensive?

Malls, hotels and offices among worst-hit

Year to date, the Bursa Malaysia REIT index has dropped 9%, only slightly less than FBM KLCI's 11% decline. Among the worst performers are YTL Hospitality REIT, IGB REIT, Sunway REIT and Pavilion REIT.

It has not gone unnoticed that some shopping malls have not been doing well in recent years; with the MCO, their performance is likely to worsen.

Datuk Hisham Othman — CEO and executive director of Hektar Asset Management Sdn Bhd, which manages Hektar REIT — acknowledges that this is a challenging time for everyone. "The scale and impact of the pandemic outbreak was unexpected and it isn't over yet. The MCO has disrupted many businesses, including ours, as it has directly affected our main source of revenue," he tells *The Edge*.

Listed in December 2006, Hektar REIT is Malaysia's first retail-focused REIT. Its portfolio of commercial properties includes Subang Parade in Selangor, Mahkota Parade in Melaka, Wetex Parade and Classic Hotel in Muar, Central Square in Sungai Petani, Kulim Central and Segamat Central.

Hisham says he is hoping for a gradual reopening of the economy to allow businesses and shoppers to slowly re-engage.

However, he does not expect the retail landscape to be the same after the MCO is lifted, as shopping and dining experiences may be different. "There may be pent-up demand ...



Leong says Axis-REIT's portfolio remains stable and that it will enjoy income contribution from assets acquired recently

but we can't have everyone crowding the malls immediately when the MCO is over.

"We intend to implement social distancing in our malls. Shoppers are already quite disciplined with the procedure before entering supermarkets and pharmacies and we will extend this practice to other retailers," he explains.

Meanwhile, KIP REIT Management Sdn Bhd managing director Datuk Chew Lak Seong says the manager of KIP REIT is currently assessing the possible impact the coronavirus outbreak and MCO would have on the company and its asset portfolio.

"What is undeniable is that the impact can be felt by all industries and no parties are unaffected. The company will assess the circumstances and adopt appropriate measures accordingly," he tells *The Edge*.

Listed in February 2017, KIP REIT's portfolio consists of six neighbourhood retail centres called KIPMalls — in Bangi, Tampoi, Kota Tinggi, Masai, Senawang and Melaka — and the AEON Mall Kinta City in Ipoh.

Chew highlights that KIPMalls across the nation have remained partially open to enable the community to purchase their daily necessities and avail themselves of essential supplies and services from supermarkets, pharmacies and ATMs.

Nevertheless, it is still premature to quantify how KIP REIT's financials will be affected at this juncture. "We will continue to study KIP REIT's current tenant base and analyse the changing operating circumstances and pressures faced by tenants so as to develop a more reasonable leasing strategy during such challenging times," Chew says.

Leong Kit May — CEO of Axis REIT Managers Bhd, which manages Axis-REIT — says more than 50% of its tenants are still operating under the MCO.

"The logistics and warehousing businesses are operating as usual. In fact, the e-commerce segment is one of the more thriving businesses during this pandemic as more people switch to online purchasing. For the manufacturing facilities, those that are involved in the supply of essential goods are operating as usual," she tells *The Edge*.

Listed in August 2005, Axis-REIT is the country's first REIT. It has a diverse portfolio of 50 properties located in the Klang Valley, Kedah,



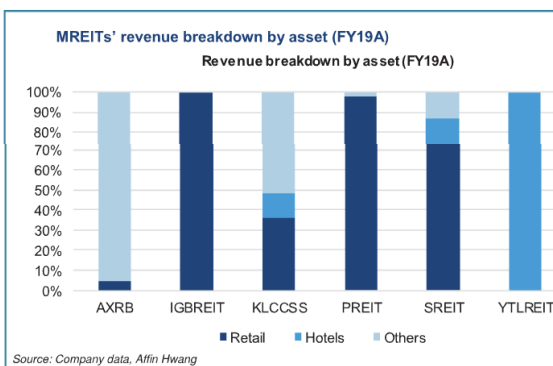
Hisham: There may be pent-up demand ... but we can't have everyone crowding the malls immediately when the MCO is over



Ng: Industrial properties and hospitals should remain intact



Chia: Retail REITs will see a weak financial performance in the first half of the year



Penang, Pahang, Negeri Sembilan and Johor.

Leong stresses that Axis-REIT's portfolio remains stable and that it will enjoy income contribution from the assets it acquired last year, as well as the two properties it bought in Bukit Raja and Nilai this year.

Therefore, Axis-REIT's dividend distribution policy — of at least 95% of the current year-to-date distributable income for the first quarter to third quarter, and at least 99% of the current YTD distributable income for the fourth quarter — remains unchanged.

Industrial REITs in a better position

Interestingly, market observers are of the view that the REITs with industrial properties may weather the storm better than their peers.

Chia Wan Chow, who has written a book on investing in REITs, points out that REITs such as Axis-REIT and Atrium REIT should be more resilient than their counterparts.

"That's because the essential manufacturers, the logistics players and the warehouses are still operating during the MCO period. For example, Nestlé, Tesco, Pos Malaysia and Northport are among the top 10 tenants of Axis-REIT," he says.

In comparison, shopping malls, offices and hotels are suffering during the MCO period, he says. "In fact, even after the MCO is lifted, their prospects will remain very challenging because they may see smaller crowds and fewer tenants and guests."

For instance, says Chia, most people probably would not want to go to cinemas anytime soon and if the cinema's business — or any

other business, for that matter — is affected, it will ask for a reduction in rent.

"Suffice to say, retail REITs will see a weak financial performance in the first half of the year. Conservatively, their profits may drop by a high-single-digit this year," he says.

Similarly, offices and hotels will also be badly hit.

"During the MCO period, many companies may have realised that working from home could save costs and increase productivity. If this becomes the new normal, some companies may not renew their tenancies," says Chia.

"Hotels will also suffer after the MCO is lifted because many countries are implementing lockdowns and travel restrictions. Occupancy will drop significantly. Their income from buffets and event halls will also be affected," he adds.

Lower earnings and dividends but ...

In an April 15 report, Affin Hwang Capital research analysts Isaac Chow and Azhahani Hashim said that at a distribution yield of 5.4% in 2021, MREITs' valuations are within their six-year average and look fair.

The research house's top picks are KLCC Stapled Group and IGB REIT, given their prime assets, prudent management and strong balance sheets.

Meanwhile, CGS-CIMB Research analyst Sharizan Rosely retains a "neutral" call on the REITs sector, although FY2020 average dividend yields could fall from 6.6% to 5.8% due to Covid-19 and MCO risks.

According to him, IGB REIT, which has high occupancy and

prime assets, as well as Axis-REIT, which owns industrial and warehouse assets, could be among the least impacted in terms of earnings and dividends.

Inveps PLT chief investment officer William Ng says within this asset class, the hospitality and retail REITs are the worst-hit, followed by office REITs.

"Industrial properties and hospitals should remain intact because their tenants usually sign long-term contracts and it is not easy to relocate a factory or hospital," he says.

However, at current valuations, Ng does not find the REITs particularly attractive. "Having said that, if they could maintain dividend yields at above 5%, it is still not bad. And if they are trading at a discount to their NTA [net tangible assets], that's even better. Bear in mind that some of them have quality assets, which means you could also enjoy appreciation of property value."

Ng further says that the Covid-19 crisis should not change the fact that REITs are still a resilient investment because they are asset-based as well as rental-based.

"To be fair, this is an unprecedented crisis. None of us has experienced an MCO before and nobody saw this (virus outbreak) coming so fast. The current crisis may have taught us that REITs are not 100% safe but I still believe that they are defensive stocks," he says.

Nevertheless, Rakuten Trade Sdn Bhd vice-president of research Vincent Lau says he is not too optimistic about REITs at the moment. "Looking at the impact of Covid-19 on REITs, perhaps they are not as resilient as they seem. Hospitality and retail REITs are among the worst-hit. Overall, I think their earnings could drop by 10% to 25%, and that's just a rough estimate. I don't think their bottom line could sustain their dividend payout ability," he says.

But considering that the share prices of REITs have also come down, Lau believes their prospective dividend yields should still hover around 5%, which is acceptable given the current low interest rate environment.

See also Page 20: Working from home — the new normal