Asia-Pacific REITs: *Yesterday's infant, tomorrow's grown-up*

From their infancy early in the millennium, Asia-Pacific (ex-Japan) REITs have grown steadily into an asset class worth more than US$200 billion. As a relatively new asset class, AP REITs have weathered various storms in the last decade: the European sovereign debt crisis (2010/2011), US Federal Reserve's taper tantrum (2013), the China equities market meltdown (2014/2015) and US-China trade war concerns (2017/2018) and delivered steady returns with strong performance[1].

In this article, Hui Min Ng, Portfolio Manager (Equities), Manulife Asset Management (Singapore) Pte. Ltd., shares her unique insights after 13 years of covering the market, and what the future potential of the asset class can offer investors at a time when investors are trying to figure out whether Goldilocks economy is back or economic recession is near.

You started your career as an analyst: how did this formative experience shape your current perspective as a fund manager for Asia-Pacific REITs?

Previously, I worked as a sell-side analyst at a securities firm where the structure was very different from an asset management company.

For analysts at asset management firms, the emphasis is on broad sector coverage and keeping track of new companies in the investment universe. However, sell-side analysts have dedicated roles and responsibilities that require greater scrutiny of companies at a micro level.

During those years, I developed my analytical skills as I was able to conduct deep-dive analyses to understand the fundamental drivers of a company – primarily through building intricate financial models. Also, conducting bottom-up research helped test my assumptions in the model – not only for the equity side of the balance sheet, but also having a firm grasp on the liability side.

Back in 2006 when you started covering AP REITs, it was a relatively small investment universe (ex-Japan and Australia) with limited research resources. Did that help or hinder you?

I was in an enviable position at the time, as I was able to cover the Asian REIT universe from what was effectively its infancy. In the major markets that we focus on, Singapore had its first REIT listing in 2002, followed by Hong Kong in 2005.

Back when that universe was smaller, it was easier to maintain coverage, and that enabled analysts and portfolio managers to get to know the management of REITs more closely.

Additionally, covering Asian REITs in the early stages provided first-hand experience and knowledge of each REIT's track record and ability to execute; not only of the REIT manager but of the sponsor (REIT parent company) as well.

You mentioned that knowing the management style of a REIT's parent company (or sponsor) is crucial. Why is that?

Sponsors started spinning-off their projects and listing them as REITs in Asia in 2002. During those hectic years of intense IPO and listing activity, I witnessed so many different corporate dynamics and cultures among various sponsors, and that also helped me to understand the background of the REITs.

Hui Min Ng
Portfolio Manager

These intellectual assets are crucial for my comprehension of the current and future expansion of REIT companies. It also means I'm able to predict more confidently whether a sponsor can turn around any failed projects, for example.

Online shopping and the broader digitalisation trend are affecting the traditional bricks-and-mortar retail model, which has implications for the occupancy rates of shopping malls. Recent technological developments may also impact the demand for office space in central business districts. To what extent do you see regional retail and office REITs being affected by digitalisation?

Over the past three to five years, we have witnessed the impact of e-commerce on the traditional retail operating model.

When it comes to retail REITs, our focus has been twofold: 1) REITs that have a higher exposure to necessity malls as opposed to discretionary malls and 2) managers who have fortified their portfolio through reconstitution and asset-enhancement initiatives.

We have also concentrated on those retail REIT managers that have taken action to ensure that their assets provide not just an outlet for traditional retail, but have restructured existing assets to provide shopping "experiences".

When we talk about digitalisation, we are thinking about the new economy in which companies like Facebook, Google, and Amazon have been new creators of office demand. We view this as a positive development for office REITs that was not prevalent during the past 10 years.

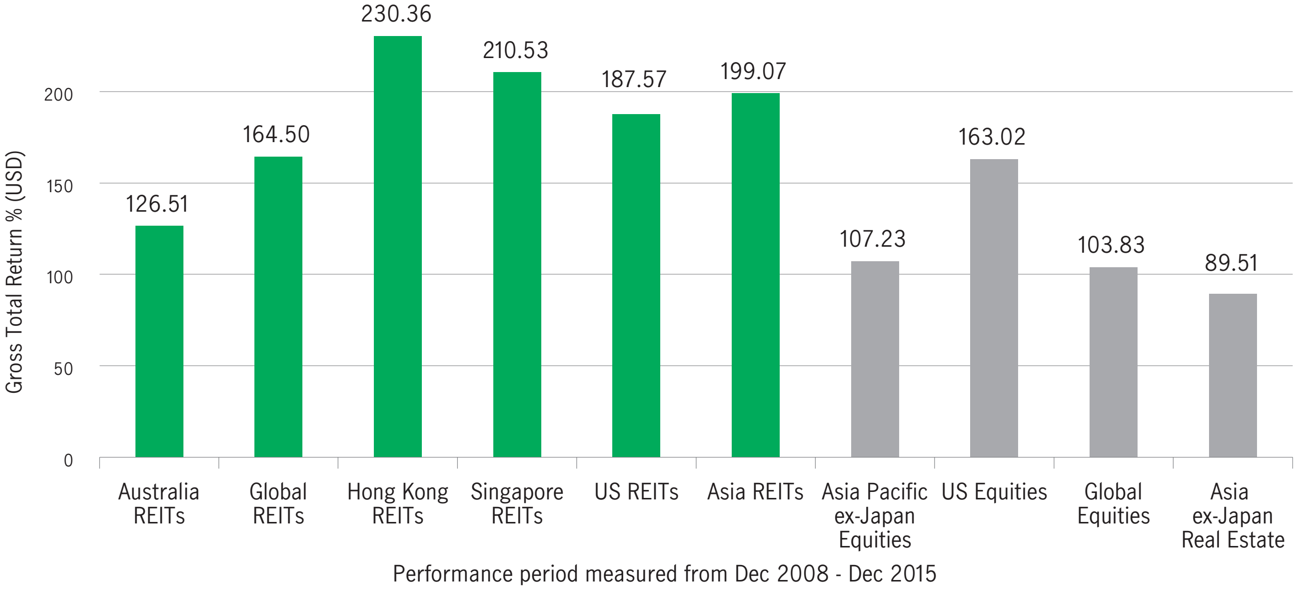
Additionally, the broader digitalisation trend has resulted in the growth of data centres. Singapore's first pure-play data centre REIT was listed in December 2014, and we see industrial REITs in Singapore acquiring data centers located overseas.

Rates have stabilised to the point where markets are expecting them to go sideways for a while. How do you expect AP REITs to perform in this environment, and will they outperform property developers?

The last time the US experienced a sideway interest-rate environment was from December 2008 to December 2015. As you can see from Chart 1, most REITs have outperformed their broader equity counterparts, as well as property developers.

Also, REITs have improved their balance sheets over the last 10 years by reducing leverage, securing a higher percentage of fixed rate debt and extending their debt maturity profile. This has provided support to REIT valuations and enhanced their investment value.

Chart 1: Most REITs outperformed equities in a sideway interest-rate environment



Source: Bloomberg, gross total returns in US dollar. Performance period: 31 December 2008 - 31 December 2015. Australia REITs are represented by S&P/ASX 200 A-REIT Index. Global REITs are represented by S&P Global REIT USD Index. Hong Kong REITs are represented by Hang Seng REIT Index. Singapore REITs are represented by FTSE Straits Times REIT Index. US REITs are represented by MSCI US REIT Gross Total Return Index. Asia REITs are represented by FTSE EPRA/ NAREIT Asia ex-Japan REITs Index. Asia ex-Japan equities are represented by MSCI Daily Total Return Gross AC Asia Pacific ex-Japan USD Index. US equities are represented by S&P 500 Total Return Index. Global equities are represented by MSCI ACWI Net Total Return Index. Asia ex-Japan Real Estate is represented by MSCI AC Asia ex-Japan Real Estate Index, which also includes REIT exposure. Past performance is not indicative of future performance.

The ABCs of Asia-Pacific REITs

1 How many different types of properties are covered by REITs in the region? Which ones offer the most significant potential, and why?

The Asia ex-Japan REITs universe offers a diversified mix of assets within the REIT space, as Chart 2 shows.

Within the universe, we are currently positive on office REITs in Singapore, Hong Kong, and Australia, given there's a supply-demand imbalance that will not be resolved until 2020/21. With high occupancy rates and continued demand for grade-A office space, we believe that high-quality office REITs should continue to see higher rental rates than previous leases (positive rental reversions).

Additionally, retail REITs in Singapore and Hong Kong have shown improving operating metrics as positive rental reversions continue.

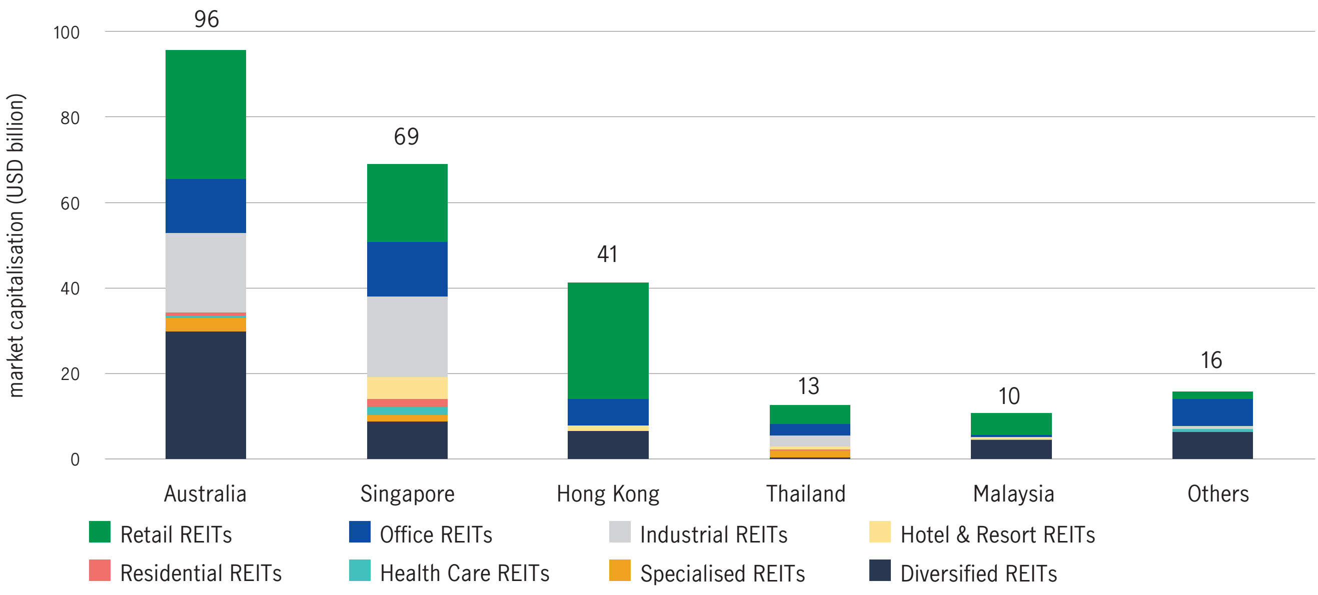
2 What are the key differences between investing in REITs and buying the shares of property developers?

REITs offer a steady and consistent income stream which is backed by longer term leases which results in REITs being more defensive relative to equities. However, REITs also offer capital appreciation potential which is driven by, but not limited to, rental income growth. REITs also offer exposure to many different types of properties.

For the most part, property developers' profits are reinvested into new projects, while REITs are bound by law to own income-producing assets and distribute their earnings to investors as dividends. In addition, there are limits on REITs' involvement in development projects. Because of these different operating models, the risk profiles are very different between the two.

Property developers' dependence on the macro cycle is much higher, given that they need to buy land, develop properties and sell assets to generate earnings continually. REITs operate on a different model and their income streams come from lease terms that are typically locked in (typically for three to seven years), and the expiry of those leases is usually staggered, so they provide visibility and stability to shareholders.

Chart 2: Asia ex-Japan REITs Universe: US$245 billion market capitalisation



Source: Bloomberg, data as of 31 March 2019.

[1] Source: Bloomberg as of 31 December 2018. AP REITs are represented by FTSE EPRA/NAREIT Asia ex-Japan REITs 10% Capped Total Return Index. AP REITs generated total return of 15.7% p.a. (Price return: 9.8% p.a. + Dividend income: 5.9% p.a.).

Manulife Asset Management (Singapore) Pte. Ltd. (Company Registration Number: : 200709952G)

The source of all opinions and information in this article is Manulife Asset Management, unless otherwise stated.

Manulife Asset Management