Navigating headwinds

REITS still attractive amid economic challenges

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AS property players move on from the pandemic, investor interest in real estate investment trusts (REITs) has certainly picked up.

However, experts and players are admittedly cautious about the outlook ahead, in light of current economic headwinds.

RHB Investment Bank property analyst Loong Kok Wen urges investors to be selective and prioritise asset quality within each of the different REIT sub-sectors.

"While we are turning more positive on the outlook for REITs, we maintain our "neutral" sector call, in line with the structural overhang and near-term macroeconomic headwinds," she says in a recent report.

Loong says she expects rental reversion to remain in the low-single digit range, given the influx of retail space coming into the market this year.

"Despite the narrowing yield spread, we think the stable dividend yield, as well as the estimated double-digit earnings growth for 2022 are good reasons for investors that are looking for a flight-to-safety.

"We urge investors to be selective and prioritise asset quality within each sub-sector and think that the industrial segment will remain a bright spot with the eCommerce boom."

AmFirst Real Estate Investment Trust (Amfirst-REIT) chairman Soo Kim Wai meanwhile says the uncertain global economic outlook, rising inflationary pressure coupled with the Russia-Ukraine conflict will continue to pose challenges for the sector in 2022.

"We will tread with caution and adopt appropriate strategic and operational measures to deliver sustainable income distribution to unit holders.

"We are mindful that we are still not out of the woods yet and will remain proactive, vigilant and agile," he says in the company's latest annual report.

AmFirst-REIT has a diverse portfolio of nine properties located in the Klang Valley (including Cyberjaya), Melaka and Penang with a total net lettable area of 3.2 million sq ft as at March 31, 2022.

Despite the challenging property market outlook, Soo notes that momentum is improving on the back of the transition to the endemic phase of Covid-19, especially with borders reopening and the lifting of movement restrictions.

Sound investment: The industrial segment will remain a bright spot with the eCommerce boom, says RHB Investment Bank.

"The supply of purpose-built offices in Kuala Lumpur went up marginally by 1.25% from 9.275 million sq metres in the second half of 2020 to 9.391 million sq metres in the third quarter of 2021, whereas the supply of purpose-built offices in Selangor stood at 4.075 million sq metres.

"Last year saw the addition of 70,000 sq metres of purpose-built office space, bringing it to a total of 23.969 million sq metres compared to 23.179 million sq metres in 2020."

Despite the slight increase in take-up rates for these offices, Soo says the total occupancy rate dropped nearly 2% in 2021 to 78.3%.

"The office market is expected to remain subdued due to demand lagging behind supply. Meanwhile, vacancies in malls have more or less stagnated within the same five-year period, but the additions of new and often bigger complexes have dragged the occupancy rate down to 76.3% as per last year."

Soo says the gradual normalisation of economic and social activities will augur well for the general recovery of Malaysia's retail sector.

Meanwhile, Sentral-REIT in its latest annual report says the Kuala Lumpur office market downcycle is expected to persist in 2022 as future supply of office space continues to come onstream, coupled with weak absorption rates exacerbated by the pandemic.

"We expect to see these pressures on the Klang Valley office market be alleviated with the eventual improvement in the economy and the gradual improvement in consumer and business sentiments in 2022."

Sentral-REIT says leasing activities are expected to pick up momentum, as businesses resume operations in light of the better economic environment.

"With the influx of new buildings with newer specifications, it is vital that landlords focus on asset management and enhancement initiatives that emphasise on adapting existing office buildings to meet the new normal requirements and specifications required by tenants."

Sentral-REIT owns and invests in assets primarily used for commercial (including retail and office) purposes. It has properties in the Klang Valley, Cyberjaya and Penang.

In terms of new investments, Sentral-REIT says it will continue to expand its asset portfolio and increase its market presence, in line with its objective to acquire and invest in accretive commercial properties primarily in Malaysia.

Meanwhile, UOB Kay Hian Research in a recent report says the REIT sector provides a "defensive stronghold" for investors.

"The sector's outperformance against the FBM KLCI proves that high-dividend yielding stocks like REITs will remain resilient.

"In the short-to-medium term, REITs act as a defensive stronghold and should continue to outperform relative to the FBM KLCI, as market sentiment may turn bleak and defensive amid stagflation and recession concerns."

The research house noted that although any rate hike is negative to the sector, it adds that the impact would be manageable, given REITs' healthy gearing levels (30% on average) and earnings recovery (36% year-on-year).

"Moreover, the encouraging and improving quarterly results will keep the sector resilient with earnings set to fully recover back to pre-pandemic levels in 2023."

UOB Kay Hian Research says office REITs offer higher stable yields, followed by retail REITs that will be boosted by an earnings recovery, especially when international tourist arrivals go up.

"As the economy transitions to endemicity, with the reopening of borders and easing of all restrictions from mid-May onwards, economic growth should stay robust. Besides the earnings recovery, the growth in turnover revenue (5% to 10% of total revenue) would significantly offset the rate hike impact and cost inflation (mainly utilities).

"We have assumed minimal rental assistance and 1% to 2% rental reversion for 2022."

The research house adds that Malaysian REITs still offer decent excess return potential over fixed income instruments.

"We remain selective and prefer the retail segment, particularly prime and niche malls for their proven business resilience."

UOB Kay Hian says its sector "buy" calls are Axis-REIT, IGB-REIT, KLCCP Stapled Group, Pavilion-REIT, Sentral-REIT and Sunway-REIT.

"Our top picks are Sunway-REIT (border reopening recovery), Sentral-REIT (high and resilient yields of 7% to 8%) and IGB-REIT (resilient earnings)," says UOB Kay Hian Research.