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KUALA LUMPUR: RHB Research remains optimistic regarding real estate investment trusts (REITs) as a resilient yield investment due to factors such as stabilised rental reversion, consistent occupancy rates, and the decline in government bond yields.

The current yield gap between the 10-year Malaysia Government Securities (MGS) and the KL REIT Index (KLREI) stands at 230 basis points, which is noted by the firm to be one standard deviation above the historical average.

"RHB Economics anticipates the 10-year MGS to decrease to 3.75 per cent by the end of the year from its current rate of 3.85 per cent," it said.

The bank backed research firm suggests that additional rises in the yield spread could be a question of timing.

"Year-to-date, US government bond yields have risen by around 50 basis points, despite expectations for three interest rate cuts, primarily due to sustained high inflation. Consequently, we may observe a broader yield spread in the latter half of 2024," it said.

However, RHB Research said the upside to earnings may be limited due to increased competition in the retail sector and moderate growth in spending due to the higher cost of living.

"Despite stable occupancy rates, earnings expansion for retail REITs will mainly hinge on rental adjustments, which are expected to stabilise to mid-single-digit levels after the robust growth observed in financial year 2023 (FY23), driven by the rebound from the COVID-19 pandemic.

"This trend is supported by Malaysia's retail trade growth of 9 per cent in 2023, with a projected softer growth of 4 per cent for 2024, according to Retail Group Malaysia," it continued.

In a research note today, it said the concern primarily lies in the elevated cost of living, which could dampen retail expenditure in the future, coupled with the opening of new malls, which poses a challenge for rental rate increases in the long run.

Furthermore, RHB Research added that the recovery of the tourism sector will positively impact retail spending, particularly benefiting city centre malls like Suria KLCC and Pavilion KL, which attract a significant number of foreign shoppers.

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"The postponement of the High Value Goods Tax implementation offers temporary relief for these malls.

"However, we exercise caution regarding Pavilion REIT's performance, especially with Pavilion Bukit Jalil, which is expected to experience higher rental adjustments only in the fourth quarter of 2023 as it enters a new rental cycle.

"Additionally, in FY25, there will likely be a balance payment placement for the mall, potentially diluting earnings growth next year," it said.

RHB Research has upheld its 'Neutral' rating on the REITs sector and identified IGB REIT as its preferred choice, citing its promising earnings prospects supported by fully occupied and strategically positioned malls.

"While there is no news yet on any indicative timeline, we think that an acquisition of Mid Valley Southkey will be a strong catalyst for the REIT and be easily funded as its gearing ratio is only at 22 per cent," it noted.