

Yield uptick for IGB Commercial REIT amid challenging KL office market

BY CHERYL POO

The decline in the unit price of IGB Commercial Real Estate Investment Trust (REIT) since it debuted on Bursa Malaysia has made it one of the higher-yielding REITs among its peers, even above the Kuala Lumpur REIT index's expected yield of 6.17%.

Bloomberg data shows that other pure-play office REITs, as well as REITs with exposure to offices, have yields ranging from 4.76% to 6.95%, with the exception of Pavilion REIT, which has the highest dividend yield of 10.62%.

Despite concerns of office space overhang in Kuala Lumpur, IGB Commercial REIT's net property income (NPI), revenue and distribution per unit (DPU) from FY2021 to FY2023 have shown a rising trend.

NPI was RM127.8 million in FY2023, RM113.62 million in FY2022 and RM36.6 million in FY2021, on revenues of RM215.15 million, RM190.4 million and RM53.4 million respectively. For FY2023, it distributed 3.49 sen per unit and 3.42 sen and 1.15 sen respectively in the preceding two years.

In an email response to *The Edge*, REIT manager IGB REIT Management Sdn Bhd's joint deputy CEO Wong Khim Chon says seizing opportunities in the "competitive Malaysian economy, which was resilient and grew by 3.4% in 4Q2023 and 3.8% for the full year despite the headwinds", led to an overall improvement in the average occupancy rate for IGB Commercial REIT's assets in both Mid Valley City and the Kuala Lumpur City Centre last year.

Assets in the REIT's Mid Valley City portfolio include Menara IGB & IGB Annexe, Centrepoint South, Centrepoint North, The Gardens South Tower, The Gardens North Tower, Southpoint Offices and Retail, and Boulevard Offices and Retail; and those in its KL City portfolio are Menara Tan & Tan, G Tower and Hampshire Place Office.

Khim Chon says, as at Dec 31, 2023, occupancy rates at Mid Valley City fell between 76.3% and 98.9%, while those of the KL City properties ranged between 66.5% and 69.6%.

"While a cautiously optimistic outlook for the KL office market prevails, challenges persist because of a large existing stock of offices and incoming supply from Merdeka 118 and [The Exchange 106 @] TRX. This, coupled with the trend of flight to quality, has put downward pressure on rental rates," he concedes.

"However, Kuala Lumpur's attractiveness, robust infrastructure, strong connectivity and government initiatives are expected to bring upside to IGB Commercial REIT's portfolio in the city centre. We remain cautiously optimistic in navigating these challenges and adapt-

Expected yields of selected REITs

	EXPECTED YIELD (%)
IGB Commercial REIT	7.07
UOA REIT	6.95
Axis REIT	4.76
Atrium REIT	5.00
KLCCP Stapled Group*	5.40
Pavilion REIT	10.62
Sunway REIT	6.12

*KLCCP Stapled Group comprises KLCC REIT and KLCC Property Holdings Bhd, which is the development arm of the former, and has a portfolio with retail, office and hotel assets

ing to the evolving market conditions in 2024, staying relevant to a select group of tenants.

"As for the portfolio in Mid Valley City, the strong ecosystem of the integrated development supports an optimistic prospect for the buildings in Mid Valley City."

IGB Commercial REIT's unit price performance has not reflected its manager's optimism, however, having fallen 34% to 48 sen last Tuesday from the opening price of 73 sen at its debut on the Main Market of Bursa Malaysia on Sept 20, 2021. Still, the DPU of 3.49 sen in FY2023 works out to a yield of 7.27%.

Former investment banker and private investor Ian Yoong offers some perspective on the counter's performance. He explains that IGB Commercial REIT's listing came amid the Movement Control Order during the Covid-19 pandemic, when many offices were closed. "It was a bad time for an office REIT to be listed."

In the listing, its units were offered to shareholders of IGB Bhd by way of a restricted offer for sale (ROFS). Originally, IGB owned the assets that were injected into the new REIT. IGB shareholders were entitled to subscribe for two ROFS units at RM1 each for every five shares held. The sweetener was that shareholders who subscribed to the ROFS were entitled to distribution in specie (DIS) on the basis of three DIS units for every two ROFS units subscribed. Therefore, the average cost of IGB Commercial REIT to IGB shareholders who subscribed to the offer was 40 sen per unit.

"The unsubscribed ROFS and corresponding DIS were placed out to institutional and selected investors, together with 130 million units offered for sale by certain shareholders. Notwithstanding the overly generous DIS, the IPO was [only] 79% subscribed," says Yoong, noting that the indicative yield to institutional placees according to the prospectus was 3.8%, which was attractive in 2021 when



global interest rates were near zero.

"The price for the institutional portion was 71 sen as opposed to the planned 80 sen. With the opening price of IGB Commercial REIT being 73 sen, it is likely that many minority shareholders of IGB sold for the 30-plus sen (75%) profit. The pricing and structure of the IGB and IGB Commercial REIT exercise was a fantastic opportunity for arbitrageurs," says Yoong.

Mixed valuations amid pessimistic office outlook

Although IGB Commercial REIT may already have had a short run during the flotation exercise, Yoong finds its yield of 7% in FY2023 and 6.8% in FY2024F to be attractive.

"With a price-to-book of 0.5 times, the attractive valuation of IGB Commercial REIT is due to the pessimistic outlook for office space. There is no doubt that there is a glut of office space [but] credit to the manager of IGB Commercial REIT for the commendable performance in FY2023. The average occupancy rate increased to 81.3% in 4QFY2023 from 80.9% in 3QFY2023. Rental rate was almost unchanged at RM6.26 psf in 4QFY2023," says Yoong.

Areca Capital CEO Danny Wong, who does not comment on individual counters, has his reservations about office REITs, though. Danny's chief concern for the subsector is that the pandemic's direct impact on demand has had many businesses downsizing office space, with some opting for hybrid working frameworks.

He says: "With more offices like [The Exchange 106 @] TRX, many multinational companies have decided to move there because of the incentives announced by the government. Some REITs' assets are mainly leased to MNCs. It makes sense for some tenants to move into modern and new offices like TRX."

To this end, IGB's Khim Chon says, for now, IGB Commercial REIT will "remain committed to building robust relationships,

providing superior services, and adapting to evolving needs" in navigating shifts in tenant preferences and the competitive market.

"The strategy focuses on open communication, actively listening to tenants' needs and prioritising satisfaction and engagement. Suitable asset enhancement initiatives will be implemented, including technology investments and facility renovations, to stay relevant to tenant demands," he adds.

In a March 12 note, AmInvestment Research pointed out that there could be buying opportunities for Malaysian REITs, owing to the widening yield spread against the 10-year Malaysian Government Securities yield amid the tail end of monetary policy tightening as well as potential interest rate cuts in developed economies in the second half.

Its economist anticipates that the US Federal Reserve will cut interest rates in mid-2024 by 75 basis points to 100bps, which would "eventually bring the fed funds rate to 4.5% to 4.75% by year's end". It also projects Malaysia 10-year Government Bond (MGS) yield to be lower at 3.63% in 4QCY2024, from the current level of 3.82%.

AmInvestment Bank Research maintains its "overweight" call on Malaysian REITs for their "stable occupancy rates and positive rental reversions across key assets in retail, office and hospitality". The research house does not cover IGB Commercial REIT, but has "buy" calls for Pavilion REIT and IGB REIT, with fair values of RM1.64 and RM1.95 respectively. It also anticipates flattish rental reversions for offices and limited improvement in occupancy rates in CY2024F. Hong Leong Investment Bank Research, which is the only research house on Bloomberg covering the counter, has a "hold" call, with a target price of 49 sen.

Fund managers and analysts concede that occupancy and rental reversion rates in the office segment are likely to remain flattish, with corporate decentralisation, flexible working arrangement trends as well as competition from The Stride Strata Office in Bukit Bintang City Centre, Merdeka 118 and The Exchange 106 @ TRX expected to further exacerbate the oversupply of office spaces.

Likewise, Yoong believes it is likely to take years to absorb the surplus in office space — this is on the premise that construction of office space will taper off.

"It appears that constructing office towers and shopping malls is a national pastime in Malaysia. Hospitality and industrial property REITs are more attractive than office REITs, given the strong growth in tourism and high foreign direct investment. There is a robust recovery in hotel occupancy rates," he observes. ■

Nonetheless, there was consternation among some market watchers that Optus was not offered to Keppel. Brookfield would most likely syndicate Optus to a bunch of capital partners and place it in one of its infrastructure funds, analysts suggested.

Instead, Keppel, which is seemingly reluctant to sell M1 to StarHub as widely speculated, could undertake the strategy as a connectivity operator. After all, it too can syndicate the investment in an infrastructure fund, and the transaction would help Keppel on its way to S\$200 billion.

In March 2023, Keppel received conditional approval from the Energy Market Authority

for the long-term import and sales of 1GW of low-carbon electricity from renewable energy sources in Asean. Keppel also signed a long-term power purchase and export agreement with Cambodia's Royal Group Power for the latter to supply and export, and Keppel to import low-carbon electricity into Singapore.

The power will be transmitted through onshore high-voltage transmission lines and subsea high-voltage transmission cables from Cambodia to Singapore and supported by proven energy storage systems such as hydro storage and batteries.

Keppel has said this is the first renewable energy import into Singapore as part of the

Lao-Thailand-Malaysia-Singapore Power Integration project to facilitate the successful implementation of the large-scale import of renewables and low-carbon energy.

"Keppel is in an enviable position, as we are already an established infrastructure asset manager and operator, with a strong track record. We also have deep domain knowledge and operating capabilities in multiple asset classes, allowing us to provide more fund products and better value propositions to our LPs [limited partners]. In 2024, we will continue to expand our fund offerings, as well as pursue a deal flow pipeline of over S\$14 billion, the majority of which are in the infrastructure

and connectivity spaces," Loh said on Jan 31.

Other real estate investment managers with a Singapore connection could get to S\$200 billion before either Keppel or CLI. ESR with its US\$150 billion in AUM and GLP Capital Partners with its US\$128 billion in AUM are contenders. As a comparison, Brookfield Asset Management, the company many in Asia aspire to, has AUM of US\$850 billion as at end-December 2023. ■

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