

# RHB Research remains optimistic on REITs amidst economic landscape

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RHB Research has maintained its positive outlook on Real Estate Investment Trusts (REITs) as a resilient avenue for yield investment in light of recent market fluctuations.

Citing stabilised rental reversion, consistent occupancy rates, and a decline in government bond yields, the firm underscores REITs' attractiveness in the investment landscape.

Currently, the yield gap between the 10-year Malaysia Government Securities (MGS) and the KL REIT Index (KLREI) stands at 230 basis points, a notable figure according to the firm, which suggests one standard deviation above the historical average.

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

The bank-backed research firm anticipates potential rises in the yield spread, citing recent increases in US government bond yields despite expectations for interest rate cuts, driven primarily by sustained high inflation.

"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 added.

However, while the outlook remains positive, RHB Research notes potential limitations on earnings growth. Increased competition in the retail sector and moderate spending growth due to the higher cost of living are identified as factors that could hinder significant earnings expansion for retail REITs.

“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% in 2023, with a projected softer growth of 4% for 2024, according to Retail Group Malaysia,” it continued.

RHB Research points to the elevated cost of living potentially dampening retail expenditure in the future. The opening of new malls also poses challenges for rental rate increases in the long run.

Nonetheless, the recovery of the tourism sector is expected to positively impact retail spending, particularly benefiting city center malls such as Suria KLCC and Pavilion KL, which attract significant foreign shoppers.

“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 further added.

Furthermore, RHB Research maintains its ‘Neutral’ rating on the REITs sector and identifies IGB REIT as its preferred choice, citing 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%,” it noted. – April 4, 2024