



Lee: An investment in REITs, especially those listed in Singapore, could be the next best thing to owning physical assets

# Fund play on S-REITs

Phillip Capital is launching Singapore's first unit trust that will invest primarily in locally listed REITs. Targeting income-seeking investors, it aims to pay annual dividend yields of around 6%. But, with equities on a downtrend, is this a good time to buy into an S-REIT investment product?

| BY KELVIN TAN |

Jeffrey Lee, the optimistic and go-getting managing director and chief investment officer (CIO) of local asset-management house Phillip Capital Management, is excited about his new fund, which will invest in Singapore-listed real estate investment trusts (S-REITs).

With S-REIT stock prices currently down more than 9% on average this year (as at Aug 24), Lee, who has more than 25 years' experience in the industry, is sensing a money-making opportunity in this high-yielding equity sub-group. Indeed, the recent stock-market slump, which he believes will be temporary, has pushed the dividend yield for many S-REITs to an unprecedented level of more than 6%. And that's presenting a good entry point for Lee to pick up some cheap, high quality S-REITs, which he considers to be "one of the most attractive asset classes" at the moment.

"Now, people are looking for physical assets and flocking to gold and silver. An investment in REITs, especially those listed in Singapore, could be the next best thing to owning physical assets," says Lee in a re-

cent interview with *Personal Wealth*. "For those who want to be in Singapore-dollar [SGD] assets and desire a reasonable yield with some level of defensiveness, S-REITs are the asset class to be in," says Lee, who is currently drumming up interest in the soon-to-be-launched investment product.

Called the Phillip Singapore Real Estate Fund, it will be Singapore's first S-REIT fund when it is launched early next month. Although the new fund could use up to 10% of its assets to buy REITs listed outside of Singapore, Lee says it will be a "pure play" on S-REITs. He adds that shares of property companies or real-estate developers listed in Singapore will not be included in its portfolio.

Designed to be an income product for investors, the fund will make dividend payouts twice a year in the first 12 months from inception. "When the fund is more established in the second year, we may increase dividend payouts to four times a year," says James Chua, an investment solution specialist at Phillip Capital, "We are positioning the fund for anyone who wants regular income."

Unlike property developers or real-estate companies whose prof-

its are derived from a combination of property sales, rental income and real-estate investments, the bulk of a REIT's profit is from rental income of properties it owns. REITs are also tax-advantaged investment vehicles as their income is tax-free for direct investors. In Singapore, a REIT is mandated to pay out at least 90% of its rental income to investors.

## Attractive yields

One of the main reasons for launching an S-REIT fund is their attractive yields, Lee says. As he sees it, a 6% yield from S-REITs is extremely attractive relative to most yield-generating asset classes in Singapore. Currently, bank deposit rates are hovering close to zero, 10-year government bonds are yielding slightly over 1.5% and stocks are giving investors an average dividend yield of just 3%. "Although the dividend yields from equities are reasonably high, they are still relatively low compared with yields from S-REITs. For bonds, yields are very, very low and investors actually get negative real returns, after factoring in inflation," says Lee.

Lee points out that the 5.1% yield gap between S-REITs and 10-year Singapore government bonds is among

the highest in the world.

Referring to a report generated by his analysts, the CIO tells *Personal Wealth* that the yield differential of REITs listed in Australia, Japan and the US and their countries' 10-year-government bonds is below Singapore's (see chart). "So, from a yield-gap standpoint, the high yields on S-REITs make them among the most attractive REITs in the world," he says.

Moreover, yields from S-REITs are also twice as attractive as the rental yields of physical real-estate investments in Singapore, according to Chua, who notes that investors who buy physical properties to rent out are getting an average rental yield of 3%. "So, instead of buying a secondary property to rent out, [real-estate investors] could consider [buying into the Phillip Singapore Real Estate Fund] and receive higher income payouts," he adds.

Lee says the idea for the Phillip Singapore Real Estate Fund came from his "yield-hungry" Southeast Asia institutional clients, who want to position their money in high-yielding SGD assets. He says the clients, who have been investing in Asian fixed income, are now seeking alternative investments because bond

yields have dropped to very low levels. "There is a very large pool of money out there that is very eager to receive regular yields. When their bonds mature, they need to look for alternatives with similar and comparable yields. S-REITs are a fairly attractive option for them."

For foreign investors, an S-REIT fund also allows them to park money in SGD assets. With a yield of 6%, they could get total returns of more than 10% going forward, after factoring in currency gains derived from a strong SGD, Lee enthuses. "So, a product like this is in high demand by foreign investors, as it gives them a reasonable yield plus currency gains. For Singapore investors, the returns are also very decent," he adds. Lee is confident the new fund will attract healthy subscriptions from both institutional and retail investors. "We have definitely got the institutional investors in. That's why we are doing this," he says. "If there is no institutional demand, the fund won't work."

## Defensive quality

Another advantage of S-REITs is their defensive characteristic, which could provide investors with "some level of capital protection" in a weak equity-

market environment, Lee points out. Supported by regular rental income that is secured by multi-year leases, S-REITs' high yields give downside protection to their stock prices, he says. And that is evident from the recent performance of S-REITs versus the Straits Times Index, he adds.

The FTSE Straits Times Re Invest Trust Index, which tracks the performance of S-REITs, turned in year-to-date losses of 9.37% as at Aug 24, compared with the blue-chip STI index, which was down 14.7%.

"The traded prices of S-REITs as a whole are about three quarters as volatile as the STI index. You have an [equity] asset class that is less volatile than blue-chip stocks. Although they are not quite as stable as bonds, I would say REITs are a hybrid asset class, in between equities and bonds," says Chua.

With global equity markets plagued by extreme volatility of late — on concerns that the US could face a recession, European countries will struggle to repay their debts and inflationary pressure in emerging markets could remain elevated — it make sense to be in defensive assets, Lee says.

He reckons that ordinary equities do not give investors "sufficient protection" in the current bearish environment. "REITs, on the other hand, are backed by rental income. Very often, the rental yields of REITs, particularly those listed in Singapore, are fairly well protected even in volatile periods like now," he adds.

There is an income cushion for S-REITs because the leases of corporate tenants are signed on a multi-year basis, Chua explains. Even if Singapore property prices drop, rental income of S-REITs are locked-in by their leases, which are four years on average, he points out. "So, at least over the next four years, the regular income is there. This creates some kind of income cushion," says Chua, who adds that S-REITs' income is easier to predict than the dividends of blue-chip companies.

"The dividend payout of a blue-chip company may be subjected to the board's decision to cut it if there is earnings pressure. But, by law, at least 90% of the income from REITs must be distributed to investors. This gives us more visibility to the income stream two or three years down the road," Chua says.

Owing to their robust regulatory framework, S-REITs are also fundamentally stronger than the REITs of other countries, Lee observes. REITs listed in Singapore are legally obligated to keep their gearing or borrowings at a reasonable level. Indeed, S-REITs without a credit rating from a major rating agency can borrow only up to 35% of their total assets, while the rated ones can leverage up to 60%. "There is a lot of debt discipline for S-REITs. Their gearing levels are very manageable, at around 35%," he adds.

"In the case of Singapore, even during the global financial crisis of 2008/09, when liquidity dried up, our REITs continued to be fairly resilient and they didn't experience the kind of distress that some Australia- and Japan-listed REITs faced. I think the REIT market in Singapore is one of the best, if not the best, in Asia," Lee adds.



The Suntec REIT will be among the top holdings of the Phillip Singapore Real Estate Fund

That's why he reckons that share prices of good-quality S-REITs will hold up relatively well versus ordinary stocks during the volatile months ahead. "If the market continues to fall, that would be a good entry point for us to buy S-REITs at a very cheap price," says the CIO, who feels that most S-REITs will not experience funding problems in the near future as interest rates in Singapore are likely to remain low for the next two years.

Higher interest rates tend to increase the mortgage expenses of REITs during refinancing. "There is plenty of funding right now because liquidity hasn't dried up, like in 2008. Given that US interest rates will stay at near-zero rates for at least two years, as indicated by the US Federal Reserve, interest rates in Singapore [which take direction from US interest rates], will similarly stay low. There will be easy funding. At the same time, the REIT manager can lock in those high rental yields," he adds.

#### High-quality names

Although there are 25 REITs listed in Singapore, Lee says the new fund will hold only 15 to 18 in its portfolio, which will be heavily weighted towards the better-quality names with good parentage or sponsors.

"The No 1 factor for us, when looking at which S-REIT to invest in, is the quality of the REIT's sponsor, which is key to the success and value creation of the trust," says Lee. He observes that during the global financial crisis of 2008/09, S-REITs with strong sponsors sailed through

the crisis quite comfortably while several with lower-quality sponsors experienced some distress.

"I would be fairly cautious towards the lower-quality names," says Lee, without elaborating. "I want to focus on the very strong names with strong sponsors, which are able to grow their rental stream of income in this uncertain environment."

So, which S-REITs is Lee most bullish on at the moment? While there are several, the three he is most sanguine about are **Mapletree Industrial Trust, Mapletree Logistics Trust** and **Fraser's Centrepoint Trust**.

Industrial REITs such as Mapletree Industrial Trust and Mapletree Logistics Trust are sponsored by Mapletree Investments, which is indirectly owned by national investment company Temasek Holdings through its wholly owned subsidiary, Fullerton Management. "They have a good sponsor and they have a reasonable pipeline of assets that look attractive," says Lee on the two Mapletree REITs. "I think they will fare reasonably well, going into this market downturn."

He observes that rental yields for industrial properties in Singapore have been on an uptrend since early this year. "There have been some curbs on Singapore residential properties and investors are now switching their attention to industrial properties. Mapletree will continue to grow their stream of income during the upturn in the industrial-property sector," he says.

The share price of Mapletree In-

dustrial Trust was up 2.34% this year as at Aug 24, while Mapletree Logistics Trust was down more than 13% on a YTD basis. The REITs currently have a 12-month indicative yield of 5.86% and 7.46% respectively.

As for Fraser's Centrepoint Trust, Lee says he likes it for its suburban mall properties, which look more resilient in terms of rental income compared with downtown malls. "The suburban malls will continue to do well whatever happens to the global economy. People will continue to shop and eat at the suburban malls, whose rentals will be maintained even during a crisis. So, there isn't a real fear," he states.

According to Chua, the main risk for mall REITs, or any other type of real estate trust, is the decline in the tenancy rate of the properties that it owns. "If there is an internal or external event that causes consumers in Singapore to stop shopping or eating out, then the yields will be negatively affected. So, an external shock will be the main risk," says Chua. "But, for a lot of the suburban malls, their tenancy demand is actually quite non-cyclical. And they are definitely less vulnerable compared with the downtown malls."

Fraser Centrepoint Trust, which owns suburban malls such as Causeway Point, Northpoint, Compass Point and Anchorpoint, is managed by Fraser's Centrepoint Asset Management, a wholly owned subsidiary of beverage and property company **Fraser and Neave**. As at Aug 24, the share price of Fraser Centrepoint Trust, which has a 12-month indicative yield of nearly 6%, was down more than 7% for the year.

Lee says other names such as **Suntec REIT** and **CapitaMall Trust**, both of which have good sponsors, will be among the fund's top holdings. "Our value-add as managers of a fund of REIT product is our expertise in analysing which S-REITs hold the better-quality assets," he adds. The fund charges a low annual management fee of 0.8% and a minimum subscription of \$1,000.

#### Scrutiny from fund experts

Fund experts whom *Personal Wealth* spoke to last week, however, have mixed views on the new S-REIT fund. "The fund is interesting and definitely has a niche strategy," says Daryl Liew, who is head of portfo-



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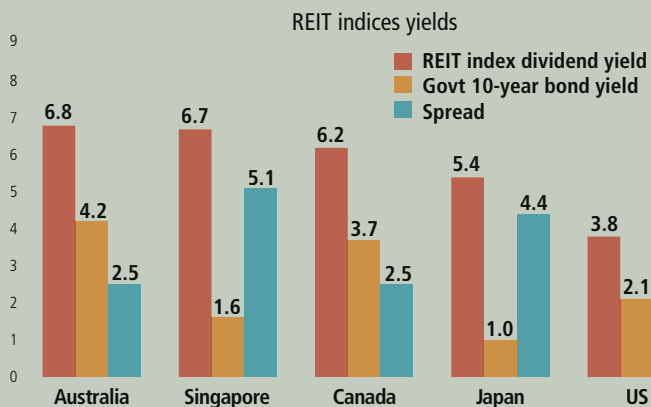
lio management at boutique wealth-management firm Reyl Singapore, a subsidiary of a Geneva-based private bank Reyl & Cie. "Critics, however, would point out that with about 25 Singapore-listed REITs, the universe really isn't large enough to warrant launching a fund. Investors could cherry-pick their preferred REITs or simply buy a basket of REITs to diversify away from company-specific risk," Liew adds. "In my view, this fund is probably suitable for smaller retail investors who basically can't do either of the above. And with the recent market volatility, there definitely is demand for such a defensive, high-yielding fund. So, I'm sure it will see some interest. It may have been more interesting to expand the universe to include other Asia Pacific-listed REITs, though this obviously would have subjected investors to currency risk."

For his part, William Cai, who is vice-president and deputy head of investments at independent financial advisory firm GYC Financial Advisory, says the new fund is investing in an "attractive asset class" and the fund manager should be able to do some degree of allocation between the various REIT segments such as office, malls, industrial and logistics. Cai recommends that potential investors pay attention to the price of REITs, and not just focus on their yields. That's because, like any other stock, their dividends may not be enough to cover capital losses during a bear market, he warns.

Indeed, during severe bear markets such as in 2008, S-REITs as a group underperformed the STI Index on a total-return basis, even after factoring in their dividend payouts. That year, S-REITs turned in a total return of 57% versus the STI's loss of 47%. But, during normal market conditions, such as in 2009 and 2010, S-REITs as an equity sector did better than the STI, in part due to their regular dividend payouts, says Lee, who isn't expecting a protracted and severe bear cycle for stocks.

"Even in a very-slow-growth environment, S-REITs on a risk-reward basis look more attractive than the equity market," insists Lee, who is confident the new fund will be a hit with both local and foreign investors. "I think in this yield-hungry environment, where people want a defensive asset class, it will attract good assets, not just from Singapore investors but also from those of the developed markets." **E**

### S-REITs have very attractive yield spreads versus 10-year government bonds



S-REIT yields are one of the highest among the major REIT markets. When compared to government 10-year bond yields, S-REITs provide the highest spread.