Singapore REITs Sector

Time to revisit but remain selective

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- The outlook for most of the property assets owned by REITs remains positive despite an economic slowdown, buoyed by China's re-opening. However, the recovery in office rents could slow down with accelerating tech layoffs.

- A pause in Fed interest rate hikes could reduce the risks of higher interest costs for the REITs. In addition, most S-REITs have comfortable debt levels.

- S-REITs offer an average dividend yield of 7.6% as of December 2022, significantly higher than the 10-year Singapore government bond yield of 2.8% now.

- We expect retail REITs to be more resilient in an economic slowdown compared to office REITs. Investors looking to build passive income without analysing individual REITs can also consider a REIT ETF.

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What happened?

Inflation has come down in recent months in the US and in Singapore. The Singapore Consumer Price Index (CPI) rose by 6.5% in December compared to the previous year, easing from the 6.7% increase in November.

As a result, interest rates have also fallen from their recent peaks. We have seen how the 10-year average yield on the Singapore Saving Bonds (SSBs) has fallen to below 3%.

With these changes, we thought it is worthwhile revisiting the REITs to examine if the worst might be over.

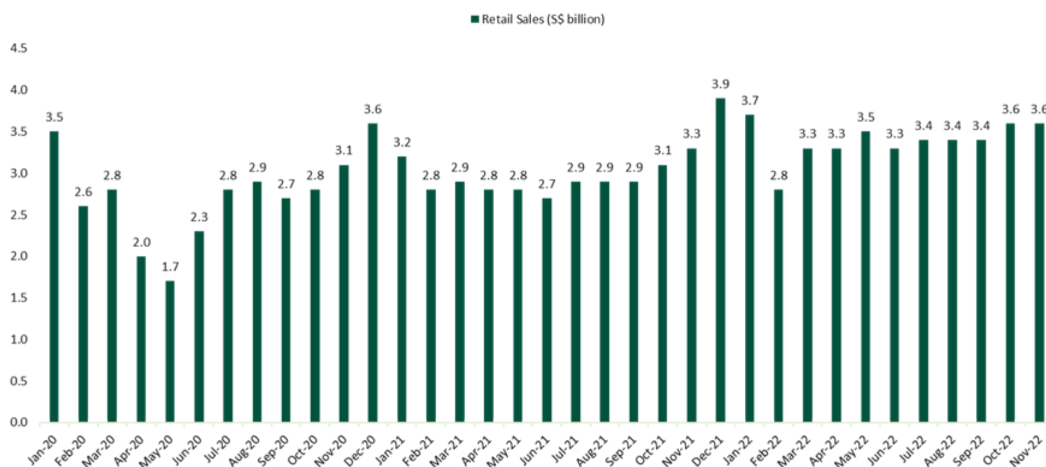
Is the worst over for S-REITs?

Operational performance remains resilient

Singapore's economic growth is expected to slow to just 0.5% to 2.5% in 2023, according to forecasts by the Ministry of Trade and Industry. However, the operational performance of the property assets owned by the REITs remains strong across most of the different sub-segments.

For shopping malls, retail sales grew at 6.2% in November compared to the previous year. This was supported by higher spending by tourists with Singapore's re-opening, as well as front-loading of large purchases ahead of the goods and services tax (GST) hike on 1 January 2023.

Retail sales has recovered to pre-COVID levels



Source: Department of Statistics Singapore

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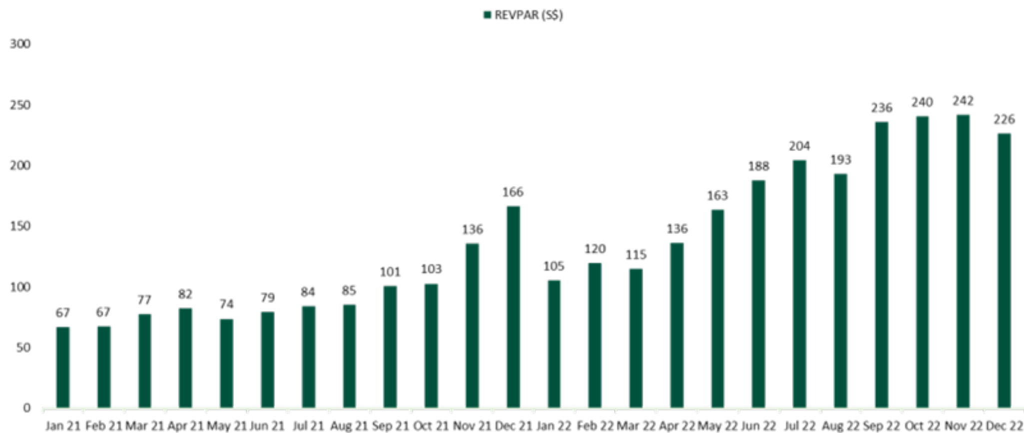
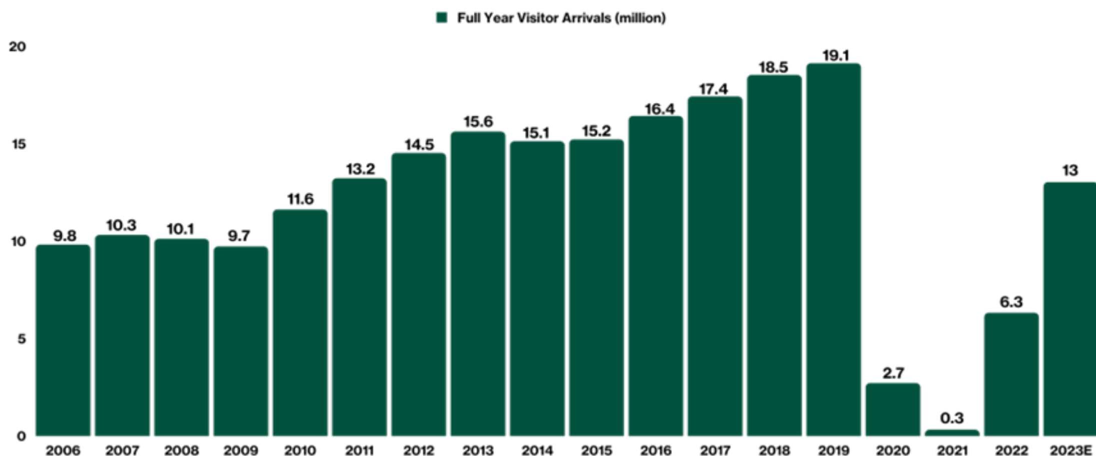
Likewise, the easing of international travel restrictions has led to a resurgence in Singapore's hotel industry. The average revenue per available room (RevPAR) recovered to S$242 in November 2022, significantly above the average RevPAR of $89 in 2020.



Looking ahead into the new year, consumer spending and hotel room rates could receive a further boost as Chinese tourists return. The Singapore Tourism Board expects visitor arrivals in Singapore to reach 12 to 14 million in 2023, doubling from the 6.3 million visitors who came last year.



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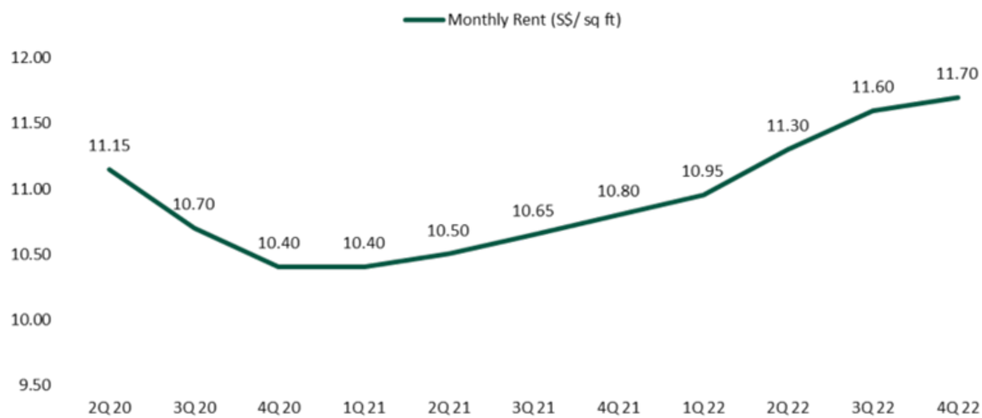
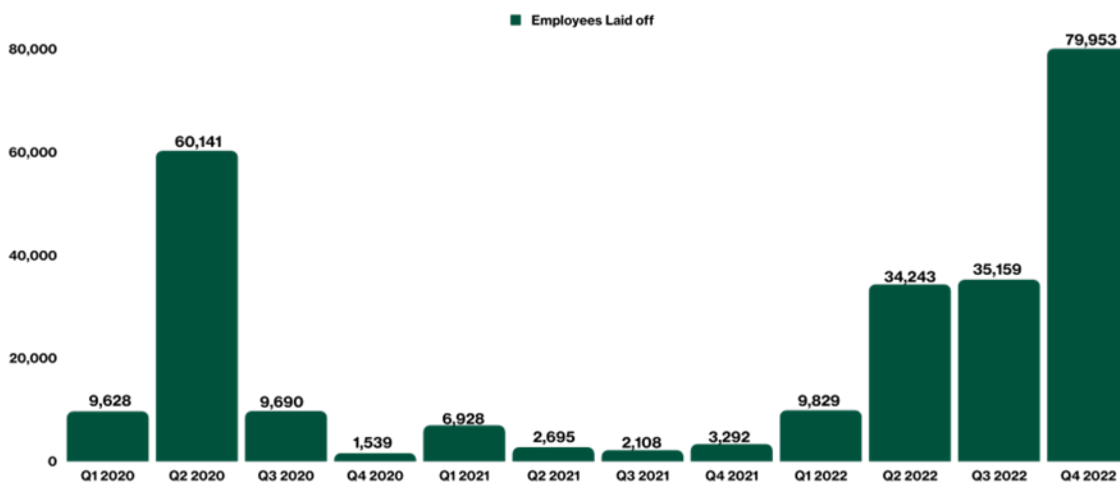
Likewise, Singapore's office market ended 2022 on a strong note, as rents rose with the workforce returned to office. The rents in Singapore's Central Business District (CBD) went up to SS$11.70 per square foot per month by the end of 2022, representing a growth of 8.3% for the entire year.



Source: CBRE Research

However, the outlook is not as rosy for the office sector. With the recent slowdown in the tech sector, some tech companies have red uced their office footprint to save costs. This could lead to weaker demand for office space. As a result, CBRE is now expecting office rents to grow by just 1.0% in 2023, compared to its previous forecast of 4-5%.



Source: Layoffs.fyi

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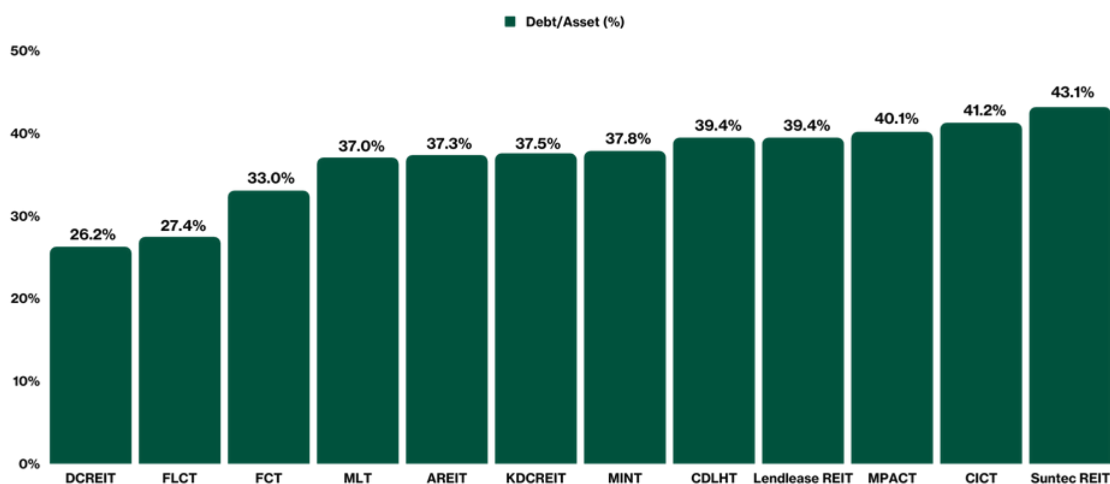
Interest rates have come down

The good news for REITs is that interest rates expectations have come down with easing inflation pressure in recent months.

Economists are currently expecting the Fed benchmark interest rate to peak at about 5% in the middle of this year. Thereafter, interest rates could be cut and end up at 4.25-4.50% by the end of the year.

The could help to reduce the risks that the distributions of REITs would be impacted by higher interest costs. S-REITs generally have low debt levels, with a gearing level (total debt divided by total assets) of 30% to 40%. This is well within the regulatory limit of 50%.

In addition, most REITs have a significant amount of their borrowing hedged at a fixed interest rate. This would limit the immediate impact of higher interest rates on their borrowing costs.



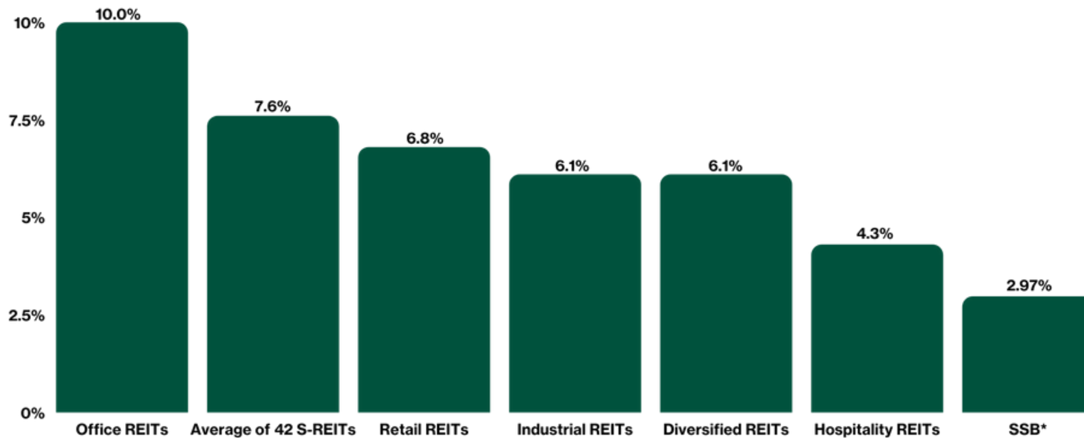
Valuation for REITs might now look more attractive

With the significant correction in the price of S-REITs in 2022, their valuations are now looking more attractive.

S-REITs offer an average dividend yield of 7.6% as of 31 December 2022. This is highest for office REITs at 10.0%, lifted by the dividend yields for REITs with US office assets.

At the lower end of the spectrum, diversified REITs and hospitality REITs offer a dividend yield of 6.1% and 4.3% respectively.

S-REITs offer a higher dividend yield compared to Singapore Savings Bonds (SSBs)



Source: Bloomberg, SGX, MAS. Data as of 31 December 2022
Sub-segments based on REITAS classification. Market cap weighted average is used for above calculation
*SSB yield based on average 10-year yield for SSB issuance in February 2023

The 10-year Singapore government bond yield has fallen to 2.8% from a peak of above 3.6% in October last year. This has made the dividend yield of REITs look more attractive compared to the return on safer instruments such as the 10-year SGS bond and the Singapore Savings Bonds.

What would Beansprout do?

Looking at the current projections, most economists are expecting the Fed to pause interest rate hikes after the March meeting, and potentially cut interest rates by the end of the year. It is worth noting that S-REITs outperformed the Straits Times Index (STI) significantly the last time the Fed paused its rate hikes in 2018.

However, with growing concerns about an upcoming recession, not all REITs might be able to earn higher rental income. For example, the office sector might be negatively impacted by a slowdown in the tech sector. This could put pressure on office occupancy and rents. On the other hand, retail REITs might be more resilient to any economic slowdown, as Singaporeans may continue to spend on essentials such as groceries.

At the same time, while interest rates might be coming down, they remain at elevated levels compared to past years. As such, we need to make sure that the REITs we own can withstand the higher borrowing costs.

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