Reopening of economy to benefit retail REITs, but rental revision not promising

BY **LEE WENG KHUEN**

Malls in the city are showing a significant increase in shopping traffic following the resumption of most economic activities and the lifting of the interstate travel ban, which is surely a good sign for retailers hard hit by Covid-19 restrictions.

With consumer spending on the uptick, retail real estate investment trusts (REITs) may be worth a closer look although much also depends on where their assets are located.

A REIT analyst with a non-bank-backed research house sees an encouraging recovery in retail sales, especially during the year-end festive season.

"As borders are still closed, we can't really travel out of Malaysia. Shopping malls will be the hangout places during the weekend for Malaysians," she tells *The Edge*, noting that during the RMCO (Recovery Movement Control Order) early this year, the performance in a number of REITs rebounded sharply, driven by revenge spending.

"So, we think recovery will be quite fast for retail REITs," adds the analyst, who maintains a "neutral" view on the REIT sector for the time being. She cautions that more guidance is needed from the management of shopping mall operators to gauge if the shopping traffic translates into sales.

Rental revision outlook may not be encouraging

Apart from that, she points out that the rental revision outlook may not be so positive in view of the headwinds in the retail space, which is plagued by a significant glut.

"It will be quite flattish at the moment. Probably some landlords might negotiate with their tenants by incorporating a higher variable portion such as turnover rent, where landlords can share a certain percentage of their tenants' sales. So, when tenants register good (improved) sales, landlords can actually charge higher rental. Landlords will never reveal how the structure will be due to the confidentiality," she explains.

SAM FONG/THE EDGE

While there has been an encouraging recovery in retail sales, operational challenges still linger for mall tenants

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Performance of REITs on Bursa Malaysia

COMPANY	SHARE PRICE ON OCT 20 (RM)	YTD CHANGE (%)	TRAILING 12-MONTH DISTRIBUTION YIELD (%)
Al-Aqar Healthcare REIT	1.24	-5.3	7.1
Al-Salam REIT	0.515	-6.4	2.4
Amanahraya REIT	0.68	3.0	8.4
AmFirst REIT	0.395	-4.8	7.1
Atrium REIT	1.45	26.1	6.7
Axis REIT	1.95	-3.9	4.7
CapitaLand Malaysia Trust	0.635	1.6	4.4
Hektar REIT	0.575	-8.7	1.6
IGB REIT	1.67	-2.9	4.1
IGB Commercial REIT	0.66	-7.0	N.A
KIP REIT	0.84	3.7	8.1
KLCC Prop & REIT — Stapled Securities	6.79	-4.1	4.2
Pavilion REIT	1.40	-6.7	3.1
Sentral REIT	0.895	2.3	7.9
Sunway REIT	1.46	-2.7	2.2
Tower REIT	0.58	No change	3.8
UOA REIT	1.13	No change	6.3
YTL Hospitality REIT	1.00	9.9	4.2

She does not think that rental subsidies need to be further prolonged given that all retailers have been allowed to open.

"Previously, rental subsidies were granted on a case-by-case basis by showing proof of affected sales. Rental rebates to affected tenants were the main reason behind a reduction in REITs' revenue. The financial numbers will look better if landlords do not have to continue with the rental subsidies programme."

RHB Research analyst Loong Kok Wen begs to differ as she expects rental subsidies to remain in the picture going into 2022 as long as tenants are still in survival mode. Moreover, rental revisions in the immediate term are projected to be soft as operational challenges still linger for tenants at large.

"Things are definitely looking up for the REIT sector, but we believe that traction for a meaningful recovery for REITs will likely take time. Our ground checks since Phase 2 of the NRP (National Recovery Plan) saw that foot traffic was especially strong for the likes of Pavilion KL and Mid Valley Megamall, so we believe the recovery theme is selective and will largely work in favour of retail pure-play REITs with prime assets.

"We expect a strong recovery in consumer spending due to pent-up demand, especially as later phases of the NRP will coincide with the seasonally stronger 4Q," she says.

Fitch Solutions in a report last Thursday noted that household spending in

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Prolonged lowdowns delayed recovery in retail sales

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Malaysia is estimated to grow 5.1% in 2022, after two years of contraction in spending levels.

"Spending will follow the wider economic recovery, as higher vaccination rates over 1H2022 allow for more localities to lift restrictions that have hampered retail sales."

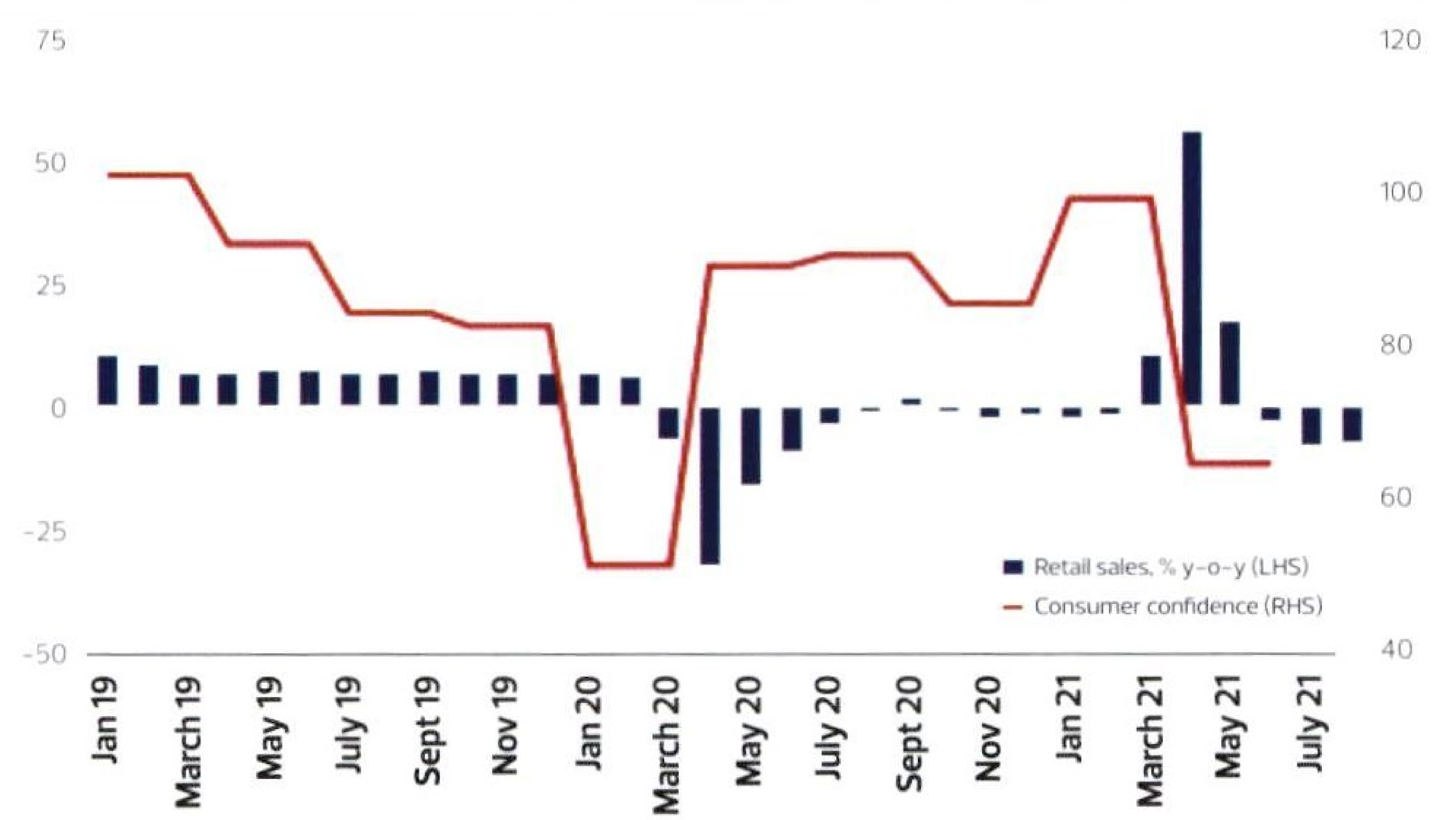
As the Klang Valley accounts for about 60% of retail sales in Malaysia, prolonged lockdown restrictions this year have delayed the recovery in retail sales.

Fitch highlights that a surge in retail sales towards the end of the year is improbable given that the country is unlikely to achieve herd immunity by end-2021 even though the rate of vaccination is increasing.

"We note further downside risks to our forecast given the high level of political risk since the beginning of 2H2021 and the risk that the Covid-19 outbreak could worsen over the coming months, which could further affect both retail sales and consumer confidence."

DEPARTMENT OF STATISTICS MALAYSIA, MALAYSIAN INSTITUTE OF ECONOMIC RESEARCH, FITCH SOLUTIONS

Malaysia: Consumer confidence & retail sales (2019-2021)



Compared with retail REITs, Loong sees growth in office REITs remaining flat on the back of an oversupply and a potential continuation of the work-from-home trend.

"The industrial segment, however, should see rather steady growth over the medium term due to rising demand for logistics/warehouses, partly boosted by the e-commerce trend as well."

On distribution yields, Loong is of the view that sentiment for REITs may be muted, in line with the research house's view that there will be no further cuts to the overnight policy rate (OPR), and a projected rate hike in 2H2022. The REIT sector currently has an average distribution yield of around 5.2%.

"Yield spreads should remain at currently unattractive levels, or narrow further, in our view as we expect dividend yields to have minimal growth," Loong says.

Meanwhile, the non-bank-backed research analyst considers the current distribution yield reasonable considering that the OPR remains at an all-time low of 1.75%.

Economists generally expect the central bank to maintain the key rate at the current level, with the first rate hike only forecast in the middle of 2022.

IGB REIT preferred proxy to cyclical recovery

Looking at proxies to a cyclical recovery, Loong picks IGB REIT for its asset quality, domestic shopper profile and strategic rental structure, which should allow it to reap the benefits of revenge spending.

IGB REIT's two key investment properties are Mid Valley Megamall and The Gardens Mall. For the cumulative six months ended June 30, 2021, its net property income was flattish at RM125.52 million against RM125.75 million in the same period a year ago.

IGB REIT's trailing 12-month distribution yield stands at 4.1%, higher than that of Sunway REIT (2.2%) and Pavilion REIT (3.1%).

Among the retail REITs, KIP REIT — which operates seven KIP Malls — has the highest distribution yield of 8.1%, nearly double the 4.4% for CapitaLand Malaysia Trust, which boasts Gurney Plaza, Penang; Sungei Wang Plaza, Kuala Lumpur; 3 Damansara Property, Petaling Jaya; The Mines, Seri Kembangan; and East Coast Mall, Kuantan.

Loong also likes Axis REIT as a key player in the industrial segment, standing relatively free from the risks associated with the pandemic.

Over half of the REITs listed on Bursa Malaysia have underperformed since early this year, with Hektar REIT the top loser (-8.7%).

Surprisingly, YTL Hospitality REIT, which has 15 commercial properties in its investment portfolio, including JW Marriott Hotel, The Majestic Hotel and The Ritz-Carlton, Kuala Lumpur — hotels hit by the pandemic, has emerged tops in performance as its share price has gained 9.9% over the same period. E