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Inside insights

The 18th entry

SIX months ago, in a column entitled "Early signs of weakness in commercial real estate" dated March 6, a review was carried out among listed Malaysian Real Estate Investment Trusts (M-REITs) in terms of the market value of their properties, and to see the impact of the pandemic on the valuation of their properties.

In summary, based on the reported data by M-REITS with the financial year-end of December 2020, there are early signs of weakness among commercial properties, but not necessarily across the board.

Even within the office, retail, or hospitality segment, M-REITs seem to be resilient enough to withstand the economic headwinds.

A quick check with M-REITs that had financial year-end outside the December period saw some material movements, but these assets were mainly confined to retail and hospitality REITs.

RM mil	UOA REITs	Sentral	Weigthed Average	IGB Commercial	IGB REITs
Share Price (RM)	1.12	0.87	–	0.71	1.69
No of Units	676	1,072	–	2,308	3,569
Market Capitalisation	757	932	1,689	1,638	6,032
NAV	982	1,291	2,273	2,302	3,803
NAV/share (RM)	1.45	1.20	–	1.00	1.07
P/NAV (x)	0.77	0.72	0.74	0.71	1.58
Dividend* (sen)	8.78	7.08	–	3.90	6.87
Dividend Yield (%)	7.84	8.14	8.00	5.49	4.07

*Source: Bursa Malaysia, IGBCR IPO, *dividends for UOA REITs, Sentral REITs and IGB REITs are based on trailing 12-month actual dividends announced*

TheStar graphics

Among them was a RM19.1mil or 5.1% drop in The Summit Subang, USJ's market value, owned by AmFIRST REIT, which stood at RM357.4mil against the carrying value of RM376.5mil.

Other notable changes were seen in YTL Hospitality REIT's (YTL REIT) assets, in particular their Australian and Japanese properties.

According to YTL REIT, these assets saw an increase of RM132.3mil and RM30mil in the market value of the properties, representing an increase of 7.2% and 6% respectively. Even YTL REIT's Malaysian hotel assets saw an improvement in value with a modest increase of RM24mil or 1.1%.

Hence, despite the lockdowns and economic challenges faced by M-REITs, we have only seen isolated cases where the value of commercial properties has declined and to the contrary, for YTL REITs, the value of its assets, even for those that are located in Malaysia, rose.

M-REITs welcomes IGB Commercial REIT

To be listed on Monday, IGB Commercial REIT (IGBCR) is coming to the market at a time when the real estate market is facing tough times.

Recent reports have suggested that the office sub-sector is facing some form of glut, not only driven by the pandemic and business closures or scale down of operations, especially with the culture of working from home, but also due to the sheer size of the incoming office supply.

In fact, the recently released data from the National Property Information Centre (Napic) for the the first half of 2021 showed occupancy rate of purpose-built office (private) in Kuala Lumpur fell to 72.2%, down 3.6 percentage points from the first half of 2020 rate of 75.8%.

Data also showed that some 70 office buildings within Kuala Lumpur or approximately 17.1% of all buildings have a vacancy rate in excess of 50%.

A year ago, this figure was 63 buildings or 15.7% of the total number of buildings. For the record, Kuala Lumpur alone has some 2.54 million square meters of available space and that represents 50.1% of Malaysia's total vacancy of 5.07 million square meters as at end of the first half of 2021.

Although no shares were offered to the public, the initial public offering (IPO) involved a restricted offer for sale (ROFS) to IGB shareholders on the basis of two IGBCR for every five IGB shares held at an offer price of RM1 per unit and a distribution-in-specie of three IGBCR for every two ROFS subscribed.

In effect, the shareholders of IGB have subscribed to IGBCR units at an effective price of RM0.40 per unit for the five IGBCR that they obtained via the ROFS and the distribution-in-specie.

The ROFS was undersubscribed by 21.3% or some 163.5 million units.

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Largest office REIT in terms of market value

Together with the original allocated institutional tranche of 130 million units, the unsubscribed ROFS of 163.5 million units too were also sold to institutions at a final fixed price of RM0.71 per unit.

Hence, based on the final numbers, the institutional tranche is approximately 12.7% of the total 2,307.3mil units to be listed on Monday while subscribers of the ROFS will hold approximately 26.3% of the total issued units, which comprise of related, non-related, and minority shareholders.

The shareholders who have subscribed to the ROFS are now sitting on some paper losses due to a drop in the share price of IGB shares itself. Based on IGB's last Wednesday's closing market price of RM1.92 and the cum-price of RM2.84, an IGB shareholder holding five shares of the company before the ex-date for the entitlement to the ROFS has suffered a loss of RM0.92 per IGB share.

As in theory, they have a gain of RM0.31 per IGBCR (the difference between the effective cost of 40 sen per unit against the reference price of 71 sen), IGB shareholders are sitting on a paper loss of 61 sen per IGB share held before the ex-date.

IGBCR will be the 18th M-REITs to be listed on the market but in terms of size, with a market capitalisation of RM1.64bil, based on the institutional offer price of 71 sen, it will be the sixth largest among all the M-REITs.

However, in terms of exposure to the office sub-sector, IGBCR will emerge as the largest office REIT with a market value that is almost equivalent to UOA REITs and Sentral REITs combined.

As a percentage of the Bursa Malaysia REIT index, IGBCR will emerge with a 4.21% weighting on the index. IGBCR comprises 10 highly valuable office buildings which were injected into the REITs at a combined value of RM3.16bil.

This was satisfied via the issuance of the current units in circulation, which is 2,307.5mil units at an issue price of RM1 per share and cash of RM853.2mil to the vendors.

The cash portion is funded via borrowings whereby IGBCR has raised RM850mil via a medium term note programme.

In essence, the market value of the company of RM1.64bil is 51.8% of the value of the ten assets combined valuation and a 29% discount to the net asset value (NAV) of the company.

The lukewarm response to IGBCR's IPO, especially via the ROFS perhaps is a reflection of the soft market conditions.

In fact, IGBCR too revealed that its current occupancy rate is at about 76.3%.

When compared with its nearest rivals, Sentral REITs and UOA REITs have a much better occupancy rate of 93% and 88% respectively as at end of 2020.

In terms of prospects, IGBCR did provide some guidance for this year, with an estimated distribution per unit of 3.9 sen per share.

This translates to a yield of 5.5% based on the reference price of RM0.71 per share.

As can be seen from the table, when compared with UOA REITs and Sentral REITs, IGBCR looks to be attractively priced on a P/NAV basis but not on a dividend yield basis as both the former have a weighted average yield that is at least 2.5 percentage points higher than IGBCR.

This could be a reflection of a lower occupancy rate at IGBCR's properties.

Valuation matrix of office REITs and IGB REITs

As IGB has gained a reputable name in the management of its assets, judging by the premium IGB REITs itself commands, which at 1.58x P/NAV and just 4.1% in terms of yield, it may not come as a surprise that IGBCR too may attract investors interest due to its premium market position and value that it brings to investors.

While IGBCR has an inferior dividend yield but comparable P/NAV with other office-based REITs, it commands a much higher dividend yield and lower P/NAV when measured against its sister company, IGB REITs.

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