

Are REITs a safe bet amid rising interest rate environment? | The Edge Markets

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KUALA LUMPUR (Feb 7): The prospect of an economic recovery this year should lead to better performance of real estate investment trusts (REITs), as more people return to malls and companies may expand office space.

However, the rising interest rate environment might pour cold water on the prospect of REITs. This is because as interest rates go higher, REITs will have to offer even higher yields to stay attractive.

RHB Research's analysts Loong Kok Wen and Raja Nur Aqilah Raja Ali, in a research note published on Monday (Feb 7), said that sentiment surrounding Malaysian REITs (MREITs) will remain lacklustre considering the rising interest rate environment.

"The US and Malaysian 10-year bond yields rose by around 0.6ppts and 0.9ppts in FY21, resulting in a yield spread between MREITs and Malaysian bonds of [about] 40bps (well below -2SD from the historical mean).

"With the US Fed's recent hawkish pivot towards higher interest rates and our economists' expectation of a 25bps rate hike in 2H22, we believe that the yield spread will remain at unattractive levels," the duo wrote in the report.

Upside remains despite headwinds for REITs

Name	Last Close Price (RM)	Discount/ (Premium) from average consensus (%)	Average target price (RM)	Distribution yield (%)	Price-To-Book Ratio (Times)	Market Cap (RM Bil)
KLCCP Stapled Group	6.4	8.7	7.0	5.2	2.3	11.56
IGB REIT	1.5	13.9	1.7	5.7	1.4	5.5
Sunway REIT	1.4	6.1	1.5	2.0	0.9	4.8
Pavilion REIT	1.3	8.0	1.4	4.1	1.0	3.9
Axis REIT	1.8	17.9	2.2	5.3	1.2	3.0
YTL Hospitality REIT	0.9	14.6	1.0	10.4	0.6	1.5
IGB Commercial REIT	0.6	27.4	0.8	1.9	-	1.4
Capitaland Malaysia Trust	0.6	-4.1	0.6	3.9	0.5	1.2
Sentral REIT	0.9	9.4	1.0	8.8	0.7	1.0
Al-'Aqar Healthcare REIT	1.1	33.9	1.5	6.4	0.9	0.8
UOA REIT	1.1	1.8	1.1	7.7	0.8	0.8
KIP REIT	0.8	-	-	7.3	0.8	0.4
AmanahRaya REIT	0.7	-	-	8.3	0.5	0.4
Atrium REIT	1.5	-	-	6.8	1.2	0.3
Al-Salam REIT	0.5	-15.7	0.4	7.1	0.5	0.3
AmFIRST REIT	0.4	-	-	5.7	0.3	0.3
Hektar REIT	0.5	-	-	21.1	0.4	0.2
Tower REIT	0.6	-	-	4.3	0.3	0.2

Source: Bloomberg

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Nevertheless, judging by yield MREITs might be attractive as some are offering double-digit yield. [see table]

For example, based on the unit price level of 90.5 sen per unit, YTL Hospitality REIT has an indicative yield of 10.4%. Meanwhile, Hektar REIT has an indicative yield of 21.08%, based on unit price of 48 sen.

The expected economic recovery should enable REITs to achieve better earnings, which will in turn translate into higher distributable income for the REITs.

UOB Kay Hian Research's head of research Vincent Khoo is among those who are upbeat about MREITs. Khoo said that they remain overweight about REITs with a view that the benefits of an economic reopening would outweigh the impact of the projected interest rate hikes.

"REITs still offer much higher yields over fixed income investments even after factoring in many rounds of rate hikes," Khoo said when contacted.

Khoo added that the research house's top picks for the sector are Sentral REIT and Sunway REIT as they hold diversified property portfolios which include retail and commercial properties.

Nevertheless, there are other factors at play that might make REITs less attractive, or become riskier for some investors' appetite.

Besides pandemic woes, Loong and Aqilah from RHB cautioned that the medium-term overhang factor for the retail sector caused by underlying oversupply situation — with nine new malls totalling 4.71 million square feet due to be opened in 2022 within the Klang Valley — and the expectation that yields will be lacklustre against the anticipated interest rate hike in the second half of 2022 make REITs unappealing at the moment as a yield play.

The REITs with exposure to the hospitality sector would also continue to suffer in 2022 as the pressure on average room and occupancy rates will remain for as long as movement restrictions are in place, according to RHB.

The analysts added that even though the interstate movement restrictions have been relaxed and staycation promotions have picked up, the developments "have not actually translated into meaningful recovery for the hotels owned by REITs within the past 20 months".

"Corporate bookings for events, which also make up the bulk of a hotel's top line, have also been on a downtrend, as mass gatherings are prohibited. We expect to see only a mild pickup in corporate bookings, as virtual meetings and events are here to stay.

"We believe the challenging operating environment for hotels is further exacerbated by the threat of alternative accommodations available," the report highlighted.

Loong and Aqilah added that investors should be selective with which REITs to invest in as asset quality will play a significant role to ride on the wave of the recovery theme.

"We like REITs with solid assets that are strategically located and have a shopper profile that is less dependent on tourism — in view of the still closed international borders — like IGB REIT," the analysts wrote.