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Capital: Reit Watch: Looking to the future, S-REITs with local sponsors expand overseas

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With Singapore's finite land area and small real estate sector, real estate investment trusts have had to go overseas to expand their portfolios.

As the capitalisation rate of Singapore properties continues to compress, buying property overseas has helped local developer-sponsored REITs with yield accretion. Another plus point for local S-REITs to expand overseas is the support from investors. These REITs are familiar to local investors, and their strong corporate governance has endeared them to other Asian investors. Thus, S-REITs can continue to expand, funded by a growing investor base.

Asked what the future holds for S-REITs, Eng Seat Moey, head of equity capital market, DBS Group Holdings, tells The Edge Singapore: "S-REITs are able to expand and diversify their asset class and geography."

The geography of choice for S-REITs such as Keppel REIT, Ascendas REIT, Cache Logistics Trust, Suntec REIT and AIMS AMP Capital Industrial REIT is Australia because of its transparent Singapore-like property market. Investors have been content to fund this growth.

As at March 18, two-thirds of S-REITs and business trusts hold foreign property. Only 12 REITs are pure-play Singapore REITs (see chart).

The trend of acquiring overseas assets is not a recent occurrence, but has been ongoing. One of the first REITs to go overseas was CDL Hospitality Trusts, which was first to enter New Zealand in 2006, and subsequently acquired a portfolio of Australian hotels in 2010. It has since diversified to the Maldives in 2013, Japan in 2014, the UK in 2015 and Germany in 2017. CDLHT is unable to acquire yield-accretive Singapore hotels, so it makes sense to go overseas to similar developed jurisdictions such as Australia and the UK.

Generally, hospitality REITs are geographically diversified. "Hotels are a cash-flow business, relying on occupancy, tourism, business travel and economic growth. If you rely on just Singapore, it's difficult to get scale," Eng says. Frasers Hospitality Trust will continue to do very well because it is geographically diversified, she adds.

Keppel REIT acquired its first Australian property — 77 King Street in Sydney — in 2010. It has since sold this property, but has expanded its Australian footprint gradually. Keppel REIT sees the Australian real estate market as one that has "developed with well-defined real estate regulations and an enforceable legal system that provides a stable environment conducive for investments". Today, 12.8% of its assets under management (AUM) is in in Australia, with the remaining in Singapore.

Suntec REIT acquired its first office building in Sydney — 177 Pacific Highway — in 2013. The property was completed in 2016. Australia

now contributes 12% to net property income (NPI).

Industrial REITs look to Australia for expansion

Ascendas REIT, which was listed in 2002 and started off as a Singapore-focused industrial REIT, is expanding in Australia. It initially acquired a couple of properties in China, which at one point accounted for 4% of AUM. The China portfolio did not quite fit and has been disposed of. Instead, Ascendas REIT has been acquiring assets in Australia, which now accounts for 16% of AUM.

In 2015, the REIT announced it was buying a portfolio of 26 logistics properties in Australia for A$1.01 billion from the real estate arm of GIC and Frasers Property Australia. The properties are located on freehold land in Sydney, Melbourne and Brisbane, and the acquisition established Ascendas REIT as the eighth-largest industrial landlord in Australia.

Ascendas REIT's investment target is for overseas markets to account for 20% to 30% of AUM. The REIT decided on Australia because of freehold land tenure, long weighted average lease to expiry (WALE), a positive yield spread and new high-quality tenants. The Australian logistics portfolio is leased to tenants on a triple-net basis (where the tenant pays all statutory outgoings and operating costs), thus operational demand will be minimal. "The Australian industrial real estate market is mature, transparent and provides opportunities for growth underpinned by domestic consumption and population growth," Ascendas REIT said at the time.

Ascendas REIT established an ownership structure in Australia that is tax-efficient. It is also building a portfolio of suburban office properties in Australia, which accounted for 4% of the total portfolio as at Dec 31.

In February 2015, Cache Logistics Trust diversified into Australia with the acquisition of three distribution warehouses in Australia — Chester Hill, New South Wales, Somerton Victoria and Coopers Plains Queensland — for A$70 million. The rationale was similar to Ascendas REIT's. Cache has been divesting of older properties with short land tenures and recycling the proceeds into Australia to enjoy freehold land and longer WALE.

Industrial property land tenures in Singapore are shorter than those of commercial property. In June 2010, the Ministry of Trade and Industry said sites to be sold in the industrial Government Land Sales would be capped at 30 years. Previously, industrial sites sold had tenures as long as 60 years. To compensate for the shorter land lease, NPI yield and cap rates need to be higher. REITs may have to start writing down property valuations as the land lease gets shorter.

"Most S-REITs have to go offshore to grow, given the limited opportunities here. Take, for example, Ascendas REIT, which in August 2015 changed its mandate to go to Australia. This made sense, as there are more opportunities there, and the market is deeper and more liquid. Furthermore, the currency is also in our favour," Eng says.

Yield-accretive acquisitions in US, Japan

Last year, Mapletree Industrial Trust announced a change of mandate to include data centres as one of its asset classes. Overseas data centre properties may comprise up to 20% of aggregate value of AUM, the REIT had said. Data centres are a fast-growing segment, and the ability to source opportunities in developed markets will avail the REIT of assets with freehold land and land with longer tenures. Data centre tenants are also likely to negotiate long leases, as they have high capital expenditure invested in these assets.

Last October, MINT took a 40% stake in a joint venture with sponsor Mapletree Investments to acquire a portfolio of 14 data centres in the US.

On Jan 16, MINT's sister REIT Mapletree Greater China Commercial Trust announced it was expanding its mandate to include Japan. On March 28, MGCCT announced the proposed acquisition of a 98.74% stake in a portfolio of six freehold commercial properties in Tokyo, Yokohama and Chiba for ¥60.93 billion ($753.4 million). Japan provides MGCCT with attractive acquisition opportunities because of largely freehold land tenure and at relatively higher yield spreads against local cost of funds, attributes that are absent in MGCCT's existing markets. After the completion of the acquisition, MGCCT will be renamed Mapletree North Asia Commercial Trust.

Singapore is a good place to list geographically diversified REITs. "The Singapore regulatory framework is more flexible, from the standpoint of acquiring foreign assets. Having a progressive regulatory framework is important to support the REIT eco-system. Look at where we started — from listing REITs with pure domestic assets, to S-REITs with a mix of domestic and foreign assets, to pure-play assets from overseas markets," Eng says.

While S-REITs have come a long way, the largest REITs — Ascendas REIT and CapitaLand Mall Trust, with AUMs of more than $10 billion — are viewed as mid-sized in a global market. "Although the S-REIT sector is the second-largest in Asia, it still has room to grow. Even Ascendas REIT is considered only mid-sized. It can grow outside Singapore. So, we [the S-REIT sector] are in a very good position to grow even bigger and build a deep international REIT market," Eng says.

As for S-REIT detractors — and there have been plenty over the years — Eng says: "You either like the S-REIT sector or you don't like it. S-REITs in general have very good assets. The REIT is a very transparent vehicle. You must like the manager and the assets. The assets must be quality assets in terms of cash flow and location."

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