

18 November 2024

Property | REITS

## Prime US REIT (PRIME SP)

**Buy** (Maintained)

### Priming For a Recovery; BUY

Target Price (Return): USD0.23 (+47%)  
 Price (Market Cap): USD0.15 (USD200m)  
 ESG score: 3.2 (out of 4)  
 Avg Daily Turnover (USD/USD) 1.26m/1.26m

- **Keep BUY and USD0.23 TP, 47% upside.** Prime US REIT's 3Q operational numbers were in line but distributable income was slightly below. We recently visited three of its assets in California. Key takeaways being management's pursuit for all-out leasing efforts that are slowly starting to bear fruit although the lead time remains long. Demand for high quality office space is steadily improving with an acceleration of flight to quality trend. Key risk remains inflation resurgence and interest rate volatility which could drag the anticipated US office market valuation recovery to 2026.
- **US election outcome a net positive for office demand but offset by likely delay in interest rate cuts.** Managements views the recent election result as a net positive for US office market demand - Donald Trump's tax cut proposals and policies are centred on creating more manufacturing jobs in the US, which in turn will likely spur employment for sectors such as R&D and production, as well as sales-related roles. Also, tariffs could prompt more multinational corporations (MNCs) to onshore jobs. The downside, however, is that a stronger economy could result in a persistent inflation and slower trajectory of interest rate decline. This could result in a delayed recovery for DPU and office sector valuations.
- **Good leasing momentum with occupancy improvement expected in the coming quarters.** PRIME signed ~210k sq ft of leases in 3Q, >2x that of in 2Q. Portfolio occupancy, however, slightly dipped to 83% as new lease signings were offset by tenant movement in some of its assets. Still, we believe PRIME is at near-trough portfolio occupancy levels with ongoing discussion on four large leases (c.60-100k sq ft), of which two are likely to materialise by early next year, bringing portfolio occupancy to >85% (from 83% currently). Rental reversion was +6.5% for the new leases signed during the quarter, with most leases having built-in annual rent escalations of 2-4%.
- **PRIME has completed refinancing of USD550m** of loans, and as such, has no debt maturing until Jul 2027 (including extension options). Average interest cost post-refinancing is expected at c.5%. We anticipate year-end valuation to range from 0% to -5%, which should keep gearing below the 50% level.
- **Waterfront at Washingtonian's asset enhancement** was completed in October, with the modernisation of tenant lounges, conference centre and full-service gyms. Occupancy increased 7ppts to c.40%, with another c.35k sqft of lease expected to be signed in 4Q, taking occupancy to 50%. PRIME is in active discussion with a large tenant, which, if signed, could stabilise the asset with ~80% occupancy.
- **We slightly lower our FY24F-25F NPI margin** due to lower recovery income, resulting in a c.5% lower distributable income and expect a 10% dividend payout. Our TP is pegged to 0.4x FY24F P/BV and includes a 2% ESG premium.

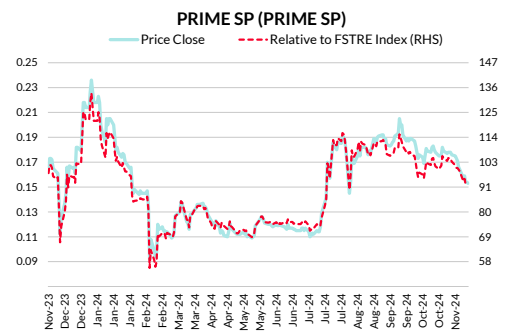
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(29.8)	(15.9)	(15.9)	37.8	7.7
Relative	(21.0)	(10.9)	(18.4)	34.2	10.8
52-wk Price low/high (USD)				0.09	-0.24



Source: Bloomberg

#### Overall ESG Score: 3.2 (out of 4)

##### E: EXCELLENT

11 out of the 12 properties in PRIME's portfolio are U.S. Green Building Council Leadership in Energy and Environmental Design (LEED) or Energy Star certified. PRIME has also undertaken additional long-term energy saving initiatives across six key assets.

##### S: GOOD

PRIME enhanced its workplace safety post COVID-19 using technology to ensure social distancing, upgrading air filters and increased cleaning frequency of high touch areas. To engage with tenants specifically, the property managers at PRIME's properties regularly held events with overall wellbeing in mind, such as Ice cream Socials, Lemonade Stands, Hot Dog Events, Holiday Breakfasts, Puppy Therapy, Friday Popcorn, as well as fitness classes.

##### G: GOOD

Majority independent board and clear delineation of roles between the board and management. Improving stakeholder engagements. Greater details in earnings quality as well as market outlook and update disclosures.

#### Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (USDm)	163	160	145	149	158
Net property income (USDm)	97.9	93.6	79.6	81.7	86.3
Reported net profit (USDm)	(27)	(116)	9	50	65
Total distributable income (USDm)	77.1	57.8	40.0	37.9	41.9
DPS (USD)	0.07	0.03	0.00	0.00	0.03
DPS growth (%)	(3.5)	(58.8)	(88.7)	(5.4)	895.1
P/B (x)	0.20	0.25	0.28	0.26	0.25
Dividend Yield (%)	42.9	17.7	2.0	1.9	18.8
Return on average equity (%)	(2.9)	(14.4)	1.2	6.7	8.2
Return on average assets (%)	(1.7)	(7.6)	0.6	3.6	4.4

Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Singapore	Recurring EPS (USD)	(0.02)	(0.10)	0.01	0.04	0.05
Property	EPS (USD)	(0.02)	(0.10)	0.01	0.04	0.05
<b>Prime US REIT</b>	DPS (USD)	0.07	0.03	0.00	0.00	0.03
PRIME SP	BVPS (USD)	0.76	0.60	0.55	0.59	0.61
Buy	Return on average equity (%)	(2.9)	(14.4)	1.2	6.7	8.2
	Weighted avg adjusted shares (m)	1,175.26	1,189.33	1,308.54	1,308.80	1,309.05
<b>Valuation basis</b>						
DDM	<b>Valuation metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Recurring P/E (x)	na	na	22.63	4.00	3.10
	P/E (x)	na	na	22.63	4.00	3.10
	P/B (x)	0.2	0.3	0.3	0.3	0.2
	FCF Yield (%)	49.2	33.6	12.9	23.8	34.0
	Dividend Yield (%)	42.9	17.7	2.0	1.9	18.8
	EV/EBITDA (x)	(8.46)	(6.56)	(7.73)	(8.31)	(8.41)
	EV/EBIT (x)	(8.46)	(6.56)	(7.73)	(8.31)	(8.41)
	<b>Income statement (USDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Total turnover	163	160	145	149	158
	EBITDA	87	85	71	73	77
	Operating profit	87	85	71	73	77
	Net interest	(22)	(28)	(30)	(34)	(35)
	Pre-tax profit	(41)	(116)	3	55	73
	Taxation	14	(0)	6	(5)	(8)
	Recurring net profit	(27)	(116)	9	50	65
	<b>Cash flow (USDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Change in working capital	(2.8)	1.0	(11.1)	0.8	1.1
	Cash flow from operations	89.2	85.6	51.3	70.9	88.8
	Capex	(0.6)	(24.4)	(25.3)	(23.2)	(20.7)
	Cash flow from investing activities	(30.1)	(24.3)	52.7	(23.2)	(20.6)
	Dividends paid	(76.9)	(64.3)	(4.0)	(3.8)	(37.7)
	Cash flow from financing activities	(61.3)	(61.1)	(125.5)	(19.8)	(53.3)
	Cash at beginning of period	13.9	11.6	11.8	11.3	38.1
	Net change in cash	(2.2)	0.2	(21.6)	27.9	15.0
	Ending balance cash	11.6	11.8	11.3	38.1	39.1
	<b>Balance sheet (USDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Total cash and equivalents	12	12	11	38	39
	Total investments	1,572	1,424	1,343	1,393	1,455
	Total assets	1,589	1,444	1,357	1,434	1,497
	Short-term debt	0	478	0	0	0
	Total long-term debt	666	218	607	627	650
	Total liabilities	695	730	635	661	694
	Shareholders' equity	894	714	722	773	804
	Total equity	894	714	722	773	804
	Net debt	654	685	596	589	611
	Total liabilities & equity	1,589	1,444	1,357	1,434	1,497
	<b>Key metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Revenue growth (%)	4.0	(2.0)	(9.1)	2.9	6.0
	Recurrent EPS growth (%)	(137.3)	325.3	0.0	465.2	29.0
	Operating EBITDA margin (%)	53.5	53.2	48.8	48.6	48.4
	Net profit margin (%)	(16.5)	(72.5)	6.1	33.5	40.7
	Dividend payout ratio (%)	(286.6)	(27.8)	45.2	7.6	58.4
	Capex/sales (%)	0.4	15.3	17.5	15.5	13.0
	Interest cover (x)	4.04	3.02	2.33	2.11	2.16

Source: Company data, RHB

## Key Takeaways From Our Site Visit

We visited three California assets: Park Tower (Sacramento submarket), Tower 1 at Emeryville (Emeryville submarket), and Sorrento Towers (San Diego submarket) in late October. Together these assets account for c.27% of total asset value and 23% of FY23 cash rental income. California has been one of the more challenged office markets in the US post-COVID-19, impacted by rising remote working trend as well as outbound migration. However, our site visit shows that some of these trends have started to reverse with some firms now starting to move back and also increasing headcount riding on the recent developments in artificial intelligence (AI) with the state being the key technology and start-up hub. Some of the other sector tenants that were seen expanding or looking for office spaces include healthcare, professional services, and consulting, with some consolidation of office spaces by a state government tenant. Below are some of our key takeaways from the site visit:

- i. **Return to office improving, but at a gradual pace.** California has been one of the hardest hit US office markets from remote working and work from home trends due to its key positioning as a hub for technology giants and start-up ecosystem. The trend though has now started to reverse, with employees' bargaining power on full remote work or hybrid options greatly reduced. More and more employers are asking employees to return to office for few days in a week citing employee productivity and collaboration as the key reasons. Based on our discussion with asset managers, a 3-day work from office schedule (Tuesday to Thursday) seems to be the most common;
- ii. **Safety and homeless situation being addressed and has positively aided PRIME's submarkets.** One of the key factors that has been driving tenant movement in many submarkets in California has been the increasing crime rate and worsening homelessness as well as the law and order situation, based on our discussion with consultants on the ground. As such, prospective tenants have been emphasising employee safety as a key priority and moving across to buildings in the submarkets which have a lower crime rate. Sacramento is one such market which we understand was impacted, but during our visit, we observed that the situation has greatly improved with increased in police patrol which is starting to bring back vibrancy in the area. Its Emeryville asset has also seen a positive spill over in demand from the Oakland submarket as a result of lower crime rate in the submarket and its proximity to the local police station, located adjacent to the building;
- iii. **Flight to quality trend** continues to accelerate as employers' key priority is to attract employees back into offices post-COVID-19. In order to achieve this, employers have been relocating into high quality office spaces which are surrounded by amenities and well connected to transport routes that can increase convenience for employees and thereby helping in attracting and retaining talent. It has to be noted that all of PRIME's assets are Class A buildings and are considered to be among the better-quality assets in the respective submarkets;
- iv. **Amenities, collaboration space and tenant engagement activities taking centre stage for tenants in choosing the right assets.** Building on the theme of attracting employees back to office for more collaboration and increase in productivity, local consultants note a strong emphasis by prospective tenants on amenities such as surrounding eateries and facilities such as gyms, common meeting areas and cafes are becoming a must in order to attract large tenants. We also noticed that most of the tenants in the building have revamped their office spaces to include large meeting rooms, quiet rooms for calls, video conferencing facilities, play areas as well as indoor cafe and relaxation spaces in order to increase employee engagement. In addition, PRIME has also been increasing its efforts on tenant engagement by conducting various monthly tenant activities in order to foster greater bonding;
- v. **Nearing the tail-end of downsizing and right sizing of office spaces** as more of the longer leases signed pre-COVID-19 has been expiring over the last three years and employers have right sized their spaces to better suit their needs. This in turn will slowly reduce the overall downward pressure on demand, in our view;
- vi. **Bigger tenants placing emphasis on landlord's financial position**, especially when signing larger floor plates in the building for a longer term. This is in order to ensure that the landlord would be able to fulfil its tenant improvements and incentives as well as reduce the hassle of moving out should a distress sale happen;
- vii. **Consolidation another key trend with pockets of expansionary demand**, especially in sectors such as healthcare, R&D, engineering and professional services.

### Park Tower, Sacramento

Park Tower is located in Sacramento, California and is part of the central business district (CBD) submarket within Sacramento's primary market. It is a prominent 24-storey Class-A office tower with a complimentary shuttle service and easy access to Light Rail and regional transit (RT) bus service. The asset underwent significant improvements in 2017 and features newly renovated amenities including a three-storey atrium lobby, fitness centre, locker rooms, conference centre and tenant lounge.

As at end-3Q, Park Tower occupancy stood at 68.3% (4Q: 72.5%). One of the key reasons for the decline in asset occupancy over the last two years based on our ground checks was the worsening homeless situation in Sacramento and an increase in crime rate. This coupled with more prevalent work from home trends in the market (in particular by the State Government) has resulted in higher vacancy levels in the market as tenants relocated to other markets and downsized their spaces. However, during our recent visit, we noticed that the ground situation has vastly improved with the local authorities taking active steps to address the homeless situation and increase police patrol in the area which has resulted in higher commercial activity in the market.

A key highlight of Park Tower is its proximity to the State Capitol building which is three blocks away and also near the newly developed Downtown Commons and Golden -1 Center, a mixed-use hotel, entertainment and shopping complex that serves as the home of the US professional basketball team Sacramento Kings. Because of the proximity and walking distance to the State Capitol building, a key government tenant is currently in advanced stages of taking over 100,000 sq ft in the asset in order to consolidate some of its employees from other nearby properties. This should increase the occupancy of the asset to over the 80% level and expected signing rents are likely to be in line with the market, which are currently slightly above the average passing rent at the asset. Based on our discussions, it is currently in advanced stages with a signing likely to materialise by end 2024 or early next year.

On the other hand, the recent bargain sale of 400 Capitol Mall located nearby is likely to create some valuation pressure on the asset during the year-end valuation as valuers consider recent comparable market transactions. Park Tower was acquired in Feb 2020 for USD166m and since then, its valuation has declined by ~14% mainly due to rising cap rates. As such, we believe asset valuation will come in lower by 5-10% during the year-end valuation.

**Figure 1: Park Tower, Sacramento**

Source: Company data

**Figure 2: Asset overview and key metrics**

Building Class	A
Sub market	Downtown Sacramento
NLA	489,171
Year built/ Renovated	1992
Acquisition date	Feb-20
Committed occupancy (%)	68.3
Valuation at end-Dec 2023 (USDm)	143.0
Purchase price (USDm)	165.5
Number of stories	2
Market Rents (psf pa)	25
Average In-Place	39.60 -42.60
Rent Reversion (last 12m)	34.92
Key tenants	State of California (11.6%), ICF Consulting (7.2%), and Delta Conveyance (5.4%)

Source: Company data, RHB,

Figure 3: Refurbished lobby space at Park Tower



Source: RHB

Figure 4: View of downtown Sacramento from Park Tower



Source: RHB

### Tower 1 at Emeryville

Tower 1 is a 12-story Class A multi-tenant office building located in the Emeryville submarket which is part of the East Bay-Oakland Metropolitan Office Market, and just a few minutes' drive east of downtown San Francisco. Tower 1 at Emeryville lies in close proximity to the Oakland International Airport and enjoys views of the San Francisco Bay, the San Francisco skyline, Golden Gate Bridge and Treasure Island. Its easily accessible via public transportation through Amtrak, AC Transit, and free shuttle connecting Emeryville's employers and shopping centres with the MacArthur Bay Area Rapid Transit (BART) station and also has quick access to Interstate-580, which passes from San Rafael in the Bay Area to Tracy in the Central Valley. This asset was acquired as part of PRIME's core IPO portfolio.

A key highlight of the asset, in our view, is the high-quality amenities offered which includes a new modern full facility gym, stylish lobby and visitor meeting areas, a huge indoor basketball court which can be used for other sporting events and yoga studio. All these facilities are currently complementary to the tenants. In addition, amenities available within the asset include a full-service bank, dry cleaners, car wash and locker rooms.

The asset was also hit by the increase in market vacancy over the last two years from an exodus of companies out of San Francisco. But we understand that the Emeryville submarket is gaining more favour among prospective tenants currently looking to move in from the neighbouring Oakland submarkets due to its greater security and safety aspect. Tower 1 is annexed by the City of Emeryville Police Department which enhances the safety and security of the asset. The asset also offers an unblocked view of San Francisco Bay which we believe is an additional advantage.

Healthcare R&D-related tenants are currently the key anchor tenants for the asset and we understand that there is potential for some of these tenants to expand into this asset in future. Additionally, we understand there are a few prospective tenants from neighbouring markets that are currently looking at the asset for relocation. Over the medium term, a greater potential for the asset based on our discussion with consultants lies in the spill over demand from the rise in AI-related start-ups and ecosystem demand in San Francisco. Currently the rents in this submarket are nearly half that of San Francisco's CBD area and as such, presents good value for emerging technology sector tenants.

Figure 5: Tower 1 at Emeryville



Figure 6: Asset overview and key metrics

Building Class	A
Sub market	East Bay
NLA	222,606
Year built/ Renovated	1979/ 2011
Acquisition date	Jul-19
Committed occupancy (%)	74.2
Valuation at end-Dec 2023 (USDm)	104.3
Purchase price (USDm)	121.1
Number of stories	12
Market Rents (psf pa)	51 -54.60
Average In-Place	45.28
Rent Reversion (last 12m)	-4.2%
Key tenants	Regus (17.1%), Adamas Pharmaceuticals (16.9%), and Beigene (8.5%) BioMade (8.5%)

Source: Company data

Source: Company data, RHB,

Figure 7: Views of San Francisco Bay from Tower 1 at Emeryville



Source: RHB

Figure 8: Meeting lobby and play area for tenants



Source: Company data

### Sorrento Tower, San Diego

Sorrento Towers (ST) San Diego, California and is part of the Sorrento Mesa submarket, a technology and life science hub, was the third and the final asset we visited. ST comprises two 7-storey Class-A office towers above a 3-storey podium garage with an NLA of 296,327 sq ft.

ST was last refurbished in 2020 and offers amenities such as state-of-the-art fitness centre, conferencing spaces, a training centre, and multiple outdoor, collaborative meeting areas. We were highly impressed with the newly refurbished assets amenities such as a grand lobby entrance, high-end spa and full-fledged gym facility in the asset which stands testament to the good asset quality.

It is well connected to the local and regional transportation arteries, including Inland Freeway (I-805), and Sorrento Court shopping centre that offers two dozen eateries, banking, and lifestyle amenities. The amenities and nearby eating facilities were one of the key reasons highlighted by tenants and is also well-liked and utilised by employees based on our ground checks. This in turn attracts footfall from neighbouring office building tenants as well.

Due to its strong location and amenities, the asset remains highly occupied over the years with current occupancy at 96.3%. One of the towers is fully leased to anchor tenant Dexcom until May 2028, which currently serves as its global headquarters. During our visit, we noticed that the tenants had heavily invested in their office spaces with state-of-the-art conference rooms, cafes and meeting rooms inside their premises which indicates these tenants are likely to stay for a longer term.

Overall, the market has been witnessing an increase in demand, particularly from healthcare-related tenants based on our discussion with consultants. The asset was acquired in Jul 2021 for USD146m and is currently valued c.14% below that due to cap rate expansion. But we believe this asset offers a good upside potential for valuation increases when interest rate stabilises.

Figure 9: Sorrento Towers



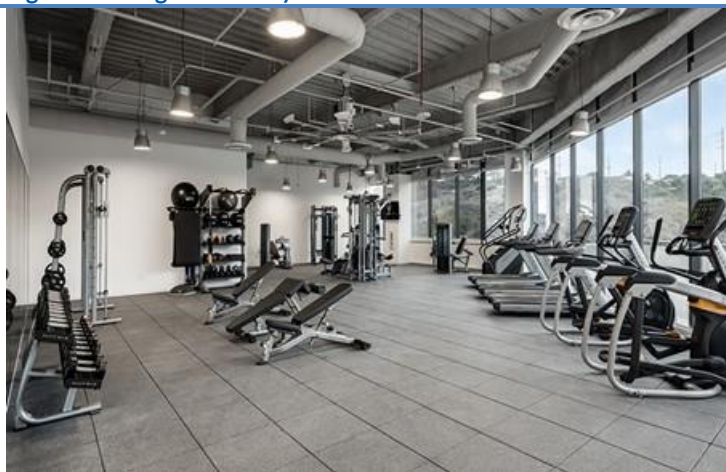
Source: Company data

Figure 10: Asset overview and key metrics

Building Class	A
Sub market	Sorrento Mesa
NLA	296,327
Year built/ Renovated	1989/2020
Acquisition date	Jul-21
Committed occupancy (%)	96.3
Valuation at end-Dec 2023 (USDm)	125.0
Purchase price (USDm)	146.0
Number of stories	7
Number Of Buildings	2
Market Rents (psf pa)	46.20 - 48.60
Average In-Place	43.99
Rent Reversion (last 12m)	6.3%
Key tenants	Dexcom (50%), FF Properties (19.9%), and Anokiwave (7.3%) TSMC North America (3.1%)

Source: Company data, RHB

Figure 11: Huge and newly furnished fitness studio



Source: Company data

Figure 12: Meeting rooms at Sorrento Tower



Source: Company data

## Emissions And ESG

### Trend analysis

In 2023, PRIME's operations totalled 24,409 tCO2e of which 95% was attributed to Scope 2 emissions. This represents an 8% decrease GHG emissions over previous year partially attributable to lower physical occupancy and management efforts to actively manage energy consumption. Overall water consumption from operations too saw a 1.3% YoY reduction for 13 properties (excluding One Town Center).

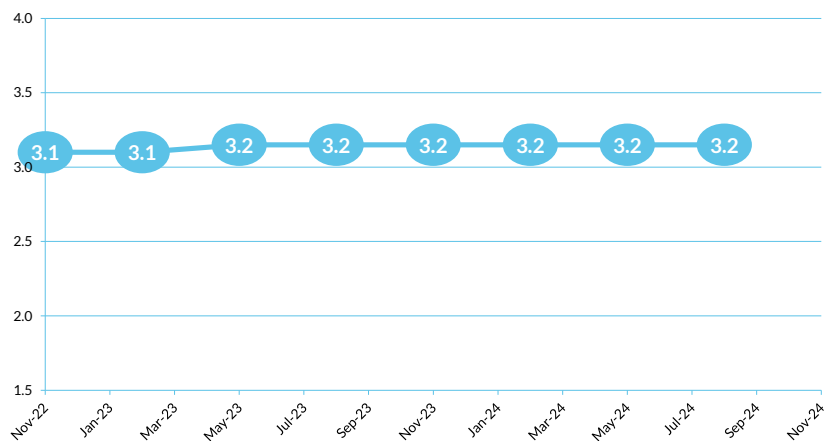
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	na	1,023	1,162
Scope 2	18,761	25,501	23,247
Scope 3	na	na	na
Total emissions	18,761	26,524	24,409

Source: Company data, RHB

## Latest ESG-Related Developments

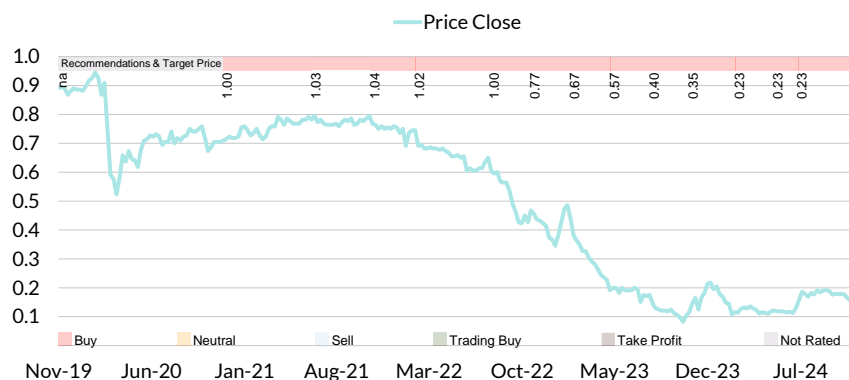
- In Feb 2023, PRIME partnered with Gridium to achieve significant energy savings and attract ESG-focused tenants.
- The newly implemented Gridium software combines utility smart meter data, utility bill data, weather data and industry benchmarking into tools to help better manage energy performance.
- PRIME also engaged in various tenant and community activities across its assets in order to improve tenant bonding.

## ESG Rating History



Source: RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-10-07	Buy	0.23	0.17
2024-07-16	Buy	0.23	0.14
2024-05-21	Buy	0.23	0.13
2024-02-23	Buy	0.23	0.12
2023-11-08	Buy	0.35	0.14
2023-08-11	Buy	0.40	0.18
2023-05-11	Buy	0.57	0.19
2023-02-09	Buy	0.67	0.45
2022-11-09	Buy	0.77	0.44
2022-08-08	Buy	1.00	0.66
2022-02-17	Buy	1.02	0.75
2021-11-07	Buy	1.04	0.80
2021-08-04	Buy	1.03	0.75
2021-06-24	Buy	1.03	0.80
2021-02-18	Buy	1.00	0.76

Source: RHB, Bloomberg



## RHB Guide to Investment Ratings

<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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