

19 August 2020

Property | REITS

REITs

Overweight (Maintained)

Well-Poised To Weather COVID-19 Challenges

- **Maintain sector OVERWEIGHT; BUY Manulife US REIT (MUST) and Keppel Pacific Oak US REIT (KORE).** Although COVID-19 infections continue to rise sharply in the US, Singapore-listed US office REITs posted robust 1H20 results, with positive operating metrics. Concerns remain on the sustainability of this growth, but our comparison shows all three REITs should be able to weather headwinds – backed by asset diversification, long WALE, and healthy balance sheets. Valuations are cheap, with segmental yields averaging 8.3%, or 280bps higher than office S-REITs.
- **2H20 DPU to remain resilient.** All three US office REITs (including Prime US REIT, which is not in our coverage) posted higher 1H20 DPU (Figure 2), as rental escalations, stable occupancy rates, and acquisition contributions more than offset rental deferrals and lower carpark income. Rental collection for 2Q20 was also healthy at 92-99%, with minimal abatements (Figure 1). Our discussions with REIT managers confirm that, despite COVID-19, requests for additional rental abatement/deferrals have been minimal, as properties were still operational. Lease expiries for all three REITs also remain low at c.3%. This, together with healthy rental collection, leads us to expect stable DPU for 2H20.
- **Well-supported by organic and inorganic growth potential.** Gearing for all three US office REITs remains <40% (well below 50% threshold), with Prime US REIT's being the lowest, at 33% and with the longest debt maturity of 5.1 years. With financial market conditions being more favourable now, coupled with depth in US office market and sponsor strength presenting opportunities, the likelihood of acquisitions in 2H20 is high. Note that the majority of office leases in the US have in-built rental escalations of c.2-3%, which provides organic DPU growth.
- **No discernible leasing impact of work-from-home (WFH) trend so far.** MUST cited recent studies showing that the WFH trend had been quite prevalent even before the COVID-19 pandemic, with 54% of employees in the US having access to such benefits. It also shared that, based on new surveys, only 12% of employees prefer the WFH option vs 10% prior to the pandemic. While leasing activities have slowed down, the latest JLL report indicates that demand is supported by the tech and finance sectors, with larger leases mainly from government, health, and health insurance. In our view, the impact of flexible office space is likely to pare down long-term demand (~5%) – but this may be partially offset by de-densification trends and moderate supply, which has been further pushed back.
- **Long WALE and below-market rental offer additional comfort.** US office REITs' WALE periods are long (c.4-6 years), with MUST having the highest, at 5.7 years. Tenants are also well-diversified with no sector accounting for >30% overall, and no single tenant occupying >10% for all three REITs. In-place average rentals for REITs are also below rates for KORE (c.10.8% lower), Prime US REIT (c.7.5% lower) and MUST (-19% to +1%, ex-Centerpointe and Michelson, which have above-market rates).
- **Key risks** are a prolonged economic downturn, collapse of co-working office players, and policy uncertainties from the upcoming US election.

Stocks Covered	2
Rating (Buy/Neutral/Sell):	2 / 0 / 0
Last 12m Earnings Revision Trend:	Positive

Top Picks

Target Price

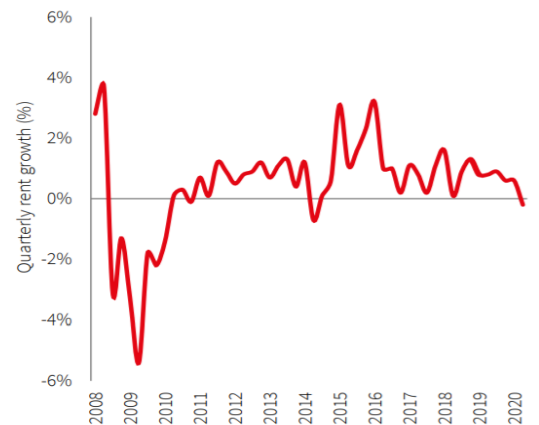
Manulife US REIT (MUST SP) - BUY	USD0.90
Keppel Pacific Oak US REIT (KORE SP) - BUY	USD0.80

Analyst

Vijay Natarajan
 +65 6232 3872
vijay.natarajan@rhbgroup.com



US Office Sector Quarterly Rent Growth



Source: JLL

Company Name	Rating	Target Price(USD)	% Upside (Downside)	P/E (x) Dec-20F	P/B (x) Dec-20F	Yield (%) Dec-20F
Keppel Pacific Oak US REIT	BUY	USD0.80	10.5	12.3	0.9	8.2
Manulife US REIT	BUY	USD0.90	21.9	13.6	0.9	8.3

Source: Company data, RHB

Figure 1: US Office S-REITS – a comparison*

S.No	Factors	Manulife US REIT	Keppel Pacific Oak US REIT	Prime US REIT**
Asset and sponsor details				
1	Total number of assets	Nine freehold properties	13 freehold properties	12 freehold properties
2	Asset size (USD bn)	2.0	1.3	1.4
3	Asset class	Trophy & Class A	Class A & Class B	Class A
4	Market locations (as % of AUM)	Atlanta (21%), Jersey City (17%), Los Angeles (16%), Irvine (16%), Sacramento (10%) Washington DC (9%), Virginia (6%), and Secaucus (6%)	Seattle (49.3%), Houston (10.7%), Denver (10.5%), Dallas (8.1%), Orlando (7.6%), Austin (7.2%), Atlanta (3.4%), and Sacramento (3.2%)	Salt Lake City (16%), Denver (16%), Atlanta (13%), Sacramento (12%), Washington DC (10%), San Francisco Bay Area (9%), Philadelphia (7%), St. Louis (6%), Dallas (6%), and San Antonio (5%)
5	Key tenants (Top 3) - as % of gross rental income	The William Carter Co (6.2%), TCW Group (4.0%), and Kilpatrick Townsend (3.6%)	Ball Aerospace (3.5%), Oculus VR (2.4%), and Lear (2.1%)	Charter Communications (8.8%), Goldman Sachs (6.1%), and Sodexo Operations (5.5%)
6	Key trade sector (Top 3) - as % of gross rental income	Legal (22%), finance and insurance (20%), and retail trade (13%)	Technology (29%), professional services (28%), and finance and insurance (21%)	Finance (14%), communications (13%), and real estate (9%)
7	Sponsor	Manulife	Keppel Capital and Pacific Oak Capital Advisors (KPA)	KBS Asia Partners
8	Sponsor stake	Manulife (7.4%)	KPA (7.7%), Keppel Capital (7.7%)	KBS Units (27.5%)
9	Sponsor size – AUM	Manulife Global Real Estate AUM: USD18.8bn	Pacific Oak Capital Advisors: >USD3.2bn	KBS AUM: USD 11.6bn
Operating metrics				
10	Portfolio occupancy rate	96.2%	94.3%	93.0%
11	Total tenants	182	>440	230
12	Top 10 tenants' contribution (%)	34.7	19.5	40.8
13	Rental escalations	1.9% pa	2.6% pa	2% pa
14	WALE (years) - by cash rental income	5.7 years	4.1 years	4.8 years
Balance sheet metrics				
15	Gearing	39.1%	37.4%	33.0%
16	Debt Profile	Fixed - 92.7%	Fixed - 84.3%	Fixed - 90%
17	Weighted Average Debt Maturity	2.3 years	2.5 years	5.1 years (fully extended)
18	Debt Cost	3.21% pa	3.34% pa	2.6% pa
19	Portfolio Unencumbered	31.7%	100%	NA
20	Management fees paid in Units	100%	100%	80%
COVID-19 impact and trends				
21	Rental collection (2Q)	96%	~92%	99%
22	Rental deferment and abatement	Rental deferment: 0.3% Rental abatement: 0.3%	Rental relief: ~2.8%	0.2% rental deferrals with no abatements
23	Co-working space (%)	~2	~2%	2%
24	Rental Reversion (1H20)	7.9%	14.7%	8.5%
Valuation metrics				
25	Market cap (USDm)	1,188	663	833
26	Dividend yield - FY20F	8.1%	8.4%	8.6%
27	Payout ratio (%)	100%	100%	100%
28	NAV per share (USD)	0.76	0.77	0.87
29	P/BV (x)	1.0	0.9	0.9
30	Free float (%)	93%	79%	52%

Note: * Based on latest available company data and price close as at 17 Aug, ** Dividend yield is based on Bloomberg estimates

Source: Company data, Bloomberg, RHB

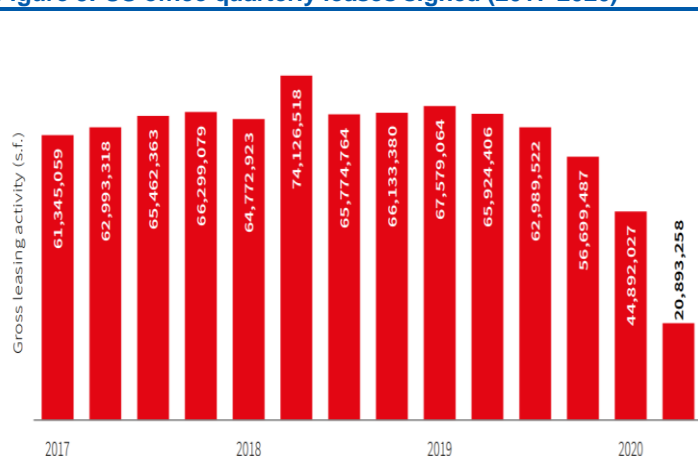
Results Summary And Key Sector Charts

Figure 2: US Office REITs – 1H20 results scorecard

(USDm)	Manulife US REIT		Keppel Pacific Oak US REIT		Prime US REIT	
	1H20	% YoY	1H20	% YoY	1H20	vs Forecast
Gross revenue	98.6	18.3	70.5	20.1	71.2	5.7
Net property income	62.2	18.8	41.9	15.7	47.5	7.6
NPI margin (%)	63.0	0.2ppt	59.4	-2.2ppt	66.6	1.2ppt
Distributable income	48.0	20.0	29.1	17.6	35.9	15.0
DPU (USD cents)	3.05	0.3	3.10	3.3	3.52	5.1

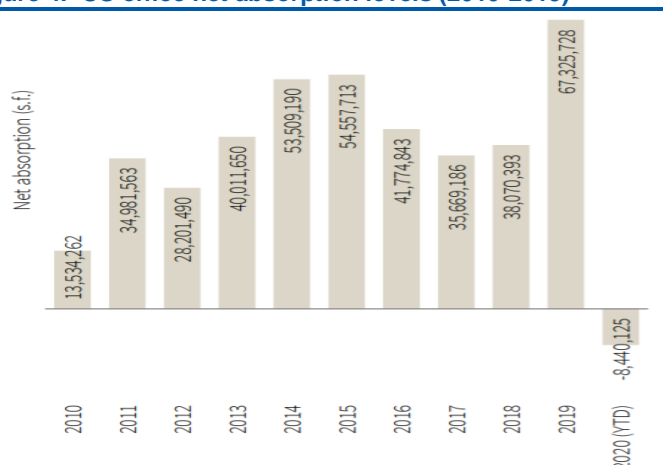
Source: Respective Companies, RHB

Figure 3: US office quarterly leases signed (2017-2020)



Source: JLL Research 2Q20

Figure 4: US office net absorption levels (2010-2019)

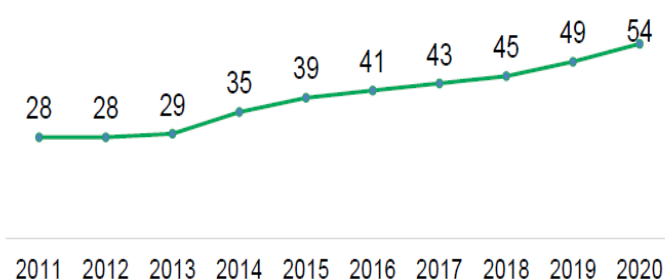


Source: JLL Research 2Q20

Figure 5: Rising trend of WFH benefits (%)

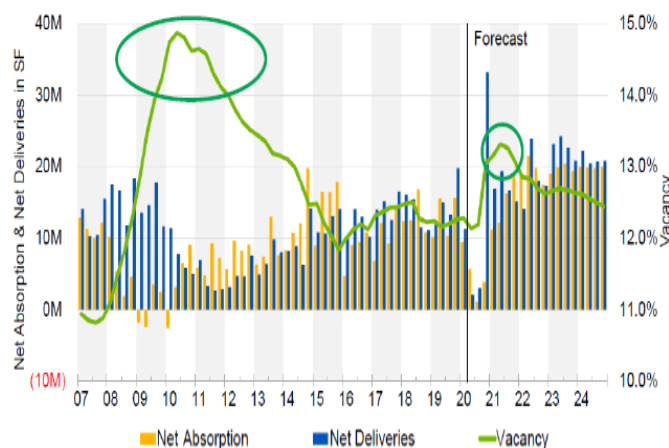
54%¹ Eligible to Work from Home (WFH) before Pandemic

Access to WFH Benefits¹ (%)



Source: Glassdoor Economic Research – Mar 2020, MUST

Figure 6: Net absorption, net deliveries and vacancies



Source: CoStar Office Big Book – Jun 2020, MUST

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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KUALA LUMPUR

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

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RHB Securities Singapore Pte Ltd.
10 Collyer Quay
#09-08 Ocean Financial Centre
Singapore 049315
Tel : +65 6533 1818
Fax : +65 6532 6211