Manulife Asset Management

Investment Note

23 February 2018

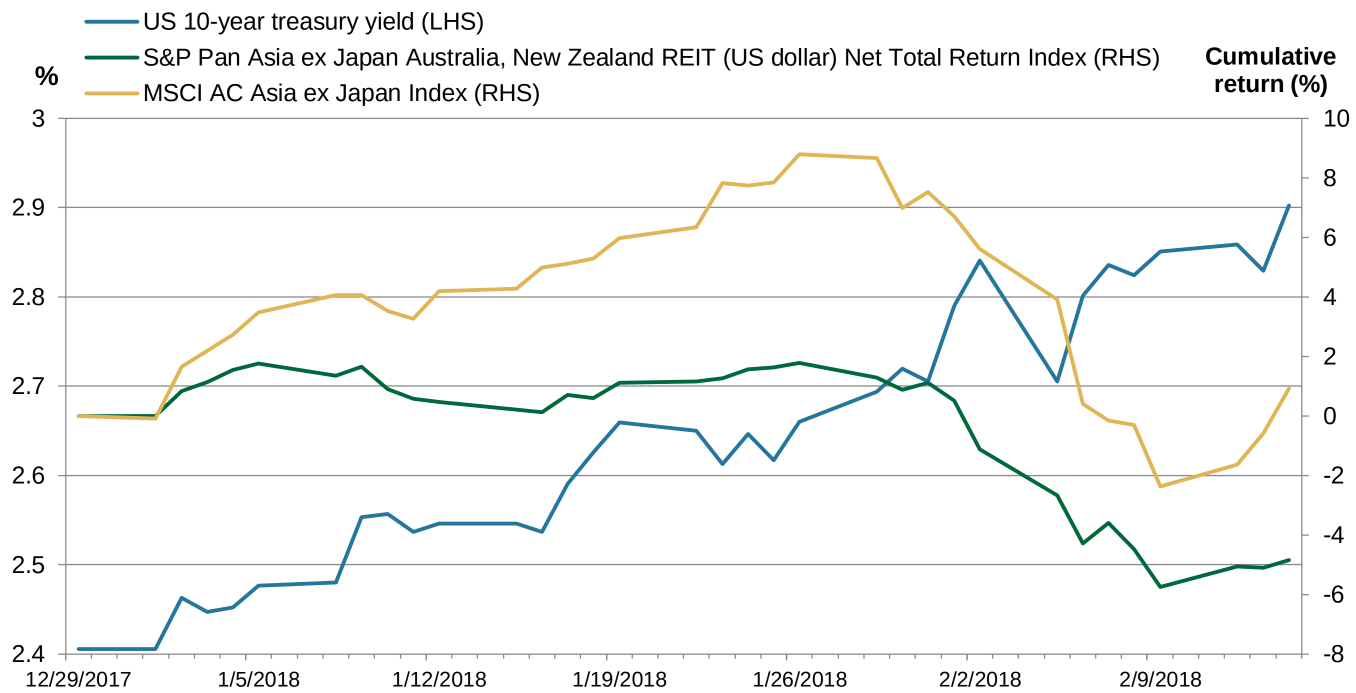
AP REITs: Stable performance continues

In the past month, Asian markets have experienced increased volatility. Amidst these market movements, the Singapore Equities team believes that Asia-Pacific REITs (AP REITs) will continue their stable performance. Economic conditions are improving and the fundamentals of AP REITs have not changed: Singapore REITs reported in-line results for 2017; regional REITs have issued positive guidance for 2018. Finally, AP REITs have historically posted positive performance during time periods of rising interest rates making them an attractive investment.

Quick glance of the Asia Pacific REITs market for 2018

We believe that the fundamentals of the Asia Pacific REITs (AP REITs) market are unchanged given the recent market volatility. As expected, AP REITs were not immune to the initial sell off in equity markets (see Figure 1). However, their fundamentals remain sound. In Singapore, REITs have reported generally in-line results for 2017 with no disappointments or surprises[1]. Guidance has generally been positive from regional REITs for 2018 as rental recovery is still expected on the back of continued economic growth.

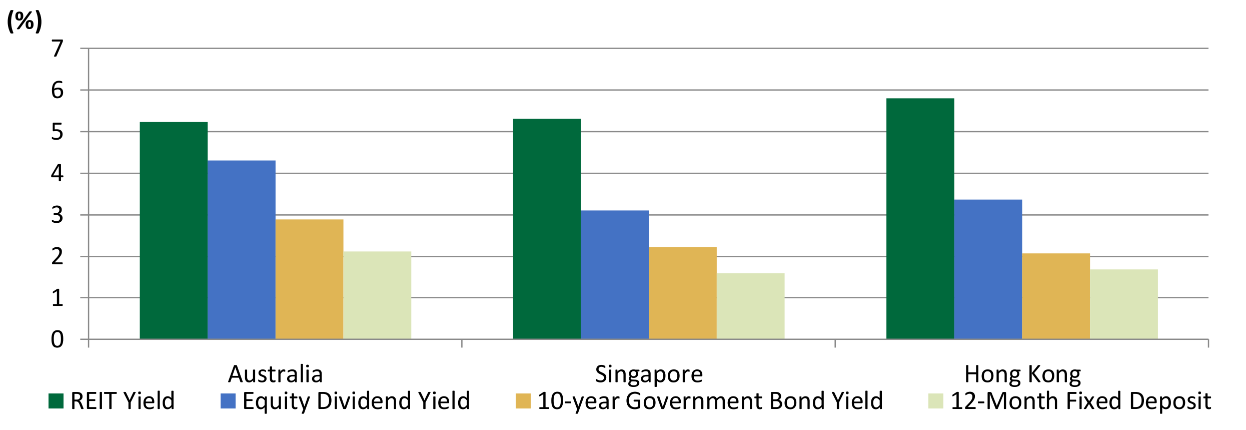
Figure 1: AP REITs performance in 2018[2]



[1] BofA Merrill Lynch, 2018.
[2] Bloomberg, as of 14 February 2018.

In addition, following the most recent market sell-off, forward 12-month yields for AP REITs remain attractive relative to other asset classes (see Figure 2).

Figure 2: Yields for selected asset classes in Asia- Pacific[3]



History as a guidepost: Initial volatility followed by stable performance

Investors may worry about the prospect of future interest rate increases as developed countries' central banks undertake monetary tightening. In a rising interest rate environment, the two primary concerns for REITs are:

- Yield spread compression between the distribution per unit (DPU) yield of REITs and 10-Year government bond yields; and
- Increase in the cost of re-financing existing debt. However, the balance sheets of AP REITs are strong with most of their debt locked in at fixed rates. The rise in current rates would not have a material impact on the distribution to shareholders. If we use Singapore as an example, the larger REITs current gearing is less than 40% while nearly 80% of their borrowings are locked in at fixed rates.[4]

As seen from Figure 3, AP REITs have historically shown resilience in previous interest rate hiking cycles. Although there is initially volatility for REITs around the expectations of the timing of interest rate hikes, overall performance has been positive in a rising interest rate environment.

[3] Bloomberg, as of 8 February 2018.
[4] Source: BofA Merrill Lynch Global Research, Real Estate/Property – Singapore: SREITs wrap: Looking out for the turn. 1 February 2018.

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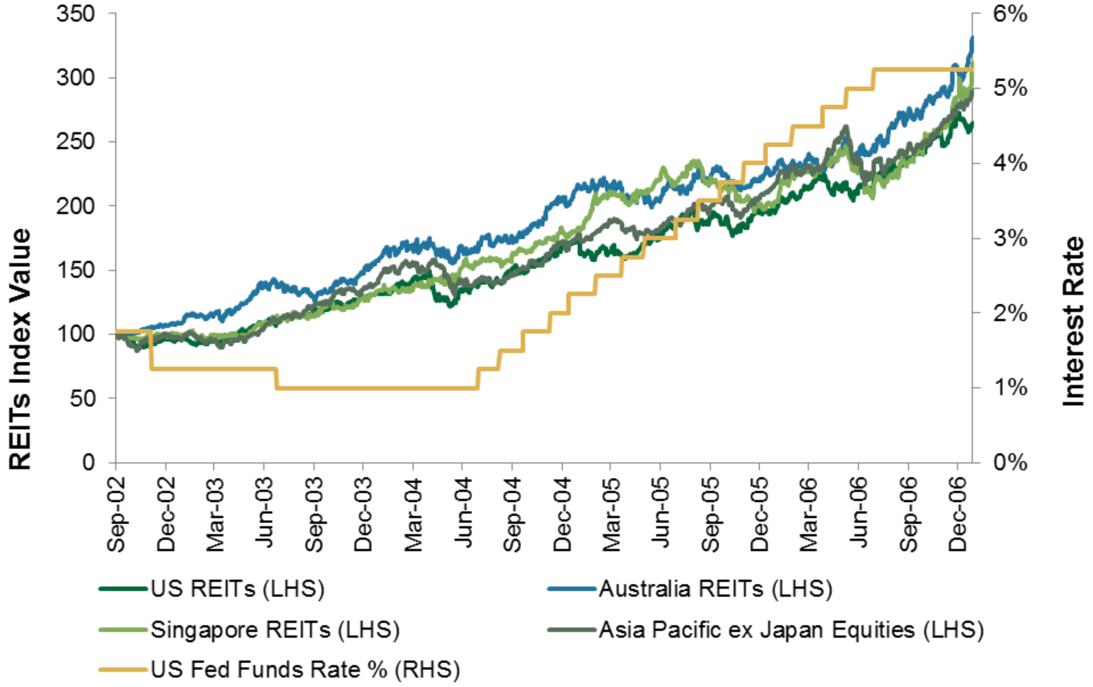
Figure 3: AP REITs performance in the previous rising interest rate environment[5]



While AP REITs may face difficulty outperforming the broader equity markets, our view is that they will remain stable performers given the improving economic environment and the attractive yields that REITs offer relative to other assets classes.

5 US REITs = MSCI US REIT Index, Australia REITs = S&P/ASX 300 A-REIT Index, Singapore REITs = FTSE ST REIT Index, Asia Pacific ex Japan Equities = MSCI AC Asia Pacific ex Japan Index. Performance figures are in US dollar, and were re-based to 100 from 2 September 2002. , based on total returns. Source: Bloomberg, Manulife Asset Management, as of 31 December 2006.

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