LION GLOBAL INVESTORS

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Rising Interest Rates and its Impact on Singapore Real Estate Investment Trusts

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BACKGROUND

The common perception is that a rising interest rate environment is negative for Real Estate Investment Trusts ("REITs"), with REITs being a yield-oriented asset class, as well as the relatively high leverage used by REITs. The US Federal Reserve has embarked on its latest rate hike cycle, with December 2015 seeing the first rate hike since 2006:

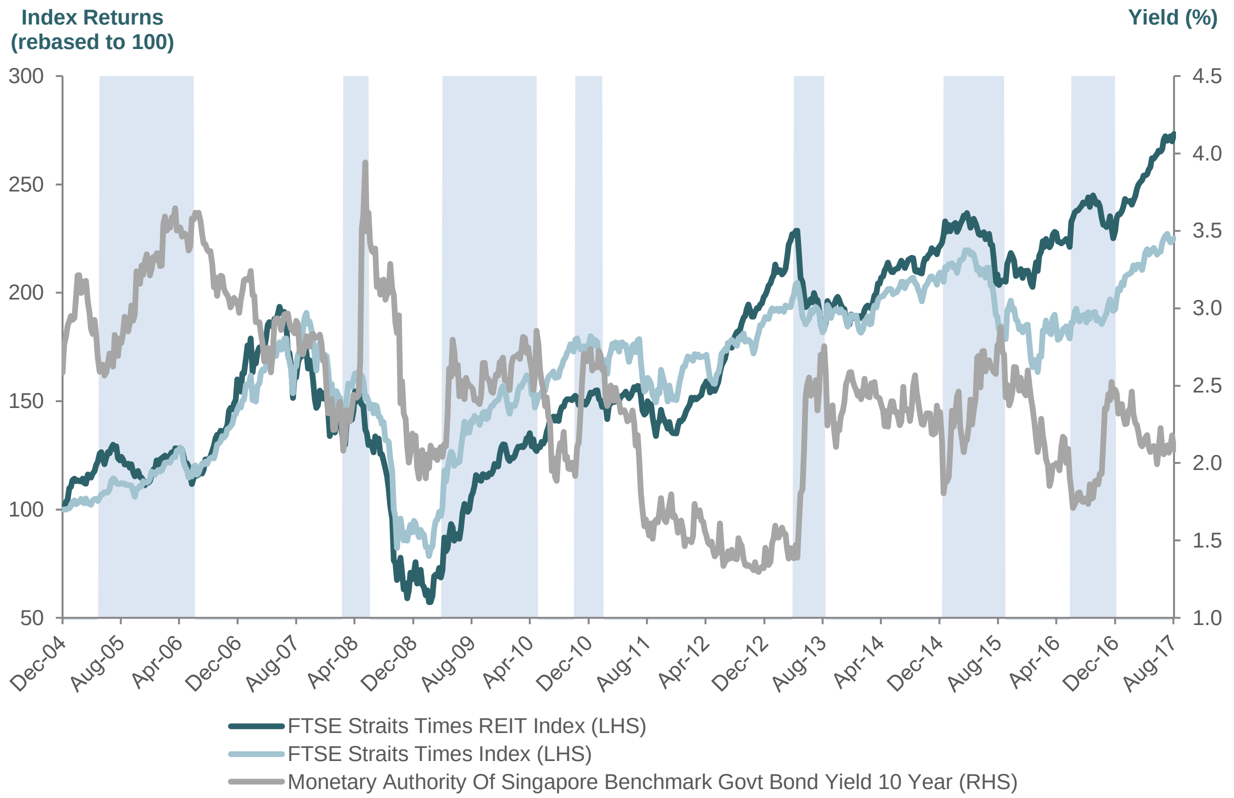
Period	Increment	Target Federal Funds Rate
December 2015	25 bps	0.25-0.50%
December 2016	25 bps	0.50-0.75%
March 2017	25 bps	0.75-1.00%
June 2017	25 bps	1.00-1.25%

Source: www.federalreserve.gov; as at July 2017.

The rate hike cycle is expected to continue. With Singapore pursuing a pass-through mechanism on interest rates, a rising interest rate is a key concern for potential REITs investors here. According to a CLSA report in April 2017, the 10-year Singapore Government Bond yield has traded on average within 5 bps of its US counterpart over the last five years.

INVESTORS CAN POTENTIALLY BE REWARDED FOR STICKING WITH SINGAPORE REITS

Nevertheless, we find that investors can potentially still benefit from an allocation to REITs in a rising interest rate environment. The chart below illustrates how the FTSE Straits Times REIT Index and the FTSE Straits Times Index performed against the changes in the 10-year Singapore Government Bond yield, for the period from January 2005 to June 2017:



Index returns are calculated on a total return basis in SGD terms. Past performance is not necessarily indicative of future performance.

Source: Lion Global Investors, Bloomberg; as at August 2017.

The table below shows the return numbers in various time periods with significant increases in the bond yield:

Period	Yield Increment (bps)	FTSE Straits Times REIT Index	FTSE Straits Times Index
Jun 05 – Jun 06	98	-5.88%	15.34%
May 08 – Jun 08	154	-4.53%	4.45%
May 09 – May 10	81	84.94%	53.84%
Nov 10 – Feb 11	69	-2.92%	-3.33%
May 13 – Sep 13	137	-19.13%	-7.14%
Jan 15 – Sep 15	90	-7.77%	-12.66%
Jul 16 – Dec 16	65	3.23%	7.52%

Index returns are calculated on a total return basis in SGD terms. Past performance is not necessarily indicative of future performance.

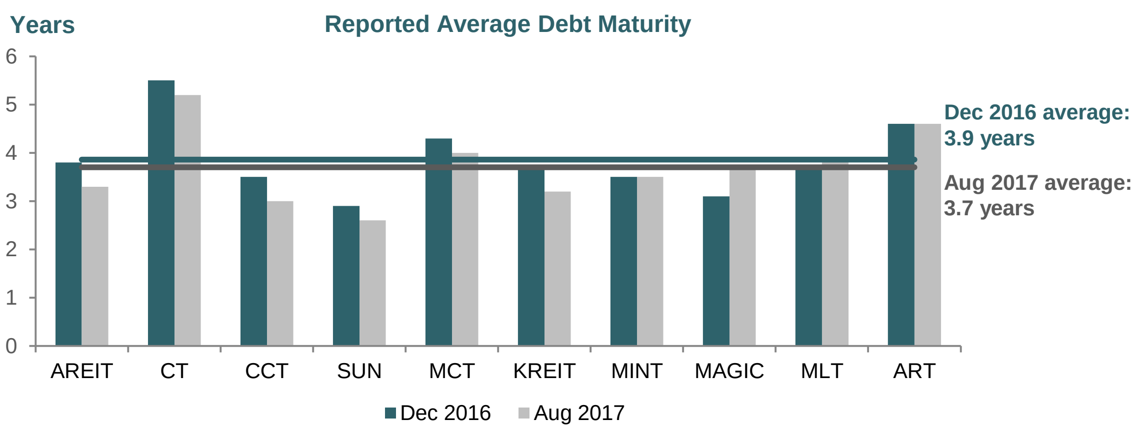
Source: Lion Global Investors, Bloomberg; as at June 2017.

We find that in 3 of the 7 time periods identified above (May 09 – May 10, Nov 10 – Feb 11, Jan 15 – Sep 15), Singapore REITs actually outperformed the broader Singapore equity index. These are also periods in which the interest rates increased on a relatively more gradual basis. Hence, it is not with certainty that Singapore REITs will underperform in a rising interest rate environment. We need to consider various sector- and stock-specific factors and catalysts that could potentially allow a Singapore REIT to outperform the broader market.

There are two key reasons why investors may choose to stick with Singapore REITs in a rising interest rate environment:

1) **Debt profile of Singapore REITs have improved**

With higher interest rates on the horizon, Singapore REITs have actively refinanced their debt maturities (average of 3.7 years) and maintained high fixed debt hedge ratios (average of 78%). Overall debt levels have also been kept at a manageable 36.6% average. These measures will help to mitigate the impact of higher borrowing costs in the near term, with lower rates and longer terms already locked in. The charts below illustrate the debt profile of the top 10 Singapore REITs by market capitalisation:



References to specific corporations/companies are not intended as recommendations to purchase or sell investments in such corporations/companies.

Source: Lion Global Investors, Bloomberg; as at August 2017.

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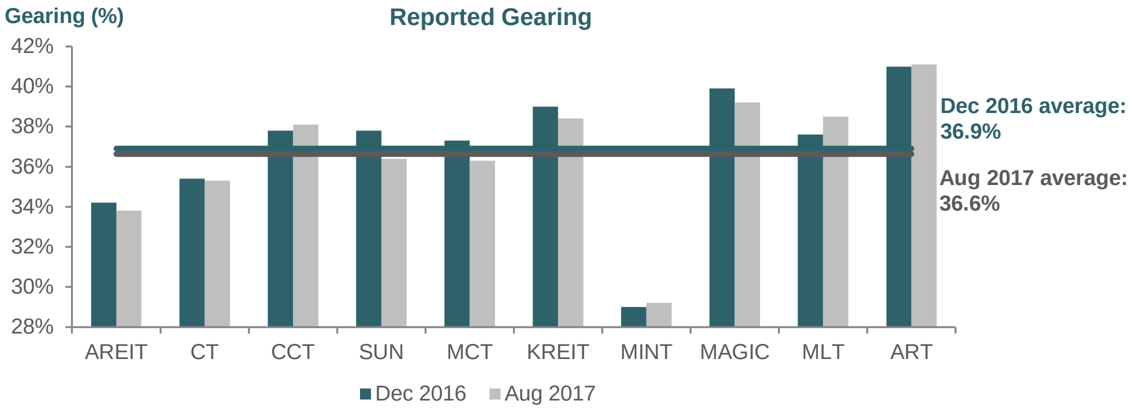

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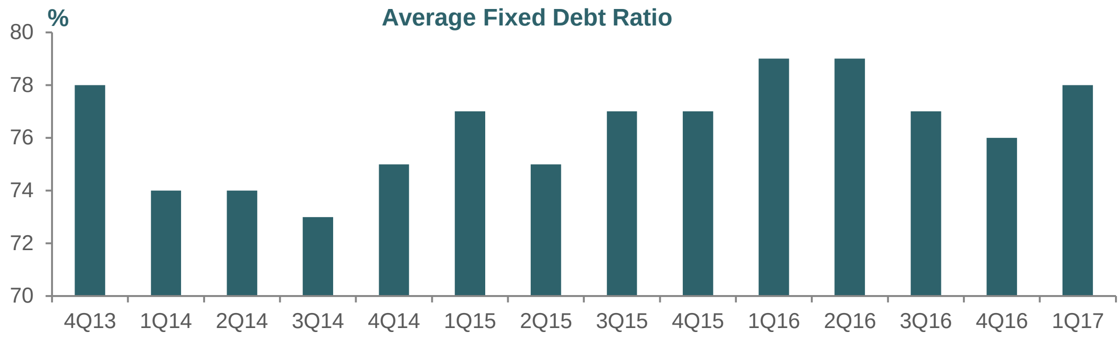
Source: Lion Global Investors, Bloomberg; as at August 2017.



Source: Lion Global Investors, Citi Research; as at August 2017.

2) Economic fundamentals are more important

If the rising interest rates are associated with economic and inflation growth, then these factors can also boost demand for real estate, and support higher occupancy rates and rents, and accordingly improve the fundamentals of REITs. To this end, Singapore fundamentals for Q1 2017 have been marginally better than expected, with a GDP growth of 2.7% for Q1, and growth likely to track above 2% for the year. Better business sentiment could imply more rental upside. Accordingly, segments such as industrial, hotels and offices could benefit more from the improved economic conditions.

CONCLUSION

REITs can continue to be an important allocation as part of a diversified portfolio, particularly with the relatively high yields found in Singapore REITs. Additionally, if interest rates do increase gradually as signaled by the US Federal Reserve, Singapore REITs may still potentially outperform the broader Singapore market. There are many other factors at play other than the interest rates. Hence, regardless of the interest rate environment, investors can leverage on an index that helps to screen for high-quality Singapore REITs, to gain efficient exposure to the sector and still reap the potential benefits of the asset class.

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