

SECTOR UPDATE

REITs – Singapore

Europe Almost Overcoming Its Energy Crisis

Europe has almost resolved its energy crisis brought about by the Russia-Ukraine war, judging by the steep fall in electricity prices. The UK has made a policy U-turn and relented on tax cuts for top earners. Recent panic selling has brought valuations for S-REITs to attractive levels and bargains have emerged. Our bottom-up and diversified BUY picks are CLAS (Target: S\$1.29), FCT (Target: S\$2.56), LREIT (Target: S\$0.91), MINT (Target: S\$3.12) and MLT (Target: S\$1.94). Maintain OVERWEIGHT.

WHAT'S NEW

- **Germany almost overcoming blackmail by Russia.** Germany plans to reduce its reliance on imports of natural gas from Russia from 55% to 10% by 2024. It has sourced imports of LNG from the US and natural gas from other European countries, such as Norway. Germany has signed an agreement with Qatar to expand trade in LNG. It has expedited the construction of five floating LNG terminals, which are targeted to be completed by Dec 22. Germany has ramped up the supply of electricity from coal-fired power stations. It has put two out of the three nuclear power stations due to shut down by end-22 on standby. Germany has also stepped up investments in renewable energy.
- **Europe is prepared for winter.** EU states have voluntarily cut their gas usage by 15% since Aug 22. Germany's stockpile of natural gas in storage tanks has hit 85% as of Sep 22. On an EU-wide basis, gas reserve has reached 80% of total capacity, two months ahead of the target set for 1 Nov 22. Europe is able to sail through winter without rationing if the forecast of mild weather materialises. The prices of electricity in Germany have collapsed by two thirds to €187/MWh, compared with the peak of €683/MWh set in Aug 22.
- **UK made fiscal policy blunder.** Chancellor Kwasi Kwarteng unveiled a £45b mini budget on 23 Sep 22, comprising unfunded cuts in corporate tax, income tax, stamp duty and national insurance. Separately, the government will be spending £150b to subsidise energy costs for businesses and consumers. The expansionary fiscal policy undermines Bank of England's (BOE) efforts to tighten monetary policy. The violent sell-down in gilts caused margin calls and a liquidity crisis for pension funds, which triggered emergency intervention by BOE to purchase long-dated gilts.
- **Anxiety abated after policy U-turn.** Chancellor Kwasi Kwarteng made a humble tactical retreat and removed the dreaded cut in top rate for income tax from 45% to 40%. To shore up confidence and reassure financial markets, he will be bringing forward the announcement of his five-year plan to reduce government spending and lower public debt. Fortunately, the financial turmoil was confined to the UK.

ACTION

- **Euro hurt by Russia-Ukraine war.** The Euro depreciated 13.8% against the US dollar and 8.7% against the Singapore dollar on an ytd basis. Yield for 10-year German Bund surged 57bp to 2.08% in Sep 22. According to UOB Economics & Markets Research, EUR Refinancing Rate is expected to hit 1.75% by end-22, compared with current 1.25%.
- **Pound sterling hurt by untimely pursuit of supply-side reforms.** The pound sterling plummeted 15.6% against the US dollar and 12.6% against the Singapore dollar on a ytd basis. Yield for 10-year UK gilts surged 129bp to 4.17%. BOE is expected to respond to the government's expansionary fiscal policy by jacking up interest rates. According to UOB Economics & Markets Research, GBP Repo Rate is expected to hit 4.25% by end-22, compared with current 2.25%.

PEER COMPARISON

Name	Ticker	Rec	Price 7 Oct 22	Target Price	Mkt Cap (US\$m)	Yield (%)				Debt to Equity (%)	Debt to Assets (%)	P/NAV (x)
						Hist	Curr	Fwd 1Y	Fwd 2Y			
CapLand Ascendas REIT	CAREIT SP	BUY	2.69	3.21	7,908	5.7	5.9	5.8	5.8	63.7	36.7	1.13
CapLand Ascott Trust	CLAS SP	BUY	0.98	1.27	2,348	4.4	5.5	6.4	6.8	71.7	37.5	0.84
CDL HTrust	CDREIT SP	BUY	1.15	1.41	995	3.7	5.1	6.3	6.4	68.5	39.5	0.88
Cromwell REIT EUR	CERT SP	NR	1.75	n.a.	964	9.7	9.7	10.0	10.0	71.9	38.6	0.69
Elite Comm REIT GBP	ELITE SP	BUY	0.525	0.65	283	10.3	9.6	7.7	8.3	75.9	41.9	0.85
Fraser's L&C Trust	FLT SP	BUY	1.21	1.51	3,130	6.3	5.9	6.1	6.2	41.6	29.2	0.92
IREIT Global	IREIT SP	NR	0.50	n.a.	404	8.2	8.1	8.1	8.4	50.5	30.8	0.63
Lendlease REIT	LREIT SP	BUY	0.77	0.91	1,290	6.3	6.4	6.4	6.6	83.4	40.0	0.98
Suntec REIT	SUN SP	HOLD	1.52	1.57	3,056	5.7	6.4	5.8	5.8	79.8	43.1	0.71

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT

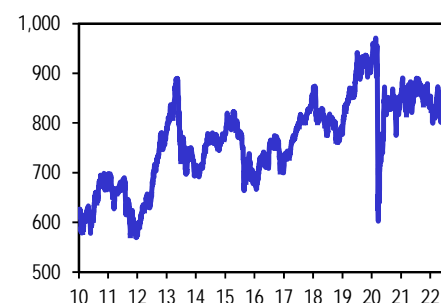
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TOP BUYS

Company	Rec	Share Price (S\$)	Target Price (S\$)
CLAS	BUY	0.98	1.27
FCT	BUY	2.16	2.56
LREIT	BUY	0.77	0.91
MINT	BUY	2.38	3.12
MLT	BUY	1.57	1.94

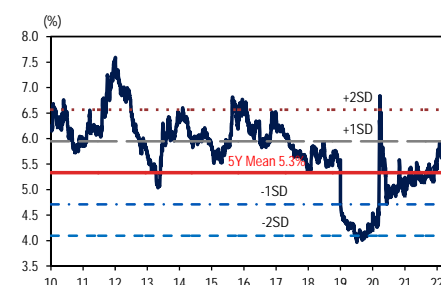
Source: UOB Kay Hian

FTSE ST ALL-SHARE REITS INDEX



Source: UOB Kay Hian

S-REIT DISTRIBUTION YIELD



Source: UOB Kay Hian

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PORTFOLIO VALUATION BY GEOGRAPHICAL REGION

(%)	Singapore	ASEAN	Australia & NZ	Japan	UK	Europe	North America	Others	Total
CLAS	17.1	7.2	12.8	17.8	6.8	11.1	20.7	6.5	100.0
CDREIT	63.8	0.0	10.6	2.7	10.0	8.2	0.0	4.7	100.0
CAREIT	61.0	0.0	14.0	0.0	7.5	2.5	15.0	0.0	100.0
CERT	0.0	0.0	0.0	0.0	6.3	93.7	0.0	0.0	100.0
ELITE	0.0	0.0	0.0	0.0	100.0	0.0	0.0	0.0	100.0
FLT	9.8	0.0	51.3	0.0	11.2	27.8	0.0	0.0	100.0
IREIT	0.0	0.0	0.0	0.0	0.0	100.0	0.0	0.0	100.0
LREIT	86.9	0.0	0.0	0.0	0.0	13.1	0.0	0.0	100.0
SUN	71.8	0.0	16.7	0.0	11.5	0.0	0.0	0.0	100.0

Source: Respective S-REITs, UOB Kay Hian

- **Composure gradually restored after panic selling.** The financial turmoil in the UK has set off panic selling for S-REITs with exposure to the UK/Europe. Heightened risk aversion has spilled over to the broader S-REITs market. Recent panic selling has brought valuations for S-REITs to attractive levels and bargains have emerged.

CLAS, CDREIT, CAREIT and FLT have aggregate exposure to the UK/Europe, representing 17.9%, 18.2%, 10.0% and 39.0% of portfolio valuations, respectively. LREIT has a small exposure to Europe (13.1% of portfolio value), while SUN has a small exposure to the UK (11.5% of portfolio value). Cromwell European REIT (NOT RATED/CERT SP) and IREIT Global (NOT RATED/IREIT SP) focus entirely on the UK/Europe and are beneficiaries of potential recovery in Europe.

CapitaLand Ascendas REIT (BUY/CAREIT SP/Target: S\$3.21)

- **Stable income from UK/Europe.** CAREIT's UK/Europe portfolio accounted for S\$1.7b or 10% of its portfolio valuation as of Jun 22. The portfolio has long weighted average lease expiry (WALE) of 5.3 years. Only 7.2% and 3.2% of gross rental income is due for renewal in 2H22 and 2023 respectively. It registered positive rental reversion of 11.7% in 2Q22 driven by its data centres. Occupancy has improved 1.0ppt qoq to 97.7% as of Jun 22.
- **High level of natural hedge.** CAREIT has borrowings of £0.4b denominated in Pound sterling and €0.3b denominated in Euro, which provides natural hedge of 71% and 100% respectively for its properties located in the UK and Europe.

- **Maintain BUY.** Our target price of S\$3.21 is based on DDM (COE: 7.25%, terminal growth: 2.6%).

CapitaLand Ascott Trust (BUY/CLAS SP/Target: S\$1.27).

- **Manageable exposures to France, Germany and UK.** CLAS owns 23 serviced residences in Europe (Belgium: two, France: 15, Germany: five, and Spain: one) and four serviced residences in the UK. Europe and the UK accounted for 11.1% (Belgium 0.9%, France 6.2%, Germany 3.2%, and Spain 0.8%) and 6.8% of CLAS' portfolio valuation. We have cut our 2023 DPU forecast by 1.7% to 6.2 S cents due to significant depreciation of the Euro and Pound sterling against the Singapore dollar.
- **Maintain BUY.** We lowered our target price from S\$1.29 to S\$1.27 based on DDM (COE: 7.5%, terminal growth: 2.6%).

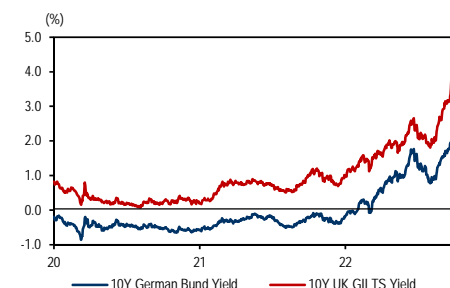
CDL Hospitality Trusts (BUY/CDREIT SP/Target: S\$1.41).

- **Limited exposure to UK/Europe.** CDREIT owns The Lowry Hotel, Hilton Cambridge City Centre and Hotel Brooklyn in the UK, Pullman Hotel Munich in Germany and Hotel Cerretani Firenze – MGallery in Italy. The UK and Europe accounted for 10.0% and 8.2% of CDREIT's portfolio valuation (Germany 5.9% and Italy 2.2%).
- **Maintain BUY.** Our target price of S\$1.41 is based on DDM (COE: 7.5%, terminal growth: 2.6%).

Elite Commercial REIT (BUY/ELITE SP/Target: £0.65).

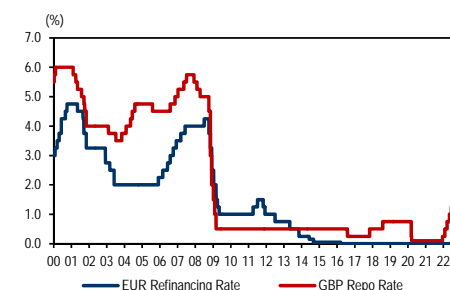
- **Benefitting from higher inflation.** The leases with the UK government are full repairing and insuring triple net leases whereby operational expenses are borne by tenants. Thus, ELITE is insulated from negative impact from higher inflation and higher cost of electricity. The leases provide high NPI margin of 97.1% in 2021. They have rent reviews every five years benchmarked against the UK Consumer Price Index (CPI). The built-in rental

YIELDS FOR 10-YEAR GERMAN BUNDS AND UK GILTS



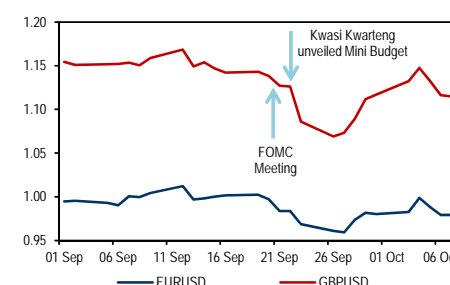
Source: Bloomberg

ECB AND BOE POLICY INTEREST RATES



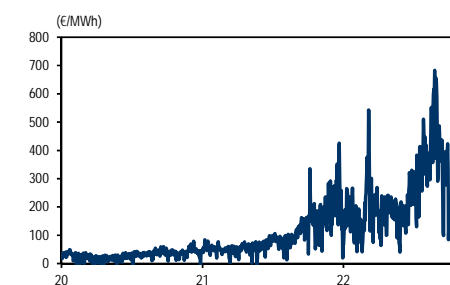
Source: Bloomberg

EUR AND GBP AGAINST THE USD



Source: Bloomberg

EXAA GERMANY DAY AHEAD BASELOAD ELECTRICITY SPOT PRICES



Source: Bloomberg

escalation is subject to an annual minimum increase of 1% and a maximum of 5%. Based on consensus estimate of 9.0% for the UK's CPI in 2022, we estimate the step-up in rents at 15.4% for Apr 23.

- **Overhang from break clauses resolved.** Majority of 136 DWP leases have no break clauses. 27 of the DWP leases are straight leases without break clauses. Break clauses were removed from 108 leases, of which rents for 97 leases were maintained while rents for 11 leases were reduced. The reduction in rents for the 11 commercial properties is estimated at 36% (before positive impact of rental escalation). DWP also signed a new five-year lease for one commercial property at East Street, Epsom. Properties with rental income secured till Mar 28 contributed 87.5% of gross rental income as of Jun 22. ELITE has a long WALE of 5.2 years as of Jun 22.
- **Affected by rate hikes.** Pound sterling is the appropriate functional currency for ELITE because its revenue, expenses, assets and liabilities are all denominated in Pound sterling. ELITE has hedged 63% of its borrowings to fixed rates. We expect ELITE to refinance borrowings of £88m due Jan 23 at a cost of debt of 6.0% (three-month Sterling Overnight Interbank Average Rate (SONIA) at 4.25% plus spread of 1.75%). We estimated average cost of debt of 4.6% for 2023. We have cut our 2023 DPU forecast by 13.6% to 4.1 pence.
- **Maintain BUY.** Our target price of £0.65 is based on DDM (COE: 8.5%, terminal growth: 2.25%). We have increased risk-free rate from 3.00% to 3.75%.

Frasers Logistics & Commercial Trust (BUY/FLT SP/Target: S\$1.51).

- **Germany most reliant on Russia.** Germany imports 55% of its natural gas from Russia through the North Stream pipeline. The Bundesbank has previously warned that an immediate ban on Russian gas imports would reduce GDP growth by 5ppt, dragging Germany into a deep recession. Our worst fear did not materialise. Germany has managed to cut usage of electricity, secure alternative sources of LNG, ramp up coal-fired power stations and put two nuclear power stations on standby.
- **Resiliency from limited supply.** The structural limited supply of logistics space and rising costs of land and building materials have fed into a steep increase in asking rents for logistics space in Germany. Prime rents have increased 7% to €96/sqm/year in 1H22. FLT's Germany portfolio has maintained occupancy at 100% and has a long WALE of 6.3 years. It benefits from higher inflation as annual rental escalation is CPI-linked. The portfolio registered positive rental reversion of 3.3% in 1HFY22 (average vs. average).
- **Maintain BUY.** Our target price of S\$1.51 is based on DDM (COE: 7.25%, terminal growth: 2.8% (previous: 2.5%)).

Lendlease Global Commercial REIT (BUY/LREIT SP/Target: S\$0.91).

- **Sky Complex benefitting from higher inflation.** LREIT has only one property, Sky Complex, located overseas in Milan, Italy. Sky Complex has maintained full occupancy of 100%. It is on a long-term lease to Sky Italia until 2032 (long WALE of 9.9 years) and annual rental escalation is based on 75% of the changes in ISTAT consumer price index (CPI). ISTAT CPI increased 6.24% in Apr 22, which translated to rental escalation of 4.68% in May 22. LREIT has term loan of €285m denominated in the Euro, which provides natural hedge of 88% for its investments in Sky Complex.
- **Maintain BUY.** Our target price of S\$0.91 is based on DDM (COE: 7.5%, terminal growth: 2.2%).

Suntec REIT (HOLD/SUN SP/Target: S\$1.57).

- **Recovery strongest at West End.** SUN opportunistically acquired Nova Properties (West End) and Minster Building (City of London) during the COVID-19 pandemic in 2021. London has since weathered Brexit and the COVID-19 pandemic. The recovery in take-up for office space in the past 12 months was broad-based but was strongest for the West End at 24% above the 10-year average. The recovery was driven by the financial services sector. The impending overhaul of financial regulations could help London reclaim the title as the busiest financial centre in the world.

- **Manageable exposure to London in UK.** London accounted for only 11.5% of SUN's portfolio valuation. The UK portfolio provides stable contribution with long WALE of 10.1 years. It has borrowings of £375m denominated in Pound sterling, which provides natural hedge of 47%.
- **Maintain HOLD.** Our target price of S\$1.57 is based on DDM (COE: 7.25%, terminal growth: 1.8%).

SECTOR CATALYSTS

- Hospitality, retail and office REITs benefitting from the reopening of the economy.
- Limited new supply for office, logistics and retail segments in 2022.

ASSUMPTION CHANGES

- We have cut our 2023 DPU forecast for ELITE by 13.6% to 4.1 pence. We have also cut our 2023 DPU forecast for CLAS by 1.7% to 6.2 S cents.

RISKS

- Escalation of the Russia-Ukraine war beyond Ukraine.
- Persistent and elevated inflation causing more rate hikes in 2023.

PEER COMPARISON

Name	Ticker	Rec	Curr	Price 7 Oct 22	Target Price	Mkt Cap (US\$m)	Hist	Yield (%) Curr	Fwd 1Y	Fwd 2Y	Debt to Equity (%)	Debt to Assets (%)	P/NAV (x)
HEALTHCARE													
First REIT	FIRT SP	NR	S\$	0.265	n.a.	381	9.8	n.a.	n.a.	n.a.	66.6	35.6	0.78
PLife REIT	PREIT SP	HOLD	S\$	4.22	4.34	1,787	3.3	3.5	3.6	3.6	50.4	32.5	1.75
HOSPITALITY													
CapLand Ascott Trust	CLAS SP	BUY	S\$	0.98	1.27	2,348	4.4	5.5	6.4	6.8	71.7	37.5	0.84
CDL HTrust	CDREIT SP	BUY	S\$	1.15	1.41	995	3.7	5.1	6.3	6.4	68.5	39.5	0.88
Far East HTrust	FEHT SP	BUY	S\$	0.595	0.77	827	4.4	5.3	6.7	7.1	43.6	33.3	0.70
Frasers HTrust	FHT SP	NR	S\$	0.49	n.a.	654	2.0	3.9	4.1	6.8	78.7	39.3	0.74
INDUSTRIAL													
AIMS APAC REIT	AAREIT SP	NR	S\$	1.29	n.a.	647	7.3	7.6	7.7	7.8	60.5	37.0	0.93
CapLand Ascendas REIT	CAREIT SP	BUY	S\$	2.69	3.21	7,908	5.7	5.9	5.8	5.8	63.7	36.7	1.13
DigiCore REIT USD	DCREIT SP	BUY	US\$	0.685	0.90	774	n.a.	5.6	5.7	5.8	35.4	25.7	0.78
ESR-LOGOS REIT	EREIT SP	NR	S\$	0.36	n.a.	1,688	8.3	8.3	8.3	8.6	82.3	40.6	0.99
Keppel DC REIT	KDCREIT SP	NR	S\$	1.68	n.a.	2,020	5.9	6.0	6.3	6.5	57.6	35.3	1.23
Mapletree Ind Trust	MINT SP	BUY	S\$	2.38	3.12	4,504	5.8	5.6	5.6	5.8	58.2	38.4	1.27
Mapletree Log Trust	MLT SP	BUY	S\$	1.57	1.94	5,277	5.6	5.8	5.8	5.8	71.4	37.2	1.07
OFFICE													
Keppel REIT	KREIT SP	BUY	S\$	0.97	1.33	2,520	6.0	6.1	5.8	6.4	68.9	37.9	0.71
RETAIL													
Frasers CT	FCT SP	BUY	S\$	2.16	2.56	2,573	5.6	5.9	6.0	5.8	47.2	33.9	0.93
Lendlease REIT	LREIT SP	BUY	S\$	0.77	0.91	1,290	6.3	6.4	6.4	6.6	83.4	40.0	0.98
Sasseur REIT	SASSR SP	BUY	S\$	0.705	1.12	606	10.1	10.7	10.9	11.3	43.5	26.5	0.74
SPH REIT	SPHREIT SP	NR	S\$	0.89	n.a.	1,749	6.1	6.1	6.3	6.6	50.2	30.2	0.97
Starhill Global	SGREIT SP	NR	S\$	0.53	n.a.	833	7.2	7.7	7.9	8.1	62.1	36.2	0.68
DIVERSIFIED													
CapLand China Trust	CLCT SP	NR	S\$	1.02	n.a.	1,195	8.6	8.5	9.3	9.6	79.3	38.6	0.68
CapLand Int Comm Trust	CICT SP	HOLD	S\$	1.94	2.17	9,004	5.4	5.8	6.0	6.1	68.9	40.6	0.91
Frasers L&C Trust	FLT SP	BUY	S\$	1.21	1.51	3,130	6.3	5.9	6.1	6.2	41.6	29.2	0.92
Mapletree Pan Asia	MPACT SP	BUY	S\$	1.77	2.07	6,482	5.4	6.0	6.1	6.2	52.0	33.8	1.02
OUE Comm REIT	OUECT SP	NR	S\$	0.335	n.a.	1,280	7.8	6.6	6.9	6.9	73.1	39.1	0.58
Suntec REIT	SUN SP	HOLD	S\$	1.52	1.57	3,056	5.7	6.4	5.8	5.8	79.8	43.1	0.71
INTERNATIONAL REITS													
Cromwell REIT EUR	CERT SP	NR	€	1.75	n.a.	964	9.7	9.7	10.0	10.0	71.9	38.6	0.69
Elite Comm REIT GBP	ELITE SP	BUY	£	0.525	0.65	283	10.3	9.6	7.7	8.3	75.9	41.9	0.85
IREIT Global	IREIT SP	NR	S\$	0.50	n.a.	404	8.2	8.1	8.1	8.4	50.5	30.8	0.63
Keppel REIT USD	KORE SP	BUY	US\$	0.58	0.99	606	10.9	10.7	10.2	10.1	65.1	37.2	0.69
Manulife REIT USD	MUST SP	BUY	US\$	0.40	0.74	702	13.5	13.4	13.7	14.2	78.3	42.4	0.56
Prime US REIT USD	PRIME SP	NR	US\$	0.51	n.a.	602	13.3	13.7	13.7	13.9	63.3	37.8	0.59
Utd Hampshire REIT USD	UHU SP	BUY	US\$	0.53	0.83	299	11.5	11.7	10.9	10.7	63.6	38.0	0.69

Source: Bloomberg, UOB Kay Hian

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