Manulife Investment Management

2020 Outlook Series: Asia-Pacific REITs

Jan 2020

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Asia-Pacific REITs (AP REITs) posted solid gains in 2019 on the back of an accommodative interest rate environment, strong operating results, and robust capital inflows. Moving into 2020, we believe that these trends should continue, providing investors continued opportunities in the asset class. In this 2020 outlook, Hui Min Ng, Portfolio Manager, outlines why the income sustainability component of REITs will be key for investors for the coming year, as well as which markets and property segments should be bright spots for investors.

Accommodative interest rate environment and resilient operating performance drove returns in 2019

AP REITs performed strongly in 2019 as the listed REITs in the region continued to show growth (organically and inorganically). REIT markets in Singapore and Australia led the overall market higher, while the REIT segments of industrial, specialised, and office were the top sector performers[i].

From a macro perspective, an accommodative global and regional interest rate environment supported performance. G3 central banks set a dovish tone[ii], followed by numerous regional central banks in markets with REITs

Lower rates, coupled with subdued economic growth forecasts, have resulted in a widening swath of negative yields for developed market bonds. This attracted capital inflows into the region, which further supported REIT prices.

From a market perspective, REITs gains were driven by numerous positive catalysts. Property fundamentals remained strong as REITs in the Asia-Pacific region reported decent growth in operating metrics[iii] and distributable income, while occupancy rates also remained high[iv]. Finally, numerous REIT accretive acquisitions also boosted future growth prospects.

Income sustainability key in 2020

Moving into 2020, we believe these tailwinds should continue: accommodative monetary policy, moderate inflation, with a potential uptick in economic growth. Based on the market gains of 2019, we believe that investors should focus on the income component of REIT returns in 2020. Indeed, consistency and predictability of distribution is one of the key merits of AP REITs. As sustainability of yield continues to grow in importance, we believe that the sound fundamentals of certain segments of the physical real estate market should provide REITs the ability to deliver consistent income to investors.

Markets in Singapore, Hong Kong, and Australia can offer attractive opportunities in 2020

We are constructive on REIT opportunities in the following key markets and segments:

Singapore: Retail and office

Singapore narrowly averted technical recession in 2019[v], but the government believes growth will modestly strengthen in 2020 given the growth outlook for Singapore's key final demand markets, and the projected recovery in the global electronics cycle in the year ahead[vi]. With capital inflows to Singaporean REITS remaining supportive, we are comfortable with general valuation levels in the market.

- Retail: Historically, rental rates in Singapore's retail sector have been defensive and resilient; we expect this trend to continue. Indeed, median rental pricing trends over the past three years have remained steady despite increasing economic volatility. Furthermore, a notable increase in supply in 2019 was well digested by the market, with forecasts of new supply coming in the pipeline remain relatively limited in the next three years[vii].

Besides, we will also be closely watching the trajectory of "omni-channel"[viii] and experiential retail strategies, which we think should be supportive for the retail segment.

- Office: Overall, the supply and demand dynamics are expected to remain positive in 2020. While demand has softened, we believe spot rents can hold up as net supply remains low. Some existing central business district (CBD) supply will be removed from the market due to re-development under the government's Urban Renewal Project. We expect that rental reversions should continue to stay positive as current spot rates are higher (over the past three years office rents have moved higher)[ix].

Hong Kong: Office and retail

Hong Kong's economy experienced a challenging year in 2019 and we're still monitoring its trajectory for 2020. That said, we're still constructive on more defensive plays in the office and retail segments.

- Office: As corporates move their offices from traditional business centres, we continue to focus on opportunities in decentralised Grade-A office space given the notable spot rent differentials with more traditional business districts (e.g. Central).

- Retail: Although retail sales have notably contracted in Hong Kong, the performance of Hong Kong REITs has a fairly low correlation with retail sales[x]. We are currently constructive on shopping malls that are geared towards meeting consumers' everyday needs such as supermarkets and food rather than luxury offerings. These properties are more resilient and defensive in an economic downturn.

Australia: Office and industrial

Despite the Reserve Bank of Australia's monetary easing in 2019, we are closely watching if it flows through to boost the real economy. With economic activity depressed and unemployment levels elevated, we are looking for opportunities in well-established segments.

- Office: Supply and demand dynamics are currently favourable in the office segment. This is particularly true for Grade-A office space in Sydney's CBD area, where limited new supply is forecast over the next two years[xi].

- Industrial: Third-party logistics and e-commerce firms are the main source of demand in this segment, which is gradually digesting excess supply.

Conclusion

Overall, we expect many of the supportive trends we saw 2019 should continue to underpin to AP REITs in 2020. The favorable macro backdrop should allow REITs in the region to further enlarge their asset bases for future growth.

Given the transparency of REIT portfolios, we see few risks to rental income, as positive rental reversions and robust occupancy rates should continue in 2020. This backdrop should result in a stable and highly secured distribution income for shareholders.

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[i] Bloomberg, as of 30 September 2019. Market performance represents the arithmetic average of all listed REITS in the individual market. Segment performance represents the performance of all listed REITS regionally for the segment.

[ii] The US Federal Reserve (Fed) retreated, cutting rates after nine increases between 2015 and 2018. The European Central Bank decided to reignite its QE programme less than a year after pausing it. The Bank of Japan reminded investors that its negative-rate policy could go beyond the current minus-0.1%.

[iii] Manulife Investment Management, company websites, as of 30 September 2019.

[iv] Manulife Investment Management, company websites, as of 30 September 2019.

[v] The Singapore economy grew by 0.5% on a year-on-year basis in the third quarter, slightly higher than the 0.2% growth in the previous quarter. Ministry of Trade and Industry (MTI), Singapore, as of 21 November 2019.

[vi] MTI expects growth in the Singapore economy to pick up modestly in 2020 as compared to 2019, 21 November 2019.

[vii] URA, Release of first quarter 2019 Real Estate Statistics, from 30 June 2015 to 31 March 2019.

[viii] Offline to online.

[ix] Capitaland Commercial Trust, Nov 2019.

[x] Bloomberg, from 31 August 2016 to 31 August 2019.

[xi] JLL, Research Actual and Dexus Research Forecast, 6 February 2019.

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