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REITs get a rise

REIT instruments could be back in favour

IN A lacklustre market, it is not unusual for participants to latch on to any theme play that offers even a faint glimmer of hope.

True enough, there were expectations last year that real estate investment trusts (REITs) would serve as a panacea for a moribund stock market.

There is no denying that the excitement and interest were there as the first few REITs rolled out but even those failed to triumph above concerns about where interest rates are headed.

Bank Negara has indeed raised the key interest rate by 80 basis points since end November last year.

Consequently, the yield on 10-year Malaysian Government Securities, generally the benchmark used for REITs, exceeded 5.1% in mid-June this year from 4.25% in end 2005.

This led to some price decompression for the REITs. The appeal of REITs generally tends to diminish as interest rates head north.

But the sector's prospects are hardly as disheartening as they appear to be.

For one thing, the rate hike cycle is expected to end soon.

"At the most, we expect Bank Negara to announce one more hike this year which means REIT instruments could be back in favour again," says Hwang-DBS Vickers analyst Ong Chee Ting.

In fact, Ong reckons the appetite for REITs has improved now that the 10-year sovereign bond yield is down to about 4.6%.

Changes brewing

More importantly, the upcoming Budget announcement is expected to yield some surprises for the REIT market.

An observer says there is good reason to believe that the Securities Commission will propose to the government to lower the 28% withholding tax levied on foreign investors.

Market talk is that the tax imposed on foreigners would be brought down to 20%.

While this would still place the local REIT market behind Singapore, observers say it is a good start for a REIT market that is only a year old.

Singapore halved the withholding tax on REIT distributions to foreign non-individual investors to 10% for five years starting from last year as a measure of enhancing the appeal of Singapore REITs to foreign investors.

For local investors, it is understood that there is a move to consider abolishing tax for the next five years.

The observer says there is also talk that the Government may deem REITs, like unit trust now, an investable asset class for EPF members.

"If all of these come to fruition, then the changes would definitely attract new classes of investors and lead to stronger retail participants in search of high yielding instruments," he says.

For REIT players, the government recently relaxed the 35% gearing limit to give them more room to borrow.

The limit is now 50% of the REIT's total asset value.

Generally, REIT players would want to avoid gearing up too much.

Given that fund raising via the equity market takes time to execute, the relaxation now at least gives players the option of borrowing first to buy and then later look for ways to reduce their debt level.

This way, REIT players have more leeway to borrow to acquire in order to improve their yields.

Upcoming REITs

Regulatory changes aside, the REIT pipeline looks just as promising. KPJ Healthcare Bhd's hospital trust was listed last Thursday. Next in line is Amanah Raya Bhd's REIT listing in October.

A local fund manager says it helps that some of the upcoming REITs are expected to add depth and diversity to the local REIT sector.

KPJ Healthcare, for instance, is the first to market an Islamic REIT.

Called Al-'Aqar KPJ REIT, the trust comprises six hospitals with a total market value of RM481mil. The syariah-compliant REIT is also supposedly the first to be introduced in the world.

Then there is Boustead Holdings Bhd which is in the midst of submitting its proposal to the Securities Commission for an Islamic REIT.

The trust would be different from the others the market has seen thus far as it is likely to consist of a clutch of performing plantation estates currently owned by the group, as opposed to properties.

In terms of asset size, Sunway City Bhd is expected to float the country's largest REIT to date towards the end of next year.

A company official has gone on record to say that the REIT would have a value of at least RM1.5bil but a local research house that took the property developer on a roadshow to Singapore recently says the figure is likely to be closer to RM2bil.

Sunway City's REIT was initially planned for this year but it appears the delay is meant to coincide with the completion of Sunway Pyramid Mall 2, Sunway Monash Campus and Sunway Carnival Mall next year, all of which are potential assets to be injected into the REIT.

At present, the YTL group holds the record for launching the country's largest REIT. Its RM1.2bil Starhill REIT was listed last December.

The size of an issue is an important consideration for foreign investors.

An analyst notes that one reason local REITs have failed to attract strong foreign institutional following is because most of the issues have not been sufficiently large to be worth the while for foreign investors.

However, this could change if some of the government-linked companies announce plans to set up REITs as they are among the largest holders of property assets in the country.

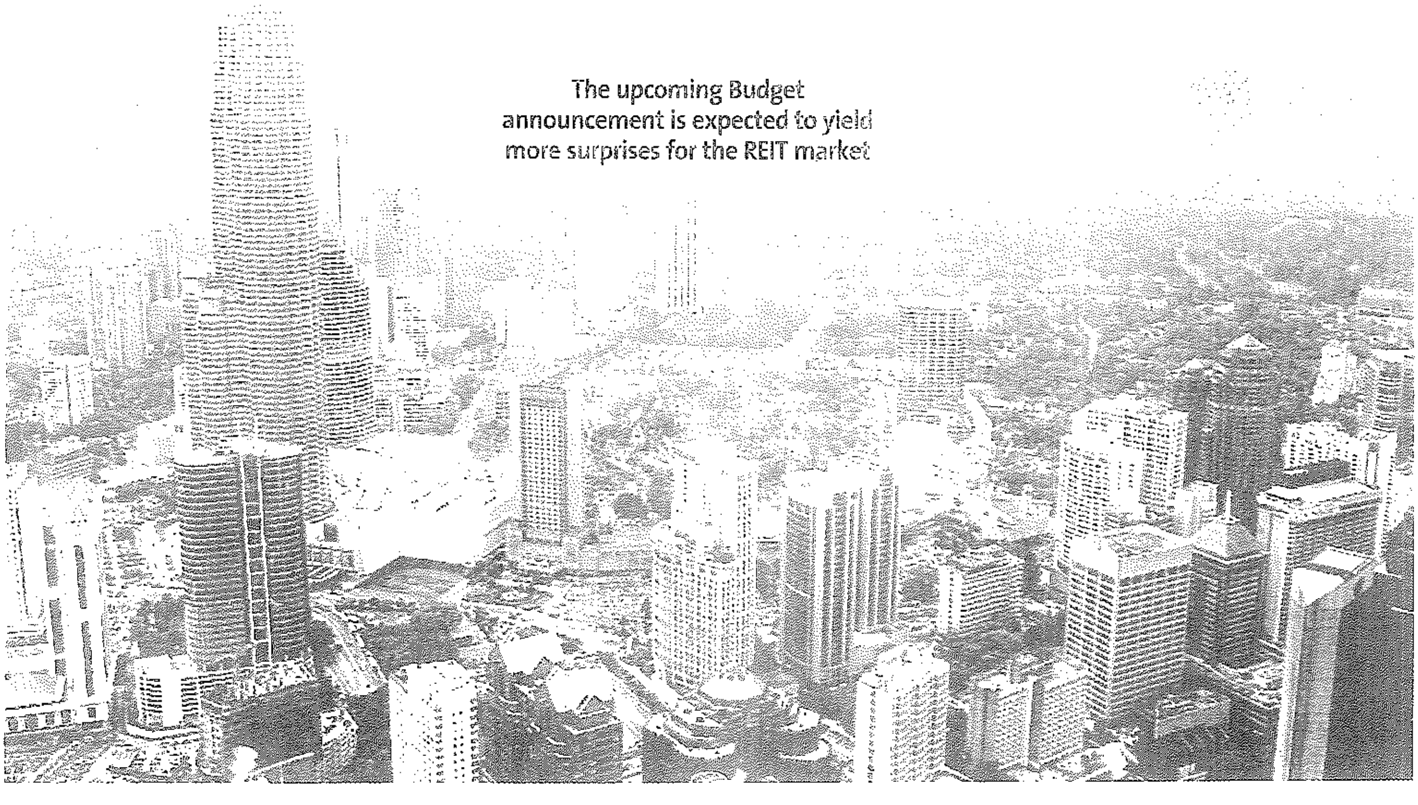
In the meantime, the performance of some of the REITs could get investors warmed to the idea of putting their money into REITs.

Axis REIT, for example, has moved on to its fourth acquisition since listing a year ago.

According to Hwang-DBS Vickers, the trust, which investment property value totals about RM400mil now, has set a target of achieving RM500mil of investment properties by year-end.

This means there is likely to be more acquisitions before the year is over.

The research house says contributions from the two most recent acquisitions should boost Axis REIT's dividend yield, which is already the highest among the REITs, substantially in the current and next financial years.



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