B&I Capital

Asian Market Outlook

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160 Robinson Road, #16-07
SBF Center
Singapore 068914

Talacker 35
8001 Zurich
Switzerland

+41 44 215 2888
contact@bnicapital.com
bnicapital.com

Market Outlook

Real Estate markets in Asia were volatile in April as macroeconomic factors continued to dictate the direction of the sector. Recent data from the US and elsewhere have swung expectations of interest rate policies to remain "higher for longer" in the US and Asian currencies and REITs have struggled as a result. We mentioned last month that the easy gains in Australia were behind us and indeed the sector sharply corrected on lowered expectations of interest rate easing. HK rallied in April from a very oversold position and one positive catalyst was the introduction of Stock Connect for HK REITs which would allow mainland investors to invest into this sector which offers both attractive yield and HKD exposure. Coming out of Golden Week, we expect continued recovery as policy makers in China appear ready to act on the property sector and this could help sentiment for all HK listed names. US jobs numbers which came in below expectation have helped the currencies in the region and if we continue to get softer data this could help take pressure off the BOJ and help sentiment for interest rate sensitives.

Japan

In early May we will get the results from the Big 3 Developers and given their strong performance year to date (+30-50%) there may a temptation to sell in May and go away. While profit-taking after such a strong move higher would not surprise us, we still believe that the improving fundamentals in Grade S office demand, solid retail and condominium sales, and strong hospitality contribution will keep earnings outlooks for the major Developers strong. We expect Mitsubishi Estate to refine its shareholder return policies and target a stable buyback and dividend rate. To date, they have rewarded shareholders with total payout in past years' average reaching 50% but the buyback consistency has been volatile, and we think they may commit like the others to a higher payout of dividend and stable buyback policy. Sumitomo Realty will be the most interesting name as they still retain anti-takeover defences and payout a relatively low amount to shareholders. The stock has been very strong since the middle of last year when the company started engaging with shareholders and opening to the possibility of removing the poison pill. Given that the company has now committed to investing a sizable sum in India and, historically, they have not recycled capital the way the others do, we are somewhat concerned about how much increase in shareholder returns they can commit to. In addition, Sumitomo's comments regarding removal of the poison pill were conditioned on changes in legislation that have yet to be enacted, so there is a possibility that they may not lift this policy at the annual results on 9th May. JREITs have continued to build on their recovery that was triggered by the BOJ removing its negative interest rate policy in March. As we commented in a separate note, we saw this as a lifting of an overhang but feel that until the JPY/USD starts to stabilize that risk of further tightening could become another overhang. Nonetheless, JREITs have continued to recover as much of the seasonal (March fiscal year end) selling pressure from regional banks has abated and we have seen some positive results and buyback announcements. So far for 2024, 6 JREITs have announced unit repurchases and we expect others to follow given that many still trade at P/NAV discounts despite a healthy transaction market in all traditional asset types. Several large cap JREITs have been negatively impacted by the upcoming MSCI constituent changes to be announced on 15th May. Notably, GLP J-REIT, Japan Metropolitan Fund and KDX Realty are all candidates for deletion and have all underperformed year-to-date. KDX Realty and JMF announced unit repurchases recently to offset the passive selling pressure. GLP J-REIT has yet to announce a unit repurchase this year however judging by management's comments we believe they may announce one around the timing of a deletion from the MSCI.

Australia

After last month's correction, REITs in Australia look attractive again despite concerns the RBA may not ease soon and may not have even ended its tightening cycle. Goodman Group continues to dominate activity in the sector as generalist investors see it as an AI proxy due to their potential to develop Data Centers in Australia and abroad utilising their industrial landbank and access to power. GMG has no desire to operate data centers, but rather seeks to offer solutions to operators and Hyperscalers by providing powered shells or in some cases turnkey DCs. While we see this adjacency as logical, the increase in valuation in what appears to be on the commodity side of the DC landscape is excessive. GMG now trades around 29 EV/EBITDA vs. Prologis's 19x (they also offer a similar DC solution from their industrial landbank) and pure DC Developer/Owner Operators Digital Realty's at 22x and EQIX's at 19x. GMG's multiple is now closer to Nvidia's than its closest peer Prologis. We suspect that GMG benefits from Australian domestic investors having limited choice to invest into the AI theme and see GMG as a beneficiary. Since GMG unveiled its DC strategy in earnest late last year the company has added AUD 26bn in market cap. While at the same time Prologis has seen its market cap fall as the company highlighted slower growth in its core logistics business in the US. GMG updated investors on 8th May.. GMG raised its EPS guidance to 13% from 11% and this should be no surprise as the company consistently gives initial conservative guidance and revises up historically as it gets closer to the end of their June fiscal year. We would not be surprised if they beat their current guidance for the fiscal year as they start to incorporate higher performance fees. While it would be tempting to call a top here and be hard to justify valuation at these levels, the risk is that the scarcity of AI plays in Australia is attracting generalist investors to the name who are not concerned with valuations as they try to get positioned into a popular theme. In addition, GMG's strong balance sheet makes it a safe haven while interest rates remain high so earnings disappointment is limited. We have gone through most of the mid period updates from the AREITs and have seen no major disappointment so far. Mirvac maintained its guidance, but it still has a lot of execution to achieve to meet it. Specifically, apartment sales have not been as strong as we had hoped, and we hear that the company is giving out incentives for buyers to complete before 30th June. The sale of 55 Pitt Street is ongoing, but all indications are that they will get this over the line. With most of the guidance re-affirmed or updated, macro data will provide the next catalysts for the sector.

Hong Kong

Golden Week saw a large increase in visitors to HK and spending versus 2023 but remained well below pre-pandemic levels. Tourism in mainland China surpassed pre-pandemic levels possibly due to economic factors or personal ones due to limited travel during the pandemic. There is a continued narrative that HK outbound spending leakage to Shenzhen will depress HK retail sales, however we are not convinced that luxury will be as impacted. In fact, luxury has outpaced other retail segments and we have seen even some retailers open stores in HK with Louis Vuitton going back to Times Square. Non-discretionary retail has also been seen as a victim to outbound spending and while bulk shopping at Costco or Sam's Club in Shenzhen is much cheaper, it does require more space at home. In any case, Link REIT and Fortune REIT are trading at multiyear low valuations and will both likely be included in the Stock Connect regime so we would not be surprised to see them bottom even if HK sales continue to disappoint. HIBOR rates will be supportive, and we are surprised there is not more attention paid to the recent drop in rates which has earnings implications for the HK REIT sector. For example, one-month HIBOR is today at 4.2% vs 5.5% at the end of 2023. Despite the drop in HIBOR, the HKD remains firm which is positive. Hong Kong, and specifically HK listed Chinese names, surged in April. HK REITs look constructive from this level despite a challenging macro environment.

Singapore

SREITs continue to lag despite very steady retail, office, and hospitality statistics. Retail sales came in at 2.8% from the impact of strong visitor arrivals from China due to removal of visa requirements and the Taylor Swift effect. Singapore was the only location to host her concerts in SE Asia. While comparisons will become more challenging going forward for all segments, we feel the office market is peaking in terms of spot rent, and we see limited downside to all three segments. The main driver for SREITs will be interest rates as investors rotate from banks (which are positively correlated to interest rates) into REITs which make up a large part of the equity market relative to other markets. Earnings updates were generally neutral with top line growth reasonable but interest costs still creeping higher on average as lower cost debt matures. We would not be surprised to see a sharp bounce in the SREIT sector as many names are oversold (Industrial in particular) and look attractive on valuations. We continue to prefer Retail and Hospitality over other REIT sectors and Developers.