Daiwa Capital Markets

The 10-second briefing

More acquisitions?

- Since the start of 2013, acquisitions, fund-raising, and acquisition appetite have accelerated in the J-REIT market
- Open-market acquisitions face structural difficulties in Hong Kong and H-REITs have had to focus on asset enhancements
- Investment conditions remain favourable in Singapore, with near record high prices and the likelihood of DPU and NAV-accretion

Pan Asia Real Estate Investment Trusts

- **Positive** (unchanged)
- Neutral
- Negative

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■ Theme: acquisitions

We consider the prospects for more property acquisitions by REITs in 2013 in this *Pan Asia REIT update*. At the macro level, our mild recovery scenario would be conducive for asset-price appreciation, and possibly further cap rate compression in all markets.

■ J-REITs: strong momentum

Acquisitions of relatively high-yielding city centre, suburban, and regional properties are on the rise, and some J-REITs are setting their sights on a wider variety of properties. J-REITs increased property acquisitions by 20% YoY for 2012, and have announced large capital increases and new listings so far in 2013. Cap rates are finally showing signs of reversing. As J-REIT buying interest has been increasing since the start of 2013, cap rates should take a meaningful downward turn. We are **Positive on J-REITs** and expect the sector to remain buoyant in 2013 on the back of: 1) a pick-up in office rents, 2) expectations for the new government's measures to shake off deflation, and 3) progress with discussions on regulatory reforms. Given that the broader market is yielding less than 2%, the recent J-REIT prospective average dividend yield of c.4% still appears attractive.

■ H-REITs: still a secondary driver

We think it is structurally difficult for H-REITs to pursue acquisition opportunities in the short term as many property assets are owned by the major developers and conglomerates and wealthy families, who tend not to sell their investment properties. But there could be some early signs of change in recent years, and the sale of Festival Walk will be closely watched by the market. We think the core value-added activity of H-REITs remains that of asset enhancement initiatives (AEI). We are **Positive on H-REITs** and think that valuations are still reasonable and the commercial property cycle is still in their favour. We like decentralised offices and suburban malls in 2013, and believe the H-REITs are well positioned to capitalise on these opportunities.

■ S-REITs: acquisition climate improves

Investment conditions should remain favourable for acquisitions, and we see opportunities across all sectors. With unit prices trading at their highest levels since the end of 2007 and therefore a high likelihood now for acquisitions and related financing to be both distribution-per-unit (DPU) and NAV-accretive, we believe there is a clear incentive for REIT managers to expand their asset size and market caps through acquisitions in 2013.

We are **Neutral on S-REITs**, as valuations no longer look compelling following a year of significant outperformance, and most S-REITs are trading near their PBR highs.

■ A-REITs: Singapore participation

Acquisitions by Singapore investors were helped by: 1) low leverage, high absolute yield and access to cheap offshore financing, 2) stability offered by long leases found in Australia, and 3) positive track records. CapitaLand's potential divestment of Australand could be the biggest M&A deal in the A-REIT market this year.

Key stock calls

	New	Prev.
The Link REIT (823 HK)		
Rating	Outperform	Outperform
Target	48.00	48.00
Upside	▲ 13.7%	
Fortune REIT (778 HK)		
Rating	Buy	Buy
Target	8.20	8.20
Upside	▲19.2%	
Suntec REIT (SUN SP)		
Rating	Outperform	Outperform
Target	1.95	1.950
Upside	▲ 9.6%	
Ascendas Real Estate Investment Trust (AREIT SP)		
Rating	Underperform	Underperform
Target	2.20	2.20
Downside	▼ 17.3%	
Nippon Building Fund (8951 JP)		
Rating	Outperform	Outperform
Target	1,090,000	1,090,000
Upside	▲ 10.3%	

Source: Daiwa forecasts

See important disclosures, including any required research certifications, beginning on page 29

Sector stocks: key indicators

		Share	Rating		Target price (local curr.)			EPS (local curr.)					
								FY1			FY2		
Company Name	Stock code	Price	New	Prev.	New	Prev.	% chg	New	Prev.	% chg	New	Prev.	% chg
Ascendas Real Estate Investment Trust	AREIT SP	2.66	Underperform	Underperform	2.20	2.20	0.0	0.164	0.164	0.0	0.205	0.205	0.0
Fortune REIT	778 HK	6.88	Buy	Buy	8.20	8.20	0.0	0.316	0.316	0.0	0.359	0.359	0.0
Suntec REIT	SUN SP	1.78	Outperform	Outperform	1.950	1.950	0.0	0.045	0.045	0.0	0.164	0.164	0.0
The Link REIT	823 HK	42.20	Outperform	Outperform	48.00	48.00	0.0	1.466	1.466	0.0	1.653	1.653	0.0
Nippon Building Fund	8951 JP	988,000	Outperform	Outperform	1,090,000	1,090,000	0.0	17,015	17,015	0.0	15,289	15,289	0.0

Source: Daiwa forecasts

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More acquisitions?

We consider the prospects for acquisitions by REITs in 2013 in Japan, Hong Kong, Singapore, and Australia

Pan Asia REIT update

Economies in recovery, with 2H13 strength

At the macro level, we forecast a stable and mildly positive economic recovery scenario across most Asian markets, with growth broadly strengthening for 2H13. We also forecast stable exchange rates. This scenario, assuming it actually materialises, would be conducive for asset-price appreciation, and possibly further cap rate compression, in our view.

■ **Daiwa: real GDP growth YoY (%) forecasts**

	4Q12E	1Q13E	2Q13E	3Q13E	4Q13E	2011A	2012E	2013E
Japan	0.3	(0.7)	0.6	2.4	3.5	(0.6)	1.9	1.4
Hong Kong	1.0	2.4	2.6	2.2	2.0	5.0	0.9	2.3
Singapore	1.5	1.0	1.9	4.3	5.0	4.9	1.3	3.0
Australia	2.9	2.6	2.9	3.2	3.6	2.4	3.6	3.1

Source: Daiwa forecasts; note: 4Q12 and 2012 are actual figures for Singapore

■ **Daiwa exchange rate forecasts (versus USD)**

	4Q12	1Q13E	2Q13E	3Q13E	4Q13E
Japan*	81.2	91.8	95.0	95.0	95.0
Hong Kong+	7.76	7.76	7.76	7.76	7.76
Singapore+	1.25	1.23	1.20	1.18	1.18
Australia*	1.039	1.043	1.035	1.02	1.035

Source: Daiwa forecasts
**average exchange rate for quarter*
+end of quarter; currencies stated to 1 USD except for Australia (USD:AUD)

Subdued leasing, investment more upbeat

According to Jones Lang LaSalle (in its 4Q12 *Asia Pacific Property Digest: Improving sentiment*), the region's property markets showed mixed trends during 2012. Increased caution by corporates, especially MNCs, saw office leasing activity levels fall by 30%, following the record year in 2011. On the other hand, commercial investment activity remained relatively stable. Consistent with these trends, JLL saw moderate yield compression in most markets as rents slowed more than capital values.

Stable investment volumes in 2012

Direct commercial real estate investment activity according to JLL totalled USD23bn in 4Q12. For 2012, investment volumes totalled USD95bn, down slightly from USD98bn for 2011. Japan retained the top investment spot, while Australia moved into second place ahead of China. Local investors accounted for 80% of the acquisitions. Australia attracted the highest amount of foreign capital (USD6.5bn).

Further yield compression in 2013

According to JLL, corporates in the region are feeling more optimistic, although this may not translate into expansion demand early on this year. On the investment side, JLL expects 10-15% higher volumes this year, partly driven by increased cross-border activity including acquisitions by pension and sovereign wealth funds.

In most markets and sectors, rents and capital values should continue to increase (according to JLL) in 2013, but with growth rates typically less than 10%. According to JLL, the increased weight of money into commercial property should see further mild yield compression with capital values increasing faster than rents. The office and retail sectors should generally deliver higher returns than the residential sector, which is likely to see continued policy restrictions in various markets.

Three trends for 2013

JLL cited three trends to watch for in 2013: 1) rising cross-border investment flows in commercial real estate between Asia Pacific, Europe and the US, with as much money coming from Asia into the US and Europe as flowing the other way, 2) increasing allocations to real estate by funds looking for returns above the rate of inflation, and 3) a rising flow of Asian companies looking to grow in the Americas and Europe. We believe the realisation of the second trend would have positive implications for Pan Asian REITs.

Pan Asia acquisition landscape

From our Pan Asian perspective, the acquisition landscape for 2013 varies slightly for each country, as discussed in the following summary paragraphs and in the more detailed country sections.

J-REITs: brisk property acquisitions

Deals gaining momentum

Property acquisitions (by value) by J-REITs rose by 20% YoY for 2012. Net of sales, the value of property acquisitions rose by 37% YoY to JPY714.0bn. J-REITs have also announced large capital increases and new listings so far in 2013. Many J-REITs are pushing ahead with purchases of buildings with higher acquisition yields than the properties in their existing portfolios. Acquisitions of relatively high-yielding city centre, suburban, and regional properties are on the rise, and J-REITs are setting their sights on a wider variety of properties (amusement-park properties, dormitories).

Cap rates likely to tighten

Cap rates (acquisition cost basis) rose significantly following the Lehman Shock, but have recently shown signs of reversing course, especially for office buildings in the greater Tokyo area, where buying interest is strong. Some REITs have recently been acquiring properties owned by firms affiliated with their sponsors amid a dearth of optimal properties available for sale. We believe strengthened ties with sponsors will be important for energising the J-REIT market going forward. We note that cap rates in Ueno (northeast Tokyo) and Toranomon (central Tokyo) have headed moderately down recently due to limited office-space supply and steady demand. As buying interest by REITs has been increasing since the outset of 2013, we believe cap rates could take a meaningful downward turn.

We believe the following J-REITs, helped by their firm sponsor pipelines and strong management motivation (to make acquisitions) are most likely to make acquisitions in 2013: Nippon Building Fund (8951 JP), Japan Real Estate Investment (8952 JP), Kenedix Realty Investment (8972 JP), Heiwa Real Estate REIT (8966 JP), Mori Hills REIT Investment (3234 JP), and Advance Residence Investment (3269 JP).

Positive: with plenty of catalysts

We are positive on the J-REIT sector. The rally in the Tokyo Stock Exchange (TSE) REIT Index has resulted in the lowest prospective average dividend yield for the sector in the post-Lehman Shock era. This may have somewhat reduced the benefit of investing in J-REITs for their high, stable dividend yields. Nevertheless, we expect the J-REIT market to remain buoyant in 2013 on the back of: 1) a pickup in office rents, 2) expectations for the new government's measures to shake off deflation, and 3) progress with discussions of regulatory reforms. Given that the broader market is yielding less than 2%, the recent J-REIT prospective average dividend yield of around 4% still appears attractive. Based on this, we have a Positive investment opinion on the J-REIT sector for the next six months.

Top pick: Nippon Building Fund (8951 JP, JPY988,000, Outperform [2])
Target price: JPY1,090,000
For more details, see *Looking for new property acquisitions to boost dividends* (21 February 2013)

H-REITs: acquisitions a secondary growth driver

Dominated by a few major owners

We believe it is structurally difficult for H-REITs to pursue acquisition opportunities in the open market in Hong Kong, and we do not expect this to change in the near future. We think one structural characteristic of the Hong Kong commercial property market is that many property assets (especially prime assets) are owned by the major developers and conglomerates and wealthy families who tend not to sell their investment properties.

That said, we have, in recent years, seen some early signs of change. We believe that as the family-run property companies gradually mature in the realm of capital management some will gradually come to realise that it is better not to tie up capital in 'low-tier' assets and that they would be better off deploying the capital in productive investments.

Asset enhancements are the major driver of value

We believe the ability to implement AEI and enhance the value of their assets remains the key for the H-REITs. This also holds for their acquisitions – that is, their ability to undertake value-enhancing acquisitions, whether from within or outside the sponsorship channel.

The Link and Fortune most likely to make acquisitions

We believe the most likely H-REITs to make acquisitions in 2013 are The Link REIT and Fortune REIT. In the current environment, we think H-REITs need to use mainly debt in order to make a deal yield-accretive. In terms of debt-raising capability, The Link and Fortune are among the strongest in the sector. With a gearing ratio of 15%, The Link REIT's debt capacity is over HKD20bn.

Meanwhile, Fortune REIT has debt headroom of HKD3.7bn before reaching the 35% gearing limit. The fact that Fortune has a supportive sponsor should also enhance its ability to make acquisitions. Since its IPO in 2003, Fortune REIT has made three acquisitions (in 2005, 2009 and 2012), which has expanded its portfolio size from 1m sq ft in 2003 to 2.4m sq ft now.

Positive: defensiveness could return to favour

Our sector rating for the H-REITs is Positive because unit prices corrected at the beginning of 2013. We also think the H-REITs' valuations are not excessive and the commercial property cycle is still in their favour.

For 2013, we like decentralised offices and suburban malls and believe the H-REITs are well-positioned to capitalise on opportunities in these areas. Meanwhile, with market sentiment having turned more cautious, we expect investor interest in defensive counters like the H-REITs to pick up. Additionally, the H-REITs would likely benefit from the uncertainties facing the developers in the wake of the new government measures to rein in demand for residential properties.

Top pick: The Link REIT
(823 HK, HKD42.20, Outperform [2])
Target price (10-year DDM): HKD48.0
See the flash *Still riding the virtuous cycle* (20 February 2013) for Jonas' target price increase

Top pick: Fortune REIT
(7778 HK, HKD6.88, Buy [1])
Target price (10-year DDM): HKD8.20
See the flash *A pure play on suburban malls* (21 February 2013) where Jonas upgrades to Buy

S-REITs: acquisition climate improves

DPU and NAV accretion is a reality

We believe investment conditions remain favourable for acquisitions in 2013, and we see acquisition opportunities for the S-REITs across all sectors. With unit prices trading at their highest levels since the end of 2007 (and for some nearing their pre-global financial crisis peaks), and therefore a high likelihood now for acquisitions and related financing to be both DPU and NAV-accretive, we believe there is a clear incentive for REIT managers to expand their asset size and market caps through acquisitions in 2013. With share prices trading at their highest levels in over five years, private placements are now a common occurrence.

Ascott Residence Trust and CapitaRetail China Trust likely to announce deals

We believe Ascott Residence Trust and CapitaRetail China Trust, both having completed private placements recently to increase their debt headroom, are the most likely S-REITs to announce acquisitions in 2013, though these expectations have probably been discounted (especially for CapitaRetail China Trust) by the market.

Positive factors appear fully priced

Our overall view on the S-REIT sector is Neutral. We are Neutral on office S-REITs because valuations no longer look compelling following a year of significant outperformance. Moreover, we believe our expectations for office rents to bottom by 1H13 is well discounted by the market, while office S-REITs are now trading near the upper end of their PBR ranges, while their NAVs reflect asset values that are close to their peaks.

We are Neutral on retail S-REITs as we believe their high PBRs already fully reflect their defensiveness. We are Negative on industrial S-REITs as they are trading at all-time high PBRs, and we believe they could be vulnerable to industrial-rent declines and their yields do not adequately compensate investors for the current macro, sector and market risks.

Top Buy: Suntec Real Estate Investment Trust
(SUN SP, SGD1.78, Outperform [2])
Target price (10-year DDM): SGD1.95
See David's sector report *A mild recovery is in the price*, for his latest views on the S-REIT Office sector (31 January 2013)

Top Sell: Ascendas REIT
(AREIT SP, SGD2.66, Underperform [4])
Target price (10-year DDM): SGD2.20

A-REITs: Singapore participation

Low yields in Singapore? Try Australia

The participation of S-REITs and Singapore investors in the Australian investment property market has increased in recent years. We believe this has been helped by: 1) low leverage, post the global financial crisis, combined with high absolute yields and access to cheap offshore financing (even when swapped to minimise currency risk) leading to highly DPU-accretive deals, 2) the stability offered by long leases and weighted average lease expiries (WALEs) found in Australia are no longer viewed as a liability post the global financial crisis, and 3) the track record for

almost all S-REITs that have completed Australian-property acquisitions in recent years has been highly positive, given the resilience of the Australian economy, currency and overall quality (in our opinion) of the assets acquired, leading to greater interest in Australian assets. Therefore, we are likely to see more deals for Australian assets by S-REITs, as the positive factors cited above have not changed.

Australand: exit CapitaLand?

We believe CapitaLand's (CAPL SP, SGD3.90, Sell [5]) possible exit could lead to the largest M&A deal in the A-REIT sector this year. As many S-REITs are looking to increase their exposure to Australia, CapitaLand is undergoing a strategic review of its own non-core overseas investments, which could lead to its divestment of Australand (ALZ AU, Not rated).

Capitaland's new CEO, Mr. Lim Ming Yan, publicly announced (on 3 January 2013) a more streamlined corporate structure and his intention to conduct a review of the company's investments outside of Singapore and China, its two core markets. At the briefing, he also referred to Australand as merely a 'financial investment'.

■ J-REITs: ratings, valuations, and key financial data

	Price JPY	Mkt cap JPYbn	Mkt cap USDbn	Daiwa rating	Current DPU JPY	Next DPU JPY	Current Yield (% p.a.)	Next Yield (% p.a.)	Gov't Yield (%)	Current Yd sprd (%)	Next Yd sprd (%)	Latest BVPS JPY	PBR (x)	Latest gearing (%)	Latest NAV JPY	P/NAV (x)
Office																
8951 JP	988,000	683.70	7.32	Outperform	15,328	15,289	3.1	3.1	0.7	2.4	2.4	727,577	1.36	44.4	795,082	1.24
8952 JP	980,000	582.26	6.23	Hold	15,346	15,507	3.1	3.2	0.7	2.4	2.4	678,328	1.44	42.2	700,290	1.40
8954 JP	516,000	146.77	1.57	Hold	11,215	10,810	4.3	4.2	0.7	3.6	3.5	542,409	0.95	49.6	523,109	0.99
8959 JP	559,000	170.56	1.83	Hold	12,339	12,109	4.4	4.3	0.7	3.7	3.6	620,957	0.90	46.0	483,690	1.16
8961 JP	841,000	203.52	2.18	Hold	19,090	16,239	4.5	3.9	0.7	3.8	3.1	584,544	1.44	47.2	550,529	1.53
8972 JP	374,500	107.31	1.15	Outperform	8,986	8,235	4.8	4.4	0.7	4.1	3.7	524,828	0.71	45.8	435,981	0.86
8987 JP	536,000	118.80	1.27	Outperform	12,200	12,300	4.6	4.6	0.7	3.8	3.9	554,134	0.97	49.7	470,549	1.14
Diversified																
8955 JP	260,400	214.83	2.30	Outperform	5,800	-	4.5	-	0.7	3.7	-	246,204	1.06	49.3	214,587	1.21
8956 JP	389,000	76.52	0.82	Hold	10,000	10,000	5.1	5.1	0.7	4.4	4.4	446,004	0.87	52.8	385,661	1.01
8957 JP	492,000	83.33	0.89	Hold	11,512	-	4.7	-	0.7	4.0	-	590,402	0.83	43.4	598,477	0.82
8966 JP	65,400	52.02	0.56	Outperform	1,655	1,646	5.1	5.0	0.7	4.3	4.3	102,077	0.64	45.6	88,919	0.74
8982 JP	424,500	65.80	0.70	Hold	11,645	9,793	5.5	4.6	0.7	4.8	3.9	543,900	0.78	51.4	501,021	0.85
3234 JP	491,000	113.68	1.22	Outperform	9,329	-	3.8	-	0.7	3.1	-	449,768	1.09	48.7	390,139	1.26
3279 JP	698,000	143.27	1.53	Outperform	16,759	14,834	4.8	4.3	0.7	4.1	3.5	459,095	1.52	42.8	490,614	1.42
Commercial																
8953 JP	183,400	381.32	4.08	Hold	3,850	3,875	4.2	4.2	0.7	3.5	3.5	157,050	1.17	44.7	150,944	1.22
Residential																
8973 JP	448,500	61.48	0.66	Hold	10,396	10,286	4.6	4.6	0.7	3.9	3.9	449,417	1.00	51.7	396,993	1.13
8986 JP	69,700	92.76	0.99	Outperform	1,363	1,382	3.9	4.0	0.7	3.2	3.2	64,686	1.08	46.1	58,546	1.19
3240 JP	487,500	73.58	0.79	Hold	12,289	12,455	5.0	5.1	0.7	4.3	4.4	469,315	1.04	53.0	415,411	1.17
3269 JP	190,200	234.90	2.51	Outperform	4,500	4,500	4.7	4.7	0.7	4.0	4.0	157,413	1.21	53.7	160,691	1.18

Source: Bloomberg, Daiwa
Note: prices as of close on 21 February 2013

■ H-REITs: ratings, valuations, and key financial data

	Price HKD	Mkt cap USDbn	Daiwa rating	Daiwa target HKD	Target upside (%)	FY13E DPU HKD	FY14E DPU HKD	FY13E Yd (%)	FY14E Yd (%)	Gov't Yd (%)	FY13E Yd sprd (%)	FY14E Yd sprd (%)	Latest BVPS HKD	PBR (x)	Latest gearing (%)	DDM Value HKD	FY13E FFO HKD	FY14E FFO HKD	FY13E P/FFO (x)	FY14E P/FFO (x)
Retail																				
Link REIT (823 HK)	42.2	12.47	O/P	48.00	13.7	1.466	1.654	3.5	3.9	1.3	2.2	2.6	30.82	1.37	13.7	48.00	1.47	1.65	28.8	25.5
Fortune REIT (778 HK)	6.88	1.52	Buy	8.20	19.2	0.363	0.404	5.3	5.9	1.3	4.0	4.6	8.81	0.78	20.3	8.20	0.32	0.36	21.7	19.2
Office																				
Champion REIT (2778 HK)	4.07	2.99	Hold	4.13	1.5	0.214	0.221	5.3	5.4	1.3	4.0	4.1	7.80	0.52	19.3	4.13	0.17	0.18	23.7	22.2
Sunlight REIT (435 HK)	3.51	0.73	Buy	4.00	14.0	0.190	0.20	5.4	5.7	1.3	4.1	4.4	6.17	0.57	26.1	4.00	0.19	0.19	18.8	18.9

Source: Bloomberg, Daiwa forecasts
Note: prices as of close on 21 February 2013

S-REITs: ratings, valuations, and key financial data

	Price SGD	Mkt cap USDbn	Daiwa rating	Daiwa target SGD	Target Upside (%)	FY13E DPS SGD	FY14E DPS SGD	FY13E Yield (%)	FY14E Yield (%)	10-yr SGS (%)	FY13E Yd sprd (%)	FY14E Yd sprd (%)	Latest BVPS SGD	PBR (x)	Latest gearing (%)	DDM value SGD	FY13E FFO/shr SGD	FY14E FFO/shr SGD	FY13E P/FFO (x)	FY14E P/FFO (x)
Office																				
CCT SP	1.625	3.73	Hold	1.59	(2.2)	0.078	0.082	4.8	5.1	1.6	3.2	3.5	1.66	0.98	29.8	1.59	0.071	0.075	22.8	21.6
SUN SP	1.78	3.24	O/P	1.95	9.6	0.094	0.106	5.3	6.0	1.6	3.7	4.4	2.07	0.86	39.5	1.95	0.056	0.089	31.5	19.9
KREIT SP	1.345	2.86	Hold	1.30	(3.3)	0.086	0.087	6.4	6.5	1.6	4.8	4.9	1.32	1.02	42.9	1.30	0.077	0.078	17.4	17.3
Retail																				
CT SP	2.18	6.09	Hold	2.06	(5.5)	0.106	0.112	4.9	5.2	1.6	3.3	3.6	1.65	1.32	36.7	2.06	0.098	0.105	22.2	20.8
FCT SP	2.06	1.37	Hold	1.96	(4.9)	0.107	0.109	5.2	5.3	1.6	3.6	3.7	1.53	1.35	30.1	1.96	0.104	0.106	19.8	19.4
SGREIT SP	0.89	1.40	Hold	0.85	(4.5)	0.051	0.051	5.7	5.7	1.6	4.1	4.1	0.88	1.01	30.4	0.85	0.050	0.050	17.7	17.7
CRCT SP	1.8	1.09	Sell	1.44	(20.0)	0.092	0.098	5.1	5.4	1.6	3.5	3.8	1.31	1.38	28.3	1.44	0.055	0.058	32.9	31.0
Industrial																				
AREIT SP	2.66	4.81	U/P	2.20	(17.3)	0.150	0.160	5.7	6.0	1.6	4.1	4.4	1.88	1.41	32.9	2.20	0.147	0.156	18.2	17.0
MLT SP	1.195	2.34	U/P	1.07	(10.5)	0.073	0.075	6.1	6.3	1.6	4.5	4.7	0.90	1.33	35.9	1.07	0.072	0.074	16.5	16.1
CREIT SP	0.745	0.73	U/P	0.62	(16.8)	0.051	0.051	6.8	6.8	1.6	5.2	5.2	0.65	1.15	36.0	0.62	0.043	0.048	17.2	15.4
Hospitality																				
CDREIT SP	2.03	1.59	U/P	1.81	(10.8)	0.123	0.127	6.0	6.3	1.6	4.4	4.7	1.61	1.26	24.9	1.81	0.122	0.127	16.6	16.0
ART SP	1.335	1.23	Hold	1.38	3.4	0.086	0.091	6.5	6.8	1.6	4.9	5.2	1.35	0.99	39.1	1.38	0.063	0.067	21.2	20.0

Source: Bloomberg, Daiwa forecasts
Note: prices as of close on 21 February 2013

Major A-REITs: valuations and key financial data

A-REITs		Price AUD	Mkt cap USDbn	FY13E DPS AUD	FY14E DPS AUD	FY13E Yield (%)	FY14E Yield (%)	10-yr bond yld (%)	FY13E Yld sprd (%)	FY14E Yld sprd (%)	Latest BVPS AUD	PBR (x)	Latest gearing (%)	FY13E FFO/shr AUD	FY14E FFO/shr AUD	FY13E P/FFO (x)	FY14E P/FFO (x)
Westfield Group	WDC AU	11.06	25.4	0.51	0.537	4.6	4.9	3.6	1.1	1.3	6.79	1.63	31.9	0.686	0.72	16.1	15.4
Westfield Retail Trust	WRT AU	3.13	9.9	0.192	0.2	6.1	6.4	3.6	2.6	2.8	3.37	0.93	21.8	0.193	0.2	16.2	15.7
Stockland	SGP AU	3.70	8.3	0.24	0.241	6.5	6.5	3.6	2.9	3.0	3.49	1.06	27.6	0.24	0.262	15.4	14.1
Goodman Group	GMG AU	4.60	8.4	0.195	0.212	4.2	4.6	3.6	0.7	1.0	2.64	1.74	21.1	0.33	0.35	13.9	13.1
GPT Group	GPT AU	3.85	7.0	0.204	0.211	5.3	5.5	3.6	1.7	1.9	3.73	1.03	21.7	0.243	0.25	15.8	15.4
CFS Retail Trust	CFX AU	2.06	5.9	0.14	0.14	6.8	6.8	3.6	3.2	3.2	2.05	1.00	27.9	0.14	0.14	14.7	14.7
Mirvac Group	MGR AU	1.61	5.6	0.087	0.091	5.4	5.7	3.6	1.9	2.1	1.64	0.98	23.8	0.11	0.118	14.6	13.6
Dexus Property Group	DXS AU	1.05	5.2	0.059	0.06	5.6	5.7	3.6	2.1	2.2	1.03	1.02	29.0	0.078	0.078	13.5	13.5
Commonwealth Property Office	CPA AU	1.10	2.6	0.064	0.067	5.8	6.1	3.6	2.3	2.6	1.15	0.95	25.1	0.084	0.086	13.0	12.7
Australand Property Group	ALZ AU	3.44	2.1	0.22	0.223	6.4	6.5	3.6	2.8	2.9	3.49	0.99	32.2	0.26	0.27	13.2	12.7

Source: Bloomberg
Note: prices as of close on 21 February 2013

*When a report covers six or more subject companies please access important disclosures for Daiwa Capital Markets Hong Kong Limited at **http://www.daiwacm.com/hk/research_disclaimer.html** or contact your investment representative or Daiwa Capital Markets Hong Kong Limited at Level 26, One Pacific Place, 88 Queensway, Hong Kong.*

J-REITs

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J-REIT property acquisitions brisk

J-REIT property purchases in 2012

Property acquisitions by J-REITs rose by 20% YoY in 2012 in terms of acquisition value. New share offerings and new listings facilitated purchases of 198 properties for a total of JPY789.3bn. In contrast, the value of property sales fell 44% to JPY75.2bn. Net of sales, the value of property acquisitions rose by 37% YoY to JPY714.0bn.

J-REITs: property transactions

Source: Company materials, JITA; compiled by Daiwa
Data through end-January 2013

An active year

Looking at property acquisitions in each month of 2012, we note that J-REITs purchased only three properties (for a total of JPY7.8bn) in January 2012. However, there were some notably large acquisitions in February, including two Tokyo office buildings purchased by Nippon Building Fund (8951 JP) for JPY12.4bn and a commercial facility in Fukuoka acquired by Frontier Real Estate Investment (8964 JP) for JPY10.1bn.

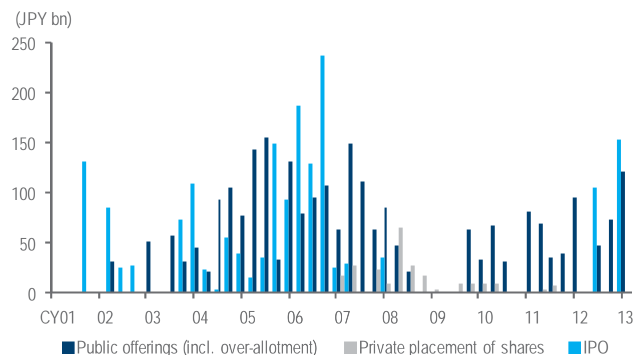
March saw some acquisitions of real estate in prime office locations, including Japan Prime Realty Investment's (8955 JP) purchase of the tentatively named Otemachi 1-6 Project (land with land leasehold rights) for JPY36.0bn. January-March asset acquisitions totalled JPY173.6bn, or JPY145.4bn net of sales. May witnessed the listing of Kenedix Residential Investment (3278 JP). This was the first listing of a J-REIT in over four and a half years, and the fund acquired 18 residential properties. Activia Properties (3279 JP) listed in June with a portfolio of 18 properties acquired for JPY170.3bn, including the large Tokyu Plaza Omotesando Harajuku complex. As a result, April-June asset purchases rose 3.5-fold YoY to JPY287.2bn.

Purchases amounted to only JPY118.1bn in July-September, but October saw Japan Retail Fund Investment (8953 JP) purchase seven properties for JPY52.1bn, including Mozo Wonder City. Daiwa House REIT Investment (3263 JP) listed in November, and acquired 20 properties including logistics facilities for JPY95.0bn in the same month. October-December asset purchases amounted to JPY210.3bn. Logistics facility specialist GLP J-REIT (3281 JP) listed in December, bringing the number of J-REITs that listed in 2012 to four.

Large capital increases, new listings should continue in 2013

J-REITs have also announced large capital increases and new listings from the outset of 2013, with four new share offerings and two new listings revealed in January. Nippon Building Fund announced a new share offering along with purchases of four properties including Celestine Shiba Mitsui Building for a total acquisition value of JPY64.8bn. Nippon Prologis REIT also plans to list with an asset scale of JPY173.0bn. The fund's investments focus on prime logistics facilities, and it plans to leverage its sponsor's pipeline to generate growth.

J-REITs: equity financings



Source: Company materials, JITA; compiled by Daiwa
Data through end-Jan 2013

J-REIT strategies for property purchases

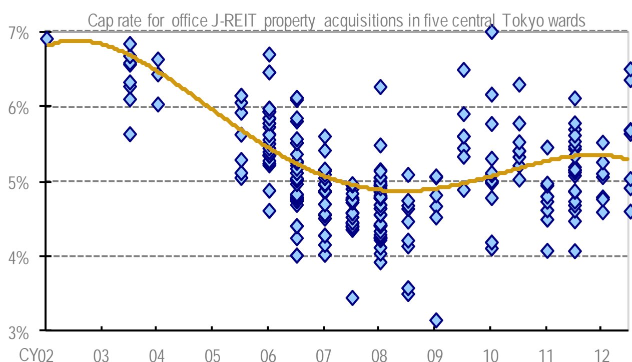
Many J-REITs are pushing ahead with purchases of buildings that yield higher returns than the properties in their existing portfolios. Acquisitions of relatively high-yielding city centre, suburban, and regional properties are on the rise, and J-REITs are setting their sights on a wider variety of properties. For instance, Japan Retail Fund Investment has purchased amusement facilities, while Nippon Accommodations Fund (3226 JP) has bought student dormitories and company-owned housing. Such properties are not traditional J-REIT targets. Sharp growth in Internet shopping at online firms such as Amazon.com and Rakuten (4755 JP) is increasing demand for large-scale modern logistics facilities. J-REIT purchases of logistics facilities are rising as a result.

Cap rate trends

Cap rates (acquisition cost basis) rose significantly following the Lehman Shock, but have recently shown signs of reversing course. This development is particularly evident among office buildings in the greater Tokyo area, where buying interest is strong. Some REITs have recently been acquiring properties owned by firms affiliated with their sponsors amid a dearth of optimal properties available for sale.

One example is Activia Properties' purchase of the Tokyu Plaza Omotesando Harajuku complex, which was the largest acquisition in 2012. Strengthened ties with sponsors will be key for energising the J-REIT market going forward.

■ J-REITs: acquisition cap rates for office

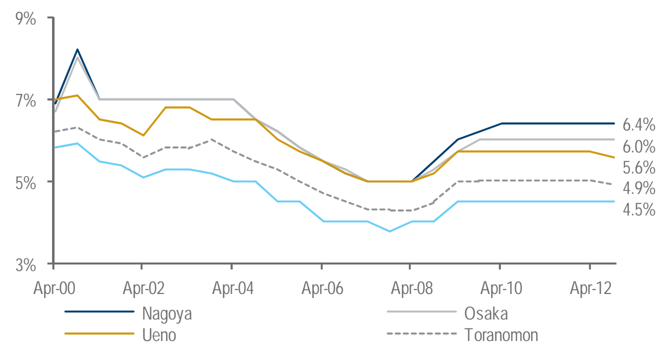


Source: Company materials, Japan Real Estate Institute; compiled by Daiwa; acquisition cap rate = net cash flow based on real estate appraisals at time of purchase / purchase price

Cap rates likely to decline

Investors' expected cap rates on real estate (published by the Japan Real Estate Institute) show that expected cap rates rose after bottoming in 2007, but have been largely flat since October 2009. However, we note that cap rates in Ueno and Toranomon have headed moderately down recently due to limited office-space supply and steady demand. As buying interest by REITs has been increasing since the outset of 2013, cap rates seem likely to take a meaningful downward turn.

■ Expected cap rates on prime office buildings



Source: Company materials, Japan Real Estate Institute; compiled by Daiwa

Sector view: Positive

Trading at post-Lehman shock highs

The TSE REIT Index ended 2012 at 1114.68 points. The advance of more than 30% over the calendar year was the strongest on record. Underpinning the rally were the relatively high dividend yields in the sector, expectations for a pick-up in real estate prices, and REIT purchases by the Bank of Japan (BOJ).

BOJ is still supportive

The TSE REIT Index has continued to fare well since the outset of 2013 despite several announcements of large-scale capital increases. The BOJ did not expand its programme for J-REIT purchases at its monetary policy meeting on 22 January. However, with the aim of achieving a 2% inflation target, it introduced an open-ended financial asset purchasing method in which it intends to continue to purchase each class of financial asset whenever necessary. It also indicated that it would hold on to the J-REIT assets it has already purchased for the long term, which is a positive, in our view. The TSE REIT Index pulled back following the 22 January announcement by the BOJ, but soon regained the lost ground.

Positive catalysts offset low yield

The rally in the TSE REIT Index has resulted in the lowest prospective average dividend yield for the sector in the post-Lehman Shock era. This may have somewhat reduced the benefit of investing in J-REITs for their high, stable dividend yields. Nevertheless, we expect the J-REIT market to remain buoyant in 2013 on the back of: 1) a pickup in office rents, 2)

expectations for the new government's measures to shake off deflation, and 3) progress with discussions of regulatory reforms. Given that the broader market is yielding less than 2%, the recent J-REIT prospective average dividend yield of around 4% still appears attractive. Based on this, we have a Positive investment opinion on the J-REIT sector for the next six months.

Office rents likely to rise from the bottom

Concerns in 2012 included a large volume of office supply combined with sluggish demand due to negatives such as the European debt crisis. Nevertheless, rents look increasingly likely to have bottomed. Indeed, the vacancy rate at the end of 2012 remained at the same level as at the end of 2011 in Tokyo's five central wards (according to Miki Shoji data). Favourable factors for demand were likely behind this, notably a rise in tenants moving from their own buildings into rented offices and an increase in floor space expansion within buildings.

Tenants moved from their own buildings into rented offices following the Great East Japan Earthquake. Attractive rents also triggered a shift from the outside to the inside of business districts. Firms also expanded the floor space within their buildings. This reflected the cramped conditions that followed some excessive shrinking after the Lehman Shock.

New supply of office buildings in 2013 appears likely to be around one-third the volume seen in 2012 and the lowest supply since 1999. This should improve the supply/demand balance and exert upward pressure on rents to rise from what increasingly appears to have been a bottom in 2012.

Expectations for government measures to shake off deflation

Expectations are rising for measures taken by Shinzo Abe's new government to shake off deflation by stepping up monetary easing and correcting the excessively strong Yen. We see two positives for the J-REIT sector. One is increasing upward pressure on rents. The other is higher real estate prices.

Japanese and foreign firms in the financial industry are concentrated in the heart of Tokyo. Demand for office space from such firms exerts a big impact on rents. Financial industry earnings appear likely to pick up as expectations for large-scale monetary easing help to correct the strong Yen and fuel a recovery in the equity market. Upward pressure on Tokyo office rents could also be generated if a weaker Yen fuels an earnings recovery in the manufacturing industry.
The value of REIT properties would gain a boost if the government's measures to shake off deflation fuelled a rise in real estate prices. This would likely accelerate investments in Tokyo office buildings by Japanese and foreign investors.

Focus on regulatory reform discussions

Discussions are currently under way concerning revisions to the Law on Investment Trusts and Investment Corporations. Diversifying J-REIT fundraising methods and capital policies is one objective of the proposed reforms. The December 2010 Action Plan for the Reinvigoration of the Financial/ Capital Markets and Financial Industry calls for changes to be implemented by the end of FY13 (March 2014). Specific proposals include allowing: 1) rights offerings, 2) the issuance of convertible bonds, 3) capital reductions without compensation, and 4) share buybacks.

The possible removal of the ban on J-REIT share repurchases is a focal point. An announcement of the ban being lifted would probably spark renewed interest in J-REIT shares. It could also lead to higher per-share dividends by reducing shares outstanding, as well as generating bargain purchase gains if funds repurchase their shares at prices below per-share net assets. Higher share prices would likely pave the way for smoother capital raising, which should allow J-REITs to expand their assets through property acquisitions.

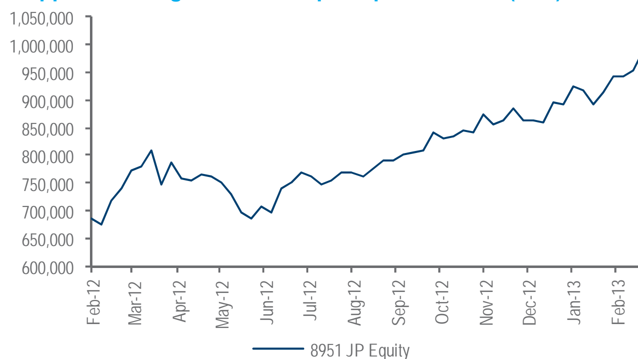
Top Buy

Nippon Building Fund

(8951 JP, JPY988,000, Outperform [2])
Target price: JPY1,090,000

Looking for new property acquisitions to boost dividends

■ Nippon Building Fund: share price performance (JPY)



Source: Bloomberg, Daiwa

■ Investment indicators

12-month price range (JPY)	677,000-995,000
Market cap (JPYm)	683,696
Market cap (USDbn)	7.32
Shares outstanding	692,000
Foreign ownership (%)	28

Source: NBF, Daiwa

Investment thesis

Nippon Building Fund (NBF) was listed in 2001 as Japan's first REIT. It invests in office properties mainly in the Greater Tokyo area. It has achieved steady growth utilising the expertise of its main sponsor, Mitsui Fudosan (8801 JP). With a total acquisition value of JPY921.6bn at the end of 2012, it is among the largest J-REITs in terms of asset size.

While a Miki Shoji survey put the end-2012 vacancy rates for office building leasing in the five central Tokyo wards at a high 8.67%, the figure for NBF was much lower at 1.8%. Since its portfolio focuses on prime buildings in the heart of the city, which hold a competitive edge, the large influx of new office buildings in the Tokyo metropolitan area in 2012 seems to have had only a limited impact on the fund.

It acquired five properties for a total of JPY22.6bn (including additional stakes in two properties) in the period ended June 2012. It then purchased NBF Comodio Shiodome for JPY28.8bn in July 2012. In 2013 so far, it has conducted an equity financing project, with the proceeds being used for acquiring four buildings including Celestine Shiba Mitsui Bldg. for JPY64.8bn. Indeed, NBF continues to achieve steady growth backed by its solid financial standing.

We expect the end of deflation to spark inflow of capital into J-REIT market

We maintain our Outperform (2) rating on NBF and see the end of deflation as a potential positive catalyst for the fund. Rents for the fund's existing properties are higher than market asking prices, suggesting a moderate decline going forward. However, new investments capitalising on the pipeline at the sponsor should help NBF maintain or increase dividends. If Tokyo office rents and real estate prices rise amid government efforts to beat deflation, we believe NBF would be well positioned to benefit given its portfolio of high-end office buildings. We see NBF as a core holding in the J-REIT sector.

Valuation

NBF trades at a dividend yield of 3.1% and a price-to-NAV ratio of 1.24x (both based on our estimates for the period ending June 2013), reflecting a valuation premium to peers. However, considering the fund's low vacancy rate, sustained stable dividend payouts, and strong financial position, we think the premium is justified.

Risk to our call

With many positive expectations already built into the share price, the risk to our rating would be possible market disappointment over the Abe government's ability to steer the economy to a meaningful and sustainable recovery, and end the cycle of asset-price deflation.

■ Nippon Building Fund: financial summary (JPYm)

	12/12	6/13E	12/13E
Op revenue	31,529	34,180	32,575
Op profit	12,620	14,770	13,380
Rec profit	9,658	11,775	10,580
Net income	9,657	11,775	10,580
EPS (JPY)	15,754	17,015	15,289
DPS (JPY)	15,754	15,328	15,289
DPS growth % chg	1.77	(2.70)	(0.25)
Div yield %	3.19	3.10	3.09
BVPS (JPY)	727,577	746,269	746,230
PBR (x)	1.36	1.32	1.32
Gearing (%)	44.4	40.2	40.2
ROE (%)	4.3	4.9	4.1

Source: Daiwa forecasts

■ J-REITs: ratings, valuations, and key financial data

	Price JPY	Mkt cap JPYbn	Mkt cap USDbn	Daiwa rating	Current DPU JPY	Next DPU JPY	Current Yield (% p.a.)	Next Yield (% p.a.)	Gov't Yield (%)	Current Yd sprd (%)	Next Yd sprd (%)	Latest BVPS JPY	PBR (x)	Latest gearing (%)	Latest NAV JPY	P/NAV (x)
Office																
8951 JP	988,000	683.70	7.32	Outperform	15,328	15,289	3.1	3.1	0.7	2.4	2.4	727,577	1.36	44.4	795,082	1.24
8952 JP	980,000	582.26	6.23	Hold	15,346	15,507	3.1	3.2	0.7	2.4	2.4	678,328	1.44	42.2	700,290	1.40
8954 JP	516,000	146.77	1.57	Hold	11,215	10,810	4.3	4.2	0.7	3.6	3.5	542,409	0.95	49.6	523,109	0.99
8959 JP	559,000	170.56	1.83	Hold	12,339	12,109	4.4	4.3	0.7	3.7	3.6	620,957	0.90	46.0	483,690	1.16
8961 JP	841,000	203.52	2.18	Hold	19,090	16,239	4.5	3.9	0.7	3.8	3.1	584,544	1.44	47.2	550,529	1.53
8972 JP	374,500	107.31	1.15	Outperform	8,986	8,235	4.8	4.4	0.7	4.1	3.7	524,828	0.71	45.8	435,981	0.86
8987 JP	536,000	118.80	1.27	Outperform	12,200	12,300	4.6	4.6	0.7	3.8	3.9	554,134	0.97	49.7	470,549	1.14
Diversified																
8955 JP	260,400	214.83	2.30	Outperform	5,800	-	4.5	-	0.7	3.7	-	246,204	1.06	49.3	214,587	1.21
8956 JP	389,000	76.52	0.82	Hold	10,000	10,000	5.1	5.1	0.7	4.4	4.4	446,004	0.87	52.8	385,661	1.01
8957 JP	492,000	83.33	0.89	Hold	11,512	-	4.7	-	0.7	4.0	-	590,402	0.83	43.4	598,477	0.82
8966 JP	65,400	52.02	0.56	Outperform	1,655	1,646	5.1	5.0	0.7	4.3	4.3	102,077	0.64	45.6	88,919	0.74
8982 JP	424,500	65.80	0.70	Hold	11,645	9,793	5.5	4.6	0.7	4.8	3.9	543,900	0.78	51.4	501,021	0.85
3234 JP	491,000	113.68	1.22	Outperform	9,329	-	3.8	-	0.7	3.1	-	449,768	1.09	48.7	390,139	1.26
3279 JP	698,000	143.27	1.53	Outperform	16,759	14,834	4.8	4.3	0.7	4.1	3.5	459,095	1.52	42.8	490,614	1.42
Commercial																
8953 JP	183,400	381.32	4.08	Hold	3,850	3,875	4.2	4.2	0.7	3.5	3.5	157,050	1.17	44.7	150,944	1.22
Residential																
8973 JP	448,500	61.48	0.66	Hold	10,396	10,286	4.6	4.6	0.7	3.9	3.9	449,417	1.00	51.7	396,993	1.13
8986 JP	69,700	92.76	0.99	Outperform	1,363	1,382	3.9	4.0	0.7	3.2	3.2	64,686	1.08	46.1	58,546	1.19
3240 JP	487,500	73.58	0.79	Hold	12,289	12,455	5.0	5.1	0.7	4.3	4.4	469,315	1.04	53.0	415,411	1.17
3269 JP	190,200	234.90	2.51	Outperform	4,500	4,500	4.7	4.7	0.7	4.0	4.0	157,413	1.21	53.7	160,691	1.18

Source: Bloomberg, Daiwa
Note: prices as of close on 21 February 2013

H-REITs

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Acquisitions: the secondary growth driver

We believe it is structurally difficult for H-REITs to pursue acquisition opportunities in the open market in Hong Kong, and we do not expect this to change in the near future.

Prized assets held by major developers, families

We think one structural characteristic of the Hong Kong commercial property market is that many property assets (especially the prime ones) are owned by the major developers and conglomerates and wealthy families, who tend not to sell their investment properties. Therefore, the amount of saleable commercial property assets in Hong Kong does not look large relative to the private wealth in the territory.

As a result, cap rates in Hong Kong tend to be low and rarely does positive carry exist in the Hong Kong commercial property market. This phenomenon has been reinforced by prevailing low interest rates in recent years, and hence in the strata-title market, cap rates of 3% or less are not uncommon, especially for assets which are below HKD100m, an affordable amount for many private investors.

Competition is less keen for bigger-ticket assets but …

As the price tag of a property gets higher, competition becomes less keen; however, we observe that in Hong Kong, there are many private individuals who can afford assets of HKD300-500m. Generally speaking, for property assets over HKD1bn, competition is less intense, although there have been past cases where private individuals or families could afford to pay over HKD2bn for property assets.

However, owners of the more valuable assets tend to be reluctant to sell, probably because the historical return offered by prime property assets in Hong Kong has been very attractive. Meanwhile, Hong Kong's banking culture on property lending has been quite conservative, and it appears that over the past few decades, one key for success in Hong Kong property has been to stay financially conservative. As such, the 'survivor' companies (or individuals) tend to be conservative in using financial leverage.

As a result, these survivor companies tend to have holding power. In our view, the amount of more valuable property assets available for sale is limited and when these properties are offered for sale, there are investors who work on sub-selling the properties on a strata-title basis before the completion of the purchase to take advantage of the lower cap rates for property assets at lower unit prices.

This low cap-rate environment does not bode well for the H-REITs' competitiveness in bidding for assets in the open market – and this is before we take into account the regulatory and other issues faced by the H-REITs which do not apply to private individuals or developers.

Some early signs of change

That said, we believe there have been some early signs of change in recent years. As the family-run property companies gradually mature in the realm of capital management, we think some of them will gradually come to realise that it is better not to tie up capital in 'low-tier' assets and that they would be better off deploying the capital in productive investments. We also think there is an increasing realisation among property developers that property assets (especially retail properties) require good management in order to hold and grow their value over the long term, and some developers are still reluctant to allocate sufficient resources in this area.

We have observed that in recent years, property companies have become more willing to dispose of non-core property assets. For example, the sellers of the two property assets acquired by The Link REIT were Nan Fung and Sino Land, both of which are well-capitalised property companies.

Festival Walk monetisation, a new trend?

We also think Swire Properties' (1972 HK, Not rated) sale of Festival Walk to Mapletree (Temasek's wholly-owned property arm) for USD2.2bn in 2011 was a noteworthy transaction, as this sale appears to have been motivated by capital and strategic management considerations. We believe Swire probably thought that this asset sale was better than launching an IPO on its own, possibly at an unsatisfactory price, and that it would be better for it to deploy the capital to invest in property projects in Admiralty-Wanchai or Island East

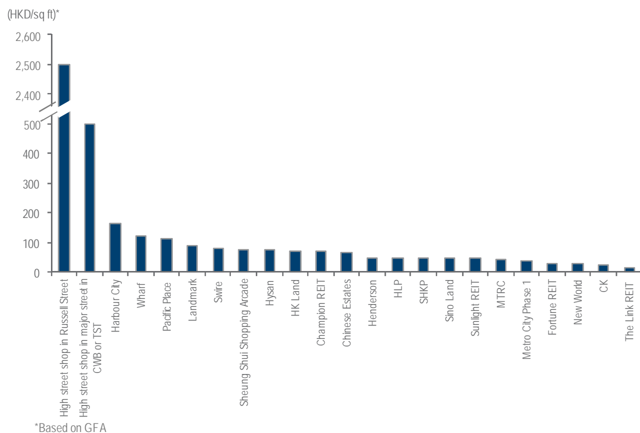
or China, where it sees stronger potential and long-term strategic value.

Such mentality is still not widely-held by Hong Kong family-run companies, but we do think that if more of them become receptive to this line of thinking, some would consider selling their mid-tier property assets when they need capital; and such a change, over time, would increase the supply of assets for the H-REITs to acquire, in our view.

AEI still the core business for the H-REITs

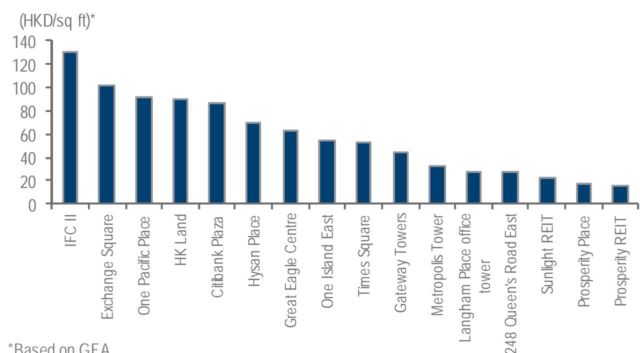
However, in our opinion, the core business of the H-REITs remains that of AEI. We believe that, structurally, one main characteristic of the Hong Kong commercial property sector is the wide range of achieved rents for commercial properties, meaning that there is considerable scope to increase achieved rents and DPU for those managers who can upgrade their properties successfully.

■ **Achieved rent of major retail properties in Hong Kong**



Source: Companies, Daiwa estimates

■ **Achieved rent of major office properties in Hong Kong**

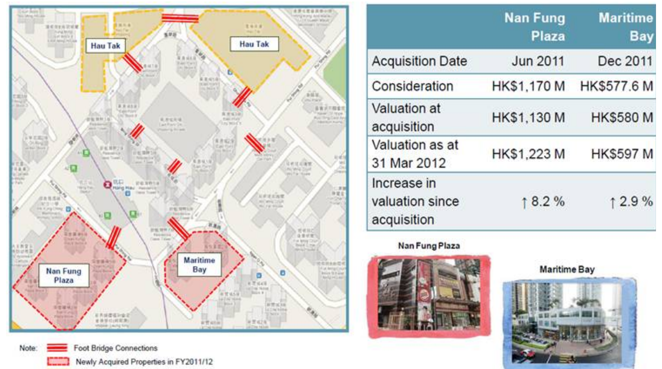


Source: Companies, Daiwa estimates, Colliers, Savills, CBRE

Moreover, our view is that the ability to increase the value of its property assets through AEI would probably be the main factor behind an H-REIT's ability to pursue acquisition opportunities. The investment market for commercial property assets in Hong Kong is likely to remain competitive, and one source of the competitive strength of a bidder probably lies in its ability to identify AEI opportunities in an acquisition target and manage (including refurbishment) the asset better than others after the acquisition.

It is probably not a coincidence therefore, that so far, The Link REIT has been the only H-REIT to successfully conclude a non-related party acquisition in the open market (so far, all of the other assets acquired by the H-REITs were from their sponsor companies). We think one rationale behind The Link REIT's two acquisitions is that it already owns many properties nearby, and through having two more assets, the relative competitiveness of its whole portfolio is strengthened.

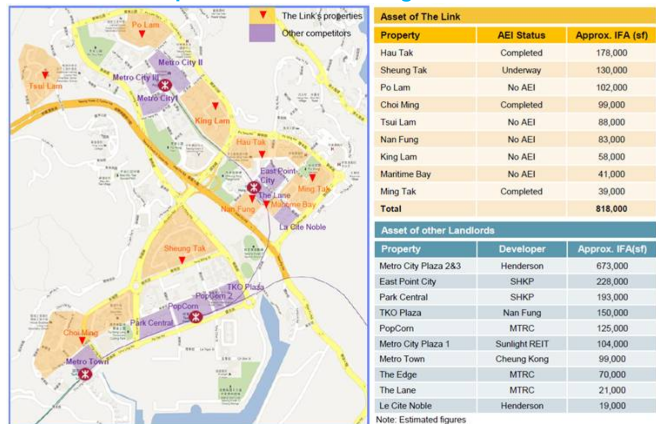
■ **The Link REIT: two acquisitions made since IPO**



	Nan Fung Plaza	Maritime Bay
Acquisition Date	Jun 2011	Dec 2011
Consideration	HK$1,170 M	HK$577.6 M
Valuation at acquisition	HK$1,130 M	HK$580 M
Valuation as at 31 Mar 2012	HK$1,223 M	HK$597 M
Increase in valuation since acquisition	↑ 8.2 %	↑ 2.9 %

Source: The Link REIT

■ **The Link REIT: presence in the Tseung Kwan O**



Asset of The Link		
Property	**AEI Status**	**Approx. IFA (sf)**
Hau Tak	Completed	178,000
Sheung Tak	Underway	130,000
Po Lam	No AEI	102,000
Choi Ming	Completed	99,000
Tsui Lam	No AEI	88,000
Nan Fung	No AEI	83,000
King Lam	No AEI	58,000
Maritime Bay	No AEI	41,000
Ming Tak	Completed	39,000
Total		**818,000**

Asset of other Landlords		
Property	**Developer**	**Approx. IFA(sf)**
Metro City Plaza 2&3	Henderson	673,000
East Point City	SHKP	228,000
Park Central	SHKP	193,000
TKO Plaza	Nan Fung	150,000
PopCorn	MTRC	125,000
Metro City Plaza 1	Sunlight REIT	104,000
Metro Town	Cheung Kong	99,000
The Edge	MTRC	70,000
The Lane	MTRC	21,000
Le Cite Noble	Henderson	19,000

Note: Estimated figures

Source: The Link REIT

Meanwhile, we think Fortune REIT's case also illustrates that the ability to carry out proper AEI is the way to create value through acquiring assets from a sponsor. The assets Fortune REIT has acquired from

its sponsor in the past have been based on market prices, but they have turned out to be yield-accretive for Fortune REIT, and we believe the main reason is that those assets were too small for the Cheung Kong Group and were under-managed in the past. However, the group has proven that it can enhance the value of these assets through proper AEI.

Our view is that, for the H-REITs, the ability to carry out AEI and enhance the value of its assets remains the key, and this also holds one of the main keys to the H-REITs' ability to undertake value-enhancing acquisitions, whether with the sponsor or outside the sponsorship channel.

Sector view: Positive

Our sector rating for the H-REITs is Positive because the H-REITs' unit prices have generally undergone a healthy correction since the beginning of the year. While the sector has already notably outperformed the Hang Seng Index over the past two years, we think the performance was backed by fundamentals, as the sector has been a neglected sector in the past, but this issue is more or less addressed now, in our opinion. We also think the H-REITs' valuations are still reasonable.

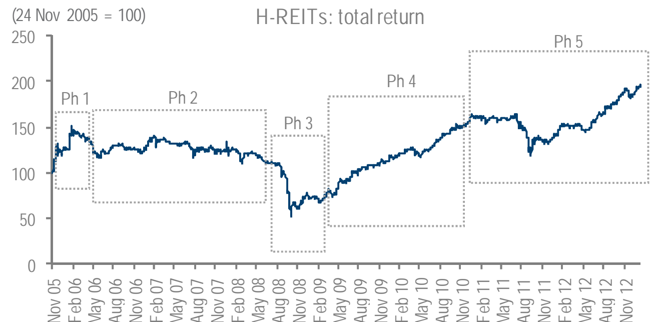
Defensive names could be in favour again

We observe that investor focus seems to have shifted to the higher-beta and cyclical names at the beginning of the year. That said, with many major stock markets having risen notably and renewed concerns over the ending of loose monetary policy, we expect investors' interest in the defensive names to pick up, and believe this would benefit the H-REIT sector.

Decentralised offices, suburban malls well positioned

More importantly, we contend that the commercial property cycle is still in the H-REITs' favour. We like decentralised offices and suburban malls in 2013, and believe the H-REITs are well-positioned to capitalise on opportunities in these areas.

■ Stages of development of the H-REITs



Source: Bloomberg, Daiwa
Phase 1: (Nov 2005 – 1Q06): a good start
Phase 2: (2Q06 – 2Q08): new supply and aggressive structure deter investors
Phase 3: (3Q08 – 1Q09): surviving the ordeal
Phase 4: (2Q09 – 4Q10): delivering the results and transparency
Phase 5: (2011 onwards): a niche sector in the Hong Kong property space

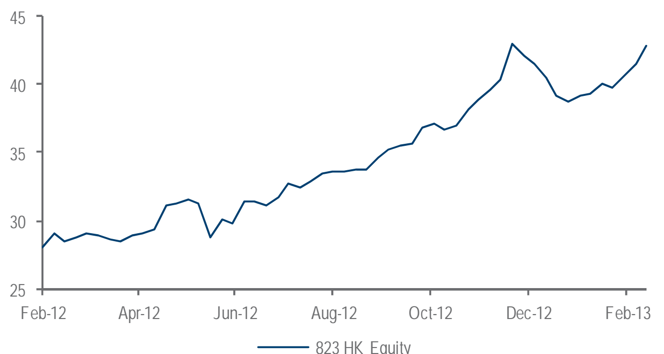
Top Picks

The Link REIT

(823 HK, HKD42.20, Outperform [2])
Target price (DDM): HKD48.0

Still riding the virtuous cycle

■ The Link REIT: share price performance (HKD)



Source: Bloomberg

■ Investment indicators

12-month range (HKD)	28.40-43.00
Market cap (USDbn)	12.47
Average daily turnover (USDm)	38.8
Shares outstanding (m)	2,292
Major shareholder (%)	Commonwealth Bank of Australia (7%)

Source: The Link REIT, Daiwa

Investment thesis

We believe suburban malls in the New Territories are now very well-positioned in the Hong Kong commercial property market, given that many international retailers are now looking to expand their presence in the suburban malls, and that for some PRC consumers, suburban malls are actually more convenient for them.

Only starting to reap AEI benefits

We think the AEI The Link REIT has done already, and will do in coming years, will position it well to ride on the opportunities in the suburban mall sector. The AEI should allow it to upgrade its tenant mix to include more retailers with higher rent-paying capacity than before. We think The Link REIT has just started reaping the benefits of the AEI it has carried out in the past few years, and believe it will take 2-3 leasing cycles or more for the full benefits of AEI to be reflected in its financial performance. We believe The Link REIT offers strong sustainable growth potential and that its growth phase is far from over. It has also started AEI for its lower-tier assets (those ranking in the 51-100 range by asset value), which should provide further growth impetus for the group. Our six-month target price of HKD48.0 is pegged to our 10-year DDM valuation. Our target price corresponds to a FY14 DPU yield of 3.4%.

Valuation

The Link REIT's share price has performed well in recent years. It is not cheap in terms of DPU yield but relative to its DPU yield range since late 2005, it is not too far out of its trading range. Moreover, while its valuation is at a premium to other H-REITs, we believe its current valuation looks reasonable relative to premier REITs in the developed markets – some premier REITs in the US trade at DPU yields of 3% or less, though we believe The Link REIT offers stronger DPU growth prospects relative to many of its global peers.

Risks to our call

The main risk to our call would be regulatory and social factors which could adversely affect The Link REIT's ability to improve its achieved rents.

■ The Link REIT: DPU yield history

Source: Datastream, Daiwa

■ Link REIT: financial summary (HKDm)

	2013E	2014E	2015E
Revenue	6,522	7,071	7,762
Net-property income	4,672	5,195	5,805
Distribution	3,360	3,814	4,340
DPU (HKD)	1.466	1.654	1.869
DPU growth % chg YoY	13.5	12.8	13.0
DPU yield (%)	3.5	3.9	4.4
Book value per unit (HKD)	26.464	26.585	26.865
PBR (x)	1.6	1.6	1.6
EPU (HKD)	1.466	1.653	1.869
ROE (%)	5.6	6.3	7.0
Gearing (%)	13.5	13.3	13.1
FFO/unit (HKD)	1.47	1.65	1.87
P/FFO (x)	28.8	25.5	22.6

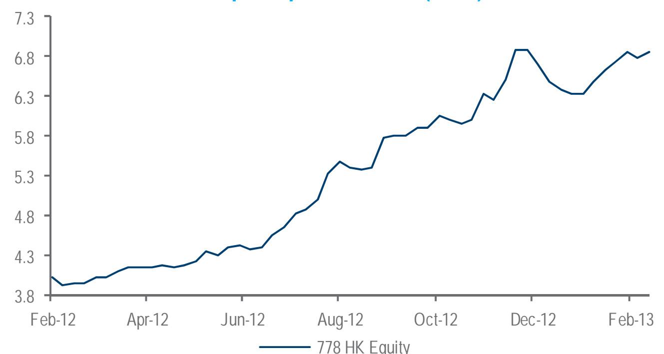
Source: Daiwa forecasts

Fortune REIT

(7778 HK, HKD6.88, Buy [1])
Target price (DDM): HKD8.20

A pure play on suburban malls

■ Fortune REIT: share price performance (HKD)



Source: Bloomberg

■ Investment indicators

12-month range (HKD)	3.95-6.92
Market cap (USDbn)	1.52
Average daily turnover (USDm)	3.6
Shares outstanding (m)	1,715
Major shareholder (%)	Cheung Kong Holdings (24.3%)

Source: Fortune REIT, Daiwa

Investment thesis

We see Fortune REIT as another name that fits into the suburban mall theme well, which we expect to be an important structural trend in the Hong Kong commercial property market in the coming years.

In our view, the group's portfolio size has reached a critical mass level after the acquisition in 2009, and we believe it is starting to reap the benefits of the AEI it has completed on its properties since then. The rental reversion it achieved in 2012 (up 19.8% over rents in the preceding lease) is an encouraging sign, and we reckon the group has been actively pursuing AEI on its major properties. It would likely take several years for

the full benefits of its past AEI and current AEI to materialise fully, and we see Fortune REIT remaining in a growth phase over the coming years.

Since its IPO in 2003, Fortune REIT has made three acquisitions (in 2005, 2009 and 2012), which has expanded its portfolio size from 1m sq ft in 2003 to 2.4m sq ft now.

Valuation

While the unit price of Fortune REIT rallied in 2012, in terms of absolute valuation, we think it is still reasonable. We believe the group is still in a growth phase, as it has just finished its first round of AEI and its attempt to revamp its entire portfolio is just starting to gather momentum. In our view, the REIT's suburban malls in Hong Kong are now very well-positioned in the Hong Kong retail property sector, and we think the full benefits from the group's AEI that it has been completed and will be rolled-out in the coming years will take 2-3 leasing cycles or more to unfold; this should underpin sustained growth in its DPU.

We reiterate our Buy (1) rating, with a six-month target price at HKD8.20, based on our 10-year DDM model. This translates into a FY14 DPU yield of 4.9%.

Risks to our call

The unit price of Fortune REIT rallied significantly in 2012 (up 69%), and so we see the main risk to our call as profit-taking.

Fortune REIT: financial summary (HKDm)

	2013E	2014E	2015E
Revenue	1,208	1,311	1,423
Net-property income	879	980	1,093
Distribution	623	699	781
DPU (HKD)	0.363	0.404	0.448
DPU growth % chg YoY	12.3	11.2	10.8
DPU yield (%)	5.3	5.9	6.5
Book value per unit (HKD)	8.795	8.690	8.593
PBR (x)	0.8	0.8	0.8
EPU (HKD)	0.316	0.359	0.411
ROE (%)	3.6	4.1	4.8
Gearing (%)	20.4	20.2	20.0
FFO/unit (HKD)	0.32	0.36	0.41
P/FFO (x)	21.7	19.2	16.8

Source: Daiwa forecasts

Fortune REIT: DPU yield history

Source: Datastream, Daiwa

The evolution of Fortune's portfolio

		GRA (sq ft)	IPO in 2003 GRA (sq ft)	Dec. 2005 GRA (sq ft)	Dec.2009 GRA (sq ft)	Dec.2012 GRA (sq ft)
1	Jubliee Square	170,616	170,616	170,616	170,616	170,616
2	Smartland	123,544	123,544	123,544	123,544	123,544
3	Nob Hill Square	91,779	91,779	91,779	91,779	91,779
4	Ma On Shan Plaza	310,084	310,084	310,084	310,084	310,084
5	Fortune Metropolis	332,168	332,168	332,168	332,168	332,168
6	Rhine Avenue	14,604	-	14,604	14,604	14,604
7	Lido Avenue	9,836	-	9,836	9,836	9,836
8	Centre de Laguna	43,000	-	43,000	43,000	43,000
9	Tsing Yi Square	78,836	-	78,836	78,836	78,836
10	Waldorf Avenue	80,842	-	80,842	80,842	80,842
11	Fortune City One	414,469	-	414,469	414,469	414,469
12	Metro Town	180,822	-	-	180,822	180,822
13	Caribbean Square	63,018	-	-	63,018	63,018
14	Hampton Loft	74,734	-	-	74,734	74,734
15	Provident Square	180,238	-	-	-	180,238
16	Belvedere Square	276,862	-	-	-	276,862
			1,028,191	1,669,778	1,988,352	2,445,452

Source: Company, Daiwa

H-REITs: ratings, valuations, and key financial data

	Price HKD	Mkt cap USDbn	Daiwa rating	Daiwa target HKD	Target upside (%)	FY13E DPU HKD	FY14E DPU HKD	FY13E Yd (%)	FY14E Yd (%)	Gov't Yd (%)	FY13E Yd sprd (%)	FY14E Yd sprd (%)	Latest BVPS HKD	PBR (x)	Latest gearing (%)	DDM Value HKD	FY13E FFO HKD	FY14E FFO HKD	FY13E P/FFO (x)	FY14E P/FFO (x)
Retail																				
Link REIT (823 HK)	42.2	12.47	O/P	48.00	13.7	1.466	1.654	3.5	3.9	1.3	2.2	2.6	30.82	1.37	13.7	48.00	1.47	1.65	28.8	25.5
Fortune REIT (778 HK)	6.88	1.52	Buy	8.20	19.2	0.363	0.404	5.3	5.9	1.3	4.0	4.6	8.81	0.78	20.3	8.20	0.32	0.36	21.7	19.2
Office																				
Champion REIT (2778 HK)	4.07	2.99	Hold	4.13	1.5	0.214	0.221	5.3	5.4	1.3	4.0	4.1	7.80	0.52	19.3	4.13	0.17	0.18	23.7	22.2
Sunlight REIT (435 HK)	3.51	0.73	Buy	4.00	14.0	0.190	0.20	5.4	5.7	1.3	4.1	4.4	6.17	0.57	26.1	4.00	0.19	0.19	18.8	18.9

Source: Bloomberg, Daiwa forecasts
Note: prices as of close on 21 February 2013

S-REITs

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Acquisition climate improves

We believe investment conditions remain favourable for acquisitions in 2013, and see acquisition opportunities for S-REITs across all sectors. With unit prices trading at their highest levels since the end of 2007 (and for some nearing their pre-global financial crisis peaks), and therefore a high likelihood now for acquisitions and related financing to be both DPU and NAV accretive, we believe there is a clear incentive for REIT managers to expand their asset size and market caps through acquisitions in 2013.

S-REITs have been prominent players in Singapore investment property sales and we see no change in their role in 2013. The major change in 2013 is that after a year of unit-price appreciation (with the FSSTI REIT [FSREI] index up 36.7% YoY for 2012), most S-REITs are now trading above their book values and NAV. (For S-REITs, we believe book values are typically very close to their intrinsic NAVs, because all S-REITs are required to carry out independent valuations of their investment properties at least annually, while a few even undergo semi-annual valuations as a matter of policy.)

Deal-flow outlook: healthy

We note that property consultants generally expect a resilient investment market in 2013. Savills, in its Singapore sales & investment briefing report (January 2013), expects 2013 investment sales to remain healthy, though the total transacted value could be slightly lower YoY. Ample liquidity and rock-bottom interest rates may still offset the global economic overhang, which has restrained investment sentiment.

Since about mid-2010, quarterly investment transactions (including and excluding residential) compiled by Jones Lang LaSalle have returned to their pre-global financial crisis levels, though the value of quarterly deals in recent quarters has not rivalled the previous peaks in 3Q07 or 1Q08.

■ Singapore quarterly investment-property values (SGDm)

Source: Jones Lang LaSalle

According to JLL's tally, real estate investment sales in Singapore totalled SGD29bn for 2012, a decline of 10.5% YoY. Even though economic uncertainties continued to loom, the investment market in 2012 remained resilient, largely supported by strong market demand and cheap liquidity. For this year, JLL has also cautioned that policy risks remain, as the market continues to witness price appreciation among most asset classes, and the possibility of more cooling measures being rolled out in 2013 is high.

According to Savills, investment sales moderated slightly to SGD29.4bn for 2012 compared with SGD30.1bn for 2011 and SGD32.0bn for 2010. The market, particularly in 4Q12, was affected by the weak global economy and still-wide bid-ask gaps.

■ Major private investment sales 4Q2012

Property	Sector	Date	Price (SGDm)	Buyer
MBFC Tower 3 (30% stake)	Office	Dec-12	1035	DBS Group
Mapletree Anson	Office	Dec-12	680	Mapletree Commercial Trust
79 Anson Road	Office	Dec-12	410	United Engineers
NOL Building	Office	Oct-12	380	Fragrance Group
Hotel Grand Pacific	Hospitality	Oct-12	210	Private consortium

Source: Savills Research & Consultancy

S-REITs have always been major players

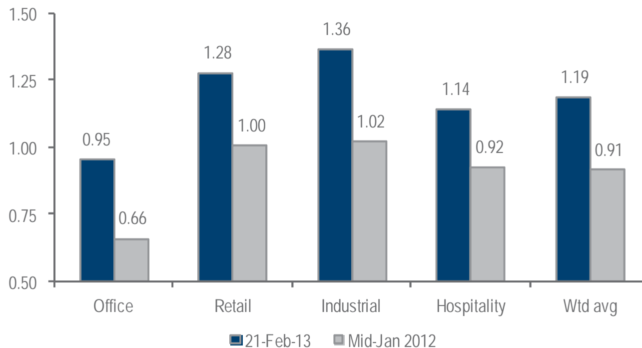
The major investment deals in 4Q12 highlight the S-REITs' prominence in the non-residential property-investment space. Although the biggest deal in 4Q12, the acquisition of Marina Bay Financial Centre Tower 3 by DBS Group, did not involve an S-REIT, the transaction had implications for Suntec REIT (with the vendor, Cheung Kong, selling its stake to DBS, we believe it is positive for Suntec as it will remove the acquisition overhang [involving income support and financing for the possible acquisition of MBFC 3]) and Keppel REIT (the pricing of the deal will have implications for Keppel REIT's purchase of the one-third stake in MBFC 3 from its sponsor, Keppel Land). The second largest transaction in 4Q12, the Mapletree Anson office development, was a related-party deal between Mapletree Commercial Trust (MCT SP, Not rated) and its sponsor.

With higher unit prices: DPU and NAV accretion

With the stable outlook for overall investment deals, we believe the likelihood of more acquisitions by S-REITs has increased for 2013. With the FSSTI REIT index gaining 36.7% YoY in 2012 (and with most of the smaller-cap REITs gaining more than the index), most S-REITs are now trading above their book values. The litmus test for acquisitions, which nearly all S-REITs managers have adopted regardless of the stage of the property cycle, is DPU accretion.

Now that most S-REITs are trading above their book values, any acquisition opportunity will be even more attractive in 2013, as the acquisition would be both DPU and NAV-accretive (assuming the new equity is issued above NAV and the blend of equity and debt financing will lead to an overall increase in the DPU). Based on the stocks under our coverage, we estimate that the weighted-average PBR for the entire S-REIT sector has increased to 1.19x from 0.91x about a year ago (in early January 2012).

■ S-REITs: average sub-sector PBRs (now vs. Jan 2012)



Source: Daiwa estimates

Outlook for acquisitions by sector:

Office – we estimate that the office sector, on a weighted-average basis, is trading at 0.95x book value (with Suntec trading at a 14% discount and the other office S-REITs trading at slight premiums to book) vs. a PBR of 0.66x in early January 2012, according to our estimates. With cap rates of prime grade-A office space holding at 4% (and cap rates tightening by 25bps for 2H12 to 3.75% for CCT's grade-A properties) and the initial yields (for the first 1-2 years) even lower for recently completed projects, we believe the most likely office transactions could come in the suburban office sector where cap rates are still over 100bps higher than for new core-CBD properties. We believe the most likely acquisitions would come from those S-REITs with an available office pipeline from their sponsors including Keppel REIT (MBFC 3) and Mapletree Commercial Trust (Mapletree Business City). A suburban-office deal would not surprise us. Although office rents are probably nearing a cyclical bottom (from their most-recent peak in 3Q11), capital values have remained resilient

Retail – we estimate that the retail sector is trading at a weighted average premium of 28% above book. In early January 2012, the sector traded at a weighted average PBR of 1.0x, according to our estimates. With the Singapore-based suburban-mall S-REITs (CapitaMall Trust [CT SP] and Fraser Centrepoint Trust [FCT SP]) trading at hefty premiums to NAV and 2013 DPU yields in the low 5% range, we would not be surprised to see further acquisitions from their respective sponsor's development pipelines, including assets such as Changi City Point for FCT and The Star Vista and possibly ION Orchard (after having completed one leasing cycle) for CT.

Industrial – we estimate that the industrial sector is trading currently at a weighted average premium of 36% above book, the highest among all sectors. In early January 2012, the sector traded at a weighted-average PBR of 1.02x, according to our estimates. With conventional industrial-property values at 12'o clock on the rental-property clock (12 o'clock denotes the [rental] peak of the cycle, while 6 o'clock denotes the trough of the cycle) according to Jones Lang LaSalle (in its 4Q12 Asia Pacific Property Digest), we believe S-REIT managers will adopt an extremely cautious stance on third-party acquisitions and favour asset-enhancement and development opportunities. Nevertheless, with the PBRs of some of the smaller industrial-property S-REITs trading at all-time highs, there is a strong incentive for REIT managers to make investments, financed partly from equity fundraising, which would help to boost their asset size and market caps.

Hospitality – we estimate that the hospitality sector is trading at a 14% premium to book. In early January 2012, the sector traded at a weighted-average PBR of 0.92x, according to our estimates. We believe the hotel sector (by industry revenue-per-available room [RevPAR]) probably peaked in 2Q12, and revPAR growth for 2H12 has slowed. Nevertheless, capital values have held up (as they have for all property sub-segments in Singapore during QE2 and QE3). The competitive investment environment in Singapore has encouraged S-REIT managers to venture overseas, with the most recent acquisition announced on 4 January 2013 by CDL Hospitality Trusts (CDREIT SP) for a single resort property in the Maldives. It was the first overseas acquisition since its SGD200m private placement in June 2010, and underscores (in our opinion) the difficulties in acquiring a suitable

investment property overseas. Unless it is a related-party deal at an extremely attractive acquisition yield, we do not expect much activity in the Singapore market due to high asking prices from potential vendors and keen competition from investors.

More private placements

With almost all S-REITs trading at or near their five-year highs, we have noticed a distinct increase in private placements. When share prices are high and the cost of equity is low, it makes perfect financial sense for S-REITs to raise equity to either recapitalise (lower their leverage for those with above sector average gearing ratios), increase their market cap and improve their free float, or raise their debt headroom for future acquisitions. The short-term impact in all of these situations is DPU dilution, which we see as an increasing risk in the sector.

Ideally, an acquisition should be completed back-to-back with new financing, normally a combination of a private placement and debt financing. In reality, such perfect timing is a luxury and deals usually take some time to complete. Nonetheless, a private placement done to shore up financing for an imminent acquisition opportunity also introduces execution uncertainty, because there is immediate dilution after the placement, and the longer a deal takes to be completed the greater the dilution.

Sector view: Neutral

Our overall view on the S-REIT sector is Neutral. We are Neutral on office S-REITs because valuations no longer look compelling following a year of significant outperformance. Moreover, we believe our expectations for office rents to bottom by 1H13 is well discounted by the market, while office S-REITs are now trading near the upper end of their PBR ranges, and their NAVs reflect asset values close to their peaks. We are Neutral on retail S-REITs because we believe their high PBRs already fully reflect their defensiveness. We are Negative on industrial S-REITs because we believe they could be vulnerable to industrial-rent declines and their yields do not adequately compensate investors for the current macro, sector, and market risks.

The downside risk would be fund rotation into more cyclical and higher-beta sectors (and countries) while the upside risk would be a further round of yield compression.

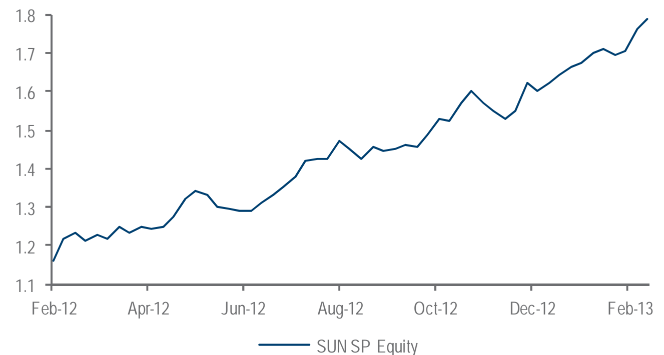
Top Buy for 2013

Suntec REIT

(SUN SP, SGD1.78, Outperform [2])
Target price (DDM): SGD1.95

The sole value in the office sector

■ Suntec: share price performance (SGD)



Source: Bloomberg

■ Investment indicators

12-month range (SGD)	1.205-1.795
Market cap (USDm)	3.24
Average daily turnover (USDm)	8.89
Shares outstanding (m)	2265
Major shareholder (%)	Suntec City Development (6.2%)

Source: Suntec, Daiwa

Investment thesis

Suntec is still one of the most attractively valued S-REITs, in our view, trading at a 14% discount to its book value of SD2.07 as at December 2012, the widest discount among the S-REITs under our coverage. On average, S-REITs are now trading at a weighted average premium of 19% to their book values, based on our estimates. Our DDM-derived target price of SD1.95 is also at a 6% discount to book.

We regard the short-term uncertainty as Suntec proceeds with a major, SGD410m AEI on Suntec City, scheduled for completion by end-2014, as an investment opportunity. The uncertainty arises from the amount of distribution support that will be used to smooth out Suntec's DPU for 2013. We believe some amount of support is required since we estimate that the average occupancy rate for Suntec City Mall will fall to 38% this year during the most intensive phases of the AEI. Our 2013 DPU forecast of SGD0.094 (vs. SGD0.095 for 2012) assumes a drawdown of SGD45m from the Chijmes divestment proceeds received in early 2012. We forecast DPU growth of 12% YoY for 2014 and 26% YoY for 2015, the first full year after AEI completion.

We see little risk from Suntec City Office Towers, which has shown remarkable resilience (nearly 100% occupied for 2012) and has been a source of strength for Suntec when Singapore office rents were in decline from 3Q11. We attribute its resilience to demand from small office space (less than 20,000sq ft) occupiers and the attractiveness of the Suntec City micro market, with relatively abundant parking lots for office tenants and established amenities (including retail and F&B). Office leases secured for 4Q12 averaged SGD8.98, on a par with some properties in the Raffles Place area.

Valuation

Our target price of SGD1.95 is pegged to parity with our 10-year DDM valuation. Our valuation assumes a cost of equity of 8.0% and a long-term growth rate of 1.5%, equivalent to an effective cap rate of 6.5%. Our DDM valuation also reflects Suntec's weighted average remaining leasehold tenure of 83 years, based on our calculations.

Risks to our call

A major risk to our Outperform rating for Suntec would be failure to deliver on management's IRR projection of 10.1% for the Suntec City AEI. We believe this is a minor risk given the leasing progress to date (pre-commitment rates of 83% for phase 1 and 37% for phase 2) and the highly value-accretive opportunities inherent in the AEI (such as replacing low-yielding convention space with high-yielding ground-floor retail space and large but low-rent (on a per square foot basis) anchor tenants [Carrefour] with higher-rent tenants).

■ **Suntec REIT: financial summary (SGDm)**

Suntec	2013E	2014E	2015E
Revenue	212	306	378
Net-property income	128	211	278
Distribution	213	241	305
DPU (SGD)	0.094	0.106	0.133
DPU growth % chg YoY	(0.4)	12.3	25.6
DPU yield (%)	5.3	6.0	7.5
Book value per unit (SGD)	2.02	2.08	2.36
PBR (x)	0.9	0.9	0.8
EPU (SGD)	0.045	0.164	0.409
ROE (%)	2.2	8.0	18.4
Gearing (%)	37.0	36.2	33.3
FFO/unit (SGD)	0.056	0.089	0.118
P/FFO (x)	31.5	19.9	15.1

Source: Daiwa forecasts

Top Sell for 2013

Ascendas REIT

(AREIT SP, SGD2.66, Underperform [4])
Exposed to all sectors of industrial property

■ **AREIT: share price performance (SGD)**

Source: Bloomberg, Daiwa

■ **Investment indicators**

12-month range (SGD)	1.97-2.64
Market cap (USDbn)	4.81
Average daily turnover (USDm)	10.83
Shares outstanding (m)	2237
Major shareholder (%)	Ascendas (18.1%)

Source: A-REIT, Daiwa

Investment thesis

AREIT trades at a considerable premium (based on yield and NAV) to its industrial-property S-REIT peers, and at one of the highest premiums to book value and NAV in the entire S-REIT sector. AREIT is widely viewed as defensive, but we believe AREIT is probably more vulnerable than its peers, due to its high exposure to multi-tenanted properties in the business park and high-tech industrial segments (and their high rental-growth correlation to GDP), if the weak economy persists. AREIT has also surprised the market with private placements in early 2011 and 2012, and we cannot rule out another 'pre-emptive' surprise, which would impose a short-term drag on the price, in 2013.

Valuation

Our target price of SGD2.20 is pegged to parity with our 10-year DDM valuation. Our valuation assumes a cost of equity of 8.4% and a long-term growth rate of 1.5%, equivalent to an effective cap rate of 6.9%. Our DDM valuation also reflects AREIT's weighted average remaining leasehold tenure of 48 years.

Risks to our call

The major risk to our negative call would be further inflows to the S-REIT sector as investors continue to

chase yield. AREIT still looks undemanding relative to its mean PBR of 1.35x and yield spread of 4.2% since its listing.

■ A-REIT: financial summary (SGD m)

A-REIT	2013E	2014E	2015E
Revenue	601	632	651
Net-property income	450	477	494
Distribution	337	359	373
DPU (SGD)	0.150	0.160	0.166
DPU growth % chg YoY	7.9	6.6	3.6
DPU yield (%)	5.7	6.0	6.2
Book value per unit (SGD)	1.96	2.02	2.08
PBR (x)	1.4	1.3	1.3
EPU (SGD)	0.205	0.216	0.223
ROE (%)	10.6	10.8	10.9
Gearing (%)	33.4	32.8	32.2
FFO/unit (SGD)	0.147	0.156	0.162
P/FFO (x)	18.2	17.0	16.4

Source: Daiwa forecasts

■ S-REITs: ratings, valuations, and key financial data

	Price SGD	Mkt cap USDbn	Daiwa rating	Daiwa target SGD	Target Upside (%)	FY13E DPS SGD	FY14E DPS SGD	FY13E Yield (%)	FY14E Yield (%)	10-yr SGS (%)	FY13E Yd sprd (%)	FY14E Yd sprd (%)	Latest BVPS SGD	PBR (x)	Latest gearing (%)	DDM value SGD	FY13E FFO/shr SGD	FY14E FFO/shr SGD	FY13E P/FFO (x)	FY14E P/FFO (x)
Office																				
CCT SP	1.625	3.73	Hold	1.59	(2.2)	0.078	0.082	4.8	5.1	1.6	3.2	3.5	1.66	0.98	29.8	1.59	0.071	0.075	22.8	21.6
SUN SP	1.78	3.24	O/P	1.95	9.6	0.094	0.106	5.3	6.0	1.6	3.7	4.4	2.07	0.86	39.5	1.95	0.056	0.089	31.5	19.9
KREIT SP	1.345	2.86	Hold	1.30	(3.3)	0.086	0.087	6.4	6.5	1.6	4.8	4.9	1.32	1.02	42.9	1.30	0.077	0.078	17.4	17.3
Retail																				
CT SP	2.18	6.09	Hold	2.06	(5.5)	0.106	0.112	4.9	5.2	1.6	3.3	3.6	1.65	1.32	36.7	2.06	0.098	0.105	22.2	20.8
FCT SP	2.06	1.37	Hold	1.96	(4.9)	0.107	0.109	5.2	5.3	1.6	3.6	3.7	1.53	1.35	30.1	1.96	0.104	0.106	19.8	19.4
SGREIT SP	0.89	1.40	Hold	0.85	(4.5)	0.051	0.051	5.7	5.7	1.6	4.1	4.1	0.88	1.01	30.4	0.85	0.050	0.050	17.7	17.7
CRCT SP	1.8	1.09	Sell	1.44	(20.0)	0.092	0.098	5.1	5.4	1.6	3.5	3.8	1.31	1.38	28.3	1.44	0.055	0.058	32.9	31.0
Industrial																				
AREIT SP	2.66	4.81	U/P	2.20	(17.3)	0.150	0.160	5.7	6.0	1.6	4.1	4.4	1.88	1.41	32.9	2.20	0.147	0.156	18.2	17.0
MLT SP	1.195	2.34	U/P	1.07	(10.5)	0.073	0.075	6.1	6.3	1.6	4.5	4.7	0.90	1.33	35.9	1.07	0.072	0.074	16.5	16.1
CREIT SP	0.745	0.73	U/P	0.62	(16.8)	0.051	0.051	6.8	6.8	1.6	5.2	5.2	0.65	1.15	36.0	0.62	0.043	0.048	17.2	15.4
Hospitality																				
CDREIT SP	2.03	1.59	U/P	1.81	(10.8)	0.123	0.127	6.0	6.3	1.6	4.4	4.7	1.61	1.26	24.9	1.81	0.122	0.127	16.6	16.0
ART SP	1.335	1.23	Hold	1.38	3.4	0.086	0.091	6.5	6.8	1.6	4.9	5.2	1.35	0.99	39.1	1.38	0.063	0.067	21.2	20.0

Source: Bloomberg, Daiwa forecasts
Note: prices as of close on 21 February 2013

A-REITs – Not rated

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Singapore participation

Low yields in Singapore? Try Australia

The participation of S-REITs and Singapore investors in the Australian investment property market has increased in recent years. Australian properties, some owned previously by A-REITs themselves, are now a common sight in the portfolios of several S-REITs*. These assets, with a slight bias to premium CBD locations, include office, retail, and hotel properties.

**CDL Hospitality Trusts (CDREIT SP) and Ascendas Hospitality Trust (ASHT SP) are technically not S-REITs, but stapled securities comprising a REIT and a business trust (BT). CDREIT's hotel properties are held in the REIT, while its BT is currently dormant. In contrast, ASHT's Australian hotels are held by the BT, while the REIT only holds the Japan hotel.*

■ **Australian properties acquired by S-REITs**

S-REIT	Ann'd	Property	Segment	City	%	AUDm	Yield (%)
KREIT	Sep-12	Old Treasury Building*	Premium office	Perth	50	160	7.15
	Jul-11	8 Chifley Square*	Premium office	Sydney	50	155	6.65
	Jul-10	77 King Street	A grade office	Sydney	100	120	n.a
	Jan-10	275 George Street	A grade office	Brisbane	50	166	n.a
SGREIT	Jan-13	Plaza Arcade	CBD retail	Perth	100	48	7.8
	Nov-09	David Jones Building	CBD retail	Perth	100	114.5	7.9
CDREIT	Jan-10	Five hotels managed by Accor	CBD hotels 3.5-4.5 star	Brisbane, Perth	100	175	8.4
FCOT	Mar-06	Central Park	Premium office	Perth	50	190	n.a
	Feb-12	Caroline Chisholm Centre	A grade office	Canberra	100	191.75	8.9
ART	Jan-08	St. Georges Terrace	Serviced apt	Perth	100	28.5	6.5
	Dec-06	Gordon Heights	Serviced apt	Melbourne	100	11.6	6.9
ASHT	Dec-11	Mirvac Wholesale Hotel Fund**	Hotels		49.2	327	7.9**

Source: S-REITs, Daiwa (yields at time of acquisition)
** under development*
***Ascendas acquired the portfolio from Mirvac, bought out the remaining shareholders and listed Ascendas Hospitality Trust (ASHT SP) in Singapore on 27 July 2012*

Australia's attractiveness has not changed

We believe it is not surprising that S-REITs' interest in the Australian market has increased. The attractiveness of its first-world infrastructure, deep and well-established investment-property market, and relatively high cap rates versus comparable assets in Singapore are nothing new.

For most of the past decade up to the global financial crisis in late 2008, Australian assets were largely shunned by S-REIT investors and REIT managers. Although most S-REIT managers might claim that they have had their sights set on Australian property deals all along, we can offer several reasons for the apparent renewed interest (or more openness by unitholders) for Australian assets.

High yields, low carrying costs

First, S-REITs have been better capitalised after the global financial crisis (through equity fundraisings, some defensive and asset divestments) than during the pre- global financial crisis period. One could even argue that some are even overcapitalised.

Even though the spread of the property yields versus the local funding (borrowing) costs in Australia are not particularly attractive now, S-REITs that can pay for Australian assets partly with cash and/or have access to low-cost offshore funding facilities, which most of them do, can enjoy relatively healthy spreads (between the yield on the investment and the overall borrowing costs), resulting in highly DPU-accretive acquisitions.

In short, low leverage combined with high absolute yield and access to cheap offshore financing (even when swapped to minimize currency risk) should lead to highly-accretive DPUs.

■ **Comparison of Australia and Singapore cap rates**

Segment	Current cap rate range (%)
Office	
Australia	
Sydney premium	6.25-6.88
Sydney A grade	6.88-7.25
Brisbane premium	7.0
Brisbane A grade	7.75-8.75
Melbourne A grade	7.74-8
Canberra A grade	7.75-8.75
Singapore	
International grade A	3.75-4.0
Grade A CBD	4.0-4.25
Retail	
Australia	
Sydney CBD	5.25-6.75
Sub regional (NSW)	5.75-8.75
Sub regional (QLD)	5.75-8.0
Sub regional (VIC)	5.75-8.5
Singapore	
Primary (Orchard Road)	4.5-5.25
Suburban	5.25-5.75
Industrial	
Australia	
(Sydney, Outer West)	
Distribution centre	8.25-9.25
Industrial estate	7.88-8.25
Singapore	
Factory	7.0-8.0%
Distribution centre	7.0-8.0%
Business park	6.5-7.0%

Source: A-REIT and S-REIT announcements, Daiwa estimates

Long WALEs are now desirable

Second, the stability offered by long leases and WALEs, by far more common in Australia than in Singapore, is no longer viewed as a liability post the global financial crisis. Locking in a predictable income stream with occasional step-up rents and matching it with long-term fixed-rate financing should add a desirable level of stability in most S-REIT portfolios.

Positive investment experience

Third, the track record for almost all S-REITs that have completed Australian-property acquisitions in recent years has been highly positive, given the resilience of the Australian economy and currency and overall quality (in our opinion) of the assets acquired. Moreover, the stability of the economy and currency are no longer considered risk factors, especially viewed against the recent weakness (from 2Q12) of the Singapore economy. Furthermore, those S-REITs with little exposure to Australia would also benefit from the geographic diversification in a generally stable property market. For these reasons, we have noticed a big change in the unitholders' receptiveness when the acquisitions of Australian assets are announced.

Singapore-backed deal flows likely to continue

We are likely to see more deals for Australian assets by S-REITs, as the positive factors we cited above have not changed. According to the local press (*The Australian*), in the middle of last year Mapletree Logistics Trust had been in long-running discussions with Stockland (SGP AU, Not rated) to acquire its AUD500m logistics portfolio, which apparently fell through. (It would have been the largest acquisition by an S-REIT in the Australian market.) With a longer operating history, A-REITs continually conduct strategic reviews and reassess their portfolios, and this could allow opportunities for asset divestments. We would not be surprised if a healthcare S-REIT ventured into the nursing home, or other health-related sectors.

Australand: exit CapitaLand?

As many S-REITs are looking to increase their exposure to Australia, CapitaLand is undergoing a strategic review of its own, which could lead to its divestment of Australand, an investment which it has held since Australand's listing in June 1997 (CapitaLand's new CEO has stated that Australand is a non-core asset, see next paragraph). DBS Land (subsequently merged with Pidemco Land to form CapitaLand in 2000) bought the assets that formed Australand from the Hooker Corporation's receiver in 1995 (for their eventual listing). Australand is now a stapled group that comprises Australand Holdings Limited, Australand Property Trust, Australand Property Trust No.4 and Australand Property Trust No.5.

A big deal

We believe CapitaLand's possible exit could lead to the largest M&A deal in the A-REIT sector this year. Capitaland's new CEO, Mr. Lim Ming Yan, publically announced (on 3 January 2013) a more streamlined corporate structure and his intention to conduct a review of the company's investments outside of Singapore and China, its two core markets. At the briefing, he also referred to Australand as only a 'financial investment' (with limited integration with the rest of the CapitaLand group).

The market may have gotten wind of CapitaLand's new stance on Australand as early as late last year. On 7 December 2013, the GPT Group (GPT AU, Not rated) made an indicative, though unsolicited and highly conditional, proposal to acquire Australand's investment property portfolio and commercial and industrial business for a cash consideration at a AUD140m premium to its 30 June 2012 book value (Australand clarified that the premium represented AUD0.234 per share, 7% above its NTA of AUD3.46 per share at the time).

However, Australand's residential business would have remained separately listed on the Australia Stock Exchange and the proposal was promptly rejected by Australand's board as it did not 'adequately compensate security holders for the transaction costs, structural inefficiencies and uncertainty as to the trading value of the residential business'. The rebuke has apparently not deterred GPT's management from making another proposal in the future.

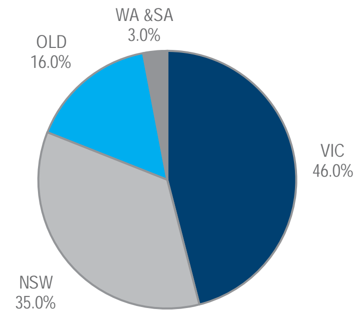
Meanwhile, it was reported in the local press (*The Australian Financial Review*) on 18 December 2012 that Mirvac (MGR AU, Not rated) was considering an AUD7bn merger plan for Australand, a deal that would create one of the largest diversified real estate investment trusts in the country. According to some market observers, Mirvac's business scope and breadth could also be the most complementary (of all the A-REITs) for Australand. Australand announced subsequently that it had not received any such proposal.

■ Australand: asset composition (as at 31 December 2012)

Property type	Number	Area sq m	Book value* AUDm	WALE years	Occupancy (%)	Cap rate (%)
Industrial	49	891,423	1,102.8	6.1	100.0	8.59
Office	13	250,539	1,048.4	4.9	94.9	7.58
Other	4	1,053	22.1	7.8	100.0	7.6
Sub-total	66	1,143,015	2,173.3	5.5	97.6	8.09
Under development	3	62,731	112.6	n.a	n.a	n.a
Total	69	1,205,746	2,285.9	5.5	97.6	8.09

Source: Australand

■ Australand: assets by geography (as at 31 December 2012)



Source: Australand

■ Major A-REITs: valuations and key financial data

A-REITs		Price AUD	Mkt cap USDbn	FY13E DPS AUD	FY14E DPS AUD	FY13E Yield (%)	FY14E Yield (%)	10-yr bond yld (%)	FY13E Yld sprd (%)	FY14E Yld sprd (%)	Latest BVPS AUD	PBR (x)	Latest gearing (%)	FY13E FFO/shr AUD	FY14E FFO/shr AUD	FY13E P/FFO (x)	FY14E P/FFO (x)
Westfield Group	WDC AU	11.06	25.4	0.51	0.537	4.6	4.9	3.6	1.1	1.3	6.79	1.63	31.9	0.686	0.72	16.1	15.4
Westfield Retail Trust	WRT AU	3.13	9.9	0.192	0.2	6.1	6.4	3.6	2.6	2.8	3.37	0.93	21.8	0.193	0.2	16.2	15.7
Stockland	SGP AU	3.70	8.3	0.24	0.241	6.5	6.5	3.6	2.9	3.0	3.49	1.06	27.6	0.24	0.262	15.4	14.1
Goodman Group	GMG AU	4.60	8.4	0.195	0.212	4.2	4.6	3.6	0.7	1.0	2.64	1.74	21.1	0.33	0.35	13.9	13.1
GPT Group	GPT AU	3.85	7.0	0.204	0.211	5.3	5.5	3.6	1.7	1.9	3.73	1.03	21.7	0.243	0.25	15.8	15.4
CFS Retail Trust	CFX AU	2.06	5.9	0.14	0.14	6.8	6.8	3.6	3.2	3.2	2.05	1.00	27.9	0.14	0.14	14.7	14.7
Mirvac Group	MGR AU	1.61	5.6	0.087	0.091	5.4	5.7	3.6	1.9	2.1	1.64	0.98	23.8	0.11	0.118	14.6	13.6
Dexus Property Group	DXS AU	1.05	5.2	0.059	0.06	5.6	5.7	3.6	2.1	2.2	1.03	1.02	29.0	0.078	0.078	13.5	13.5
Commonwealth Property Office	CPA AU	1.10	2.6	0.064	0.067	5.8	6.1	3.6	2.3	2.6	1.15	0.95	25.1	0.084	0.086	13.0	12.7
Australand Property Group	ALZ AU	3.44	2.1	0.22	0.223	6.4	6.5	3.6	2.8	2.9	3.49	0.99	32.2	0.26	0.27	13.2	12.7

Source: Bloomberg
Note: prices as of close on 21 February 2013

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