

SECTOR UPDATE

REITs – Singapore

US Office REITs: The End Is Near For Working From Home

Long-suffering US office REITs are finally seeing the light at the end of the tunnel. Leasing volume has picked up and tenants are more willing to commit to long-term leases. New construction has petered out and occupancy could recover to pre-pandemic levels by 2027. Upcoming rate cuts would support a continuation of the recovery. BUY KORE (Target: US\$0.39) and PRIME (Target: US\$0.37), which provide 2026 distribution yields of 19.2% and 27.6% respectively.

WHAT'S NEW

- Pick-up in leasing as confidence is restored.** Leasing volume increased 7% yoy and 15% qoq in 2Q24, reaching 90% of pre-pandemic levels. Demand bottomed out in 1Q23 and rose steadily over the next five consecutive quarters. Renewals accounted for 45% of leasing volume as tenants avoided incurring out-of-pocket build-out costs. Tenants have shown more confidence in signing long-term leases in recent quarters. Larger leases of above 100,000sf are becoming more commonplace. Tenants from the finance and legal sectors were more active. Demand from technology companies was generally slow, except for Artificial Intelligence companies.
- Reaching a new equilibrium.** Major tenants have cut office space by an average of 11.4% over the past 12 months when their leases expire. 60% of leases were signed before the COVID-19 pandemic and are subject to future downsizing. Nevertheless, many tenants have reached their targeted office footprint. Downsizing has gradually diminished as office space per employee stabilised at 147sf, down 9% from pre-pandemic levels. Some tenants have also started to expand their footprint.
- Office construction at historic low.** Ground breakings remained at historic lows in 2Q24. The few projects that broke ground are smaller scale developments in high-growth markets, which are already pre-committed. According to Jones Lang LaSalle (JLL), the pipeline of office space of 46m sf in 2Q24 is 70% lower compared to 2019 levels. About 65% of the pipeline is pre-committed. The available office space of 16m sf will be completed over the next four quarters. Thus, completion of new office space is expected to be minimal over 2H25 and 2026. According to CBRE, completions would fall dramatically in 2025 and vacancy for prime office buildings is expected to return to the pre-pandemic level of 8.2% by 2027.
- Obsolete offices removed through redevelopments.** Local governments in 17 out of the 20 largest CBD markets have provided new incentives and revised regulations to promote redevelopments, including conversions to residential properties. Demolitions exceeded new deliveries and office stock has declined for the second consecutive quarter in 2Q24. JLL expects 100-150m sf office spaces to be removed by end-26.
- Regulator tightens supervision of home offices.** Financial Industry Regulatory Authority (FINRA) has tightened supervision of brokers and dealers working from home. It requires financial institutions to disclose and register home offices, which meet eligibility requirements, and subject them to periodic inspections. Currently, Bank of America, Citigroup, JPMorgan Chase and Goldman Sachs have implemented five-day work weeks. Barclay's, Citigroup and HSBC have summoned more staff to work full-time at the office. Temporary relief provided during the COVID-19 pandemic came to an end on 30 May 24.

PEER COMPARISON – US OFFICE REITs

Name	Ticker	Rec	Price	Target	Mkt Cap	Yield (%)				Debt to Equity (%)	Debt to Assets (%)	P/NAV (x)
			8 Oct 24	Price		(US\$m)	Hist	Curr	Fwd 1Y			
KeypacOak REIT USD	KORE SP	BUY	0.225	0.39	235	11.1	0.0	0.0	19.2	81.7	42.7	0.32
Manulife REIT USD	MUST SP	BUY	0.112	0.168	199	0.0	0.0	0.0	24.9	139.8	56.3	0.33
Prime US REIT USD	PRIME SP	BUY	0.169	0.37	221	16.0	2.3	2.7	27.6	100.0	48.9	0.31

Source: Bloomberg, UOB Kay Hian

OVERWEIGHT
(Maintained)

TOP BUYS

Company	Rec	Share Price (US\$)	Target Price (US\$)
KORE	BUY	0.225	0.39
PRIME	BUY	0.169	0.37

Source: UOB Kay Hian

YIELD SPREAD – US OFFICE REITs



Source: UOB Kay Hian

P/NAV – US OFFICE REITs

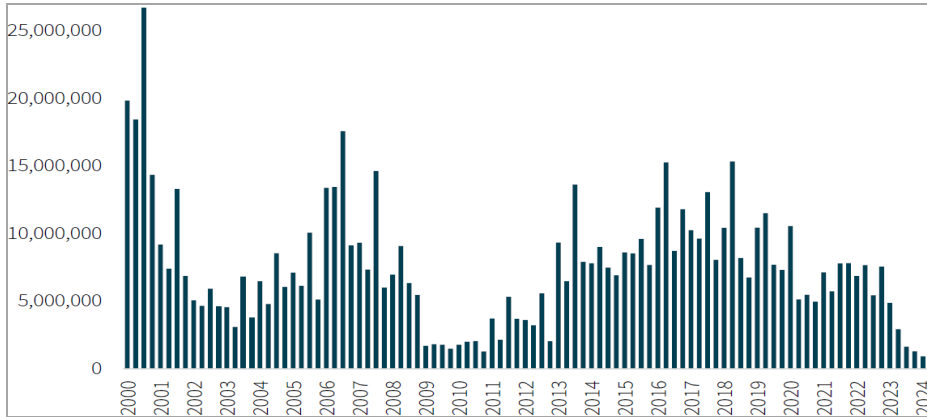


Source: UOB Kay Hian

ANALYST(S)

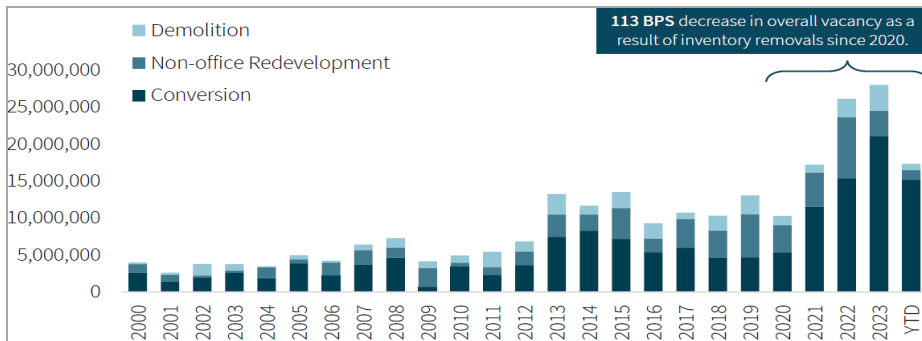
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CONSTRUCTION STARTS HAVE FALLEN TO ALL-TIME LOW



Source: JLL

INVENTORY OF OFFICE SPACE REMOVED



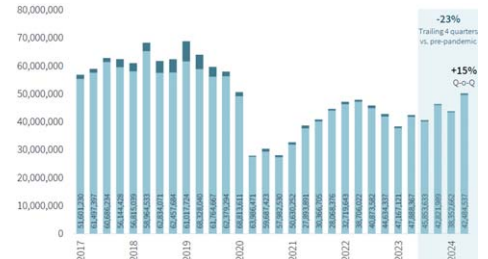
Source: JLL

- Amazon joins the Work From Office bandwagon.** Amazon is the latest to join the chorus of companies (like Boeing, United Parcel Service, Walmart and X) demanding employees work full-time in-person at the office. CEO Andy Jassy has announced that staff must return to the office five days a week starting January next year. Management sees significant advantage in having teammates collaborating, brainstorming and connecting in-person. The company will end hot desking and revert to assigned floor plans.
- Physical occupancy on an upward trend in 2024.** The balance of power has shifted to the management in the tussle to bring employees back to working from the office. It has become easier to replace recalcitrant employees as the labour market has softened. Many companies are trying to improve productivity by enforcing minimum hours of office attendance or mandating that employees return to the office. According to Placer.ai which monitors office attendance by tracking mobile phones, physical occupancy has recovered to 72.2% of pre-pandemic levels in Jul 24 (Jan 24: 60.4%).

ACTION

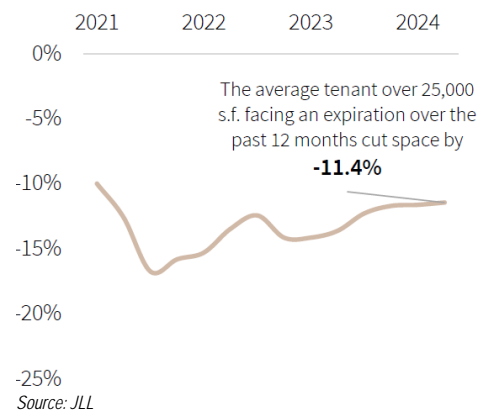
- The end is near for working from home.** Long-suffering US Office REITs have exhibited nascent signs of recovery. Leasing volume has picked up and tenants are more willing to commit to long-term leases. New construction has petered out and occupancy could potentially recover to pre-pandemic levels by 2027. Upcoming rate cuts would support a continuation of the recovery.
- Portfolio valuations underpinned by lower interest rates.** The Fed has cut the benchmark Fed Funds Rate by 50bp to 4.75% on 18 Sep 24, the first rate cut in more than four years. Based on the latest dot plot, the Fed is expected to lower the Fed Funds Rate by another 50bp to 4.25% by end-24 during the next two FOMC meetings on 7 Nov 24 and 18 Dec 24 (potentially two rate cuts of 25bp each). The Fed Funds Rate is expected to fall by another 100bp to 3.25% in 2025 (potentially one rate cut of 25bp every alternate FOMC meeting). The resultant lower discount rate would reduce the risk of US office REITs suffering out-sized revaluation losses at end-24.

QUARTERLY LEASING ACTIVITY (SF)



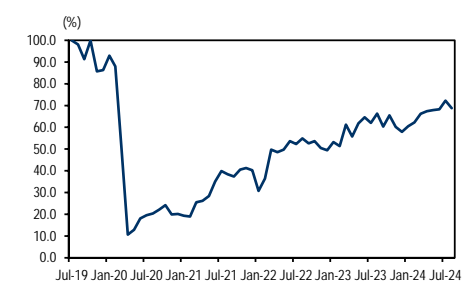
Source: JLL

DOWNSIZING RATE FOR MAJOR TENANTS



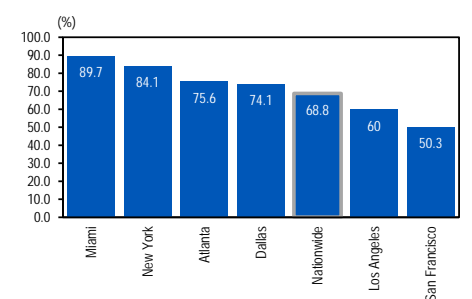
Source: JLL

OFFICE VISITS NATIONWIDE (% OF 2019)



Source: Placer.ai

OFFICE BUILDING VISITS RECOVERY (AUG 24)



Source: Placer.ai

- **Overwhelmingly attractive valuations beckon.** US office REITs listed on the SGX are trading at a 2026 distribution yield of 23.9% and average P/NAV of 0.32x, which is overwhelmingly attractive. Comparable US office REITs listed on the NYSE, such as Boston Properties (BXP US), Cousins Properties (CUZ US) and Vornado Realty (VNO US), trade at an average distribution yield of 3.9% and P/NAV of 1.60x.

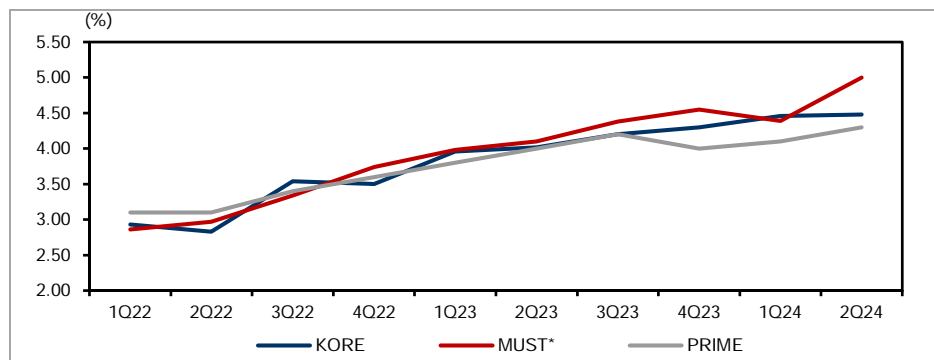
Keppel Pacific Oak US REIT (BUY/KORE SP/Target: US\$0.39)

- **Positive rental reversion and healthy occupancy reflect well on quality of office portfolio.** KORE registered mild positive rental reversion of 1.2% for 199,494sf of office space leased, representing 4.2% of portfolio NLA, in 2Q24. Bellevue/Redmond, Denver and Orlando contributed to most of the leasing completed in 1H24. Portfolio occupancy improved 0.6ppt qoq to 90.7% in 2Q24. Occupancies at Westech 360 in Austin, One Twenty Five in Dallas and Iron Point in Sacramento improved 6.4ppt, 2.7ppt and 5.9ppt qoq to 76.6%, 95.0% and 65.9% respectively. KORE had built spec suites at these three properties, which were well taken up.
- **Benefitting from rate cuts.** KORE has a relatively low aggregate leverage of 42.7% as of Jun 24. About 31% of its borrowings are on floating interest rates, which would benefit from upcoming rate cuts. KORE's current cost of debt is 4.5% in 1H24. We expect cost of debt to recede to 4.3% by end-25. We raise our forecast for distributable income by 1% for 2026.
- **Maintain BUY.** KORE will recapitalise its balance sheet by suspending distributions for 2024 and 2025. KORE intends to resume distribution in 1H26. KORE trades at 2026 distribution yield of 19.2% and P/NAV of 0.32x. Our target price of US\$0.39 based on DDM (COE: 9.75% (previous: 10.0%), terminal growth: 0.5% (previous: 0.0%)).

Prime US REIT (BUY/PRIME SP/Target: US\$0.37)

- **Leasing momentum has picked up.** Lease signings more than doubled yoy to 268,600sf in 1H24. Occupancy at Reston Square in Washington DC improved 14.1ppt qoq to 61.1% in 2Q24 due to a new lease with a law firm for 23,300sf. Occupancy at 17117th Street in Atlanta edged higher by 2.5ppt qoq to 73.5% in 2Q24 due to a new lease with a healthcare firm for 12,700sf. PRIME also signed renewals and new leases at several properties, including Tower 909 and 101 South Hanley. It incurred a small negative rental reversion of -1.3% in 2Q24. Portfolio occupancy was stable at 80.0% as of Jun 24. Occupancy was 83.9% if we exclude OWC and One Town Center.
- **Benefitting from rate cuts.** PRIME has aggregate leverage of 46.4% as of Jun 24. PRIME does not require any refinancing over the next two years till Jul 26 About 33% of PRIME's borrowings are on floating interest rates, which would benefit from upcoming rate cuts. PRIME's current cost of debt is 4.2% in 1H24 and 5.0% post-refinancing. We expect cost of debt to recede to 4.6% by end-25. We raise our forecast for distributable income by 2% for 2026.
- **Maintain BUY.** We expect PRIME to maintain payout ratio at 10% in 2024 and 2025, and resume paying 100% of distributable income in 2026. PRIME trades at 2026 distribution yield of 27.6% and P/NAV of 0.31x. Our target price of US\$0.37 based on DDM (COE: 11.0% (previous: 11.5%), terminal growth: 0.5% (previous: 0.0%)).

COST OF DEBT



Source: Respective S-REITs *Includes sponsor-lender loan exit premium.

CAPITAL MANAGEMENT

	Aggregate Leverage (%)	Cost of Debt (%)	Fixed Rate Debt As % Total Debt (%)	Average Debt Maturity (years)
KORE	42.7	4.5	69	2.3
MUST	56.3	4.6	80	3.0
PRIME	46.4	4.2	67	3.3

Source: Respective S-REITs

SECTOR CATALYSTS

- Strength of the US Dollar, which would enhance the valuations of properties located in the US.
- Growth from growth cities and Sun Belt states.

ASSUMPTION CHANGES

- As mentioned above.

RISKS

- Escalation of the Russia-Ukraine war beyond Ukraine.
- Persistent and elevated inflation causing more rate hikes in 1H23.

PEER COMPARISON

Name	Ticker	Rec	Curr	Price	Target	Mkt Cap	Yield (%)				Debt to	Debt to	P/NAV
				8 Oct 24	Price	(US\$m)	Hist	Curr	Fwd 1Y	Fwd 2Y	Equity (%)	Assets (%)	(x)
HEALTHCARE													
First REIT	FIRT SP	NR	S\$	0.275	n.a.	440	9.0	8.7	9.1	9.5	76.5	39.5	0.97
PLife REIT	PREIT SP	BUY	S\$	4.00	5.07	1,857	3.7	3.6	3.7	4.4	57.4	35.3	1.70
HOSPITALITY													
CapLand Ascott	CLAS SP	BUY	S\$	0.955	1.38	2,774	6.9	5.7	6.2	6.4	68.1	37.2	0.83
CDL HTrust	CDREIT SP	BUY	S\$	0.99	1.50	952	5.8	5.8	6.6	6.7	64.6	37.7	0.67
Far East HTrust	FEHT SP	BUY	S\$	0.64	0.80	988	6.4	6.2	6.2	5.8	38.7	30.8	0.69
Frasers HTrust	FHT SP	NR	S\$	0.455	n.a.	672	5.4	5.5	5.7	6.2	59.0	35.3	0.69
INDUSTRIAL													
AIMS APAC REIT	AAREIT SP	NR	S\$	1.29	n.a.	803	7.3	7.1	7.4	7.5	66.3	33.1	0.99
CapLand Ascendas	CLAR SP	BUY	S\$	2.80	3.74	9,445	5.4	5.5	5.8	6.0	67.5	37.8	1.24
Daiwa Hse Log Trust	DHLT SP	NR	S\$	0.595	n.a.	318	8.8	8.4	8.4	8.4	66.6	36.8	0.90
Digi Core REIT USD	DCREIT SP	BUY	US\$	0.58	0.88	754	6.4	6.1	6.3	6.4	52.6	34.4	0.86
ESR-LOGOS REIT	EREIT SP	NR	S\$	0.285	n.a.	1,680	9.0	7.7	7.4	7.4	66.2	36.5	0.93
Keppel DC REIT	KDCREIT SP	BUY	S\$	2.14	2.28	2,829	4.4	4.4	4.5	5.1	59.4	35.8	1.56
Mapletree Ind Trust	MINT SP	BUY	S\$	2.45	3.05	5,329	5.5	5.6	5.8	5.9	61.5	39.1	1.40
Mapletree Log Trust	MLT SP	HOLD	S\$	1.43	1.44	5,503	6.3	5.8	5.8	5.8	79.6	39.6	1.04
OFFICE													
Keppel REIT	KREIT SP	BUY	S\$	0.945	1.20	2,768	6.1	6.4	6.3	6.2	81.1	41.3	0.73
RETAIL													
Frasers Centrepoint	FCT SP	BUY	S\$	2.26	2.71	3,138	5.4	5.2	5.3	5.3	50.8	39.1	0.99
Lendlease REIT	LREIT SP	BUY	S\$	0.60	0.77	1,056	6.5	6.5	6.5	6.4	86.4	40.9	0.79
Sasseur REIT	SASSR SP	BUY	S\$	0.715	0.98	683	8.7	8.4	9.1	9.5	41.8	25.3	0.84
PARAGON REIT	PGNREIT SP	NR	S\$	0.895	n.a.	1,951	5.6	5.1	4.9	5.0	47.5	29.0	0.96
Starhill Global	SGREIT SP	NR	S\$	0.525	n.a.	912	6.9	7.2	7.4	7.2	64.5	36.8	0.73
DIVERSIFIED													
CapLand China Trust	CLCT SP	NR	S\$	0.82	n.a.	1,072	8.2	7.4	7.6	7.8	90.9	40.8	0.69
CapLand Int Comm Trust	CICT SP	BUY	S\$	2.10	2.59	11,132	5.1	5.1	5.4	5.5	66.2	39.8	0.99
Frasers L&C Trust	FLT SP	BUY	S\$	1.15	1.48	3,315	6.1	6.0	6.0	6.1	55.3	33.2	0.99
Mapletree Pan Asia	MPACT SP	BUY	S\$	1.47	1.76	5,929	6.1	5.7	5.9	5.9	73.9	40.5	0.84
OUE Comm REIT	OUECT SP	NR	S\$	0.315	n.a.	1,327	6.6	6.3	7.0	6.7	71.3	38.7	0.52
Suntec REIT	SUN SP	HOLD	S\$	1.30	1.18	2,906	5.5	4.8	4.9	4.9	69.5	42.3	0.62
INTERNATIONAL (US/EUROPE)													
Cromwell REIT EUR	CERT SP	NR	€	1.59	n.a.	983	9.9	8.9	8.8	8.4	81.0	40.5	0.76
Elite UK REIT GBP	ELITE SP	NR	£	0.295	n.a.	227	11.6	9.8	11.9	10.2	81.3	41.4	0.73
IREIT Global	IREIT SP	NR	S\$	0.305	n.a.	315	8.8	n.a.	n.a.	n.a.	67.4	36.9	0.54
KepPacOak REIT USD	KORE SP	BUY	US\$	0.225	0.39	235	11.1	0.0	0.0	19.2	81.7	42.7	0.32
Manulife REIT USD	MUST SP	BUY	US\$	0.112	0.168	199	0.0	0.0	0.0	24.9	139.8	56.3	0.33
Prime US REIT USD	PRIME SP	BUY	US\$	0.169	0.37	221	16.0	2.3	2.7	27.6	100.0	48.9	0.31
Utd Hampshire REIT USD	UHU SP	BUY	US\$	0.47	0.64	274	10.2	8.8	9.4	9.9	76.6	41.9	0.64

Source: Bloomberg, UOB KayHian

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