Uniquely RHB

Regional Thematic | August 2021

MARKET DATELINE
PP19489/05/2019 (035080)

Workspace
Today, In transition, Tomorrow

Contents

Preface

The real estate market in the region has been undergoing very challenging times over the last 6-7 years. While people will still need a home to live in, we may or may not need an office to get our work done anymore.

Having covered the real estate market since 2008, I believe nobody could have foreseen how the sector has evolved over the last 15 years. Technology, and the invention of smartphones, has significantly changed our lifestyles since 2004-2005. Our taxi services have been taken over by e-hailing, and the rising trends of online shopping and lodging services have also changed the way we shop and travel. This megatrend has, to a large extent, dampened the performance of brick-and-mortar retail malls and hotels, which used to be the asset class that was highly sought after.

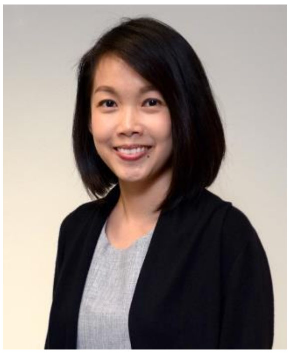
The COVID-19 pandemic has accelerated these changes. Now, even the relatively "boring" office segment will see some changes in the coming years. Both corporates and asset owners will have to be well-prepared. After the pandemic, many corporates will most likely revisit their office space requirements, and ramp up the necessary IT infrastructure and facilities that would enable remote work, to ensure the continuity of their business operations. Interestingly, based on my interviews with some office-based workers (from non-financial services sectors), a few local companies and most multi-national corporations in Malaysia had already been practicing remote/flexible work arrangements even before the pandemic.

Given the increasing emphasis on ESG among the investment fraternity in the region, we believe many local corporates, especially the listed ones, will have to start ramping up efforts to improve employee welfare – including health and workplace safety. International firms are generally ahead of local ones, in this aspect.

Given the expected "new norm", the RHB real estate team recently carried out a survey. Based on the survey's results, this report provides an analysis on how WFH will affect the office sectors in Malaysia and Singapore and, as such, the office REITs and asset owners in both countries.

I wish to thank my teammates, colleagues, friends, clients, corporates, and everyone who participated in, and helped to circulate the survey. With cooperation from all parties, a total of 892 respondents from both Malaysia and Singapore participated in our survey within a month.

Last but not least, I hope you will continue to stay safe and healthy.



Loong Kok Wen, CFA
Regional Real Estate Head

23 August 2021

Property | REITS

Office REITS

Workspace: Today, In Transition, Tomorrow

Stocks Covered	13
Rating (Buy/Neutral/Sell):	8 / 4 / 1
Last 12m Earnings Revision Trend:	-

Top Picks	Target Price
Suntec REIT (SUN SP) – BUY	SGD1.76
PRIME US REIT (PRIME SP) – BUY	USD1.03

- **Work from home (WFH) – the new norm.** RHB Research's real estate team recently carried out a survey to evaluate COVID-19's impact on the office sectors in the region. Although there will be a greater propensity for employees to WFH more regularly – for health and safety reasons – office properties are here to stay. Based on the survey's data output, we have also identified five key trends in the office sector in the coming years. Investors should keep their exposure to REITs, or companies that own quality assets, as a long-term sustainable investment strategy.
- **Major trends going forward.** Key trends identified from the survey's findings: i) Potential downsizing of office space by 20-30% in Malaysia and Singapore (mainly from the financial services sector); ii) the adoption of a more formal hybrid model (both home and office), which seems more viable over the long term; iii) decentralisation of regional operations could support demand for office space; iv) structural changes in Malaysia's office sector, as tenants seek high-grade buildings; and v) Singapore should capture more international real estate investors as the city state pursues more sustainable and integrated office developments.
- **Malaysia: Flight-to-quality trend to trigger a major retrofitting exercise.** Our survey points to a flight-to-quality trend going forward. As working behaviours change, corporate tenants will likely seek office spaces that provide greater workspace flexibility, IT infrastructure that can support remote working, and areas for team collaboration. Major capex spending to redevelop/refurbish old office buildings could be necessary for asset owners, to ensure their office properties stay relevant in the market.
- **Singapore: Resilient demand due to availability of high-grade offices.** The outlook for the office sector in Singapore should remain positive, as high-grade office buildings will continue to be highly sought-after by real estate investors. As sustainability and mixed developments will be the theme going forward, the country should attract high-profile corporate tenants that will support office rentals over the long term.
- **Decentralisation of operations could be the next driver.** New demand may be created, as some local and regional companies could start looking at decentralised and flexible office accommodations, as part of their risk management efforts. There may also be some potential positive spillover to co-working spaces, due to the quality and flexibility offered – but the medium- to long-term impact is uncertain, due to the cost differential between office rental and charges by co-working facilities.
- **BUY office REITs that own quality assets.** In the region, we like Suntec REIT and PRIME US REIT in Singapore. Although we like KLCCP Stapled for its asset quality in Malaysia, near-term earnings may be affected by the underperformance in other segments. These REITs have ESG scores of 3 and above, based on our proprietary ratings.

Company Name	Rating	Target	% Upside (Downside)	P/E (x) Dec-21F	P/B (x) Dec-21F	ROAE (%) Dec-21F	Yield (%) Dec-21F
Axis REIT	Buy	MYR2.30	17.8	20.4	1.3	6.5	4.9
Capitaland Integrated Commercial Trust	Neutral	SGD2.10	1.0	23.7	1.0	4.4	5.1
CMMT	Sell	MYR0.52	(16.8)	36.0	0.5	1.5	2.8
IREIT Global	Buy	SGD0.70	9.4	15.3	0.9	6.0	6.9
Keppel Pacific Oak US REIT	Buy	USD0.90	21.4	15.4	0.9	5.9	8.5
Keppel REIT	Neutral	SGD1.20	9.1	18.9	0.9	4.7	5.6
KLCCP Stapled	Neutral	MYR6.90	3.1	17.6	0.9	5.3	4.8
Manulife US REIT	Buy	USD0.87	17.6	14.0	1.0	7.3	7.8
Pavilion REIT	Buy	MYR1.55	12.3	42.9	1.1	2.5	2.5
Prime US REIT	Buy	SGD1.03	21.9	11.8	0.7	6.2	11.0
Sentral REIT	Buy	MYR1.00	14.9	12.6	0.7	5.6	7.8
Suntec REIT	Buy	SGD1.76	21.4	22.9	0.7	3.1	6.0
Sunway REIT	Neutral	MYR1.44	2.9	18.3	1.0	5.4	5.2

Source: Company data, RHB

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Embracing The New Normal

What does the survey tell us?

The unprecedented global pandemic has changed the way we work, accelerating the emerging WFH trend. To evaluate the impact on office space, RHB's real estate research team carried out a survey in June. We mainly targeted office-based workers in Malaysia and Singapore, as both countries have relatively matured REIT markets.

We gathered replies from 892 respondents in Malaysia and Singapore, with 89% of them aged 25-54 years. About half of them work in financial services, while 12-14% are from the real estate/construction industries. The rest are from the technology, accountancy/consultancy, energy, and retail sectors. Although the distribution by sector did not have a good balance, these are nonetheless the key office tenants in Singapore and Kuala Lumpur. Only about 15-20% of our respondents hold senior managerial positions.

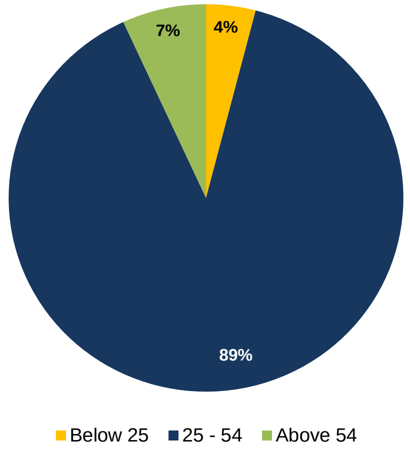
Although we have a relatively small sample size for Singapore (151 respondents), the responses from office workers in both countries were generally quite consistent – particularly in terms of their views on the option for WFH and/or a remote work programme.

Key highlights from the survey's results:

- >50% of workers believe that their employers will offer a remote work programme post pandemic;
- >80% of workers prefer to work in the office three days a week or less;
- 60-70% of workers are willing to use shared desk spaces under a flexible work programme;
- >70% of workers indicated that they are equally or more productive while WFH;
- About 40% of respondents think that their relationships with clients deteriorated while WFH;
- Only about 30% of workers are not able to maintain a work-life balance while WFH;
- Social isolation and difficulty in communicating with co-workers and clients are the key challenges while WFH;
- WFH has a slightly more negative impact on mental health than physical health.

This survey captures mainly employee sentiment and preferences after 6-12 months of WFH arrangements, but provides little indication on the challenges and difficulties faced by companies. While there could be limitations on flexible work arrangements such as client relationship management, we believe companies should not ignore the importance of having proper pandemic risk management, or contingency plans due to unforeseen circumstances. Companies will likely strive for a balance, in our view.

Figure 1: Age profile of our respondents in Malaysia



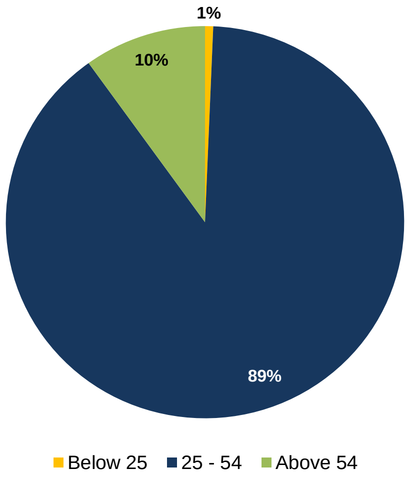
Source: RHB

Figure 2: Distribution of respondents in Malaysia by sector

Financial services	46.56%
Real estate/construction	13.90%
Oil & Gas / Energy	6.21%
Technology	4.45%
Professional (accountancy/consultancy)	4.05%
Manufacturing	2.70%
Public services / government	2.56%
Insurance	2.43%
Retail	2.16%
E-commerce	1.75%
Creative/media	1.62%
Academic	1.62%
Telecommunications	1.48%
Others	8.50%

Source: RHB

Figure 3: Age profile of our respondents in Singapore



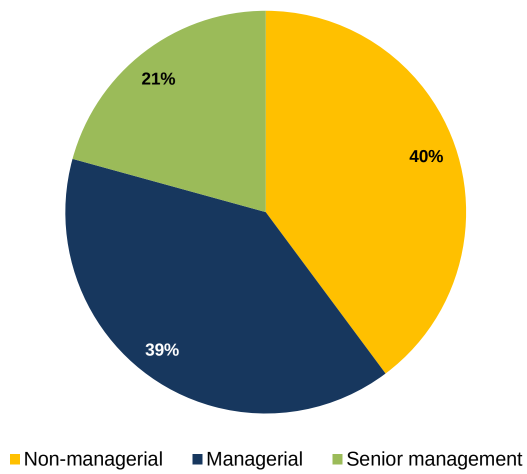
Source: RHB

Figure 4: Distribution of respondents in Singapore by sector

Financial services	54.30%
Real estate/construction	11.26%
Technology	9.27%
Professional (accountancy/consultancy)	3.31%
Creative/media	2.65%
Retail	2.65%
Energy	1.99%
Academic	1.99%
Insurance	1.99%
Manufacturing	1.32%
Hospitality	1.32%
Others	7.94%

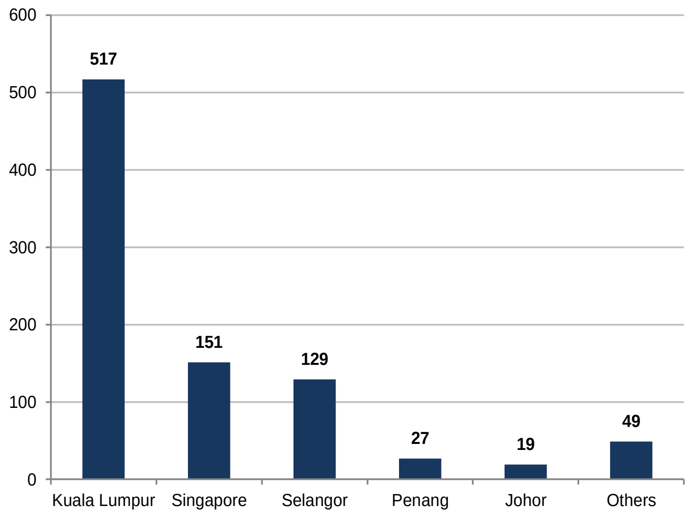
Source: RHB

Figure 5: Positions held by respondents



Source: RHB

Figure 6: Number of respondents by place of work



Source: RHB

WFH's Impact On Office Space Demand

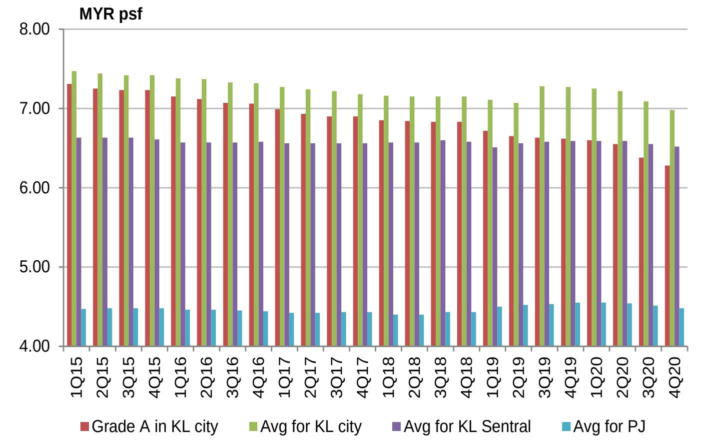
Despite potential downsizing, office properties are here to stay

We think remote work programmes would be something inevitable going forward. As businesses are preparing their employees to return to the office, we believe these companies will also revisit their office space requirements at the same time. Any surplus in existing tenancies will likely be cut, upon lease expiries and/or renewals.

Based on our interviews with some mid-sized to large companies in Malaysia, office tenants will likely cut down their leased space by 20-30% when the pandemic eases. The impact of downsizing and, as such, pressure on rental reversions would be more severe for office buildings in Malaysia than in Singapore. The extent of the negative impact would also depend on the relative quality of the office property – lower-grade office buildings will likely be worse off.

Having said that, the accelerating WFH trend will not eliminate the importance of office space. We believe many companies will still want to retain a physical presence in the city centre or in key business districts in other states. The "flagship" office is still required for a corporate image and staff collaboration. More importantly, it could also be part of licensing requirements for certain industries such as oil & gas, technology, and telecommunications. Certain roles still require a physical presence, such as finance and procurement (some procedures still require physical documentation, and phasing out will take time), as well as IT support on servers.

Figure 7: Office rental rate trend in the Klang Valley

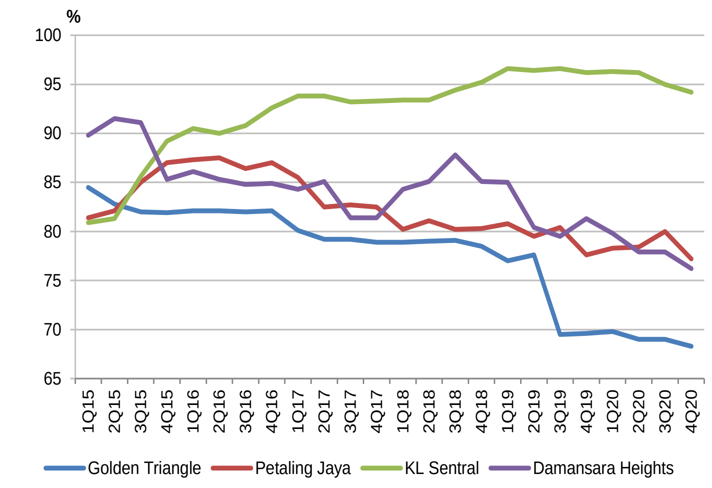


Source: Knight Frank

Figure 8: Office rental rate trend in Singapore

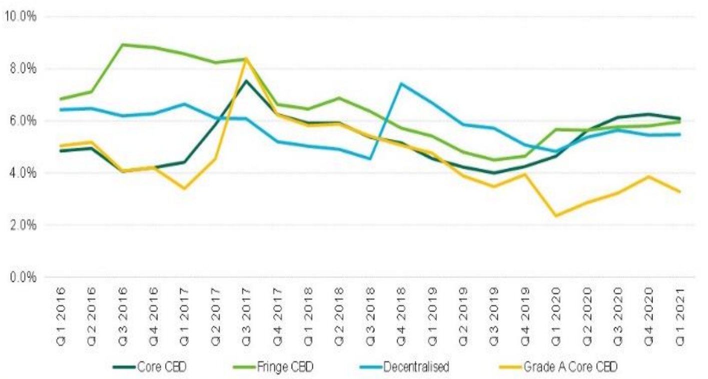
Source: CBRE

Figure 9: Office occupancy rate trend in the Klang Valley



Source: Knight Frank

Figure 10: Office vacancy rate trend in Singapore



	Raffles Place	Marina Centre	Shenton Way	Marina Bay	Tanjong Pagar	Orchard Road	Beach Rd / City Hall	Decentra-lised
Total Stock Q1 2021 (mil sf)	11.66	3.76	6.37	9.43	4.96	5.74	5.38	14.43
Vacancy Rate Q1 2021 (%)	8.0%	3.4%	8.8%	3.1%	5.8%	7.7%	4.2%	5.5%

Source: CBRE

Structural Shift For Malaysia's Office Sector

Flight-to-quality trend in Malaysia over the long term

As companies prepare for an agile working environment, the demand for higher-quality office space is expected to increase, as tenants will likely seek offices that offer greater flexibility in usage – either for the distribution of work desks or team collaboration areas – and, more importantly, sustainable infrastructure and technology that enables WFH arrangements over the long run.

As Malaysia still has relatively less high-quality office spaces and, given the narrow gap between the rental rates for high-grade and low-grade buildings, tenants will be able to switch to high-grade buildings easily under these circumstances. Over the medium term, this trend will weigh on the demand for low-grade buildings, and landlords for this segment will likely suffer the most – given the downward pressure on average office rental rates in key business districts.

Major refurbishments or redevelopments are needed to stay relevant

Landlords that own old and/or low-grade buildings in major business districts in the Klang Valley, Penang and Johor will probably need to embark on major refurbishment or redevelopment exercises, so that their assets are still able to stay relevant in this increasingly challenging office market. Of course, such exercises are typically costly, and will take up several years to complete.

A good example would be the massive redevelopment of the former Hotel Equatorial Kuala Lumpur along Jalan Sultan Ismail, which was torn down in 2012. According to some media reports, the redevelopment exercise cost MYR1bn and, after seven years of construction, the old building has been successfully transformed into today's Equatorial Plaza. The new building now features a 52-storey integrated development comprising premium Grade A+ office space and a 5-star hotel. It has over 1m sqf in GFA, including 23 levels of office space (about 460k sqf). Great Eastern Life Assurance (Malaysia) is the owner of the office tower.

It was reported that the building, which earned a Green Building Index (GBI) Gold Certification, incorporates the latest energy-saving technology, a raised floor system and flexible variable air volume air-conditioning. Currently, the building houses several multi-national corporations across various sectors, including Standard Chartered Bank Malaysia, WeWork (a US-based co-working space operator), and McDermott Asia Pacific (a leading provider of integrated engineering, procurement, installation and construction (EPIC) services to the oil & gas industry.

Figure 11: The old Hotel Equatorial Kuala Lumpur

Source: buro247.my

Figure 12: The new Equatorial Plaza

Source: equatorialplaza.com

Singapore's Office Sector To Remain Vibrant

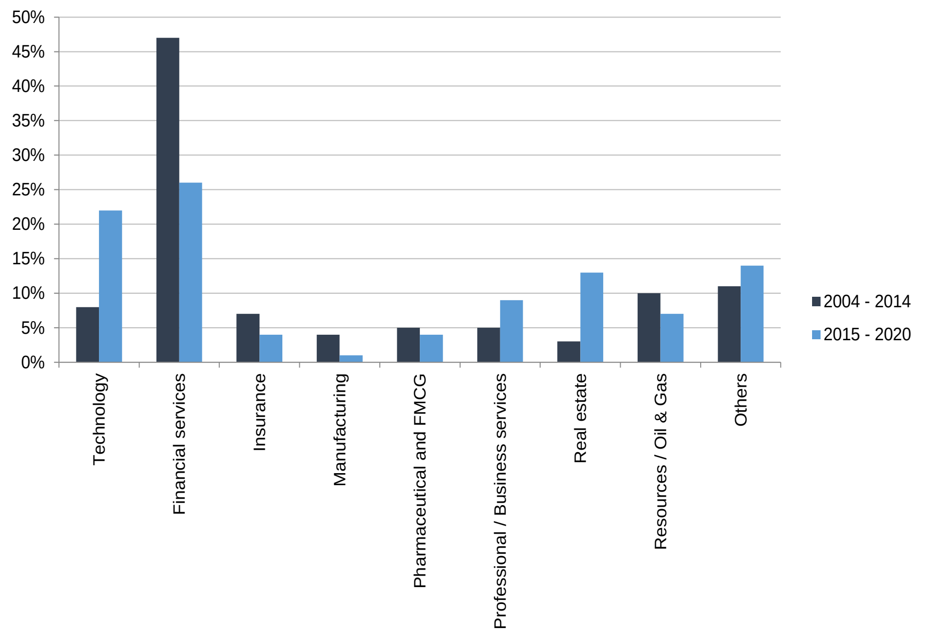
Singapore to see net positive impact upon full re-opening of economy

The office sector in Singapore is already seeing downsizing/rightsizing – mainly by financial institutions – but we believe this will mainly be a one-off exercise. We expect the sector to remain solid, given the availability of high-quality office space in the city state, and the country's strong position as an international financial hub, on top of its efforts to attract top technology companies and talent. As such, the impact of downsizing should be limited and, given the well-controlled supply of office space, the potential drop in occupancy rates will be absorbed by new demand rather quickly.

Based on our discussion with REIT managers, the reduction in demand from financial institutions is estimated at 10-30%, partly due to increasing preference for WFH, as well as the economic impact brought about by the pandemic. Major global banks such as Standard Chartered, UBS, Citigroup, Mizuho and HSBC are among the financial institutions that have undertaken rightsizing exercises.

However, the demand for office space by technology firms has risen significantly, partly boosted by the changing digital trend during the pandemic as well as US-China trade tensions over the past few years. As a result, many Chinese and western technology firms have established and expanded their presence in Singapore. Key technology companies that have announced major hiring and expansion plans include Google, Facebook, Alibaba, Zoom, Tencent, Bytedance, and Tesla.

Figure 13: Singapore offices' changing tenant profile mix (percentage of office space leased in new buildings by tenant industry)



Source: JLL Research

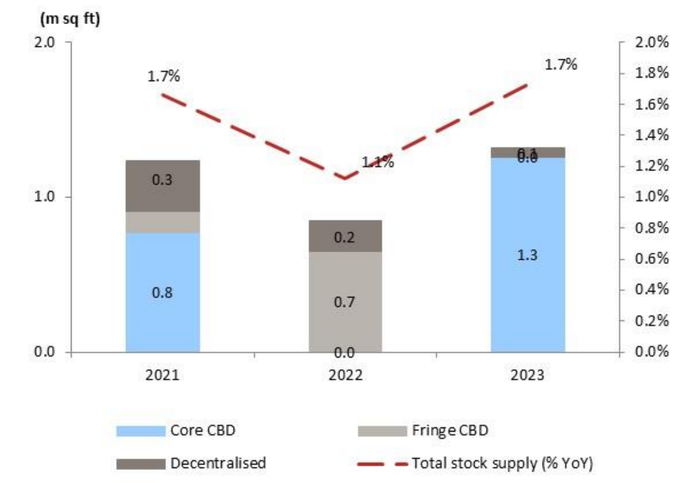
Figure 14: Key technology firms that moved to Singapore in 2020

Jan 2020	Feb 2020	May 2020	Jun 2020
• Known suitors for Singapore digital banking licences include ByteDance, Ant Financial, a consortium involving fintech players Yillion Group and Hande Group, another consortium featuring Xiaomi Finance, and a consortium led by Chinese e-commerce group Zall	• Twitter announced that it will set up its first Asia-Pacific engineering centre in Singapore and create 65 technical jobs in the next few years, in product engineering, software engineering, data engineering, and data science	• Alibaba's Singapore subsidiary inks deal for a half-stake in a Grade-A office building, AXA Tower	• Huawei is picked as the key vendor for TPG Telecom's 5G mm-wave networks in Singapore

Jul 2020	Aug/Sep 2020	Sep 2020	Dec 2020
• Google supports 3,000 locals through a new jobs-and-skills initiative to boost employment and employability outcomes, under the SGUnited Jobs and Skills Package • South Korea's Naver relocates its data centre to Singapore, from Hong Kong	• Video-streaming platform Bigo confirms plans to move its servers from Hong Kong to Singapore • Zoom to open a new data centre in Singapore • WeChat owner Tencent confirms plans for a new Singapore office for its South-East Asia expansion	• Alibaba is reportedly in talks to invest USD3bn in Grab • ByteDance ramps up Singapore hiring with plans to invest several billion dollars • Chinese e-commerce group Zall plans to recruit hundreds of employees over the next few years • Tesla plans to open its office and expand headcount	• Zoom announces plans to open a new research & development centre, and hire hundreds of engineers • The Government announces a new work pass to attract top-tier tech professionals

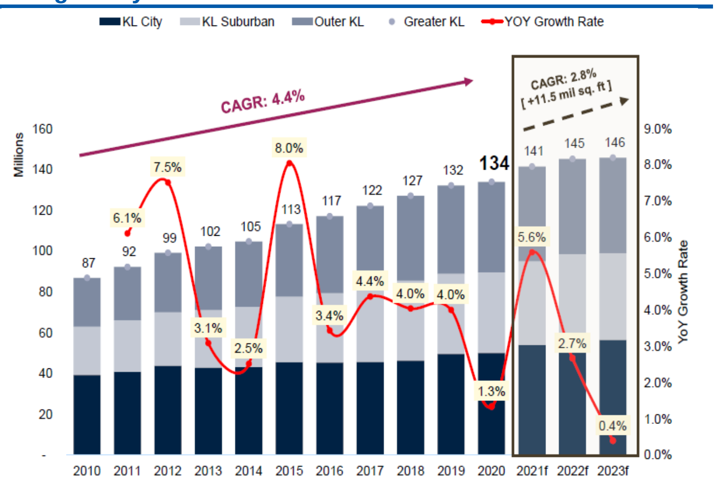
Source: The Business Times, Economic Development Board, Bloomberg, Financial Times, The Straits Times

Figure 15: Office supply pipeline in Singapore (2021-2023)



Source: CBRE, Urban Redevelopment Authority (URA), RHB

Figure 16: Cumulative and new supply of office space in the Klang Valley



Source: Savills Research Malaysia

Decentralisation or localisation could be the next driver

We believe many international firms will probably see the need for and importance of having decentralised or localised operations, due to travel and movement restrictions during the pandemic. Regional corporates with a limited physical presence but with business exposure in various countries will most likely look to decentralise their operations for risk management purposes, over the long run.

New demand for office space could be created due to decentralisation. While the cheap rental rates in Kuala Lumpur and Johor could be a plus point to attract companies in the region, Singapore would be able to pull demand from top-notch international firms based in East Asia and the western countries – given the ready availability of high-quality office space, technology and infrastructure. Singapore is already capturing new demand from many technology firms from Hong Kong and China, especially in recent years. Malaysia, on the other hand, benefitted from the inflow of foreign direct investment in the manufacturing sector prior to the pandemic, mainly due to the US-China trade tensions.

We believe the COVID-19 pandemic will accelerate this shift. Once the economy is re-opened, international corporations will likely start looking for new office space, and the new set-ups are expected to be done on a smaller scale, compared to their existing regional offices. Singapore is more ready to cater to this new demand, as Malaysia still needs to build up high-quality stock and infrastructure over the medium term.

Singapore is in a sweet spot to capture global demand from ESG investors

International real estate investors and REITs with ESG mandates will likely focus on Singapore, due to the country's growing pool of investable green buildings.

Citing research by JLL, according to the Ministry of National Development, about 3,200 buildings in Singapore have met the Building and Construction Authority's (BCA) Green Mark standards as of Jan 2018. This represents over 94m sqm, or approximately one-third of the total GFA of Singapore's building stock.

Under the Singapore Green Plan 2030, the country has targeted to achieve "green" standard for 80% of the buildings in terms of GFA by 2030. Many corporates have also set net-zero carbon goals in their businesses. Post-pandemic, we think the importance of sustainability features in office buildings will become even more significant. As such, efforts to accelerate the number of green buildings will likely intensify. Existing buildings will likely undergo progressive retrofitting and refurbishments to meet key objectives, including low-carbon emissions, a reduction in water and energy consumption, waste disposal/recycling, and the increased sustainable use of resources.

Developers and asset owners are expected to capitalise on the fast-evolving green financing in Singapore to focus on their initiatives on sustainability agendas. Borrowing costs are said to be lower, as financiers peg lending rates to ESG performance. We understand that the issuance of real estate green and sustainability-linked loans have surged more than eight-fold, from SGD785m in 2017 to SGD6.6bn in 2020.

Figure 17: Key targets for Singapore's Green Plan related to real estate

- 80% of new buildings to be Super Low Energy buildings from 2030, and 80% improvement in energy efficiency over the 2005 baseline for best-in-class green buildings by 2030.
- Increase rail network to 360km by early 2030s.
- Increase share of trips taken on mass public transport to 75% by 2030.
- Phase out refrigeration and air-conditioning equipment that use high global warming potential (GWP) refrigerants from 4Q22.
- Use 15% less energy in Housing and Development Board towns by 2030.
- Create new and diverse job opportunities in sectors such as green finance, sustainability consultancy, verification, credits trading and risk management.
- Be a leading centre for green finance in Asia and globally, by building up the financial sector's resilience to environmental risks, developing green financial solutions, build knowledge and capabilities, and leveraging innovation and technology.
- 80% of GFA in buildings to be green by 2030

Source: Greenplan.gov.sg

Our Recommended Strategies

WFH trend to continue

The lingering concerns over the COVID-19 pandemic has resulted in severe economic slowdowns and various changes to lifestyles. Social distancing and WFH trends are now at the forefront, and we believe both office workers and corporates will have to adjust to the new norm.

The results of our survey in both Malaysia and Singapore point to a shift towards the WFH trend, even after the COVID-19 pandemic. This trend is important, particularly for REITs, asset owners and developers – as various factors will need to be taken into account when designing their office investment properties, as well as making investment choices.

Go for quality in sustainability

As a long-term sustainable investment strategy, the increased working flexibility and growing importance of ESG among the investment fraternity would mean investors should look towards REITs and owners of quality assets. With the sheer size of green and high-grade office space in the city state, we think Singapore should be able to withstand the near-term potential downside in occupancy rates and recover strongly, once the demand for office space returns. The aggressive expansion of regional technology companies from West and East Asia should be the key driver. Despite COVID-19, these companies are expected to maintain their expansion plans – because it is the pandemic itself that has resulted in the greater adoption of technology by most businesses and households.

Given the long-term trend, we advise investors to increase exposure to office REITs listed in Singapore, and our choices are Suntec REIT and PRIME US REIT.

For Malaysia, we prefer KLCCP Stapled. While its retail and hospitality segments will likely drag on earnings over the near term and, hence, our NEUTRAL call currently, this hybrid REIT has the best office grade in Malaysia. Although Sentral REIT is offering a higher dividend yield currently, this REIT will need to keep up its asset quality for tenant retention in order to sustain earnings and dividends over the long run.

Most of the office REITs under our coverage have a minimum ESG score of 3 (out of 4) based on RHB's proprietary ESG rating scale. Most of the office REITs in Singapore also have high scores for the Environmental pillar, as these players are stepping up their efforts to address the environmental issues – which makes them more advanced than their Malaysian counterparts.

Further details on the Malaysia and Singapore markets are from page 14 onwards.

Figure 18: ESG heatmap for office REITs in Singapore and Malaysia

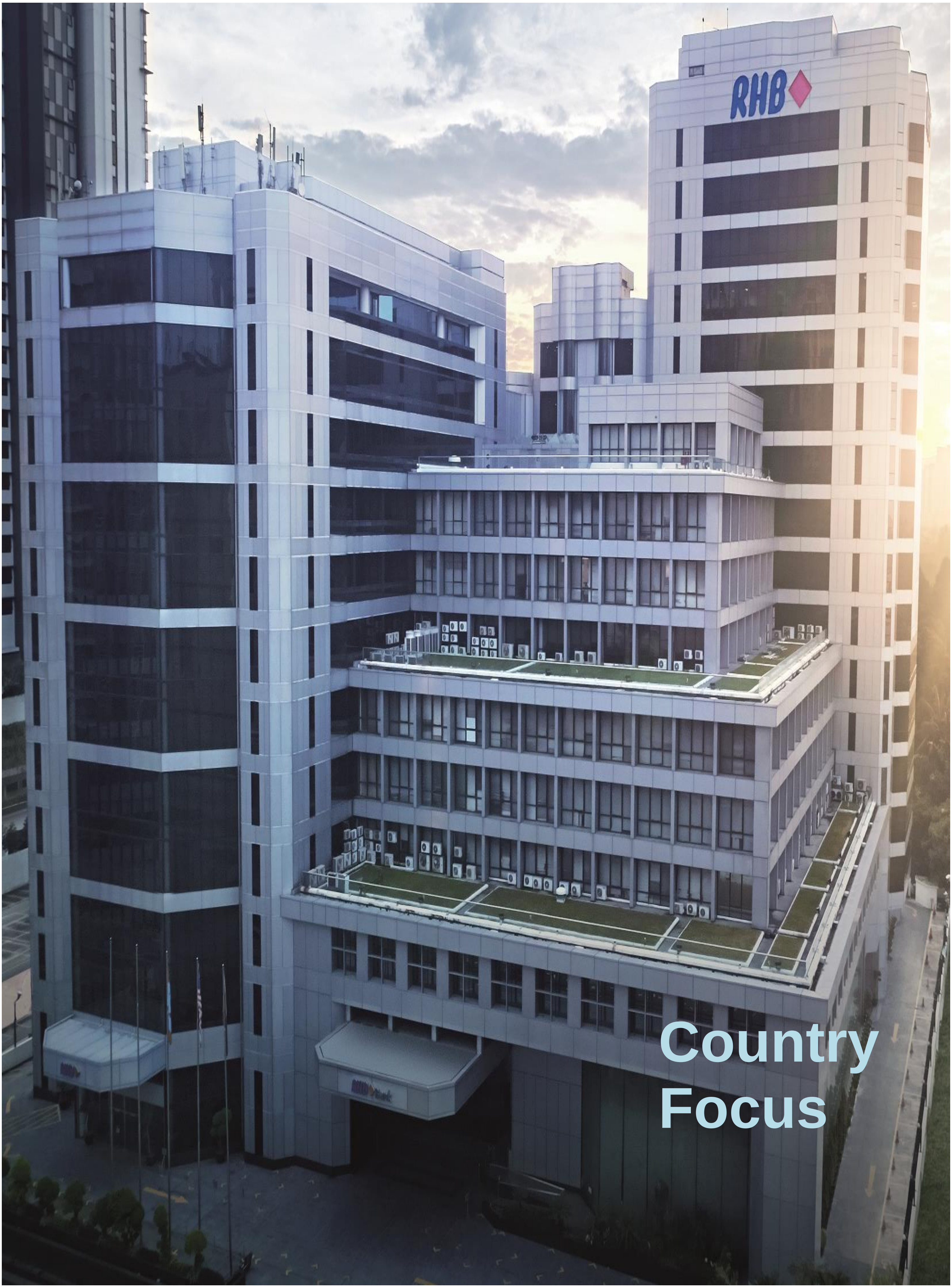
	Environment	Social	Governance	Aggregate Score
Sunway REIT	3.7	3.3	3.3	3.4
CapitaLand Integrated Commercial Trust	3.7	3.0	3.3	3.3
Manulife US REIT	3.3	3.7	3.0	3.3
Axis REIT	3.0	3.0	3.7	3.2
Keppel REIT	3.7	3.0	3.0	3.2
Prime US REIT	3.3	3.0	3.0	3.1
KLCCP Stapled Group	3.3	3.0	3.0	3.1
Sentral REIT	3.0	2.7	3.3	3.0
CMMT	3.0	2.7	3.3	3.0
Suntec REIT	3.0	3.0	3.0	3.0
IREIT Global	3.0	3.0	3.0	3.0
Pavilion REIT	2.7	3.0	3.0	2.9
Keppel Pacific Oak US REIT	2.7	3.0	3.0	2.9

Source: RHB

Figure 19: Peer comparison for office REITs listed in Singapore and Malaysia (as of 13 Aug 2021)

	Mkt cap (USDm)	3M-ADVT (USD '000)	Last price (LCY)	1D (%)	5D (%)	1M (%)	3M (%)	6M (%)	12M (%)	YTD (%)	vs 52W-low (%)	vs 52W-high (%)	P/B (x)	Div yield (FY-1)	Div yield (FY-2)	Yield Spread (%)	Gearing/ simple ave	WALE (years)	% FY-1	% FY-2
Singapore - Office (4)	**18,023**	**56,535**		**(0.7)**	**0.3**	**(3.0)**	**0.0**	**(1.1)**	**9.6**	**(1.0)**	**18.3**	**(10.8)**	**0.8**	**5.5**	**5.5**	**4.1**	**40.2%**	**3.0**		
Suntec REIT	3,044	18,849	1.45	0.0	0.7	(6.5)	(2.7)	(2.7)	5.8	(2.7)	9.8	(11.6)	0.7	6.2	6.2	4.8	44.4%	2.5	17%	18%
Keppel REIT	3,097	8,443	1.14	0.0	0.9	(5.0)	(5.8)	(2.6)	5.6	1.8	15.2	(10.2)	N.M	5.3	5.3	3.8	35.2%	3.0	8%	16%
OUE Commercial Trust	1,663	743	0.42	(1.2)	(1.2)	(6.7)	5.1	10.7	12.2	7.8	31.7	(8.8)	0.7	7.0	6.7	5.5	40.4%	3.3	12%	18%
CapitaLand Integrated Commercial Trust	10,219	28,500	2.14	(1.4)	0.0	0.0	3.4	0.0	13.2	(0.9)	24.4	(10.5)	1.0	5.1	5.1	3.7	40.8%	3.1	12%	21%
Overseas (6)	**5,639**	**4,968**		**0.6**	**(0.3)**	**(3.0)**	**3.9**	**4.1**	**8.7**	**5.6**	**16.7**	**(4.1)**	**1.0**	**7.5**	**7.6**	**6.9**	**38.0%**	**4.8**		
Prime US REIT	975	124	0.84	0.6	0.0	(2.3)	(1.8)	3.7	5.7	6.3	16.7	(4.5)	1.0	8.3	8.3	7.0	33.8%	4.3	8%	8%
Manulife US REIT	1,226	1,145	0.77	0.7	(1.3)	(4.3)	4.8	6.9	6.2	3.4	19.4	(5.5)	1.1	7.8	7.8	6.5	41.3%	5.3	6%	18%
Keppel Pacific Oak US REIT	784	1,211	0.76	0.7	0.0	(6.8)	2.7	10.2	5.6	9.4	12.7	(6.8)	0.9	7.9	7.9	6.6	37.5%	3.7	8%	13%
Cromwell European REIT	1,659	1,761	2.52	0.4	(0.4)	(1.2)	5.4	(0.2)	14.5	5.0	18.6	(2.3)	1.0	6.9	7.1	7.4	38.5%	4.8	14%	9%
Elite Commercial REIT	444	360	0.68	1.5	0.0	1.5	1.5	0.7	7.0	7.0	15.7	0.0	1.0	7.9	8.2	6.3	42.1%	7.4	0%	1%
IREIT Global	552	367	0.65	0.8	1.6	0.8	2.6	(0.5)	0.8	1.8	14.0	(2.6)	0.82	7.1	7.1	7.6	35.0%	3.4	2%	25%
Malaysia - Office (7)	**6,315**	**4,805**		**(0.1)**	**0.4**	**(0.8)**	**(1.7)**	**(1.6)**	**(12.0)**	**(5.9)**	**4.6**	**(16.8)**	**1.7**	**4.6**	**5.2**	**1.4**				
KLCCP Stapled Group	2,834	841	6.65	0.0	0.2	(1.9)	(2.2)	(3.5)	(15.9)	(6.1)	1.1	(17.9)	2.4	4.8	5.1	1.6	18.2%	na	na	na
Sentral REIT	226	403	0.90	(0.6)	(1.1)	1.7	1.7	(3.2)	26.1	2.3	27.0	(6.3)	0.7	7.8	7.8	4.6	38.3%	4.2	22%	16%
Sunway REIT	1,132	1,717	1.40	0.0	1.4	1.4	(4.1)	(1.4)	(12.5)	(6.7)	4.5	(18.6)	1.5	5.0	5.0	1.8	37.1%	5.9	42%	17%
Pavilion REIT	978	262	1.36	0.0	0.0	(0.7)	0.0	0.7	(13.4)	(9.3)	7.9	(16.6)	1.1	2.2	5.1	N.M	34.8%	1.5	19%	42%
CapitaLand Malaysia Mall Trust	309	265	0.62	0.0	0.8	0.0	(0.8)	1.6	(10.1)	(0.8)	6.0	(16.2)	0.5	3.2	3.2	0.0	35.4%	1.0	41%	35%
Axis REIT	659	1,072	1.93	(0.5)	0.5	(1.0)	(0.5)	1.0	(6.8)	(4.9)	6.6	(14.2)	1.3	5.2	5.2	2.0	36.3%	5.7	21%	17%
UOA REIT	177	246	1.11	0.0	(0.9)	(1.8)	0.9	0.9	(8.3)	(1.8)	3.7	(12.6)	0.74	8.1	9.0	4.9	39.5%	1.4	28%	30%

Note: Office segment figures are used where the blended average is not available for diversified REITs
Source: Bloomberg, RHB



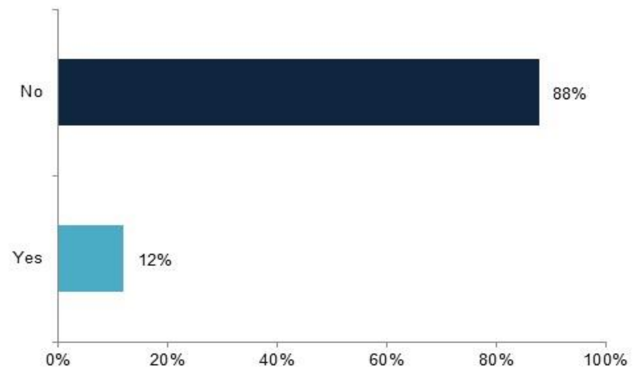
Country Focus

Singapore

Receptive to flexible work arrangements

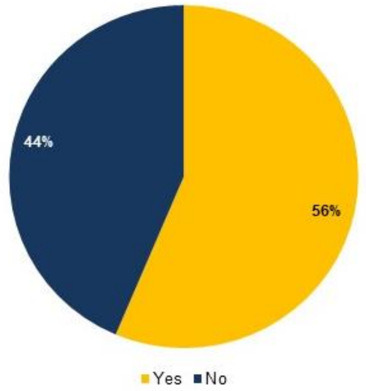
Remote work arrangements are possible in most of the sectors… An overwhelming 88% of the respondents surveyed indicated that they are able to carry out their normal work duties without having to be in the office. This is broadly in line with on-the-ground evidence that, although the transition to WFH arrangements has been sudden and brought on by COVID-19 disruptions, most employees have adjusted relatively well. Anecdotally, it also has to be noted that, unlike many Western nations (the US and Europe) where we understand that some form of WFH arrangements were prevalent even before COVID-19, WFH arrangements in Singapore (pre-pandemic) have been rather limited. However there seems to be a shift in employers' approach post-COVID-19, with 56% of our respondents suggesting that their employers are now more flexible and are likely to give more long-term flexible WFH options.

Figure 20: Respondents on the necessity to work from the office



Source: RHB

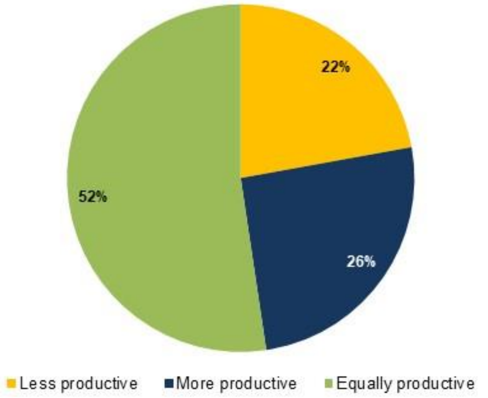
Figure 21: Employers' willingness to offer WFH flexibility, based on respondent's perception



Source: RHB

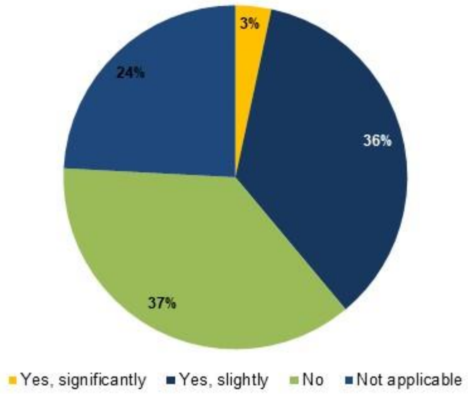
…without much loss of productivity or client relationships. Nearly half the respondents noted that WFH has been equally productive, with another 26% saying that their productivity has increased due to WFH. Only 22% indicated a drop in productivity. Similarly, only 3% of respondents highlighted a significant negative impact in client relationships, while another 36% noted a slight impact on client relationships due to WFH. Almost 95% noted that they were able to be reach out easily to supervisors in a timely manner, and 85% said the goals were clearly conveyed during remote work – which is not surprising, considering the availability and advancements, as well as the widespread adoption of technology/communication tools.

Figure 22: Limited impact on productivity from WFH



Source: RHB

Figure 23: Slight negative impact on client relationships due to WFH



Source: RHB

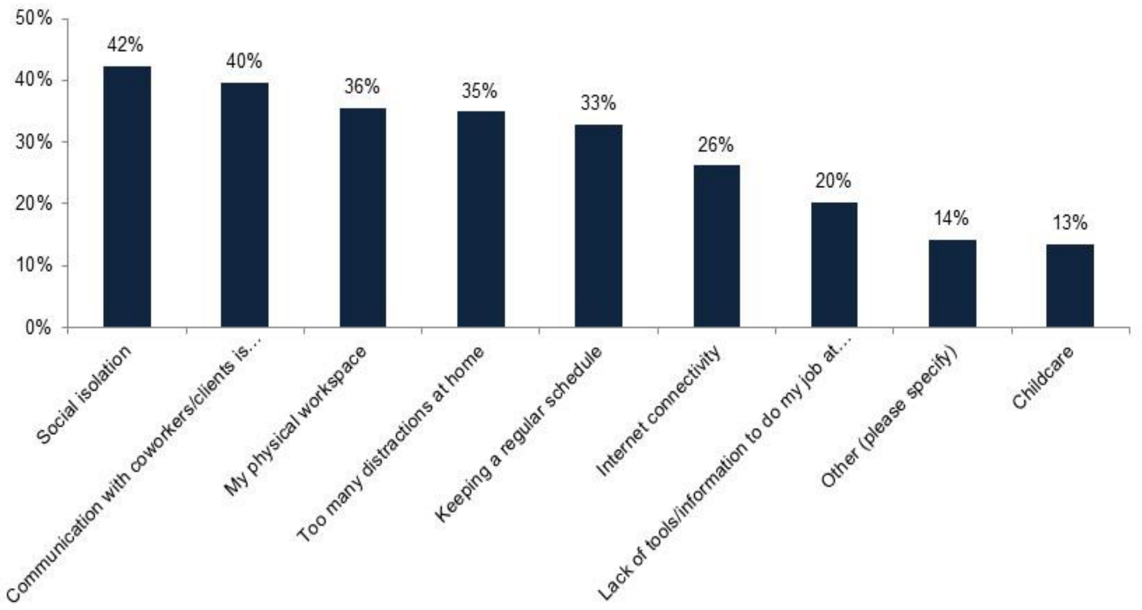
Key advantages and challenges of WFH

Minimal impact on work-life balance and professional ability to grow. Nearly half of our survey respondents indicated that they have been able to maintain a work-life balance by WFH, while another 18% said that there is no difference compared to working from the office. Similarly, on the professional growth front, an overwhelming 63% said that they were able to grow significantly by WFH – which we believe could be due to additional time saved vs times when people have to commute to the office and back.

Social isolation the biggest challenge of WFH... Unsurprisingly, the biggest challenge of WFH has been social isolation and the lack of a personal touch with colleagues and clients, with 42% and 40% of them attributing this as a major challenge. This issue was followed by the lack of a proper physical workspace (36%), distractions (35%) and keeping a proper schedule (33%). On the other end, employees seem to have adjusted to childcare needs (13%) over this period – with this being noted as the least of concerns among the respondents surveyed.

... **but employees are able to save considerable commuting time.** Nearly 60% of the respondents spend, on average, 1-2 hours commuting to the workplace, while 22% spend more than two hours in a commute. Only 19% live fairly closer to the workplace, and spend less than an hour travelling to the workplace.

Figure 24: Biggest challenges of WFH



Source: RHB

WFH is more stressful on mental health. Nearly 60% of those who surveyed said WFH has resulted in lower levels of mental health, which is not surprising as social isolation and the lack of a personal touch were identified as the key challenges. On the other hand, WFH has so far had a lesser impact on physical health, with 60% scoring above average (average = 50).

Based on our survey results and market trends we have identified four key themes for the office sector post-COVID-19:

i. Flexibility and wellness at the office;

ii. Flight to quality;

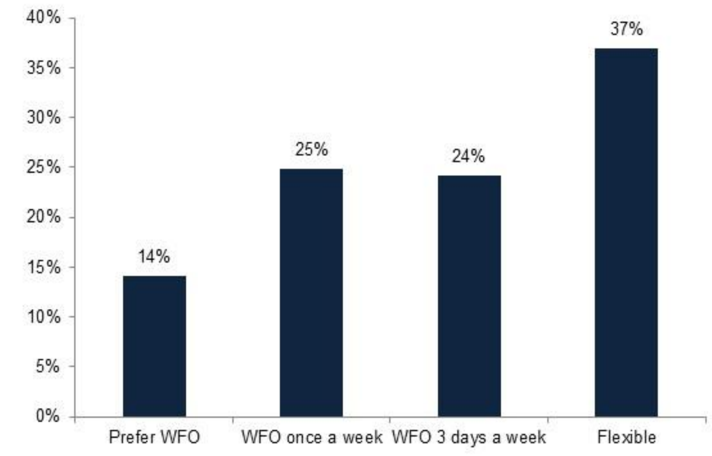
iii. Transformation of the central business district (CBD);

iv. Co-working.

Theme 1: Flexibility and wellness at the office

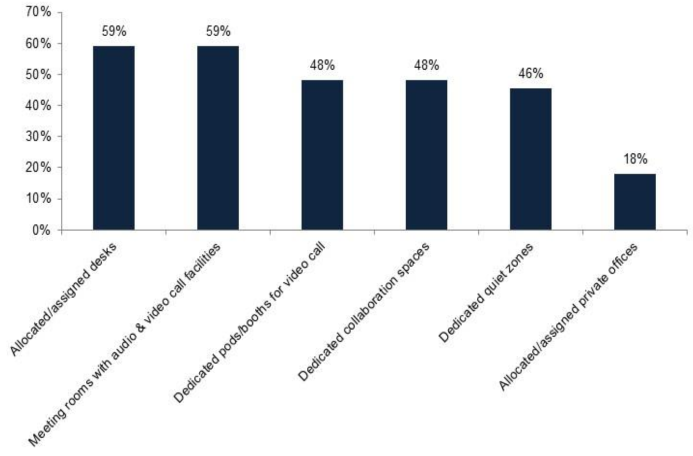
The office is not dead – employees prefer more flexibility rather than a complete WFH arrangement. Only 14% of the respondents to our survey preferred to have a complete WFH schedule, vs 37% who would like to have a more flexible approach to the office environment. Another 24% and 25% prefer to be in the office once and thrice a week respectively. This trend is in line with many other global surveys conducted that indicates the key to the future of the office is: Greater flexibility and not the lack of office space itself. As such, our view is that while WFH trends are likely to result in some reduced demand for office space (likely 10-30%) for specific sectors, there are other compensating factors (more collaborative space) that would partially mitigate the impact.

Figure 25: Respondents' workplace preferences



Source: RHB

Figure 26: Respondents' office preferences



Source: RHB

Rightsizing/downsizing risk mitigated by growing diverse demand drivers. Anecdotal evidence suggests that banks and financial institutions have taken the lead in rightsizing/downsizing their office space by ~10-30% of existing space. Recent movements regarding office space have been something undertaken by major global banks like Standard Chartered, UBS, Mizuho, and HSBC. There have been concerns about decreased office space demand arising from the WFH trend.

Our view is that companies are likely to take a core-flex approach, where they will maintain a core long-term working space, with the rest of the demand shifting to flexible leases. While this may result in an overall 5-15% reduction in office space demand over the medium-to-long term, it is likely to be offset by recent de-densification trends, which have resulted in more sqf of space per employee and, as a result, an overall increase in office space.

Our discussions with various professionals from REITs also indicate that there has been some spillover demand from companies shifting from Hong Kong – especially for family offices and office leases due to business continuity plans. However, this has not been significant, so far.

Futuristic office design: To focus more on collaboration and technology aspects. Another key finding from our survey is that the majority (59%) of the respondents would still prefer to have their own allocated/assigned desks. Other key aspects employees expect from future office spaces include: Meeting rooms with audio & video call facilities (59%), dedicated collaboration spaces (48%), and dedicated booths for video calls (48%). This aspect is now being reinforced by many global financial and technology firms – including big local banks like DBS, OCBC and UOB – which have expressed their strong belief that the office remains essential for productivity, collaboration and innovation.

Wellness: Another key emerging theme. Behind every successful organisation lies healthy and happy employees. This theme is likely to be accelerated by the challenges brought about by COVID-19 – as such, the promotion of health, hygiene and wellness at the workplace has never been more pronounced. To help reduce the threat of contact transmission, de-densification of the workspace and contactless technologies will become commonplace in the workplace.

Case Study 1: Citibank opens its largest wealth hub globally in Singapore

Citibank opened its largest wealth advisory hub dedicated to Citigold and Citigold Private Client customers in Singapore in Dec 2020. Officially named Citi Wealth Hub at 268 Orchard, it occupies 30,000 sqf, spread across four floors at 268 Orchard Road. The hub has over 30 client advisory rooms, as well as flexible work and event spaces.

Designed to enhance a visitor's connectivity to nature, the wealth hub embodies a biophilic design and will also be Leadership in Energy and Environmental Design (LEED)-certified. Biophilic elements can be found in many Singapore's iconic buildings, such as Jewel Changi and Gardens by the Bay. Client meeting rooms will be named after national flowers and trees found in countries and jurisdictions where Citi has a presence, with some transformed into "garden pods." Shrubs and trees will evoke an atmosphere where everything seems to flourish in a natural and sustainable manner, as a nod to the ideals of wealth management.

Figure 27: Citi Wealth Hub at 268 Orchard Road

Source: Ministry Of Design

Figure 28: Client meeting rooms

Source: Ministry Of Design

Case Study 2: Microsoft Experience Centre Asia (Frasers Tower)

Spread across 12,500sqm and six floors, the new Microsoft office brings 1,400 people together in an environment that allows the digital and physical worlds to exist in harmony. Artificial intelligence-enabled cameras enable frictionless access to maintain secure spaces. Employees have seamless movement between the six floors, efficiency-driven IT support with smart lockers, and IT vending machines that streamline the process and complement Microsoft's IT service desk. A common request from its employees was for an instant replacement for IT peripherals, such as keyboards, mice, headsets, cables and more. The smart vending machine automates the distribution of such products. A quick swipe of the employee badge will log the product, providing convenient inventory tracking.

Microsoft Experience Centre Asia has four key practices:

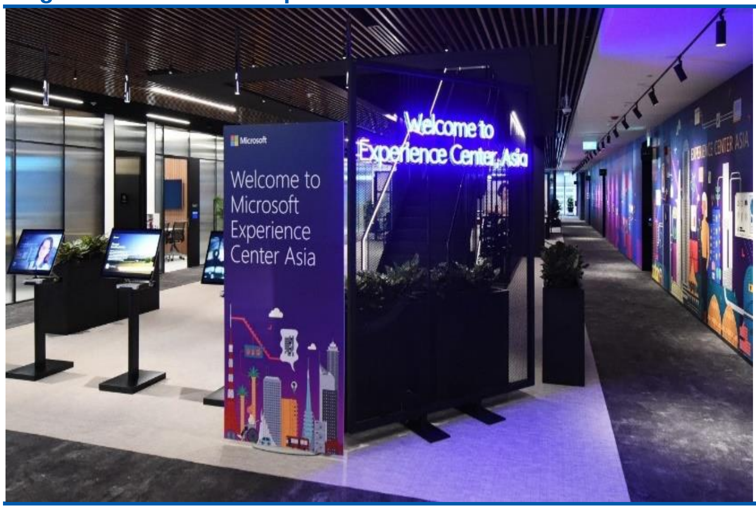
i. The Experience Zone, which showcases immersive demonstrations and current implementations across industry sector;

ii. The Microsoft Technology Centre which provides facility-based technical engagements, enabling customers to focus on their decision process;

iii. The cybersecurity centre;

iv. The Innovation Factory.

Figure 29: Microsoft Experience Centre Asia



Source: Microsoft

Figure 30: Innovation Factory at Microsoft

Source: Microsoft

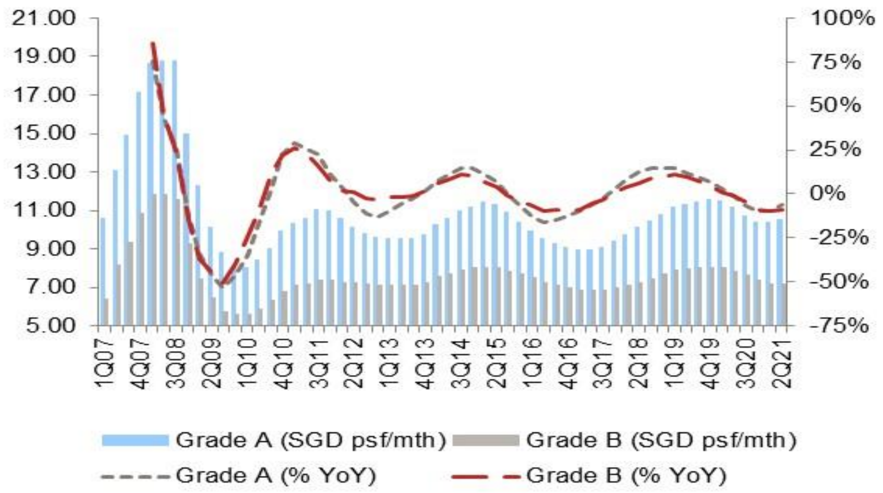
Theme 2: Flight to quality

The need for quality and well-designed work places surrounded by amenities is likely to amplify trends of flight to quality post-COVID-19. Already, signs are visible from the relative resilience of the Grade A (core CBD) market in 2020, which registered a positive net absorption of 0.5m sqf, while the Grade B (island-wide) market witnessed a reduction in occupied office stock of 0.8m sqf, based on CBRE data.

CBRE, in its latest report, noted that the fairly tight vacancy rate in the Grade A market has helped landlords of better-performing buildings to push for higher rental rates, as they benefit from the prevailing supply tightness. For 2Q21, Grade A core CBD rental rates rose 1.0% QoQ to SGD10.50 psf/month, marking the first rental rate growth since 4Q19. Conversely, the Grade B market struggled to backfill the existing vacant stock, and this placed further pressure on Grade B core CBD rental rates, which dropped by 1% QoQ.

As key commercial REITs under our coverage, Suntec REIT (SUN SP, BUY, TP: SGD1.76), Keppel REIT (KREIT SP, NEUTRAL, TP: SGD1.20), and CapitaLand Integrated Commercial Trust (CICT SP, NEUTRAL, TP: SGD2.10) own the highly prime Grade A office buildings in Singapore. They are set to be key beneficiaries of this trend.

Figure 31: Singapore office rental rates (Grade A vs Grade B)



Source: CBRE

Theme 3: Transformation of the CBD

The traditional CBD has been evolving even before pandemic started, from largely office buildings and a place of work to integrated developments – where people work, shop, play and stay. These changes are likely to accelerate at a much faster pace, due to the pandemic.

In the future, city centres would no longer just be places to work. They have begun to evolve into spaces where people also want to live and spend their leisure time. With this in mind, the Urban Redevelopment Authority (URA) – in its 2019 URA Master Plan - unveiled two new schemes to help transform Singapore's financial and commercial centre into a vibrant mixed-use urban neighbourhood that does not sleep. They are:

i. CBD Incentive Scheme. This scheme will allow a gross plot ratio increase of 25-30%, depending on the location and land use. They may be private residences with shops on the first floor or hotels, or a mixed development with commercial and residential uses;

ii. Strategic Development Incentive Scheme. The aim of this scheme is to help rejuvenate commercial buildings across the island that are at least 20 years old, from the date of their temporary occupation permits. These would include mixed-use developments with predominantly commercial uses.

Already, real estate developers are tapping into these schemes. We have seen some of them announcing rejuvenation and redevelopment plans for their assets. City Developments (CIT SP, BUY, TP: SGD8.70) earlier this year announced that it has commenced asset rejuvenation plans on Fuji Xerox Towers and Central Mall, tapping in the above schemes.

Another developer that could benefit from the schemes is UOL (UOL SP, NOT RATED) which is expected to benefit from the rejuvenation of its assets in the Marina Centre area and older CBD office assets.

Trend 4: Co-working spaces

Co-working gaining popularity but more landlords are carving out their own niches. The flexible workspace sub-sector has been witnessing tremendous growth in Singapore since 2015, similar to the trends seen in key global cities around the world. According to Colliers, the sub-sector accounted for 3.7m sqf of commercial space island-wide (5% of total) in 2019 – more than triple from 1.2m sqf in 2015. The sector has also been seeing an expansion in demand, even in the middle of the pandemic, as companies' needs for shorter and flexible leases increased during the pandemic. Based on data tracked by Colliers, 83% of the flexible workspace stock is located in the CBD, with 12% in the city fringe and 5% in suburban areas. The top seven flexible workspace operators now hold 65% of the market, with the top three – WeWork, IWG, and JustGroup – holding 51% of the enlarged pie as of Sep 2019.

With co-working space becoming mainstream and COVID-19 accelerating the needs of flexible workspaces in buildings, developers have taken an active lead in forging their own partnerships or curating their own flexible leasing concepts in their buildings to give an added advantage. Major Singapore developers like CapitaLand, City Developments, Frasers Property and GuocoLand have created their own flexible leasing concepts, or partnered with renowned flex space operators to tap into this growing segment as well, to capture changing business needs (Figure 32). Based on our discussions with various REIT managers, SREITs' exposure as a percentage of total income remains small at 2-4%.

Figure 32: Key co-working concepts in developer/REIT buildings

Developer/REIT Name	Co-working concept/partner	Key building presence
CapitaLand / CapitaLand Integrated Commercial Trust	The Work Project (CapitaLand Owns 50% stake)	Asia Square, Capital Tower, CapitaGreen
CapitaLand / Ascendas REIT	Bridge+	79 Robinson Road
City Developments	Distrii (CDL owns 24% stake)	Republic Plaza
Keppel Corporation / Keppel REIT	Kloud	Keppel Bay Tower
Frasers Property / Frasers Logistics and Commercial Trust	JustCo(22% stake)	The Centrepoint, 5 One Central
Lendlease	csuites	Paya Lebar Quarter
GuocoLand	In-house Core & Flex leasing scheme	Guoco Midtown (Under development)

Source: RHB, Companies data

Figure 33: Selected SREITs' exposure to the co-working sub-sector

Developer/REIT Name	Selected co-working players in the REITs buildings	Estimated exposure (as % of total income)
CapitaLand Integrated Commercial Trust	The Work Project, WeWork, The Executive Centre, The Great Room	~4%
Keppel REIT	The Executive Centre, Kloud	~1-2%
Suntec REIT	WeWork, The Executive Centre, Ucommune	~2%
OUE Commercial REIT	Ucommune, Spaces	~1-2%

Source: RHB, Companies data

Newer office developments allocating 10-15% of space to flexible workspaces. As the core-flex model gains traction and is slowly becoming mainstream, developers are allocating 10-15% of their NLA in new projects for flexible working space concepts.

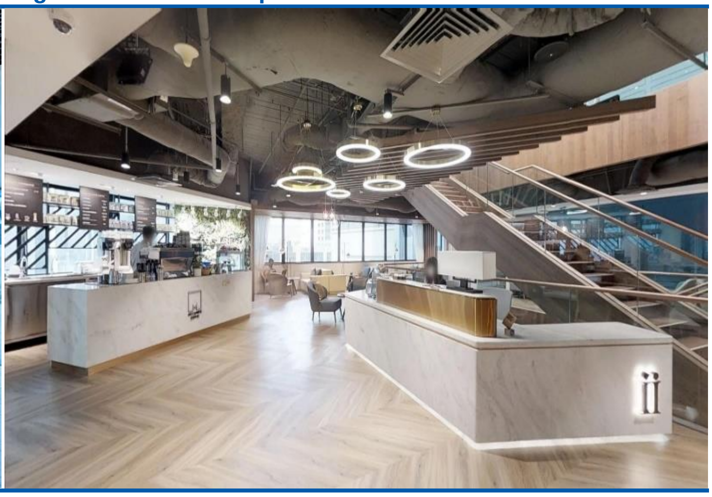
In CapitaSpring, about 68,700 sqf or 10% of the development's office NLA has been set aside for flexible workspaces. These are spread across three floors – one at each of the low-rise, mid-rise and high-rise sections of the building on Levels 21, 39 and 40, so that building occupants can have easy access to these flexible amenities. CapitaSpring is a redevelopment of the former Golden Shoe Carpark, and is currently jointly developed by CapitaLand (45%), CapitaLand Integrated Commercial Trust (45%) and Mitsubishi Estate (10%). It is expected to be completed by end-2021.

Similarly, GuocoLand has set aside 15% of the office NLA (770k sqf) for adaptable spaces at its upcoming development, Guoco Midtown. This, according to the developer, is to "meet the demand from companies with dynamic business needs and shorter business cycles".

Figure 34: The Work Project – Asia Square

Source: www.Indeawards.com

Figure 35: Distrii – Republic Plaza



Source: www.distrii.com.sg

Figure 36: Kloud – Keppel Bay Tower

Source: www.kloudsco.com

Figure 37: JustCo – The Centrepoint

Source: www.chio.space

Maintain OVERWEIGHT on SREITs

Singapore's office sector to remain vibrant and relevant. Among all the sub-sectors, the office segment is second-best, preferred next only to the resilient industrial segment. While COVID-19 has accelerated the WFH/flexible office trends in some sectors (especially for financial services), we believe there are sufficient counterpoints that would mitigate this. These include rising demand from other sectors (technology, healthcare), a potential shift from other global markets with Singapore's rising status as a global wealth management hub, and de-densification trends that will keep the office sector in Singapore vibrant.

We believe the key factors for tenants selecting an office space would be more about the quality of space itself, with employee wellness and the ability to collaborate possibly being the top priorities. Flexibility and attention to sustainability are the other key considerations both landlord and tenants are likely to keep in mind.

We believe our key Singapore office sector picks – Suntec REIT and Keppel REIT – are well-positioned to ride on this trend, given their high-quality Grade A assets and their constant attention to adapting to changes in market trends.

Similarly, for overseas REITs, all three US office REITs under our coverage – Prime US REIT, Keppel Pacific Oak US REIT and Manulife US REIT – are also holding high-grade assets that should strategically benefit from these evolving trends.

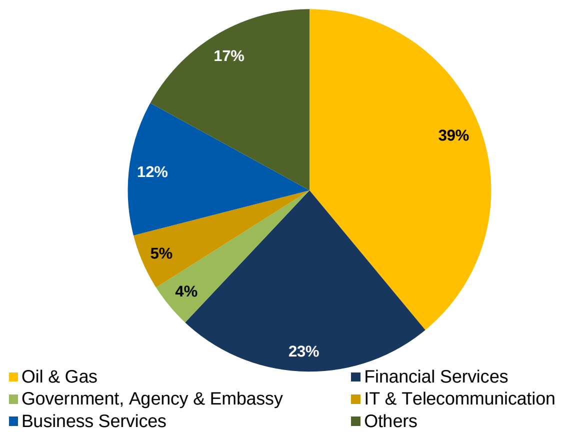
Malaysia

Industries are not reliant on office space per se

Most jobs do not require being in the office. 80% of respondents answered "no" to the question of whether the nature of their jobs require a physical presence in the office. In tandem with the spread of the industries the respondents are from, almost half who answered "no" are from financial services (49%), followed by real estate (13%) and oil & gas (7%).

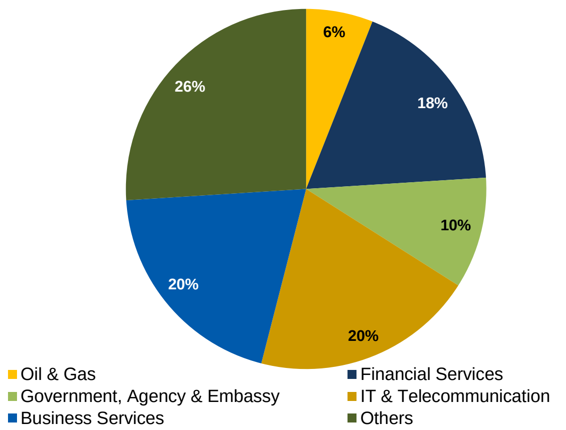
Oil & gas players and financial services tenants dominate the office buildings in the Kuala Lumpur city centre. For the REITs under our coverage, we note that that this holds true for the office buildings owned by KLCCP Stapled (Petronas Twin Towers, Menara 3 Petronas, Menara Exxonmobil) as well as Sentral REIT (Menara Shell and Wisma Technip). While Petronas has a long-term triple net lease agreement with KLCCP Stapled – which should secure full tenancy for the duration of the lease – we have reason to believe that renewals may not be as robust for the other oil & gas players which may opt to downsize in the new normal. As it is, the recent quarterly results by Sentral REIT saw an existing tenant in Platinum Sentral downsizing its presence within its office blocks.

Figure 38: Occupier profile for office buildings in the Kuala Lumpur city centre



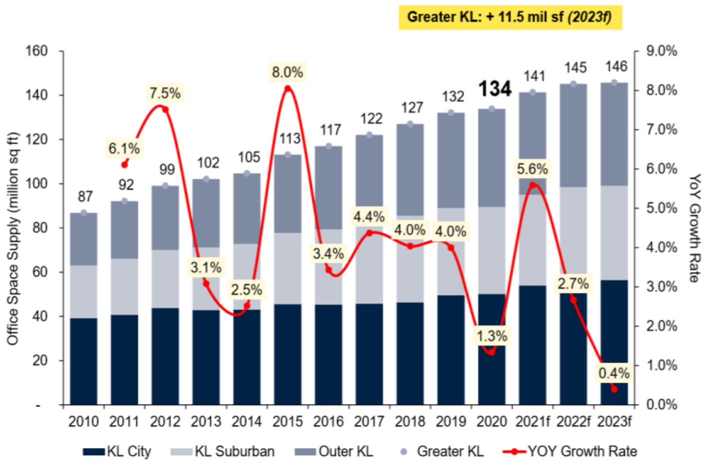
Source: RHB, Savills Research

Figure 39: Occupier profile for office buildings in Kuala Lumpur fringe



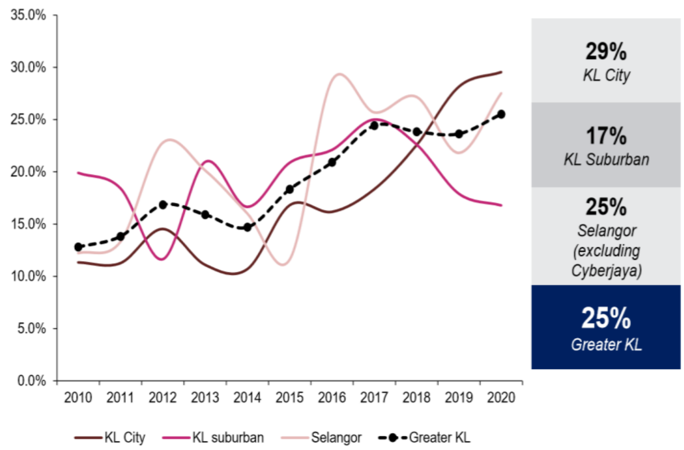
Source: RHB, Savills Research

Figure 40: Cumulative supply of office space in Greater Kuala Lumpur



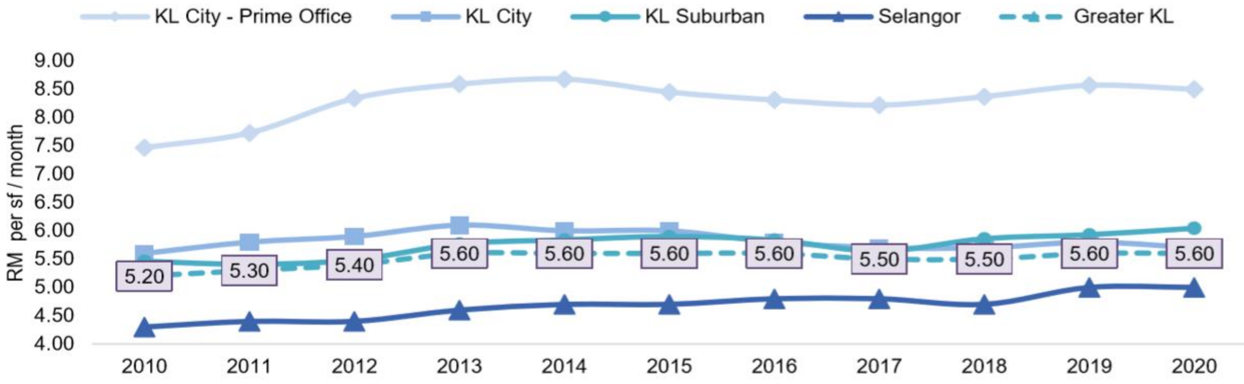
Source: Savills Research

Figure 41: Average vacancy rates in Greater Kuala Lumpur



Source: Savills Research

Figure 42: Average gross asking rental rates in Greater Kuala Lumpur (2010-2020)



Source: Savills Research

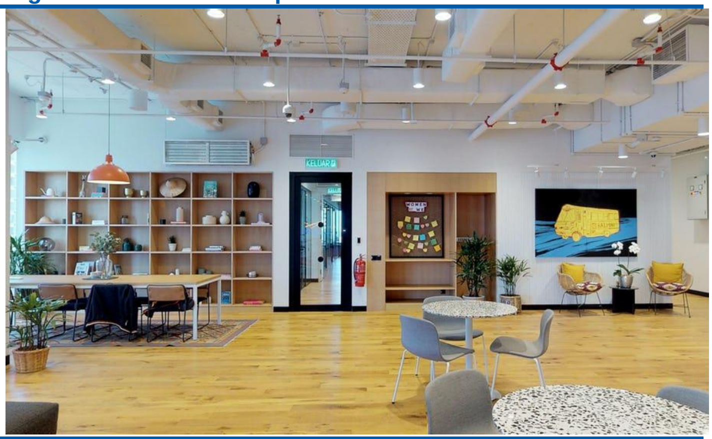
Co-working space operators taking up the space left behind. In the face of the persistent supply glut looming over the office and retail segment for years now, we have been seeing the absorption of these spaces by co-working space operators (WeWork, Common Ground, Regus, Co-labs, etc) in recent years. These operators typically take up at least an entire floor of an office building, or a big floor plate in a retail mall – which suggests that the average rental paid would be lower, given the bigger space occupied.

Additionally, we gather from some industry players that each office building within Mid Valley City houses a co-working space operator. That said, we are lukewarm on the prospects of the emergence of this trend, because while occupancy rates may be propped up, the rental rate growth is likely to remain subdued in the coming years in Kuala Lumpur, as it has been the past 10 years.

Figure 43: Spaces (Regus) – Platinum Sentral

Source: regus.com

Figure 44: WeWork – Equatorial Plaza

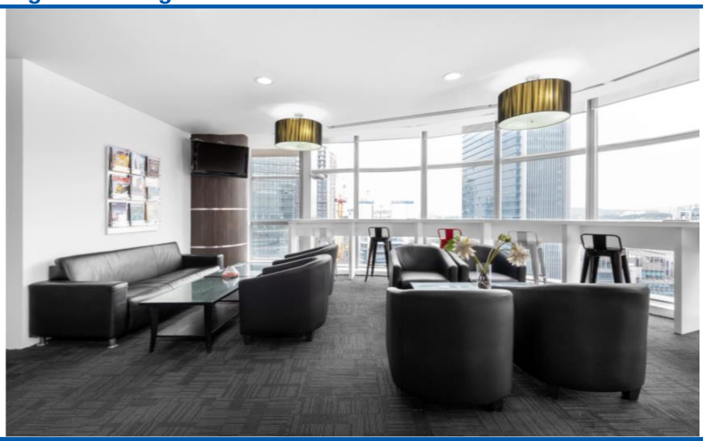


Source: wework.com

Figure 45: Common Ground – Mercu UEM

Source: commonground.com

Figure 46: Regus – The Gardens South Tower



Source: regus.com

Tendency to decentralise going forward

We believe that the tendency for corporates to decentralise will also have an impact on the demand for office space by various corporations. Aside from the convenience that a location in the outskirts of town may offer in terms of traffic congestion or lack thereof, international corporates and multi-national corporations may look to decentralise their operations in order to have proper business continuity planning and pandemic risk management. Elsewhere, we think some companies from Singapore may need to have a small office presence in Johor or Kuala Lumpur – which would bode well for corporations, as office rental is also typically much cheaper in Malaysia than in Singapore.

Maintain space, but make it minimal. Our conversations with oil & gas players as well as multi-national IT firms throughout the duration of the survey suggest that the physical presence in offices is, nevertheless, still vital to operations for staff collaboration purposes and for the sake of maintaining a corporate brand image. Companies are only likely to downsize or re-plan office space post-pandemic instead of exit office buildings altogether. Based on the feedback we have gathered from some companies, they are estimating to downsize their presence in office spaces by 20-30%.

We note that Axis REIT has office buildings in Petaling Jaya, while Sentral REIT has a cluster of buildings located in Cyberjaya. While the distance of these locations from the Kuala Lumpur CBD may seem unattractive, decentralisation in the future may change that perception – and these office buildings with good infrastructure would be able to benefit. Geographical diversification is key to being able to capture the demand by tenants that are to be located in areas outside of Kuala Lumpur. While a major government-linked company tenant had exited earlier in the year, we note that Sentral REIT's Quill Buildings 1-4 in Cyberjaya have just seen a renewal in leases late last year.

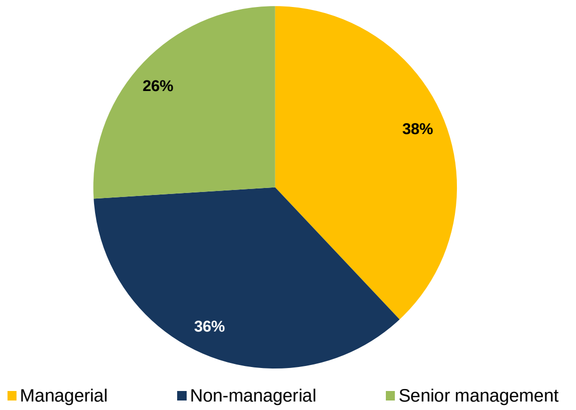
The great East/West mindset divide

Cultural differences between the East and West. An astounding 46% of our respondents do not believe that their employer is prepared to offer them the option to work remotely in the long term. Elsewhere, we have noted that Facebook, JPMorgan Chase, Ford, Apple and Deloitte UK have taken great strides in permanently transitioning to either a completely remote or a rotational/hybrid model. Similar surveys also indicate that multinational corporations in Western countries are prepared to accept a greater propensity of employees working from home – with the threat of high attrition in the case of a full return to the office. We attribute this, in part, to a cultural divide between the mindset of the Western and Asia-Pacific population.

Age group also a pivotal point. Out of the 338 respondents that said "no" to whether their employer is prepared to offer WFH long-term, 64% hold managerial and senior managerial roles, while 69% of them are aged 35 and above. Interestingly, a PwC US remote work survey highlighted that the least experienced workers (0-5 years) will need the office space the most, with 30% of them partial to working remotely no more than one day a week.

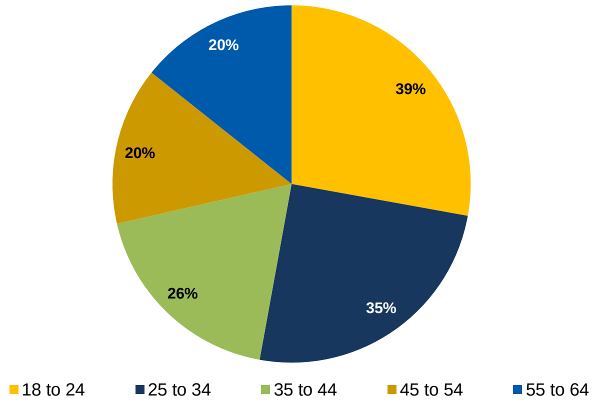
Unlike SREITs, all office assets owned by the MREITs under our coverage are located within Malaysia, and senior management positions – even for multi-national corporations – are still dominated by locals. There would need to be a fundamental shift in the culture of the locals, for there to be a more open acceptance to a complete transition to a hybrid or completely WFH programme.

Figure 47: Breakdown of respondents who do not believe their employer is prepared to offer WFH long-term, by position



Source: RHB

Figure 48: Breakdown of respondents who do not believe their employer is prepared to offer WFH long-term, by age



Source: RHB

The new (paranoia-laden) normal?

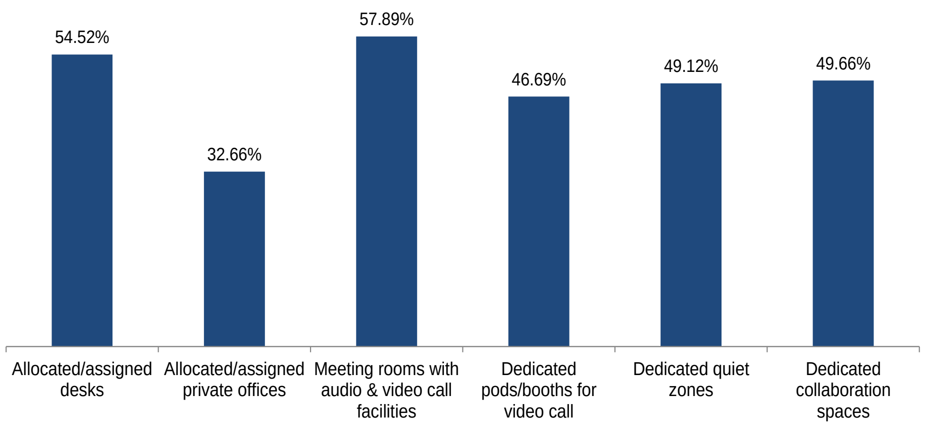
No issues with being in close proximity to others. As it is, the vaccination rate in Malaysia is among the highest in the world, with over 500,000 daily doses administered in recent weeks – on track to meet the target of fully vaccinating 50% of the adult population by the end of August. This will be beneficial in instilling confidence for the workforce to return to the office.

That said, it is not surprising to note that 67% of respondents are willing to use shared desk spaces upon returning to the office, or in the event that visiting the office becomes part of their routine. We gather that office tenants have taken the precautionary measures to ensure that their employees remain socially distant and abide by stringent standard operating procedures – especially as office clusters have been a prominent issue in the past 1.5 years. This begs the question if the hesitance to return to the office is due to resistance in being exposed to the virus and susceptibility to infection in the face of variants, or this reluctance may be due to other reasons.

Structural changes are the way to go

Malaysia will probably see some structural changes in the office sector, as tenants tend to prefer office buildings that have good infrastructure and facilities (in this case, usually Grade A buildings) to complement their business models if they want to prepare for a remote work programme for workers. Hence, demand for Grade A and high-quality office space will increase. Asset owners that hold old office buildings should plan to upgrade their properties, in order to stay relevant in the market. A good example would be Equatorial Plaza. According to the results, the following would be prime areas of improvements required, if office spaces were to go through with enhancement initiatives within its spaces:

Figure 49: Preferred features of the office in the new normal



Source: RHB

Acquiring appealing assets could be a faster option

Acquisitions over enhancements, maybe? We find that the prospects of acquiring prime office buildings could potentially unlock value for REITs more meaningfully, as opposed to going through with asset enhancement initiatives for old buildings. A large number of assets owned by the REITs are well over 20 years old, which would make enhancement initiatives rather costly.

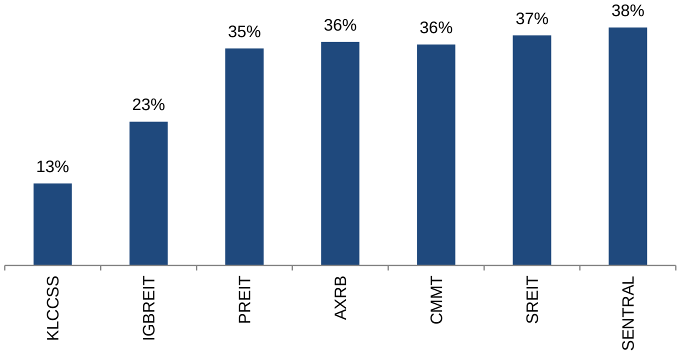
Some recent office building acquisitions include The Pinnacle Sunway into Sunway REIT and UOA Corporate Tower into UOA REIT – both completed end of FY20.

i. The Pinnacle Sunway, a 24-storey Grade A office building located within Sunway City, with a market value of MYR450m;

ii. UOA Corporate Tower, a 40-storey Grade A office building located in Bangsar South, with a market value of MYR586m.

MREITs are not highly geared, considering the ultra-low interest rate environment, the average gearing for MREITs of 33% and the temporarily raised cap of 60% that will last until end of FY22. As such, MREITs should be able to comfortably gear up to proceed with any acquisition plans that could add value to their portfolios.

Figure 50: MREITs' gearing level as of 1Q21



Source: RHB, Company data

Figure 51: Office pipeline assets for selected REITs

REIT	Pipeline assets
KLCCP Stapled	Lots M, N, 185, 91 located around KLCC Precinct – still under construction
Sentral REIT	Menara Celcom in Petaling Jaya – awaiting data collation as the building is new
IGB Commercial REIT	Southkey office towers in Johor Baru, ready to be injected only in 3 years
UOA REIT	UOA Business Park in Shah Alam, UOA Tower in Ho Chi Minh City

Source: RHB, Company data

What makes a Grade A property, anyway?

No clear-cut definition for Grade A. Our discussions with various REIT managers led to the unanimous agreement that there is, in fact, no definition for what constitutes a Grade A office building in Malaysia. Unlike the case for green building certification or Multimedia Super Corridor (MSC) status which are prescribed by the likes of Green Building Index and Multi-media Development Corp (MDEC), there is no single entity that is responsible for the assessment of office buildings to prescribe a grading.

However, we believe that the grade and quality of office buildings would depend on but are not limited to the below factors;

i. Location – this would have a huge bearing on the tenants that the office building would be able to attract, such as multi-national corporations, which are known to withstand economic downturns better;

ii. Proximity to public transport – an accessible office building located nearby transportation hubs would bode well for attracting tenants;

iii. Building age – newer buildings are likely to have better infrastructure;

iv. Speck and physical appeal – traits such as the distance between the floor and the ceiling, and the elevator quality among others would also contribute to the grade of an office building;

v. Facilities in place and amenities.

As of now, only the buildings owned by KLCCP Stapled and UOA REIT have a clear grading for their buildings while Sunway REIT has The Pinnacle that is considered Grade A. The other buildings are deemed regular buildings – which may fall behind when it comes to tenant retention, as newer buildings such as the Tun Razak Exchange could prove to be a much more attractive alternative for tenants to occupy.

Equal productivity when WFH, if not more

Quality of buildings aside, our survey also aimed to get a feel of the general acceptance of WFH culture, by gauging the impact that WFH has had on respondents' productivity, professional growth and physical/mental health, among others. In the event that office buildings remained status quo with little to no enhancements or structural changes in the future, would tenants resist going back to the office?

Only less than one-third have been less productive at home... Contrary to the belief that employees may potentially be slacking off at home without the supervision of managers, 51% of respondents believe that they have been equally productive in the past 12 months of WFH, while only 29% of the respondents feel that they have been less so. We note that some of the challenges faced by respondents revolving around a lack of trust when WFH include requests for performance trackers by managers who do not trust their subordinates, managing the discipline of subordinates and difficulty in monitoring staff. That said, it is interesting to note that 90% of respondents also saw minimal disruptions when it comes to connectivity with their team and/or their manager.

… but with limited upside to professional growth. However, 59% of respondents believe that professional growth in the past year of working from home has been relatively subdued, while 17% believe that they have not been able to learn and grow in a professional capacity. Opportunities tend to come around better when productivity is visible and co-workers are present. Working in isolation with little interaction between team members may limit the potential for growth, especially for junior employees, as learning opportunities in the form of mentorship or tutelage is impacted.

Minimal implication on relationships with clients. Meanwhile, 49% of respondents with vital relationships with clients have not in fact seen their relationships with clients being impacted, while 38% have seen their relationship with clients being only slightly impacted. Technology advancements in the past decade have allowed for video calls and virtual meetings to become the norm, which is more convenient than in-person meetings. Additionally, objectives pertaining to tasks for work have also been communicated effectively in the past year, with 79% of respondents believing that goals have indeed been conveyed effectively.

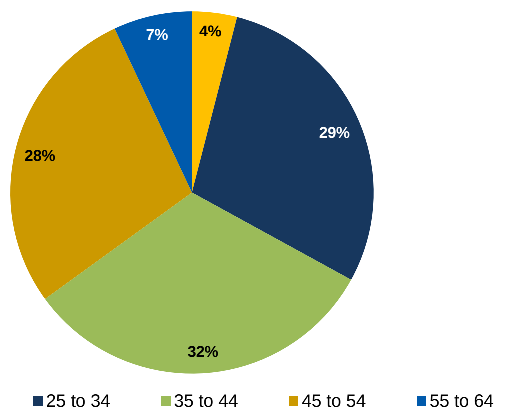
Half of the respondents have been able to save 1-2 hours of commute time a day, which is another reason why we believe that buildings would need to be well-connected to transport links, or decentralisation will be appealing to tenants whose employees reside outside of Kuala Lumpur.

Given the above findings – where disruptions are largely only in the form of a limitation in professional growth and commute time – instead of productivity and professional relationships, we reiterate our view that office buildings would have to go through a structural change with improvements in its facilities to be able to retain tenants.

Still a big preference for WFO

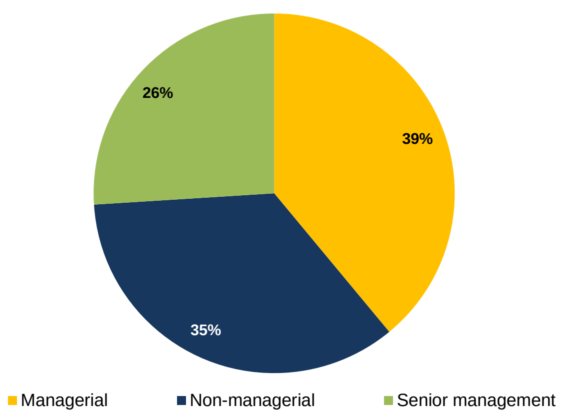
Despite a large number of people having grown accustomed to WFH and the perceived minimal disruption that WFH has posed to operations, there still seems to be a gravitation towards having a presence in the office, as WFO is still preferred in the case of a hybrid remote work programme. 58% of respondents prefer entirely WFO or for three days of the week – of which, 65% hold managerial or senior managerial roles and 67% are aged 35 and above.

Figure 52: Respondents with a preference for WFO, by age



Source: RHB

Figure 53: Respondents with a preference for WFO, by role



Source: RHB

A lack of a proper workspace and tools. From our findings, we believe that the primary reason for the relevance of office space at present would be the absence of a proper and suitable workspace/ergonomic setup and necessary equipment needed to work effectively from home. 31% of respondents are not equipped with the suitable workspace and the necessary equipment required to work from home effectively. Some shared that a lack of tools such as the Bloomberg terminal, stable Internet connection and printing services for hardcopy materials are some of the biggest challenges of WFH.

Other reasons include the lack of compensation for costs incurred when working from home as utility bills would have shot up during WFH and preparing meals for the family would have become the norm during lockdown.

Mental wellbeing a priority to employees. Additionally, 30% of respondents have not been able to maintain a healthy work-life balance when working from home, while 18% have not seen a difference in their mental wellbeing working in either locations.

Challenges faced by respondents are ranked as per below:

i. Social isolation (46%);

ii. Communication with co-workers/clients is harder (41%);

iii. Too many distractions at home (39%);

iv. Internet connectivity (37%);

v. Lack of tools/information to execute tasks at home (31%);

vi. Keeping a regular schedule (30%);

vii. Physical workspace (30%);

viii. Childcare (11%).

We also note that 27% of respondents who have vulnerable dependents at home would be affected upon their return to the office. In our view, Malaysia still falls behind certain European countries such as Sweden and Hungary – where even benefits like paid paternity leave has become a widely accepted norm. Office buildings would have to begin strategising and incorporating services such as childcare and nurseries in Malaysia for employees with young children to be able to return to the office comfortably.

Ecosystem at the office. Discussions at the Malaysian REIT Forum 2020 by Malaysian REIT Managers Association and APREA "Navigating The New Normal" alluded to the fact that in the long term, there would need to be an ecosystem formed within and surrounding office buildings in a way that there is symbiosis between tenants and convenience for tenants. We believe that office buildings that are part of integrated developments or are in close proximity to transport links and amenities such as shopping malls would be able to benefit from this establishment. However, as an ecosystem would require a tenant to hold up a larger space, we do not discount the possibility of rental rate growth continuing being soft in the long run.

Largely neutral-to-positive impact on overall health

Mental health is crucial for employees to function as best as they can, and produce quality work. On a scale of 0 to 10, the average score obtained was 6.2 which indicates that respondents for the most part have seen a positive impact that WFH has had on their physical health. Meanwhile, the average score was 5.6 for the impact that WFH has had on their mental health, which is barely any difference between WFH and WFO.

Much like pent-up demand in relation to revenge spending, we think that a lot of employees have been in social isolation for too long and would have no qualms in returning to the office – especially if there is a remote work programme or a hybrid model in place. Collaboration, in-person meetings and human feel remain key components to an effective work environment, so returning to the office is inevitable.

The bottomline here is that the demand for space will remain despite possible downsizing by many corporates, and it is incumbent upon REIT managers to ensure that office buildings owned by their respective REITs are able to cater to the changes in the requirements of an office building in the new norm, whether it is providing better facilities (gym, childcare, meeting rooms with video call equipment), having a more appealing interior design or enhancing the façade of a building.

Maintain NEUTRAL on MREITs

We reiterate our NEUTRAL call on the sector, premised on the unappealing yield spread between MREITs and the 10-year Malaysian Government Securities yield. Our economists expect to see a further uptrend in the bond yield curve, which would entail a further narrowing of the yield spread in our view. Additionally, we think that the share price recovery for a lot of the bashed-down MREITs would take time to recover – as sentiment around the MREITs remains soft.

History repeating itself? While the office segment has been demonstrating relative resilience despite the challenges presented by the pandemic, we have reason to believe that the WFH trend will finally catch up to the underlying issue of a supply glut, which has been plaguing the office segment for years on end. Much like the completion of the Petronas Twin Towers around the time of the economic downturn during Asian Financial Crisis, which saw the average occupancy rate of office buildings in Kuala Lumpur dropping and staying below the 90% mark – the completion of Tun Razak Exchange during the COVID-19 pandemic may mark another point, where the adverse impact on office space in Kuala Lumpur could be further exacerbated.

KLCCP Stapled for office exposure. That said, we recommend that investors stick with REITs that own good-quality assets, which are highly accessible and are likely to remain appealing to strong tenants that are able to withstand financial volatility for years to come. We prefer KLCCP Stapled (NEUTRAL, TP: MYR6.90), when it comes to exposure to the Malaysian office segment, due to its iconic Grade A buildings. The strategically located and fully occupied Petronas Twin Towers, Menara 3 Petronas and Menara Exxonmobil are all on a long-term triple net lease agreement with Petronas, which sub-leases to tenants that presently occupy the building – with revisions to rental rates taking place every three years. Our current Neutral rating on this hybrid REIT is largely because of the expected underperformance in its retail and hospitality segments over the near term.

Figure 54: Office buildings owned by selected MREITs

	Location	Grade	Age (years)	Occupancy (%)	NLA (sqf)	Market value (MYRm)	Access to public transport
KLCCP Stapled							
Petronas Twin Towers	Kuala Lumpur	A	23	100	3,195,544	6,680.6	Yes
Menara 3 Petronas	Kuala Lumpur	A	9	100	812,806	1,971.6	Yes
Menara Exxonmobil	Kuala Lumpur	A	24	100	408,105	536.8	Yes
Sentral REIT							
Menara Shell	Kuala Lumpur	n/a	7	99	557,053	657.0	Yes
Platinum Sentral	Kuala Lumpur	n/a	9	84	482,913	675.0	Yes
Wisma TechnipFMC	Kuala Lumpur	n/a	27	83	233,021	173.0	Yes
Quill Building 1	Cyberjaya	n/a	18	100	92,284	135.0	No
Quill Building 2	Cyberjaya	n/a	17	100	184,453	123.0	No
Quill Building 3	Cyberjaya	n/a	16	91	117,198	78.0	No
Quill Building 4	Cyberjaya	n/a	14	100	99,183	135.0	No
Sunway REIT							
Menara Sunway	Subang Jaya	n/a	26	97.8	291,807	172.0	No
Sunway Tower	Kuala Lumpur	n/a	24	35.2	268,306	120.0	No
Sunway Putra Tower	Kuala Lumpur	n/a	27	85.5	317,051	133.0	No
Wisma Sunway	Shah Alam	n/a	23	100	171,544	60.0	No
The Pinnacle Sunway	Subang Jaya	A	7	98.4	576,864	450.0	Yes
Pavilion REIT							
Pavilion Tower	Kuala Lumpur	n/a	13	85.8	163,844	133.0	Yes
CMMT							
3 Damansara Office Tower	Petaling Jaya	n/a	12	65.9	101,258	496.0*	No
Axis REIT							
Menara Axis	Petaling Jaya	n/a	16	73.5	178,406	112.5	No
Crystal Plaza	Petaling Jaya	n/a	25	45.8	204,851	111.0	No
Quattro West	Petaling Jaya	n/a	38	100	104,196	59.0	No
UOA REIT							
UOA Centre	Kuala Lumpur	B	26	78.0	124,009	78.7	Yes
Wisma UOA II	Kuala Lumpur	B	22	78.0	427,289	291.6	Yes
Wisma UOA Damansara	Kuala Lumpur	B	23	85.0	186,395	118.7	Yes
Wisma UOA Damansara II	Kuala Lumpur	A	13	88.0	291,133	231.1	Yes
Parcel B – Menara UOA Bangsar	Kuala Lumpur	A	12	93.0	308,086	300.0	Yes
UOA Corporate Tower	Kuala Lumpur	A	4	94.0	732,871	718.0	Yes

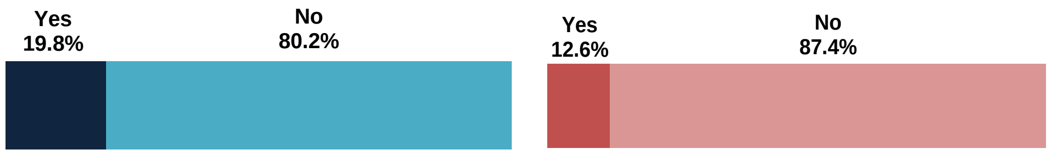
**Note: Value of 3 Damansara Property Retail and Office Tower*
Source: RHB, Company data

Appendix

Results Of Our Survey

Questions **Malaysia** **Singapore**

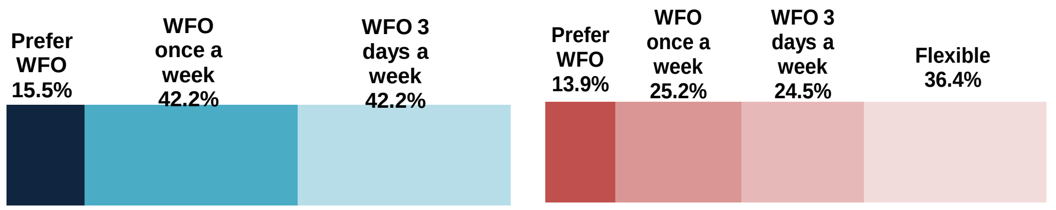
Does the nature of your job require you to physically be stationed at the office (due to facilities/services only available at the office)?



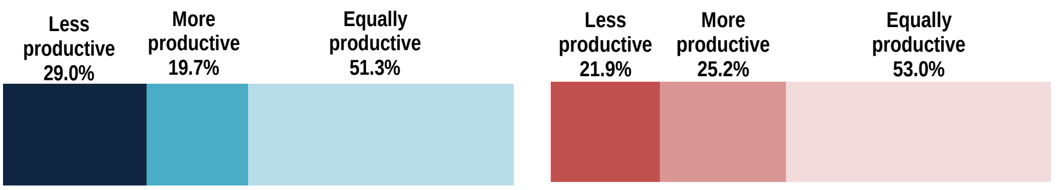
Do you think your employer is prepared to offer employees long-term WFH as an option (assuming the nature of your work allows it)?

Are you willing to use shared desk spaces if WFH and visiting the office are part of your routine (assuming proper storage space is provided)?

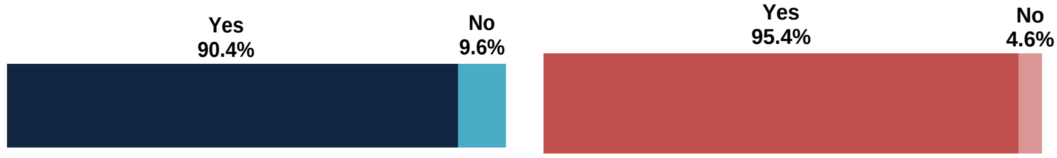
Should there be a remote work programme, how often do you see yourself working from the office (WFO)?



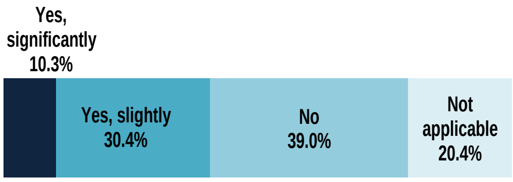
Based on your experience over the last 12 months, how has WFH affected your productivity?

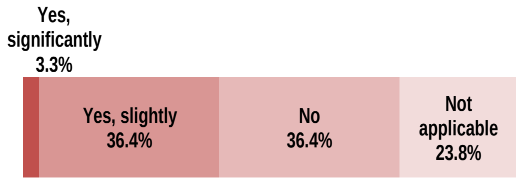


Are you able to regularly contact the team/manager while WFH and is your organisation able to provide the proper and sufficient support?

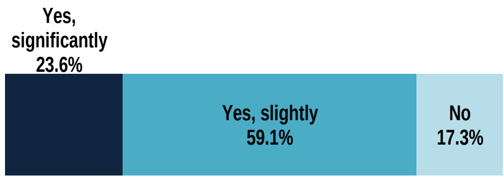


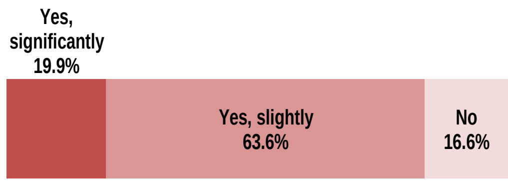
Has your relationship with clients been affected while WFH?



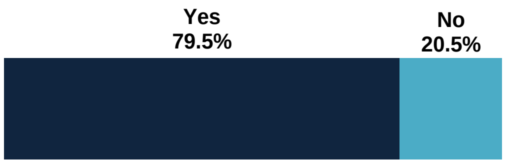


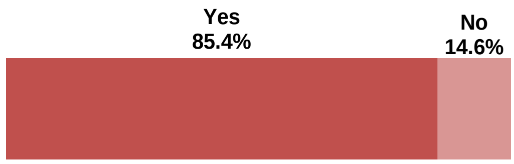
Have you been able to learn and grow professionally in the past year of WFH?



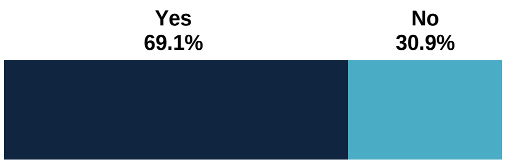


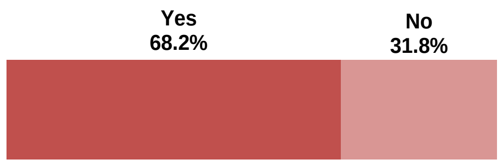
Are the goals/objectives of your weekly tasks/work communicated clearly and efficiently while WFH?



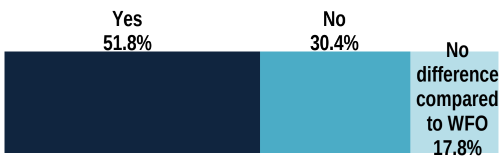


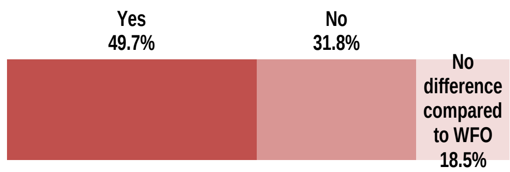
Do you have a suitable workspace/all the necessary equipment needed to WFH?



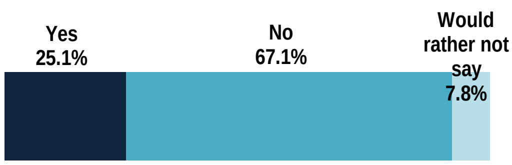


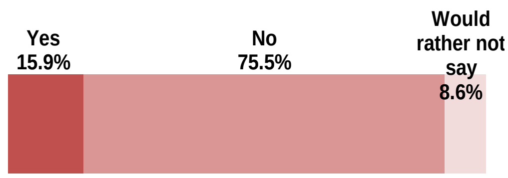
Are you able to maintain a healthy work-life balance when WFH?



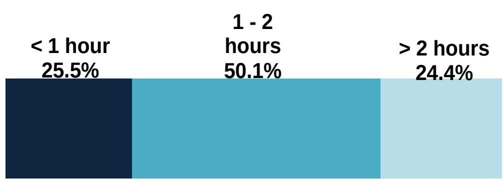


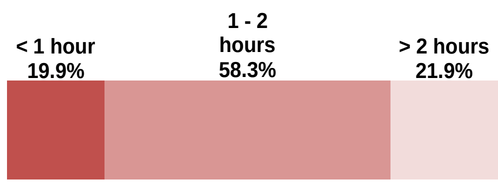
If comfortable answering, do you have vulnerable dependents (children, family members) at home that would be affected when you could return to the office?





How much time spent commuting to work are you able to save a day on average by WFH?





What are the biggest challenges you are currently facing while WFH?

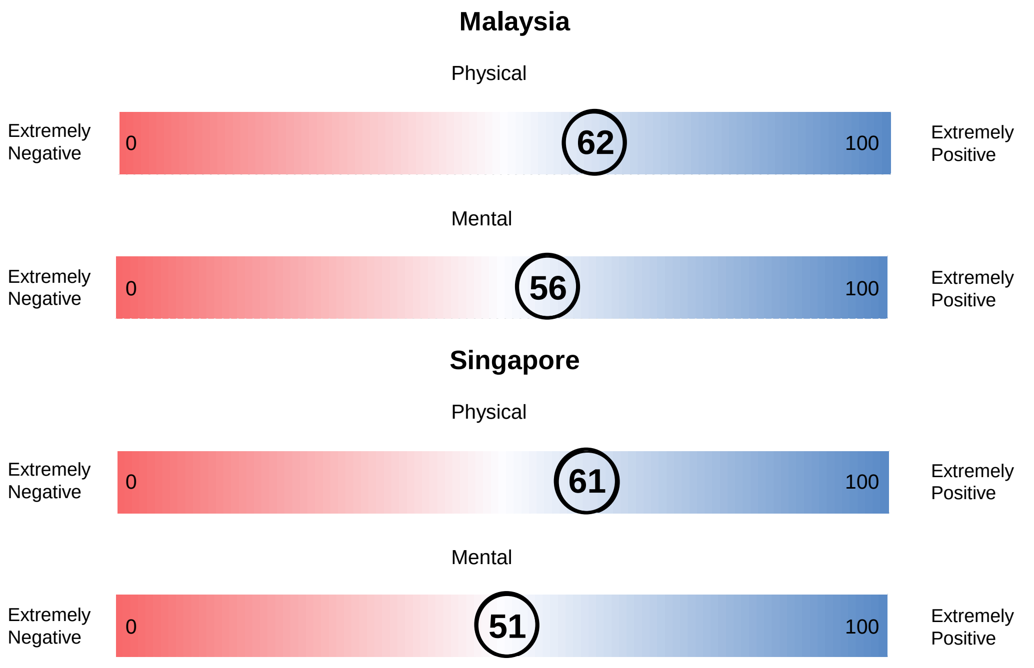
Malaysia

Social isolation	45.8%
Communication with coworkers/clients is harder	40.8%
Too many distractions at home	38.6%
Internet connectivity	37.0%
Lack of tools/information to do my job at home	30.6%
Keeping a regular schedule	30.2%
My physical workspace	30.1%
Childcare	20.5%
Other (please specify)	11.1%

Singapore

Social isolation	43.1%
Communication with coworkers/clients is harder	39.7%
My physical workspace	36.4%
Too many distractions at home	34.4%
Keeping a regular schedule	32.5%
Internet connectivity	26.5%
Lack of tools/information to do my job at home	19.9%
Other (please specify)	13.9%
Childcare	13.3%

What impact do you think WFH has on your physical / mental health?



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