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MARKETS

	MONDAY	CHANGE
STI	3,263.39	-17.30
KL Comp	1,457.99	-1.04
Nikkei 225	CLOSED	-
Hang Seng	17,930.55	-252.34
Shenzhen B	1,135.85	+1.21
DOW (11am EDT)	34,637.01	+18.77

Tweaking regulatory limits for S-Reit gearing seen as double-edged sword

The need for flexibility should be weighed against investor protection considerations: observers

By Raphael Lim
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Under the current rules, which were revised in 2020 following a public consultation, Reits should not have aggregate leverage exceeding 45 per cent of the funds' deposited property. PHOTO: BT FILE

HIGHER interest rates and lower property valuations have pushed aggregate leverage ratios of real estate investment trusts (Reits) towards regulatory limits.

However, industry watchers are divided on whether tweaks should be made to the gearing ratio limits to offer some relief to the Singapore-listed real estate investment trusts (S-Reits).

Experts polled by *The Business Times* (BT) said the need for flexibility needs to be weighed against investor protection considerations.

Tan Boon Gin, chief executive of Singapore Exchange Regulation, noted that office Reits with overseas assets, for example, have suffered a "triple whammy".

"Tenants now want smaller spaces and are moving away from workstations to common areas. They may also need to green their building. These are all very capex intensive," he said in a fireside chat at the Reit Association of Singapore conference in August.

To raise money, Reits could increase equity or sell properties. But these options may not be feasible when unit prices have fallen significantly, and market conditions for asset sales are not conducive.

Borrowing – even from the sponsor – could also impact interest coverage ratio (ICR) and leverage limits, Tan noted.

He believes a case could be made to waive the leverage rules, if the purpose of borrowing is for asset enhancement, so as to increase property income and valuations.

"This will lead to deleveraging in the long term even if there is an increase in gearing in the short term," he noted.

Tan also believes a principles-based approach may justify a waiver if the principle behind the rule, which is to promote well-managed risk taking, was not compromised. He noted that the rule may not have been designed with such high and rapidly increasing interest rates in mind.

He added that any changes would have to be deliberated very carefully.

Investor protection

Sigrid Zialcita, chief executive of Asia Pacific Real Assets Association (Aprea), however, believes that changes to regulatory limits are unlikely.

"Regulators are likely to resist setting a precedent that could introduce higher risk to an asset class that is first and foremost a yield instrument predicated on stable and regular payouts, without further contemplation," she said.

She noted that leverage limits are already at a flexible level for companies to generate sustainable profits and deliver a steady growing distribution.

Under the current rules, which were revised in 2020 following a public consultation, Reits should not have aggregate leverage exceeding 45 per cent of the funds' deposited property. The Reit may exceed this threshold up to a maximum of 50 per cent, if it has an ICR of at least 2.5 times.

Gabriel Yap, a veteran Reits investor and chairman of GCP Global, believes that the cap on the aggregate leverage ratio for Reits remains very relevant for the protection of minority unitholders.

"In the current high interest rate environment, it 'forces' and directs Reits to be even more disciplined in their operational and M&A endeavours," he said.

Leverage limits should not be changed or tweaked unnecessarily to accommodate commercial reasons as "Reits will then be perceived as less reliable as a steady income play and become more volatile instruments", he added.

Noting that the current period of rate hikes is similar to that of the 1970s, which brought many US Reits and European Reits listed at that time "to their knees", Yap said: "Loss of confidence can quickly give way to liquidity risk which can in turn, lead to (insolvency)".

But the current situation may also present a chicken and egg scenario, as loosening leverage limits in certain circumstances could potentially allow some Reit managers a way out from their current challenges. A DBS spokesperson noted that Reit managers had been prudent in managing their leverage prior to the current rate hike cycle, with leverage in the 35 per cent to 45 per cent range. However, significant headwinds – including a high interest rate environment – have created a challenging operating environment.

"DBS has been involved in industry and policy workgroups to identify appropriate support for

> **"Specific to the leverage limit, the rules provide that if a Reit exceeds the leverage limit due to factors beyond its control, such as a decline in property values, this will not constitute a breach of the leverage limit. The rules also allow S-Reits to refinance existing borrowings without counting such refinancing towards the leverage limit."**
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> MAS spokesperson

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Raising leverage ratios may give some Reits a lifeline, but being selective remains key for investors, Page 6

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the sector to tide over external shocks in the interim, and to emerge stronger," the spokesperson said.

Morningstar analyst Xavier Lee believes that scrapping the regulatory limit could remove potential unit price weakness for Reits that are close to the limit, as investors anticipate future equity raising to recapitalise the balance sheet.

He noted that the aggregate leverage ratio exists to protect the risk of excessive debt leading to debt-servicing problems, but believes this should be a business decision rather than regulator-driven.

"Rather than debate over what the ideal aggregate leverage ratio limit should be, we think Australia is an example where, even without gearing limit, the Reit managers will still exercise financial discipline even when they are free to take on more debt," Lee said. He noted that Australian Reits' gearing is around the same level as Singapore Reits.

In response to queries from BT, an MAS spokesperson said the authority closely monitors macroeconomic conditions and the impact on the S-Reit sector, and has regular engagements with the industry to discuss market developments and trends.

"Specific to the leverage limit, the rules provide that if a Reit exceeds the leverage limit due to factors beyond its control, such as a decline in property values, this will not constitute a breach of the leverage limit," the spokesperson said. "The rules also allow S-Reits to refinance existing borrowings without counting such refinancing towards the leverage limit."

Aprea's Zialcita noted that past revisions to financial ratios were a result of regulatory review to maintain Singapore's competitiveness as a Reit listing destination, or events with far-reaching consequences such as the pandemic.

"While the office market in the US is undergoing a structural shift that is unlikely to reverse in the short term, these are less evident in other parts of the world. The current challenges unfortunately just further penalise foreign S-Reits, which are already seen to be undervalued," she said.

"As Singapore's geographical size makes overseas expansion and listings critical in maintaining a vibrant Reit market, it remains to be seen if the current episode would prompt some soul searching by the authorities."

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