THE BUSINESS TIMES

# COMPANIES & MARKETS



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# More visibility needed in renewal of land tenure for industrial Reits

TUE, JUL 10, 2018 - 5:50 AM

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THE government's move to shorten industrial land leases has clearly served its purpose well in keeping costs down for end-users. On the other hand, it has been a bane for industrial Reits, which have found limited room for expansion locally and sought out greener pastures overseas in recent years.

But as the land leases of their existing properties are increasingly run down, industrial Reits are stuck between a rock and a hard place if they wish to maintain their asset exposure in their home market.

On the one hand, they face limited new development opportunities here as new sites released by the government come with shorter land leases of 20-30 years since mid-2012, down from the previous 60 years. There are also few quality industrial properties available for sale that are not already part of a Reit.

At the same time, there is also the uncertainty of whether they are able to renew the land leases for existing properties before they are substantially depleted.

Under the existing policy of government agency JTC, lessees of JTC properties may apply to renew their leases for a new term at least three years before the expiry of their leases.

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JTC will typically engage lessees six years prior to the end of their existing lease terms to discuss their business plans for the next term. For third party facility providers, such as Reits, the anchor subtenant's business plan is evaluated. Should the Reit meet all the criteria of JTC to renew and extend the lease, the Reit will pay a premium for the lease top-up.

Arguably, a lead time of six years may be too short for Reit managers to start planning for re-development or re-investment exercises, since a property's asset value depreciates more rapidly as it approaches the tail end of the tenure.

On that note, the Reit Association of Singapore (Reitas) has been discussing with JTC on giving Reit managers clarity well in advance.

With policy changes since 2012 affecting industrial land, developers and Reits have found it unattractive to acquire new industrial land in Singapore for development. In the latest industrial government land sales (GLS) programme for the second-half of 2018, all six sites on the Confirmed List spanning 4.09 hectares have a land tenure of 20 years each and a gross plot ratio (GPR) of 1.4 or 2.5. For a 20-year leasehold site, after three years of construction, the site is typically left with 17 years on its lease.

In recent years, many industrial Reits have gone overseas to acquire assets that are freehold or longer in land leases. Diversifying geographically has also enabled these Reits to mitigate concentration risks and cyclical risks associated with being in one single market.

Among them, Cache Logistics Trust, which has weighted land lease of 27.7 years left for Singapore properties by gross floor area as at end-2017, has picked up freehold warehouses in Australia since 2015 and one warehouse in China in 2011 with a 50-year lease from Sept 18, 2006.

For Mapletree Industrial Trust (MIT), its weighted average land lease for 85 Singapore properties by land area stood at 38.4 years as at March 31, 2018. It has gone into the US, jointly acquiring a portfolio of 14 freehold data centres last October for US$783.4 million through a 40-60 joint venture with its sponsor. MIT has two plots whose land leases have run down to 13 years as at March 31, 2018, namely Kallang Basin 1 and Kallang Basin 2.

Similarly, Viva Industrial Trust (VIT) has three properties with remaining land leases of less than 20 years as at end-2017. They are Viva Business Park in Chai Chee Road (13.3 years), Jackson Square in 11 Lorong 3 Toa Payoh (11.4 years) and 30 Pioneer Road (19.1 years).

A merger of ESR-Reit and VIT is currently under way via a scheme of arrangement; each of their portfolios - entirely in Singapore - have a weighted average land lease expiry of 33.5 years as at March 31, 2018.

It may be a matter of time for industrial Reits that have not ventured overseas - namely ESR-Reit, VIT, Sabana Reit and Soilbuild Reit - to do so. But those without a sponsor with a strong overseas network will find it harder to scour for deals.

Having overseas assets will also expose a Reit to foreign exchange risks. The 45 per cent gearing limit on Reits currently hinders them from optimising the capital structure for overseas acquisitions to better hedge against currency risks.

Of course, not all Reit managers shun properties of short land leases in Singapore as they tend to be cheaper to acquire and looks justifiable in net property income yield. From time to time, such deals are still sewn up.

On its part, JTC can provide greater visibility for Reit managers on the potential for lease top-ups earlier rather than later. Perhaps, such conversations can begin 10 years before the land lease expires. This will allow industrial Reit managers to decide whether to enhance the asset or recycle capital from it in good time, and in turn enable end-users to make longer term plans.