REITAS

DPU yield and price to NAV are two key metrics that retail investors consider when investing in REITs including during a sale or M&A transaction. As part of our effort to increase understanding of S-REITs, one of our members (Ernst & Young LLP) penned the article below which sheds some light on this topic.

The debate between DPU and NAV

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Singapore has the largest Reit market in Asia (ex-Japan) and continues to be on a growth trajectory to becoming a global Reit hub. PHOTO: REUTERS

THE Singapore real estate investment trust (Reit) regime started in 2002 when it saw the successful listing of its first Reit. Over the course of 18 years, the market segment has now grown to 43 Reits and property trusts totalling around S$100 billion in market capitalisation. Singapore now has the largest Reit market in Asia (ex-Japan) and continues to be on a growth trajectory to becoming a global Reit hub.

As a sign of the regime's ongoing maturing process, there have been more instances of consolidation among Reits in recent years, including those with differing asset classes. Such consolidations first happened in 2018, and the market has since seen the completion of three other mergers, with two other reported proposed mergers pending approvals.

In certain cases, how the Reits are to be valued in these transactions - whether to base it upon distribution per unit (DPU) or price to net asset value (NAV) - especially during a sale or M&A transaction, has drawn much interest from investors and analysts.

Understanding DPU and NAV

DPU yield and price to NAV are two key metrics that retail investors consider when investing in Reits. Reits are a popular investment option among retail investors - and it is not hard to see why. Reits are generally seen as a more defensive option compared to stocks, and the requirement to distribute at least 90 per cent of taxable income annually is attractive to retail investors looking to receive regular investment returns.

DPU yield is the annualised DPU divided by the share price. While Reits with a high DPU yield look attractive, it may be misleading to conclude that high DPU yield alone indicates a good Reit. After all, a higher return in the form of DPU yield may be necessary to compensate investors for undertaking higher investment risks, such as those associated with asset class and underlying currency in which earnings are denominated. The good-old investment principle of high risks requiring commensurate higher rates of returns almost always holds true.

The NAV of a Reit is associated with the value of its underlying real estate assets. The price to NAV ratio gives an indication of whether the Reit is currently over- or under-valued with respect to its intrinsic value. In such cases, it is useful for investors to understand why Reits may not be trading at NAV and to that end, know how the NAV of Reits are determined.

Simply put, NAV equals the estimated market value of a Reit's total assets minus the value of all liabilities. For Reits, real estate property assets are generally the single largest line item on the balance sheet. The Property Fund Guidelines within the Code on Collective Investment Schemes issued by the Monetary Authority of Singapore requires all listed Reits to report their real estate property assets at fair value. This fair value must be determined by full property valuations carried out by independent professional valuers at least annually.

However, the valuation process can be subjective and fair market value concluded on any real estate property asset is only an estimate. At best, this fair market value serves only as an indication of what the asset is worth at a given point in time, and there is no certainty that the asset will indeed be sold at that value. In essence, property valuations are regarded realistically as a range of possibilities rather than a specific value amount. Hence, it is interesting to note that valuers are required by their professional standards to conclude on one specific value and not a range of possible values.

Given the level of subjectivity involved in constructing the NAV, it is easy to see why the market may price a Reit at above or below the reported NAV. Informed and efficient market participants, including investors, are free to express their individual views about the intrinsic value of a Reit through their investment decisions. It is also possible that the market may price in certain premiums or discounts as a result of other considerations, including qualitative ones.

Taking a more holistic view

Mergers between Reits typically present themselves as DPU-accretive from the perspectives of both sets of unitholders. However, depending on whether the Reits concerned have been trading at

above or below NAV, such mergers could mean that unitholders may have to accept an offer that is DPU-accretive yet at a discount to NAV. How unitholders respond to this comes down to how they see the prospect of realising the Reit's portfolio at a value close to the reported NAV.

In reality, the market has been a lot more sophisticated in responding to this dilemma. It appears that investors have chosen, in their wisdom, to holistically consider the offers that have been put to them beyond just DPU and NAV metrics. Based on observations of past successful mergers, investors have recognised that there may not be a win-all situation and that certain short-term tradeoffs may be acceptable in view of other benefits, including qualitative ones.

Perhaps this tradeoff between DPU and NAV has been overplayed. The market has its own dynamics and confidence in navigating through less-than-perfect situations and accepting short-term trade-offs may be necessary. Afterall, isn't that the very core of what investing is all about - accepting short-term trade-offs for greater future potential gains?

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  The views are the writer's and do not necessarily reflect those of the global EY organisation or its member firms. The article has been written for Reitas (Reit Association of Singapore) as part of its efforts to increase understanding of Singapore Reits.