TRANSCRIPT

Ascendas Reit's 2Q FY16/17 RESULTS MEDIA & ANALYST BRIEFING

Venue: Raffles City Convention Centre, Fairmont Executive Meeting Room, Orchard Room
20 October 2016, Thursday

On the Panel:

Mr Chia Nam Toon, Executive Director and CEO of the Manager of Ascendas Reit

Ms Yeow Kit Peng, Head, Capital Markets & Corporate Development

Ms Koo Lee Sze, Chief Financial Officer

Participant A (David Lum, Daiwa): Hi, *David Lum from Daiwa*. Regarding the negative rental reversion of 5% for the logistics and distribution centre and the 1% decline in the high specs industrial sectors, can you give us some colour on those segments and whether these will persist in subsequent quarters?

Mr Chia Nam Toon: I think the logistics and high specs sectors are facing challenges because of two reasons. One, we all know that there is heavy supply coming on stream, so as a consequence to that, people are taking the opportunities to shift and move into spaces that probably better suit their requirement and also capitalize on the lower rental. But that said, our log spaces are well-spec, so we are also able to continue to lease them out, albeit the rates being a bit softer.

In so far as the high specs are concerned, this is what I call a sandwich segment. During good times, this is where the first take-up will come in. People will upgrade but during the weaker period, this is the segment where you will see a little bit of softness. So we are experiencing exactly that. What we have been calibrating is to see, in the next few years, what we should do with some of these portfolios of assets. We're trying to segment them and see how we can reposition those assets accordingly. But high specs is one of those areas that will see the shift. Some will downgrade, some will go to smaller spaces and some will move to light industrial.

Participant B (Derek, DBS): Hi, good evening. *Derek from DBS*. Just two questions. I am just curious about the vacancy. It's been there for some time, so I am just wondering what are your discussions with tenants. Why is this vacancy at 10% for such a long time? Is it structural in nature?

Mr Chia Nam Toon: I think two folds. You all know that over the last few years, we have been experiencing conversion of STBs (single-tenant buildings) to MTBs (multi-tenant buildings). So as we lease out some of the older spaces, some of the new STBs have been converting as well. Albeit you will see that the STBs conversions are much less for us now.

Second thing is of course, we continue to grapple with some of the stubborn spaces where subletting rules affect us. So obviously those are a bit harder.

That said, this year we have made the concerted effort to work with the authorities to see whether we can reposition some of these assets and allow us to lease out the vacant space, because some of the rule changes have affected us mid-stream. I think the authorities are quite sympathetic. They are taking into account that we have built additional GFA in some assets and because they changed the rules, we got affected by it. They have actually started to look at giving us dispensation. That said, it will take a while for us to lease out some of those spaces.

Broadly, those are the key reasons why you see some of the spaces continue to be stubborn. Of course this year, being a much softer year, we expect take up to take a little bit longer.

The one trend you will see is the renewals are much slower this year. But what is good is that we have got the strength of our fairly large group marketing teams looking at international MNCs. We have been able to alleviate some of the problems with new take-ups. So our new take-ups are actually a lot stronger than what we anticipated. Renewals are much weaker.

Participant B (Derek, DBS): Sorry, just one last question. Thinking about refurbishment and repositioning, could you give us a sense of whether any of your assets, will undergo this route in your next half year or so? How large will it be?

Mr Chia Nam Toon: We underwent quite massive AEIs over the last six years. We spent about $600 to $700 million over the last few years, so what is remaining is much less now for at least Business and Science Park. That's on the AEI front.

We have also continuously spent quite a fair bit of money on M&E refurbishments. That's a continual programme. So, lift upgrades, chiller changes, air-conditioning, all those have been changed over time and in fact, we are still continuing with that.

As far as AEI is concerned, going forward, one thing that we will do a little better this year is that we are starting to segment even within the different clusters to see what is required for AEI. How much do we spend for AEI? And then calibrate the price point accordingly. So we are starting to refine that a little bit more.

The other thing that we are doing is to ensure that the new interior designs put in are relevant for today's use. As we start seeing people talk about co-working spaces and the use of lobby spaces, we must ensure that those designs remain relevant. We don't just do AEI just for the sake of AEI. We will continue to upgrade the assets accordingly.

JTC is coming out with 30-year leases as we all know, and it is becoming harder to get access to land as well. We have started to convert some of the older assets from MTBs to STBs where it is suitable. Since we have a fairly large portfolio, we have the opportunity to look at those more intently. We are continuing to talk to different clients who need spaces for themselves, expansion requirements, to see whether we can convert some of these assets.

That's one area. The other area is to see whether we can add some value to the assets, how we can reuse some of the assets for different purposes. We are constantly looking for new ideas.

Participant C (Michael, UBS): Hi. It's *Michael from UBS*. Can you remind me for the two assets that will not be renewed this year, which are the two and what are your plans for them?

Ms Yeow Kit Peng: Those two assets together will only account for about 20% of a total of 111,000 sm of STB due this financial year. One is in the light industrial cluster; the other is in the logistics cluster.

Mr Chia Nam Toon: We don't typically divulge or identify the assets. We are reviewing the suitability of repositioning them.

Participant D (Adrian, Citi): Hi. *Adrian from Citi.* Just two questions from me. One is on 40 Penjuru Lane, the reduction in the occupancy there. I seem to recall that this asset was recently converted to MTB, so I am just trying to get some colour on the lease non-renewals. Is this just happening after one very short rental cycle or did the tenant just close shop or something?

For Australia, in terms of the improvement in occupancy at Great Western Highway, you mentioned that this was renewed at roughly the same rental, does this include any incentives? Thank you.

Ms Yeow Kit Peng: The rent indicated for Great Western Highway is at the gross level.

Mr Chia Nam Toon: Since we are on Australia, the good news is that the government of Australia is looking at GDP forecast of between 2.5%-3.5%. We are starting to see pick up in leasing demand. As you know since we acquired those assets, some of those spaces remain vacant until now. In recent times, we are starting to see uplifts in leasing enquiries. In fact, you can see this quarter, we have moved from 90% to 94%. In the next few quarters, you should see quite good take ups.

Now, going back to the question on 40 Penjuru Lane, I think most of you will remember 40 Penjuru was also subject of an AEI. We built a new block in 40 Penjuru. The area that we have pre-terminated was taken up by one particular client. This is in the old block. The new block is actually enjoying quite good take up. We are in fact quite cautious about how we lease it out because it is quite a modern facility, and there has been quite a lot of interest. Over time, occupancy at 40 Penjuru should be fairly alright.

Participant E (Wilson, Morgan Stanley): Hi. *Wilson from Morgan Stanley*. I have just two questions. First, on the AEI at 50 Kallang. Just to clarify that it is the one identified in the placement. And also what is the expected ROI or yield-on cost on that project?

Second question is on your Business Park and Science Park. Are you still seeing demand from tenants that are leaving the office buildings to come to the Business and Science Parks?

Mr Chia Nam Toon: Let's do the 50 Kallang first. We typically don't divulge the hurdles but the returns on that particular asset will exceed our hurdles. Otherwise we won't proceed with it. The good news is that, the asset itself because of its age, allows us to do some repositioning. In fact, this is the type of exercise we like to do. In more recent times, we have been exploring actively how we can do more of these.

On Science Park leasing, it's a combination of things. The Science Park take up is still alright. As I was saying the other thing we are looking at is how we can reposition Science Park. I mentioned quite a few times now since I came on board that we are working with the Sponsor to see if we could totally redevelop Science Park 1, and even possibly Science Park 2. Some of those things are in talks at the moment. The Sponsor is also actively working alongside outsiders to improve accessibility of Science Park 2. Some of the activities are starting to take traction.

We are also going to introduce several activities into the Science Parks to see how we could activate the whole park. So I think for Science Park, we are quite confident. We have plans in place but it will take some time for us to deliver all of them. As far as the rest of Business Parks are concerned, we continue to still see some softness in IBP (International Business Park). But as far as CBP (Changi Business Park) is concerned, no problem there. There's still quite a fair bit of demand.

Participant E (Wilson, Morgan Stanley): What about relocation from the office area?

Mr Chia Nam Toon: It's hard to tell. I think there are lots of choices now. If you talk about CBD relocation, this is my two cents worth – some people have moved to the decanted areas within CDB itself. Then within the fringe areas, there's some decanting so you can also move to those, and some of them will move to the Business Parks depending on requirements. So it's very hard to say that we are seeing a lot of it. I think there are a lot of options for some of these people looking at trying to shift from CBD to other areas.

Participant F (Nicholas, Credit Suisse): Hi, *Nicholas from Credit Suisse*. I just have one question. You mentioned just now that the expiry in Australia is about five leases that you are looking at? For the STBs there, do you have any indication at the moment, if there is any risk of some of them not renewing or consolidating space or anything like that?

Mr Chia Nam Toon: In so far as asking whether if there is any risk of them not renewing, there will always be the risk. We have already actively started re-negotiating FY17/18 leases. I believed we have renewed several leases. So far, there's no major indication that we will lose all of them. I think some of them have talked about even expansion as well. But we can't give you specifics at this stage.

Participant G (Min Chow, Nomura): Hi, *Min Chow from Nomura*. Can you remind us how much of your portfolio in Singapore is still affected by the anchor tenant rule in JTC?

Ms Yeow Kit Peng: Generally, meeting the requirement is not expected to be a problem because it states that not more than 30% of the space should be leased to non-anchor tenants. So, we should be able to fulfil the requirement come December next year.

Mr Chia Nam Toon: I was saying earlier that we are in talks with the regulators. One of the things I mentioned earlier was about some GFA we have increased as a consequence of AEI and suddenly because of the change in regulations, leasing is affected. So, we have gone back to the authorities and they have said, “Ok, we can think about dispensation for those”.

There are also other types of dispensation that we are looking at. Some tenants want to expand from other buildings but because the current rules are not clear, the authorities don’t deem that to be expansion by existing tenants unless we move them wholesale to the building, which is not possible at this stage. They have also started looking at some dispensation there as well.

But generally, we are quite used to tackling these subletting issues. Obviously there will still be stubborn spaces but I don’t think it has reached a stage where we are too concerned. I think the main concern at this state is around the market softness.

Participant H (Krishna, Jefferies): This is Krishna from Jefferies. If I hear you correctly, you said some of these buildings you are converting from multi-tenanted to single-tenanted. So given the soft rent environment are you thinking of going for longer leases? Do you see a benefit in converting some of these buildings from multi-tenanted to single-tenanted one?

Mr Chia Nam Toon: Well, one of the things we are capitalising on is that there is less land being allocated by JTC for BTS (built-to-suits). People can apply, depending on whether they qualify or not. They may or may not get those allocations.

The second thing that we're capitalizing on is the fact that there are 30-year leases and we still have assets that have much longer leases to run.

Then the third thing worthwhile noting is that some of the assets are much older. They are either ready for AEI or massive repositioning. This is when we could think about whether we can lease the entire building to a single-tenant. That can only happen when we have a large enough portfolio. Just to give you an example, like today, my team and I were just discussing about some tenants requiring something like 13,000 – 15,000 sm of space. We can hunt all the assets that meet the criteria, then we see whether we can reposition some of the assets for that.

Smaller players will find it difficult to do that, because they only have very limited choices. In our case, we have more choices. Now of course, it involves some decanting, some shifting of tenants. But again, the benefit of being a larger portfolio allows us to do some of those options. In fact, as we speak, we are in at least two or three discussions on such cases.

Participant I (Tan Xuan, CLSA): Tan Xuan from CLSA. Can you talk more about acquisition strategy? Are you still focusing on Australia or looking at other countries?

Mr Chia Nam Toon: Good question. We have always emphasized that this is home. Singapore is still our preferred place, if we can find something to buy. So if you hear of anything, please let us know.

We are constantly spending a lot of time combing through the Singapore market to see if there's any opportunities to buy anything. That said, because we have gone into Australia, we will try to expand selectively the Australian business. We believe that at the current scale, while it is reasonable as a starting platform, it is too subscale at the moment. We like to see, giving an indication of 5-6 years' time, it will at least double in size. We have bought one business park asset recently, the Mascot asset in Sydney. We like to see a bit more of that. That said because Australia is suddenly a hot favourite market for most private funds, there will be competition for those assets. So we have to start building access through joint ventures, through talking to local players, working with local developers to see whether we can access in other forms and mode. The emphasis will still be Singapore and Australia for the time being.

I did say some time ago that for China, if somebody comes along with a large enough platforms that gives us scale, that we can actually make sense of it, and at a reasonable price, we will look at that. Other than that, there are no plans for any other alternate market for the time being.

Participant H (Krishna, Jefferies): This is Krishna again. How big is your Australia team on the ground and your Singapore team on the ground? Both in terms of leasing and investment side.

Mr Chia Nam Toon: Maybe let us talk structurally first. The biggest set of number of people we have is the frontline people. We have the largest number in Relationship Managers and Asset Managers. Those are the people who have daily contact with our customers. Merely because of the sheer size that we have, we do need to have the customer facing side of things. So you will see we emphasize quite a fair bit of making sure that we take care of the customers because that's our lifeblood.

Then on the second large group that we have is the Business Development team. The team that goes out to look out for deals, new clients and new take ups. Then also the Investment team that looks at potential purchases, acquisition, M&As, even AEIs. So those are the biggest numbers. In Singapore, in total our headcount is about 60-70.

In Australia, we have three Australians, one Singaporean and probably another one going soon, plus a bit of support from our Group team in Sydney as well. We have a small group team looking at the hospitality side, providing some common services that we can share as well. We are looking to build up our Australian team as we progressively grow in Australia. The most important thing about Australia is to be able to build a strong local team. We are not looking to try to send Singaporeans there. In the short term, we are sending Singaporeans there primarily to make sure that we augment the team quickly, and build up the processes so that we have it all in place quickly. That's the game plan we have.

Participant J (Brandon, JP Morgan): Hi. *Brandon from JP Morgan*. Couple of questions. Coming from sponsor background, do you think there is any impact from JTC consolidating the HDB industrial portfolio and second question is, with what we have seen in the economy, do you think the government will relax the existing industrial policies?

Mr Chia Nam Toon: Let's tackle the second one first. I think the industrial policies themselves have been shifting only recently, especially the subletting rules. I think they are recent events. Even the 30-year lease tenure is a recent event. So I don't think they will be shifting so quickly. In terms of being more empathetic when we go and meet them, for sure they will listen a little bit harder. I think it is quite important, that we work with the regulators quite closely in the industrial sector.

Another thing to note is that unlike the CBD assets, unlike the retail sector, unlike the hospitality sector, this is the most regulated of all sectors. It is good and bad. The bad news is that because it is highly regulated, you have to work very hard. The good news is that because it is regulated, we have, hopefully, less competition from foreign private funds. So there are plus and minuses here. Because of that, the range of volatility is also very low.

Now, going back to your first question of HDB transferring land to JTC and how we see it. In fact, this is not something new. HDB has owned industrial assets for a long time and there has always been talk about the transfer of land. And it makes sense because if you think about it, every time JTC shifts its regulations, the rest follows them. Because of the need to coordinate, the land transfer has always been in the cards as well. So, it is not new. We expected it to happen and it is happening. I think that's good overall so that we have one central coordinator. I think as a government, it will be a lot more effective as well.

Does that affect us? Not really. We don't think so. What JTC does with the portfolio is left to be seen. They have got a whole variety in there. I believe they talked about flatted factories and some single tenant factories as well. So what they did in the past with MTBs was they released it to the market. We will wait and see whether they do the same.

Any more questions? Ok looks like nothing else. We can bring the meeting to an end. You can ask me any other questions when you stay over for some refreshments. Thank you.

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