For the brave, distressed Manulife US REIT offers deep discount to NAV

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The year 2024 is likely to be a better one for the Singapore REIT (S-REIT) sector on the whole, ahead of anticipated rate cuts by the US Federal Board, say market watchers.

That could buy crucial time for troubled Manulife US REIT (MUST) to live another day and repay investors who are betting on a reversal of its fortunes.

The unit price of MUST is hovering around its all-time low at between 5 US cents (6.7 cents) and 8 US cents since August 2023.

MUST closed at 6 US cents on Feb 2, which is 94.34% lower than its peak of US$1.06 on Jan 31, 2020, and 92.77% lower than its initial public offering (IPO) price of 83 US cents.

Gradual fall from grace

MUST listed on the mainboard of the Singapore Exchange (SGX) in May 2016 and was the first pure-play US office REIT to be listed in Asia at that time.

The decline in MUST's unit price was a gradual one. After reaching its peak between late January 2020 and early February 2020 at around the time of its FY2020 results, MUST plunged to 64 US cents in the March 2020 stock market crash.

Although MUST's unit price did recover slightly to between 70 US cents and 80 US cents from June 2020 to August 2021, it had been falling as DPU and occupancy rates continued to dip due to the impact of the Covid-19 pandemic.

In March 2022, *The Edge Singapore* noted that the REIT's DPU and occupancy rates were at a standstill and had not seen the same highs after its DPU peaked at 5.96 US cents in FY2019.

The report also questioned MUST's acquisition spree, when it purchased Tanasbourne Commerce Center in Oregon and Park Place and Diablo Technology Park in Arizona for a total of US$201.6 million during the pandemic.

The acquisitions were made by then-CEO Jill Smith, who was bullish on the recovery of US offices at the time. With the acquisitions came the fundraisings.

On Nov 30, 2021, MUST announced plans to raise US$80 million through a private placement of new units. The eventual amount came up to US$100 million with a total of 154.1 million new units issued at 64.9 US cents each.

In July 2023, MUST plunged even further when it announced that its portfolio valuation fell by 14.6% to US$1.63 billion as at June 30, 2023.

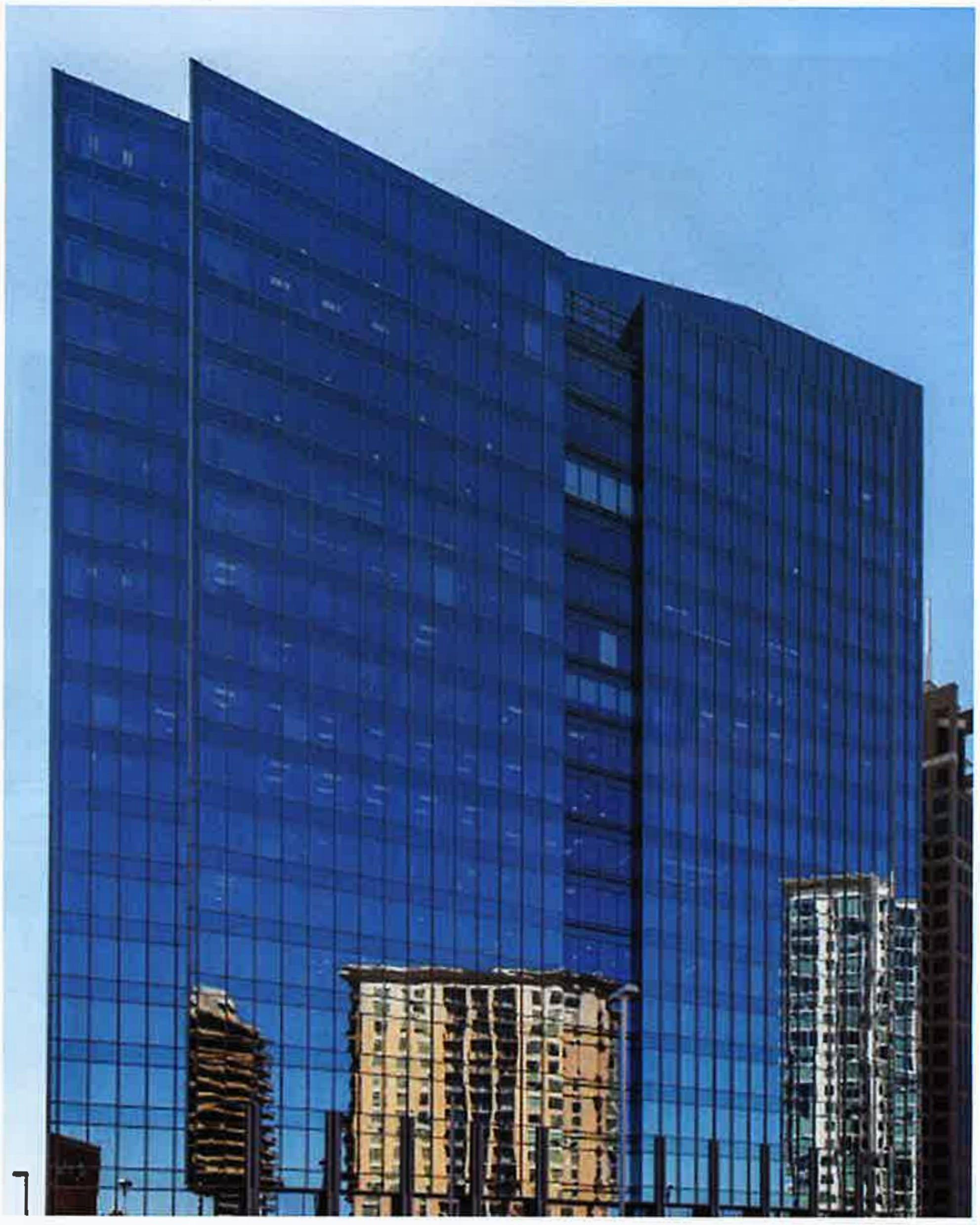
The lower-than-expected figure, which was mostly attributable to higher discount rates, terminal capitalisation rates and vacancy levels, resulted in a breach in the REIT's financial covenants.

Following the valuation drop, MUST's aggregate leverage stood at around 57%, which was in breach of its regulatory 50% limit while its adjusted interest coverage ratio was around 2.6 times as at June 30, 2023.

"MUST has exceeded its aggregate leverage limit which ... is not a breach or default [as it occurred due to a decline in its portfolio valuation]. However, MUST has breached a financial covenant in some of its financing documents relating to the ratio of unencumbered debt to unencumbered assets. Its net asset value has decreased as a result of the decrease in property values," explained the REIT manager in its July 18, 2023, filing.

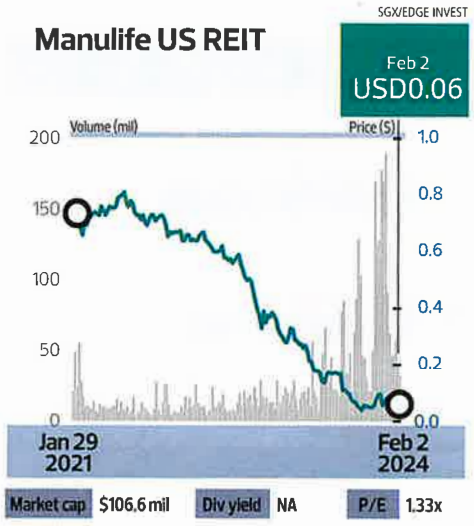
The breach meant that the REIT's loans had to be reclassified as current liabilities.

MANULIFE US REIT



Phipps in Atlanta, Georgia, US, is a 20-story Class A office building offering state-of-the-art on-site amenities. The property provides direct access to Phipps Plaza and is minutes from a variety of hotels, restaurants and retail amenities

SGX/EDGE INVEST



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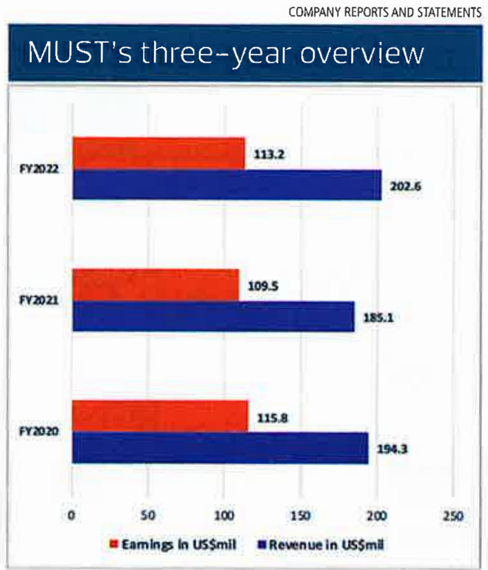

Things came to a head when the REIT declared in its 1HFY2023 results announcement on Aug 14, 2023, that it would halt its half-yearly distributions as it sought to repay its upcoming loan maturities and fund its capital expenditure (capex) and leasing costs.

At the time, William (Tripp) Gantt, CEO of MUST's manager, reassured unitholders saying the REIT was negotiating with its lenders to "address the breach" and embarking on a plan to bolster the REIT's liquidity needs.

In October 2023, during a presentation by MUST's manager and CGS-CIMB Research, Gantt reportedly said that the REIT had to "stay alive till [2025]" when asked about his thoughts on the US office property market.

In November 2023, the REIT announced it would restructure its debt through a recapitalisation plan to reduce its leverage.

Part of the plan included the proposed divestments of Park Place in Arizona that would fetch some US$98.7 million. The plan also meant that the REIT's distributions would be suspended till December 2025 or earlier should the REIT achieve its early reinstatement conditions.

MUST completed the divestment of Park Place on Dec 18, 2023, and days later announced it had repaid US$235 million of its debt. As at June 30, 2023, the REIT had total liabilities of US$1.08 billion.

On Jan 5, MUST reported a further decline in its valuations, which fell by 8.0% to US$1.41 billion as at Dec 31, 2023. The decline represents a drop of 7 US cents per unit, bringing its net asset value (NAV) to 33 US cents from 40 US cents as at June 30, 2023. Again, the drop in valuations was due to higher discount rates and terminal capitalisation rates for some of its properties.

Analysts have been mixed on MUST's prospects. After upgrading MUST to "buy" from "fully valued" on Nov 6, 2023, DBS Group Research analysts Rachel Tan and Derek Tan downgraded their call to "hold" on Nov 30, 2023.

The downgrade, with an unchanged target price of 10 US cents, came after the REIT announced its recapitalisation plans. In their report on Nov 30, 2023, the DBS analysts noted that the plan comes at a "hefty price" and that the "journey to resolving MUST's debt issue is lengthy with execution risks".

"Previously, we upgraded the stock in early November 2023 and highlighted that it was a short-term tactical play on reaching a tripartite agreement with the sponsor, lenders and MUST but that the long-term resolution could be lengthy with some risks involved," they say. "We now take on a more cautious stance in the long term, given the suspension of distributions, uncertainty in the recovery of the US office market and execution risks."

RHB Bank Singapore analyst Vijay Natarajan, on the other hand, kept his "buy" call with a lower target price of 13 US cents from 25 US cents on Dec 6, 2023.

"MUST's much-awaited sponsor-led debt restructuring package fell short of our and market expectations. Still, the deal — in our view — presents the best path to restore long-term value for unit holders amid a lack of other viable options," he writes. "Key next steps would be the optimal execution of proposed asset dispositions and stabilisation, with signs of interest rates peaking. We believe such opportunities could arise as early as 2H2024."

To risk or not to risk?

At its latest Federal Open Market Committee (FOMC) meeting, Fed chairman Jerome Powell said that the Fed's decision to reduce rates is unlikely to happen by March.

S-REITs may also have to deal with higher costs of debt even though the interest rate hikes are likely to have peaked.

In its report dated Jan 5, the team at OCBC Credit Research warned that many S-REITs will have to continue refinancing debt at a higher cost in 1H2024 compared to the cost of debt reported in the latest quarterly disclosures. The interest rate cycle may also continue to hurt valuations, the team adds.

In its circular dated Nov 19, 2023, ahead of its extraordinary general meeting (EGM) on Dec 14, 2023, the manager said that it may also re-approach unitholders for an equity fundraising (EFR), which may be further dilutive to the REIT. However, the manager assured unitholders that this will happen only after it has managed to divest its Tranche 1 assets, which are Centerpointe, Diablo, Figueroa and Penn, or its Tranche 2 assets of Capitol, Exchange, Peachtree and Plaza.

Despite the uncertainties that lie ahead, one thing is certain: MUST's NAV and book value are likely to remain at a premium to its unit price for some time.

When MUST listed at 83 US cents, its group NAV stood at 87 US cents, which gave a premium of 4.6%. At its all-time low of 4.1 US cents last September, its NAV also fell to an all-time low of 40 US cents, giving a premium of 89.75%. At its Feb 2 closing price of 6 US cents, MUST's NAV of some 33 US cents represents a premium of 81.8%. E