Edited Transcript for First REIT 1Q 2024 Business Update Briefing for analysts

Pearl Lam:
Welcome everyone to our 1Q 2024 result briefing for analysts. We will now commence with the Q&A.

Elizabelle Pang (DBS):
What is First REIT's latest hedging policy? Are there any changes and, please share the current hedge rate on the JPY and IDR.

Victor Tan:
There is no change to the hedging policy. We want to hedge around 50% of our income from Indonesia or Japan. Some of the hedges have expired and as at 31 March 2024, we have hedged about 34%. Hedging income from Indonesia can be very costly and we are monitoring the rates very closely.

Elizabelle Pang (DBS):
On rentals outstanding of S$5.2 million from PT Metropolis Propertindo Utama ("**MPU**"), just trying to understand the impact of MPU and the worst-case scenario. Understand that there is a security deposit of S$2.3 million. So does that mean in the worst-case scenario, First REIT will realise a loss of S$2.9 million? Can you also elaborate more on the novation agreement with PT Siloam International Hospitals Tbk ("**Siloam**") – so does this mean that First REIT can use Siloam's security deposit to offset the MPU rentals outstanding?

Victor Tan:
We continue to engage MPU very closely. To date, MPU has not said they are not paying, nor have they asked us for a rental discount or rebate. MPU is committed to paying us but its cashflow is a bit tight right now as it is still looking to divest some assets.

As MPU is a property development company, it has many assets and is in the midst of monetising some to raise cash for its working capital requirement as well. I understand that there is a bit of delay in completing some of these divestments, and so MPU has come to us to say it needs a bit more time and continues to assure us it will pay us.

Regarding the novation agreement, the novation came about when we restructured our leases for hospitals. Prior to 18 May 2021, our leases were directly with MPU. But post-restructuring, Siloam came in as a joint tenant for the hospital leases with MPU, making it a tripartite arrangement whereby there are three parties to the lease. In these restructured hospital leases, Siloam contributes the larger portion of the rental, and MPU contributes the smaller portion.

Based on their rental paid, both MPU and Siloam have their respective security deposits for the hospital leases. As at 31 March 2024, MPU's security deposits regarding hospitals that it is a joint tenant of is around S$0.6 million while Siloam's security deposits for these hospitals is about S$3.9 million, which represents around 87% of the total security deposits for these hospitals.

In the event there is a default, contractually we cannot use Siloam's security deposit to offset the MPU rentals outstanding. But we have a step-in right to do something to the asset in the event of a default, which may bring implications to Siloam as well.

Elizabelle Pang (DBS):
On divestments by MPU, have they hinted a timeline to anticipate?

Victor Tan:
MPU is in the midst of divesting some assets. So hopefully within the next few months, there would be progress and the rentals outstanding will be settled.

Peggy Mak (Phillip Securities):
How many months has MPU been in arrears?

Victor Tan:
Over three quarters, as we bill them on a quarterly basis.

Peggy Mak (Phillip Securities):
In your valuation last year, did the valuer take this into account?

Victor Tan:
No. It is also covered by the security deposit.

Peggy Mak (Phillip Securities):
For this first quarter, how much of your rent from Indonesia is performance-based rent?

Victor Tan:
There are 3 hospitals that are on performance-based rent, and the other 10 are on 4.5% rent escalation.

Peggy Mak (Phillip Securities):
The lease expiry for your nursing homes in Singapore is in 2027. If you look at the environment for nursing homes in Singapore, do you think there is a trend that the authorities might want to take over the operations of these homes and then you may be contracting with different tenants?

Victor Tan:
We are in the midst of looking into extending the land tenure of these nursing homes. We are confident we can get the extensions, hopefully, a fresh 30-year lease.

Peggy Mak (Phillip Securities):
When will the current land tenure expire?

Pearl Lam:
As at 31 December 2023, the remaining land title tenure is 8.3 years for our nursing home in Bukit Merah, 9.4 years for our nursing home in Bukit Panjang, and 13.6 years for our nursing home in Lentor.

Victor Tan:
This is the reason why we are not in a hurry. If we ask for an extension now, they will give us a 30-year extension starting from now and we will lose out the few years we have left.

Peggy Mak (Phillip Securities):
Even without the land lease extension, you're confident that you're able to recontract these tenants again when it expires in 2027?

Victor Tan:
Probably by 2027, we will need to extend the land lease. Because we believe that any tenant would want the certainty that it will be able to operate our nursing home for a longer period of time. We will definitely help the tenant, be it existing or potential new tenant, to see how we can extend the land tenure of our existing nursing homes.

Peggy Mak (Phillip Securities):
Have you had any capital reserves set aside in case First REIT needs to do any AEI works or for any expenses you need to incur?

Victor Tan:
We have been distributing almost 100% of our taxable income. In the event we need to do AEI or any major capex, we will probably tap onto our credit facility.

Elizabelle Pang (DBS):
Will there be a change in management fees to be paid in units this quarter?

Victor Tan:
Are you referring to the proportion of management fees in units and in cash? If that's the case, it should remain at 50:50.

Pearl Lam:
Can you share more on the divestment status on any non-core assets?

Victor Tan:
One of our focus areas this year will be on the divestment front. And this includes our non-core asset, Imperial Aryaduta Hotel & Country Club ("**IAHCC**"). There are challenges in the property market in Indonesia but we are working hard to divest this asset. We continue to work towards divesting IAHCC this year. We are talking to a few interested parties, and following up with the authorities, hence it is taking some time.

Peggy Mak (Phillip Securities):
In reference to slide 9, DPU is S$0.60 cents and I noticed your full year average borrowing cost was 5% and it's flat for the first quarter. Can I conclude that your slight drop in DPU is more a function of the currency factor and a bigger base unit, not so much of a higher interest rates?

Victor Tan:
Year-on-year, yes because last year, the cost of debt is only 4.7% for 1Q 2023. So there is a slight increase in interest cost as well, from period to period. But you are right that the main contributing factor to the slight decrease in DPU is from the forex – because of the stronger SGD against the JPY and IDR.

Peggy Mak (Phillip Securities):
Given your tradition of maintaining your quarterly payout, can we just take the full year as a S$0.60 x 4?

Victor Tan:
Assuming nothing has changed fundamentally, then yes, potentially.

Pearl Lam:
The wildcard would be currency.

Li Jialin (Maybank Kim Eng):
You mentioned that there will be a few other hedges that will expire this year. Do you intend to renew them?

Victor Tan:
On the income side, for currency rate hedges, we definitely want to enter into a few hedges. If you look at Indonesia currency side, there is slightly over 25% hedged currently and so we are definitely looking at hedging a bit more from Indonesia.

For interest rate hedges, some will only expire this year-end. It is still early and we are not sure if we are going to enter into new hedges. Based on current market sentiment, the Fed may cut rates at the end of the year so I don't think we will do any more interest rates fixing.

Li Jialin (Maybank Kim Eng):
So can I assume that the full year cost of borrowing guidance will be largely stable at current levels?

Victor Tan:
Yes, that's correct. Because 87% of our debt is already on fixed or hedged basis already, so only 13% is not hedged.

Charles Lee (Phillip Capital):
Just to get some understanding on the developed markets footprint itself, I believe you should be shifting more on the Japan side of business. How is the Japanese market landscape right now and the key challenges of Japan market compared to Singapore?

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Victor Tan:
Yes, we will continue to focus on expanding in Japan.

As of now, we have quite a sizeable portfolio there, valued about S$250 million plus. We can continue to add more healthcare assets in Japan. We are not confined to just nursing homes, although our portfolio there now is entirely nursing homes and it's a very strong and big market in Japan. Because it is a very fragmented market now, so there are a lot of opportunities for us to add more of these types of assets in Japan. We are working closely with the team in Japan, which we have inherited, and they are helping to source for assets there.

We are in the midst of finetuning our strategy in Japan, which will help us to be more focused in what we want to do. If you look at our current portfolio in Japan of 14 nursing homes, the bulk of it now is currently in Hokkaido. Although there is a strong factor to continue remaining there, especially in Sapporo city, we also want to look at other areas in Japan so we can diversify our portfolio there. Some of our nursing homes in Japan are also a bit aged, so we may potentially look at these assets to recycle.

Apart from Japan, we are also looking at developed markets like Australia. Likewise, we will be doing some market studies to help us with our growth strategy moving forward.

Nariaki Nakamura (Daiwa Asset Management):
I wanted to ask about cap rate movement both in Japan and Indonesia – are they stable?

Victor Tan:
Yes, cap rate movement in Indonesia is quite stable, but in Japan it's coming down a bit because everybody is going to Japan these days so cap rate would have compressed a bit compared to 1-2 years ago.

Nariaki Nakamura (Daiwa Asset Management):
So would that mean some compression in Japan due to property price increase or some competition in the healthcare market?

Victor Tan:
I would say both. Mainly due to the competition, now there are more people looking at the Japan market so that drives the cap rate in that sense. We also realise that Japan is starting to experience come inflation, so hopefully that will translate to higher interest rate in Japan. Then maybe that could also help raise the cap rate in Japan.

Li Jialin (Maybank Kim Eng):
Following up on the discussion on cap rates, you mentioned you're looking at potentially new acquisitions in Japan. Geographically, would you be prefer locations similar to Hokkaido or will you look at large regional cities? And will the cap rates differ significantly between these two types of locations?

My second question is if you were to recycle any assets in Japan, I know the cap rate has come down a fair bit due to the increased interest in Japan. So what is the trend now and where does the buyer interest come from?

Victor Tan:
On the Japan side, we are focussing on coming up with a strategy to identify which city/area we want to go into. We still like Hokkaido, but as of now, more than half of our portfolio is already there and so it may be good for us to look elsewhere.

In one of our recent market research which we commissioned, it was shared that Osaka is facing a shrinking ageing population. Whereas in Tokyo, near that region, in Fukuoka and Yokohama areas, the ageing population is growing, so we are hopeful we can enter such cities. So we are focussing on cities with a growing senior citizen population. But definitely for some of these cities such as Tokyo, the cap rate will be lower compared to suburb areas, so we also have to be mindful when we try to invest in these key cities.

On your question on divestment and recycling old nursing homes in Japan, the cap rate will come down a bit but we also need to look at it in the long-run. For instance, if we don't recycle some of these old nursing homes now, in time to come the valuation may drop or decline even further. So it may be good for us to take a bit of pain, so we can recycle and buy better nursing homes. And if we do, we will try to see how we can structure some rental escalation in the new leases so that it can also help us to raise the value for newer nursing homes.

Li Jialin (Maybank Kim Eng):
Given your current gearing level and market expectations of interest rates, how will you time your capital recycling – will you be looking at new assets first or getting some liquidity first?

Victor Tan:
Our gearing is 38.8% as at 31 March 2024. Although we still have a bit of headroom if we want to go up to 45%, we hope not to go that path. In that regard, we will likely have to divest first. This is the reason why we are actively looking at divesting our IAHCC, and now we're contemplating divesting some of our nursing homes in Japan as well so that we can recycle those proceeds to buy better, newer nursing homes in Japan. We are also open to divesting our mature hospitals in Indonesia, so that we can channel those funds to developed markets, like Japan or even Australia.

Li Jialin (Maybank Kim Eng):
So let's say you take on new acquisitions in Japan, is there any limit for your Japanese denominated loan as a percentage of your total debt load?

Victor Tan:
If you look at the funding we get directly from Japan, it's about 60-65% max, so the balance we tend to fund via Singapore debt. But as we grow in Japan, hopefully, we will get a higher quantum in time to come.

Li Jialin (Maybank Kim Eng):
You mentioned you're not limited in terms of asset class, does your current mandate allow you to diversify into wellness clinics etc?

Victor Tan:
Yes. Our mandate covers all kinds of healthcare and healthcare-related assets, and this encompasses a lot of things, not just confined to hospitals or nursing homes. We can actually look at wellness centres. We can also look at medical office buildings, medical suites, pharmaceutical warehouses, even logistic warehouses with healthcare or pharmaceutical tenants, life sciences – all these falls within our mandate.

Elizabelle Pang (DBS):
On Japanese nursing homes, I'm quite surprised that management is considering divesting old nursing homes. Will you be considering AEI on the old Japanese nursing home or is this part of a broader strategy to focus on growing regions instead?

Victor Tan:
When working on our market strategy, we looked at the age of our nursing homes, and also our operators. Following which we are looking at reconfiguring our portfolio in Japan. We are exploring doing AEI in Japan, especially if the nursing home is old but operator is strong.

Ernest Lim (CGS International):
I understand that your focus is on disposal of properties in 2024. What would you divest and how much do you think these divestments will amount to?

Victor Tan:
The one we've been talking about, IAHCC, has an appraised valuation of around S$30 million. As mentioned earlier, the Manager is also exploring the possibility of divesting some in the Japan portfolio, and will recycle them and use the proceeds to buy newer nursing homes in Japan. The Manager is also exploring divesting mature assets in Indonesia, in line with our 2.0 Growth Strategy. As and when there are any material developments, we will make an announcement in accordance with the listing manual of the SGX-ST.

Pearl Lam:
Thank you for joining us.