

# Perpetual Bonds Outlook

Non-calls risk expected, but risk reward improved



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- Ascott Residence Trust has opted not to call its 4.68% perpetual bond on the first call date of 30 June 2020, setting an industry first.
- We are wary of upcoming non-call risk of perpetual bonds as companies seek to (i) allow coupons to reset lower and save on finance costs, and (ii) conserve cash amidst difficult economic conditions.
- However, some perpetual bonds remain attractive as risk-reward conditions improve after prices fall.

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### A new precedent – The first perpetual non-call

Given the harsh impact on the hospitality sector, Ascott Residence Trust announced on Friday, 29 May 2020 that it has taken the prudent step of not calling their 4.68% perpetual bond with first call date on 30 June 2020. This sets a precedence in the Singapore perpetual bond market since its inception in 2011, apart from defaults and restructuring.

### Moving forward for ARTSP 4.68%: Lower distribution rate with ongoing option to redeem

The ARTSP 4.68% Perp will, from the first call date of 30 June 2020, pay a lower distribution rate based on the date's Swap Offer Rate (SOR) + 2.5%. Based on the current 5-year SOR rate of 0.525%, the new coupon rate will be around the 3.025% area. This translates to a YTC of 6.16% assuming the bond is called 1 year later, and a YTW of 3.16% based on the current indicative ask price of 97.

Given Ascott's option to call the perpetual every distribution date after 30 June 2020 (every 6 months), the company's management has indicated their consideration to call the bond when credit markets stabilise possibly within the next 1-2 call dates.

### Wary of non-call risk for upcoming perpetual call dates

Perpetual bonds with upcoming call dates may face the same fate as the ARTSP 4.68% Perp. To determine the risk of non-call, we look at the potential new refix coupon rate compared to the current coupon rate. A lower refix coupon rate will translate to higher cost savings for the issuer if not called, suggesting a higher non-call risk. We outline the SGD perpetual bonds with upcoming call dates in Figure 1.

**Figure 1: SGD perpetuials with upcoming call dates. The %Chg shows the magnitude of change in refix coupon to the bond's current coupon at the upcoming call date. Larger negatives (darker orange) suggest higher non-call risk.**

Issuer	Bond	Call Date	Coupon	Refix Cpn*	%Chg
ASCOTT RESIDENCE TRUST	ARTSP 4.68% Perp	30/06/2020	4.680%	3.03%	-35.36%
WING TAI PROPERTIES FIN	WINGTA 4.35% Perp	24/08/2020	4.350%	3.882%	-10.76%
OVERSEA-CHINESE BANKING	OCBCSP 3.8% Perp	25/08/2020	3.800%	2.035%	-46.45%
ASCENDAS REAL ESTATE INV	AREIT 4.75% Perp	14/10/2020	4.750%	2.955%	-37.79%
CITIC ENVIROTECH LTD	CELSP 3.9% Perp	19/10/2020	3.900%	7.755%	98.85%
KEPPEL REIT	KREITS 4.98% Perp	02/11/2020	4.980%	3.230%	-35.14%
JULIUS BAER GROUP LTD	BAERVX 5.9% Perp	18/11/2020	5.900%	3.85%	-34.83%
DBS BANK LTD	DBSSP 4.7% Perp (Retail)	22/11/2020	4.700%	4.7%	-

\*Refix coupon rate includes any step-up coupon at call date

Source: Bloomberg, swap rates as at 1 Jun 2020 used for refix coupon

**Limited downside: yield to worst levels are attractive historically**

Given the large selloff of perpetuals in March this year, we believe that non-call risk has largely been priced in, limiting downside risks to bond prices. Yields have been compressed as we start to see demand for attractive risk-reward despite non-call risks.

Looking at average yield-to-worst (worst yield scenario) of the SGD perpetual bond market, yields are historically attractive and have room for further yield compression. We do not see demand for perpetual bonds weakening.

**Figure 2: SGD perpetual bonds yield to worst are still historically attractive**



Source: Bloomberg

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**Overweight ("OW")** – We expect the issuer's specific bond to outperform the issuer's other bonds, bonds of issuers operating within the same sector, or bonds with similar tenors but from different sectors over the next six months.

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### Issuer profile rating:

**Positive ("Pos")** – We view the issuer's credit profile as strong or expected to become strong over the next six months.

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