Questions from SIAS on OUEHT Annual Report 2018

Q1. Would the manager provide unitholders with better clarity on the following operational matters? Specifically:

(i) Mandarin Orchard Singapore (MOS): The hotel was affected in December 2018 when the banquet operation was suspended following a bout of food poisoning that affected 333 people at several events held at MOS. The National Environment Agency (NEA) only lifted the suspension after nearly two months in late January 2019. **Can the REIT manager help the stapled securityholders understand how it works with the master lessee (and the hotel manager) to operate the hotel in a sustainable and profitable manner to deliver consistent and long term value to the stapled securityholders? Does the REIT manager evaluate and benchmark the performance of the master lessee and the hotel manager?**

[OUEHT reply]

The master lease agreements have been structured in the form of a variable rent subject to the minimum rent to provide stable distributions, which allows the stapled securityholders to benefit from the outperformance of the hotels with a downside protection. In addition, the interests of the master lessee and the hotel managers are also aligned as their respective lease/fee structure will incentivise them to maximize the performance of the hotels.

(ii) Crowne Plaza Changi Airport (CPCA): Since 3Q2017, the group has fully drawn down its income support for CPCA. The group currently benefits from the downside protection accorded by the minimum rent of $22.5 million per annum as part of the CPCA master lease agreement. This would allow CPCA to mature in a competitive hotel market. **Can the REIT manager help stapled securityholders understand the actual level of income achieved by CPCA? What is the shortfall from the minimum rent of $22.5 million? What are the key targets (in occupancy, rates or RevPAR) that would allow CPCA to report income exceeding the $22.5 million?**

[OUEHT reply]

For FY2018, CPCA has shown progressive improvement in terms of its operating performance, with its RevPAR gaining 7.7% over FY2017 to $180. CPCA has also stabilised its occupancy to the low-80% which is optimal in driving the room rates.

Depending on the occupancy, the breakeven RevPAR threshold for the minimum rent is between $190-$195.

We are optimistic that CPCA will be able to benefit from the investments made by the Changi Airport Group in the expansion and development works to increase passenger capacity of the Changi Airport. The upgrading works at Terminal 1 is almost complete, while the enhancement works for Terminal 2 is scheduled to start soon within this year. CPCA also enjoys a seamless connection to the newly-opened Jewel via a pedestrian bridge to Terminal 3, which is an approximate five-minute walk.

(iii) Mandarin Gallery (MG): Despite the retail mall reporting the highest ever committed occupancy of 99.1%, rental reversion for 8% of net lettable area at MG was (8.9)%. This was due to "a strategic move to optimise leasing strategy". The effective rent has slipped from $23.3 per square feet per month (psfpm) to $22.5 psfpm. In 4Q2018, the effective rent was just $22.2 psfpm. **Would the REIT manager elaborate in greater detail the new "strategic move to optimise leasing strategy"? With a lower effective rent of $22.2 psfpm achieved in 4Q2018, does it mean that the topline from MG will continue to fall in the new financial year and the net property income will be under pressure?**

[OUEHT reply]

For FY2018, 30% of the mall's NLA was renewed or re-leased, and around 80% of which were originally signed in 2015 when the retail rental market was at an all-time high. Therefore, the drop in effective rent simply reflected the current market condition. Nevertheless, in FY2018, while the effective rent was lower, the NPI came in marginally higher at $25.5 million (increase of 0.8% y-o-y).

During the course of 2018, we did observe the stabilization of demands for retail space, and the property manager has also been constantly making efforts to retain tenants which are complementary to, and to identify new brands which can enhance the mall's offerings.

We also tailored some of the leases signed to build in a lower fixed rent with a higher turnover rent to attract tenants and brands which are complimentary to the mall. Such rent structure will provide flexibility to the tenants upfront, and allow the landlord to participate in the upside of the tenants' operation in the long run.

Q2. The stapled group has a strategy that includes (a) Optimising assets and delivering operational excellence, (b) Prudent capital management and (c) Growth through strategic acquisitions.
Notwithstanding that the portfolio has grown from the two initial assets worth $1.15 billion to $2.22 billion with the addition of the 563-room Crowne Plaza Changi Airport ("CPCA"), the distribution per stapled security has been on a downward trend. The financial highlights from page 7 of the annual report is reproduced below for reference:

	FY2014	FY2015	FY2016	FY2017	**FY2018**
Gross Revenue (S$ million)	115.9	124.6	122.5	131.1	**129.7**
Net Property Income (S$ million)	103.2	109.1	107.4	112.7	**112.8**
Distributable Income (S$ million)	89.0	87.4	82.5	92.9	**90.8**
Distribution Per Stapled Security (DPS) (S cents)	6.74	6.55	4.61	5.14	**4.99**
Distribution Yield[1]	7.5%	8.5%	7.0%	6.1%	**7.4%**

(Source: Annual report 2018)

(i) Has the board reviewed the performance of the group? What deliberations did the board have on the trend of the distribution?

[OUEHT reply]

The board reviews the performance of the group and each asset quarterly, taking into consideration factors including but not limited to general market conditions, presence of large-scale events, tourist arrivals and room/retail supply, which will have an impact on the performance of our portfolio.

(ii) How has the manager's acquisition strategy been further finetuned given the experience of previous acquisitions made by the trust? Has the board/management re-evaluated the role of income support in its acquisition?

[OUEHT reply]

The acquisitions of CPCA and CPEX were completed in 2015 and 2016 respectively, and the income support of $7.5 million for CPEX was drawn over the period from 2016 to 2017. Excluding the income support of $4.8 million in FY 2017, the DPS for FY2018 of 4.99 cents was 2.5% higher than FY2017.

At the time of acquisition, CPCA was already an operating property with a good performance track record, and the development for CPEX was approved by relevant authorities. The OUE H-REIT management decided to acquire both CPCA and CPEX, after taking into consideration the demand for hotel accommodation in the vicinity of Changi Airport, and the potential of additional demand generated from the investment made by the Changi Airport Group to upgrade and expand the capacity of the Changi Airport. The acquisition of CPCA and CPEX was structured to include income support as CPEX, being an Inseparable part of the overall CPCA operation, was to be acquired by OUE H-REIT immediately after the completion of the construction, and typically it will take about three years for a new hotel to stabilise its operations. Therefore, an income support of S$7.5 million in total was built in to the acquisition to provide the income stability to OUE H-REIT during the ramp-up period of CPEX.

OUE H-Trust has a global investment mandate, and we continue to explore opportunities in key international cities around the world, in addition to our current exposure in Singapore. We will evaluate on a case-by-case basis whether income support will be needed for future acquisitions, depending on the stability of the operations of the target asset.

(iii) Has the REIT manager evaluated any other third party asset? What is the experience of the REIT manager in sourcing for good quality hospitality/hospitality-related assets?

[OUEHT reply]

In addition to the Sponsor's pipeline, the OUE H-REIT Management is constantly reviewing potential acquisition opportunities from third parties in key international cities. The target acquisition would need to fit well into our current portfolio of prime hospitality assets, while meeting criteria as such yield and/or DPU accretion.

Q3. On 8 April 2019, the potential merger between OUE Commercial Trust (OUECT) and OUE Hospitality Trust (OUEHT) through a trust arrangement was announced. It has been proposed that OUECT would offer to buy OUEHT via a cash and stock deal.
The combined OUECT and OUEHT would have an estimated market cap of $2.8bn and assets worth $6.7bn, with hospitality assets accounting for 25% of the enlarged portfolio.
(i) Would the manager help stapled securityholders understand if it was OUECT who made the move in this proposed merger?

(ii) Is the merger in line with the group's strategic growth plans?

(iii) What synergies are there between the group's hospitality operations and the commercial assets in OUECT?

(iv) Can the directors help stapled securityholders understand their roles in this proposed merger?

[OUEHT reply]

This AGM is to transact the business for the financial year ended 31 Dec 2018, and is not a platform for the proposed merger, which should and will be discussed at a separate scheme meeting to be convened.

The Independent Directors of the H-Trust Managers will be seeking the views of the IFA before providing its recommendation to the Stapled Securityholders.

However, the Board believes that the Trust Scheme represents a credible offer and an opportunity for Stapled Securityholders to participate in a key transaction and hence should be presented to Stapled Securityholders for their consideration.