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REITs are back in the black

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Solid yields and surging share prices are earning Australian real estate investment trusts some credibility as a safe harbour for investors against the stormy seas of uncertainty whipped up by the looming federal election, changes to superannuation, structural issues in other businesses and record low interest rates.

In the past week alone, trade has been strong in the leaders, such as GPT Group, Stockland, Goodman Group and the retail centre owners, Vicinity and Scentre. This has seen the overall sector pushed up 3 per cent in the first week of May.

This demand could be further buoyed by another rate cut, which economists are predicting could happen in August.

But with yields of about 4 to 6 per cent on a yearly basis, investors cannot get enough.

The office leasing market in the CBD is delivering good results, particularly for landlords. *Photo: Janie Barrett*

Riding low rates

Winston Sammut, the managing director of Folkestone Maxim Asset Management, said with the accommodative stance to monetary policy adopted by the Reserve Bank of Australia and its counterparts globally, he was of the view that in a "lower for longer" interest rate environment, the listed property trust (or A-REIT) sector would continue to be well supported.

"The A-REIT sector is considered to be in good shape and continues to be supported with an average income growth of around 3 per cent. Even though cap rates appear close to peak levels, assets continue to be in demand and we expect that A-REITs will persist in selling non-core assets with a view to funnelling proceeds into higher yielding developments as opportunities arise," Mr Sammut said.

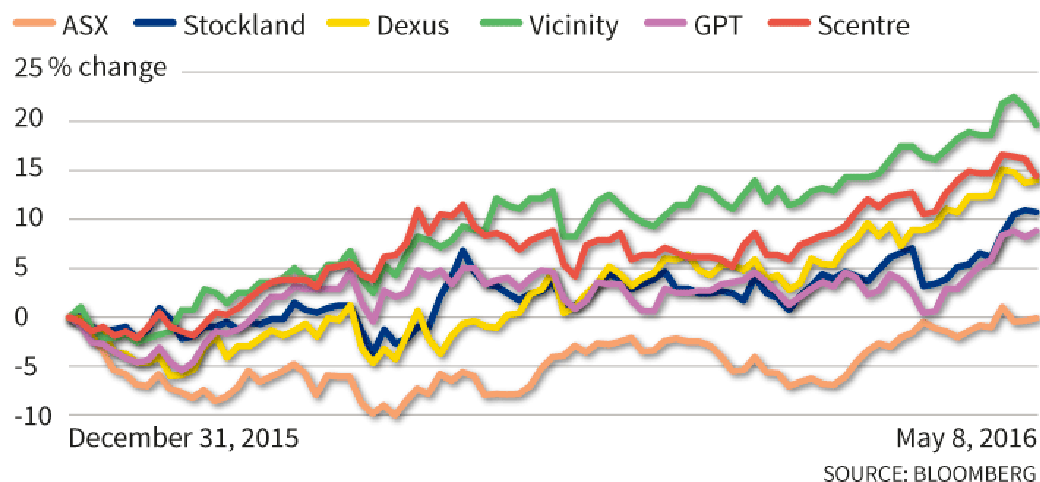
"Accordingly, we remain positive on the sector's outlook on a relative basis, albeit we do not expect it to maintain its current high level of outperformance."

The sales pitch for those backing A-REITs, particularly for self-managed super funds, retirees and cautious investors, is that they are the owners of close to 80 per cent of all investment-grade shopping centres, office towers, residential developments and warehouses and after the post-GFC crash, they are climbing their way back to levels of close to a decade ago.

Winston Sammut, MD Maxim Asset Management, believes low interest rates will support listed property trusts. *Photo: Louie Douvis*

Most superannuation funds have about 10 per cent invested in the A-REIT sector.

The tenants generate a monthly, consistent rent roll and in recent years are rarely vacant. They can be impacted by external forces, such as falling employment for offices and lower consumer spending in shops, but at current levels these impacts are at the margins.



Consolidation could come

Some sharemarket merger and acquisition activity will also impact investors, but again, this increase in scale usually sees the creation of a more cost-efficient entity and in most cases the cash paid out to the target is channelled back into the sector.

The latest example is the cash and scrip offer for GPT Metro Office Fund by Growthpoint. It is a sweetened offer and GPT Metro's independent board committee is undertaking a review of the proposal.

Office landlords are predicting sub-6 per cent vacancies along the eastern seaboard capital cities, which is good news for investors.

The new wave of buying old offices and converting them into city and fringe apartment towers is a bonus as it limits office stock supply.

Credit solid

The credit ratings are also healthier with Moody's Investors Service saying that its outlook for the sector is stable over the next 12-18 months. The stable outlook reflects Moody's expectation that the sector's operating income will increase modestly.

"The A-REIT industry's aggregate annual comparable net operating income should grow at around 2 per cent during the coming 12-18 months, as rents on existing leases rise," says Maurice O'Connell, a Moody's vice-president.

"Moody's see that the A-REITs' average net debt/earnings before interest, tax, depreciation and amortisation (EBITDA) will likely inch up to 5.7 times during the current financial year, from 5.5 times for the year ended June 30, 2015, as the A-REITs take on modest amounts of debt to fund development costs and acquisitions. Nevertheless, this result would still provide a strong buffer against an unexpected deterioration in business conditions."

The sector is also a beneficiary of the turmoil in other sectors, as evidenced by the gains last week at the same time as blue-chip bank and mining stocks took a pounding.

Undiluted issuers

Another positive for the A-REIT sector has been the lack of equity issuance. In the post GFC year of 2007 more than $10 billion was raised by the trusts through deep discounted capital raisings to help pay for their failed expansion forays. Investors were gouged and the dilution hit the prices hard.

But the A-REIT managers learnt their lesson and have used the cheaper bank debt for cash rather than dilute investors' holdings.

The only recent raisings have been from Aventus Retail Property Fund, which is looking to raise $104.5 million with the help of Macquarie Capital and UBS to buy five large format retail centres in NSW, Victoria and Queensland.

Australian Unity is the next cab off the rank with its proposal to list the Australian Unity Office Property Fund on the Australian Securities Exchange.

The fund is an unlisted property fund, established in 2005, which owns a portfolio of eight office assets in NSW, Victoria, ACT, South Australia and Queensland, with assets valued at $391 million.

Mark Pratt, general manager of Australian Unity Real Estate Investment, said Australian Unity was well positioned to progress with the listing.

"We believe an ASX listing is in the best interests of existing investors as it will provide access to additional equity for the sustainable growth of the fund and liquidity to those investors seeking to withdraw," he said.

Defensive qualities

JP Morgan's A-REIT team said the limited steepening in global rates markets and likely further cuts over the second half of 2016 for local rates should provide support for the defensive sectors in A-REITS, infrastructure and utilities.

"Scenarios which could result in an equity raising are that while A-REITs have made no comment on their intention to raise equity nor their view on raising equity at current levels, we believe there are scenarios

that could result in an equity raising (none of which are our base case). For example, Scentre Group could potentially raise equity to repay its property linked notes which expire on December 31, 2016," JP Morgan said in a research note.

"A-REITs with disposal programs are less likely to raise equity. Goodman, Vicinity and Mirvac are all part way through announced disposal programs, which in our view makes them less susceptible to raising equity, given the proceeds will enable them to either further strengthen their balance sheets and/or be deployed to pursue respective growth strategies."

The impact of the federal budget was also fairly benign for the Australian consumer.

Macquarie Bank analysts said while clearly less of a headwind to spend than the last two budgets, with the personal income tax cut offset by an increase in the tobacco excise, the changes to disposable income overall are relatively minor.

"From a landlord perspective, we remain cautious given downside risk to tenant profitability and elevated levels of supply still coming into the market which is limiting development returns. Preferences in the sector remain Goodman, Westfield, Lendlease and GPT," the Macquarie bank analysts said.