SHARECAFE

BY CHRISTOPHER HALL – APRIL 2016

REIT RESURRECTION /ROLL-OVER – WHAT YOU NEED TO KNOW

Cracks are beginning to show in a favourite group of shares many Australian investors flock to for dividend security - the Real Estate Investment Trusts, or REITs.

CRACKS IN THE REIT SECTOR

"The (REIT) space is at an interesting juncture, with some dispersion in returns for the first time since 2011" says Hugh Dive, Senior Fund Manager at Aurora Fund Management (AUP).

This juncture is becoming more obvious in the share prices as some REITs such as BWP Trust (BWP) have recently made new highs while others have continued to slide lower throughout 2016 so far.

Last week we looked at Cracks within REITs, which showed some of the worst performing REITs on the ASX being the companies dependent on development profits or trading profits. This is of little surprise to some, especially after the Australian Bureau of Statistics announced last month that the Sydney property market fell in the December quarter of last year - that was the first fall in the Sydney property market since 2012.

REIT RISE OVER?

"(Australian) residential construction is viewed as having peaked with apartment oversupply across Australia" says Vincent Cook, Senior Equities Analyst with CBG Asset Management (CBC).

There are similarities in the REITs that have continued to perform well. Dive says they have focused on investing in trusts that "hold higher quality property assets and are backed by recurring earnings, rather than development profits"

One example that has performed well for Dive at AUP is "***Investa Office Trust*** (IOF). We saw that IOF was a well-managed trust with fewer earnings risks than some of their office trust peers. We also viewed that their assets would be attractive to foreign investors looking for stable yield and were being undervalued by the market."

EXTERNALLY-MANAGED PROPOERTY TRUSTS AS TAKE-OVER CANDIDATES

Interestingly Dive views "IOF as one of the last externally managed Property trusts was also viewed as a prime takeover candidate for other trusts looking to increase assets under management and is currently the subject of a takeover by rival ***Dexus*** *(DXS)*. IOF has returned +14% since we added it in May."

Cook at CBC took a similar insight to the externally managed Property Trusts. Galileo Japan Trust (GJT) is up strongly because of the take-over offer and Cook's view is that Astro Japan Property Group's (AJA) recent strong performance is also associated with AJA being one of the last externally managed REITs.

QUALITY IN TENANTS

Dive has been focused on REITs with "**recurring earnings, rather than development profits** and as such one of our largest overweights has been ***SCA Property***. Over the past year SCP has been re-rated by the market as it has delivered solid but unspectacular returns from their portfolio of solid but unspectacular neighbourhood shopping centres."

"We viewed that the market was undervaluing the quality of the trust's earnings and the stability afforded by very long leases (average term 11.8 years). We see that in an economic downturn, food and liquor sales are more stable than apparel sales and development profits. Similarly we have been

invested in ***BWP*** based on the same theme, but no longer have a position as the trust traded too far above our valuation." Says Dive.

Cook notes a similar focus on these top performing REITs (SCP and BWP) with a common theme of long-term leases from defensive industries where the expiry risk is low, but so too is the rental growth of around 2-3%, what Cook calls 'boringly slow'.

REITS TO AVOID

Dive has Actively Avoided **"**trusts whose earnings were **dependant on development profits or trading profits**."

Dive notes that many investors in these trusts have been relying on the development profits to bolster earnings. These development profits are effectively one-off profits, something Dive values around 1-2x times earnings. But the sector has been massively over-valuing this development activity of the REITs somewhere between 14 and 16 times earnings.

"We sold ***Cromwell*** (CMW) as we viewed that the Valad Europe acquisition not only exposed the company to a property market outside Australia (which has historically has been a poor decision for Aussie LPTs), but it decreased earnings quality and dramatically increased gearing. Similarly, we have avoided both ***Mirvac*** (MGR) and ***Charter Hall Group*** (CHC) due to concerns about the proportion of earnings supported by development profits in an Australian property market that was close to a peak."

Cook's view of the REIT sector is that it's "difficult to see rental growth for the next 1-2 years ahead. Therefore, the growth per share is muted. Plus, the whole universe (REITs sector) is trading at a premium of 15-20% to NTAs (Net Tangible Assets)." Cook is not currently holding REITs.

OPPORTUNITIES

While Lend Lease (LLC) is not a REIT, Cook notes this is an opportunity for Australian investors in the property space on the ASX.

LLC is a well-run business that has seen a lot of growth from the residential sector in Australia but is invested ahead of the curve. LLC has pre-sold several billions worth of apartments with buyers sitting on 10-20% capital gains. With the residential cycle behind Australia Chicago and New York, LLC are reinvesting overseas with a focus on Chicago and New York where LLC is participating in Join Ventures for their own projects, with the first pre-sales due in the second half of the FY. LLC are focusing on large regenerative projects (like Barangaroo in Sydney) in Singapore and Malaysia and UK apartments that have provided a strong track record that are often 95% pre-sold"

DISCLAIMER

ShareCafe (www.sharecafe.com.au), including all of its features and content is a service made available by Spring FG Digital Pty Ltd ("Spring"), ACN 143 840 528, and all content, information and software provided on and through this Website ("Content") may be used solely in accordance with these Terms and Conditions of Service.

Warning

The information and advice we provide does not constitute personal investment advice. The advice we provide through ShareCafe has been prepared without taking into account your particular objectives, financial situation or needs.

You should, before acting upon any of the information provided by us, consider the appropriateness of the advice in light of your own objectives, financial situation or needs. You should consult your personal financial adviser before making any investment decision. If you do not have a personal financial adviser, you should contact a financial adviser or stockbroker who is licensed to provide you with personal financial product advice. Your financial adviser will provide you with a Statement of Advice (SoA).

If you are seeking to acquire a specific financial product or security, you should obtain a copy of and consider, the Product Disclosure Statement ("PDS") or Prospectus for that product before making any decision.

ShareCafe is published by Spring.

Disclaimer

The information on ShareCafe has been prepared from a wide variety of sources, which to the best of its knowledge and belief, considers accurate. ShareCafe makes no representation and takes no responsibility as to the accuracy or completeness of any information on this website or in the newsletter. You should make your own enquiries about the investments and we strongly suggest you seek advice before acting upon any recommendation.

None of ShareCafe and its employees, directors or associates guarantee the performance of a security or financial product. All of ShareCafe and its employees, directors and associates disclaim to the maximum extent permitted by law any liability for any loss or damage however caused arising as a result of any recipient relying on information provided on the website.

ShareCafe is not responsible and will bear no liability for your access to the internet.

ShareCafe is not responsible for lack of access due to changes made by third parties such as companies that produce internet browsers and or security software. We always endeavour to make any such solution where we have been notified or made aware of any access issues due to a third party change available to our members and free trial members as soon as possible.

ShareCafe endeavours to deliver all the reports via email, where requested. ShareCafe, despite our best efforts to get it through to you, does not guarantee delivery of the service via email notification. We accept no liability for lack of email delivery due to third parties, such as Internet Service Providers (ISP's) preventing the email coming through to you.

Delivery policy

ShareCafe is published electronically by Spring. The publication is wholly online and is accessible by subscribers using their personal username and password to login to the subscription page of ShareCafe.

The information published on the website service can be downloaded by the subscribe and can be printed for personal use only.

Disclosure

Employees and/or associates of Spring may hold one or more of the stocks reviewed by ShareCafe.

Cookies

This website utilises cookies. If you do not have cookies enabled in your web browser some functions of the site may not work as intended.

Links

Our websites and emails may contain links to websites not owned or operated by Spring. We do not accept liability for the availability or content of these sites.

Copyright

The information contained on ShareCafe (www.sharecafe.com.au) remains the copyright of Spring. You are not permitted under any circumstances to republish, reproduce, distribute or otherwise disperse the information contained on www.sharecafe.com.au unless you have the express written permission to do so. To make such enquiries please contact us

Members are expressly forbidden from claiming, or making any assertion that they, as an individual or a representative of a company, are the author of the work(s).

ShareCafe reserves the right to cancel, without notice or refund in whole or in part, the membership of any member who we discover is forwarding, copying and pasting, republishing, distributing or otherwise breaching the terms and conditions.