In search of a save haven

Aussie property's defensive earnings profile

by Mark Story

High earnings visibility and solid distribution growth in an uncertain environment is underpinning listed property trust performance. So what are the core drivers?

Australia's listed property sector, viewed by many as virtually immune from any downturn in the economy is capturing the attention of an increasingly sceptical investment market. One of the most successful financial products on the Australian Stock Exchange (ASX) , listed property trusts (LPTs) – currently in favour across the Tasman – are providing investors with high yields, capital growth and relatively low levels of volatility.

According to Australian broker UBS Warburg, industrial has been the strongest performing LPT sector in the last three years - generating total returns of 18.0% annually. In the year to March 2003, yields from LPTs averaged 7.7% - as a result of a diversified sector yield of 7.2%, a retail sector yield of 7.5%, a commercial office sector yield of 8.1%, an, industrial sector yield of 8.6% - and a hotel sector yield of 10.0%. Based on a favourable outlook, the broker expects LPTs to deliver a 10% 12-month total return versus 16.5% for the Australian All Ords.

“What's appealing about this sector is its yields. When you're losing a lot of money on Telstra shares, the prospect of 7-8% income yield looks pretty good. It's low growth, but there is high dividend certainty,” says Andrew Stubing, head of Deutsche Paladin's Sydney-based listed property trust team.

Good value

LPTs in Australia are trading at an average NTA premium of 18.9%, and a narrower discount to fair market value (sector average discount 6.8%). In fact, property trusts are currently trading at parity to the market price-to-earnings (PE) – one year forward - compared to an historical discount of 19% (8% discount at 31 August 2002).

Nevertheless, Stubing argues that the sector is far from over-bought - especially given the expectation of falling interest rates later this year.

Not surprisingly, in an otherwise lacklustre market, LPTs are being recommended by many brokers as top picks for investors in search of defensive earnings. Unprecedented growth in this sector means they've got plenty to choose from.

Pension funds – core driver

What's seemingly fuelling the boom in property stocks is Australia's ageing population.
In fact, fast-growing pension funds are channelling larger chunks (between 5% and 10%) of their money into property than ever before.

As a result, The S&P/ASX 200 property index is up 4% since the start of last year, against a 17% drop in the market overall. Benefiting from a strong overall sharemarket, the A$45bn Australian property sector (assets A$62.6 billion) now makes up 8% of Australia's benchmark S&P/ASX 200 index, compared with a 1% weighting in the US market. There are now 30 listed property trusts on the (ASX 300) Index, half are in retail, a third in office towers – with the remainder in carparks and industrials.

What are LPTs?

LPTs offer exposure to both the value of the real estate the trust owns, and the regular rental income generated from the properties. They can be bought and sold at any time during ASX trading hours through an accredited stockbroker or other financial adviser.

Key determinants of LTPs share price movement are interest rates, market sentiment, quality of the properties, size of the Trust, takeovers, mergers, litigation and the relative attractiveness of the other alternatives. But the single largest driver is the bond price and relative risk premiums.

What LPTs can achieve for you?

Higher than most shares, the distribution yields on LPTs (based on current prices), are between 6% and 10% annually. Distributions are made either quarterly or twice yearly - allowing investors to regulate their cash flow. Primarily a yield investment, LPTs have been found to be 40% less volatile than the general share market.

Capital hungry sector

LPTs must pay out all earnings to unit holders. This means that when they want to buy new properties or make acquisitions, they have to turn to the market for more capital. Australia's LPTs have raised between A$2bn and A$4bn in new capital annually over the past seven years.

According to Thomson Financial, the sector announced US$3.5bn worth of acquisitions last year. So far this year, the sector has raised A$860m, and UBS Warburg expects A$3bn in capital raising activity over 2003. Not surprisingly, the 'LPT Index', a weighted average of unit prices in all LPTs, is now the sixth largest index on ASX - representing almost 5% of market capitalisation.

"It's a capital hungry sector and investors have been well rewarded by the returns over the years," says Antony Green, JP Morgan Chase's head of real estate investment banking for the Asia-Pacific. UBS Warburg has been market leader in this sector for several years. But JP Morgan Chase has been involved in three of the last six property trust capital raisings.

Limited Australian properties

With property companies currently on the acquisition trail, the need for new capital is greater than ever. The trouble is with an estimated 70% of investment-grade properties already securitised, property trusts are running out of real estate to buy across the Tasman. In fact, Simon Doyle, senior Australian economist with AMP, says it's becoming harder to find quality property investment that are reasonably priced.

But from where UBS Warburg sits, Australia's domestic property market still offers substantial opportunities for trusts to acquire quality assets with only 50-55% of institutional grade real estate listed. Last year Jones Lang LaSalle recorded A$5.1bn in property sales greater than A$20m in value. LPTs accounted for 26% of transactions by asset value.

Future acquisition opportunities could arise from recently developed projects including Freshwater Place, Melbourne, Grollo's Queen Victoria development in Melbourne, King Street Wharf, Sydney and 11 Exhibition Street, Melbourne.

Preferred LPTs – UBS Warburg (3 April 2003)

Stock	Code	Price A$	Price target A$	Discount to target	FY 04F yield
Westfield America	WFA	2.04	2.43	-16.2%	8.09%
CFS Gandel Retail	GAN	1.38	1.53	-10.0%	7.37%
Investa Property	IPG	2.05	2.28	-10.0%	7.89%
C'wealth Property					
Office Fund	CPA	1.14	1.28	-10.8%	8.35%
Westfield Trust	WFT	3.41	3.88	-12.0%	7.16%

Major Australian Office Markets (1st January 2003)

Market	Total Stock (m_)	Total Vacancy (%)	Previous Year Vacancy (%)	12 Month Net Absorption (m_)
Sydney CBD	4,487,243	8.40%	7.00%	-82,473
North Sydney	805,399	12.10%	9.60%	-20,168
Melbourne CBD	3,067,387	6.70%	6.70%	-63,460
St Kilda Road	733,998	8.90%	7.80%	-25,585
Brisbane CBD	1,647,592	6.80%	7.50%	33,491
Canberra Region	1,491,676	4.90%	5.30%	26,566
Adelaide Core	907,135	10.80%	11.10%	22,522
Perth CBD	1,251,976	11.60%	9.10%	-28,407
Hobart CBD	321,358	9.50%	10.50%	4,397

Source: Property Council of Australia