Two words from this reporting season: rest easy

MARCH 2017

The recently completed reporting season for the AREIT sector (half year for most, full year for a few) for the period ending 31 December 2016 has again highlighted how delightfully boring the listed property sector currently is.

For an investor seeking low risk secure income, this is no bad thing. In fact, it's exactly how we like it. Boring is good, and with the outlook remaining positive, income investors have little to worry about and much to appreciate.

In What to watch this reporting season we listed three key property fundamentals - net operating income growth, vacancy rates and net tangible asset (NTA) value growth - against which company results could be scored. The short story is that the sector scored well on all three measures, plus a few more:

1. Strong NTA growth means investors can rest easy

It is the trajectory of NTA movements, not the absolute level relative to AREIT pricing, that investors should watch. Due to the impact of stocks like Goodman Group and Westfield, which are valued in part on their funds management and property development divisions, simple price-to-NTA relativity is misleading.

How misleading? The premium-to-NTA that these stocks currently trade at is 79% and 46% respectively[1]. Together, they represent around a quarter of the AREIT index, distorting the overall market pricing premium to NTA. This might be a consistent, independent "assessment" of an entity and the market value of its assets but it's not an especially useful one.

The trajectory of NTA growth is a better guide. Here, investors have some good news. In the last 12 months, NTA sector growth rose 9.7% and greater than the 7% p.a. on average over the three years[2]. That's a key takeaway from this reporting season and a figure which should give AREIT investors much comfort.

2. Debt is falling, keeping the bankers sweet

The level of debt AREITs have relative to the asset base they borrow against continues to fall. Weighted average gearing (on a debt to gross assets basis) fell to 28.8%[3]. Gearing levels have remained between 28% to 32% since 2009, falling from around 31.4% in Dec 2014.

This isn't the only measure that indicates that AREIT sector balance sheets are extremely secure and well managed. Others include the fact that 61% of all debt is hedged over the next five years; debt facilities extend for 4.9 years; and interest cover for the sector is 4.5 times[4]. That means that, on average, AREITs have a level of cashflow that is 4.5 times that needed to cover interest charges. The bankers would be extremely happy, as should shareholders.

3. Vacancy rates low

As we said in the aforementioned post, "low vacancy rates across a sector, for example, indicate the potential for rent rises in a way that net operating income cannot. This makes vacancy rates a broader indicator of the overall economic health of a sector and physical assets."

Again, reporting season bought good news, revealing that retail vacancy rates for top class assets was 0.5% and up to 0.9% for secondary assets. These are very low figures, with the 4.5% vacancy rates for office assets and 3.6% for industrial not bad, either.

This data confirms that AREIT managers are proving their value, achieving occupancy rates higher than the market and delivering investors the highest level of income. For the overall economic health of a sector and physical assets, this figure is a good indicator and one that should reassure investors.

4. Earnings and distributions to continue to grow

This reporting season revealed that AREIT managers expect, on average, higher earnings and distributions over the next 6-12 months.

This position is endorsed by broker forecasts, which, after reviewing all the information released during the reporting season, also came out stronger. JP Morgan, for example, upgraded their FY17 forecasts for EPS and DPS growth to 4.20% and 4.10% respectively. That's good for earnings and yield.

5. Fundamentals were even stronger than expected

Overall, net property income growth (a very simple yet critical metric) was up 3.6% in the first half of this financial year, the best result since 2009. Again, this is reassuring, although it's important to understand how the overall figure breaks down.

The commercial office sector, up 5.9% in the half, has the strongest outlook, driven by exceptionally strong rental growth in Sydney and, to a lesser extent Melbourne. Retail, up between 2.8% - 3.3% depending on the category, remains an attractive, low risk asset class in a low growth environment.

In Australia right now wages growth is a meagre 1.9% year-on-year with inflation around 1.8%. Real wage growth is effectively zero, an environment perfectly consistent with low growth in retail sales and retail rents. On that basis, the income growth being generated by Australian retail assets makes sense, and seems sustainable. As for industrial, a small part of the pie, it was up 2.0%.

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1 As at 27/2/2017. Source: Iress & company announcement
2 Source: JPM research
3 Source: JPM research
4 APN data

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