Where to find exceptional value in REITS? North America

There's an emerging view that the combination of fiscal and monetary policies and a successful vaccine rollout will be positive for the global economy into 2022. That's good news for investors.

The bad news is that, in many areas of the market, this expectation is already priced-in. The S&P 500 trades at all-time highs and is now up 75% since the low of 23 March last year. The internet and technology-related sectors are especially hot.

With the GPR 250 REIT Index (AUD) 23% below its pre-pandemic high, the same cannot be said for commercial property. For investors in APN's Global REIT Income Fund, this is cause for celebration. Where bargains are hard to find almost everywhere else, there are no shortage of them in commercial property.

A 2021 Global REIT Outlook published by a respected buy-side investment house claimed that the global recovery had "already begun to gain traction" and that "our valuation models suggest that global REITs are priced at a 25% discount to intrinsic value which implies over 30% upside in price."

We'd agree with that view, albeit with a qualification. Averages can hide substantial variations, which is to say not everything is cheap and some REITs appear so for a reason.

The acceleration of the shift to online retail bought about by the pandemic has cast a shadow over the ability of shopping centres to sustain rental yields. In the office market, the move to work-from-home has created similar concerns.

In the U.S., fourth-quarter earnings results now rolling in can be categorised accordingly. In CBD office property there is evidence of weakening leasing results and selected write-offs of bad debt. The same is true for some kinds of retail. But in sectors like industrial and cell towers, rents and net operating income are accelerating.

The result is that while many REITs look cheap by historical standards, some deserve to be. And in other areas there are no shortage of opportunities where discounts to intrinsic value exceed the aforementioned view of 25-30% upside.

For a high-conviction, active fund like APN's Global REIT Income Fund, this is an exciting time. A few portfolio holdings illustrate the extent of the opportunities.

In Preferential treatment: High-income opportunities in global REIT preferred securities, we made the case for an asset class that isn't available in Australia. Over the past three months this sector, accounting for over ten percent of the GREIT portfolio, has performed admirably.

RPT Realty Trust Series D, for example, a preferred security issued by RPT Realty Trust, owner of a national portfolio of U.S. open-air shopping destinations, is up more than 30% over the last three months. Brookfield Property REIT Series A, a preferred security issued by Brookfield Properties REIT, received an offer to take it private, the share price jumping more than 35% over the same period.

Another important area of the portfolio with a weighting -twelve percent are US Net Lease (Long WALE) REITs. In the midst of a pandemic, fourth quarter results show an impressive 90%-plus rent collection with Spirt Realty Capita a good example. Investing primarily in single-tenant, operationally essential real estate assets subject to long-term leases, its share price has risen by almost 30% in the past three months.

Medical Properties Trust (NYSE:MPW), another REIT in which the fund holds a position, made a recent £800m acquisition (via a sale and leaseback) of a behavioural health portfolio from Acadia Healthcare/Priory Group. This will deliver an initial yield of 6.5%, rising to an average of 8.6% over the 25-year lease period.

Whilst the APN Global REIT Income Fund targets income in stocks like MPW, we're very excited about the opportunities to deliver capital growth in securities like these.

In historical terms, REITs now trade at lower multiples compared with global equities, offer wider yield spreads to US Treasuries and sport low price-to-net asset values compared with private asset values.

And even though rising bond yields may offset these positive factors somewhat, the dividend yield spread among REITs is greater now than at almost any time. But it's the individual, stock-driven opportunities, currently thick on the ground, that excite us the most.

Despite the turmoil in North America, we are confident about the sustainability of the fund's 4.21% current running yield[1] but the prospects for capital growth are substantial. Since inception on 1 April last year and in the midst of a pandemic, the Fund has returned 4.21%[2], twice the benchmark index. That's what North America offers Australian income investors - enhanced income and higher capital growth.

1. As at 30 January 2021. Current running yield is calculated daily by dividing the annualised distribution rate by the latest entry unit price. Distributions may include a capital gains component. Distributions are not guaranteed and past performance is not an indicator of future returns.
2. Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Past performance is not an indicator of future performance.

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APN Property Group

A specialist real estate investment manager

We actively invest in, develop and manage real estate and real estate securities on behalf of institutional and retail investors. APN's approach to real estate investment is based on a 'property for income' philosophy.

Established in 1996, APN's listed on the ASX and manages $2.9 billion (as at 31 December 2020) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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