Property outlook | Yield underpins good times

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Investors in local property stocks found themselves among a growing crowd last year, with everyone from retail investors to major institutions chasing the steady yields real estate investments trusts can deliver.

As the money flowed into property stocks, the sector surged. Both the S&P/ASX 200 A-REIT and the 300 A-REIT indices gained about 20 per cent.

That growth delivered windfall returns to those who had come for yield. With the overall dividend yield in the sector above 4 per cent, total returns neared 24 per cent.

At the same time, the broader sharemarket made only minimal gains after it was pegged back by the resource giants.

Even after those bumper returns of 2014, yield remains the main rationale to invest in property stocks this year. The sector is diverse. The big retail property landlords include Westfield, the rebranded Novion and Federation. Dexus and Investa control large office towers, while fund managers such as Charter Hall and GPT have diversified portfolios.

And there is an emerging group of so-called niche REITs, which are delivering good returns from boutique property, including Arena and Folkestone with - childcare property trusts, Ingenia in retirement villages, ALE in pubs and Generation Healthcare REIT in medical property.

Morningstar analyst Tony Sherlock says the hunt for yield, as interest rates stay low globally, remains the chief driver in property stocks. But it has also caused a “disconnect”. Cash earnings are increasing only slightly while share prices has risen very strongly.

“When the search for yield ends, that disconnect will probably unwind,” he says.

“The catalyst for that to happen is rising interest rates and at the moment that doesn’t appear to be a near-term thing.”

Low rates deliver a double benefit to property stocks. Lower borrowing costs improve cash flows. And as rates fall, share prices in the sector have risen. “The thing for property investors is to be very focused on interest rates, that’s what’s given them the excess returns over the last two years,” Sherlock says. His advice is to “be vigilant on the outlook for interest rates”.

He favours industrial property giant Goodman. Its $27 billion global portfolio has strong end-user demand. And the Goodman platform attracts large co-investment flows as well.

Westfield Corporation, now solely focused on shopping malls abroad, has had a strong run since its restructure and is fully priced. Even so, Sherlock says, the weakening Australia dollar adds fresh appeal to Westfield’s foreign earnings.

Atchison Consulting’s Ken Atchison agrees property yields – which can hit 6.5 per cent in some stocks – are sustainable across most of the sector this year. Nevertheless, investors should carefully consider the ability of a trust’s portfolio to deliver that income. With rising vacancy and lease incentives, office towers are under most pressure to deliver income growth. Brisbane and Perth are especially weak.

Meanwhile, Atchinson urges caution for those attracted by the higher yields in the unlisted sector, where syndicators are again active. With that premium comes risk. Unlisted portfolios can be less secured by income. Atchison says investors should also be wary of higher fees set by some funds.

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