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AREITS EARNINGS YIELD UPDATE – OCTOBER 2017

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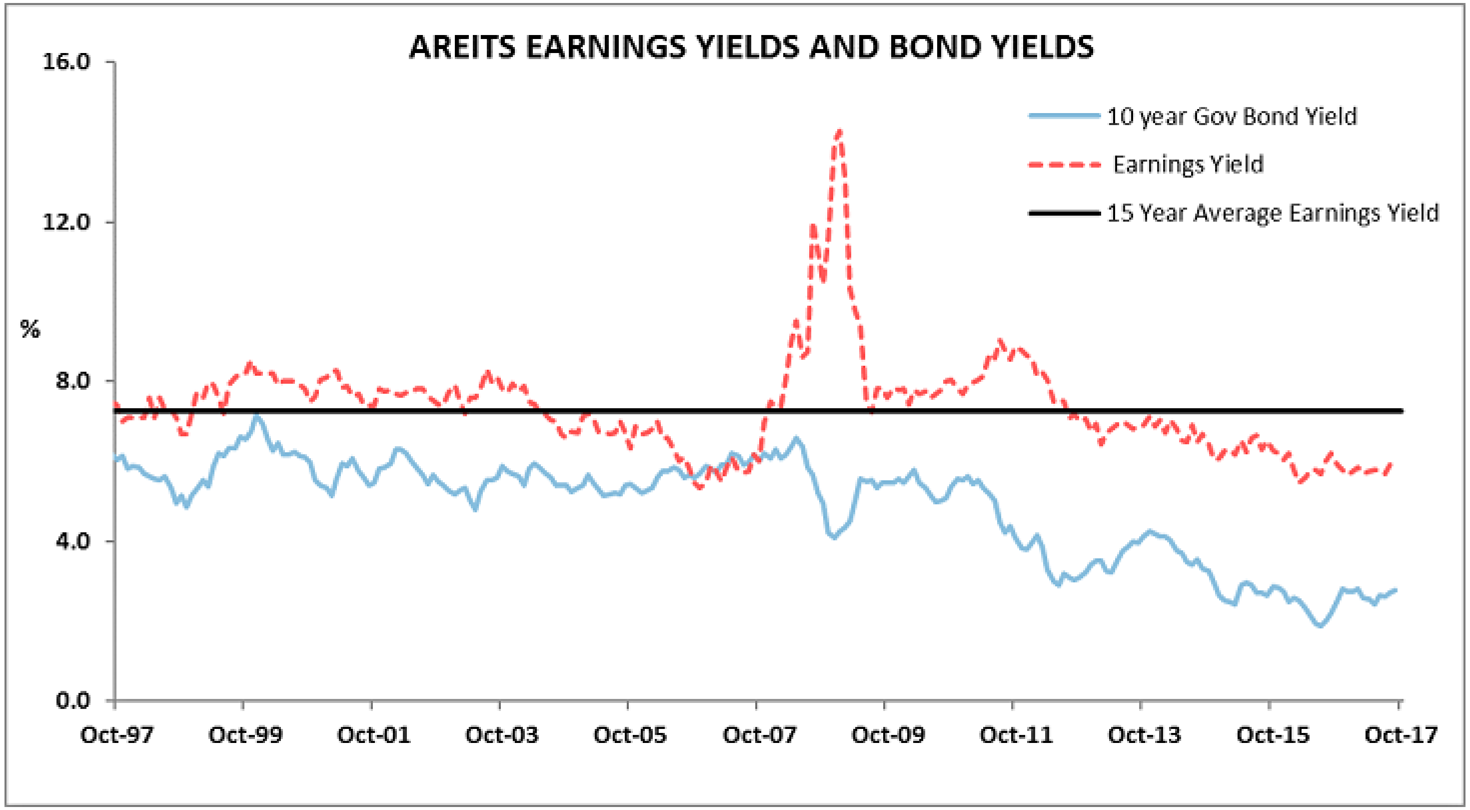
During the month of October, earnings forecasts were increased in the office and retail sectors. The higher forecasts were the result of expectations occupancy rates and rents would rise over the forecast periods.

Australian real estate investment trusts (AREITs) continue to provide relatively attractive yields in the current low interest rate environment. As at 31 October 2017, the average forecast earnings yield [1] was 5.9%.

At the end of October, the earnings yields exceeded the 10-year Australian government bond yield by 3.1%. This is higher than the long term average of 2.7%. The premium over the bond yield increased by 0.1% during

October 2017 reflecting a combination of a 0.1% increase in bond yields and AREIT earnings expectations increased by 0.2%.



Source: RBA, UBS

Forecast earnings yields by property sector over the next year are as follows.

Forecast Earnings Yields

Sectors	Yield (%p.a)
Retail	5.8
Office	6.1
Industrial	5.4
Diversified	6.0
Total	5.9

Source: UBS

[1] *Earnings per unit divided by unit price. Weighted by market cap.*

Retail REITs

The retail property sector is facing cyclical and structural headwinds. One key cyclical headwind is higher household debt resulting from weak wages growth. The higher housing debt-to-income ratio has negatively impacted the level of disposable incomes as higher mortgage repayments displace other forms of spending. Another key cyclical headwind is the change in consumer spending behaviour, driven mainly by demographic shifts, technological change and the shift in spending towards "experiences".

Structural headwinds are emanating from:

- increased adoption of e-commerce, with the department store segment of the market suffering the most and
- the looming entry of Amazon, the world's largest online retailer.

As a response to these cyclical and structural challenges, a number of retail REITs have been

- selling non-core assets and

- upgrading the quality of their overall portfolios.

Below is a summary of key information on major retail AREITs. Forecast earnings yields are expected to be generally in line with current earnings yields.

Valuations, Earnings Yield and Occupancy Rates

	Current Earnings Yield*	Forecast Earnings Yield**	Occupancy rates***
Scentre Group (ASX:SCG)	6.20%	6.20%	99.50%
Westfield Corporation (ASX:WFD)	5.60%	5.90%	93.40%
Vicinity Centres (ASX:VCX)	7.00%	7.20%	99.50%
SCA Property Group (ASX:SCP)	6.40%	6.30%	98.40%
BWP Trust (ASX:BWP)	5.80%	5.70%	99.90%
Charter Hall Retail (ASX:CQR)	7.50%	7.60%	98.00%

*FY 17 **FY18 ***As at 30 June 2017 source: Credit Suisse, ASX

In our experience, occupancy rates in excess of 90% represent historically high levels. We expect retail REITs which are holding assets that meet changing consumer spending preferences and are in strong catchment locations to deliver future growth in earnings.