Slower property growth puts premium on quality tenants

By Ben Hurley

22/01/2018

International diversification and securing long-term leases to reliable tenants will be critical for property portfolios in 2018, IOOF portfolio manager, property, Simon Gross argues.

Gross spoke to *Investment Magazine* about three global trends influencing his outlook and allocations for the coming year: the ability of tenants to pay increasing rents, negative population growth in parts of Europe and Japan, and the appetite of purchasers towards relatively modest yields.

The first issue is the importance of questioning whether tenants will have the ability to pay increasing rents.

"It's critically important all the lessees of the building, all the occupants, have the financial capacity to pay the rent," Gross says. "In this world of [rather] contracted yields, investors are quite reliant upon recurring income streams and increasing rent levels."

The second issue is that, while Australia and the US have relatively strong population growth, Japan and parts of Europe have negative population growth. Gross says the effect of this on demand for property could be exacerbated in the coming year.

“Without population growth, clearly the labour force shrinks, and a shrinking labor force is bad for the economy and detrimental to property, due to the lack of ability to pay the rent, and the number of lessees,” he explains. “It’s a chain reaction.”

Thirdly, contracting yields may affect the ability of property owners to offload assets.

“Values have gone up, yields have contracted, and there are plenty of people who want to sell property but it will be up to the purchasers to decide whether they will accept contracting yields,” Gross says. “The vendors are now asking relatively inflated prices for assets…That’s a big factor for the next 12 months.”

IOOF is an ASX 100 company with a market cap of $3.3 billion and about $147 billion in funds under management, advice and supervision (FUMAS). The firm has 30 per cent of its multibillion-dollar property portfolio in international assets, 20 per cent in domestic real estate investment trusts, and half in Australian direct property.

Gross notes international diversification will be more important than ever in the year to come. In the company’s Australian direct property portfolio, he has ensured that assets are in core markets such as Sydney and Melbourne, and have a secure income stream from long-term leases to quality tenants.

“What that means in simplistic terms is, even in a correction of values, the people keep paying the rent,” he says.

Gross was speaking ahead of participating in the upcoming *Investment Magazine* 2018 Real Estate and Private Markets Conference, to be held at Crown Towers, Melbourne, on February 27-28. He will join State Super senior manager, unlisted assets and alternatives, Megan Chan and QBE manager, property and alternatives, Gavin Mork for a panel discussion titled ‘Determining exposure strategies’. The session will be facilitated by Atchison Consultants managing director Ken Atchison. For more information, see the event website or contact Emma Brodie +61 435 023 004, emma.brodie@conexusfinancial.com.au