FINANCIAL REVIEW

Investors get ready for 11pc return from property stocks

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Traditional real estate investment trusts could deliver a total return to their investors of as much as 11 per cent over the next 12 months, as confidence firms for a reopening rebound from retail landlords such as Westfield-owner Scentre, say Jarden analysts.

The listed landlords, or REITs as they are known, have outperformed the S&P/ASX200 by 8.5 percentage points over the past six months, driven by consensus earnings upgrades and strong growth in their net tangible assets.

Shoppers in masks on Sydney's Pitt Steet. Retail will be one of the first beneficiaries of the reopening. Edwina Pickles.

But there is more of that outperformance to come, say Jarden's Lou Pirenc and Andy MacFarlane, who forecast total returns of 11.2 per cent and a 5.1 per cent distribution yield for the more passive-style REITs.

"We appreciate the structural pressures from online and cost inflation but believe the market is underestimating the growth and rerating potential from gross [rent] collection levels to return to pre-COVID levels," the analysts wrote in their wrap-up of earnings season.

Improving rent collection, once reopening is under way, could lift pre-tax earnings by 17 per cent to 24 per cent in the 2022 calendar year for the more discretionary retail REITs, they wrote.

Scentre – the country's biggest listed retail landlord based on a portfolio of 42 Westfield shopping centres and more than $50 billion in assets under management – has been upgraded to a "buy" by Jarden, which tips a 24.9 per cent total return over the next 12 months for the stock, including a 5.1 per cent dividend yield. SCA Property Group, whose portfolio is focused on smaller convenience-based shopping, was also upgraded to a "buy".

Also shining brightly are more active-style landlords involved in funds management, such as Charter Hall, which could deliver a 15.5 per cent total return to its investors and is also rated a "buy" by Jarden. However, industrial funds giant Goodman has soared so much its valuation is looking "stretched", the analysts wrote.

"We continue to be supportive of the dedicated fund managers, as ongoing assets under management growth, strong demand from co-investors, fund performance and investment capacity should drive superior growth."

Macquarie analysts also identified the funds management thematic as one avenue for growth that emerged over the earnings season as listed property stocks seek to lift earnings in a low-growth environment.

That augurs well for Charter Hall and Goodman, according to the Macquarie analysts, although they also consider the "consensus earnings upgrade story may be abating" for Goodman. Macquarie has

upgraded Dexus to “outperform” given its resilient earnings and valuations, its ambitious capital recycling and the “upside risk” in its efforts to step up funds management.

“The current ‘slowdown’ phase of the economic cycle is positive for the REITs, albeit an increase in yields resulting from FOMC [Federal Open Market Committee] tapering remains a risk,” the Macquarie analysts wrote.

The rebound in property stocks contrasts starkly with volatility of last year, when the pandemic first hit, causing listed landlords to pull their earnings guidance and, in the cases of Scentre and Vicinity Centres, to write down portfolio values drastically.

Meanwhile, unlisted property funds are also enjoying rising confidence, with much of that underpinned by low rates, according to Ken Atchison, managing director at Atchison Consultants.

The mood was already beginning to lift by December last year, and a rebound well and truly under way by the June quarter this year as investors, facing negligible returns for term deposits, headed into property.

The “sweet spot” in property syndicates, according to Mr Atchison, has been smaller, needs-based retail assets and even suburban office blocks, backed by strong leases often to government tenants.

“The first shift came from the fund managers getting their act into gear, then the investors followed,” he told The Australian Financial Review.

“The syndicate investor base – the dealer groups with the high net worths, retirees, self-managed super funds – yes, they are [back], carefully. It is the secure income stream they are looking for.”

Headed for new ownership? The deal, if it comes off, would be Dexus’ first ownership of operational infrastructure.

Underlining the shift in sentiment among syndicate investors is the recent, brisk activity from fund managers such as Fawkner Property and Castlerock.

Fawkner raised $152 million in just four weeks for its Essential Services Trust No.18, which is anchored by Perth mall The Square, Mirrabooka and comprises 28 commercial properties in all. It is forecasting a 7 per cent distribution yield, paid monthly, with tenants ranging from Coles and Woolworths to Viva Energy, Chemist Warehouse and KFC.

”We are pleased that we have been able to deliver a nationally diversified property trust that investors believe will help them achieve their investment goals,” managing director Owen Lennie said.

Fund manager Castlerock was also knocked in the rush, raising $90 million in seven weeks to fund the acquisition of the $145.2 million Icon building in Ipswich’s central business district, where the major tenant is the state government. It will be held in the Auslink Property Trust No.2, which has a forecast return of 7.2 per cent.

“This capital raise was the largest in Castlerock’s 18-year history, so it was extremely gratifying to see such keen investment appetite for the fund,” Castlerock director Adam Bronts said.