TOP STORY FOR THE WEEK 22 Feb - 26 Feb 2021

AREITs earnings yield update – January 2021

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Australian real estate investment trusts (AREITs), as represented by the S&P/ASX 200 AREIT Index, returned -4.1% in the month ending 31 January 2021. The AREIT index has significantly underperformed the S&P/ASX 200 return of +0.3% over the month. Over the 12 months to January 2021, AREITs posted a total return of -14.0%, which is 10.9% lower than the S&P/ASX 200 return of -3.1%. AREITs have rallied in recent months, from their 35.5% fall in March.

Sector Performance

Table 1 below shows the performance of AREITs for various periods ending 31 January 2021.

Table 1 – S&P/ASX 200 AREIT Accumulation Index Performance: Total Returns (31 January 2021)

	1 Month (%)	3 Months (%)	6 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Total Return	-4.1	9.1	15.5	-14.0	5.1	5.9
Volatility				45.7	26.1	21.8

Source: S&P/ASX 200 AREIT Accumulation Index (2020)

The easing of COVID-19 restrictions has had a positive impact on the performance of AREITs during January. Over the 3 years and 5 years to the end of January, the sector produced total returns of 5.1% and 5.9% per annum respectively.

Sector returns in January were led by Retail AREITs with -2.9%, followed by Diversified AREITs with -3.5%, Office AREITs with -4.8% and Industrial AREITs with -6.2%. The negative returns from all AREIT sectors can be partially attributed to the rising Australian Government bond yields.

Table 2 below shows the income performance of AREITs for various periods ending 31 January 2021.

Table 2 – S&P/ASX 200 AREIT Accumulation Index Performance: Income Returns (31 January 2021)

	1 Month (%)	3 Months (%)	6 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Income Return	0.0	1.3	1.6	3.6	4.4	4.6
Volatility				1.8	2.0	2.0

Source: S&P/ASX 200 AREIT Accumulation Index (2020)

The income component of the total return was 3.6% for the 12-month period to January 2021. Annual volatility of income returns was 1.8%, which is low when compared with other asset classes.

AREITs were trading at an earnings yield of approximately 6.3% which was significantly higher than yields of both cash and Commonwealth Government bonds. Australian 10-year government bond yields finished January at 1.09%. The spread of the earnings yield over the Government bond yield rose from 5.1% to 5.3%.

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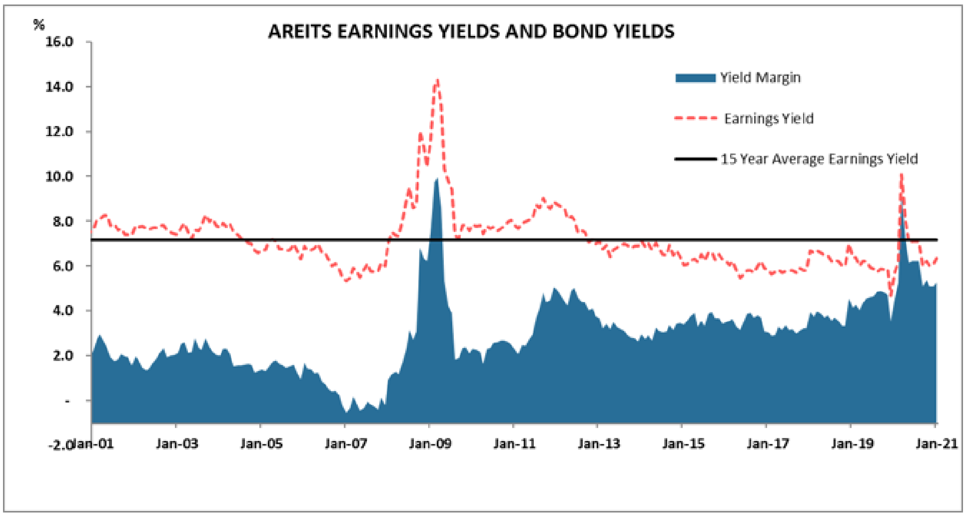
Changes over time of the spread between the earnings yield of AREITs and the 10-year government bond yield are shown in Chart 1.

Chart 1– AREITS Earnings Yields Compared to Bond Yields



Source: RBA, UBS (2020)

Online retail spending has surged from $6.7 billion in 2010 to $44.2 billion in 2020 and the pandemic has only accelerated this growth. This translates into further demand for warehouses and distribution centres, with the value of the industrial property sector set to hit $120 billion in 2025, up from $96 billion in 2020. According to JLL Research, for every $1 billion in online sales, an additional 70,000 square metres of warehouse space is needed. Over the past 12 months, online retail spending has increased by $14 billion, well above the average $2 billion increase a year. Industrial AREITs such as Goodman Group are performing well with this surge in demand.

Over the past 12 months to January 2021, Goodman Group has seen net profit increase from $810 million to $911 million. Amazon, its largest customer, has helped Goodman increase assets under management by 12%. Goodman's portfolio generated $2.9 billion of valuation gains through 2020, with its weighted average cap rate sitting at 4.9%. As the shift to online shopping continues, retailers are looking for ways to deliver goods quicker and more efficiently. One practice has been simply to set up warehouses closer to the end consumer, in densely populated areas. This is known as 'last-mile real estate'. Demand for last-mile real estate far outreaches supply and is an opportunity for Goodman Group.

The past four years have seen industrial land values increase 150% in South Sydney and 50% in Port Melbourne, with both these locations seeing land values above $1000 per square metre. According to CBRE, demand for industrial real estate will continue, with last-mile real estate coming to the forefront. CBRE expects under-utilised space in urban shopping centres to be converted for the handling and fulfilment of online orders in the coming years.

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