TOP STORY FOR THE WEEK 22 Mar - 26 Mar 2021

AREITs earnings yield update – February 2021

Melbourne, Australia 30 Mar 2021.

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Australian real estate investment trusts (AREITs), as represented by the S&P/ASX 200 AREIT Index, returned -2.6% in the month ending 28 February 2021. The AREIT index significantly underperformed the S&P/ASX 200 return of +1.5% over the month.

Over the 12 months to February 2021, AREITs posted a total return of -12.0%. This is 18.5% lower than the S&P/ASX 200 return of +6.5%.

Sector Performance

Table 1 below shows the performance of AREITs for various periods ending 28 February 2021.

Table 2 – S&P/ASX 200 AREIT Accumulation Index Performance: Income Returns (28 February 2021)

	1 Month (%)	3 Months (%)	6 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Income Return	0.5	1.9	2.0	3.7	4.3	4.5
Volatility				1.9	2.0	2.0

Source: S&P/ASX 200 AREIT Accumulation Index (2021)

Higher government bond yields had a negative impact on the performance of AREITs during the month. Over the 3 years and 5 years to the end of February, the sector produced total returns of 5.4% and 4.7% per annum respectively.

Sector returns in February were led by Retail AREITs with +3.7%, followed by Office AREITs with -1.5%, Diversified AREITs with -4.7% and Industrial AREITs with -6.1%. Easing of lockdown restrictions has encouraged a more positive view of retail prospects.

Table 2 below shows the income performance of AREITs for various periods ending 28 February 2021.

Table 1 – S&P/ASX 200 AREIT Accumulation Index Performance: Total Returns (28 February 2021)

	1 Month (%)	3 Months (%)	6 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Total Return	-2.6	-6.2	4.2	-12.0	5.4	4.7
Volatility				47.8	26.7	21.9

Source: S&P/ASX 200 AREIT Accumulation Index (2021)

The income component of the total return was 3.7% for the 12-month period to February 2021. Annual volatility of income returns was 1.9%, which is low when compared with other asset classes.

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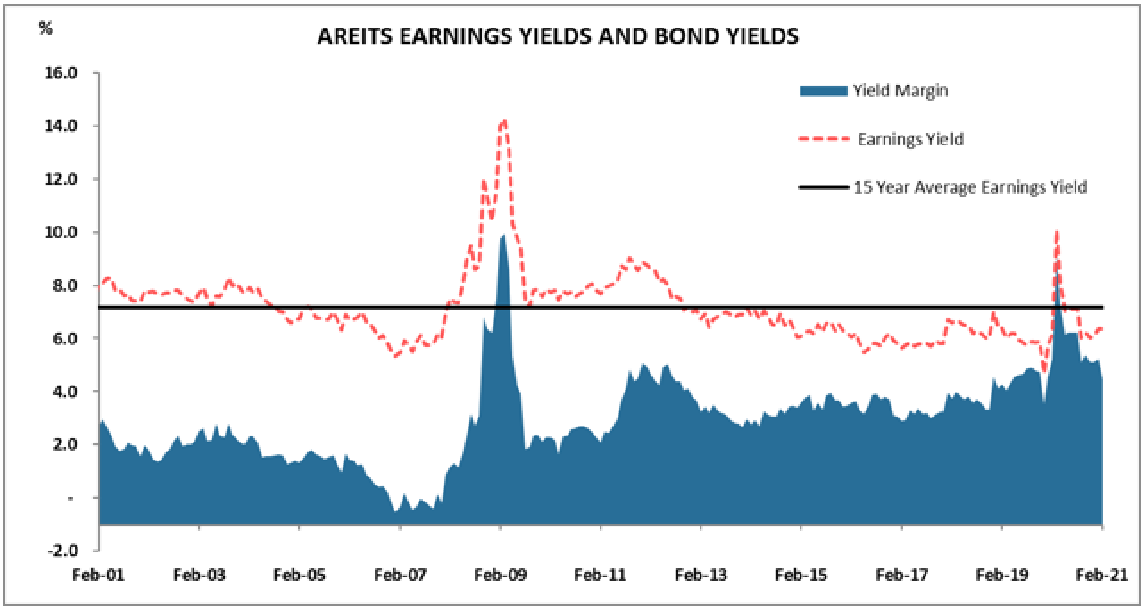
AREITs were trading at an earnings yield of approximately 6.3%, significantly higher than yields of both cash and Commonwealth Government bonds. The spread of the earnings yield over the 10-year government bond yield fell to 4.4%.

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 (2021)

Market Review

The 10-year government bond yield rose from 1.16% to 1.91% in February, having reached a low near 0.70% in mid-October. Concerns that extraordinary US Government spending would impact on inflation drove the jump in US bond yields which then flowed through to the domestic bond market. As a consequence, investors focused on valuations of real estate assets, which are sensitive to government bond yields in their role as risk-free rates. This brought about a hesitation to invest in AREITs by potential buyers or outright selling by some existing holders.

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