AREITs earnings yield update – May 2020

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Australian real estate investment trusts (AREITs), as represented by the S&P/ASX 200 REITs Index, returned 7.0% in the month ending 31 May 2020. The AREIT index outperformed the S&P/ASX 200 return of 4.4% over the month.

Over the 12 months to May 2020, AREITs posted a total return of -16.8% (21.2% lower than the S&P/ASX 200 return of 4.4%).

Sector Performance

Table 1 below shows the performance of AREITs for various periods ending 30 May 2020.

Table 1 – S&P/ASX 200 AREIT Accumulation Index Performance: Total Returns (30 May 2020)

	1 Month (%)	3 Months (%)	6 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Total Return	7.0	-21.1	-23.7	-16.8	0.8	3.8
Volatility				41.6	25.0	21.1

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

The restrictions arising from the pandemic have had a substantial impact on the medium-to-long term performance of the AREIT sector. Over the 3 years and 5 years to the end of May, the sector produced total returns of 0.8% and 3.8% per annum respectively.

Sector returns in May were led by Industrial AREITs with 16.7%, followed by Diversified AREITs with 8.4%, Retail AREITs with 0.7% and Office AREITs with -0.9%. The returns from Industrials and Diversifieds reflect recoveries after steep declines in March. Retails AREITs saw returns lower than the high of 29.6% in April. Office REITs have not recovered.

Table 2 below shows the income performance of AREITs for various periods ending 30 May 2020.

Table 2 – S&P/ASX 200 AREIT Accumulation Index Performance: Income Returns (30 May 2020)

	1 Month (%)	3 Months (%)	6 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)
Income Return	0.0	0.1	2.1	4.5	4.8	4.8
Volatility				*2.1*	2.1	2.1

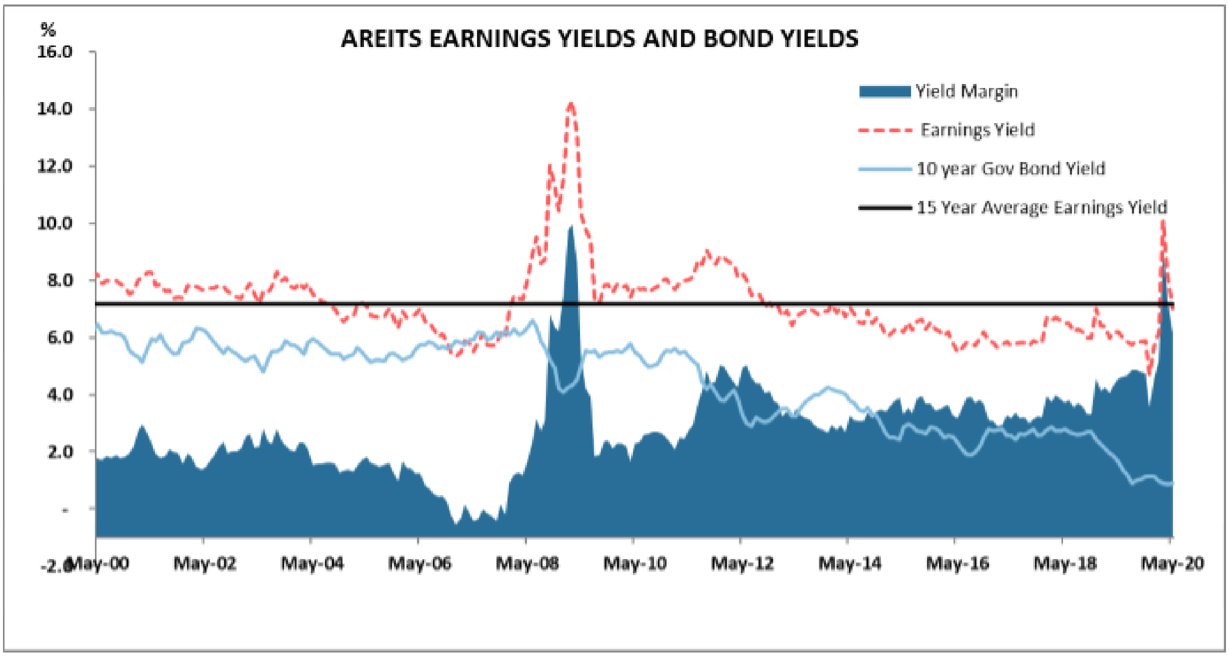
Source: S&P/ASX 200 AREIT Accumulation Index (2020)

The income component of the total return was 4.5% for the 12-month period to May 2020. The annual volatility of income returns was 2.1%, which is low when compared with other asset classes.

The AREIT sector was trading at an earnings yield of approximately 7.0%, which was higher than yields of both cash and Commonwealth Government bonds at the time. Australian 10 year government bond yields currently sit at 0.88%.

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

Chart 1– AREITS Earnings Yields Compared to Bond Yields



Source: RBA, UBS (2020)

Market Review

There are two main consequences for office property from the coronavirus and the shutdown which has occurred. They regard future occupancy levels of offices and the immediate impact on rent.

The code of conduct established by state governments and industry does introduce rent freezes, waiver of rents and deferral of payment. Complications arising from the differences in each state and territory are accentuating disputes between landlords and tenants. Ultimately, while uncertainty persists, the consequences are not expected to be significant in office rents as the industries most affected do not include major office-based businesses. Rent payments will be made.

Future occupation rates are most significantly influenced by a prospective shift in location of work. Remote working has seen a massive shift during the crisis. In the return to office work, it is expected that a notable proportion of the office workforce will opt for continuation of remote working. Surveys indicate at least 10% would prefer this. Prior to COVID, approximately 4.7% of the work force was in remote working arrangements. An increase of 1%-2% in office personnel working remotely might be expected.

Part of this trend reflects not just the preference of working from home but also the demands of commuting. Limits on remote working will reflect the blurring of professional and personal lives. Social disruption in personal living will encourage return to office work. Senior roles will be paid a level of income that permits establishment of suitable home working arrangements. For the majority this will not apply. There will be some reduced growth in demand but also a change in the type of demand; lower-density office space will be more attractive. Social distancing requirements will change the structure of offices. Trends towards higher density will reverse.

The notion that businesses will no longer require the same space is unlikely to occur. Rather, locations which reflect the commuting challenge will attract tenants. While public transport will be out of favour temporarily, commuting by car will not be supported by climate change advocates and will not persist. Offices offering high quality services, smart fit outs reflecting technology, collaboration facilities and quality communications will prevail, as will locations providing commuting efficiency.