Retail and residential to lead REITs in 2016

Trusts Mall owners and residential developers are hot prospects.

Nick Lenaghan

The residential and retail sectors are firming as early favourites within the real estate investment trust sector for 2016.

The resilience of large shopping centres may come as no great surprise. Scentre Group, the owner of Westfield malls in Australia, along with Shopping Centres Australasia, which was spun out of Woolworths three years ago, were the stand-out performers in 2015, posting total returns of more than 20 per cent.

The landlord for Westfield malls in the United States and Europe, Westfield Corporation, is also a hot prospect, with its strong development pipeline, capacity for acquisitions and currency advantage.

And as retail endures – especially the larger, fortress-style regional shopping malls – the residential developers are returning to favour.

Mirvac, Stockland and Lendlease – all diversified players with a large residential development component – were at times weighted down with market worries in 2015 over the longer-term housing recovery.

The brake on investor borrowing, tighter regulation of offshore buyers, the slowdown in China, along with fears of increased settlement risk and potential over-supply contributed to the negative sentiment.

Such concerns have now been priced in and, notwithstanding, the developers remain operationally strong, booking bumper pre-sales.

On the estimation of UBS analysts, including Grant McCasker, Mirvac, Stockland and Lendlease are some 15 per cent to 20 per cent below their valuation.

It is a discount "too big to ignore", the UBS team wrote in a December survey of the Australian property trust sector.

Mirvac's price to earnings discount to the REIT sector is back at the levels last seen in the global financial crisis, the UBS team wrote.

Its earnings growth is forecast to hit 7 per cent to 8 per cent over the next two years, with much of that underpinned through pre-sales. Stockland and Lendlease are also expecting solid earnings growth from pre-sales.

SG Hiscock's portfolio manager Grant Berry said the issue of settlement risk had been overplayed and the default risk was actually quite low.

"It has been the overhang on Mirvac and Stockland over the past year, holding back relative performance.

"While operationally both Stockland and Mirvac have been performing well, with solid outlooks for the 2016 financial year, recently we have started to see Mirvac really outperform and Stockland as well, to a lesser degree."

Heading into the new year, the A-REIT sector had delivered total returns of about 12 per cent, as most stocks prepared to trade ex-dividend.

It was a substantial moderation on 2014's outperformance of 27 per cent. That trading lasted into January in 2015, which delivered close to another 8 per cent.

While the run rate slowed in 2015, the sector was kinder to its shareholders than the broader market, whose investors would have done better leaving their money in the bank.

"We would expect returns from the A-REITs to continue to moderate from here, but remain well supported," Mr Berry said just before the New Year.

"The sector is slightly expensive in our longer-term view, although it represents good value in the context of the current low-interest-rate environment.

"It will be really interesting to see if the sector can sustain an outperformance for three years in a row. That's the big question."

One potential driver for that is further strong performance from the retail landlords, who are finally closing the gap on the negative re-leasing spreads that have bedevilled the sector in recent years.

Shopping fundamentals are good. Foreign tourism is strong, while local travellers saddled with a weaker Australian dollar are staying home and spending. The rebounding residential market has added to the wealth effect.

Specialty sales have responded with increasing growth. On the other hand, supermarkets, locked in a discounting war, remain under pressure.

And while the cap rate compression cycle may be nearing an end among the office towers – where rental incentives are still high – it has some way to go in shopping centre portfolios.

Underscoring that demand for tightly held, top-shelf retail property was Brookfield's record sale of a half share in World Square to ISPT for $285 million just before Christmas. The deal will show a yield under 4.5 per cent.

"The market is yet to be really tested in terms of pricing for top-tier regional malls," Mr Berry said.

"Office has probably run its cycle in terms of cap rate firming, but in the top-tier retail assets, there is some scope for cap rates to come in further."

While valuations are nearing the peak in the office sector, the outlook for rental growth is rosier as office absorption and vacancy improves in Sydney especially.

Even so, UBS analysts are more persuaded by the growth potential in regional malls than in office portfolios such as those controlled by major landlords DEXUS and GPT.

Hot property

Best and worst performing REITs in 2015 (%)

BEST		WORST	
Generation Healthcare	+40.4	360 Capital Industrial Fund	+10.1
Scentre Group	+26.3	Cromwell Property Group	+10.1
SCA Property Group	+21.2	Westfield Corp	+9.1
Folkstone Education	+20.6	Hotel Property Investments	+8.8
Arena REIT	+20.0	GDI Property Group	+8.3
Growthpoint Properties	+19.4	Charter Hall Retail REIT	+8.0
BWP Trust	+19.2	Astro Japan Property Group	+6.6
Mirvac Group	+16.8	Charter Hall Group	+6.2
Ingenia Communities	+16.1	Stockland	+5.4
Industria REIT	+15.5	Vicinity Centres	+3.6

SOURCE: BLOOMBERG

Sydney's Bvlgari House was in hot demand when it sold. PHOTO: CHRISTOPHER PEARCE

Allegra European spends $29m on Bvlgari building

Mercedes Ruehl

Spanish property company Allegra European Holdings has made its maiden real estate purchase in Australia, buying the Bvlgari House building in Sydney for $29 million.

The property, in the heart of Sydney's luxury retail strip on Castlereagh Street, was hotly bid for by several overseas and domestic groups.

The property was sold by JP Morgan Asset Management, which took control of the property after it bought Aviva Investors' Asia Pacific property platform in 2014. The deal reflects a passing yield of about 5.6 per cent.

CBRE's Tim Grosmann and Sharon Yang negotiated the sale on behalf of the vendor, while Allegra was represented in the negotiations by Manuel Pavia, of Blueprint Property. Allegra did not comment.

Bvlgari Australia, which is owned by Louis Vuitton Moet Hennessy, occupies the entire 974-square-metre building, which includes a basement showroom, ground-floor retail and first-floor office space.

The net rental is about $1.6 million a year.

Mr Grosmann said the long-term lease over the building to luxury Italian jeweller Bvlgari had helped drive buyer interest in the property, which is in Sydney's tightly held, high-end fashion district. "The immediate location is home to some of the world's most recognisable luxury brands, including Chanel, Dior, Hermes, Jimmy Choo, Omega, Tiffany & Co and Cartier," Mr Grosmann said.

Allegra European Holdings has been an active buyer and seller of real estate in Europe in the past couple of years. Last year it sold Facebook's London headquarters for £80 million ($167 million) to CBRE Global Investors.

Ms Yang said demand from foreign retailers for physical space had increased. "Many premium and luxury international retailers, who have often previously sold their products via distribution arrangements with department stores or domestic retailers, are now withdrawing from these agreements and opening their own independent stores."

Markham snaps up Elizabeth St building for $148.8m

Mercedes Ruehl

Private real estate group Markham has bought an office building on Elizabeth Street in Sydney's CBD for $148.8 million. The deal reflects a cap rate of about 7 per cent and demonstrates the premiums commanded for well-located and quality real estate in gateway cities.

The office investment market is off to a strong start for 2016, particularly in Sydney. January is expected to see a rush of deals and more evidence of strong returns for commercial property investors.

James Barber, James Girvan and James Quigley, of Colliers International, negotiated the 179 Elizabeth Street deal on behalf of LaSalle Investment Management. The property was held in the LaSalle Asia Opportunity Fund III. The A-Grade office building was marketed as an investment and a development opportunity.

The purchase by one of Markham's managed funds comes off the back of the property group's sale of the IMAX Theatre to Grocon for $70 million and the sale of a St Leonards office tower to Holdmark Property Group for $30 million in 2015.

While there is development potential, the long leases and the improving Sydney office market mean Markham will hold it as an investment, it is understood. The weighted average lease expiry is more than four years. The building has 15,001 square metres of net lettable space and parking for 107 cars.

Markham confirmed the purchase but did not comment. The group was established for residential and mixed-use developments in Sydney.

Investment opportunity: 179 Elizabeth Street, Sydney – Grade A office space.

Since 2000 the business has encompassed investment management. A number of big office sales are set to hit Sydney in the first quarter of 2016. Coming deals are tipped to set price records, such as the sale of 420 George Street and 151 Castlereagh Street in Sydney. In North Sydney, Singapore's Ascendas is closing in on a deal to buy 100 Arthur Street for more than $315 million.

Future campaigns include the David Jones building on Market Street, on which CBRE and Savills are appointed, and Eureka Funds Management's tower at 55 Clarence Street, where CBRE and Colliers International hold the listing. But the Urban Land Institute (ULI) has warned the strong buying and yield compression of the last couple of years may slow this year.

ULI Global CEO Patrick Phillips told *The Australian Financial Review* in December that while Sydney and Melbourne were in the top five for investment and development buying globally, he expected more of a "holding pattern" in 2016.