

# The A-REIT market: current situation and outlook

presentation to the Association for Real Estate Securitization (ARES) Real Estate Investment Forum, Tokyo, Japan

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# Outline

- 1 Overview of A-REITs
- 2 Key features
- 3 Investment performance
- 4 Pricing considerations
- 5 Summary remarks

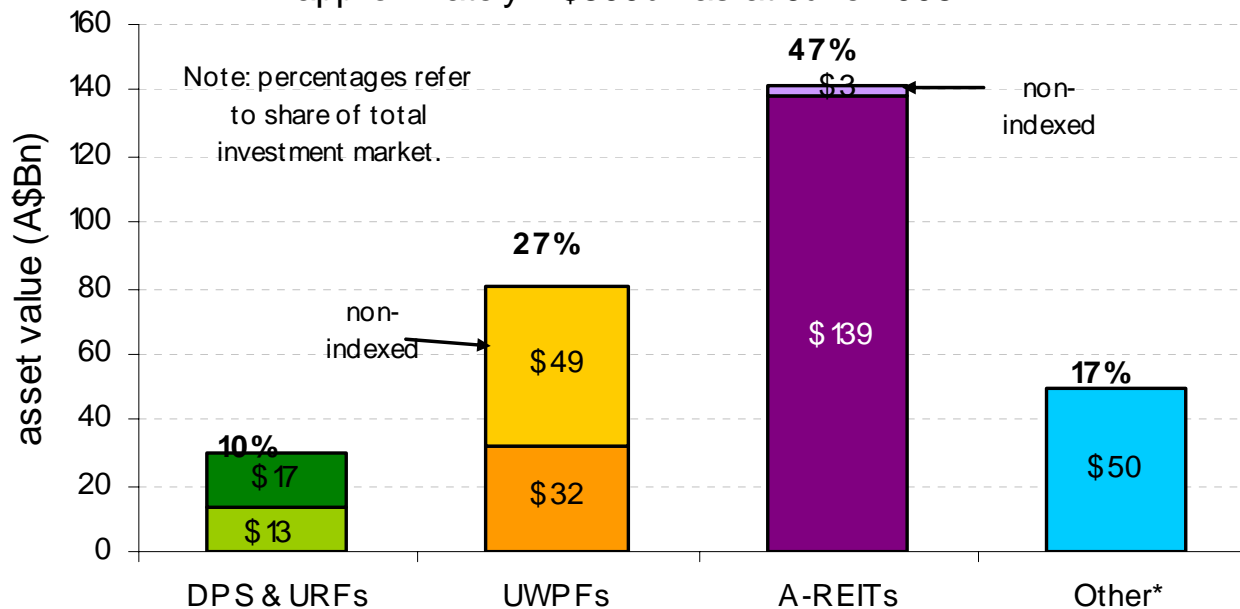
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# Australian property investment market - A-REITs dominate the investment space

## Size of Australian property market by segment

approximately A\$300bn as at June 2008

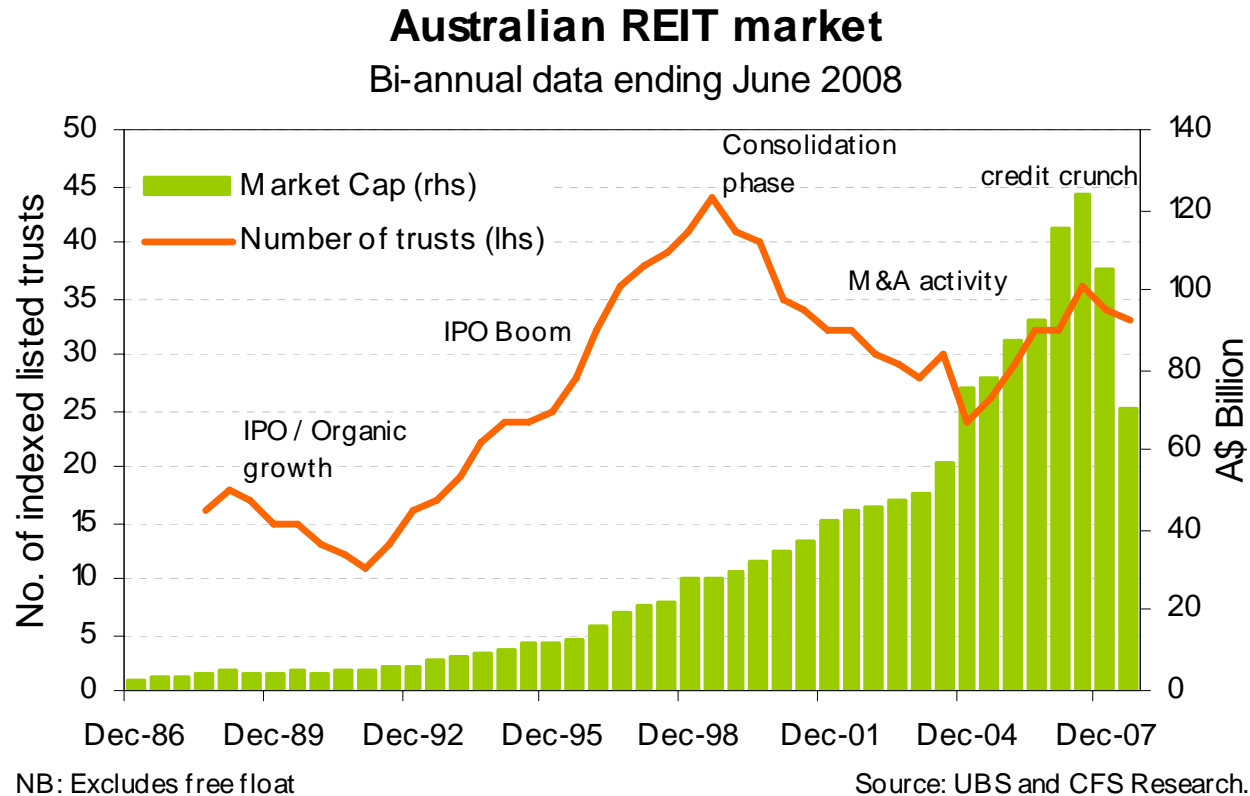


Note: "Other" denotes other private property investments.

Source: PIR, Mercer, UBS, ARS and CFS Research

- Property investment market valued at A\$300bn (or ¥30.6 trillion).
- As at June 2008, A-REITs valued at A\$141.2bn (¥14.4 trillion); representing about 50% of the commercial property investment market and 55% of the securitised property investment market.

# Market growth profile for A-REITs - fall in market cap after period of strong growth



- As at August 2008, market cap for A-REITs stood at A\$72.7bn with 33 trusts (48 with non-indexed).
- Growth supported by capital flows from superannuation - allocation to property: c10%.
- 5 ➤ Consolidation phase (in 2000's) saw many REITs adopt internal managed model.
- Currently, A-REITs represent about 7% of S&P/ASX200 index; was 10% in Aug-07.

# A-REITs in the global REIT market

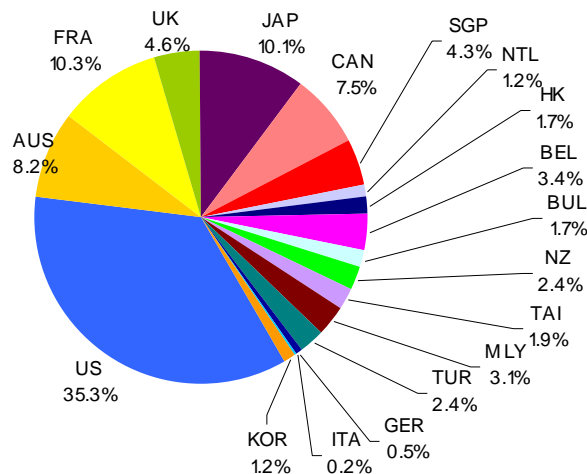
## - represent a significant part of the world market

### Number of REITs

### Market Capitalisation

#### Composition of the existing global REIT market

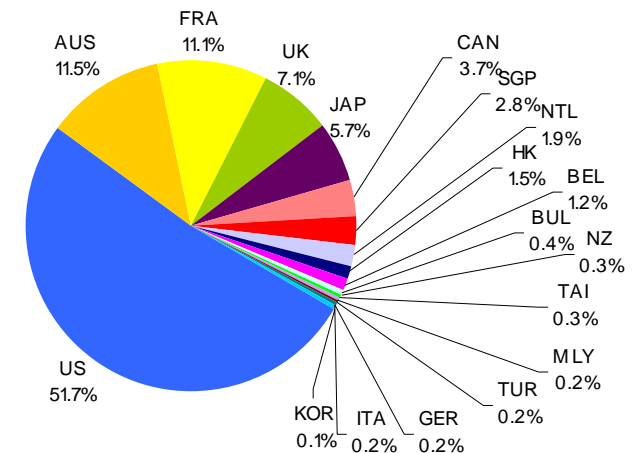
Number of REITs (416), as at August 2008



Source: Bloomberg, IRESS, NAREIT and CFS Research.

#### Composition of the global REIT market

Market cap of US\$591.1bn, as at August 2008



Source: Bloomberg, IRESS, NAREIT and CFS Research.

- Global REIT market is valued at approximately US\$590 bn (or ¥70 trillion).
- Significant global REIT markets include: US, AUS, France, Japan, UK and Canada.
- Australia's share of the global REIT market remains significant despite the emergence of Asian REITs.

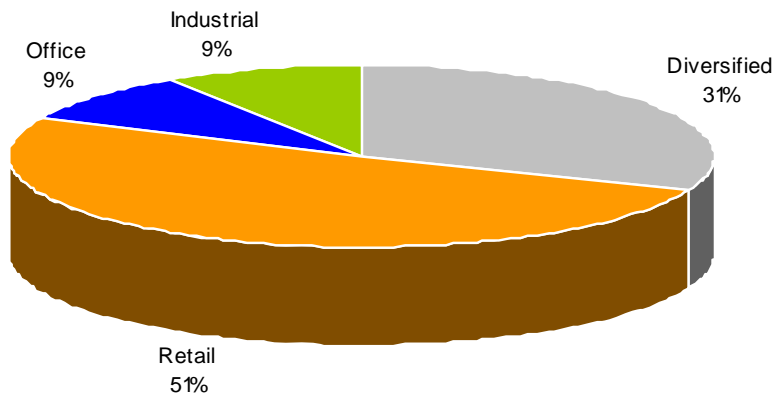
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# Sector exposure for A-REITs

## - asset exposure mainly in core property sectors

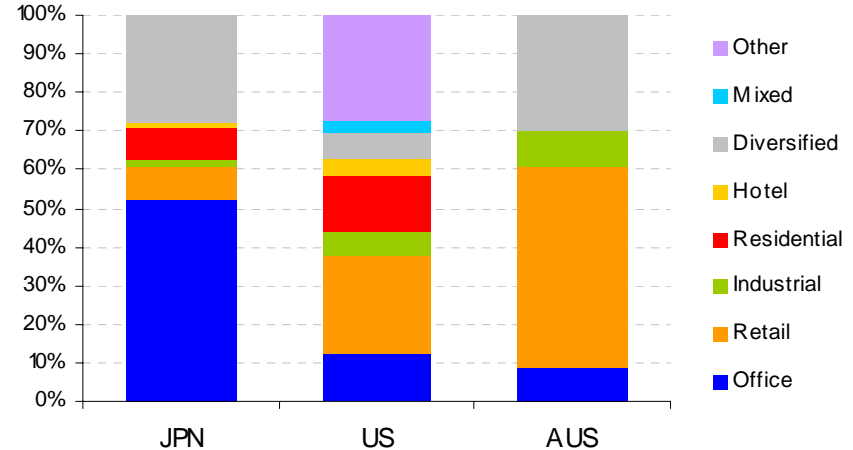
**Composition of A-REITs index by sector**  
as at August 2008



Note: split based on market cap value.

Source: UBS & CFS Research.

**Sector split across selected REIT markets**  
as at August 2008



Note: Japan data as at November 2007

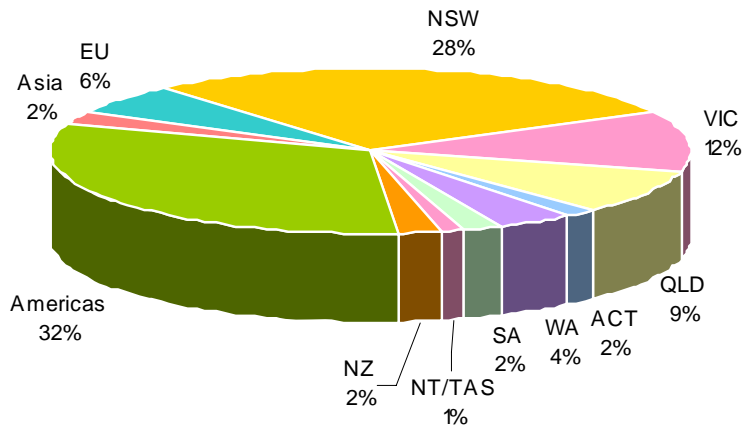
Source: NAREIT, UBS, IRETO and CFS Research.

- Sector-specific vehicles represent around 70% of all A-REITs by market cap.
- Since 1992, the launch of new REITs have become increasingly sector specific, primarily driven by investor demand.
- Sector diversity varies across global REIT markets.

# Geographical exposure for A-REITs

## - asset exposure both domestically and overseas

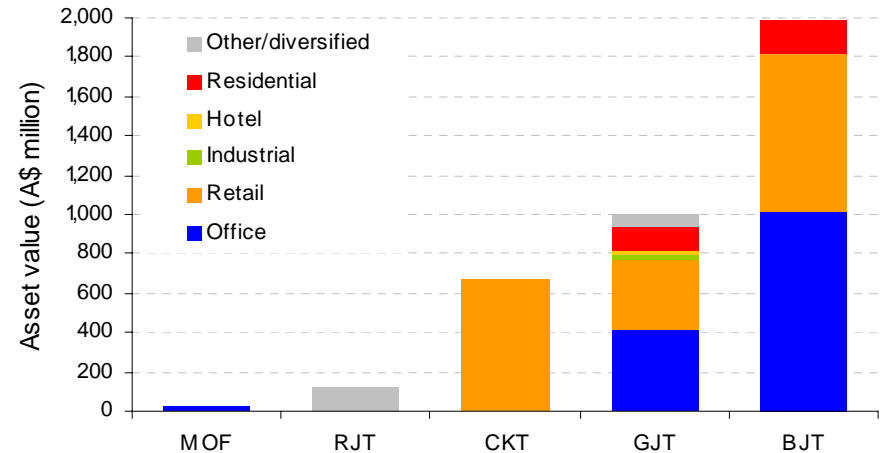
**Geographical composition of A-REIT index**  
as at August 2008



Nte: shares based on asset value.

Source: UBS & CFS Research.

**A-REITs containing Japanese assets**  
sector split by asset value as at June 2008

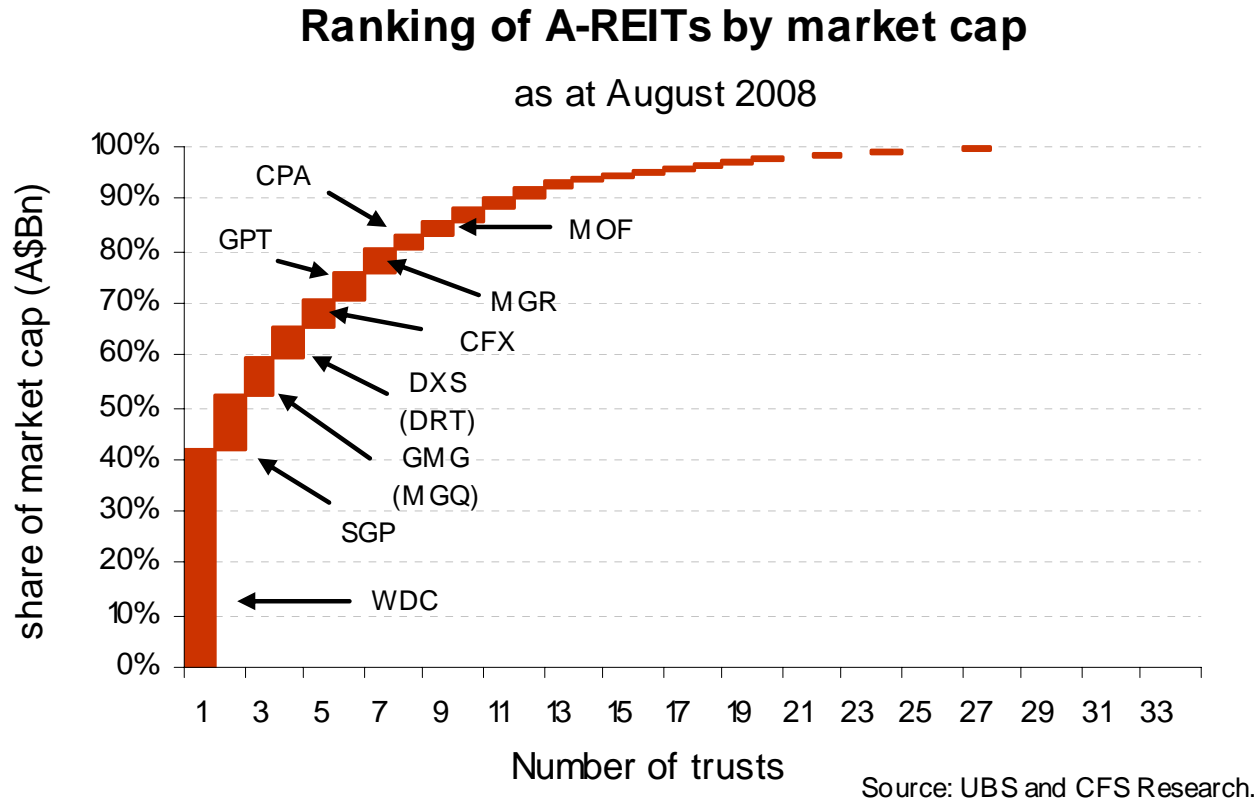


Source: IRESS, UBS and CFS Research.

- Offshore property assets represent about 43% of total A-REIT assets.
- Overseas expansion due to: i) excess capital to product; & ii) seeking growth and diversification.
- A-REITs house assets owned in the US (mainly), Europe, Asia (Japan) and NZ.
- Property exposure to Japanese assets is around A\$3.8bn.
- This allows investors to gain exposure to foreign assets without the tax and management complication of investing directly offshore.

# Trust manager composition

## - dominated by a couple of large managers

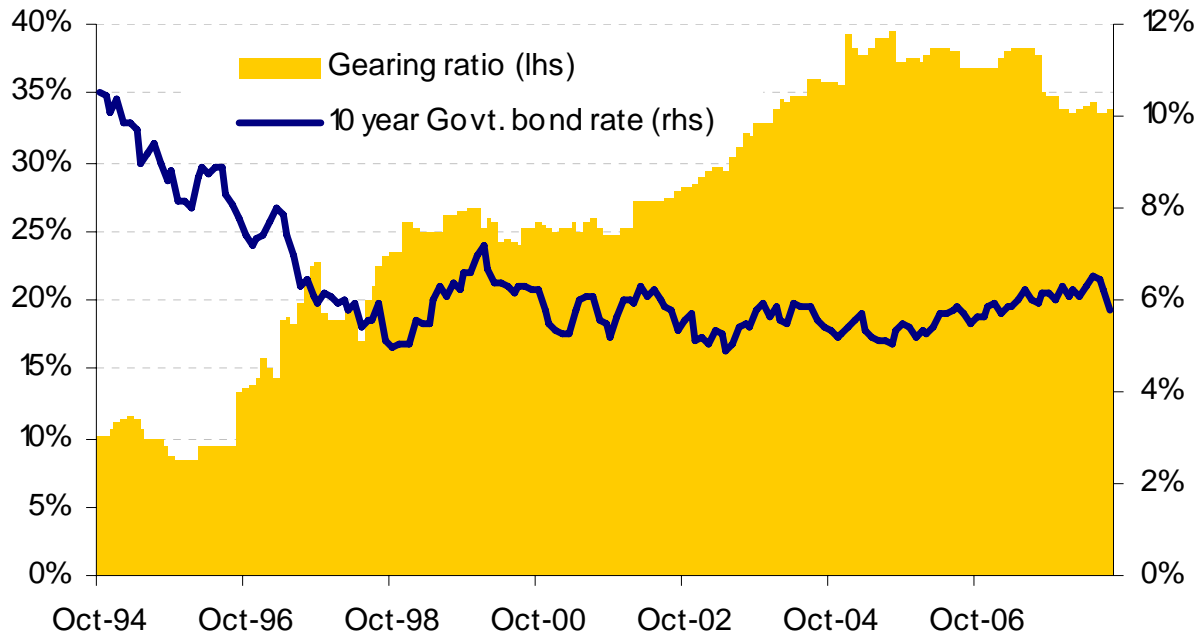


- Notably, WDC (Westfield Group) is the largest trust in the A-REIT index with a market cap of A\$30.2 bn (¥2.8 trillion), with a sector share of 42%.
- The top ten trusts represent over 86% of the REIT index in terms of market cap.

# Leverage has been trending up - recent turnaround; heading towards 30%

## A-REITs: gearing ratio and interest rates

Monthly observations ending August 2008

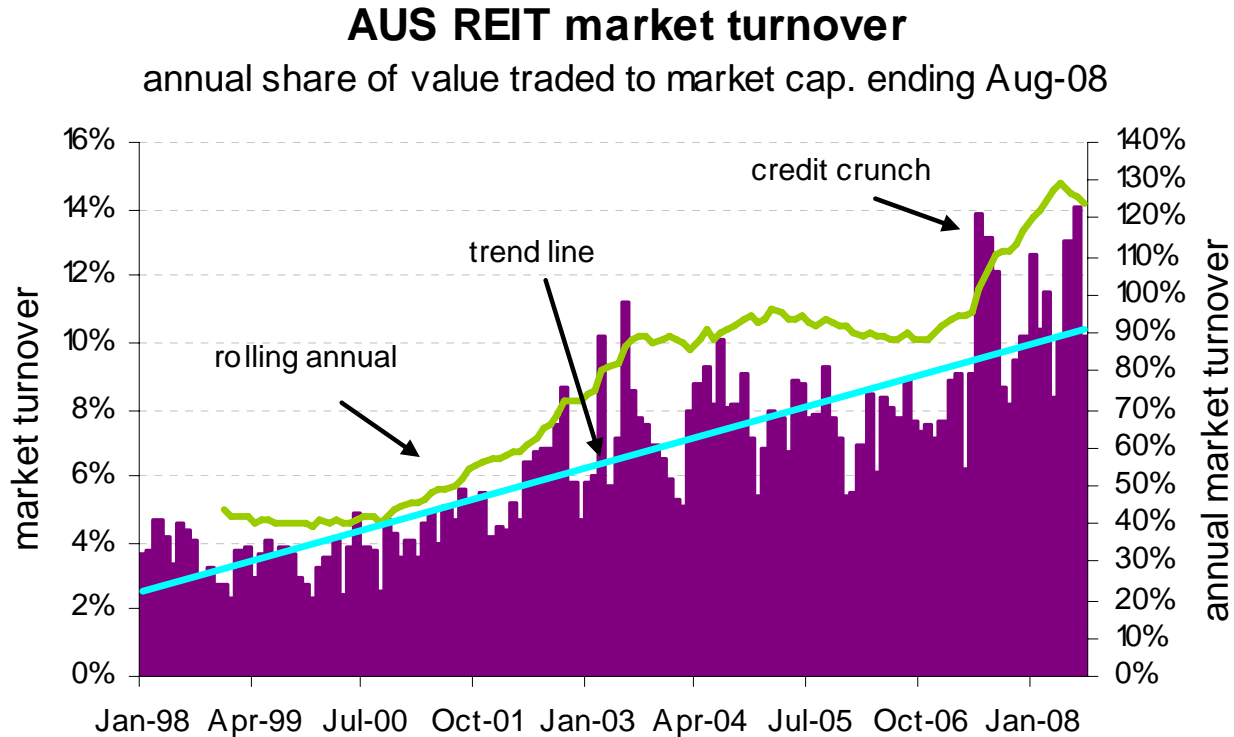


Source: UBS, RBA and CFS Research.

- As at August 2008, the gearing ratio was 34% (versus 38% as at August 2007).
- Increased gearing due to: i) low interest rates & ii) greater use of capital management.
- Up until recently, high gearing evident in trusts with offshore exposure.

# Liquidity profile

- turnover for the A-REIT sector has been rising

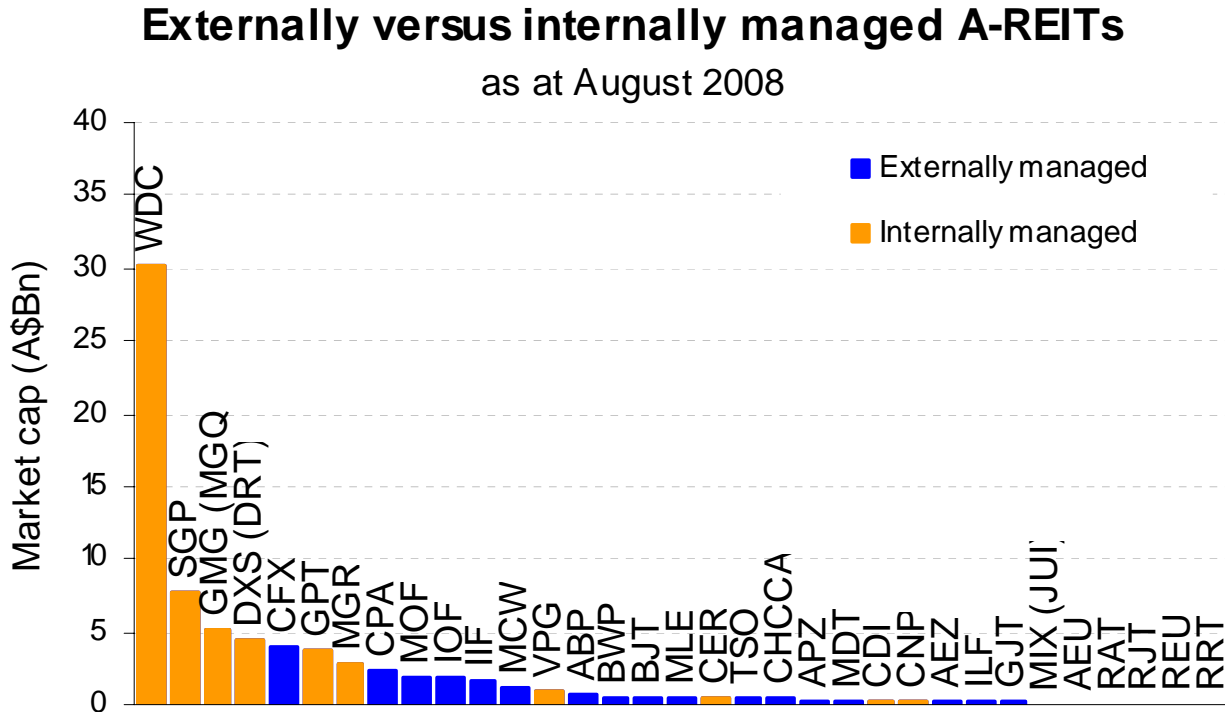


Source: IRESS, UBS and CFS Research.

- Rising liquidity (turnover) due to increasing maturity of the sector.
- Since 1998: annual turnover has increased from 44% to over 100% value of market capitalisation.

# Management structure

## - A-REITs are mainly internally managed

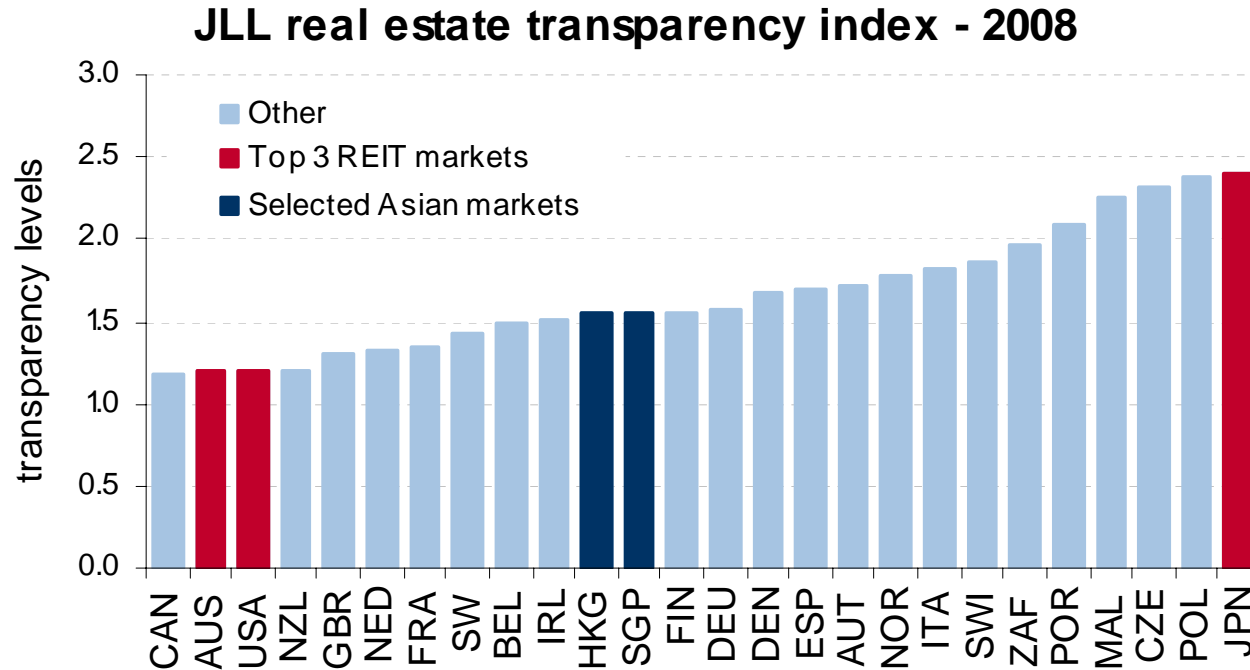


Note: Excludes free float.

Source: UBS and CFS Research.

- Eleven trusts (with over 77% share of market cap) use the 'stapled' structure.
- Diversification of earnings growth away from passive income towards more variable income streams (such as funds management & development activity).
- Both management structures have dis/advantages. Performance depends on the quality of the management team, its strategy and ability to execute the strategy.

# High transparency in AUS property sector - supported by stable political and legal system



Notes: lower score suggests higher transparency.

Source: JLL and CFS Research.

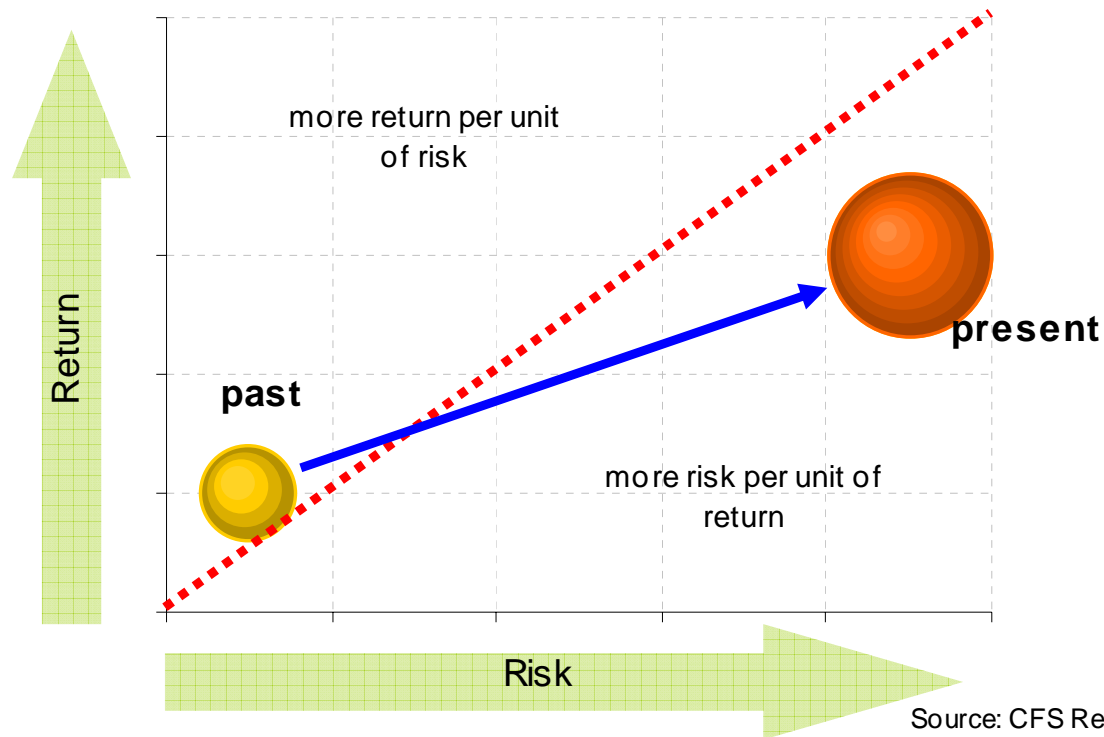
- Australia's property investment market has a high degree of property information that is publicly available.
- Transparency, supported by 'legislation' and 'research', makes the A-REIT market one of the most transparent property markets in the world.
- 14 ➤ Availability of pricing and transactional information.
- Tax transparent structures.

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# Transformation of the A-REIT sector - increasing risk profile with growth strategies

## AUS-REITs: return versus risk

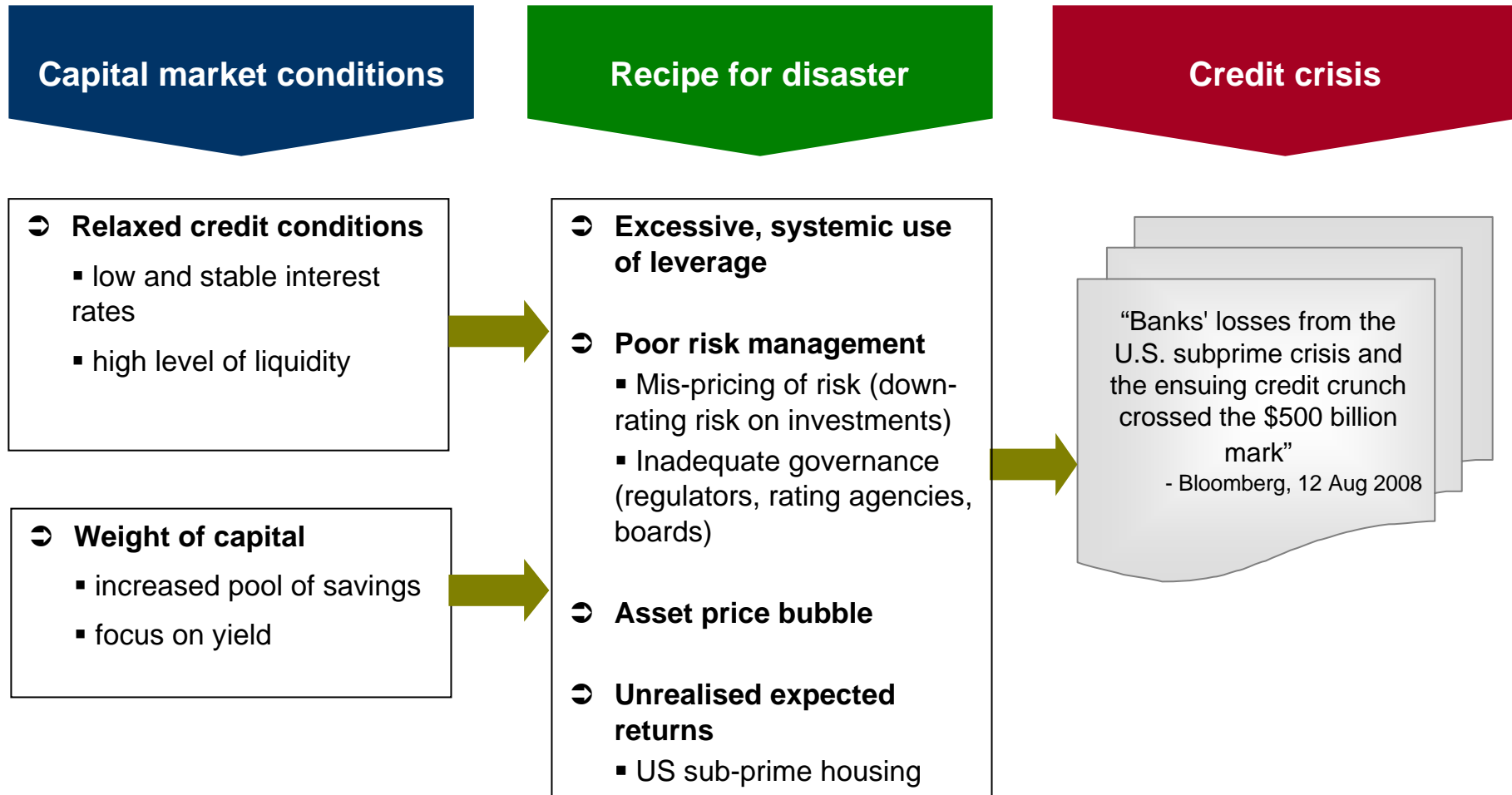


Source: CFS Research

➔ The quest for growth has seen the AUS-REIT sector take on more risk:

- increased gearing levels
- growing offshore exposure
- rise of stapled trusts
- increased market concentration
- poor capital management

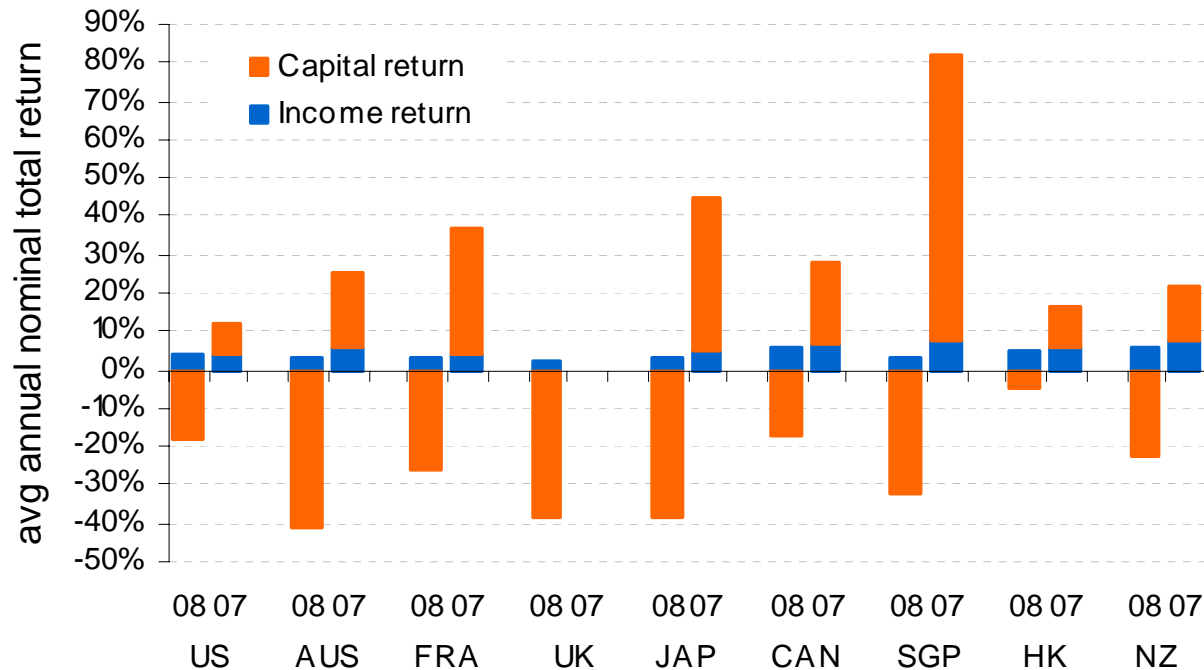
# A background to the global credit crisis - fallout from an interplay of many factors



# Impact transmitted across REIT markets - price falls not only restricted to A-REITs

## Returns for selected REIT markets

average annual returns ending June



Source: S&P/Citigroup and CFS Research.

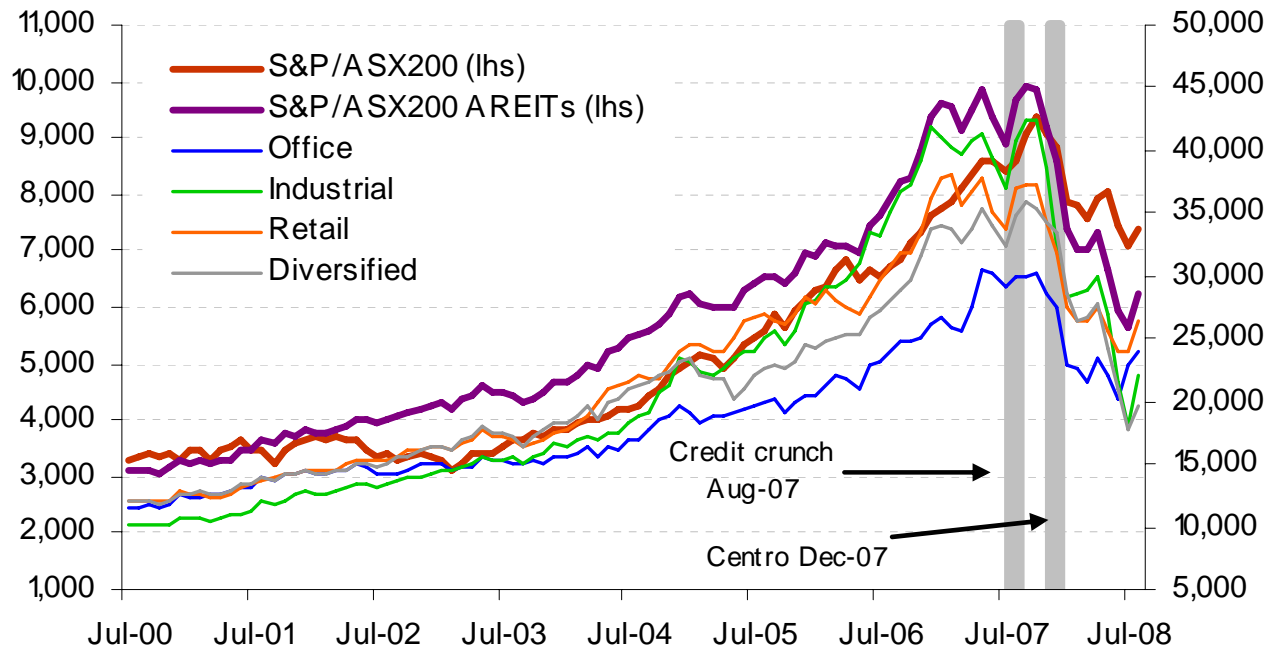
- REIT markets have relatively high and stable income return.
- A-REIT sector was not alone in experiencing a significant re-pricing as a result of the credit crisis. Most REIT markets across the global also experienced price falls.

# A-REIT sector underperforms equities

## - however, decline in prices varies across sectors

### A-REIT sector accumulation indices

monthly rests ending August 2008



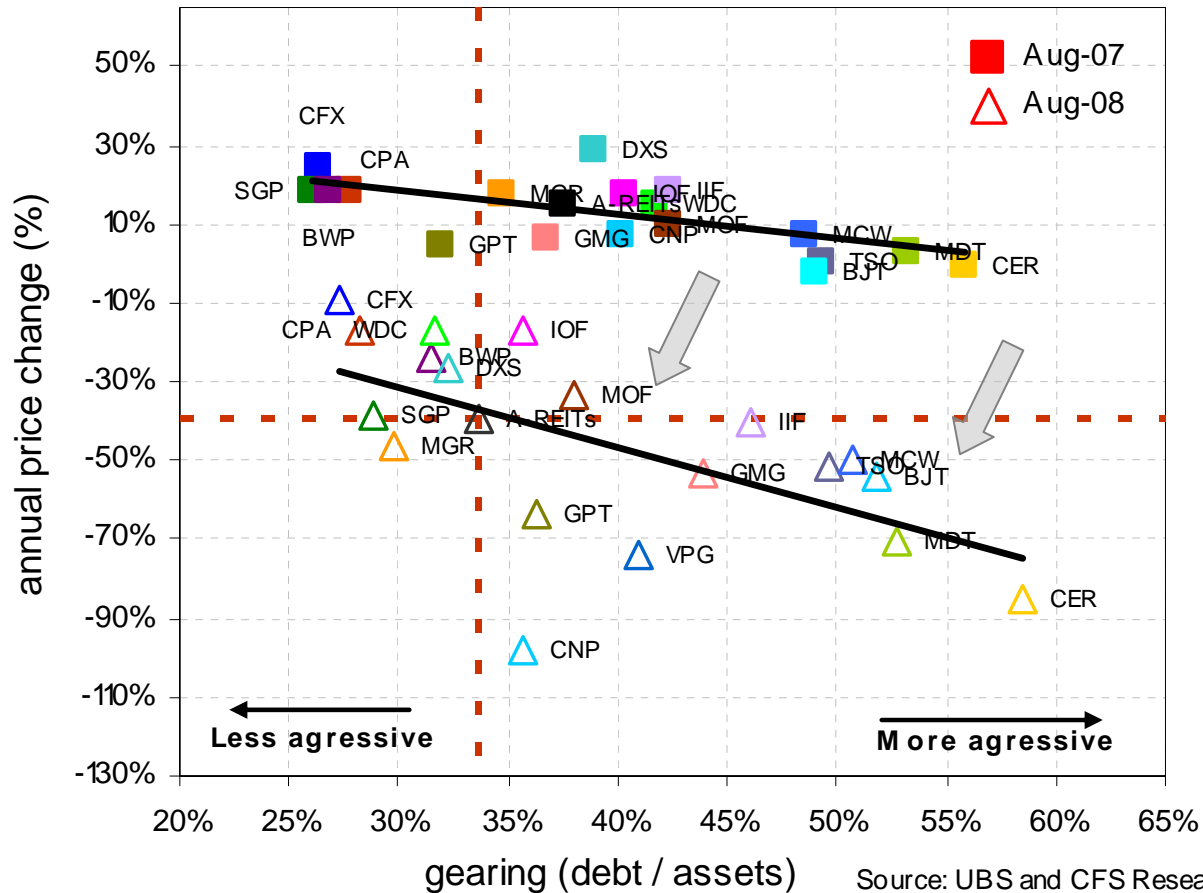
Source: UBS and CFS Research.

- A-REITs fell by 35% over the year to August 2008 while shares only fell by 14%.
- Price falls varies across sector: -20% for office; -29% for retail; -46% for industrial.
- Largest declines across individual trusts: Centro Properties Group (CNP) and Centro Retail Group (CER) decline by 98% and 85% respectively.
- Disconnect with share market in 2001/02.

# Price erosion varies across trusts

## - trusts penalised for carrying too much leverage

**A-REITs: gearing levels versus price return**

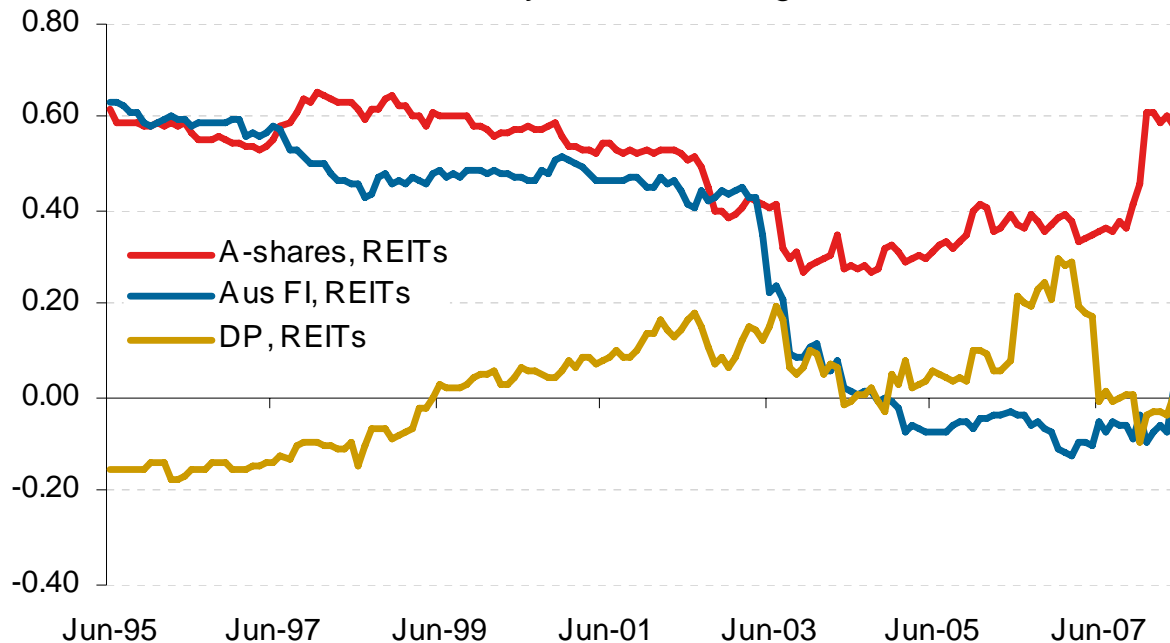


Source: UBS and CFS Research.

# Return correlations across asset classes - highlights 'defensive' characteristic of A-REITs

## Correlations: A-REITs with selected assets

based on monthly returns ending June 2008



Note: based on a five year window.

Source: CFS Research

- A-REITs have low to moderate return correlation with other asset classes.
  - However, correlation values are highly variable over time.
- 21 ➤ Beta value for A-REIT sector has been historically around 0.4. Recently it has increased to around 1.0 due to its higher correlation to shares in a falling market.

# Potential for diversification benefits

## – A-REITs deliver enhanced risk-adjusted returns

### Portfolio construction using selected Australia asset classes

based on monthly nominal total returns

statistic	Asset class			Portfolio*		
	Shares	Bonds	A-REITs	P-1	P-2	P-3
Allocation to A-REITs				0%	10%	20%
<b>panel A: 10 years to June 2008</b>						
return	11.4%	10.1%	8.1%	10.7%	10.5%	10.2%
std dev	11.5%	11.3%	12.6%	2.7%	2.6%	2.5%
SR	0.99	0.89	0.65	4.04	4.09	4.07
<b>panel B: 10 years to June 2007</b>						
return	13.2%	7.3%	14.7%	10.3%	10.7%	11.1%
std dev	11.3%	11.1%	9.3%	2.6%	2.5%	2.4%
SR	1.17	0.66	1.58	3.93	4.29	4.64

Note 1: SR refers to Sharpe Ratio.

Source: CFS Research.

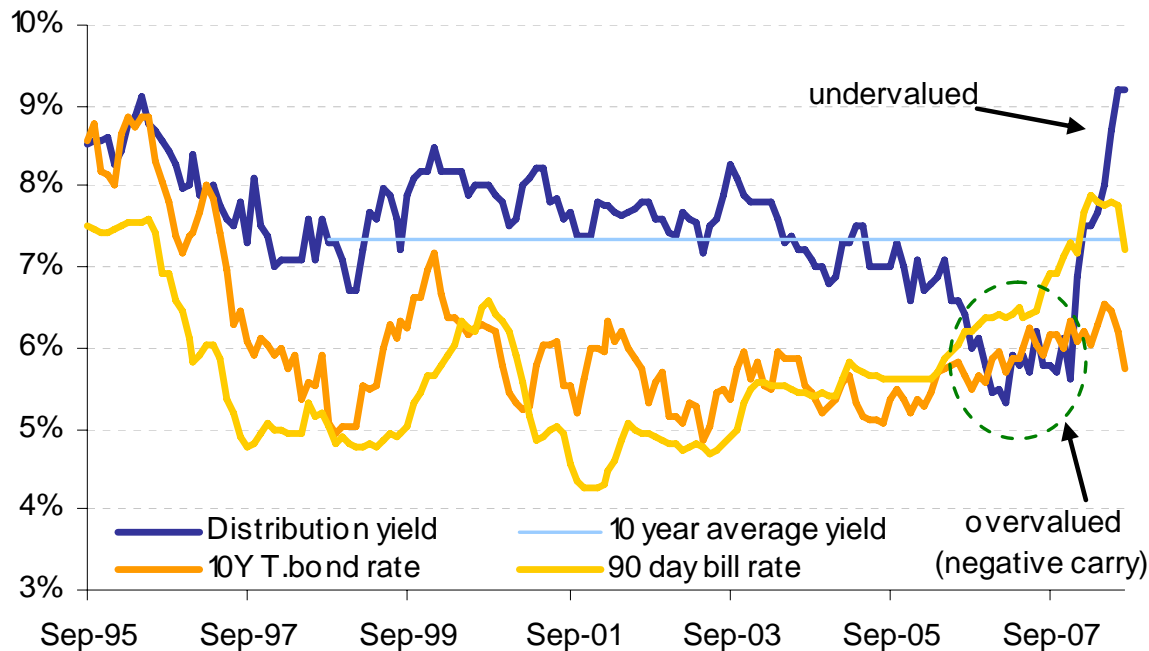
Note 2: P-1 allocates 0% to A-REITs. P-2 allocates 10% to A-REITs and P-3 allocates 20% to A-REITs.

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# Cyclical softening in distribution yield - indicates relative value

**A-REITs: yield versus bond rate and bill rate**  
monthly observations ending August 2008



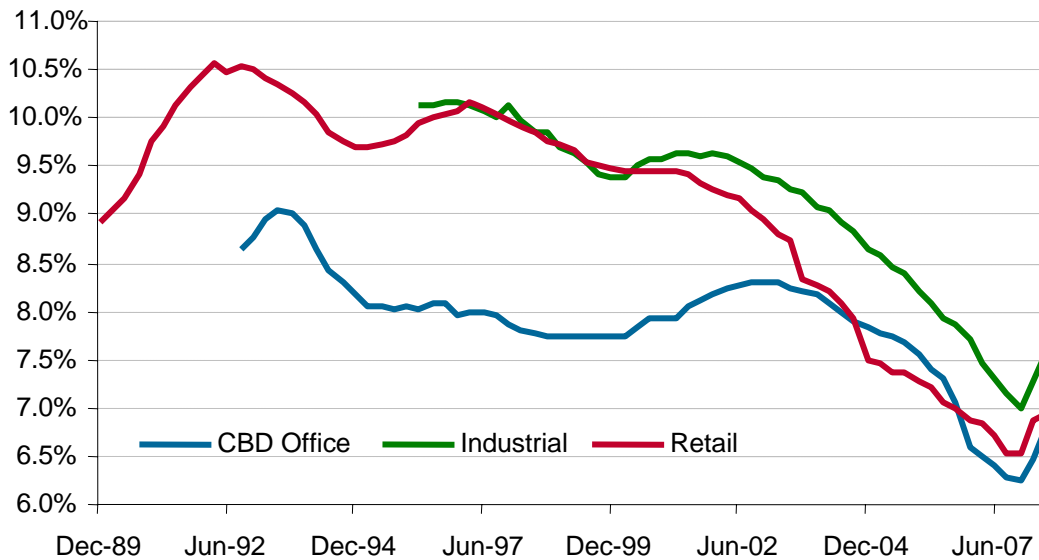
Source: UBS, RBA and CFS Research.

- Yields softening with the rising cost of debt and upward revision of risk premium.
- The A-REIT distribution yield has softened to 9.2%; 10 year average yield is 7.3%.
- The tight pricing had implicitly assumed very aggressive earnings growth forecasts.
- Investor uncertainty on the short-term direction of market.

# Property sector investment yields soften - reflects higher cost of capital

## Australian real estate prime investment yields

Average yield across each core real estate sector

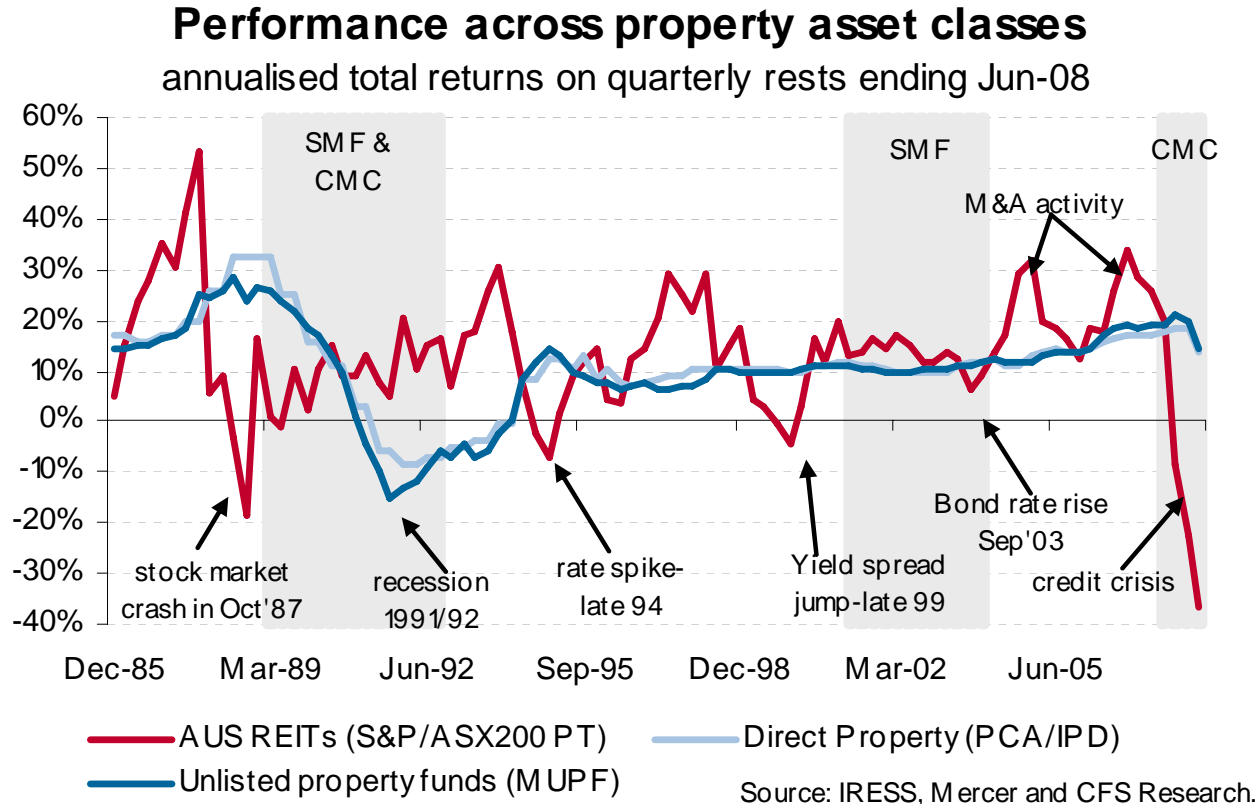


Source: JLL, and CFS Research.

- ➔ Increased cost of debt
  - sourcing finance
  - rising interest rates
  
- ➔ Rise in the risk-premium
  - lack of market depth
  - review of asset quality
  - risk to earnings growth
  - market transparency
  
- ➔ Flight to quality
  - widening in the yield spread across asset grade
  
- ➔ Secondary spill-over effects
  - impact on real economy
  - impact on space markets

# A-REITs out of sync with direct property

## - property fundamentals remain relatively solid



- Current property market characterised by deteriorating capital market conditions (CMC) while space market fundamentals (SMF) remain relatively favourable.
- Direct property investment segment to experience a mild erosion in capital returns.
- Limited rotation of capital out of unlisted property due to current crisis deemed to be cyclical by investors.

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# Summary remarks

## - investment opportunities exist but be cautious

### ➔ Sector dynamics

- mature market with exposure to core sectors
- transformation of sector - the quest for growth has come with much more risk

### ➔ Investment environment

- equity market volatility to persist with uncertainty surrounding credit crisis
- weight of capital - strong flow of capital from superannuation funds

### ➔ Focus on value proposition (performance attributes)

- relatively high and stable income component
- potential to deliver favourable portfolio (diversification) benefits

### ➔ Pricing

- risk: general upward re-pricing of risk across the property asset quality spectrum
- direct property yields to experience further (cyclical) softening, depends on SMF

### ➔ Performance

- focus on defensive trusts unpolluted with aggressive growth strategies
- focus on quality (fund and asset) managers with proven track records
- buying opportunities and consolidation (takeovers)

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