VIEWPOINT

FOUR QUADRANTS

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Having started the year none too poorly REITs have seen a dramatic change in fortune in March, unspared by the wider correction in stock markets. In the first quarter of 2020, EPRA's UK and Europe ex UK indices were down -25% and -31% respectively, on a par with the global fall of -27%. Volatility has been at record levels, as investors have struggled to price in events of this magnitude, be it a near full shutdown in many sectors, Government stimulus, rapid downgrades to national and global GDP forecasts, or highly unsettling news flow.

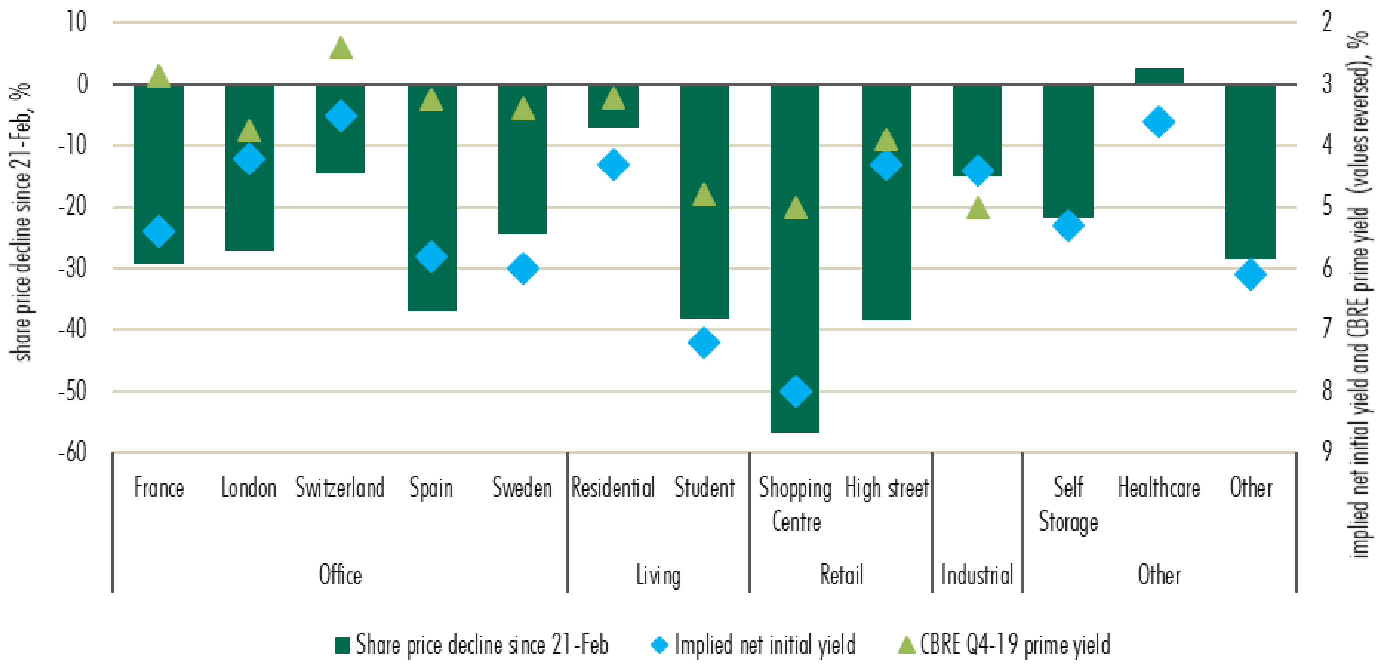
The result is that at the end of Q1 REIT pricing looked unimaginable from where it had been at the end of 2019. It also provides an interesting basis on which to assess the market going forward, but also one to compare to the past – specifically to the Global Financial Crisis (GFC).

This time is at least initially fundamentally different in nature to the GFC, being likely one of short-term income disruption rather than longer-term valuation correction. Most REITs are materially better placed to cope with this type of disruption – i.e. they have good liquidity (be it cash or undrawn committed facilities) - than they were during the challenges posed by the GFC. They have a wider array of providers of credit and typically longer maturity profiles relative to the last downturn. Nonetheless, most are taking prudent steps to minimise cash outflows through deferring or cancelling capital expenditure, reducing operating costs and service charge expense, stopping new investment and reviewing their dividends outlook for 2020.

At a more granular level, the recent sell-off in REITs, while fairly general, has shown some differentiation. UK retail has again borne the brunt of investor disinterest – this is due to a combination of the direct impact of store closures but also weaker balance sheets on average. UK offices have fared better but lag their Continental counterparts. A number of sectors favoured in more optimistic times – healthcare, multifamily, industrial and self-storage – have held up relatively well. The exception to this, indeed the only sector to really see a reversal of the entrenched trends of the past couple of years, has been student housing (PBSA), where short-term cashflow concerns have weighed on the sector as students review their spend in the short-term.

In most markets for which data is available, implied net initial yield levels offer a significant buffer to those on underlying direct real estate. Quite where the rest of the year takes the commercial property market is unknowable at this point in time. But we can be reasonably confident that – as has usually been the case – the public markets will be the first to hint at what the future holds, given the value on offer and the comfort of liquidity they provide.

Figure 1. Change in share price and implied net initial yield versus CBRE prime property yields, European REITs



Source: Factset, Company filings, CBRE. Note: prime yields as at Dec-19.

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