Global Real Estate Securities
Monthly Review
December 2015
Global real estate stocks outperformed the broad-market index in December

The most talked-about economic news in December was the U.S. Federal Reserve’s unanimous vote mid-month to increase the target range for the federal funds rate for the first time in seven years. While this has been long anticipated, there are concerns about the impact of rate increases on a global economy that is showing some weakness. Rates in the U.S. remain low, with the 10-year government bond yield closing the period at 2.27%, up 7 bps in December and up 10 bps in 2015.

Global real estate stocks outperformed the broad-market index in December, with property stocks outperforming their broad market peers in the United States, Continental Europe, Japan, Singapore and Australia. The FTSE EPRA/NAREIT Developed Index gained 0.6% this month, while the MSCI World Equity Index of broad-market stocks was down 2.1% (all returns stated in local currency). For the full-year 2015, property stocks gained 2.9%, while the broad-market was ahead 2.6%.

The U.S. economy grew at a revised 2% annualized rate in the third quarter

U.S. REIT stock prices were ahead 1.9%, while the U.S. broad-market index lost 1.7%. There was a dispersion of returns in U.S. REIT sectors this month. Health care REITs (up 5.5%), self-storage REITs (up 4.7%), and regional malls (up 4.3%) were the best performers, while lodging REITs lost 6.1%.

The U.S. economy grew at a revised 2% annualized rate in the third quarter; supported by consumer spending with strong employment levels and low energy costs. U.S. retail sales rose 3.3% for the last two months of 2015, about the same pace as in the previous year. Sales growth came despite lower foot traffic, as visits to physical stores declined 6.4% in November and December.
Conditions in the office sector continue to improve with rising occupancies and rents in most markets, particularly the West Coast and New York City. Apartment fundamentals remain robust while hotel rate growth has lagged expectations. Industrial demand remains steady. Recent weakness in retail sales and traffic data has raised new concerns about regional mall fundamentals, but the outlook for “A” malls in which we mostly invest remains positive. The bifurcation in performance and risk between “A” malls and lower quality “B” and “C” malls has expanded.

The Green Street Commercial Property Price Index was unchanged in December; for the year, property prices are up 10%, matching last year’s gain. The acquisition environment remains difficult due to intense competition for quality assets. There was some corporate activity in the U.S. this month. American Homes 4 Rent, the largest U.S. single-family home landlord, agreed to acquire American Residential Properties for USD 1.5 billion. A major REIT-owned hotel in Times Square-New York City was sold for USD 1.15 million per room (a 3.4% capitalization rate).

**European equities were weak after the additional stimulus measures unveiled by the ECB failed to impress investors**

Continental European property companies lost 1.2% and their broad-market index declined 4.6%. European equities were weak after the additional stimulus measures unveiled by the ECB failed to impress investors. Germany’s unemployment rate has fallen to a record low since reunification of 6.3%, and German investor confidence has begun to improve. Recent company results have largely been in line with expectations. Prime retail companies reported strong retail sales figures (around 5%), while the office companies in Continental Europe are experiencing more sluggish markets.

UK real estate shares continued to be weak, down 2.5% while the broad UK market lost 1.9%. The UK economy is still in very good shape, backed by a strong employment market, GDP growth, and stronger-than-expected manufacturing data. UK consumer confidence is slightly lower, however. The London property market is arguably moving later into the cycle; cap rates are at all-time lows and prime rental rates are at all-time highs. Demand for real estate in London is still vibrant, with investment volumes in London at their highest since the peak in 2007.

**Australian retail vacancies are falling and international retailer demand is strong**

Australian property stocks gained 3.8%, ahead of the Australian broad-market index, which was up 2.7%. Australian unemployment fell to 5.8% (a 19-month low) with retail sales up 3.9% YoY in the latest reading. Retail vacancies are falling and international retailer demand is strong. New regulations allow for much higher foreign purchases of commercial real estate without government approval and are expected to increase incoming property investment. Dexus Property Group and Investa Office Fund have agreed to move forward with Dexus’ proposed takeover, for about USD 1.8 billion (an estimated 6.3% cap rate).

Japanese real estate companies lost 1.7% this month, with the broad Japanese market losing 2.1%. Japan’s third-quarter GDP was significantly revised from an initial estimate of down 0.8% (annual rate) to up 1.0%, helped by a stronger-than-expected gain in capital spending. The Bank of Japan maintained its current stimulus level, which disappointed some investors. In one change, the government’s maximum holding amount in each individual JREIT was increased from 5% to 10%. The December Tankan Survey of business confidence among major manufacturers was positive and above consensus. Unemployment was down to 3.1% in October, the lowest since 1995. November’s office vacancy rate in Tokyo’s five central wards fell from 4.46% to 4.19% MoM, and asking rent per tsubo is up 4.1% compared to the same time last year.
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Real Estate companies underperformed in Hong Kong this month, off 1.3% while the broad Hong Kong equity market gained 0.8%. Growth in the Hong Kong economy is positive but slowing, although December saw an increase in consumer confidence. Following the U.S. Federal Reserve’s action, the Hong Kong Monetary Authority’s raised its base rate for the first time in nine years. There has been some weakness in the residential sector in the latter part of 2015. Office rents were up almost 3% in 3Q, and vacancy remained low, at 1.2%, for a 3rd straight month, as absorption from mainland companies continues.

Real estate stocks in Singapore increased 2.7% while the broad Singapore stock market was up 1.3% this month. Singapore’s fourth quarter GDP growth estimate was reported at 5.7%, with the annual GDP rate is estimated to be 2.1%, the lowest annual growth since 2009. Consumer prices continue to fall, as do retail sales and office rents (projected to contract more than 10% this year). Singapore home sales climbed in November, as new projects were opened.

December was another light month for equity placements by global real estate companies.

December was another light month for equity placements by global real estate companies. About USD 1.2 billion was issued mostly in the U.S. and Singapore. It was a much larger month for debt, with about USD 13.6 billion issued in the period. Year-to-date, property companies have raised about USD 44 billion in equity and about USD 107 billion in senior debt securities.

Real estate fundamentals continue to be solid, with modest economic growth generally driving incremental demand.

We expect slow-to-moderate economic growth over the next several years, with low inflation. Real global growth is projected to increase to 2.6% in 2016 and about 3% thereafter. Inflation remains well below target in most economies. Despite concerns, interest rates have remained low this year.

Although GDP growth is slowing in a number of countries around the world, real estate fundamentals continue to be solid, with modest economic growth generally driving incremental demand. Occupancies and rents remain firm or are improving in most markets, with new development often economically feasible. Real estate remains in demand with investors, and quality property for sale attracts numerous qualified buyers.

Our projections call for growth in same-property operating-level earnings of 3.2% on average over the next four years. We expect global real estate companies to benefit from their solid operations and selected external growth opportunities producing earnings growth per share of about 7% per year on average through 2019. Global property stocks currently offer a cash dividend yield of 3.6%, and we expect dividend growth in line with earnings growth. The companies’ stocks trade at a 4% discount to Net Asset Value on average, and below their long-term average premium.
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