

Sean Roger: Why it's time to reconsider listed property

By Perpetual Asset Management

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After a tough few years, REITs are once again looking attractive, argues Perpetual's co-portfolio manager Sean Roger

- REITs look attractive as rates fall
- Return to office, strong retail spending
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Robust retail spending and a return to working in the office are underpinning a rebound in fortunes for listed real estate investment trusts (REITs), says Perpetual portfolio manager Sean Roger.

REITs have faced a perfect storm since the onset of the pandemic as working from home, store closures and rising interest rates damaged asset valuations and share prices.

But things are now turning for the sector, which looks good value and is showing strong signs of operational improvement.

“It was headwind on headwind for a few years, but now it feels like we might have turned the corner,” says Roger, co-portfolio manager for Perpetual Equity Investment Company (ASX:PIC).

Retail REITs look undervalued

Roger says that despite persistent cost-of-living pressures, retail spending remains resilient, underpinned by strong population growth.

“Because we’ve had decent population growth and limited supply growth, the amount of retail space per person has continued to reduce.

“So, spending on a per person basis might have reduced over the past couple of years under cost-of-living pressure, but aggregate retail spend has continued to increase.”

Roger says this means REITs with exposure to well-located retail assets look well priced compared to the cost of building new properties.

“There are two issues – one, you just can’t find the land to build new malls, especially in densely populated residential areas, and two, high construction costs mean the replacement cost of some of these assets is well north of the book value of existing properties.

“So, it makes sense for companies to buy other malls rather than develop.”

Office rebound underway

Roger says REITs holding prime office assets in markets like Sydney and Brisbane are starting to see improving leasing rates and a reduction in the incentives they need to offer to entice new tenants.

Partly, that is based on an increasing trend to return to working in the office.

“There are definitely signs that office has started to turn the corner,” he says. But high replacement costs are also underpinning valuations.

“If you were to try to build an office tower in the core of Sydney, the rents you would need to justify that spend are 20 to 30 per cent above market rents.

“That means there is no incentive to bring on new supply.

“In that environment, it’s likely that you get slower supply growth until the rents in market improve.”

At the same time, the capital outflows that have characterised the sector in recent years are easing, as increasing corporate interest in the sector starts to lift transaction activity.

“That tends to be a good lead indicator that asset values may start to improve,” he says.

Interest rate headwinds reverse

Further underpinning the positive outlook is the prospect of falling interest rates over the remainder of 2025.

REITs tend to be highly leveraged, so lower interest rates directly improve earnings as interest payments fall. Lower rates also directly lift asset valuations.

Vicinity, GPT stand out

Roger says Vicinity (ASX:VCX) and GPT Group (ASX:GPT) look attractive.

“Vicinity have been divesting smaller assets and acquiring prime assets but also doing development work at their prime assets in Sydney’s Chatswood Chase and Melbourne’s Chadstone.

“The other thing we like is Vicinity is coming to the end of two substantial development programs, which will reduce the overall capex burden on the business.”

For GPT, Roger says a strategic shift towards a funds management model – where assets are managed on behalf of external owners – will generate higher returns on capital than the traditional model of fully owning underlying assets.

About Sean Roger and Perpetual equities

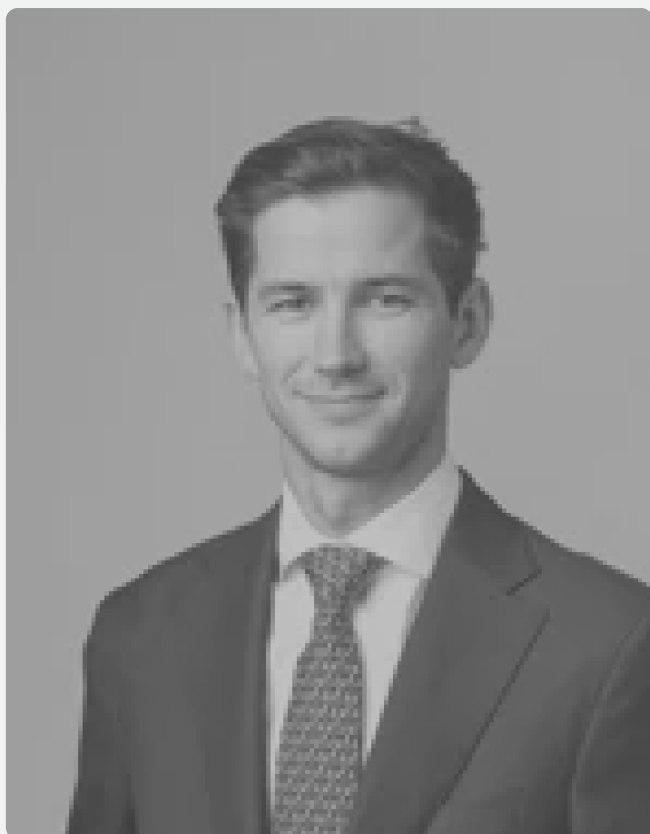
Sean is deputy portfolio manager for Perpetual’s SHARE-PLUS Long-Short Fund and Perpetual Pure Equity Alpha Fund.

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