

Time to revisit the benefits of real estate investment trusts

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Now is a good time to invest in real estate investment trusts (Reits). Over the past few months, the property sector has seen renewed interest from equity investors, assisted by rising economic activity. In addition, many investors have been also focusing on the defensive characteristics of Reits.

This new, positive trend is likely to continue, serving the long-term interests of existing and future investors, as well as helping Reits to perform well in the coming months.

Outperforming asset class

Property shares as a whole have been outperforming the broader global equity market for some time now. The UBS Global Real Estate Investors index has returned over 50% over the last 12 months in sterling terms, more than double the return of the broader based MSCI World index. Over the year to the end of June, global real estate securities have gained 5.6%, compared to a fall of 2.4% for the global equity market.

In addition, their betas (a measure of volatility relative to the underlying market) have begun to fall globally from their peak in 2009. This was partly driven by the actions taken by Reits' managers to reduce their leverage.

Responding to the credit crunch

In the midst of the credit crisis, which saw increased risk aversion, Reits substantially underperformed the wider market. In large part, this was due to the financing structure many Reits had taken on to maximise returns, which placed asset values under heavy pressure when the availability of debt financing dried up. However, fund managers were quick to improve the equity position of their investment trusts. This has spurred a strong recovery across markets and helped Reits to reclaim their defensive position within portfolios.

The relative resilience which Reits have demonstrated during the recent period of market volatility could be seen as a positive outcome of the European sovereign debt crisis. Moreover, the significant reform packages announced by the EU



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in response to the crisis seem to have succeeded in preventing the risk of it spilling over into some of the major economies outside Europe. There may, in fact, be a positive benefit for key global economies as monetary policy is likely to remain easy for longer.

Opportunities for investors

These advantages, coupled with the relative resilience of Reits to the movements of the wider equity market, as well as improving economic conditions, present opportunities for asset managers to increase their positions in property securities.

We look for Reits poised to take advantage of improving economic conditions through management and strong development pipelines which ensure continuous rise in earnings. For example, we have recently added a holding in Kimco Realty Corporation, a Reit listed on the New York Stock Exchange which has significant leverage to an improving US retail sector and good access to joint venture capital. This is shown by its recent venture with the Canada Pension Plan Investment Board to acquire prime neighbourhood shopping centres throughout the US.

In contrast, we are reducing the fund's exposure to global firms which had performed well but would face uncertainty in a slowing economy. Examples include CB Richard Ellis Group, which due to its heavy reliance on asset sales and leasing volume is facing the risk of global corporate decisions and capital market financing being pushed back by market turbulence.

Andrew Nicholas and Stuart Martin are manager and co-manager of the First State Global Property Securities fund respectively.

