ST BRIDE'S MANAGERS

Bull and Bear

Listed REITs

This week, Bull and Bear look at the case for investing in listed REITs as part of their overall property strategy for 2021.

Bull: Have you noticed how many self-proclaimed property experts have sprung up over the past year? Of course we have long known that everyone thinks that they are resi-wizards, but I bumped into a couple last week who reckoned they know exactly what is going to happen to commercial property too.

Bear: Yes; I know. They were my bearish cousins. They told me that your paths had crossed.

Bull: They droned on and on about the demise of the office, the emaciated state of our shopping centres and the mass destruction of the hospitality sector. Talk about doomsters!

Bear: They have every reason to be gloomy, not least as over the past year their personal wealth has taken a complete battering. Equities have been a disaster. They fell by 13.2% last year. The impact on their pension pots has been devastating. And that is on top of some pretty anaemic long-term performance too.

Bull: So how exactly does that qualify them to blab on about property?

Bear: Because ever since Intu (who owned their local shopping centre) went up in smoke last summer, they thought they had better check out how the rest of the listed REIT sector was faring. And, at minus 11.5% last year, the whole thing has been a horror show compared to the MSCI All Property Total Return of -2.3%.

Bull: Fair enough, but tell them that they shouldn't lose heart. After every crisis-led sell-off there is usually a period of significant out-performance of REITs over the direct property market. As we are already approaching halfway through a standard trough, I expect I will start filling my boots towards the end of this year.

Bear: But the listed REITs market is … well … so volatile. All that craggy roller-coaster stuff is hardly conducive to long-term investment. I much prefer the gentler slopes of the real market.

Bull: I understand that but, as you know, I have long held the view that direct and indirect property should live side-by-side. You need both, working together in harmony. Blending your short and long-term strategies. And don't forget that the share component also provides you with easy access into some of the heavy-weight sectors, or areas of specific expertise.

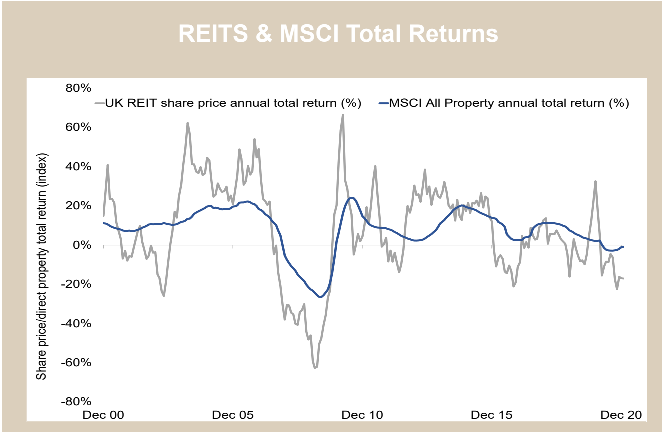
Bear: Not that old chestnut again.

Bull: Absolutely; and don't forget that pooled funds (and mortgages/debt) can play a valuable part in building a comprehensive strategy too.

Bear: Despite their seemingly repetitive liquidity transgressions?

Bull: Yep; you just have to account for the liquidity risk in your overall model. The trouble is that historically, property shares/REITs have been managed by equity managers and property credit has been managed by the fixed income bods. Someone needs to bang heads together and get the whole thing properly choreographed.

Bear: I can see the sense in that. After all, they are all just different variants of property, aren't they?



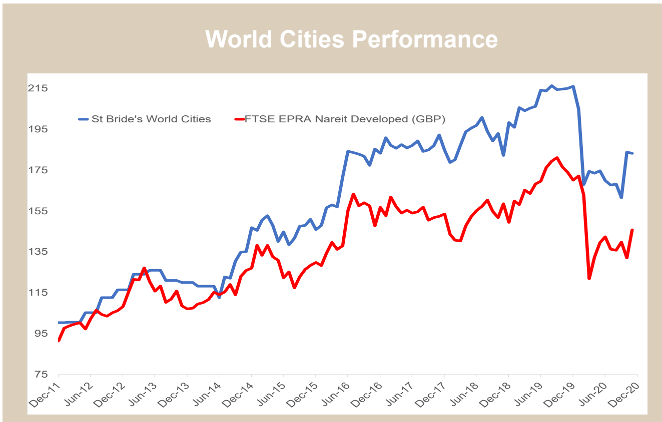
Source: Panmure Gordon

Bull: Yes. And don't forget overseas investment too. Now that we are out of Europe, we really cannot afford to shrink into our domestic shells. Do you remember that World Cities Real Estate Securities portfolio St Bride's launched ten years ago?

Bear: The one where they only invest in companies which have at least an 80% exposure to their Top Twenty World Cities … London, New York, Tokyo, Hong Kong etc?

Bull: That's the one. It has performed really well against the benchmark FTSE NAREIT Index.

Bear: Has it?



Source: St Bride's Managers/ FTSE EPRA NAREIT

Bull: Yes; and it is all-the-more so as there has been a strict ban on any trading of the shares other than when a city has been promoted or demoted from their Top Twenty. It has always been their intention that the portfolio should be tinker-free and agnostic to sector selection. They have simply invested in the world's best managers in the world's best cities. And it has worked.

Bear: It is easy to see that the portfolio's relative past performance has been impressive, but given the horrendous impact of the current pandemic, do you really think that the leading World Cities will continue to out-perform over the next ten years?

Bull: One hundred percent 'Yes'. After all, one of the reasons why the cities get to be ranked in the Top Twenty in the first place is because they are resilient. And London, at Number One, is the most resilient of them all.

Bear: So which UK REITs are included in the World Cities portfolio?

Bull: I am not going to give away too many of their trade secrets, but you will not be surprised to hear that the London component includes Derwent London, Great Portland, Shaftesbury and Workspace. They are all great companies in a great city.

Bear: Really? All four companies are close to the bottom of the UK REITs league table at least in terms of discounts to NAVs. That hardly indicates much investor support for them, does it, particularly as they were all trading at or about par at the start of 2020?

Bull: You are completely missing the point. From a prospective buyer's viewpoint, discounts are great. They mean that you can buy into Shaftesbury's terrific estate in Soho for just 86p in the £ or Derwent's high-grade London office portfolio for 85p in the £. And if you believe in the return of flexible office occupancy, which I know you do, you can buy into Workspace at a really juicy 73p in the £.

Bear: I understand the logic, but who is to say that London property values won't fall further?

Bull: True; that is possible, but if they do, at least you will be sitting on a built-in cushion of 15% or more.

Bear: So, what does that say about the REITs at the top end of the table whose shares are trading at a stonking great premium? For instance, Big Yellow's shares are at a 52% premium.

Bull: That is a fair point. In that particular case, investors can take significant comfort from their diverse tenant base and their strong rent collection track-record which means that the dividend yield of c.3% should be secure.

Bear: What I also find revealing from the list is how each of the different asset classes seem to be clustered together. Near enough all the storage, healthcare and industrial REITs are trading above par and all those specialising in retail, offices and hospitality are below the line … with residential hovering somewhere in the middle.

Bull: Yes; and the spread from top (Big Yellow +52) to bottom (Hammerson -73) is a massive 125 percentage points. This tells me that investors may well be adopting too much of a broad-brush approach.

Bear: The other thing which stands out is the number of REITs with comparatively small market caps. Fifteen of the thirty-three shown in the table are capitalised at below £1 billion, and ten of those are below £500 million. Is that sustainable?

Bull: The sector has been calling for some significant consolidation for years, but to little avail. And I am not sure that it is going to happen this time around either. Perhaps the most likely candidates are Shaftesbury and Capital & Counties whose estates are almost adjacent to each other (Covent Garden and Soho). However, even though Capital & Counties acquired a 25% stake in Shaftesbury last year, I still wouldn't hold my breath, if I were you.

Bear: I guess the other stand-out is SEGRO. What a success story they have been recently. With a market cap now of £11.5 billion they are 2.5 times larger than Land Securities, the sector's historic bell-weather stock. And, given investor demand, they didn't seem to have any difficulty in raising £680 million last year for further European expansion.

Bull: Bully for them, I say. It is great to have a real success story in our own backyard.

Bear: Okay; in no more than 30 words, what is your advice for investing in UK REITs this year?

Bull: That is easy – BUY now those sectors which are above the par line. Then SWITCH to those below the line once there is a clear plan to escape from our COVID-jail. And enjoy the ride!

Bear: That's 33 words. It is just typical of you to be 10% above the mark.

Bull: That is why they call me Mr Bull. See you next Sunday.

UK REITs League Table

REIT	Market Cap £bn	Sector	Premium / Discount %
Big Yellow	2.0	Self-storage	+52
Safestore	1.6	Self-storage	+45
Shurgard	3.4	Self-storage	+39
Primary Health	1.9	Healthcare	+29
Assura	1.9	Healthcare	+27
SEGRO	11.5	Industrial	+24
LondonMetric	2.0	Industrial, RW	+23
Unite	3.8	Student Accom	+13
Supermarket REIT	0.7	Supermarkets	+7
Tritax Big Box	3.1	Industrial	+6
Target Healthcare	0.5	Healthcare	+6
Sector Average			**+1**
Urban Logistics	0.4	Industrial	0
Civitas	0.7	Social Housing	-1
Triple Point	0.4	Social Housing	-1
Picton	0.5	Diversified	-7
Grainger	1.8	Residential	-7
PRS REIT	0.4	Residential	-9
GCP Student Living	0.7	Student Accom	-12
St Modwen	0.9	Industrial, Resi	-12
Shaftesbury	2.2	Retail, Offices	-14
Derwent London	3.5	Offices	-15
Great Portland	1.6	Offices, Retail	-17
Secure Income REIT	1.0	Hotels, Leisure	-19
Regional REIT	0.3	Offices, Industrial	-23
Cap & Counties	1.4	Retail	-24
Workspace	1.3	Offices	-27
Helical	0.4	Offices	-28
British Land	4.3	Offices, Retail	-30
Emperic	0.4	Student Accom	-35
McKay Securities	0.2	Offices, Industrial	-37
Land Securities	4.5	Offices, Retail	-40
Capital & Regional	0.1	Retail	-71
Hammerson	0.9	Retail	-73

Source: Panmure Gordon/ Stifel. Data as at 13 February 2021