Core Property
Fund Research & Ratings
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Listed Property

Reporting Season Wrap Up
December 2017 results

27 March 2018

A summary and update of the major listed A-REIT results for the December 2017 period

Reporting Season Review for December 2017 results

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About Core Property Research

Core Property Research Pty Ltd was established in July 2017 to provide market leading and insightful research on the property funds sector for its clients and investors. Our ratings and research covers sector level research, ratings and recommendations on listed and unlisted property funds, and is built upon the extensive research experience of its staff.

The Core Property team collectively, has over 50 years' experience across property, financial services and investment markets. The team has also evaluated over 500 different funds across multiple sectors and a range of investment structures over the last decade.

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27 March 2018

Reporting Season – Wrap Up

Key Picks:

Yield and P/NTA

Code	Prem (Disc) to NTA	FY18 Yield
PLG	2.1%	7.3%
CIP	2.8%	7.7%
AOF	-1.7%	6.9%
CMA	-3.8%	7.9%
CQR	-8.4%	7.4%
GDF	-3.4%	7.8%
CRR	-3.9%	7.3%
VVR	-5.7%	6.9%

Throughout February 2018, the listed A-REITs reported their results for the December 2017 period. Core Property reviewed the results of 28 AREITs and published weekly updated reports during the reporting season. The key picks mentioned in the left hand column are based on valuation screens (Prem/disc to NTA, FY18 distribution yield) and management commentary. While several large and high quality AREITs have been left out, we remain focused on value rather than weighting in the index. The key themes are summarized below:

- **Industrial sector remains strong:** The industrial sector reported a very strong result with occupancy levels and like-for-like income growth being the highest for 4 years, fueled by strong economic and infrastructure works in NSW and Victoria. Both PLG and CIP offer the best yields in the sector, with both A-REITs directly or indirectly involved in M&A transactions.

- **Office metrics expected to remain resilient for at least another two years:** The Sydney and Melbourne CBD office markets remain buoyant with expectations the market will remain strong for another 2-3 years. Brisbane and Perth have shown early signs of a recovery. AOF and CMA appear to be well placed with fringe/metropolitan assets and trading on strong yields for FY18, with AOF having further potential upside from its Parramatta NSW assets.

- **Retail conditions remain challenging:** The retail environment continues to remain “challenging” with a continual shift in spending patterns, store closures as well as the increased threat from online platforms. Like-for-like growth and Moving Average Turnover (MAT) growth were positive, however, growth rates were at lower levels than previous periods. The uncertain nature of the retail landscape is evidenced by SCG & VCX currently reviewing commercial and residential development options across its portfolios. Whilst VCX trades on a high yield, it has a degree of uncertainty factored in whilst the new CEO undertakes a strategic review. We consider CQR provides an attractive yield at current price levels.

- **Diversified REITs:** Whilst CMW has a forecast FY18 yield of 7.8%, it trades at a 15.6% premium to NTA. Core Property notes that GDF is also yielding 7.8% and trades on a 3.4% discount to NTA.

- **Specialised REITs:** Both CRR and VVR operate convenience and petrol station assets with long WALEs and stable income streams. At current levels CRR and VVR offer attractive yields of ~7.0% with VVR having debt capacity to undertake additional acquisitions. REITs exposed to social infrastructure such as ARF and FET continue their strong growth trajectory at the back of the Federal government’s increased funding to childcare and education.

- **Buyback opportunities:** We expect a number of A-REITs, which are trading at a discount to NTA, will be considering options to buy back their securities in order to drive earnings growth. Potential buy backs may come from IOF (13.1% discount to NTA), CQR (8.4% discount to NTA) and CLW (3.7% discount to NTA). VCX (18.1% discount to NTA) is unlikely to undertake a buyback of its securities until it finalizes its capital requirements for its potential developments.

- **Price performance since results:** A-REITs in our list have increased on average 1.6% since each result was reported albeit with higher volatility. The tables in this report have been updated to reflect the prices as at 23 March 2018, with updated yields and price/NTA calculations.

A summary table of the results is provided on the next page, followed by sector summaries for the Industrial, Office and Retail sectors.

Key Financial & Valuation Metrics

The following table is an update on reported results based on prices as at 23 March 2018.

Key financial and valuation metrics

Code	Price (cps[1])	Operating earnings		Distributions		Leverage		Valuation		Guidance on EPS & DPS		
		EPS (cps)	(% chg)	DPS (cps)	(% chg)	Gearing (%)	Chg (%)	NTA (cps)	Prem/ (Disc) to NTA %	FY18 EPS (cps)	FY18 DPS (cps)	Implied DPU yield
Industrial												
CIP	253	10.1	-6.5%	9.7	-10.2%	40.6%	-2.5%	246	2.8%	19.5–20.0	19.4	7.7%
GMG	829	23.3	7.9%	13.75	8.3%	6.4%	-0.5%	438	89.3%	46.5	28.0	3.4%
IDR	252	9.1	-7.1%	8.2	2.5%	32.2%	1.4%	257	-1.9%	18.4-18.6	16.5	6.5%
PLG[2]	99.5	5.52	185%	3.6	133%	30.6%	0.1%	97.5	2.1%	9.0	7.3	7.3%
Office												
AOF	227	8.6	-5.5%	7.8	5.4%	33.0%	6.0%	231	-1.7%	17.2	15.6	6.9%
CMA	230	9.4	2.2%	9.05	3.4%	29.6%	0.1%	239	-3.8%	18.6	18.1	7.9%
IOF	430	15.3	2.7%	10.15	1.5%	23.8%	2.4%	495	-13.1%	30.3	20.3	4.7%
GDI	122.5	3.865	-18.4%	3.875	0%	9.5%	1.5%	112	9.4%	NA	7.75	6.3%
Retail												
CQR	384	15.3	0.7%	14.0	-0.7%	33.9%	0.8%	419	-8.4%	30.4–30.6	27.4-29.1	7.4%
SCG	383	24.29	4.25%	21.73	2.0%	32.1%	-1.8%	424	-9.7%	25.3	22.2	5.8%
SCP	231	7.52	3.2%	6.8	6.3%	32.5%	1.1%	223	3.6%	15.3	13.9	6.0%
VCX	240	19.31	-15.9%	8.10	-6.9%	26.6%	1.9%	293	-18.1%	18.0-18.2	18.0-18.2	7.5%
WFD[3]	848	43.0[3]	2.3%	32.3[3]	1.6%	38.1%	-0.3%	658	29.5%	NA	NA	NA
Diversified												
DXS	924	31.6	3.3%	23.7	9.2%	26.5	-0.2%	916	0.9%	NA	47.5-47.7	5.2%
GOZ	332	12.5	-4.6%	11.0	3.8%	35.8%	-2.7%	308	7.8%	24.3	22.2	6.7%
MGR	219	5.8	-6.2%	5.0	2.0%	23.8%	1.7%	220	-0.5%	15.5	11.0	5.0%
SGP	401	18.0	16.9%	13.0	3.2%	23.0%	0.3%	418	-4.1%	35.1–35.6	26.5	6.6%
CNI	139.5	12.1	218%	4.1	78%	13.3	-0.6%	125[3]	11.6%	15.8-16.2	8.2	5.9%
CHC	571	20.4	4.3%	15.6	8.4%	26.8%	6.7%	369	54.7%	37.0	31.45–35.15	5.8%
CLW	387	13.0	1.8%	13.7	6.9%	28.6	-1.3%	402	-3.7%	26.4	26.4	6.8%
GDF	115	4.63	-8.0%	4.5	-4.3%	27.1%	-4.6%	119	-3.4%	8.6 – 9.0	9.0	7.8%
CMW	107.5	4.32	-4.0%	4.2	0%	40.1%	-5.1%	93	15.6%	8.25	8.34	7.8%
GPT	468	30.77	3.0%	24.6	5.1%	24.4%	0.3%	504	-7.1%	31.7	25.3	5.4%
Specialised												
ARF	222	6.42	5.1%	6.4	9.4%	24.0%	-3.5%	189	17.5%	NA	12.8	5.8%
FET	276	8.3	10.7%	7.55	6.3%	26.8	-0.9%	267	3.4%	NA	15.1	5.5%
CRR	270	8.1	NA	8.1	NA	29.3%	-0.7%	281	-3.9%	18.3-18.6	18.1	7.3%[2]
VVR	200	13.41	NA	13.2	NA	32.1%	-1.7%	212[4]	-5.7%	13.81-13.91	13.81-13.91	6.9%
BWP	301	8.78	1.6%	8.78	1.7%	19.8%	-0.6%	282	6.7%	17.8	17.8	5.9%

Note 1: Price as at 23 March 2018. Source: Company Announcements, Core Property Note 2: CRR FY18 yield is based on 6.7% yield for 11 months, equivalent to 7.3% p.a. Note 3: WFD's EPS, DPS and NTA are reporting in US dollars. We have assumed a conversion rate of 1.00 USD = 0.79 AUD. Note 4: VVR NTA of $2.19 adjusted to $2.12 for the Dec 2017 distribution of $0.066.

Industrial Sector Review

The industrial sector delivered solid results for the December 2017 period off the back of strong economic conditions in NSW and Victoria driving higher demand for industrial sites. Occupancy levels were up, and like-for-like growth increased by around 3% across the board, providing very favourable conditions for industrial operators. The strong conditions are expected to continue in the near term off the back of infrastructure spending.

Core Property considers both PLG and CIP to provide an attractive distribution yield of 7.3% - 7.7%, however we note that CIP debt levels of are relatively higher at 40.6%. Both CIP and PLG improved occupancy levels and reported the biggest reduction in capitalisation rates. Both A-REITs, either directly or indirectly, are subject to M&A activity. However, from a valuation perspective (using the Price/ NTA, and forecast distribution yield), the current pricing does not factor in a big takeover premium.

The pure industrial A-REITs are currently attractive takeover targets, with a number of cross shareholdings currently in place.

- CIP: 19.9% is owned by Centuria Capital Group (ASX: CNI) and its associates
- PLG: 19.89% is owned by e Shang Redwood (backed by private equity giant Warburg Pincus)
  9.3% is owned by CNI
  7.7% is owned by CIP
- IDR: 18.2% is owned by GOZ (purchased in July 2017 at around $2.30 per unit)
  14.2% is owned by APN Property Group
  7.4% is owned by APN Funds Management

1H18 Results to 31 December 2017

Key financial and valuation metrics

Code	Price (cps[1])	Operating earnings	Distributions		Leverage	Valuation	Guidance on EPS & DPS		
		(% chg)	DPS (cps)	(% chg)	Gearing (%)	Prem/ (Disc) to NTA %	FY18 EPS (cps)	FY18 DPS (cps)	Implied DPU yield
CIP	253	-6.5%	9.7	-10.2%	40.6%	2.8%	19.5-20.0	19.4	7.7%
GMG	829	7.9%	13.75	8.3%	6.4%	89.3%	46.5	28.0	3.4%
IDR	252	-7.1%	8.2	2.5%	32.2%	-1.9%	18.4-18.6	16.5	6.5%
PLG	99.5	185%	3.6	133%	30.6%	2.1%	9.0	7.3	7.3%

Note 1: Price as at 23 March 2018. Source: Company Announcements, Core Property

Key Metrics

The industrial sector delivered its strongest performance in four years with the highest occupancy levels and like-for-like growth in income.

Effectively, a combination of high occupancy rate, improving income growth and maintaining Weighted Average Lease Expiry (WALE) profile of around five years has in turn supported investors being attracted to the asset class.

The biggest driver of performance has been the compression in cap rates (or higher multiples of income) which has triggered strong capital appreciation of assets.

Market Outlook

Core Property expects the industrial property sector to remain strong through FY18/FY19 as increasing demand continues to drive the market. Construction activity has increased off the back of stronger economic conditions in NSW and Victoria. Initial signs are that capitalisation rates will continue to fall as valuation increase and yields soften.

The Sydney market remains positive supported by strong leasing activity, lower vacancies and increasing land values. A number of industrial developments will come to the market during 2018, including Dexus' Dolerite Way (31,000 sqm, due to complete in September 2018), Goodman's Erskine Park Road (31,000 sqm), Stockland's Ingleburn Logistics Park (37,000 sqm), and two projects in Eastern Creek (a 30,000sqm and 11,000sqm facility).
The Melbourne market is expected to maintain reasonable growth, supported by population growth and a pipeline of infrastructure projects.

Key industrial sector metrics

Key Industrial Metrics	Dec-13	Jun-14	Dec-14	Jun-15	Dec-15	Jun-16	Dec-16	Jun-17	Dec-17
Occupancy	96.2%	95.8%	96.1%	95.7%	96.2%	96.2%	96.6%	96.3%	97.5%
LFL growth %	2.4%	2.1%	2.6%	2.5%	0.9%	0.8%	1.6%	2.3%	3.0%
Cap rate %	8.3%	8.1%	7.8%	7.6%	7.3%	7.1%	7.0%	6.7%	6.6%
WALE (years)	5.5	5.7	5.7	5.7	5.7	5.6	5.7	5.7	5.5

Source: Core Property based on average reported metrics

Capitalisation Rates

At an aggregate level over a two-year period, based on A-REITs with exposure to the industrial sector, capitalisation rates have firmed by 50bps. However, there is a notable variance among these AREITs. The biggest movements in capitalisation rates were in the PLG and CIP portfolios (-36bps and -31bps), both of which are rumoured takeover targets. Core Property expects capitalisation rates to continue to reduce for industrial properties as demand for investment grade stock remains high in the near term.

Capitalisation Rates for listed Industrial portfolios

Capitalisation Rates – Industrial Portfolio	Jun 16	Dec 16	Jun 17	Dec 17	Dec 16 Change	Jun 17 Change	Dec 17 Change
CIP	7.45%	7.42%	7.33%	7.02%	-3bps	-9bps	-31bps
DXS	7.38%	7.28%	6.88%	6.65%	-10bps	-40bps	-23bps
GMG	6.40%	6.00%	5.90%	5.70%	-40bps	-10bps	-20bps
GPT	6.81%	6.54%	6.39%	6.31%	-27bps	-15bps	-8bps
IDR	7.62%	7.50%	6.70%	6.70%	-12bps	-8bps	0bps
MGR	6.56%	6.37%	6.37%	6.33%	-19bps	0bps	-4bps
SGP	7.30%	7.20%	7.00%	6.90%	-10bps	-20bps	-10bps
PLG	NA	7.40%	7.22%	6.86%	NA	-18bps	-36bps
GOZ	7.10%	7.10%	6.90%	6.80%	0bps	-20bps	-10bps
Average	**7.08%**	**6.98%**	**6.74%**	**6.59%**	**-10bps**	**-24bps**	**-16bps**

Source: Company Announcements, Core Property

Office Sector Review

The office sector has remained strong with average like for like income growth of 3.6% recorded during the December 2017 results (unweighted average). This growth can largely be attributed to an increase in market rents as well as a big reduction in tenant incentives in the core markets of Sydney and Melbourne. The other CBD office markets are either flat or leasing conditions have been challenging.

Investor demand for quality office assets remains elevated and offshore investors continue to be the dominant group amongst buyers of office assets. Australia is one of the preferred destinations for these investors and continue to allocate nearly 10% of the pan Asian asset allocation strategy.

As such, demand for Sydney/Melbourne CBD office assets is expected to continue and the A-REITs with the highest exposure to these markets (IOF, DXS and GPT) are trading on FY18 yields of around 4.8 – 5.2%.

Occupancy levels improved primarily through acquisitions of full occupied assets (AOF and CMA) or driven by market thematics in Sydney where several buildings have been withdrawn from the market to make way for new rail infrastructure and residential developments. Capitalisation rates firmed on average by 18bps in the 6-month period, at a slower pace than the 21bps reduction previously.

Core Property sees value in fringe CBD office A-REITs such as AOF and CMA, which are trading on 7.0%-7.6% yields; whilst GDI trades on a 6.4% yield and is highly leveraged to the Perth CBD office market.

1H18 Results to 31 December 2017

Key financial and valuation metrics

Code	Price (cps[1])	Operating earnings	Distributions		Leverage	Valuation	Guidance on EPS & DPS		
		(% chg)	DPS (cps)	(% chg)	Gearing (%)	Prem/ (Disc) to NTA %	FY18 EPS (cps)	FY18 DPS (cps)	Implied DPU yield
AOF	227	-5.5%	7.8	5.4%	33.0%	-1.7%	17.2	15.6	6.9%
CMA	230	2.2%	9.05	3.4%	29.6%	-3.8%	18.6	18.1	7.9%
IOF	430	2.7%	10.15	1.5%	23.8%	-13.1%	30.3	20.3	4.7%
GDI	122.5	-18.4%	3.875	0%	9.5%	9.4%	NA	7.75	6.3%
CMW (94%)	107.5	-4.0%	4.2	0%	40.1%	15.6%	8.25	8.34	7.8%
DXS (84%)	924	3.3%	23.7	9.2%	26.5%	0.9%	NA	47.5-47.7	5.2%

Note 1: Price as at 23 March 2018. Source: Company Announcements, Core Property

Office Sector – Key Portfolio Metrics

Key Office Portfolio Metrics

	Dec-13	Jun-14	Dec-14	Jun-15	Dec-15	Jun-16	Dec-16	Jun-17	Dec-17
Occupancy	93.7%	95.1%	95.4%	94.5%	94.6%	94.7%	95.1%	95.0%	93.9%
LFL growth %	2.4%	1.4%	1.0%	2.7%	3.4%	2.5%	5.9%	3.4%	3.4%
Cap rate %	7.8%	7.7%	7.6%	7.4%	7.0%	6.87%	6.60%	6.40%	6.21%
WALE (years)	5.1	4.8	5.0	4.8	5.2	5.0	5.2	5.0	4.9

Source: Company Announcements, Core Property

Occupancy Levels

Despite the strength of the office market in the Sydney and Melbourne markets, it was interesting to see overall occupancy levels fall across the listed Office sector – five entities recorded declines, three entities increased occupancies and two entities had flat occupancies during the six-month period.

- **Increasing occupancies** were recorded by AOF and CMA who both benefitted from the inclusion of fully occupied acquisitions. MGR also recorded an 0.5% increase in occupancy rates.
- **Declining occupancies** were recorded by portfolios with specific issues including CMW's Tuggeranong ACT site becoming vacant as the tenant moved into new Cromwell-built offices next door. GDI's property at 197 St Georges Terrace, Perth WA was impacted by tenant exits and DXS was also impacted by a tenant exit at 30 The Bond, Sydney, which is currently being re-leased.

Capitalisation Rates

Capitalisation rates were lower by between 7-50bps, with the exception of GDI which increased capitalisation rates by 4bps due to asset sales causing a reweighting of its portfolio to the Perth market (with higher capitalisation rates).

Overall, with the threat of rising bond yields, Core Property expects capitalization rates to remain stable and at best, show only modest reductions over the short to medium term.

Capitalisation Rates – Office Portfolio

	Jun 16	Dec 16	Jun 17	Dec 17	Dec 16 Change	Jun 17 Change	Dec 17 Change
AOF	8.00%	7.80%	7.50%	7.00%	-20bps	-30bps	-50bps
CMA	7.90%	7.31%	7.17%	6.87%	-59bps	-14bps	-30bps
CMW	7.10%	6.96%	6.56%	6.34%	-14bps	-40bps	-22bps
DXS	6.20%	5.95%	5.78%	5.50%	-25bps	-17bps	-28bps
GDI	7.60%	7.30%	7.32%	7.36%	-30bps	+2bps	+4bps
GOZ	6.80%	6.50%	6.30%	6.10%	-30bps	-20bps	-20bps
GPT	5.60%	5.55%	5.25%	5.18%	-5bps	-30bps	-7bps
IOF	6.20%	6.01%	5.74%	5.56%	-19bps	-27bps	-18bps
MGR	6.20%	5.96%	5.92%	5.81%	-24bps	-4bps	-11bps
SGP	7.00%	6.70%	6.40%	6.30%	-30bps	-30bps	-10bps
Average	**6.87%**	**6.62%**	**6.40%**	**6.21%**	**-26bps**	**-21bps**	**-18bps**

Source: Company Announcements, Core Property

Market Outlook

The Sydney CBD office market is expected to remain strong in the short term. Low supply and limited construction activity in the next 2-3 years is likely to be offset by office withdrawals and demand for space. Although developers are responding to the strong conditions, new developments appear to be modest.

- The key beneficiaries of the Sydney CBD office market include IOF (63% of portfolio), DXS (60% of office portfolio is in CBD/fringe locations), GPT (56% of the office portfolio is located in NSW). The fringe Sydney/NSW office locations are also impacted by the Sydney CBD office market - AOF has 24% of its portfolio in the Parramatta office market and CMA has 32% of its portfolio in fringe NSW office assets.

The Melbourne CBD office market is also expected to remain strong over the next 1-2 years, driven by the strong Victorian economy and population growth. Over the medium term (FY19 onwards) a number of new developments is likely to have a moderating effect on the market.

- The key beneficiaries of the Melbourne CBD office market include IOF (16% of portfolio) and GPT (32% of office portfolio located in Victoria). The fringe Melbourne office locations are also impacted by the Melbourne CBD office market - GDF has 44% of its portfolio in Melbourne fringe office assets and GOZ has 14% of its portfolio in Melbourne fringe office assets.

The Brisbane CBD office market appears to have stabilized with a mixed outlook – prime locations continue to show strength, however the secondary market continues to remain soft. Overall market conditions suggest a recovery is underway.

- The key beneficiaries of the Brisbane CBD office market include DXS (15% of office portfolio is located in Qld), IOF (15% of portfolio), AOF (25% of portfolio). GOZ has 19% of its portfolio in Brisbane fringe office assets.

The Perth CBD office market has shown signs of bottoming with rents stabilizing during 2017. There are early signs of a turnaround, however the market remains dependent on the resources sector and we would be looking for stronger signs of growth for the property market to benefit.

- GDI has 74% of its portfolio in the Perth CBD office market.

CBD office market commentary for the December 2017 results

Select Market Commentary – Key CBD markets

Market	Commentary
Sydney CBD	**GPT:** "Vacancy contraction and net rent growth forecast for medium term. Net supply to remain low with limited construction in short term." Forecast net effective rental growth 10% (12 months), forecast average vacancy ~5% (3 years) **IOF:** "Supply cycle to dominate leasing market conditions. Near term: weak supply through 2018 to reflect further pipeline of office withdrawals and little new supply. Medium to long term: the development cycle is activating and the supply outlook is improving. Underlying demand is expected to largely absorb future supply…the supply outlook looks modest" **DXS:** "The rate of supply during FY18-FY22 to be less than half of supply in FY16-FY17 (including Barangaroo). Demand expected to largely absorb the supply keeping vacancy at or below average …solid fundaments to support growth"
Melbourne CBD	**GPT:** "Continued vacancy tightening and rent growth next two years. Demand fueled by strong Victorian economy and population growth." Forecast net effective rental growth 11% (12 months), forecast average vacancy ~6.5% (3 years) **IOF:** "Melbourne development cycle to ease market conditions. Short term: Melbourne market has another strong year ahead before the next supply cycle starts to impact market conditions. Medium to long term: from 2019, ANZ Docklands, Vic Police Headquarters, Collins Arch, Olderfleet, 80 Collins South will begin the supply cycle…. Office demand conditions positive…new office supply expected to provide further attraction for external tenants to migrate to Melbourne CBD" **DXS:** Short term outlook is for growth given vacancy is below average"
Brisbane CBD	**GPT:** "Ongoing demand recovery has stabilized vacancy, with rental growth to turn positive. No supply forecast for 2018 and to remain moderate over medium term." Forecast net effective rental growth 5% (12 months), forecast average vacancy ~15% (3 years) **IOF:** "Leasing market to find new equilibrium. Withdrawals to drive conditions to 'new norm'….10-12% vacancy is the new 6-8%...Prime office market leading Brisbane CBD cycle, while secondary market conditions remain soft" **DXS:** "Market is well into recovery phase given falling prime vacancy…fundamentals improving with demand positive over the past year"
Perth CBD	**IOF:** "On the path to recovery…Net absorption has turned the corner…flight to quality…elevated incentives, easing face rents and excess capacity has supported tenant upgrading activity…Secondary market outlook: absorption turnaround and largest effective rent differential in 12 years could ease 'flight to quality' trend" **DXS:** "Conditions have improved as the drag from mining investment ends. Market has bottomed with positive take up and vacancy declining. Well placed for recovery with rents stabilising in 2017... fundamentals improving with demand positive over the past year"

Source: Company Announcements

Retail Sector Review

Perhaps, the sector with the strongest headwinds has been the retail sector, a market darling for over three decades. Retail spending remains subdued, heightened by the increased threat of online competitors including Amazon's soft launch in Australia. In addition, the number of retail businesses being closed or under threat of closure has escalated during the past 12 months.

Whilst the listed A-REITs reported positive growth, growth rates have progressively declined over the past few years. The nature of retailing is undergoing structural change and Core Property expects this will continue in the near term, creating uncertainty for the retail A-REITs.

The changing nature of retail has prompted VCX, under its new CEO Grant Kelley, to undertake a review of its centres in order to consider development opportunities including residential and commercial options. Core Property notes that SCG is also looking at similar development options as well.

CQR currently appears attractive, trading on a 7.4% yield for FY18 and an 8.4% discount to NTA. SCP currently has a 4.9% shareholding in CQR.

WFD is one of few AREITs still trading at a significant premium to NTA and is a reflection of the value created by management via valuation uplifts through development and the fees earned on development and management of retail centres globally. In contrast Scentre Group (the spin-off of Westfields Australian assets) trades at a discount to NTA with no value attributed to development and management income.

Perhaps, the potential takeover of WFD by Unibail-Rodamco before June 2018 at the announced metrics provides a floor to pricing. However, WFD securityholders need to be mindful of the impact of currency and Unibail-Rodamco's share price when deciding to vote in favour or against the proposed takeover.

1H18 Results to 31 December 2017

Key financial and valuation metrics

Code	Price (cps[1])	Operating earnings	Distributions		Leverage	Valuation	Guidance on EPS & DPS		
		(% chg)	DPS (cps)	(% chg)	Gearing (%)	Prem/ (Disc) to NTA %	FY18 EPS (cps)	FY18 DPS (cps)	Implied DPU yield
CQR	384	0.7%	14.0	-0.7%	33.9%	-8.4%	30.4-30.6	27.4-29.1	7.4%
SCG	383	4.25%	21.73	2.0%	32.1%	-9.7%	25.3	22.2	5.8%
SCP	231	3.2%	6.8	6.3%	32.5%	3.6%	15.3	13.9	6.0%
VCX	240	-15.9%	8.10	-6.9%	26.6%	-18.1%	18.0-18.2	18.0-18.2	7.5%
WFD	848	2.3%	32.3	1.6%	38.1%	29.5%	NA	NA	NA

Note 1: Price as at 23 March 2018. Source: Company Announcements, Core Property

Retail Sector – Key Portfolio Metrics

Retail Metrics

Key Retail Portfolio Metrics	Dec-13	Jun-14	Dec-14	Jun-15	Dec-15	Jun-16	Dec-16	Jun-17	Dec-17
Occupancy	99.0%	99.2%	99.3%	99.1%	99.1%	99.1%	99.2%	99.1%	99.1%
Cap rate %	6.94%	6.80%	6.64%	6.50%	6.27%	6.15%	5.92%	5.78%	5.66%
LFL income growth	2.2%	2.5%	3.2%	4.3%	5.2%	2.9%	3.1%	2.8%	2.4%
LFL Specialty MAT growth	2.2%	2.5%	3.2%	4.4%	6.0%	3.8%	2.4%	2.0%	1.7%
Specialty MAT Sales per sqm	8,945	9,297	9,352	8,899	9,522	9,387	9,615	9,672	9,704
Specialty MAT Sales/sqm growth		3.9%	0.6%	-4.8%	7.0%	-1.4%	2.4%	0.6%	0.3%

Source: Company Announcements, Core Property, Note: metrics exclude WFD

Average retail sector metrics show a slowdown in the rate of growth for specialty sales over the past 2 years. The slower sales growth translated to an immaterial 0.3% average increase in Specialty sales per sqm, highlighting the challenging retail environment.

However, occupancy levels continued to remain stable across the sector with only a marginal reduction in CQR's occupancy to 97.8% at December 2017 (from 98.0% at June 2017). All other retail A-REITs reported unchanged occupancy levels.

Comparable income or like-fo-like net income growth has been modest barring GPT's result being an outlier. Rents achieved on new leases are below that of in-place tenants and to a certain extent explains the lower income growth.

Portfolio metrics comparison across A-REITs with exposure to large retail malls

Portfolio metrics	WFD (USD)*	SCG*	VCX	GPT*
Occupancy	93.2%	99.5%	99.5%	99.6%
Majors sales growth	-	-0.4%	3.0%	3.10%
Specialty Store sales growth	2.0%	1.5%	-0.7%	0.30%
Specialty stores sales ($/sqm)	7,890	11,201	9,347	11,185
Comparable net income growth	2.2%	2.8%	1.0%	3.80%
Avg specialty rent ($/sqm)	1,011	$1,622	1,383	1,913
Occupancy cost (rent/sales)	12.8%	14.5%	14.8%	17.1%
No. of lease deals completed	-	2,466*	499	402*
Leasing spread	-	-2.4%	0.8%	-1.20%

Source: Core Property

Capitalisation Rates

Capitalisation rates were lower by between 0-34bps during the six-month period. The average movement in capitalisation rates of -13bps is marginally lower than the -14bps movement in June 2017.

It was interesting to note that both SCP and SGP held capitalisation rates flat during the 6-month period, which may be an indication that the reduction in capitalisation rates is drawing to a close. If so, we would expect a number of other retail A-REITs to follow suit during the next reporting period.

Capitalisation Rates for listed Retail portfolios

Capitalisation Rates – Retail Portfolio							
	Jun 16	Dec 16	Jun 17	Dec 17	Dec 16 Change	Jun 17 Change	Dec 17 Change
CQR	6.71%	6.40%	6.31%	6.16%	-31bps	-9bps	-15bps
SCG	5.54%	5.33%	5.25%	4.91%	-21bps	-8bps	-34bps
SCP	7.13%	6.62%	6.47%	6.47%	-51bps	-15bps	0 bps
VCX	5.95%	5.75%	5.61%	5.45%	-20bps	-14bps	-16bps
GPT	5.52%	5.39%	5.28%	5.10%	-13bps	-11bps	-18bps
MGR	6.10%	5.95%	5.67%	5.60%	-15bps	-28bps	-7bps
SGP	6.10%	6.00%	5.90%	5.90%	-10bps	-10bps	0 bps
Average	**6.15%**	**5.92%**	**5.78%**	**5.66%**	**-23bps**	**-14bps**	**-13bps**

Source: Company Announcements, Core Property. Note: table excludes WFD's international operations.

Market Outlook

Retail conditions remain challenging and this has been evidenced by the number of high profile failures over the past 12 months, particularly in the apparel sector, including David Lawrence, Oroton, Marcs, Rhodes & Beckett, Herringbone, Surfstitch, Maggie T and Diana Ferrari. Currently Toys R Us' future is uncertain following its US parent's demise and profit warnings have been issued by Myer Holdings (ASX: MYR) as well as Retail Food Group (ASX: RFG), which run the franchises for Gloria Jeans, Michel's Patisseries, Brumby's Bakeries and Donut King, considering the closure of up to 200 stores nationally.

The A-REITs also continue to manage their way through rising electricity costs, and some have three-year plans in place. However, the costs will rise once these plans roll off. A number of A-REITs have installed solar options to offset these costs.

The growth of online retailing provides the biggest threat, and although Amazon has undertaken a small-scale launch in Australia prior to Christmas 2017, there remains increased concerns about is potential impact on the Australian retail scene, given its market dominance in the US.

- In Australia, ecommerce sales as a percentage of total retail sales is around 6-8%, compared to 15-17% in the US and UK.
- Online sales penetration in Australia is around 60%, compared to 76% in the UK, and 67% in the US.
- Shopping centre density is far higher in the US than in Australia.
- In the USA, Amazon accounts for 43.5% of all online sales, beating out retailers such as Apple, Best Buy, Macy's and Walmart.

Ratings Process for A- REITs

Core Property Research evaluates recommendations on listed A-REITs continuously, based on a range of qualitative and quantitative criteria ranging from management, appropriateness of the A-REIT's capital structure and the property portfolio metrics. From a quantitative perspective, Core Property's recommendations are based on Total Expected Returns (forecast distribution yield plus forecast capital gain or loss) for a 12-month time horizon, using a range of valuation methodologies. The two most commonly used valuation techniques are Discounted Cash Flow (DCF), which uses an A-REI's expected free cash flow, and the net Asset Valuation (NAV) approach.

The 12-month Total Return is compared with set total return bands and assigned a 12-month recommendation based on the Recommendation Definitions below.

Recommendation Definitions

Recommendation	Definition
Buy	If the 12-month Total Expected Return is forecast to be 15% or more.
Accumulate	If the 12-month Total Expected Return is forecast to be at least 10% and less than 15%.
Hold	If the 12-month Total Expected Return is forecast to be at least 5% and less than 10%.
Reduce	If the 12-month Total Expected Return is forecast to be at least 0% and less than 5%.
Sell	If the 12-month Total Expected Return is forecast to be less than 0%.

At times of extreme volatility, it is quite possible that the recommendations will swing between each of our bands. During such times, Core Property will adopt a more flexible approach to recommending stocks, based on a slightly longer duration, and as such, recommendations may appear to be inconsistent when compared with the bands. This is to avoid clouding value judgments with short-termism.

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