Listed trusts show extent of fallout

Report Robert Harley

On Thursday night, 300 property developers, lawyers, real estate agents and politicians gathered at the Sydney Westin for the NSW Urban Taskforce's annual Development Excellence Awards. You might think the mood would be sober. Real estate stocks were falling, interest rates were rising and the spectre of a credit squeeze was in the air.

But you would be wrong. Hardly a flicker of concern crossed the room.

The chairman of the Urban Taskforce, veteran developer Bob Rose, said the real fallout would be very limited. Meanwhile, demand for his product is increasing, with sales at the waterfront Breakfast Point project in Sydney's inner west at six-year highs.

Nevertheless, the financial turmoil is having an impact on property.

The head of real estate at JPMorgan, Tim Church, said the cost of equity and debt had risen, while the currency – important in this time of global property – had gone down.

Most importantly, the attitude to risk had changed and the listed real estate investment trusts show the change.

The key REIT index, S&P/ASX Property 200, is now about 16.5 per cent below the highs of early 2007.

The biggest falls have been in stocks such as Goodman International and Centro Properties Group – which overshot last year and have funds management operations being repriced. Other stocks including the Babcock & Brown Japan Trust have been dragged into the vortex of their parent.

UBS head of research Simon Garing said the fall was "a liquidity issue rather than a fundamental issue".

Property fundamentals around the world remain sound, with strong demand and tightly constrained supply. On the UBS numbers, Australia's REITs are trading at an 11 per cent discount to valuation.

"Only three times since 1993 has it been this cheap," Mr Garing said.

While some investors will return to listed property, Goodman International chief executive Greg Goodman said the volatility on the stockmarket would send many to unlisted property.

Prices have jumped across all sectors of non-residential property in recent years because yields – the returns investors are prepared to accept – have compressed.

In some markets, such as the UK, yield compression has already begun to reverse and the sub-prime turmoil is likely to be the end of the era.

"We've seen the end of firming cap rates," the managing director of fund manager Resolution Capital, Andrew Parsons, said.

Cheap money is going to be harder to find, especially for deals that carry more risk.

The chief executive of CB Richard Ellis in Australia, Tom Southern, said any yield retreat would most likely occur in secondary and riskier property.

John Winter, the marketing director of property finance and investment house Ashe Morgan Winthrop, said the failure of so many sub-prime loans in the US was a warning for Australian lenders to get their lending book in order. "Cheap money is going to start becoming harder to find, especially for deals that carry more risk," he said.

Some lenders may choose to decrease risk by reducing the loan-to-value ratio; others will choose to ratchet up interest rates; and some will do both.

"The days of construction loans of less than 1 per cent above the market indicative bank bill rates are likely to be numbered," he said.