

# The global credit crisis and the impact on AUS-REITs

Presentation at PCA in Adelaide,  
South Australia

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23<sup>rd</sup> April 2008

# Outline

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  - Impact on investment markets
  
- ➔ Impact on AUS-REITs
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# Global credit crisis

# A background to the global credit crisis

## - fallout from an interplay of many factors

- ➔ Weight of capital
  - increased pool of savings
  - focus on yield products (since tech wreck in 2000)
  
- ➔ Relaxed credit conditions
  - low and stable interest rates (in line with low inflation environment)
  - high level of liquidity
  
- ➔ Mis-pricing of risk
  - greater level of embedded leverage in investment products
  - de-risking of investments; reflected in narrower spreads across asset grade
  
- ➔ Unrealised expected investment performance
  - expectations that US (sub-prime) housing would continue to rise

# A background to the global credit crisis - mounting credit losses and write-downs

<b>Sub-prime debt write-downs</b>	
as at April 2008	
<b>Institution</b>	<b>US\$ billion</b>
UBS	38.0
Merrill Lynch	25.0
Citigroup	21.0
Morgan Stanley	12.0
Deutsche Bank	7.0
Credit Suisse	6.0
Bank of America	5.0
Royal Bank of Scotland	3.0
Barclays	3.0
Goldman Sachs	3.0
Bear Stearns	2.6
HBOS	0.5
Lehman Brothers	0.3
<b>Total</b>	<b>126.4</b>

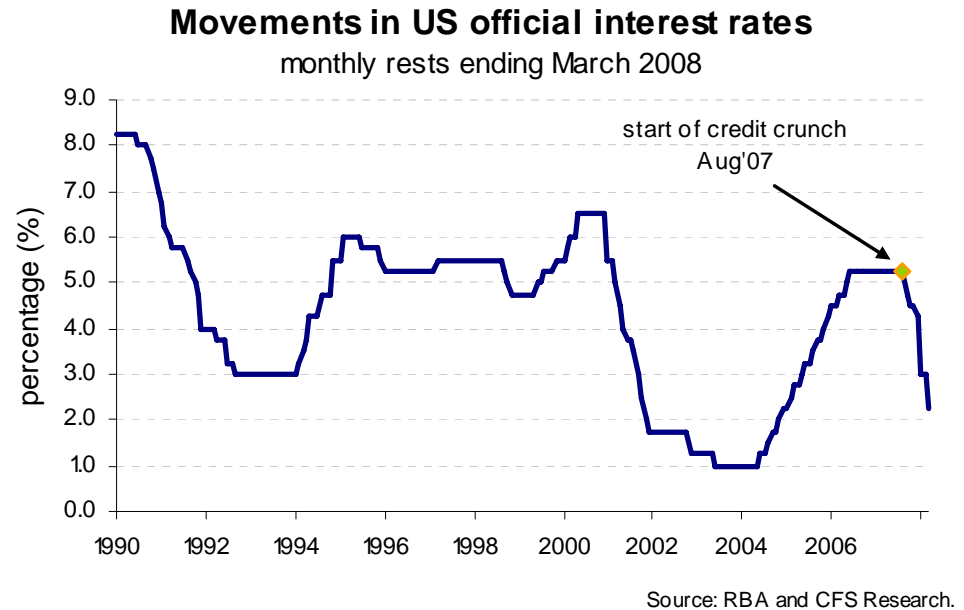
Source: The Guardian & CFS Research

- 5      ↻ The US\$945bn figure reported by IMF is a projection that includes the write downs on the sub-prime, not only on bank balance sheets but also includes potential write downs across other asset classes in the US.

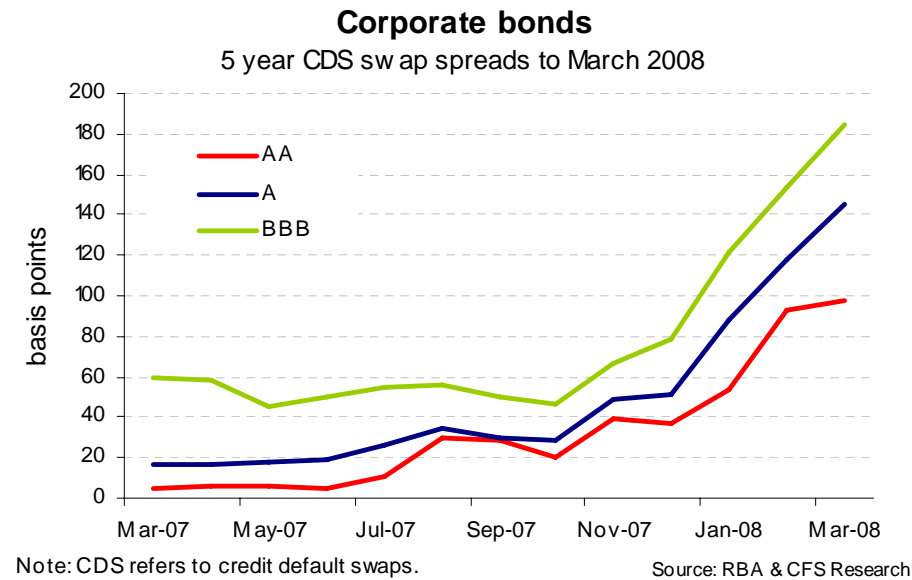
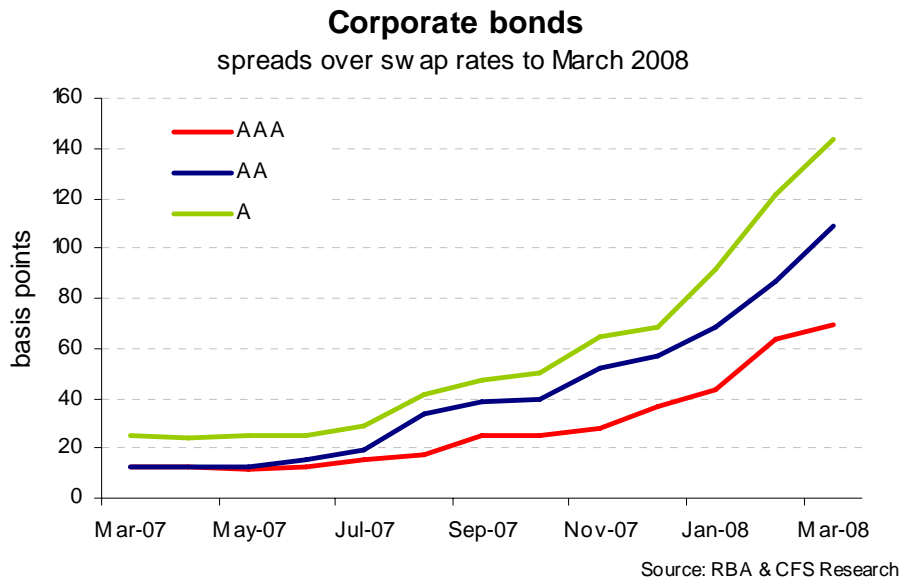
# US policy response to the credit crisis

## - Fed actions aimed at improving confidence

- The Federal Reserve (Fed) took aggressive action following the credit crunch in August 2007, cutting its target interest rate, the Federal Funds rate, by a total of 225 bps over that period.
- The Fed relaxed terms for the provision of credit to help inject liquidity into the financial system.
- On March 16 the Fed approved the buy-out of Bear Stearns by JP Morgan using funding provided by the Fed.
- The Federal govt. is providing a fiscal stimulus package of approx. US\$100 bn aimed at providing funds for households.



# Debt markets hit by repricing of risk - credit spreads rise sharply across quality

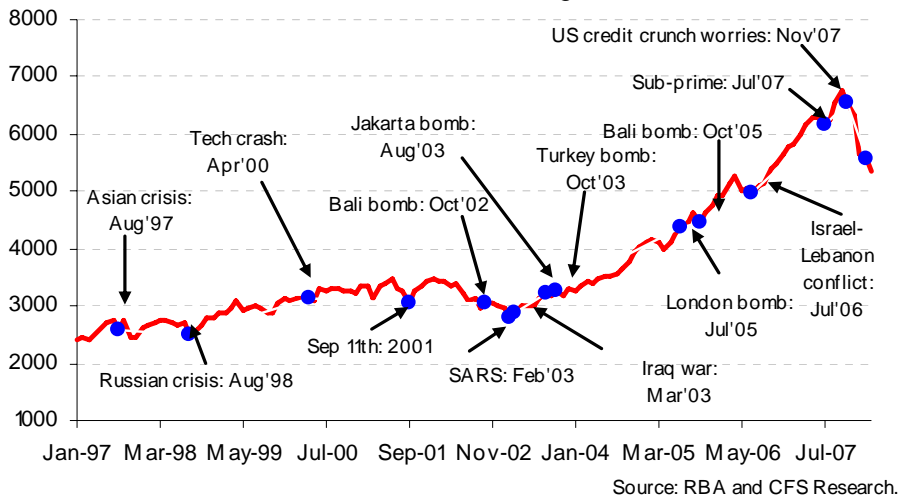


➤ Credit spreads started to widen considerably since late 2007 as the credit crisis started to unfold.

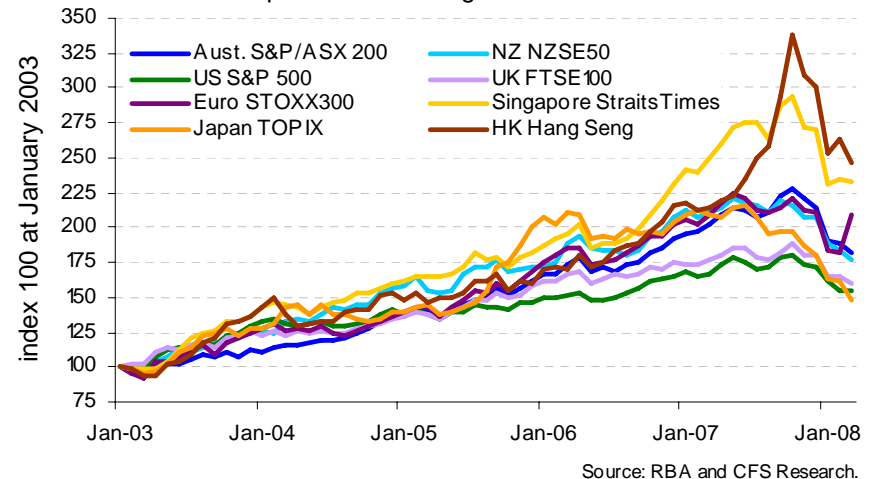
# Listed equity markets tumble

## - upward pricing of risk against growth strategies

**Australian listed share market**  
S&P/ASX 200, Price Index ending March 2008



**Performance in selected listed share markets**  
price index ending March 2008



- Australian S&P/ASX200 records annual price decline of 11% to March 2008.
- Listed equity markets retreat with an upward repricing of risk on many aggressive growth strategies.
- Increased market volatility with greater uncertainty surrounding expected earnings growth and the extent of the US slowdown.

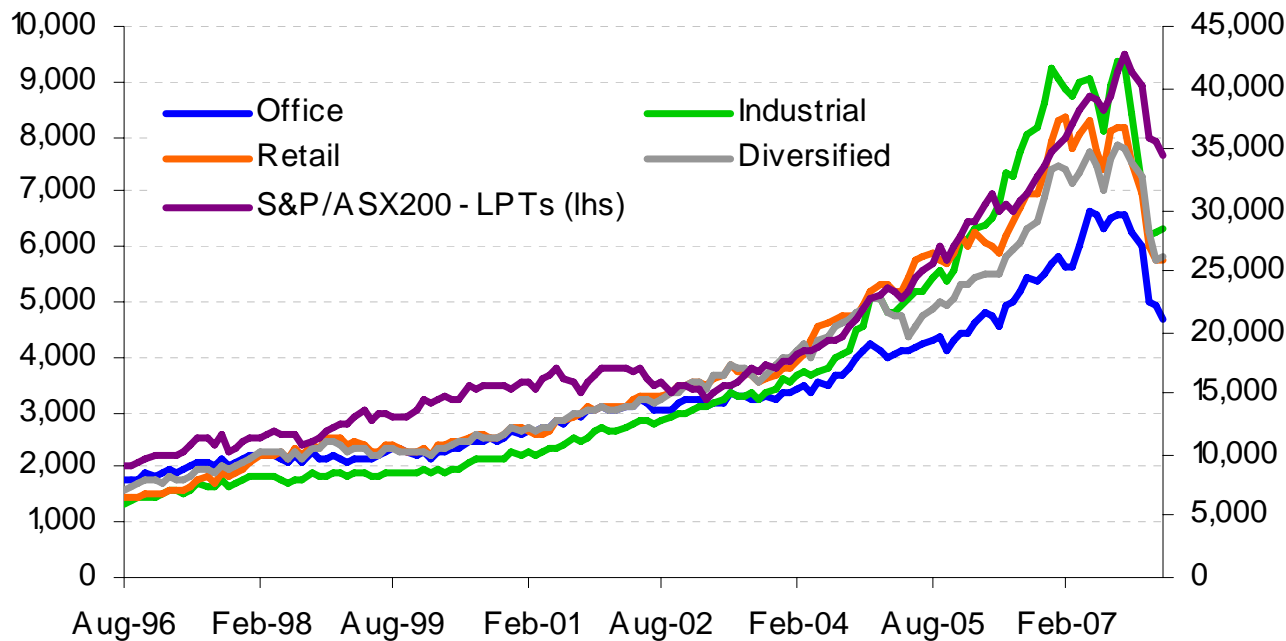
# Impact on AUS-REITs

# AUS-REIT return performance

## - significant falls in prices across all sectors

### AUS REIT sector accumulation indices

monthly rests ending March 2008



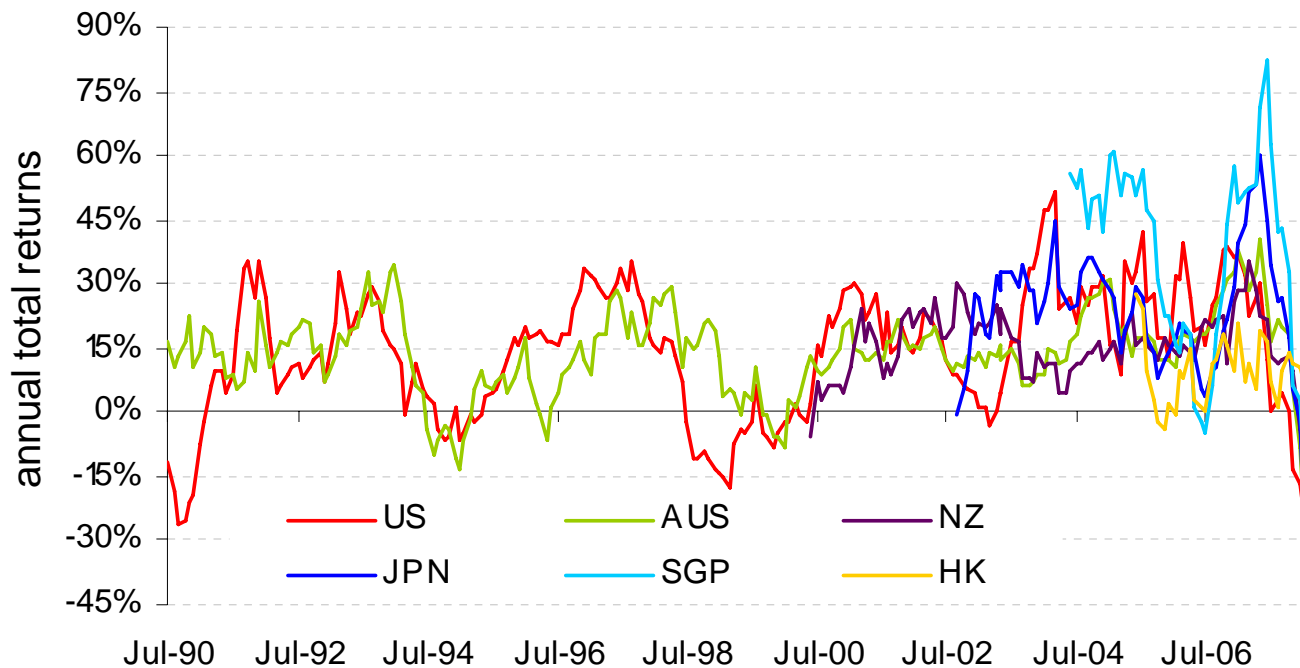
Source: UBS and CFS Research.

- AUS-REITs experience an annual price decline of 27% to March 2008. However, this varies across sub-sector eg. 22% for office; 30% for retail).
- Large declines across individual trusts: Centro Properties Group (CNP) and CentroRetail Group (CER) decline by 97% and 80% respectively.

# Impact across global REIT market - price declines not restricted to AUS-REITs

## Trend in global REIT total return performance

rolling annual returns on monthly rests: as at March 2008

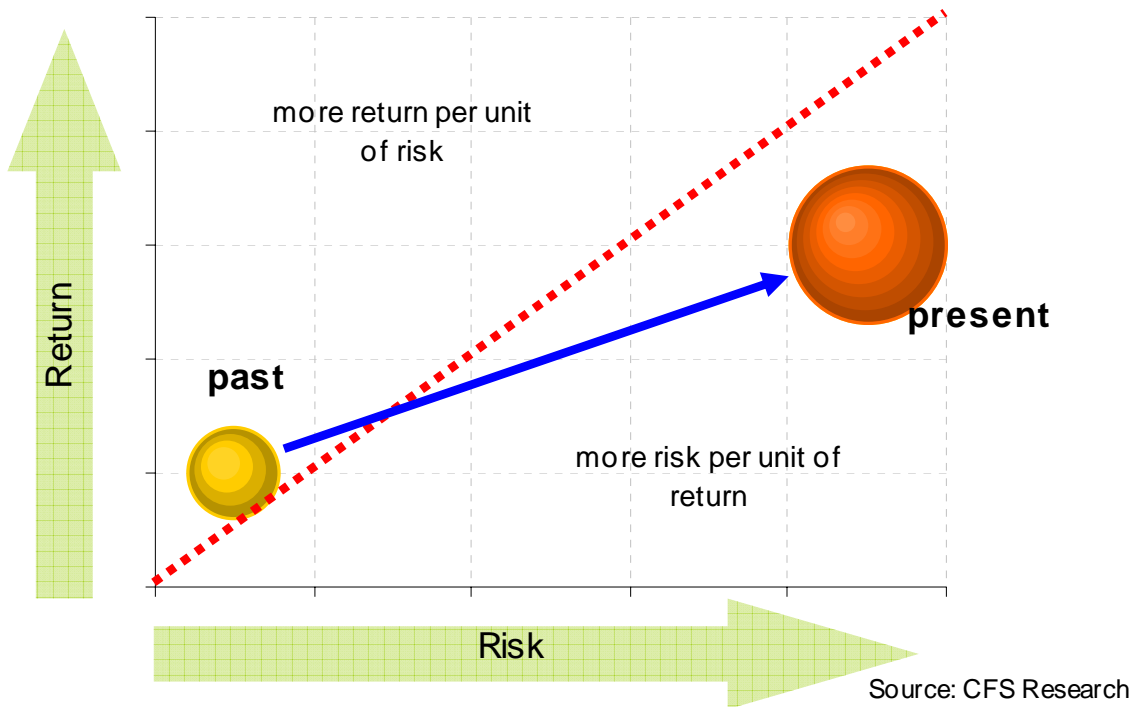


Source: Citigroup and CFS Research.

# AUS-REITs and the risk-return space

## - increasing risk profile with growth strategies

**AUS-REITs: return versus risk**

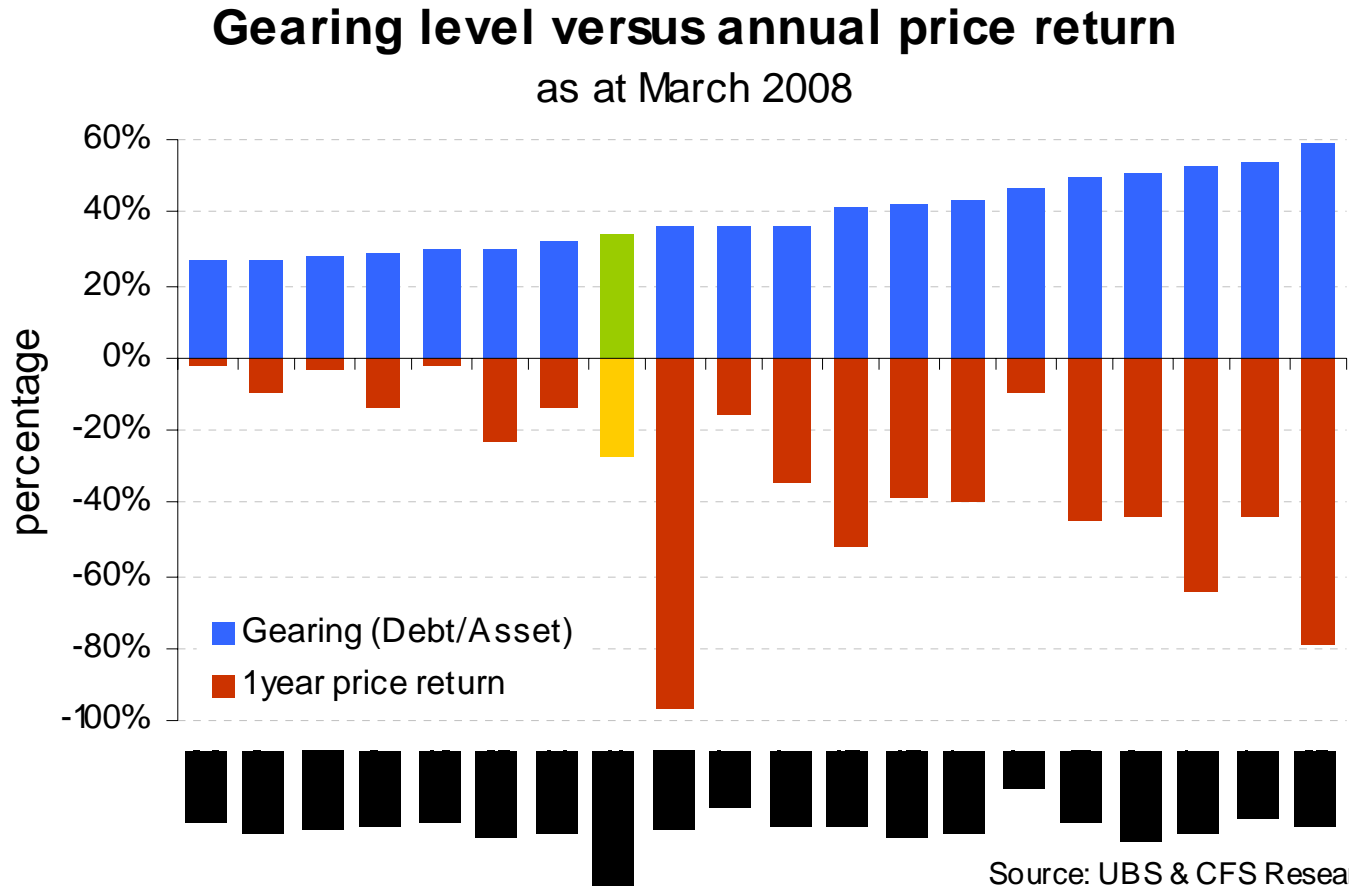


➔ The quest for growth has seen the AUS-REIT sector take on more risk:

- increased gearing levels (currently c35%)
- growing offshore exposure (currently around 40%)
- rise of stapled trusts (over 70% of LPTs are stapled)
- increased market concentration (top 10 trusts comprise 80% of market cap)
- poor capital management & lack of transparency

# AUS-REITs price return versus gearing

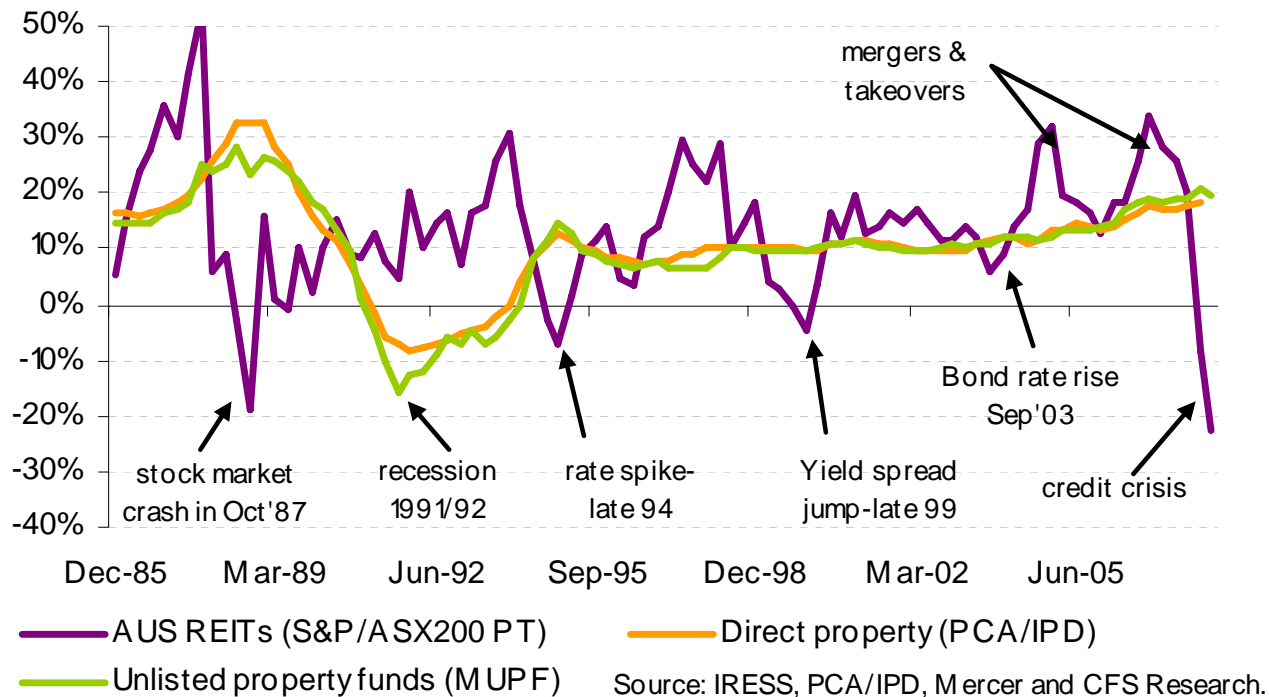
## - trust penalised for carrying too much leverage



# AUS-REITs out of sync with direct property - property fundamentals remain relatively solid

## Performance across property asset classes

Annualised total returns on quarterly rests ending Mar-08



➤ To date, fall-out from credit crisis reflected in capital returns for listed markets.

14 ➤ While space market fundamentals remains relatively solid, capital returns for direct markets to be adversely impacted with a rise in discount rates.

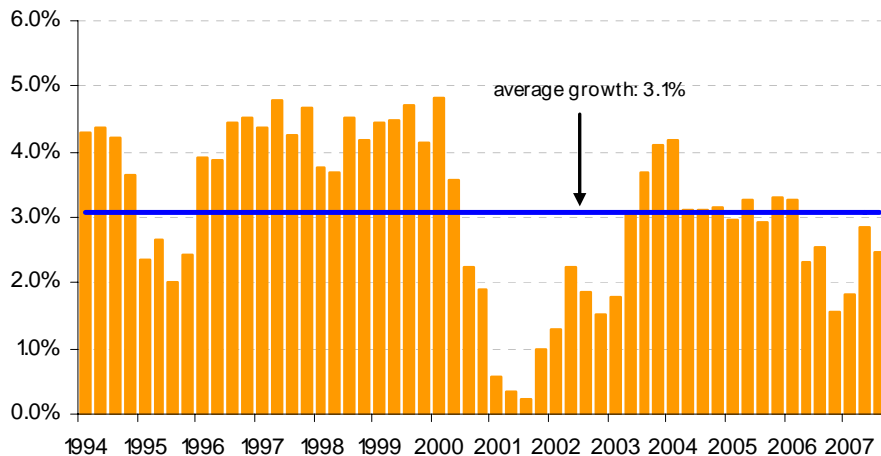
# Outlook on markets

# Global economy set to slow

## - US cooling driven by contraction in housing

### Real GDP growth for USA

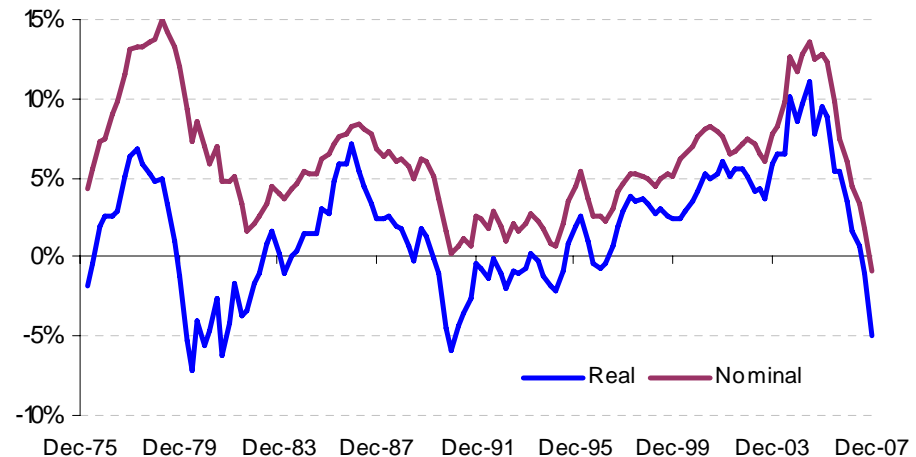
annual growth rate on quarterly rests ending Dec 2007



Source: RBA and CFS Research.

### OFHEO US house price index

annual growth on quarterly rests ending Dec -07



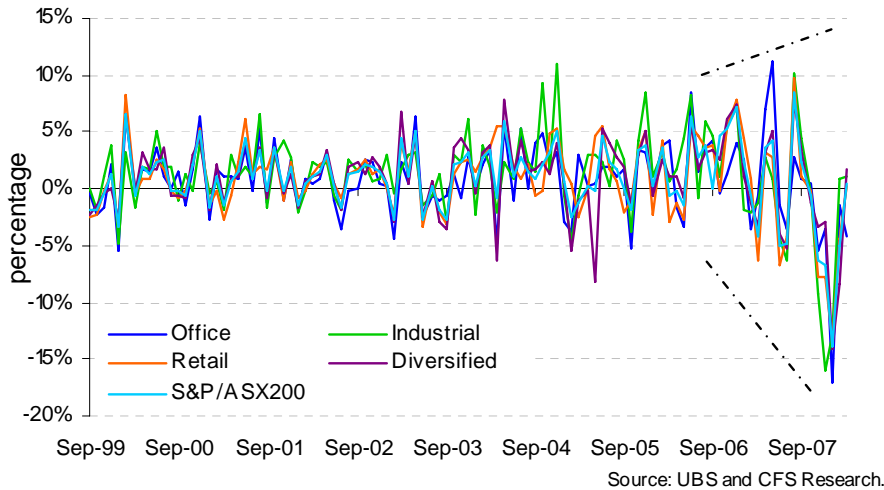
Source: Office of Federal Housing Enterprise Oversight & CFS Research.

- US is significant part of global economy.
- Single-family house prices continue to fall. This contraction is starting to drag retail sales down and push the US into a recession.
- Support for global growth is likely to come from Asia (China & India), although these economies are also set experience more moderate growth.

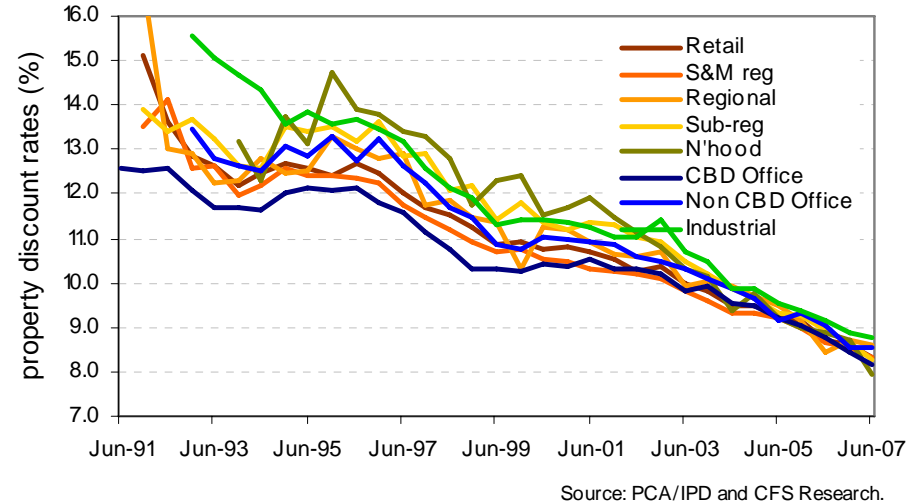
# Property investment markets

## - return volatility rising; yields softening

**AUS-REIT sector return volatility**  
compounding monthly rests to March 2008



**Discount rates for selected property sectors**  
nominal w eighted averages on biannual rests ending Jun-07



- ➔ Listed markets plagued by increased volatility (on the downside). Set to continue until there is steady stream of positive news.
- ➔ REITs & general equities probably close to bottom of the cycle. However, this depends on further deterioration in the US economy & financial sector.

- ➔ Property market discount rates to soften with a re-rating of risk & rising cost of debt.
- ➔ Price softening to restore spread across asset grade – i.e., greater softening in yields for secondary grade than prime assets.

# Summary

# Summary remarks

## - investment opportunities exist but be cautious

### ➔ Economic environment

- growth to moderate in line with global growth & tightening monetary policy
- inflation to remain persistent in the short-term

### ➔ Investment environment

- investors to have greater scrutiny of risk: focus on asset quality
- equity market volatility to persist with uncertainty on growth & losses

### ➔ AUS-REIT sector

- risk: general upward re-pricing of risk across the asset quality spectrum
- pricing: property yields & discount rates experience (cyclical) softening
- sector remains attractive to long-term players, offering risk-adjusted return

### ➔ Property strategies

- buying opportunities of trusts (with discount to NTA, low gearing & high yield)
- focus on defensive trusts unpolluted with aggressive growth strategies
- consider hybrid property products which mitigate market volatility

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