

PROPERTY INVESTMENT STRATEGIES: PERFORMANCE & ALTERNATIVE ASSETS

Presentation at PFA's Annual Conference

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Outline

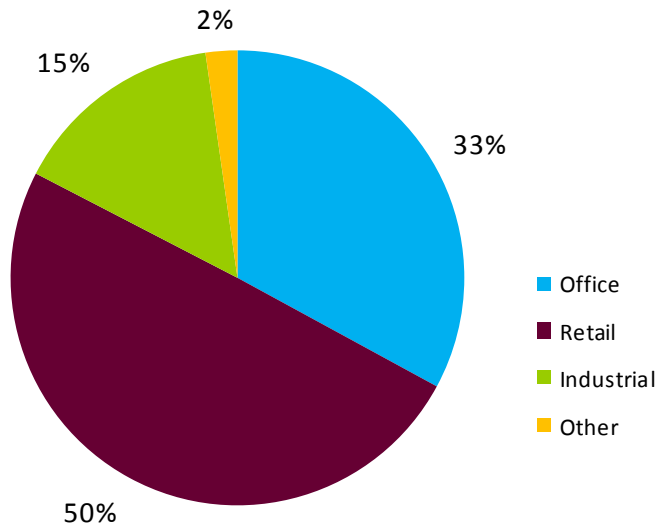
- 1 Property asset pricing**
- 2 Property asset allocation**

Outline

- 1** **Property asset pricing**
- 2 Property asset allocation

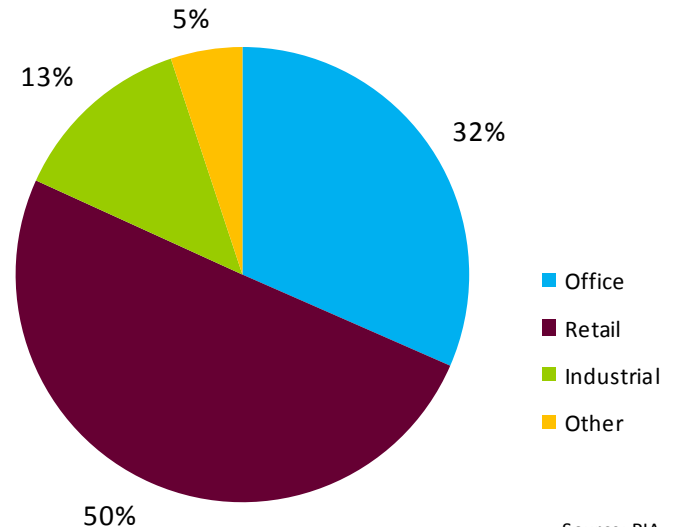
Alternative property sectors: represents a small share but growing quickly

AUS commercial property market by sector
based on asset value (\$) as at Dec 2012



Source: RIA

AUS commercial property market by sector
based on asset value (\$) as at Dec 2017

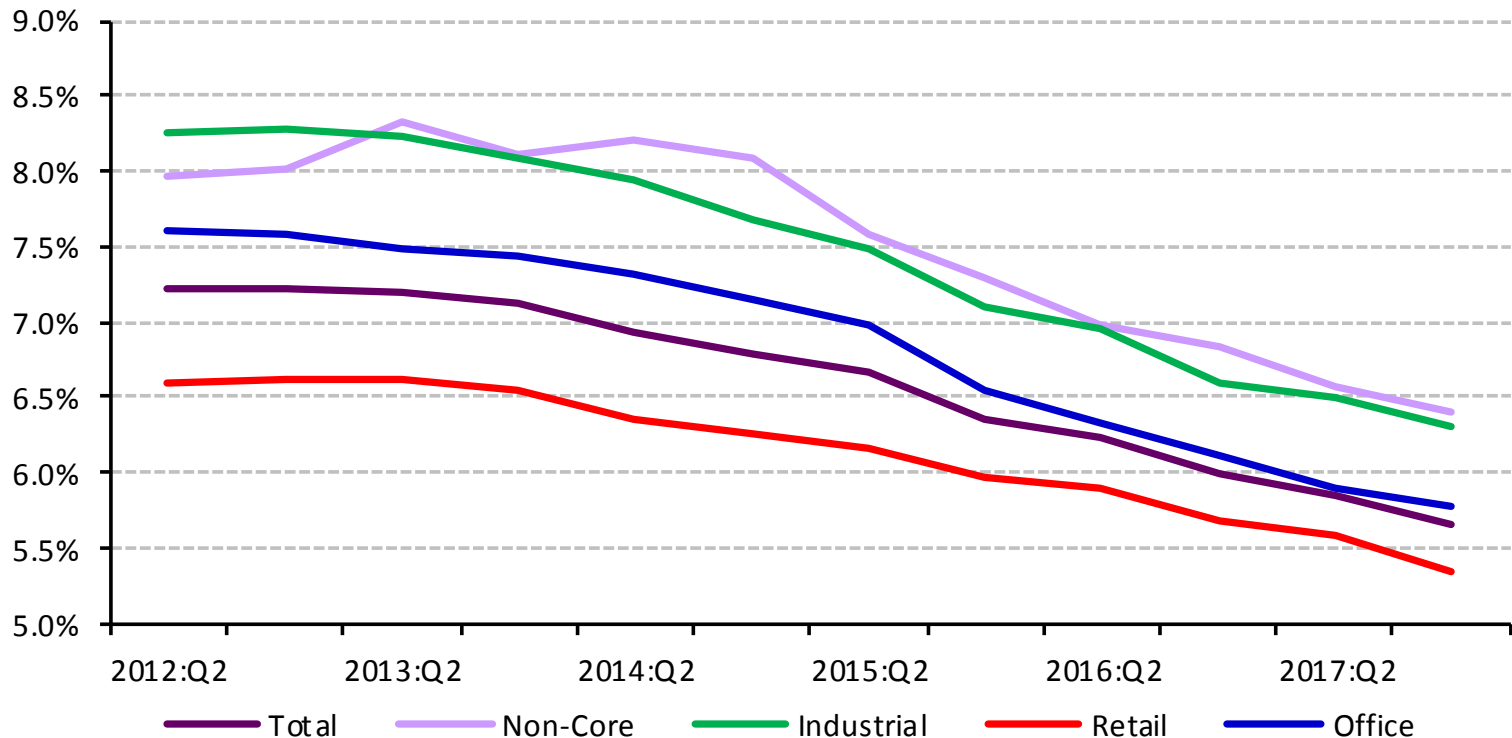


Source: RIA

- Other relates to non-core sectors and includes: aged care / retirement, car parks, child care / early learning, healthcare, hotels, pubs, storage and tourism.
- Values sourced from RIA property database.

Asset pricing for alternatives tends to follow trend for traditional property sectors

AUS commercial property market cap rates by sector
bi-annual periods to December 2017

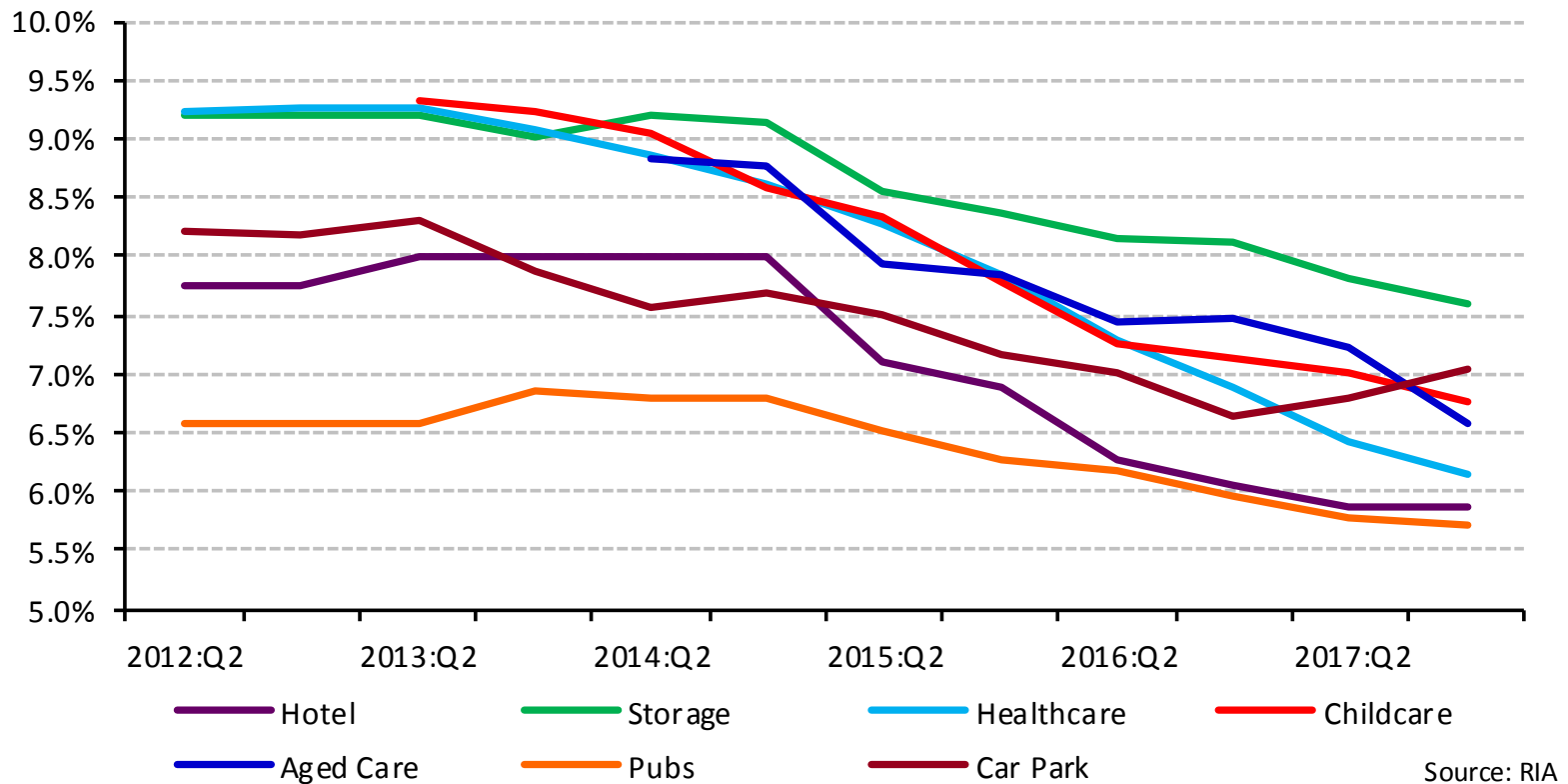


Source: RIA

- Cap rates start to firm more rapidly from 2013.
- The spread in cap rates between total property and non-core property currently resides at 75bps. This spread was c130bps in 2014.

Not surprisingly, pricing relativities across alternatives remains highly diverse

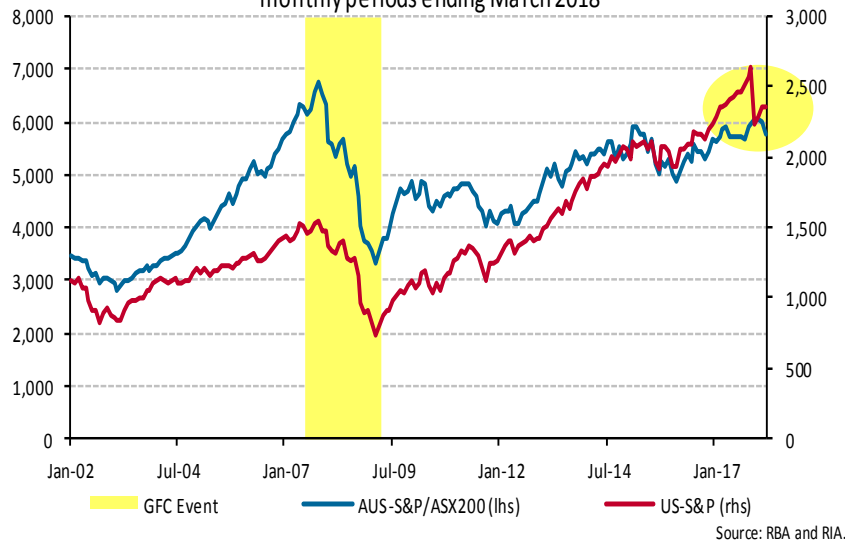
AUS property market cap rates by non-core sector
bi-annual periods to December 2017



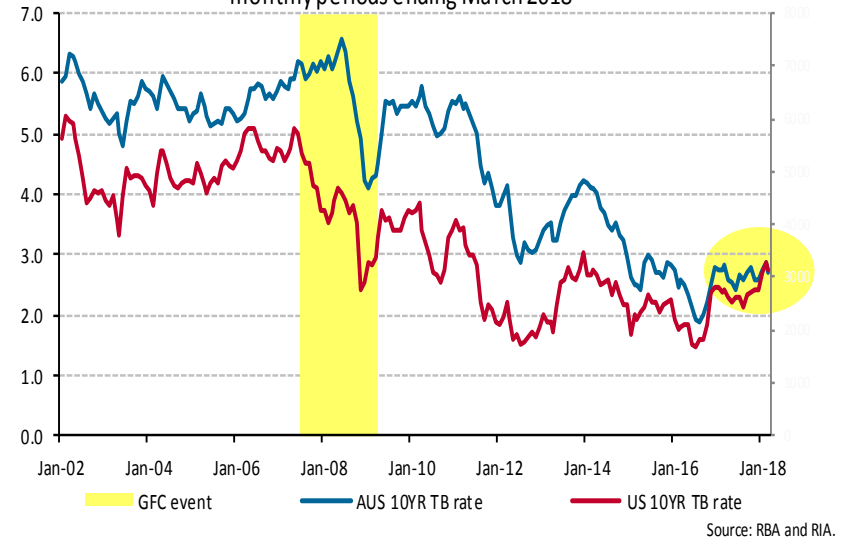
- The spread in cap rates across non-core sectors currently sits at c200 bps. This was c250bps in 2014.

Adjustments to cap rates ... firstly consider capital market drivers

US and AUS stock market price indices
monthly periods ending March 2018



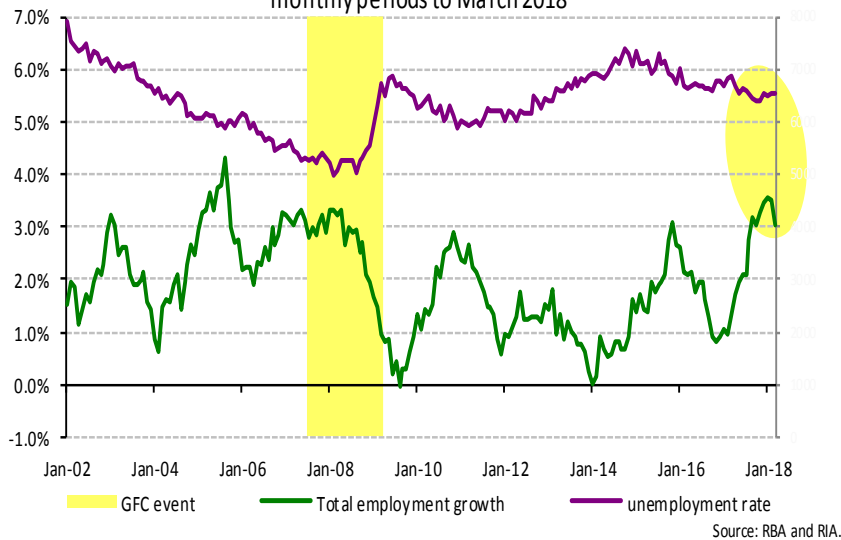
US and AUS 10YR T Bond rates
monthly periods ending March 2018



Adjustments to cap rates ... now consider space markets drivers

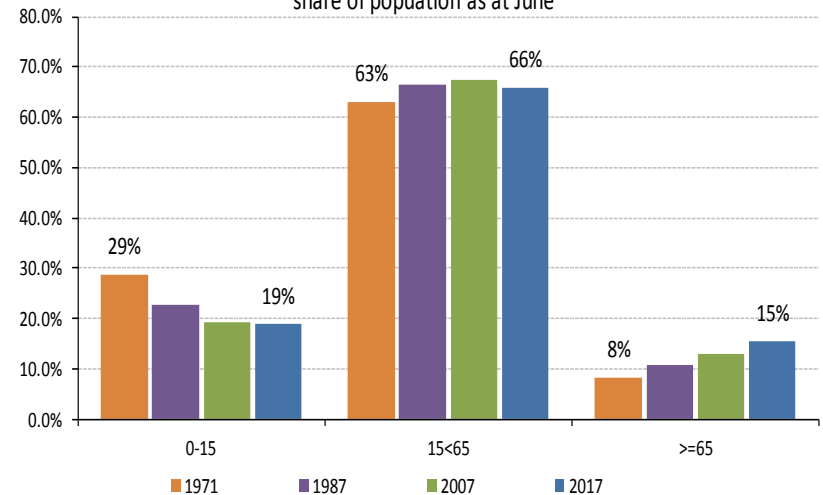
Labour market indicators for Australia

monthly periods to March 2018



Australia's population profile by age cohort

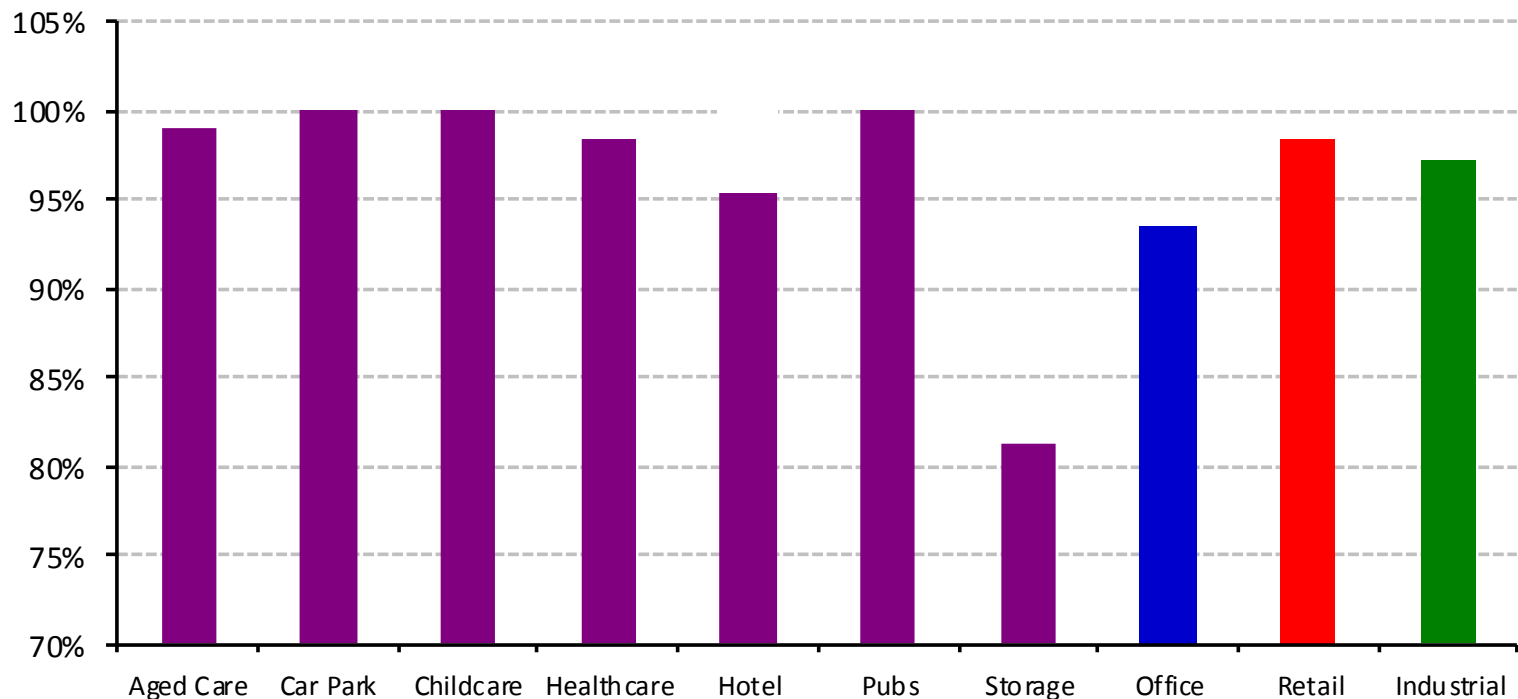
share of population as at June



Source: ABS and RIA.

The higher occupancy rates for alternatives should provide some buffer in a softening cycle

AUS property occupancy rates across core & non-core sectors
as at December 2017



Source: RIA

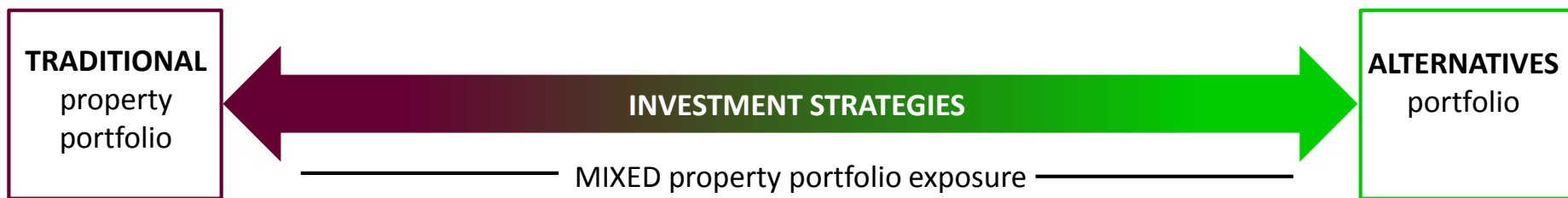
Take away points – asset pricing

- Cap rate for alternatives is converging towards traditional property.
Its premia to traditional property is compressing with general firming in cap rates.
- Adjustment to cap rates facilitated by both capital markets and space market influences.
Recall: cap rate softening with GFC was due to onset of unanticipated global event which generally concurrently impacted capital & space markets.
Early signs of a cyclical adjustment is unfolding. However, this is likely to be moderate due to its anticipated nature and disparity in capital and space market influences.
- The different nature (and generally relatively favourable) demand drivers for the overall alternatives sector is likely to see a somewhat relatively softer adjustment to the cap rate.

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Mixing traditional and alternative property exposure ... what is the right mix?

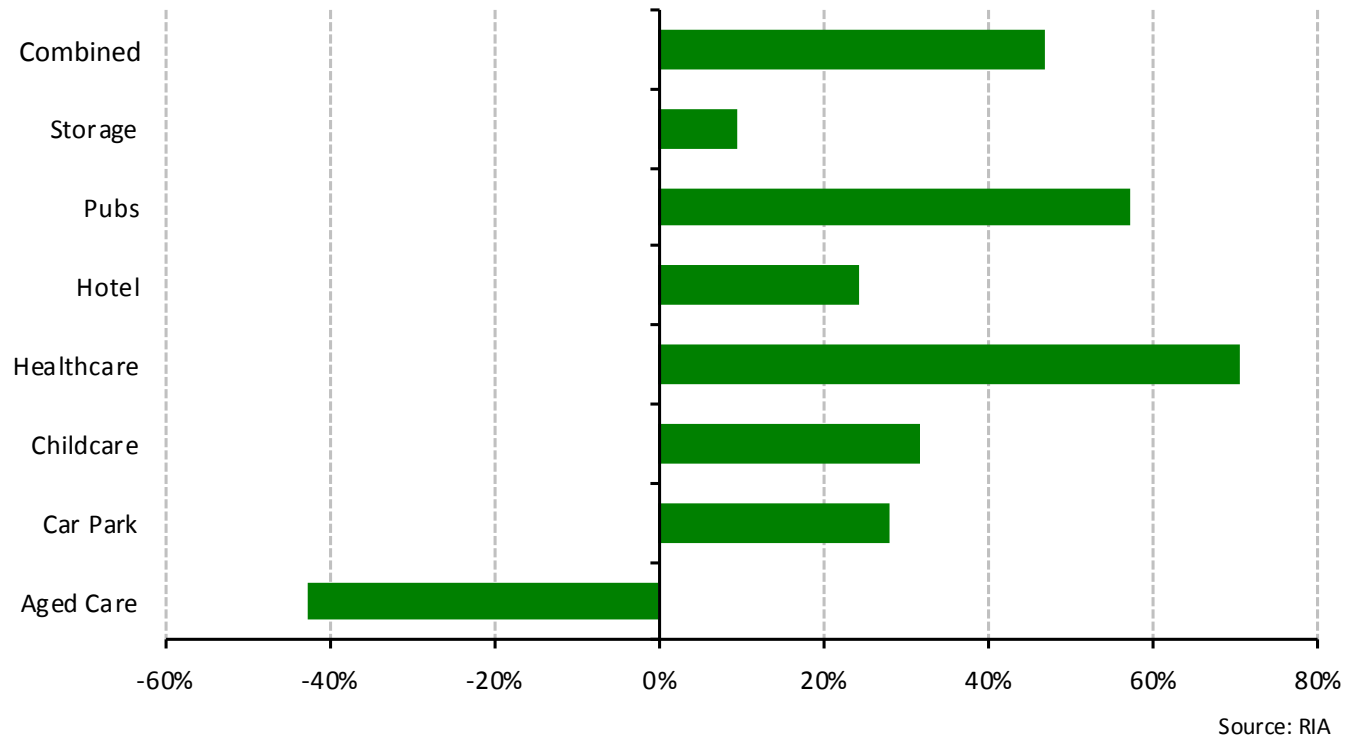


depends on a key parameter considerations:

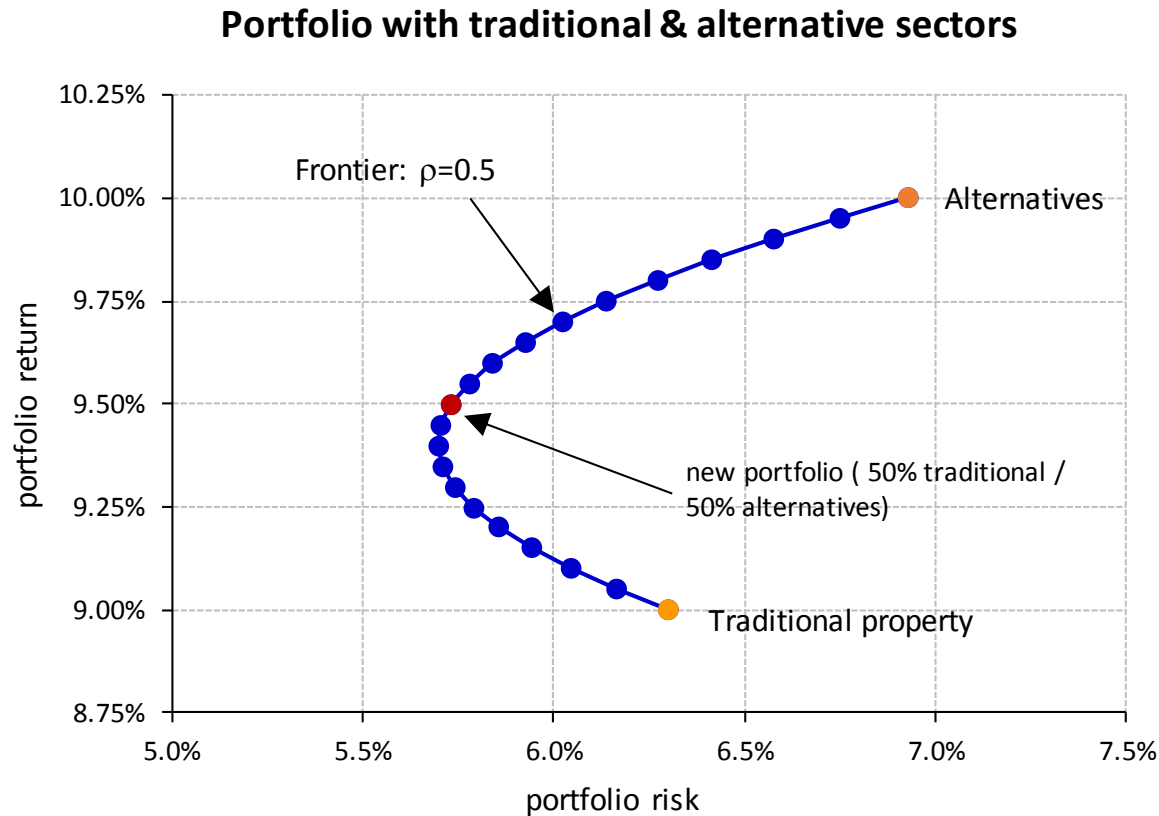
- *return estimates*: based on structural expected value measures (such as discount rate)
- *risk estimates*: empirically based on price volatility
- *correlation values*: based on price growth as this is the main contributor to return variability

Wide range of correlation values below 1 suggest a broad scope for diversification benefits

Correlation values: alternative sub-sectors to traditional
based on 5 years data to December 2017

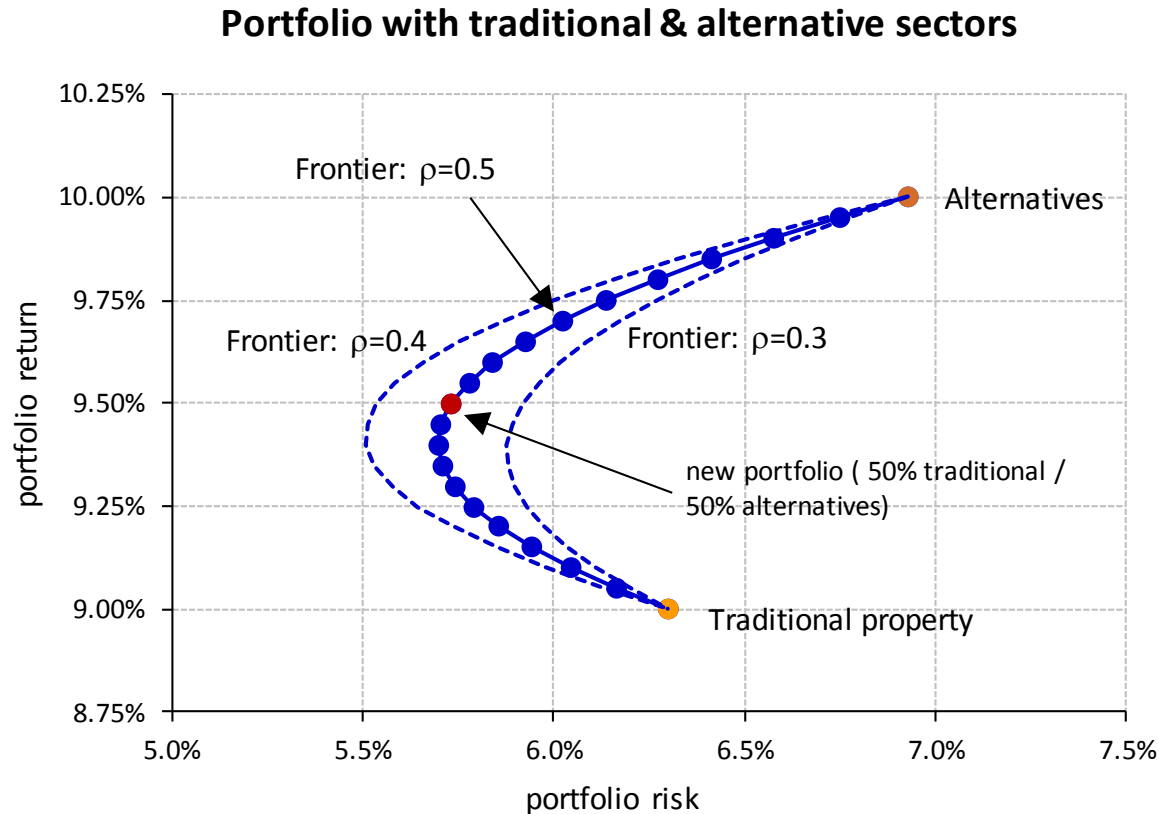


Consider the case of including alternative sectors to an existing portfolio of traditional property



Source: RIA

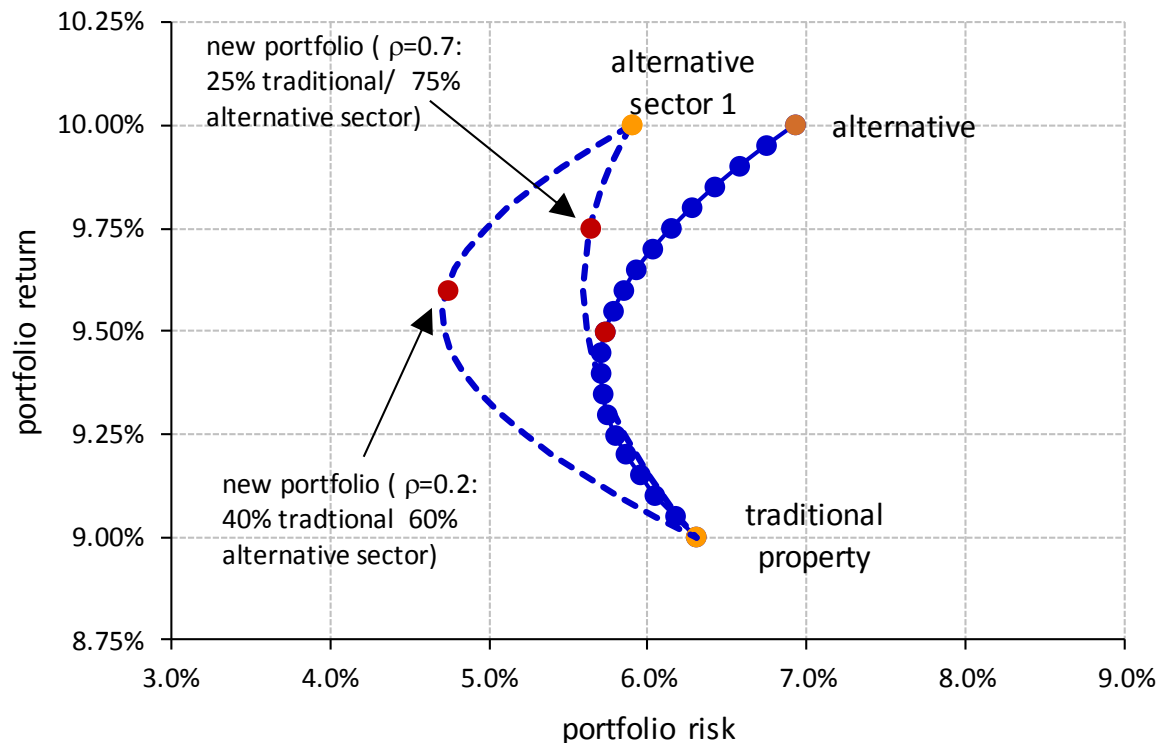
Scope for diversification benefits even when allowing for variability in correlation values



Source: RIA

The influence of a specific alternative sector with a relatively high risk-adjusted return

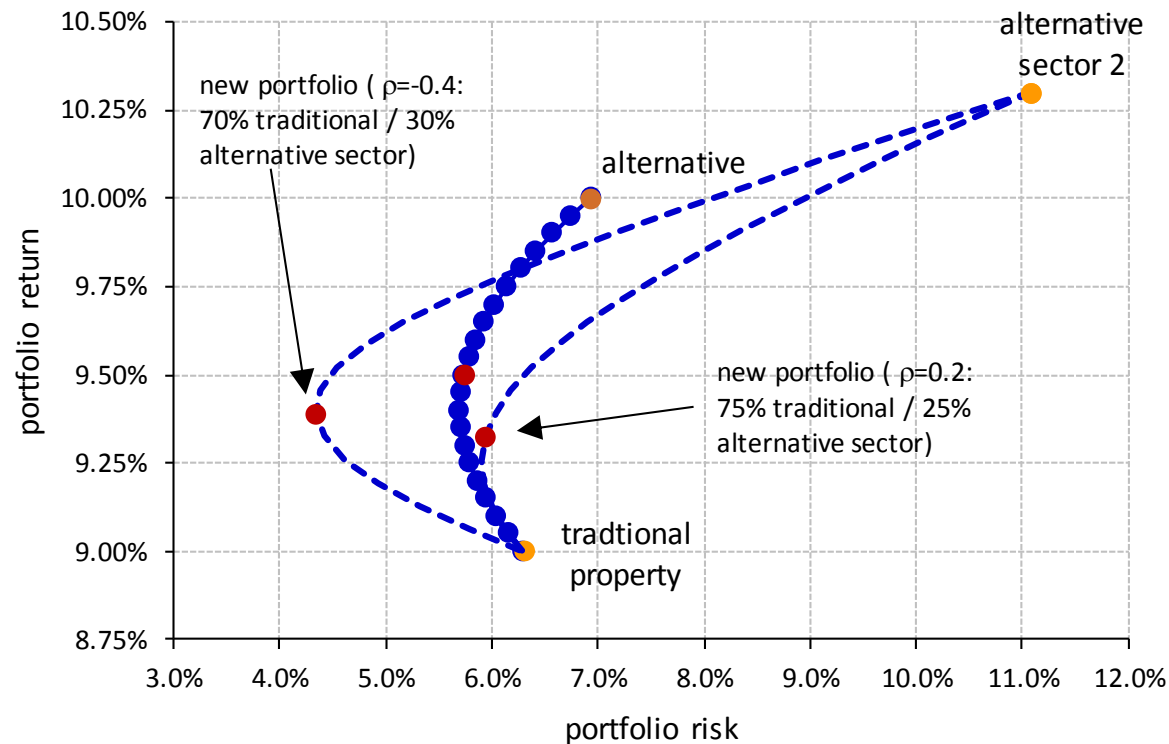
Portfolio with traditional & specific alternative sector



Source: RIA

The influence of a specific alternative sector with a relatively low risk-adjusted return

Portfolio with traditional & specific alternative sector



Source: RIA

Take away points – asset allocation

- Trend towards increasing capital allocated to alternative investments.
- Alternatives represent a diverse range of investments with different performance attributes. This diversity gives rise to a wide range of correlation values.
- An investment strategy that encompasses a mix of traditional property and alternatives tends to improve portfolio performance, in particular the risk-adjusted return.
- Considering specific alternative sectors gives rise to a wide range of investment strategies that can be tailored towards a focus on income or capita growth performance.

Thank you

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