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Don't expect miracles to emerge from property crash

Turi Condon, Property editor | *June 28, 2008*

"Another day, another downgrade," says Citigroup senior property analyst Quentin Velleley, describing the recent horror run of Australia's $81 billion listed property trust sector.

In the past six months, the main benchmark, the S&P/ASX 300 property trust index, has lost 30 per cent and is down 37 per cent over the past year.

Rising interest rates and falling asset values have badly affected many of the highly geared property stocks in the wake of the credit crisis.

Among the wreckage, there will be opportunities, particularly if the expected takeover activity boosts falling share prices.

However, research group Adviser Edge warns not to expect miracles.

"Investors shouldn't be hanging on in the hope that this (mergers and acquisitions) will push prices up, but there will be selective opportunities," says Adviser Edge head of property Louis Christopher.

After the last property crash in the late 1980s to 1992, property stocks took a long time to recover, Christopher says.

"We expect the sector to bottom out and flat-line for some time," he says.

One of the country's biggest residential developers, Mirvac Group, last week flagged $300-400 million of write-downs on its $7.5billion property portfolio and warned of an earnings downgrade, while Valad Property Group said its distribution would fall 11 per cent short of guidance offered only three months ago. It also expects to write down $65-85 million or 3-4 per cent of its investment and trading assets.

Centro Properties Group's December announcement that it was unable to refinance $3.9 billion worth of maturing debt in the risk-averse credit markets heralded the listed property sector's sharp decline.

Centro Properties' security holders have seen their shares drop from a high of $10 in July last year to yesterday's close of 26c, and their distribution drop from 39.8c for the 2007 financial year to zero for 2008.

A rash of companies have cut distributions and turned on their dividend reinvestment plans in a bid to retain cash.

Velleley says that on Citigroup's estimates, most of the groups on the S&P/ASX 200 property trust index are paying out an average of 120 per cent of their free cash flow.

"There are only three ways to do that -- sell assets, raise debt or raise equity," Velleley says.

Justin Blaess, who oversees $1.8billion of listed property securities as ING's listed property and infrastructure director, advises investors to stick to the plain vanilla property trusts -- those with secure income from rents and comparatively low gearing.

His picks are two Commonwealth Bank-managed trusts, Commonwealth Office Property Office Fund, which owns office towers around the country, and CFS Retail Property Trust, which owns shopping centres, including a stake in Melbourne's flagship Myer store. Adviser Edge's Christopher also likes CPA and picks Valad, saying the group has been punished for "telling it like it is".

"On our numbers, Valad's NTA (net tangible assets) is just over $1, but it is trading around 70c," Christopher says.

Stay away from groups exposed to cost pressures, such as developers hit by the rising cost of materials, Blaess says.

Blaess also believes there will be buying opportunities with many troubled, heavily geared trusts trading at deep discounts to NTA. "But there is a hell of a lot of risk, you won't sleep that well at night," Blaess says.

Several trusts are close to breaching their loan covenants as a result of falling asset values, Christopher says.

"There are still some bombs to go off," he says.

While some analysts say takeover activity, and therefore rising share prices, will be limited for the cash-starved sector, Mirvac managing director Greg Paramor predicts a wave of activity after the August reporting season ends and financial positions become clearer.

The merger and acquisition activity so far -- Lend Lease's offer on FKP and its 6 per cent stake in another retirement village operator, Babcock & Brown Communities; and AMP's bid for MacarthurCook -- will be the tip of the iceberg, Paramor says.

"After the reporting season and a more fully informed market, I would expect the first wave of activity and then a second wave when everybody has sorted out their financial situation," he says.

Paramor says that rents being earned from buildings are relatively strong and there is a mining and infrastructure boom supporting the economy.

He believes sentiment could turn relatively quickly when the credit crisis finally abates.
