Global Property Securities
Outlook commentary

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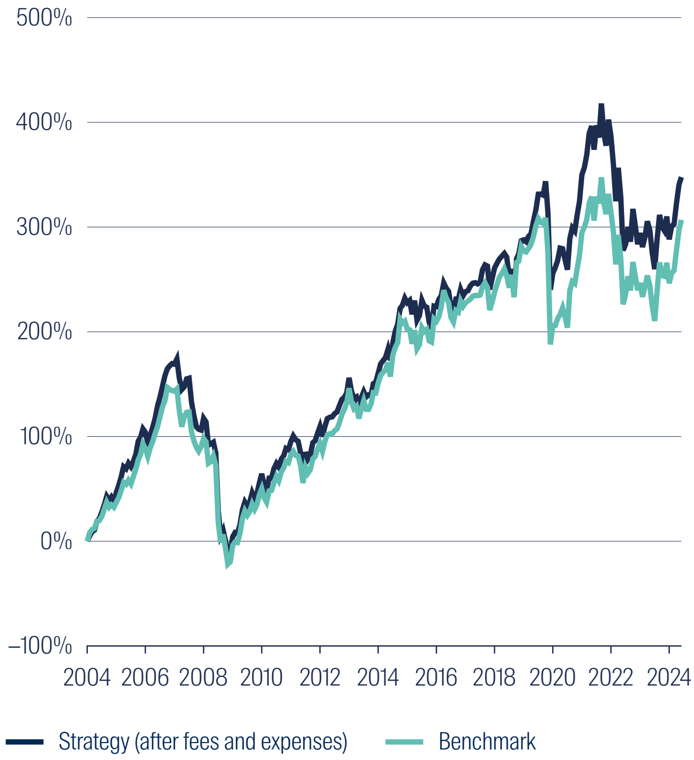
October 2024

The impacts of interest rate changes on asset values are well understood by financial markets. Typically, for capital intensive assets such as real estate, the access and cost of capital are important contributors to future operating fundamentals. However, this is not necessarily the case for real estate investment trusts (REITs), who typically retain cashflows to fund their future capital needs.

Although at certain points in economic cycles, the REITs can look to external growth opportunities to drive excess returns, in these circumstances the cost of and access to capital are an important driver to earnings. Over the last few years, interest rate changes have led to elevated market volatility with little consideration given to operating fundamentals. A stabilising of interest rates and the macro-economic environments would allow for the return of the consideration of operating fundamentals to the listed real estate sector, where long term growth in the asset class is being underpinned by key sectors of necessity such as rental housing, data centres and modern logistics facilities.

As seen in *Chart 1*, as interest rates increased in March 2022 the sector was sold off as investors priced in a higher cost of capital for the sector. We would expect that as interest rates fall investors will react in a similar manner, favouring the REIT's ability to fund external growth opportunities with a lower cost of capital.

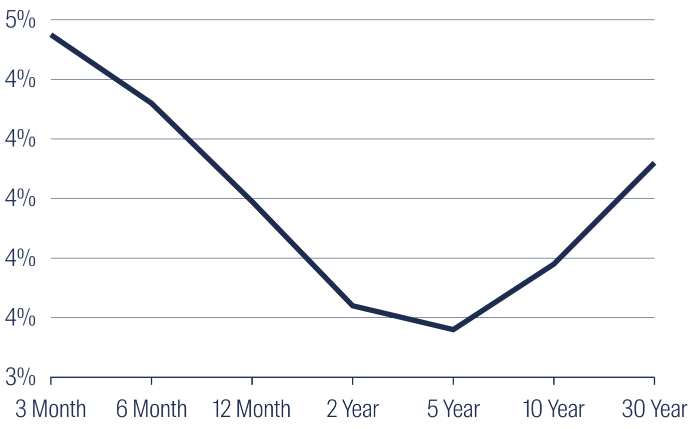
Chart 1 – Historical performance of the Global Property Securities Strategy vs Benchmark



Source: First Sentier Investors as at 30 September 2024 – Net of fees. The data and performance returns shown are not those of the First Sentier Global Property Securities Fund but for a representative Global Property Securities Strategy account that implement the same investment strategy as the First Sentier Global Property Securities Fund. Inception is 11 May 2004. Outperformance shown versus: The benchmark from inception was the S&P/Citigroup World Property Index (100% Hedged), from 01/08/05 the EPRA/NAREIT Global Property Index (100% Hedged), from 01/09/06 the UBS Global Real Estate Investors Index AUD Hedged, from 1/04/15 the FTSE EPRA/NAREIT Developed Index AUD Hedged. Past performance is not a reliable indicator of future results. It is not a recommendation or solicitation to purchase or invest in any fund. Differences between the representative account-specific constraints, currency or fees and those of a similarly managed fund or mandate would affect results.

As noted on the US Treasury Yield Curve, interest rates have peaked, and expectations are for interest rates to fall over the next two years. With the falling cost of capital, we believe the valuation anomalies for the real estate securities sector are likely to close delivering positive return outcomes for investors. This is in context to current good operating fundamentals.

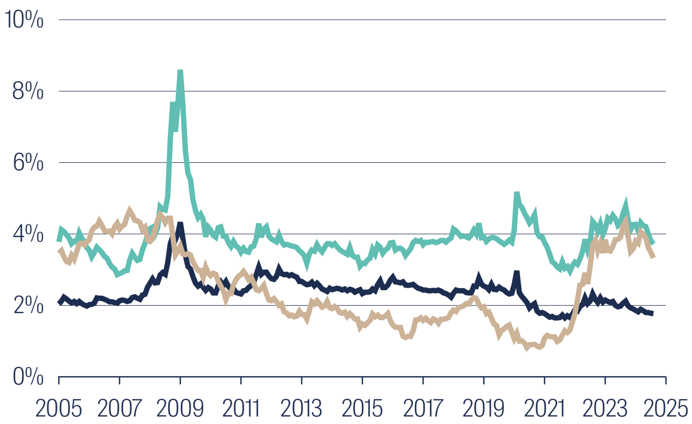
Chart 2 – United States Treasury Yield Curve



Source: Bloomberg. Data as at 30 September 2024.

The higher interest rate sensitivity of REITs can be seen in *Chart 3* where REITs have a higher dividend yield than both equities and bonds. Falling interest rates will likely see REIT share prices rise compressing the dividend yields in the lower interest rate environment.

Chart 3 – Dividend Yield (%)



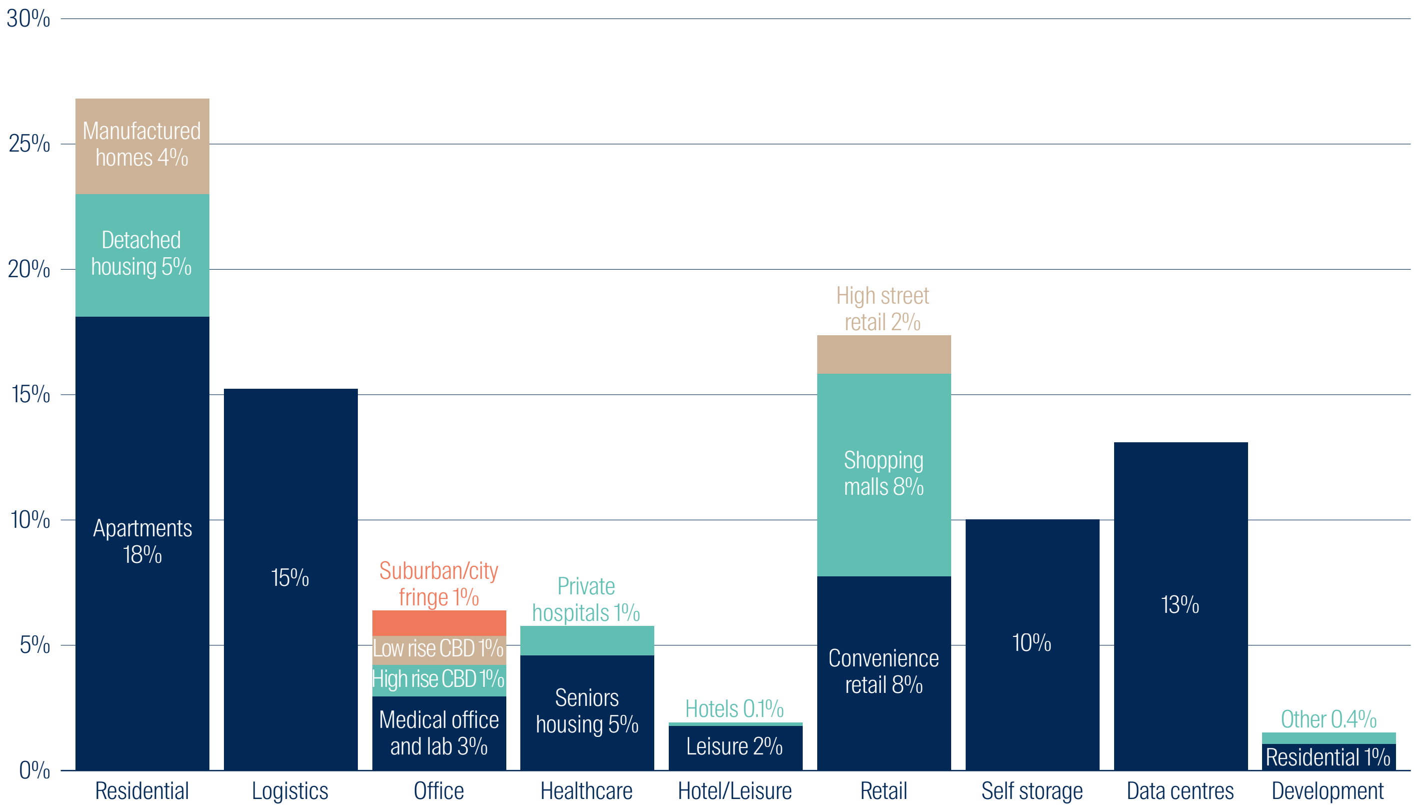
Data as at 30 September 2024. Global Reits as represented by the FTSE EPRA Nareit Developed index. Global Equities as represented by the MSCI World index. Global Bonds as represented by Bloomberg Global Aggregate Bond Index. Source: Factset

As financial markets adjusted to higher interest rates, many asset classes experienced falling valuations. This led to the Fund trading at a large valuation discount relative to historical norms. With expectations that interest rates have peaked and will continue to fall in line with lower inflationary expectations, the valuation discounts shown in *Chart 4* would likely return to historical averages. We would expect the fund would return to trading at a spot NAV premium with the solid operating fundamentals associated with long term structural thematics.

Chart 4 – Portfolio Discount/Premium to Net Asset Value

Metrics are for the the Global Property Securities representative account and the FTSE EPRA/NAREIT Developed Index. Source: First Sentier Investors. NAV (Net Asset Value) is our assessed value of property assets owned plus the value of other businesses operated. Past performance is not indicative of future performance.

Chart 5 – Sector breakdown (look-through basis) at 30 September 2024



Disclaimer: Note: these metrics are for the portfolio on a 'look through' basis (i.e. they represent the portfolio's actual exposure to property type and location, without reference to the market domicile or GICS classification by sector of each stock in the portfolio). First Sentier Global Property Securities Fund.
Source: First Sentier Investors

On a sector basis:

- We are positive on data centres, as the sector is benefiting from robust demand and increased pricing power driven by digital transformation and increased artificial intelligence requirements. The shortage and difficultly accessing power for new data centres is heightening barriers to entry which is expected to support rental growth. We believe the sector is well-positioned over the medium to long term, as it is integral to supporting the growth of the digital economy and also boasts low economic sensitivity due to the current supply/demand imbalance.
- Detached housing rental growth continues to be robust as the cost of renting versus owning remains at historic wide levels. Housing affordability is a major issue for younger generations, and we believe the aspiration to own a home will continue to wane as priorities shift towards lifestyle and experiences. Furthermore, rising costs of materials and labour shortages have exacerbated the supply/demand imbalance of residential housing, placing upward pressure on rents. We believe that the shift from buying to renting should underpin continued tenant demand for institutionally owned residential-for-rent assets that can maintain real pricing power amidst volatile macroeconomic conditions.
- Senior housing net operating income growth continues to be sector-leading with both strong occupancy and rental rate growth. The sector is expected to benefit from the strong structural thematic of ageing populations. As an example of the strength of this tailwind, the senior housing resident profile which is predominately aged 80 and up is growing at a rate four times that of the average population growth. This anticipated growth is further supported by a low supply pipeline, indicating that the demand for senior housing will likely continue to strengthen over the coming years.
- We are moderately positive on the logistics sector and see any overestimations of required supply to be transitory in nature. We are cautious of moderating tenant demand but do expect that the moderately low vacancy rates should continue to firm in 2025. The tailwinds generated from the increasing e-commerce sales as a percentage of total retail sales will continue to drive the sector tenant demand for years to come.

Combining both the falling interest rate environment and the good operating fundamentals, we believe the listed real estate sector is well placed to potentially deliver strong investor returns over the next few years.

Designed by the EMEA/US Design Team – FSI-PC1039-GPS Outlook Commentary rs1