

# Outlook 2015: Global Property Securities

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**With growth in the global economy looking uncertain in 2015, property investment offers a number of compelling characteristics for a wide range of market environments.**



As we head into 2015, we believe that the property sector can offer investors a degree of stability as the global economy struggles to recover. This has been acknowledged by some of the largest government pension schemes including the world's largest government scheme, the Japanese Government Pension Investment Fund (GPIF), and Europe's largest pension fund, the Norwegian Government Pension Fund, which have both increased allocations to real estate by 5%. These two allocations alone amount to over \$50 billion of buying power.

A significant amount of the capital allocated to real estate is seeking prime property, including trophy assets, which tend to be held by the listed sector. This is giving listed companies the opportunity to realise gains at stretched valuations and redeploy these gains into new opportunities.

The flood of capital has not, though, boosted supply in many markets. In London – one of the world's most buoyant real estate markets – the Deloitte Real Estate's London Office Crane survey states that office space under construction has fallen to a three-year low and office space across central London has been running at below-average levels for five years. We believe that these effects will support the fundamentals of the listed sector in the major global gateway markets through 2015.

## **Economic news should support property**

There are two likely economic scenarios we anticipate as we head into 2015. The first is that the global economy weakens which will put pressure on central banks to keep interest rates low and to continue their policies of quantitative easing. Due to its resilient income stream, this is likely to lead to a continued demand for property from investors searching for yield.

On the flipside, a strong economic growth scenario will most likely lead to interest rate rises. As long as these rises are the result of sustainable economic growth, then the property sector should see increased occupier demand as companies look to expand. This in turn will lead to rental growth and should offset any increased borrowing costs property firms may be exposed to. Companies with property in secondary locations may struggle, as occupier demand is likely to be stronger in major cities and prime locations which are normally held by the larger quality names in the sector.

## **Can the US continue its good run?**

The US listed property sector has delivered over 20% returns so far in 2014, but the key question now is whether there any more juice left in the tank. Undoubtedly a large number of US property companies are trading at fair value, but we still believe that there is upside potential on a selective basis. Real estate fundamentals remain solid and the initial outlook for 2015 appears to be positive across most major property types. San Francisco, Seattle and New York City continue to experience growth on the back of demand from the tech, media and telecommunications (TMT) sector, which is showing no signs of slowing down. We are also seeing continued demand for office and industrial property in hydrocarbon centres on the back of the fracking boom.

## **China continues to slow, but Asia still looks relatively cheap.**

The slow progress of the Chinese economy has been a fringe concern for investors for over a year and is now becoming a key issue. Whilst stimulus measures are in place, there is a headwind of high property supply - some 3 million excess units per annum - that is hurting prices and slowing volumes given that real estate accounts for 10% of GDP. Despite the relaxation of home purchase restrictions in many areas, the fundamentals are still looking weak, with a slowdown in residential sales and economic growth.

Hong Kong continues to be one of the cheapest markets globally. Nonetheless, employment concerns, lower consumption levels and

anti-corruption measures in China are feeding into sluggish growth. We cannot see a catalyst for a rerating of this market in the short-term but any positive news from China in 2015 may result in a positive shift in sentiment.

### **UK surprises for the right reasons whilst the eurozone struggles**

In Europe, a select number of companies continue to surprise to the upside; those with exposure to London offices have seen strong rental growth. We anticipate that this trend will continue as a lack of development finance results in low levels of supply. In our view, the main upside risk in the short-term is that the inflow of capital from Asia and the US could trigger a widespread fall in property yields, which could push annualised total returns over 10% per year for a limited period. The main downside risk is that the sovereign debt crisis could re-ignite if deflation takes hold and governments fail to meet targets to cut their budget deficits.

We will remain keenly focused on companies whose prices do not reflect the risk-adjusted value of their respective businesses. Our view is that this approach will continue to serve our investors well as we head into 2015.

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