Are investors being rational in pricing UK listed property?

9th April 2020

Conventional valuation methods currently meaningless

Equity markets have possibly witnessed their most extreme and indiscriminate sell-off in a life time. An unfathomable concept within basic economic theory of both supply and demand evaporating across the piece has rendered conventional valuation techniques all but meaningless.

Early March yielded strong questioning around Chinese exposure and related supply chains; a week later it was margins and profits; now balance sheet scrutiny, survivability scenarios and (more recently) the inevitable rescue fundraises.

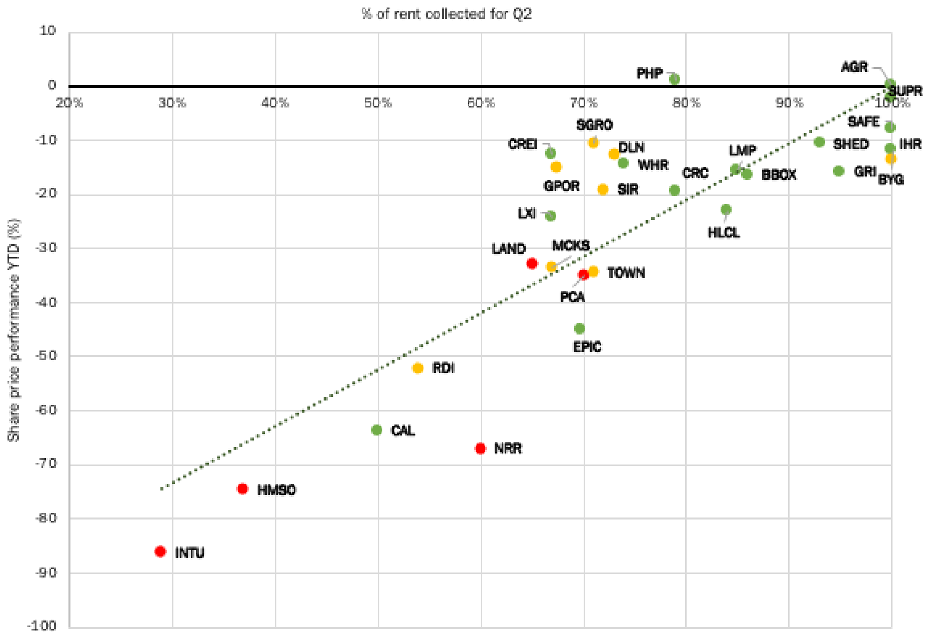
Property has been no different. Investors, who have traditionally viewed the sector through NAV lenses are faced with the fact that all underlying property valuations are now subject to material uncertainty clauses and the **V is now largely meaningless** until greater clarity prevails.

Given this underlying valuation uncertainty, can we see any firm patterns emerging in how investors are pricing listed property? To answer this, we have looked at two of the key metrics that the majority of property companies have been recently reporting; rent collections and available balance sheet headroom.

Rent Collection

Figure 1 below maps % of rent collected in March for the following quarter (x-axis) versus share price performance year to date (y-axis) for 28 real estate companies. The colour of each data point denotes the **likelihood of future dividend payments**: green is where the company has indicated future dividend; amber represents where dividends are being reviewed; and, red is an outright cancellation.

Figure 1



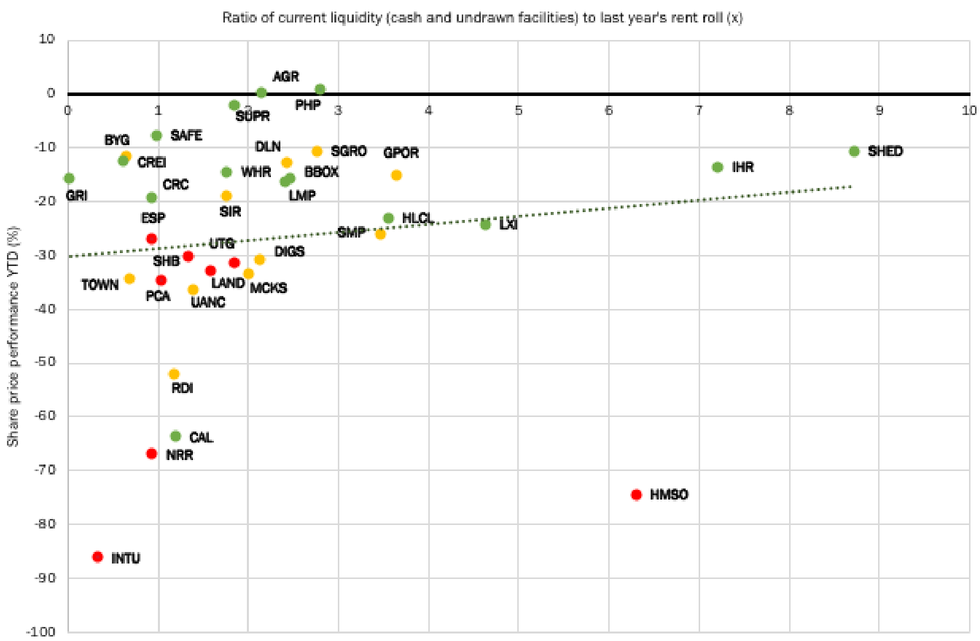
There is a **clear correlation** between rent and share price, while the dividend likelihood provides further evidence to this argument. Observationally:

- Most companies have reported collection of Q2 rents between 65% and 75%. Our analysis finds that the average is between 85% and 95% at this point in a normal market cycle, suggesting c.20% stress at present;
- This range appears to be the point at which dividend payment likelihood tends to shift;
- Logistics, Healthcare and Self-Storage (Sheds, Meds and Boxes) are demonstrating most resilience in the early COVID days.

Available liquidity versus rent roll

For a handful of property companies, **'rent collection' is not comparative**. Moreover, companies that reported earlier in the crisis have not provided this metric. However, **liquidity has been a major reporting item** throughout. Figure 2 maps 'available liquidity' in the form of cash and undrawn facilities as a ratio of last year's revenue and then compares to year to date share price movement.

Figure 2



Note: It must be noted that IHR (Impact Healthcare REIT) and SHED (Urban Logistics REIT) are yet to substantially deploy the proceeds from recent fundraises.

Figure 2 incorporates 33 data points and shows a **clear discrimination between dividend payers and non-payers**. We can see from Figure 2 that most companies that have reported their available liquidity sit within the 1-3x bucket. The majority of the positive outliers (ie, further to the right) have tended to be outperformers in share price terms. It is also notable that the vast majority of cancelled dividends sit below 2x rent cover.

Conclusions

Even though we are still in the early stages of what could be a prolonged period of economic dislocation, there are clear signs that there is some method in the madness of recent share price volatility. We can see clear correlations between perceptions of risk relating to rent collections and balance sheet headroom and share price movements.

Nature abhors a vacuum and in the absence of any confidence in the reliability of underlying property valuations; other metrics have come to the fore.

The opportunity for investors will be in determining which companies are more, or less, at risk than share prices are currently discounting. The outliers in both of these analyses will require closer examination. For example, within retail property, both Capital & Regional (dividend maintained, better than average rent collections and available headroom) and Hammerson (available headroom) both stand out from the crowd.

Companies who have yet to update the market will need to be mindful of what themes investors are clearly wanting comfort on.

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