

# Resolution Capital's Andrew Parsons

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By William Kemble-Diaz



**Andrew Parsons**  
Senior portfolio  
manager and CEO of  
Resolution Capital

*Andrew Parsons is senior portfolio manager and CEO of Australian REIT investment firm Resolution Capital. The firm manages more than \$1 billion in global property securities, and Parsons is a well-known figure within Australian property circles.*

*SNL asked him about the current state of the Australian property market, ahead of the A-REIT annual earnings season later in August. On the one hand, a big wave of fresh write-downs is likely — as much as A\$7.3 billion, according to The Australian newspaper in July. On the other hand, the sector is now well-capitalized after a series of share*

*sales. In some cases, debt-gearing ratios have sunk below 20%, such as at Mirvac Group and Stockland.*

*The following is an edited transcript of an emailed discussion this week.*

**SNL: Broadly speaking, where in the cycle do you see Australia's listed property sector — firmly on the road to recovery or still convalescing?**

**Parsons:** It's fair to say that balance sheets have largely been restored but weaker operating conditions suggest that we haven't quite cleared all the hurdles. Nevertheless, history suggests that markets that have made mistakes, recognized and dealt with them often provide robust performance in the future.

**How does the A-REIT market compare with REIT markets elsewhere in the world?**

Australia's balance sheets are now among the world's strongest. Real estate operating conditions, whilst soft, are generally top quartile. But like many other global real estate markets, it's a limited talent pool so you have to be selective, which is why Resolution Capital opted to invest globally for its clients. We don't focus so much on markets but prefer to concentrate on investing long term in well-managed portfolios in desirable high barrier to entry markets.

**So which non-Australian property do you currently like?**

Those with strong recurring cash flows from good quality covenants in supply-constrained markets.

**What can we expect from this month's wave of A-REIT/property company earnings? More write-downs?**

Asset write-downs are a given, the extent of which may be the more intriguing issue. Currently REIT prices would suggest asset values are 10[% to] 15% overvalued. More importantly, I think management is just starting to come to grips with credit market conditions,

so I hope we will see a more rational perspective compared with the anxiety and denial evident over the past 12 months. What I'd like to see is some rational analysis by managers about how they propose to generate sustainable value in the future.

**What will the markets focus on?**

Probably the wrong things. I expect the market will be looking for the extent of deterioration in real estate operating metrics, notably occupancy and rents. The future of some of the externally managed vehicles also will be of interest in light of Macquarie Bank's recent decision to internalize management [of] some of its listed satellite funds. Sadly, the strategies of many of these vehicles have proven to be flawed to the detriment of unit holder wealth. Nevertheless, the management teams have extricated significant fees through the life of the fund whilst taking comparatively minimal risk in terms of capital outlay. The external managers have a fiduciary duty to act in investors' best interests. That unit holders should be required to pay multiples of the cost of running the management platforms for the ability to determine who is responsible for overseeing their money is an insult.

**What should they focus on?**

No comment.

**Which companies have the most potential to surprise on the upside and why?**

I'm reluctant to single out names. It wouldn't be a surprise if I knew.

**Which are the likely weak links?**

Management discipline remains questionable and strategy unsophisticated. But before you think I'm being too self-deprecating about the local market, Australia does not have exclusive rights on these attributes.

**Has the sector got over its debt troubles?**

With a couple of exceptions the sector has now recalibrated distributions and recapitalized balance sheets. However, the impact on investor returns has been catastrophic. It's like the sector has been reborn and is hoping that the sins of the past will be forgiven and forgotten.

*[Editor's note: Goodman Group on Aug. 6 became the latest A-REIT to announce an equity raise, with a A\$1.28 billion fully underwritten institutional share placement and entitlement offer.]*

**Have A-REITs now recapitalized sufficiently?**

Ignoring the cost of doing so, as far as its immediate needs are concerned it is fair to say that the sector has largely dealt with the major issues of loan-to-value covenants and debt maturities. But, anyone who thinks the sector is now in a position to aggressively acquire property without resorting to more equity is encouraging the same mistakes experienced over the past five years.

What the sector does have is currency, in the form of liquidity and well-capitalized shares, to assist vendors in liquefying their investments. Belgium REIT Warehouses De Pauw's units for property swap

first announced late last year with [global courier firm] DHL is an example of what can be achieved.

### **Some A-REITs now have debt-gearing ratios below 20%. Is this ideal?**

It's difficult to be prescriptive about the right level of gearing because of the different characteristics of the underlying real estate and debt markets. But as a general rule management has demonstrated that they can't be relied upon to responsibly manage anything other than moderate gearing. Gearing should be used to enhance returns not the dominant driver.

### **What about sector leader Westfield Group? Do you buy into talk that it could be looking to raise up to A\$3 billion?**

Whilst I would not dismiss the validity of the speculation, I have learnt with Westfield to expect the unexpected. For example, two years ago Westfield was selling real estate when everyone was buying. I believe they need to raise equity in order to exploit emerging opportunities in its core markets. However, there are a number of possible alternatives to a simple secondary share offer, so I can't be sure but I would be sure it will be on their terms and in their time.

### **Do A-REITs and other Australian companies have it relatively easy due to the abundance of domestic capital as a result of Australia's compulsory savings scheme?**

It's a blessing and a curse. I think a number of flawed business cases were launched on the back of the expectation that the superannuation money would overlook poorly conceived business models, support growth and dilute the flaws. The issue is that the Australian superannuation industry has outgrown the local real estate market. That's why we launched Resolution Capital Global Property Securities Fund — to invest in the best real estate platforms around the world that have local talent and are not conflicted.

### **Does that access to an ample supply of equity give A-REITs a more defensive quality or does it encourage A-REIT managers to expand too aggressively?**

There's no doubt that the inflow into the sector encouraged a number of initiatives that were poorly conceived, such as the global expansion via externally managed joint venture vehicles.

### **We've seen some A-REITs retrench back to their home market, most recently GPT Group. Is that the end for the A-REIT sector's foreign adventure or is a return to cross-border property investment inevitable given the limited amount of Australian property stock?**

I think the experience of a number of real estate operators suggests whilst it has its own challenges, you can diversify geographically or by sector but it's near impossible to successfully do both on a long-term sustainable basis.

It's worth recognizing that Westfield's long-term commitment to international expansion in regional malls has been a success; it is now a global powerhouse. Goodman's global expansion will probably pay off, but it has to be done with the right capital structure, which is the thing that also caught out its major rivals ProLogis and to a lesser extent AMB Property Corp.

### **What will be different next time around if or when A-REITs expand abroad?**

Recent bad experience, the exorbitant costs of doing so and lack of competitive edge means it will be some time before a new player ventures overseas. Besides, it's some other market's turn to make the same mistakes Australian REITs made, and before them the U.K. and Japanese real estate companies in the 1970s and 1980s.

### **What about Westfield — will its results be dominated by the poor performance of its U.K and U.S. assets?**

It will be a feature but I think the market has been conditioned thanks to the results of Liberty International Plc, Simon Property Group Inc., etc.

### **Which is your top Aussie pick right now and why?**

Australia to retain the Ashes.

*Editor's note: The Ashes is a biennial and highly charged sporting contest between England and Australia involving the game of cricket. It dates back to 1882. England lead 1-0 in the current five-match series, with two games left to go.] **i***