"We think that the sector will show signs of recovery in the second half of this year "

Interview with Simon Hedger, Portfolio Manager, Principal Global Investors

Principal was amongst the few asset managers, doing a good job in the past market correction. The Real Estate Magazin asked Simon Hedger about the current status of the market crisis and an outlook on the global REITs segment.

Simon Hedger, Portfolio Manager, Principal Global Investors

REAL ESTATE MAGAZIN: There has been a nice correction in the global REIT markets. Have you anticipated such a strong pullback?
HEDGER: I think it is true that no one in the market anticipated such a strong correction, but of course it was quite clear that after the strong performance in the past there was some pullback in pricing to come. That is why we were able to position our portfolio appropriately and get a much better return compared to our benchmark.

REAL ESTATE MAGAZIN: Was there simply too much exaggeration in the market?
HEDGER: Real Estate is still a physical asset class. If you look at the long term of global property securities performance with a return of around 12% p.a. and compare these with the performance of 30% or more in the previous 3 years, one should not wonder about a correction.

REAL ESTATE MAGAZIN: What were your reactions in the portfolio?
HEDGER: We moved quickly out of the second quality assets we had in the portfolio and focussed on prime quality assets. In bull markets its fine to have this second row in the portfolio but in times of a market crisis only quality counts. Further we reduced our exposure to stocks that were highly geared. The banks are very selective now to whom and how much they will lend.

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REAL ESTATE MAGAZIN: What is your strategy in terms of Real Estate Sectors?
HEDGER: We will have a close look at the office sector, because if we go into a recession then office rents will clearly come down. We are much more comfortable with a higher exposure to the retail sector, which seems to be more robust. But again only the top quality. What we also avoid in the portfolio are companies with a high exposure to development.

REAL ESTATE MAGAZIN: Which are the markets to invest now, where do you find value?
HEDGER: We here at Principal are basically bottom-up stock-pikkers. So our very first criteria is a company and its fundamentals. It is first of all a question if the single stock can help the portfolio as country allocation is a secondary filter. Basically we feel much better with countries like Switzerland, Swiss stocks are currently very stable. Also countries like Belgium, the Netherlands and some nordic countries offer high yields with stable but growing cash flows. But as I already said, first of all it is the stock selection that counts.

REAL ESTATE MAGAZIN: What are the numbers you are looking when investing in real estate companies at the moment?
HEDGER: The premium or discount to the NAV number, the net asset value, is the key driver to the sector at the moment. We also look closely at the Cashflow-Yield, which I think is a very important number in term of REIT Companies. Also the growth in rents

is a key factor for us. It is always very interesting to see, where the rent income trend is going compared to the whole market.

REAL ESTATE MAGAZIN: What is your outlook for the German market and the devlopment of a German REIT culture?
HEDGER: The development of a real REIT culture needs time. Of course it was obviously not the best timing in Germany starting REITs after a long delay just before that market correction we have seen. But what we will see in Germany over the long term is the development of a similar REIT culture as we have seen in the US and many other countries. Also looking at the different markets and the valuations, Germany is also an interesting market for investors. You have to look quite close in the different cities and the different sectors, but there are opportunities as many German cities offer strong fundamentals.

REAL ESTATE MAGAZIN: Speaking again more global. What are the major reasons for a global REIT-Fund, i.e. compared to direct real estate investments, and what is your outlook in terms of performance?
HEDGER: We think that the sector will have its recovery in the second half of this year. Returns are expected to be at around 6-8%. As I already mentioned the long term performance has been at around 12% and we should see performance trend back to this number. But speaking more generally on the advantages of a global REIT fund. I think there are mainly three reasons, in particular compared to direct real estate investments, making it an important part of an asset allocation: First of all the liquidity it provides every day compared to direct real estate investments plus the lower entry and exit costs for that real estate exposure. Secondly, there is a tremendous growing number of buying opportunities for REITs, in particular here in Europe. Globally the property securities sector has trebled in size over the past three years, offering greater opportunity for investment. Finally, diversification is a driving factor, where REITs make it much easier to get a well diversified portfolio compared to direct investments because of the low correlation with other asset classes and the low-risk nature of the sector over the longer term. Many different markets, many different sectors and many investment stories, that is what you get in buying a global REIT fund.

REAL ESTATE MAGAZIN: Thanks a lot for the interview.

The Interview was conducted by Frank Schnattinger.