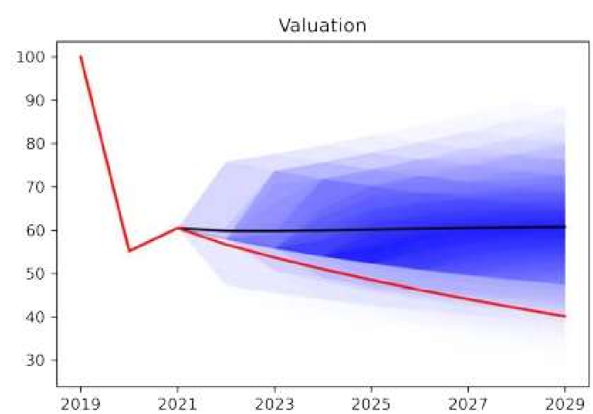
Busted REITs; danger in lease land

It's understandable, but most REITS tend to publicly ignore or obscure the effect of Working from Home (WFH) on their business. The chart (source: Gupta, Mittal and Van Nieuwerbergh) below is from an academic paper and is the first we have seen that has a guess on the effect of WFH on office values. It's all notation and Markov chains etc, so it does suffer from what assumptions you use, but their conclusion is pretty clear. New York office values will never reach pre Covid levels again. The black line assumes economic expansion and people going back to work while the red lower line is the expectation if people continued to WFH for the rest of the decade. The blue shaded areas are probability estimates.

If this is repeated in Australia, a median fall of 40% and a possible fall of 60% if WFH continues for a decade sends some office REITs broke and the business model of all office REITS go to the mincers. Not much read through for hybrids. There is only 1 REIT issuer and the banks are pretty light on property. Challenger is probably the most affected of the hybrid issuers.

Figure 12: Office Valuation Distribution for NYC, Normalized to 100 in Dec 2019



otes: The graph shows the evolution of the office value V for a transition from expansion in 2019 to WFH-R in 2020 and WFH-E in 2021. om 2022 onward, the state evolves stochastically. The shaded areas show percentiles of the distribution of simulated paths, with the rkest color indicating the 40–60 percentile range, and the lightest color the 10–90 percentile range.

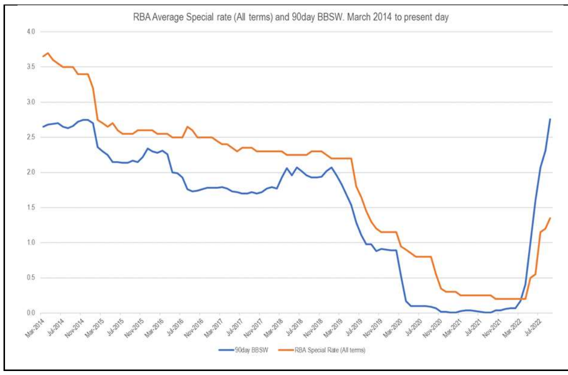
Busted TD rates?

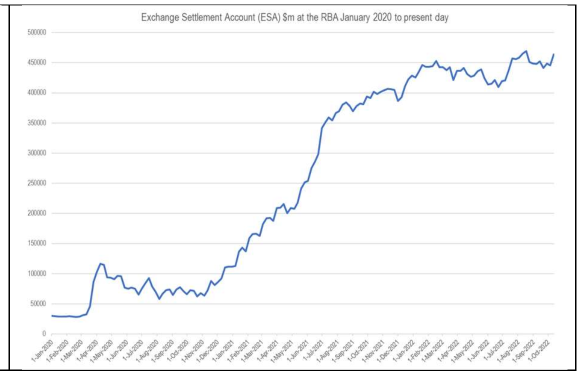
Those of you who have term deposits (TD's) coming up for reinvestment are in for a rude shock. After years of being loved by banks, retail depositors now are as popular as leprosy. The lefthand chart below shows the "RBA Average Special Rate (All Terms)" rate compared to BBSW. Until the end of Covid retail did better than wholesale rates but since then TD rates have lagged. The reason can be found in the righthand chart (below) which shows Exchange Settlement Accounts (ESA) balances at the RBA. When banks have money that they can't use elsewhere they deposit it in the RBA ESA. It shows an enormous increase since Covid. Some of that is the $180b Term Funding Facility or TFF they borrowed at a cost of 0.1% but the rest is a combination of Covid saving, the Twiggy Forrest's inspired

Balance of Payments surplus which means all the AUD gets reinvested somewhere in the banking system and some other factors. Whatever the causes, the large ESA balances were meant to be very temporary but the timeline to run down is getting longer and longer.

Simply put, if the only thing banks can do is put your TD deposit on deposit with the RBA at the cash rate, they will pay less than the cash rate. So, TD rates are dependent on how quickly the ESA is run down. The TFF will run off and banks will have to buy more bonds, but the balance is still large. As a guide, total loans by the Australian banking system total $3.2t, so the ESA balances are around 15% of total loans. We would be interested to see someone guess as to when balances get to normal levels.

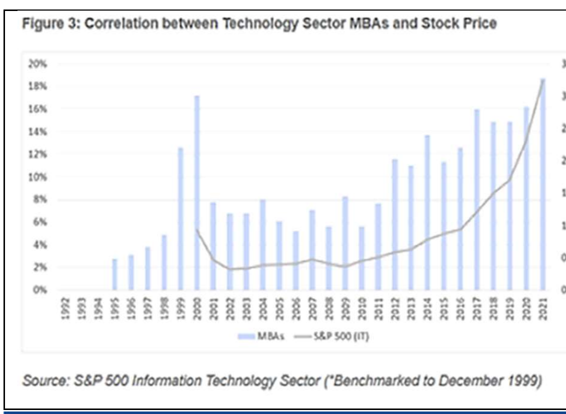
The read through for hybrids is positive. Income yields for a hybrid , which is riskier than a government guaranteed TD approach 6% annual rate compared to the 1.5% TD. There should be continued leakage out of TD's.

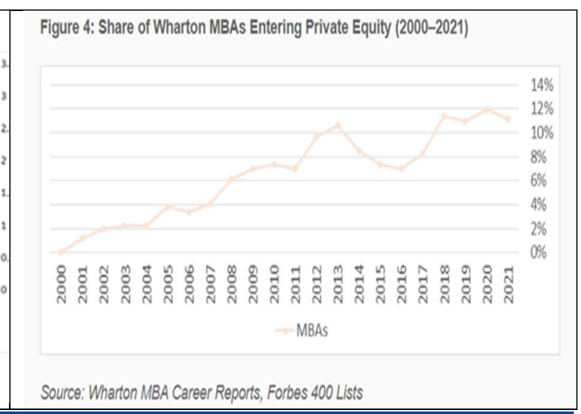




Bust MBAs

Harvard describes its MBA cost as a "shared investment in the future" but they would say that. Cost for 2 years in Boston is $225k (USD). So, it's interesting to compare the career choices of the MBA's and they, either wittingly or unwittingly, tend to follow stock market bubbles. The charts below (source Verdad) show the trend following MBAs (or maybe that's where the money is) and if history repeats itself, both tech and private equity are probably very peak-ish.





Elstree
HYBRID FUND (EHF1)

More about Elstree Hybrid Fund (EHF1)

Elstree Hybrid Fund (CBOE: EHF1) is an Exchange Traded Product or ETP. The fund is designed to allow retail investors to access the same successful and long-term investment strategy as our actively managed unlisted wholesale fund, the Elstree Enhanced Income Fund.

The Elstree Hybrid Fund is an ideal investment for investors seeking a cash or bank term deposit alternative investment that displays an acceptable and appropriate risk adjusted return outcome.

The Elstree Hybrid Fund has 'on market' liquidity provided by a market maker. The iNAV which is estimate of the live NAV, is updated every 20 seconds.

Additional details can be found on the Elstree Hybrid Fund website or email Norman Derham for further information.

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