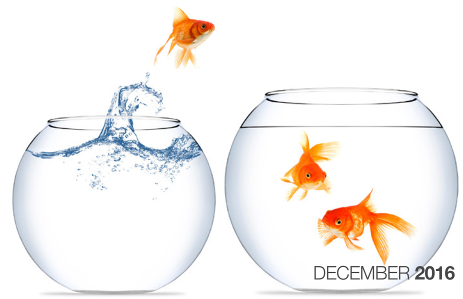
Property trusts: Are you investing for the wrong reasons?



Whether you've invested in Australian real estate investment trusts (AREITs) or Asian REITs over the last few years, there has been little difference to your total returns. As the table below shows, both have performed remarkably well.

Most of that return, though, has come not from income but capital growth. Historically, that's unusual. Investors in the sector typically prioritise income over capital appreciation, which is why the sector developed in the first place. REITs – still popularly known as property trusts – cater to investors that are looking for income-driven investments.

But the sector's recent performance, driven by unusually low interest rates, poses a question to all property trust investors; can the run continue and if not, is this a good time to get out?

As at November 30, 2016	3 year return pa	5 year return pa	Since inception return pa[1]
APN Asian REIT Fund	11.83%	18.28%	14.73%
APN AREIT Fund	14.48%	16.47%	15.46%

Let's take a step back. Most REITs deliver a steady income stream backed by contractual rent from commercial properties. Lease terms range often from 2-20 years, signed off by high credit-rated national and multinational companies as well as government entities. This makes them inherently defensive investments favoured by income investors.

For Asian REIT investors, the bar is set even higher. Unlike in Australia, the payout of income by REITs is mandated at 90% or more. That means income is derived almost exclusively from boring, predictable rent-collecting activities as opposed to the more "colourful" earnings such as property development.

Either way, the sector has been purpose built to attract conservative, risk-averse investors that depend on regular income rather than less predictable capital growth. And yet it is exceptional capital growth that has grabbed the attention of investors unaware of this fact. The recent price falls in the sector mean they're now paying the price for it.

With the world fighting low growth, central banks have lowered interest rates in an attempt to stimulate economies. In fact, the duration of the current low-rate cycle is matched only by the aftermath of the Great Depression. In Australia, the cash rate is at an all-time low, which is hurting savers. With retirees' term deposits paying just 2%, the hunt for a higher return has led investors towards REITs.

That increased demand has pushed up prices, which in turn has lured more capital into the sector, not just for the income on offer but also the prospect of capital growth. Such is the burden of out performance and those who fail to see the underlying reasons for it.

Too many of these investors have forgotten what the REIT sector is all about, which is why the recent sell off concerns them.

Capital growth should not be the primary reason for investors to jump into the sector. APN's long term return expectations for the Australian and Asian REIT funds are 7-10% a year. Most of that return should come from income, not capital growth. The recent sell off is an indication that too many investors, attracted by share price appreciation in the sector, forgot this critical point. If you're one of them you might be wondering what you should do now.

Those thinking of selling may well have missed the boat. With the ASX AREIT index down 17% (as at 2 December 2016) from its high on 1 August, locking in a capital loss only makes sense if you expect the sector to fall even further, and no one can reliably forecast that outcome.

What we do know is that APN's AREIT Fund currently yields 6.52% and our Asian Fund 6.57% (as at 2 December 2016)[2]. Both these figures are much higher than they were just a few months ago. And, as anyone with a term deposit would know, finding a reliable yield with a '6' in front of it isn't easy.

That's the upside of the recent price fall. For genuine income investors thinking of topping up their property trust portfolios, or simply transferring funds from cash and term deposits into something with a more attractive yield, the incentive to do so has become a lot stronger in recent weeks.

The bigger lesson is to understand why you're making an investment in the sector in the first place, and not get sucked into thinking that just because something has risen strongly in the past few years it will continue to do so over the next few years.

Genuine income investors understand this point. Because they're not fixated on capital growth, the short term price fluctuations don't worry them. Instead, the recent price falls offer an opportunity to access an even more attractive yield.

For the speculators the choice is a little more tricky: do they want to lock in a capital loss in order to chase capital growth elsewhere or just sit still and enjoy the higher yield? And only they can answer that.

1 Inception date for Asian REIT Fund is May 2011 and AREIT Fund is Jan 2009. Returns after all fees and expenses. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Past performance is not an indicator of future performance.

2 Current running yield is calculated daily by dividing the annualised distribution rate by the latest entry unit price. Distributions may include a capital gains component. Past performance is not an indicator of future returns.

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Established in 1996, APN's listed on the ASX and manages $2.2 billion (as at 30 June 2016) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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