Why APN launched an Asian REIT Fund

MAY **2017**

Since starting the APN Asian REIT Fund in July 2011, one question we've certainly been asked on more than one occasion by professional advisers, shareholders and others is : why did we bother?

It's a fair question. Consider the investment objectives of the Australian REIT Fund and its Asian counterpart: both aim to deliver lower-than-market volatility; both feature a high level of distributable income "equivalent to at least 110% of the average yield" of the relevant benchmark index; and both pay monthly income to investors with an investment timeframe of 5-7 years.

Both funds are also intimately connected through our 20-year property-for-income philosophy; a robust, time-tested approach that delivers a stable, monthly income at lower-than-market risk by focusing on the fundamental drivers of commercial property returns. That might sound dull but when it comes to investing our clients' money for the long term we're OK with being described as dull.

Given our investment philosophy and fund objectives, one might expect the current running yield and total returns from both funds to be similar. The table shows that they are and it's very pleasing for us to see that our Australian-developed REIT investment process is working effectively for the Asian REIT Fund's income focused commercial property portfolio.

	Australian REIT Fund	Asian REIT Fund
Current running yield[1]	6.02%	6.43%
5 year total return pa[2]	16.04%	16.70%
Total return since inception pa[3]	15.76%	14.42%

So, both funds have similar objectives anchored by APN's philosophy of stable, income-focused returns. Both offer similar running yields and have delivered similar investment performance since inception. In which case, why is one fund $1.263 billion in size and the other $11 million (there are no prizes for guessing which is which.)

That's what I mean by a fair question. If the Australian REIT Fund has the same objectives and similar performance to the Asian Fund, why should advisers and investors bother with it?

Let's take a step back. According to the ASX Share Ownership Study, just 13% of Australian investors held shares listed on an overseas exchange. Nor is that over-exposure – Australia represents less than 3% of global market capitalisation – addressed through the ownership of internationally-focussed managed funds. With just 10% of investors, including SMSFs and company structures, owning any managed funds at all outside of superannuation, the percentage investing overseas through a managed fund must be tiny. Meanwhile, one-in-five share investors also owns Australian residential investment property (see Are you over-exposed to residential property?).

Perhaps you can see where this is heading. After 25 recession-free years the income of many investors is almost totally reliant on the health of the Australian economy, its sharemarket and residential property sector. For investors still working, perhaps with an outstanding mortgage, that dependence is even greater. If Australia's economy tumbles, the income of many investors is going to go down with it. That's a risk we think is worth insuring against. The question is how.

Enter the Asian REIT Fund, which offers Australian income investors all the benefits local listed property investors have come to depend on, but with smart diversification, focussed on the globalised cities of the world's fastest growing region.

We're the first to admit we may have launched the Asian REIT Fund ahead of it's time in 2011 but we don't mind that. It's happened before. We recognise that patience is required to take advantage of some of the best opportunities in commercial property and we know this as we have launched funds with investment mandates which are new to the market on a number of occasions before (for example Australia's first self storage property trust and one of Australia's first petrol station funds). Slowly, the attractiveness of Asian REITs is gaining traction, not just with advisers but also with retail investors, especially those familiar with the high quality shopping centres and office buildings of Singapore, Hong Kong and Tokyo, where nearly 90% of the fund is invested.

These global cities appeal to investors in Australian property trusts that understand the impact on long term returns of location, population growth and land shortages. A global shift in wealth is underway and Singapore and Hong Kong, land-locked hubs where office rents are higher than in Sydney and Melbourne, are at the heart of it. These markets also feature some of the world's best shopping centre assets, including Singapore's very own Westfield.

As for Tokyo, it's the world's biggest office market and, as Pete Morrissey explained in Why would anyone invest in Japan?, unlike the rest of the country enjoys a growing local economy. It's also in the midst of a huge tourism boom. By 2020, the country aims to have 40 million visitors a year, almost all of whom will visit Tokyo. Such are the benefits of the huge growth in Asia's middle class, which now numbers 800m, Asia's hub cities are catching the eye of global capital.

It all adds up to a powerful argument for yield-focused investors to diversify away from an over-dependence on Australia as a source of income, towards Asia's global gateway cities.

Asian REITs, unlike their Australian equivalents, are also generally restricted from property development activities, which lowers their risk profile. Gearing is also restricted, which should please local property trust investors that fell victim to the excesses of the sector prior to the GFC. The Asian REIT sector is far less concentrated than it is in Australia, where a few big names dominate, and is experiencing remarkable growth. The fact that Asian REITs are mandated to pay out more than 90% of their income adds to their attraction, especially for income oriented investors.

From a standing start 16 years ago, when Japan established a REIT market, the Asian REIT sector has a combined market capitalisation of $266 billion[4]. That dwarfs the local REIT market with a combined market cap of $142 billion[4]. Performance has been impressive, too. The APN Asian REIT fund has returned 14.42% p.a.[2] since its inception in 2011, putting it ahead of European and US REIT markets but also ahead of Asian and Australian equities.

There's no doubt this story is making inroads with professional advisers. According to an Asia Pacific Real Estate Association (APREA) survey conducted at the end of 2012, 70% of managers expected to increase their allocations to [Asian REITs] in the coming years. The recent growth in the sector suggests advisers followed through with that intention. 'Relevance' doesn't always happen overnight – it is only recently (July 2016) that the REIT sector as a whole was even given its own stock market classification, so we're confident that listed Asian commercial real estate will only continue to grow in its relevance to investors around the world.

Slowly, advisers and investors in Australian are waking up to the opportunity. Not only does the APN Asian REIT Fund add geographic diversification to a property investment portfolio, in return for accepting some risk through exchange rate movements, investing in Asia's global cities offers an attractive running yield of 6.24%[1] and, in our view, potentially higher capital growth over the long term.

That's why we started the Asian REIT Fund and why we're sticking with it. Australian investors need to diversify their income sources away from Australia to a region of big opportunity but also to products that offer safety and stability of income. That's what APN's Asian Fund is all about.

This article has been prepared for general information only and without taking your objectives, financial situation or needs into account. You should consider these matters and read the product disclosure statement (PDS) for the APN Asian REIT Fund in its entirety before you make an investment decision. The PDS is issued by APN Funds Management Limited ABN 60 080 674 479 (AFSL No. 237500) and contains important information about risks, costs and fees associated with an investment in the Fund. For a copy of the PDS and more details about the APN Asian REIT Fund its performance, visit our website at www.apngroup.com.au.

1 As at 30 April 2017. 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.

2 As at 30 April 2017. Returns shown are net of fees and expenses and are annualised for periods greater than one year. Assumes distributions are reinvested. Investors' tax rates are not taken into account when calculating returns. Past performance is not an indicator of future performance.

3 Inception date: Asian REIT Fund May 2011 and AREIT Fund January 2009.

4 Bloomberg as at 30 April 2017.

APN Property Group
A specialist real estate investment manager

We actively invest in, develop and manage real estate and real estate securities on behalf of institutional and retail investors. APN's approach to real estate investment is based on a 'property for income' philosophy.

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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