Are you breaking investing's golden rule?

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What can one make of the recent ASX study1 that revealed 75% of investors hold only ASX-listed shares? Personally, I found it shocking. Sensible diversification is perhaps the golden rule in investing and three out of four Australian investors are breaking it.

It's easy to understand why. In investing as in life we gravitate towards the familiar. We stick with familiar brands in familiar countries, which usually means the one we're living in.

And so, despite most Australian investors being aware of the Asian growth story, and an acceptance that the region is becoming more politically and economically influential, investors view Asia as a no-go area.

That's a missed opportunity in my view, based on an outdated understanding of what the region actually offers. The Asian real estate investment trust (REIT) market is a good example of how perception lags reality.

The REIT structure was created in the US in the 1960s and has since been adopted in many countries, including Australia in 1971, now the third largest REIT market in the world. The Asian REIT market was late to the party; Japan had its first REIT listing in 2001, followed by Singapore in 2002 and Hong Kong in 2005.

The late arrival gave Asian regulators the opportunity to develop legislation based on the experience of other jurisdictions.

This is a crucial point. Regulators in Japan, Singapore and Hong Kong want to attract foreign investment. Transparent, open markets and effective legislation that protects investors is a prerequisite. But these countries have taken things a step further.

The Asia Pacific Real Estate Association (APREA), the leading real estate body for the region, was, in part, formed to unify REIT disclosure and act as the agent of change for corporate best practice.

APREA provides widely followed guidelines on reporting requirements and also offers recommendations on issues such as related party transactions, board independence and minority shareholder representation. APREA works with regulators across the region to develop legislation that protects investors' interests.

Take Singapore as an example. The Monetary Authority of Singapore's Code on Collective Investment Schemes specifically outlines requirements that Singapore REITs must adhere to in order to retain their REIT status.

The code stipulates that Singapore REITs must cap gearing at 45% of total asset value; ensure that at least 90% of annual income is paid out to shareholders; and limit speculative development to 10% of total assets2. Hong Kong and Japan have followed a similar path, as the table shows.

Legislative Comparison	Singapore	Hong Kong	Japan
Management Structure	Internal / External	Internal / External	External
Minimum Real Estate Investments	75%	100%	75%
Foreign Assets	Permitted	Permitted	Permitted
Development	Up to 25% of deposited property	Up to 10% of deposited property	Prohibited
Gearing Limit	45% of total assets	45% of total assets	No restriction
Payout Ratio	90% of taxable income (no depreciation)	90% of net income after tax	90% of taxable income (post depreciation)
Tax Concession for Investors	10% withholding tax for non-resident companies until March 2020	No	No

Source : UBS May 2017

Where's the value for investors in these specific REIT restrictions? There are three principal benefits:

1. Gearing limits reduce risk

Investors holding REITs during the Global Financial Crisis know what can happen when highly leveraged property trusts are unable to refinance their debt.

To fund a spending spree on US properties, in 2007 Centro Property Group's gearing had risen to 48%, well beyond its target range of 35-45%. The GFC caused the value of these assets to be depreciated, massively increasing the debt burden relative to the company's asset base. Centro had to slash its dividend to stay solvent and the share price fell by 70%3 on the day of the announcement.

Ensuring gearing is capped at 45% of a REIT's total asset value gives investors comfort that debt will be managed responsibly.

2. A guaranteed high payout ratio works against empire building

A mandated high payout ratio means company management can't hoard cash and then go off and do something stupid with it. For investors looking for reliable, regular income, this is a great regulation.

If a REIT management team wants to expand but has to pay out almost all its income to investors it must instead raise capital from equity markets. That offers a real impediment to a manager's intent on empire building. Requiring that 90% of earnings are paid out to investors ensures a focus on rental income rather than expansion.

3. Limiting property development reduces risk

Income-focused investors want REITs to have the flexibility to upgrade and redevelop their properties to command higher rental rates. What they don't want is management teams betting the farm on speculative developments with the potential to destroy shareholder value. Limiting speculative development to 10% of total assets ensures this2.

As an aside, whilst Japan has no gearing restriction, development work is not permitted. This nuance makes sense for the region; APN Property Group's analysis has shown that although Japanese REITs are more highly geared, due to the historically low cost of Japanese debt the ability to service it is greater than Asian peers.

Investors may still view Asia as a distant, unfathomable place but rules that restrict gearing and property development and insist on high payout ratios make Hong Kong, Singapore and Japan some of the safest places in the world to invest in commercial real estate.

Not only does APN's Asian REIT Fund deliver investors badly needed international diversification into the world's fastest growing region, it also offers exposure to some of the safest governance structures around.

That might come as a surprise to Australian investors currently breaching one of investing's golden rules but it might pay them to get their heads around it.

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