Dullness is a virtue

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With all the talk around the US$1tn valuations of Apple and Amazon, trade wars and US markets at record highs, it comes as no surprise that property and equity markets have become quite ‘noisy’. Investors would be forgiven for losing track of the simplest of messages amongst all the commentary, analysis and fancy jargon.

Yes, it might seem dull by comparison. But that’s the point. If you want stable, predictable income, dullness is a virtue.

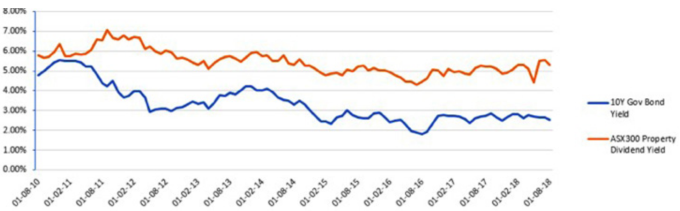
As a reminder to our readers, here are eight reasons why we believe conservative investors looking for sustainable income over the long term should consider AREITs for their portfolios:

1. Sustainable income

Whilst commercial property investing is primarily about income, over the last decade AREITs have done rather well in terms of capital growth.

But their most attractive feature is the strong and stable distributions generated by recurring rental income from commercial property tenants. The chart below, which plots the historical yield premium AREITs have generated compared with bond yields, makes the point.

ASX300 Property Dividend Yields vs 10yr Government Bond Yields



Source: Bloomberg

It shows a smooth dividend yield profile but also a consistent premium against 10-year government bond yields since 2008.

APN’s AREIT Fund currently yields 6.04%[1], which favourably compares with the current 10-year bond yield of 2.59%[2].

If you want sustainable income rather than roaring share prices or mediocre yields on a term deposit, commercial property is a good place to consider right now.

2. High quality property exposure

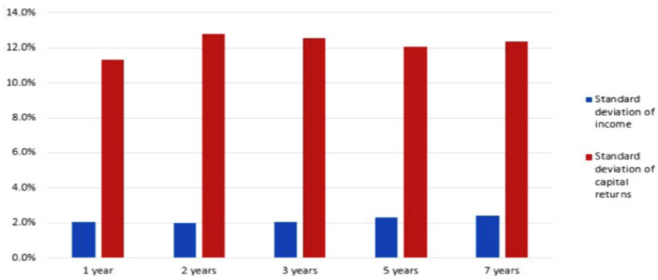
In Australia, there are about 40 listed AREITs with a combined market capitalisation of about $128bn. These listed property trusts own some of the highest quality, best performing assets in Australia, including Chadstone Shopping Centre in Melbourne, Westfield Bondi Junction and Deutsche Bank Place, one of Sydney’s leading commercial offices.

In addition, AREITs also offer exposure to storage and industrial parks, hospitals, aged care facilities and hotels. The calibre and range of tenants offers protection to investors and the attractive income benefits on which they rely.

3. Lower risk

Take a look at the chart below, which shows the stability of income from commercial property compared to capital growth. Income returns (as shown by the blue bars) are far less volatile (and therefore less risky) than capital returns (the red bars).

ASX300 Property Index Volatility of Returns of Capital and Income



Source: Bloomberg

That’s because rent must be paid whether a tenant makes a profit or not. The same cannot be said of ordinary dividends. Whether a company makes or loses money has no impact on its legal obligation to pay rent but may well impact its decision to pay dividends. Dividends can change rapidly: rents tend to rise slowly over the life of a rental contract.

If you want stability of income at low risk, AREITs deliver it.

4. Built-in diversification

AREITs offer exposure to thousands of different properties and tenants in various locations. The APN AREIT Fund is a good example, with over 2,000 underlying properties including shopping centres, office buildings, industrial property, childcare centres, service stations and more.

This inbuilt diversification across businesses and sectors offers protection from normal business failures and economic cycles.

5. Lease terms boost defensiveness

The income from rents collected from commercial property is secured by long term lease agreements that often last anywhere from 5 to 10 years.

Because rents increase over the lease period, either through changes in the Consumer Price Index, fixed annual increases or market-based reviews, rents generally cannot fall during the contract’s lifetime. This makes investors’ income streams safer and increases the defensive nature of their investment.

6. Buy and sell when you want

Property is an illiquid asset. But investing in commercial property through AREITs means you can buy and sell at any time. As with shares, AREITs are tradable on the Australian Securities Exchange.

In contrast, direct property ownership is an "all or nothing" proposition. You can't sell a floor of an office building, a room in a house or one level of a shopping centre to release cash.

7. Tax-advantaged benefits

Most distributions paid by AREITs include a 'tax-deferred' component. This occurs when distributable income is higher than taxable income.

Because a trust can offset its taxable income through a range of deductions – including depreciation on plant and equipment, capital allowances on building structures, interest and costs – this is frequently the case.

Tax deferred income reduces an investor's initial cost base, increasing the potential capital gain when the investment is sold. Although this can mean more capital gains tax (CGT) at the point of sale, it is often offset by the reduced level of tax paid on income through the life of the investment.

This unique benefit is not widely known but has the potential to increase after-tax returns. For long-term investors, the benefits can be even more significant. If the units are held by a superannuation fund that realises the investments during the pension phase they have the potential to be tax-free.

8. Cost

To purchase a commercial property outright requires deep pockets. The minimum investment amount in the APN AREIT Fund, meanwhile, is just $1,000. This delivers exposure to a broad portfolio of high quality properties that would otherwise be impossible to access as a private investor.

That's an impressive list of benefits, even if they might send other, more aggressive, investors to sleep.

The AREIT sector is currently yielding 5.16%pa[3] while APN's AREIT Fund currently yields 6.04%pa[4]. If you like the sound of it, you can find out more visit http://apngroup.com.au/fund/areit/.

1 Current running yield as at 7 September 2018 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 10 year Australian Government Bond Yield as at 10 September 2018.
3 AREIT 300 Property Index yield as at 7 September 2018.
4 Current running yield as at 7 September 2018 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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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 $2.8 billion (as at 30 June 2018) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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