The Goodman Effect

If you're an Australian Real Estate Investment Trust (AREIT) investor looking for reliable, stable income, you are being misled. The AREIT Index is not what you think and Goodman's latest result shows how much you're being led astray.

Describing its mission as "logistics space for the world's greatest ambitions", Goodman is riding a logistics wave, attracting tenants of the calibre of Amazon, DHL and Toll Holdings.

According to its latest results presentation, the group manages over 384 properties around the world, many of which are warehouses and large scale logistics facilities.

The growth of online shopping and an increasingly globalised economy means logistics and last mile delivery assets are in demand. With a further 68 projects in 12 countries underway, Goodman is a company in the right place at the right time; big, growing and global.

Investors have been quick to catch the wave. Over the past 12 months[1] Goodman's stock has risen almost 60%, only 2-3% of which has been from distributions. This has made the company the best performing AREIT over the past 12 months and the largest by market capitalisation.

How can an AREIT-classified stock - the epitome, or so one might think, of conservative, income-focused investing - enjoy such a meteoric rise?

Goodman's latest half year result sheds light on the discrepancy. It reveals that 72% of earnings were derived from property development and funds management income. Such earnings are notoriously cyclical. A lot of money can be made in the good times but when the cycle turns it can disappear just as fast. With only 28% of earnings coming from rent (i.e. income from tenants under their leases) you can start to see why we as income-focused investors start to struggle with stocks like Goodman. We're not saying it isn't a great business – as a lot of general equities funds have recently decided – but it's simply a different beast to the lower risk rent collectors we are looking for on behalf of our investors.

Rents are more stable and predictable than funds management fees (including performance fees some of which are 'one-offs' and property development profits); a tenant of an office block or shopping centre pays rent whether they make money or not. As a comparison, Scentre Group's (which owns a portfolio of shopping centres) latest result revealed that 79% of its earnings derived from rental income.

For income investors with an interest in property trusts this is a crucial point. If you're reliant on a monthly or quarterly cheque to cover your living expenses you're almost certainly better off with a rent collector than a property developer.

Unfortunately, the AREIT Index fails to make any such distinction. Australia's most conservative investors might therefore inadvertently hitch their wagon to a company with highly cyclical earnings and distributions without really knowing it.

This is not Goodman's fault. It hasn't broken any rules and is not misrepresenting anything. This is a fine, well-managed company. That said, if Goodman tried to list as a REIT in Singapore, Hong Kong or Japan it would be shown the door. Not in Australia, where a property developer bears the same safety-first AREIT label as a rent collector.

For investors genuinely orientated to secure, stable income this poses a conundrum, one also faced by APN's AREIT Fund.

If we are to be true to label and follow our mandate we're obligated to limit our exposure to stocks like Goodman and Charter Hall, both of which heavily rely on earnings from sources other than rents.

This we are unequivocally doing. As of 31 March 2019, Goodman accounted for 17.80% of the S&P/ASX300 Property Index. The APN AREIT Fund weighting is just 5.22%.

Such an underweight position in a high performing stock has naturally hurt our short term total return performance when compared to the AREIT Index. This does not concern us and nor should it concern our investors. We have always said we are benchmark 'unaware' and we are not about to change this now.

APN's approach is to avoid risky exposures. We seek out passive property investments that deliver sustainable income from good tenants on long term leases run by good quality property managers.

Some may call this boring but that's the point. Our aim is to deliver to our investors a sustainable, monthly distribution with lower risk than investing in the AREIT index. An index weighting to Goodman would take us away from that goal. Investors should get true to label income-focused investment performance from the APN AREIT Fund (and they may well choose to get their 'racier' exposures from other sources).

The danger for many income-oriented investors is that whilst they're attracted to the short term returns they may be unaware of the risks they're taking to get it. Investors shouldn't automatically assume that every AREIT is a relatively secure way to get regular, reliable income.

1 As at 31 March 2019

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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 31 December 2018) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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