



## Investor update - 18 March, 2020

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Writing this on 18 March and these are unquestionably extraordinary times.

This update is written particularly with respect to the APN AREIT Fund but the comments apply across APN's funds and more broadly – it's a continuation of a previous note that I wrote last week (<https://apngroup.com.au/blog/commercial-property-to-go-viral/>).

### 1. Could the AREIT Fund unit price go lower?

Yes. It is possible. There is no way to guarantee how the market will continue to react. It could go lower. We have already seen wild swings and some selling which we would describe as 'panic selling.'

Companies including ANZ, BHP and Woolworths have seen declines in their share prices of over 25% over recent weeks. Few stocks or companies are unaffected by the current disorder. Volatility is high and may remain this way for some time given the amount of uncertainty regarding Coronavirus/ COVID19 and the measures being taken to combat it.

I think it is exactly the same with the APN AREIT Fund and you need to focus (as we are) on the income. This is what we have done for over 20 years. The income led the listed property market to an outstanding market performance coming out of the global financial crisis in 2008-2009. If ever there was a time that regular cash distributions would be highly valued, we believe it will be in the coming months. Investors need to remember that markets consistently overreact to uncertainty but can come 'roaring back' when clarity improves.

### 2. What's going to happen to the APN AREIT Fund's distributions? How sustainable is the distribution income?

For many years the AREIT Fund has been managed with intense focus on the reliability of the cash earnings from its investments. For this reason it has significantly lower holdings in groups which generate significant earnings from non-rental income sources such as property development and funds management activities which are traditionally more variable. This is what we think differentiates us from a number of others.

The AREIT Fund continues to pay distributions at a current rate of 0.8694 cents per unit per month and we have no intention of changing this. Whilst it's not possible to guarantee that the APN AREIT Fund unit price may not fall even further or that it may become necessary to reduce the current rate of distributions, since we first launched the Fund it has always aimed to hold investments which are well placed to deliver strong and sustainable rental income streams – this has also not changed.

The APN AREIT Fund has holdings in retail property trusts including Charter Hall Retail, Scentre Group, Shopping Centres Australia and Vicinity Centres. Some of these stocks have been hit particularly hard as investors price in views that retailers (who pay the rent) may ask for rental abatements due to declining foot traffic or shopping centre closures. APN has increased its focus on non-discretionary retail portfolios (for example supermarket anchored shopping centres which have been deemed essential by the Government and will remain open for normal trade) over recent months and has been reducing the Fund's exposure to discretionary focused shopping centres.

It's essential in our thinking that people ask themselves what is most likely to happen and how long will it last. In the current situation it appears that there is a coordinated and accelerating approach between Central Banks, Governments, the community and business to unite to confront the shared challenges. Without this, a depression style economic slow down could not be ruled out. If there is a major support response, betting against this coalition and their wartime mission by selling out after significant falls could be very much regretted later.

We believe that after this extraordinary period – which may be very difficult for many to see past currently – that life will go on and return to normal. What the intervening period looks like and how long is hard to predict. We discussed retail, however, it's not to say that office, industrial or other specialised real estate will be completely immune – they will be impacted in some way. Our focus remains on AREITs with quality assets in good locations with a diversified pool of strong tenants and experienced management teams that maximise 'pure' rental earnings for APN AREIT Fund investors.

Investors in commercial real estate should also remember that the lease contract is a legal obligation on the tenant to pay the rent ahead of any obligation to shareholders. This

'cash flow priority' is a key consideration when looking at income risk. If you believe that listed companies will survive this maelstrom, it is fair to conclude that their landlords are in a more secure position.

### 3. How does the AREIT sector compare to 2008?

Some of the other key concerns we have been testing are how strong balance sheets are across the listed property sector. At the December 2019 results announced through February the average sector gearing was 25%, its lowest level since the late 1990s, with significantly increased debt expiry profiles and diversification with far less reliance on Australian banks. This approach by AREIT management teams and their enhanced debt management post the global financial crisis (GFC) provides a level of additional protection from potential recapitalisations. We cannot categorically rule out equity issuance but this is a critical point to consider when thinking about the downside risks from this point (including through equity issuance and consequential earnings dilution).

While this may well be a 1 in 100 year event and it may take some time to play out first, it is almost certainly temporary and second, it is a 'real world' event unlike the GFC's genesis in 2008. The difference here being the overwhelming unity we are seeing between governments, central banks and businesses to 'fix' the current issues – that is a war chest that does not exist anywhere else in the world or in financial markets.

### 4. Should I sell?

Let me be very clear on this. This is not personal advice by any stretch – you must make your own mind up.

If you are a self-directed investor we strongly recommend that you speak to a trusted professional advisor.

If you are thinking of liquidating investments in response to what has happened recently, we very strongly urge you to consider whether this is the right course of action.

### 5. What's the upside?

I don't have a crystal ball. What I do know is that there are lots of examples of investors massively overreacting to news (good and bad). Our portfolio of real commercial property assets has a real physical value and we believe is well placed to continue to deliver us with strong and sustainable cash flows. Yes there may be temporary reduction for some stocks but we think our portfolio remains well positioned to lower risk rental income. This is the case even despite our expectation that plenty of the REITs will withdraw their earnings guidance given the current uncertainty in the market. We expect that we will be in for a much longer period of even lower rates. Reliable cash income streams will continue to be highly prized by investors who need income – of all shapes and sizes. If the Government and Central Banks response follow through on Donald Trump's 'We're going big' response effort, a stabilisation and significant rebound in the unit price of the APN AREIT Fund would not surprise us. In the meantime we will continue to focus as we always have on delivering our investors with consistent income.



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Established in 1996, APN's listed on the ASX and manages \$3.1 billion (as at 31 December 2019) of real estate and real estate securities. APN trades on the ASX under the code 'APD'.

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### Further information or assistance

We are committed to open, regular and transparent communication with all of our investors.

If you have any queries regarding your investments with us we would be more than happy to discuss these queries with you. Our Investor Services phone line is 1800 996 456; or you may contact us at [apnpg@apngroup.com.au](mailto:apnpg@apngroup.com.au). And for our financial adviser clients, please don't hesitate to reach out to your Regional Manager..

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