

APN ASIAN REIT FUND

Experience the growth story

A property securities fund that invests in a quality portfolio of **Asian Real Estate Investment Trusts (REITs)** that aims to deliver a competitive yield, capital growth over the long term and lower risk than the market.

- Income focussed
- Diverse portfolio of quality Asian commercial property
- Actively managed fund
- Local investment team
- Highly disciplined, proven investment process
- 100% liquid

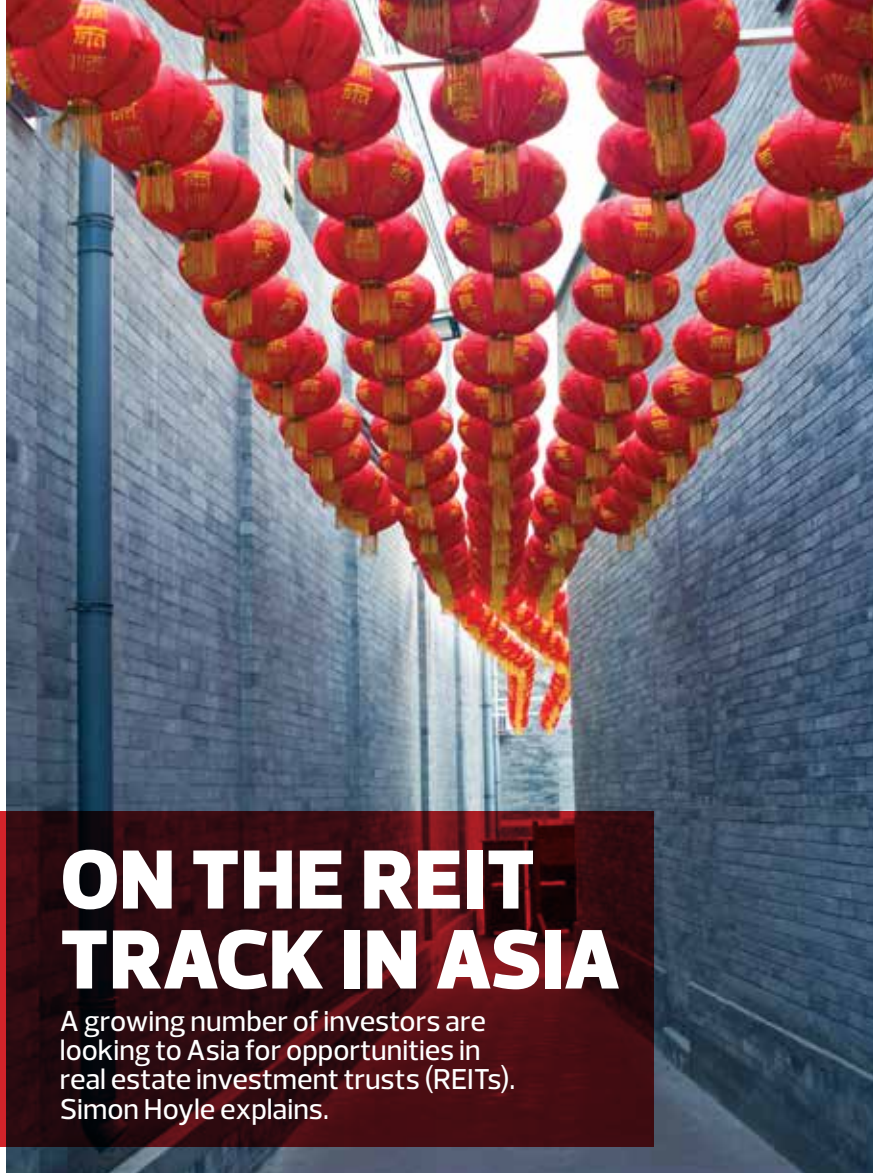
To find out more

 apngroup.com.au

 1800 996 456

 apnpg@apngroup.com.au

APN | Asian REIT Fund



ON THE REIT TRACK IN ASIA

A growing number of investors are looking to Asia for opportunities in real estate investment trusts (REITs). Simon Hoyle explains.

A healthy economy begets a healthy property market, and there are few healthier economies around at the moment than those in Asia.

Economic growth in 2014 is forecast at 6 per cent year-on-year for some countries, and this is underpinning a strong property development pipeline. Property development companies looking to offload some of their holdings, or to free up capital to fund further developments, are driving the development of the real estate investment trust (REIT) sector.

And although the REIT sector is assessed as still being in its infancy, as the REIT

sector grows it is presenting opportunities for investors to gain exposure to the Asian economic growth story through an asset class other than "straight" equities.

Louis Christopher, founder and research director of SQM Research, says the Asian REIT sector has bright growth prospects.

"Where the Asian REIT sector is right now, it's still in its infancy in terms of the number of managers offering product, as well as the number of REITs that are available," Christopher says.

"Mind you, it has exploded in terms of the number of REITs, but I think it's going to get a lot bigger than it is now through more

and more Asian economies developing a REIT sector.

"In terms of the countries offering REITs, Singapore, Japan and Hong Kong are the main ones, and then you have got some offshoots, like Malaysia. Indonesia doesn't really; and others have some REITs."

Jonathan Baird, an investment analyst with Zenith Investment Partners, says Asian REITs have "experienced a fair bit of growth in recent years" and will grow further in coming years.

"The REIT structure has been around for a while in Asia, but now we are seeing more and more players coming to the market," Baird says.

"Thailand, for example, is becoming more developed, and more structured.

"Asian REITs are definitely growing, and growing in popularity. We're part-way through our sector [research] cycle, and relative to last year we're seeing greater allocations to that space, in funds that allocate to REITs globally.

"People are getting more confident to get into this space, and into emerging markets generally as we see emerging markets going from emerging to emerged.

"Where there is demand, people are going to meet that demand, so there is definitely supply coming on in that space."

Stephen Finch, chief executive of APN Property Group's Asian operations, says there are opportunities for Australian investors to diversify their property holdings, and "Asia definitely gives some opportunity for diversification".

Finch says historical correlations between Asian property markets and the Australian property markets are "not that high – in fact, in one or two cases they're approaching zero to negative".

"It's also about tapping into a very interesting growth story," Finch says.

"Australia is quite a mature market for real estate, while Asia is a market that is growing very rapidly, both in terms of the

Assurance of liquidity

underlying economies, and the growth in the rental streams that are supported by that economic growth, but also in the context that REITs in Asia are still a relatively small part of the investable commercial real estate space.

"If you think about all the commercial real estate that's available to invest in in Australia, there's a very high penetration rate of professional money in the commercial real estate space already."

"In Asia, it's still in its relative infancy – probably about 20 per cent or so," he says.

"There's a lot of room to grow, just in terms of bringing high-grade commercial real estate into REITs."

Christopher says there are a few things that need to be in place before a REIT market can operate effectively.

One of these preconditions is "suitable taxation laws". "You need suitable title ownership as well," he says. "That's what you need for these things to work – and the ability of these trusts to list on an exchange."

Christopher says there are "plenty of property-related stocks in Asia, and generally they have been dominated by Asian property developers". He says that these are not really REITs, even though a number of the companies do hold significant property assets on their balance sheets.

"So some of them could be classed as 'semi-REITs'," he says.

Finch says a requirement for a healthy REIT market is "first of all, a fairly mature commercial property market, and [on] top of that have a big inventory of mature commercial assets that are available to go into REITs".

"That's not a feature of fast-developing economies," Finch says.

"When you think of classic emerging economies, where things are changing very rapidly and the economy is growing very rapidly, the concept of mature, stable commercial property is not really fully established."



THE TRANSMISSION MECHANISM

APN's Stephen Finch says that in a basic sense, property values and growth are driven by nominal GDP growth.

"The transmission mechanism of that is as the economy grows and there's expansion in the business sector, there's need for more space – that's obviously office space – and that's especially true in the consumption sector. As consumption grows in the economy, it's a direct driver of retail spend, which in turn is a driver for retail rents.

"At another level, for the logistics space – which is a very important sector in Asia – again it's driven largely by the retail spend. There's a lot of logistics space going into Asia, and we're seeing it finding its way into REITs and securities [funds]. It's supporting the whole delivery mechanism for the retail sector – the so-called fulfilment concept for internet vendors, et cetera. It's all about providing fulfilment of consumer goods to the end party.

"So basically, we see that nominal GDP growth captures both inflation and real growth, and I think that's quite important because your leases and your lease rates are a reflection of what's going on in the nominal economy, versus real.

"We definitely see a lot of growth there, in Asia, and we see it coming through GDP growth, which is already high overall in real terms. Even the mature economies



in Asia – Japan and Hong Kong and Singapore and the like – are growing at 3 per cent, plus or minus. Asia overall is growing at something like 6 per cent. So it's quite high on a real basis. And if you think of that in nominal terms, where we are seeing some reasonably strong inflation numbers in Singapore and Hong Kong, et cetera, it's actually even higher. That all ends up driving the businesses of the tenants, and therefore their ability to pay. And that's the linkage."

"What I want to underline in terms of the growth in GDP and what's happening in Asia that I think is particularly interesting is that I think we're all familiar with Asia as an export platform and essentially being a leveraged play on global growth through its strong export engine – and that's certainly been the story for the past 15 years or so. What's happening now, and this has been accelerated a bit in the last few years with the financial crisis and all the rest of it, is that Asia is very much moving towards a more domestically driven consumption growth story. It's happening in fits and starts and it's not even in every country; and all of that, but in general most of the countries, are moving towards promoting domestic consumption and promoting a better lifestyle for a larger percentage of the people.

"You can see it happening with the new government in Korea, you're seeing it in Singapore, you're seeing it in China, and even in Japan with Abenomics – a lot of it is going to end up trying to drive domestic consumption in Japan, rather than savings."

Strength of diversity



Finch says another requirement is "a reasonably well developed domestic capital market".

"The equity market is important because that's where you find the REITs listed; but the primary reference for value in the real estate space and the REIT space is the income that is being driven out of these commercial properties relative to what you'd receive in a fixed-income market," Finch says.

"So the development of a reasonably healthy fixed-income market is a corollary to developing a REIT market, in my view.

"When you apply that to Asia, you're really looking at Singapore, Japan and Hong Kong as the ones that clearly tick all those boxes, and that's why you've seen those countries develop their REIT markets

first, with the greatest depth. In the next wave are what you'd really characterise as more middle-class countries. We're seeing fairly decent growth coming out of Malaysia, and there are a few interesting vehicles in Thailand and perhaps more to come in the next year or so, which will help as well."

Christopher says SQM expects more countries to develop REIT markets as the conditions become right for them to do so.

"There will be more and more countries opening up REIT legislation," Christopher says.

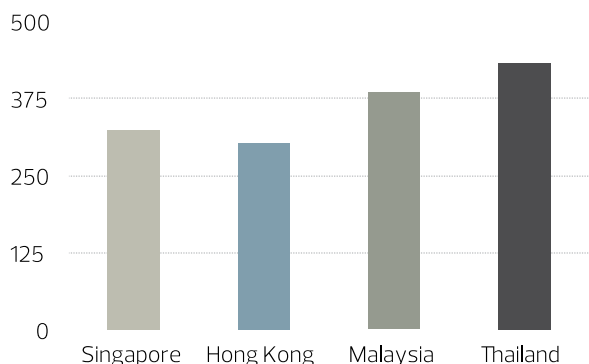
One such country is Vietnam, he says, and "the investment universe for pure REITs will get wider and wider and wider".

"We think there are plenty of opportunities for investors – and the benefits are already there," he says.

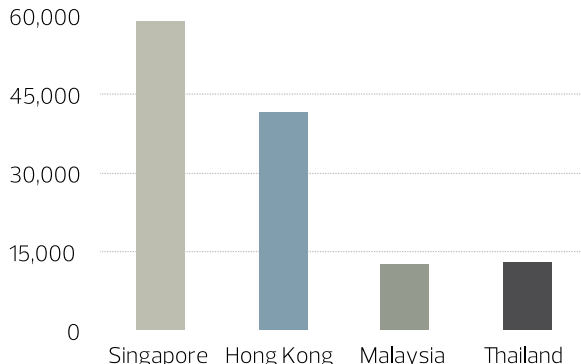
"They represent a wider investment universe than just straight-out domestic REITs. It means managers can differentiate themselves a little bit more.

"They may say we want to focus on seven countries and that's what we want, to give our product an edge; some managers may say we're going to make our fund sector-specific; some may say

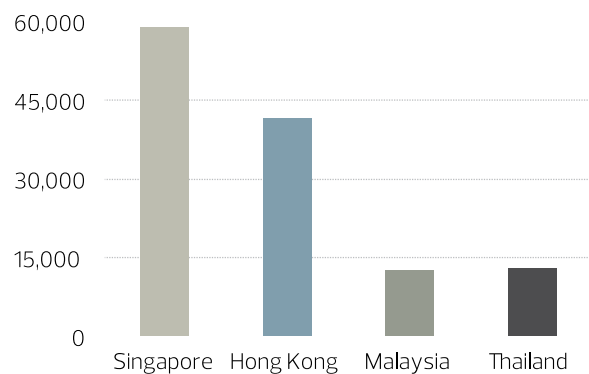
NOMINAL GDP (\$US BN) 2014 (FORECAST)



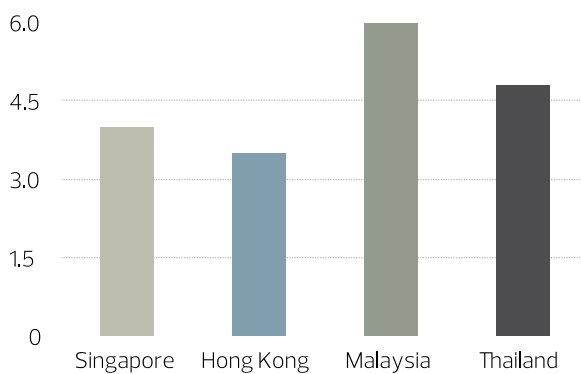
GDP PER CAPITA (\$US) 2014 (FORECAST)



REAL GDP (% YOY) 2014 (FORECAST)



REAL CONSUMPTION GROWTH (% YOY) 2014 (F)



Source for all charts: Citi

Recurring income



“BUT IT'S QUITE POSSIBLE TO SET UP A FUND AND NOT HAVE TO HEDGE IT. THAT'S A CLEAR BENEFIT AND IT'S GOING TO KEEP COSTS DOWN.”

we're going to have a broader portfolio and we're going to invest in the property developers as well.”

Christopher says that with any overseas investment, investors need to be aware of the potential impact of currency.

“There's less currency volatility between the Australian dollar and some of the Asian currencies – for example, the Singapore dollar,” he says.

“Some of the currencies are pegged to the US dollar, so you have to watch for that. But it's quite possible to set up a fund and not have to hedge it. That's a clear benefit. It's going to keep costs down on that fund

and that's a benefit over global [REIT funds], where most of the funds are hedged because there's currency volatility.”

Christopher says hedging has direct costs and can be devastating to fund returns if the manager gets it wrong, as has happened in the past.

Baird points out that in 2009, for example, distributions from REITs “generally didn't happen”. However, Christopher adds that “Australian investors like the notion of Asia and it's a fantastic opportunity”.

He says that dividend yields from Asian REITs have generally been stronger than yields from Australian REITs or from global

REIT funds. Christopher says Asian REITs represent a great stepping-stone between a pure domestic exposure and a broad, global exposure.

Baird says Asian REITs were not immune from the same issues that hit the sector globally prior to the global financial crisis.

He says REIT managers deviated from their core business of being “rent collectors” into activities like property development and funds management, and also, in many cases, became highly leveraged in an attempt to bolster returns.

“There has been a painful period of reconstruction since then.” ■

CONCERNS ABOUT CORPORATE GOVERNANCE

SQM Research's Louis Christopher says an issue of concern for Australian investors in Asia is the quality of corporate governance compared to that domestically, but he says this is slowly changing.

“Up until recently you would have to say that corporate governance hasn't been as good as we have in Australia, but it's been improving...and most analysts I speak to who cover this sector are saying they get a very good insight into the companies,” he says.

APN's Stephen Finch says it's an issue investors need to bear in mind, but it should not be something that necessarily stops them from investing.

“Here, the situation is different from Australia,” Finch says.

“Most of the REITs in Asia are affiliated with major property developers or corporates in Asia. Very few of them would be a purely independent REIT, in the sense that they go out and buy properties on their own, raise their own capital, and they're not involved with any other party.”

Finch says that is largely a result of the fact that “most of the prime commercial property in Asia has been developed and owned either by entrepreneurs or by large corporates that hold those assets very tightly”.

“So what's happened is these companies and entrepreneurs have essentially adopted the REIT model as a way of recycling capital in their own business, and as a way also that they are able to offer these assets into the marketplace – but they're still, broadly speaking, part of their corporate franchise,” he says.

“You need to be really aware of the relationship between the REIT and its

affiliated company. In Asia, the reality is that's where your pipeline comes from. That's where your ability to access additional assets and growth through acquisition is really going to be from – your sponsor.

“The one thing I wanted to emphasise is that within Asia, and it's certainly true within Singapore and Hong Kong specifically, and it's also true in Japan, is that there are a number of requirements that a manager has to go through before he can purchase property from an interested party.

“You have not only the normal things like valuations and the like, but you have also to go through an EGM [extraordinary general meeting], get shareholder approval, and ultimately you have to raise capital from the market to support that. There are a number of mechanisms that make it difficult to have interested party transactions that are disadvantageous to investors. It's not impossible, and that's where, again, you need a manager who knows what's going on and can work their way through those issues.

Zenith's Jonathan Baird says the development of capital markets in Asia generally is raising the standard of governance.

“You get developers and REITs that have a relationship,” he says.

“There are ties there, and they do transactions at prices that just aren't rational. And that's OK, if you're on the right side of the transaction; but if you're on the wrong side it can be quite painful.

“But like in the equity space, we're seeing these markets becoming more and more developed, and people are getting more confident to go in.”

Experience the growth story...

...  apngroup.com.au

APN | Asian REIT Fund

Assurance of liquidity **Strength** of diversity **Recurring** income

A resolute focus on the fundamentals of real estate investing underpins APN's long held philosophy since 1998 that high and sustainable yields from commercial property revenue streams drives value.

With this philosophy in mind, the **APN Asian REIT Fund** is designed to provide investors with a relatively high and consistent level of income and capital growth over the long term sourced from a carefully selected spread of Asian domiciled REITs.

Investing in 100% liquid securities, investors enjoy peace of mind knowing that they can redeem their investment at any time.

The **APN Asian REIT Fund** offers diversification across countries, sectors, properties, tenants and property managers. The careful selection of underlying securities, which is based on a proven investment strategy plays a key role in reducing risk for investors.

To find out more

 apngroup.com.au

 1800 996 456

 apnpg@apngroup.com.au

APN | Property Group

The information provided does not constitute financial product advice and does not purport to contain all relevant information necessary for making an investment decision. It is provided on the basis that the recipient will be responsible for making their own assessment of their financial needs and will seek further advice about the investment as is considered appropriate. Please refer to the Product Disclosure Statement for the APN Asian REIT Fund (ARSN 162 658 200) for further information. The Product Disclosure Statement can be downloaded from www.apngroup.com.au or a hard copy can be obtained free of charge by contacting us on 1800 996 456.