

# Property trusts still attractive, if a tad expensive

Their outlook is mixed, but analysts are broadly supportive

EVA BROCKLEHURST

Australia's increasingly expensive real estate investment trusts (also known property trusts) remain an investor favourite, harbouring a string of stocks with an ability to grow returns in the months ahead, according to a batch of analyst reports released following the recent reporting season.

Underpinned by well positioned office portfolios, the A-REITs sector remains in demand, though slowing retail sales create some headwinds and residential valuations clearly look less compelling.

On a macro perspective, analysts put forward interest rates — especially the trajectory of US interest rates — as the outstanding issue for the sector in the months ahead.

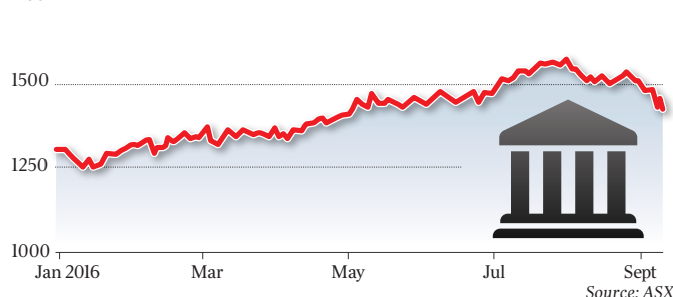
From a sector perspective, office A-REITs are preferred over retail-focused property trusts while among property managers, the active managers of assets are regularly preferred over passive players.

While the sector may struggle against rising rate expectations worldwide, investment brokers favour stocks with a so-called "growth bias", such as Goodman Group (GMG), Lend Lease (LLC), Stockland (SGP), Mirvac (MGR) and Charter Hall Group (CHC), and Dexus Property (DXS) and Investa Office (IOF).

Among the major brokers the outlook is mixed, but broadly supportive:

## Property trusts lose steam post-results season

S&P/ASX 200 A-REIT Index



- Morgan Stanley retains an "attractive industry" view, but observes the risks are present in rising bond yields, positive earnings momentum for industrial stocks and material tightening in credit conditions. In residential sub-sectors, there is still a sweet spot across the board, but the broker prefers Stockland to Mirvac because of the clarity in the outlook with a record level of net deposits.

- Stockbroker UBS considers residential valuations are less compelling now, but Mirvac appears the cheapest in terms of the implied value for its development business. Mirvac is the broker's preferred choice among the large caps, with its NSW and office exposure and implied multiples for development business.

UBS continues to believe Australian property is attractive on a global basis, as its yields versus bonds are wider than average compared with other developed markets. USB is surprised by the robust outlook for the office market and sees an 11 per cent and 19 per cent upside to estimates for Dexus Property and Investa Office, respectively, over the medium term.

- Credit Suisse suggest that against spot bond rates A-REITs appears reasonably priced on most traditional valuation measures. The broker continues to view Investa Office and Mirvac's office portfolios as best positioned in the current environment. Credit Suisse also finds the earnings quality questionable generally, with office A-REITs the largest beneficiaries of the expiry of incentives on leases being below that of replacement leases.

- Goldman Sachs believes settlement risk in the market is overstated in the residential sector and while volumes and margins are strong, the house price outlook is more mixed and construction approvals are flattening. This suggests to the broker that the cycle is close to a peak and pre-sales growth is likely to slow.

- According to Ord Minnett the highlight of profit season was the strength in residential, with both Stockland and Mirvac reporting higher sales and expanding margins. The broker also, notes Sydney office incentives have declined and monetising this in terms of better income growth is challenging. Looking at the



The A-REITs are in demand, with the office trusts preferred over retail trusts

wider reporting season for A-REITs, Ord Minnett highlights a stark contrast in earnings/cash flow growth, with developers and fund managers typically growing the fastest, and the passive rent collectors missing out.

- Stockbroker Macquarie says backdrop is strong for fund managers such as Goodman and

Charter Hall, while Lend Lease has an attractive profile at a reasonable valuation. Stocks which serve as retail bond proxies, such as Vicinity Centres and Scentre Group, are expensive in Macquarie's opinion, offering limited upside risk to earnings. Aventus Retail Property (AVN) is preferred by Macquarie in terms

of its tenant base. Meanwhile, Westfield is considered expensive and translating lost earnings from dilutive asset sales into accretive developments will take time, in the broker's view.

*This is an edited version of a feature that first appeared at [www.fnaarena.com](http://www.fnaarena.com)*

## Super has split rules for divorce

MONICA RULE



As superannuation becomes more important, the way it is treated in divorce proceedings has become a key investment issue. When a marriage breaks down, family law and superannuation law both come into play, yet many investors have little idea of how all this might work ... here's an introductory guide to the area.

Under Australian law, superannuation is to be treated as property that can be divided between couples. Separated couples can choose between three arrangements.

### A payment split

This can be made if a condition of release to access superannuation is legally satisfied.

### An interest split

Such an arrangement can be made where the superannuation is divided by specifying an amount that is to be paid to the "non-member spouse". A non-member spouse is a person who is going to receive a share of their spouse's superannuation as part of the property settlement. They may also be a member of the same superannuation fund.

### A flag arrangement

Here the couple can postpone their superannuation, according to an agreement or a court order.

When a flag is in force, the superannuation trustee must not make any payments from the fund. A flag continues to operate until it is either terminated by a court order or a flag lifting agreement is served on the trustee. The spouses may make a flag-lifting agreement that either provides that the flag is to cease operating without any payment split, or, specifies an amount, method or percentage to enable the trustee to calculate the payment split amount. A superannuation interest of a member spouse that is in the so-called payment phase cannot be flagged.

A superannuation agreement is only binding on the parties if it is signed by both parties and includes a statement to the effect that each party has received independent legal advice. It must be accompanied by a signed certificate from the legal practitioners who provided the advice.

Under a valid agreement, whenever a superannuation payment becomes payable, the non-member spouse is entitled to the relevant payment split amount.

It's worth understanding these concepts if you have significant levels of superannuation because how they work can make a huge difference to your investments. Until recently, family wealth in property or estate planning took out the majority of attention in settlements, but more recently with the immense spread of superannuation wealth (and DIY superannuation operators) advisers have to look more closely at these issues. As you can see, superannuation and divorce is a complex business.

*Monica Rule is an SMSF specialist and author of *The Self Managed Super Handbook*.*

[www.monicarule.com.au](http://www.monicarule.com.au)

## FLOAT WATCH

## Liquid assets won't leave you high and dry

### DUXTON WATER

ASX code: D2O  
Shares on offer: 90 million  
Listing price: \$1.10  
Market capitalisation: \$127.7m  
Listing date: September 21

Duxton Water is an Australian investment company focused on water investments. The company owns a portfolio of Australian Water Entitlements, which the company leases to producers, which in return pay annual rent to the company. At completion of the offer, Duxton Water will own and manage an initial water entitlement portfolio valued at \$38 million. The company seeks to raise \$99m by issuing 90 million shares at \$1.10.

The portfolio of water rights is forecast to deliver a weighted average gross yield of 5.9 per cent, with potential scope for capital growth over the long term. Upon settlement over 88 per cent of the existing portfolio will be leased back and the company intends to declare the

first dividend within the first 12 months of listing. Income visibility is high with an average lease term of seven years.

However, the company carries a concentration risk as its entire portfolio is invested in Australian water entitlements. Water price indices have been rising for the past four years and there is a risk that this may present a cyclical peak. Lease concentration is high as upon listing about 86 per cent of lease revenue is being paid by one lessee, Duxton Viticulture.

The listing offers investors the ability to gain exposure to the Australian water market, which has historically shown a low correlation to high-risk asset classes. Capital growth will depend on rising water prices, which is not assured. While capital growth may be limited the IPO provides an attractive income opportunity to investors looking for yield.

*Simon Hermann is an analyst at wise-owl.com*

## A cautionary tale for asset-rich but cash-poor retirees

TONY NEGLINE



An Administrative Appeals Tribunal case decided in May this year should make anyone using an account-based pension and wanting to give money to a child extremely cautious.

The case involved Irene and Harold Winch who in December 2011 gave their daughter \$50,000. Technically, under the social security laws, this was a gift.

One year later when Mrs Winch turned 65 she applied and was granted a part-age pension. At the time Mr Winch wasn't 65. Because of the assets test Irene received a reduced age pension.

All seemed to be working well until February last year, when the

Winch's contacted Centrelink saying that they were having trouble making ends meet because their super fund had inadequate cashflow and couldn't make any income payments from the account-based pension.

To make ends meet they had been borrowing money from friends.

As a result, the Winches asked Centrelink to pay them more age pension by ignoring their super fund pension account balance when working out their social security entitlements. That application was rejected and led to the appeal to the AAT.

The SMSF had a cashflow issue because the last remaining asset of the fund was three adjacent blocks of farming land that was owned by the SMSF and Mrs Winch's siblings and other relatives, presumably all as tenants in common. They had acquired ownership via an inheritance. The land was unencumbered.

All these parties had been receiving rent and royalties from

mining operations conducted on the farm land. However, these had ceased and the land was being rehabilitated by the mining company. It appears that the right to use some of this land had been returned to the owners not long before the Winches sought relief from Centrelink.

All up the farm land was worth about \$1 million net after sale costs.

As the land is jointly owned by three parties, they all had to agree to sell the land, and getting agreement to do this hasn't been straightforward.

An attempt had been made to sell one block. An offer had been accepted but it was withdrawn before completion.

Because of the cost involved the owners were reluctant to sell the land via auction. The other blocks were difficult to sell because they were subject to Environmental Planning Authority restrictions.

The Winches owned a retirement village apartment which was

**SMSF Trustees have a statutory obligation to ensure the fund can meet its future cashflow requirements — such as pension payments — and they can be fined for breaching this requirement**

valued at about \$500,000. They did not want to sell this because they like the location and they didn't want to rent.

They had been told that they couldn't borrow against the value of this property because they owned the building but not the land.

Not long after moving into the retirement village they had been on a holiday that had cost about \$40,000.

Ultimately the AAT rejected the Winches application for clemency because the gift they had given their daughter was more than the maximum permitted and overall they didn't satisfy the hardship requirements.

What isn't discussed in the AAT decision is the position of the SMSF. SMSF trustees have a statutory obligation to ensure the fund can meet its future cashflow requirements — such as pension payments — and they can be fined for breaching this requirement.

In addition, if the required minimum income payments

weren't paid before the end of a financial year, then the fund was not paying a pension.

This means the income and realised capital gains earned by the fund during the relevant years — in this particular it appears to be the 2015 financial year at a minimum — would have been taxed at 15 per cent.

And finally we come to the practical issue of the fund trustees not having a written agreement to force a sale of the real estate when they deem it necessary.

As the fund owned little or no assets other than the real estate, at some point the trustees would have to sell their share so they could continue to make pension income payments.

Ultimately this case appears to be a typical situation of retirees being asset-rich but income-poor and expecting taxpayers to solve this problem, even temporarily.

*Tony Negline is author of *The Essential SMSF Guide 2016-17* published by Thomson Reuters.*

## PERFORMANCE THAT TURNS HEADS AND HEARTS

### THIRD LINK GROWTH FUND an Australian share fund where your fees are donated to charity

#### KEY FEATURES

- ✓ Managed by industry veteran, **Chris Cuffe**
- ✓ A fund-of-funds, meaning Third Link Growth Fund is invested with other investment managers, including Aberdeen Asset Management, Bannellong Australian Equity Partners, Colonial First State, Cooper Investors, Goldman Sachs Asset Management, Greencape Capital, Harness Asset Management, JBWere Wealth Management, Lazard Asset Management, Montgomery Investment Management, Paradise Investment Management, Ophir Asset Management and Pengana Capital.
- ✓ The fees you pay (net of expenses) are donated to a variety of children's charities (showcased on the website). **Over \$4.5 million donated to date.**
- ✓ Minimum you can invest is **\$20,000**

#### FUND PERFORMANCE as at the end of JUNE 2016

(fund performance percentage returns are annualised and are after fees with the assumption that distributions were reinvested)

	Three Months	Six Months	One Year	Three Years	Five Years
Third Link Growth Fund	<b>+4.5%</b>	<b>+3.3%</b>	<b>+14.2%</b>	<b>+14.3%pa</b>	<b>+12.6%pa</b>
S&P/ASX 300 Accumulation Index	<b>+4.0%</b>	<b>+1.2%</b>	<b>+0.9%</b>	<b>+7.7%pa</b>	<b>+7.2%pa</b>
Performance relative to benchmark	<b>+0.5%</b>	<b>+2.1%</b>	<b>+13.3%</b>	<b>+6.6%pa</b>	<b>N/A*</b>

\*A comparison of the Fund return to the S&P/ASX 300 Accumulation index for the 5 year period has not been included as until 12 January 2012 the Fund had a different benchmark.  
All investments carry risks and returns may be volatile. Past performance is not indicative of future performance. Full performance information is available from the Fund's website, [www.thirdlink.com.au](http://www.thirdlink.com.au)

For more information or a **Product Disclosure Statement** visit **[thirdlink.com.au](http://thirdlink.com.au)** or call **1300 793 855**

**thirdlink**  
investment managers

This advertisement has been issued by Third Link Investment Managers Pty Ltd (Third Link), ABN 31 128 965 702, AFSL 321311, as investment manager of the Third Link Growth Fund (Fund), Bannellong Funds Management (BFML), ABN 39 111 214 085, AFSL 296806, is the responsible entity of the Fund. BFML has appointed Third Link to invest and manage the investments of the Fund. You should consider the PDS available from [www.thirdlink.com.au](http://www.thirdlink.com.au) before deciding to invest or continue to invest. Applications may only be made by using the form accompanying the Product Disclosure Statement (PDS) issued by BFML, dated 24 June 2016.

**Find a class asset. Advertise a role in Wealth Management. 1300 307 287.**

**THE AUSTRALIAN** IN PARTNERSHIP WITH **seek**