Cuffelinks
Connecting investors with ideas

Edition 199, 28 April 2017

This Week's Top Articles

- **Why Australians love dividends and franking** *Don Stammer*
- **Unpacking the '30-year bull market' in bonds** *Warren Bird*
- **Do options provide LIC investors with value?** *Peter Rae*
- **Lessons from a famous shareholder activist battle** *Annabelle Symons*
- **The meaning of life and real estate portfolio construction** *Adam Geha*
- **Four tips on what makes a good commercial property** *Damian Collins*
- **What Luxembourg and UCITS offer Australian investors** *Pierre Oberlé*

Why Australians love dividends and franking

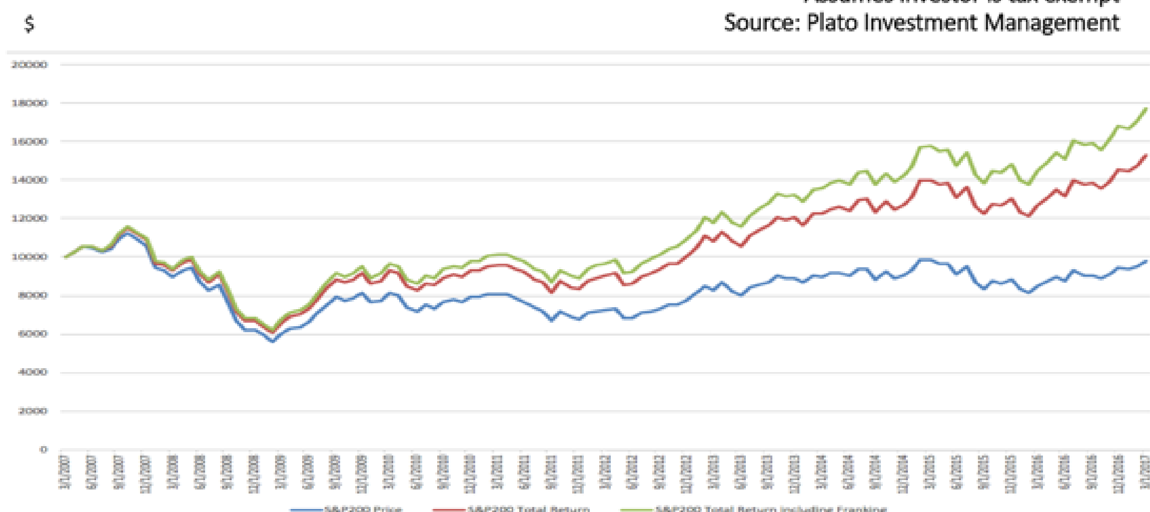
Don Stammer

In no other country do shareholders love dividends as much as in Australia. Here are 10 key facts on dividends, including one concluding piece of trivia.

1. Over the long haul, dividends have generated about half of the total return – capital gains plus dividends – investors have earned from Australian shares.
2. Dividends have more than pulled their weight in the last 10 years. Despite the collapse of share prices in 2008, the average investor who entered the share market a decade ago has achieved positive total returns, mainly due to the combination of good dividends and franking credits. The S&P/ASX200 Price Index (excluding dividends) is currently around 5,900, still well below its October 2007 level of 6,754.

CUMULATIVE RETURNS ON $10,000 INVESTED IN AUSTRALIAN SHARES 10 YEARS AGO:
SHARE PRICES (BLUE), WITH DIVIDENDS (RED), AND ALSO WITH FRANKING (GREEN)*

* Assumes investor is tax exempt
Source: Plato Investment Management



The importance of dividends and franking credits to investor returns is illustrated in the above chart from Don Hamson of Plato Investment Management. For many years, Plato has successfully run a managed fund specialising in franked dividends, and is currently launching a similar listed investment company.

3. Dividend franking particularly benefits investors on low tax rates. To a tax-free investor, including superannuation funds in pension mode, each dollar of a fully franked dividend is worth $1.43. That dollar of fully franked dividends would be worth $1.21 to an investor paying tax at 15%, including superannuation funds in accumulation mode. (From 1 July, tax at 15% will also apply to income paid into a retiree's superannuation balance on assets exceeding $1.6 million).

4. For eight years, the average dividend yield on Australian shares has consistently been between 4% and 4.5% a year. With interest rates at low levels, and many investors on the hunt for yield, shares with good dividend prospects have had additional appeal.

5. Of course, it's sustainable dividends that matter in stock selection. Among other things, investors need to avoid holding shares on which dividends are 'paid' from asset revaluations and capital raisings, and to be alert for 'dividend traps' (where the high dividend yield on a share may simply reflect the low share price because of an expected cut dividend).

6. Over the investment cycle, dividends are more stable than either company earnings or share prices. At times, however, dividends vary suddenly and unexpectedly, such as the dividend cuts announced by banks in 2009 and resource companies in 2016. The usual sequence in the investment cycle is for share prices to go through their cyclical turning point (maybe after one or more 'false dawns'), followed by the turning points in company earnings and (later) in dividends.

7. On average, dividends account for about 80% of the after-tax earnings of Australian companies. That's more than double the proportion paid in the US, where dividends are taxed twice and capital gains are taxed at lower rates than in Australia. Often in the US, total share buybacks exceed dividends. Even then, however, US companies finance a higher proportion of their future growth from retained earnings than Australian businesses.

8. Over the long haul, the average dividends per share in Australia has risen by about 7% a year – or slightly above the long-term increase we've experienced in nominal GDP. Looking ahead, trend growth in average dividend per share is likely to be a more modest 5% a year.

9. Dividend franking will lose some appeal from the recent legislation to cut the rate of company tax on businesses with revenues of less than $50 million.

10. Finally, let's look at a dividend yield that shows this year's dividend as a per cent of the share price an investor would have paid when purchasing the share many years ago. When the Commonwealth Bank was floated in 1991, its shares each cost $5.40. In the last 12 months, the dividend per share has been $4.21. Thus, the dividend yield is 5% on the current share price, but 78% when calculated on the share's original cost. A zero-taxed investor would also have benefited by $1.80 a share in the past year from the franking credit, giving a dividend plus franking yield of 111% on the price many (patient) investors would have paid.

Don Stammer has been involved with investments since the early 1960s including senior executive positions in Deutsche Bank and ING. These days, in his semi-retirement, he's an adviser to Altius Asset Management, Stanford Brown Financial Advisers and the Third Link Growth Fund and he contributes a fortnightly column on investments for The Australian. The views expressed in this article are his own.

Unpacking the '30-year bull market' in bonds

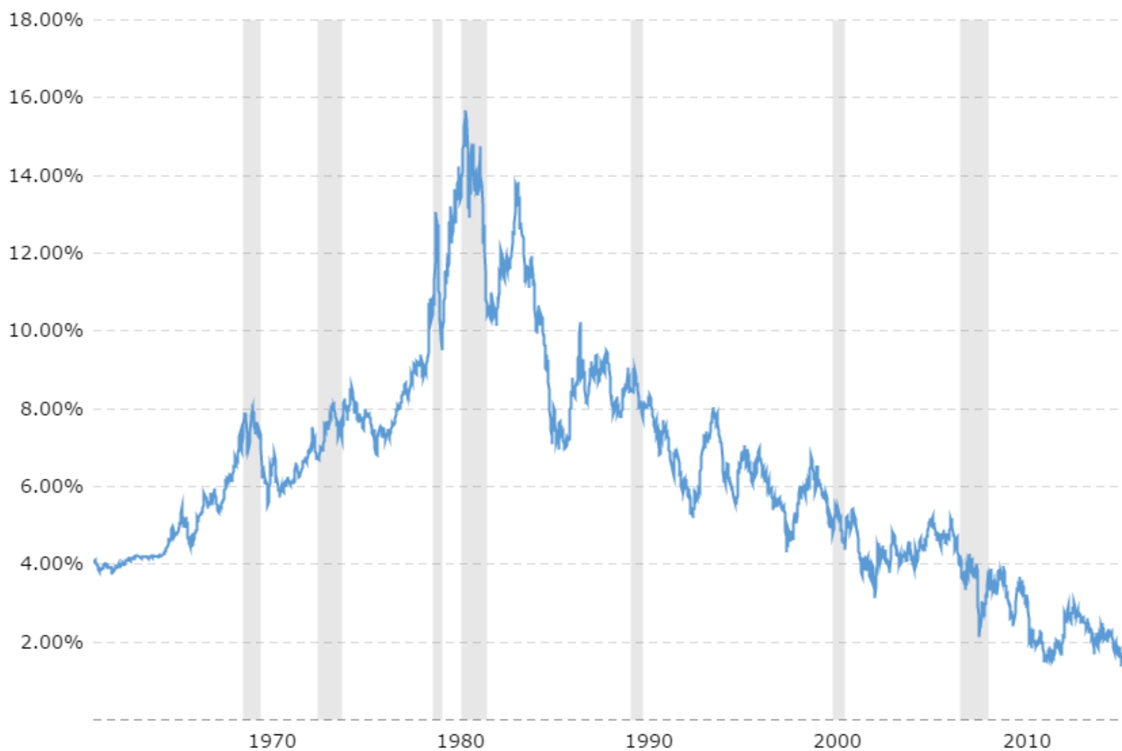
Warren Bird

The financial press regularly quotes someone referring to 'the 30-year bull market in bonds'. Often, they're reporting the latest prediction that this amazing period of (alleged) bond market prosperity is about to come to a crashing end. This article reviews the history of bond yields, prices and returns to explain what the bond market has really done for the past few decades. This can help to understand what various future scenarios might actually mean.

The problem with characterising the past 30 years or so as a 'bull market in bonds' is that it's not an accurate depiction. Reality simply doesn't support the statement.

Always worth par on maturity

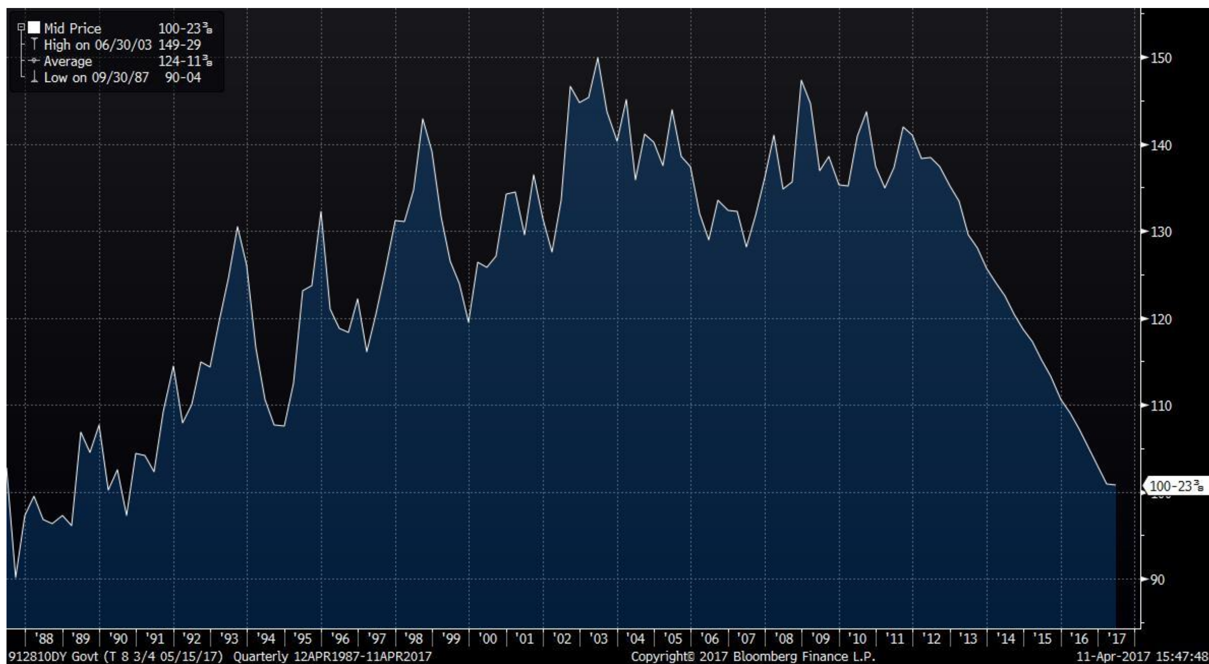
Most commentators speak of the long-run trend in US bond yields when they refer to the 30-year bull market. The following chart (courtesy of Macrotrends) gives a 54-year history of 10-year US Treasury bond yields.



Bond yields were at an all-time peak 36 years ago and have in recent years been at all-time lows. (The peak was in 1981 and the low point in 2012.) Commentators naively infer that bond prices must, therefore, be a lot higher because when yields fall, prices rise. Ipso facto, we've had a multi-decade bull market in bonds!

However, it's wrong to simplistically turn a long-term change in yields into an on-going bull market. A simple question will help you understand why it's not possible: *when it matures next month, what will be the price of the May 2017 US Treasury bond that was issued in 1987 at par value of $100?* If there's been a 30-year bull market then surely this bond is now worth thousands of dollars.

That's not the case. There are few things you can predict with confidence in financial markets, but that the May 2017 Treasury bond will mature at exactly $100 is certain. The following chart, courtesy of Bloomberg, shows the full history of the price of the May 2017 Treasury bond since its issue in 1987.



The price of this bond did increase early in its life, peaking at just under $150 value in 2003. So, you could say that there was a bull market over its first 16 years, albeit with some rather large 'corrections' in 1994 and 1999. There was then a clear bear market from 2003 to 2006 and overall the period from 1998 until 2012 looks more like a range trade in the $130-145 region. Since 2011 the bond's price has been in rapid descent to the current level of just under $101. The remaining $1 above par will be discarded by the market over the next couple of weeks and it will pay holders at maturity the same $100 at which it was issued 30 years ago.

Since the definition of a bull market is a persistent increase in asset prices, the May 2017 US Treasury bond has not been in one for at least the past 14 years. This is especially so if you consider real, or inflation-adjusted prices. $100 is not worth as much in 2017 as it was back in 1987. Furthermore, the same could be said of every bond that has matured during the last 10, 20 or 30 years. They've all matured at par value. Not one bond has paid investors an inflated price. If that's a bull, then I wouldn't bother entering it in the Royal Easter Show!

More subdued over time

Now, let's combine the trend in yields and prices to the history of bond market returns since the early 1980s. What we find is that the years of great returns are front loaded. There was a bull market in bonds at one time, but it was in the early years of this 30-year period. Since then, returns have been more subdued over time:

- During the mid to late 1980s, rolling five-year returns from the US Treasury market were often above 15% pa and always in double digits.
- By the 1990s, things had changed and returns were running in the 7.5–10% region.
- Since the late 1990s, rolling five-year bond returns have been closer to 5% pa and, over the past half dozen years or so, investors have received in the region of 2-3% pa.

Astute readers will compare these return outcomes with the 10-year yield chart and notice something remarkable. When yields were high, so were returns! However, as yields declined, although initially this gave a boost to total returns, ultimately it resulted in lower returns.

Does that sound like a long-term bull market? Owners of bonds have made good returns in the past 30 to 36 years. But it's been from the yields they've been paid, not from any long-lasting capital price appreciation.

What next for bond returns?

The long-run trend in declining yields appears to have ended about five years ago. Since then we've had two small 'bear markets', during the taper tantrum in 2013 and in response to stronger growth expectations in 2016. The latter has petered out, with Treasury yields back to the low end of their post-election range.

But what if we are in for a period of rising bond yields? If that happens, then investors with long-duration investments will experience potentially significant negative returns for a time. However, a sustained rise in bond yields will gradually result in rising bond returns in exactly the same way as the historical trend has been for falling yields to gradually reduce returns.

And along the way, whatever bond prices do in 2017 or any other year, every bond will pay back its par value at maturity (assuming no defaults). Never let the scaremongers divert your thinking from the simple mathematical reality of how bond markets behave.

Warren Bird is Executive Director of Uniting Financial Services, a division of the Uniting Church (NSW & ACT). He has 30 years' experience in fixed income investing. He also serves as an Independent Member of the GESB Investment Committee.

Do options provide LIC investors with value?

Peter Rae

Since January 2013, there have been 30 new listed investment companies (LICs) join the ASX. Each of these LICs issued investors with options as part of the initial public offer (IPO). In most cases, investors received one 'free' option for each share, although there were some offers where the ratio was less than one-for-one. Why do LICs include options as part of their IPO structure and why are they seemingly popular with investors?

Options often expire valueless

Due to the expenses associated with an IPO, the initial Net Tangible Assets (NTA) of a new LIC will be below the issue price of its shares, so a new LIC with an offer price of $1.00 will have a starting NTA below $1.00. The discount to offer price will vary, but generally costs equate to 2-3% of the amount raised. By offering investors a 'free' option there is the perception of providing value to compensate for the IPO costs. The option initially has some 'time value' in that it allows the investor to subscribe for additional shares in the LIC at some time in the future, normally at the IPO issue price.

Most options have expiry dates between 12 to 24 months after the IPO date. Theoretically, the market value of the option on listing will offset the reduced NTA arising from the IPO costs. In time, the option may also gain some intrinsic value if the price of the underlying shares rises above the offer price, driven by increases in NTA due to portfolio performance.

However, our analysis shows that options often expire without delivering any real value to LIC investors. Of the 30 LICs in our study, options for 15 of these LICs have already reached expiry. Nine experienced take up rates of less than 50%, with seven achieving take up rates of 15% or less. So, a significant number of investors who acquired shares in these LICs received no value for their options. Generally, options will not be exercised if the underlying shares are trading below the exercise price, as it makes no sense to acquire new shares at a higher price through an options exercise when they can be bought cheaper on-market. For Wealth Defender Equities (ASX:WDE), PM Capital Asian Opportunities Fund (ASX:PAF), Perpetual Investment Company (ASX:PIC) and CBG Capital (ASX:CBC) almost all their options lapsed at expiry. Investors who sold their options in these LICs on-market would have been in a better position than those who let the options lapse at expiry.

Dilutive effect for existing shareholders

Another issue for investors is that options exercised at a price below NTA will be dilutive to existing shareholders. There were six LICs in our study that achieved option take up rates above 50%. In each case, the new shares were issued at a discount to NTA. For investors who acquired shares in the IPO and exercised their options, this is not such an issue, as they would have received new shares at a discount to NTA. However, investors who did not exercise their options would have seen value transferred to those that did.

Investors who acquired shares on-market in the period post-IPO would also have experienced dilution via a drop in NTA without receiving new shares at a discount as compensation. Two LICs in our study achieved higher option take up rates due to underwritten options shortfall arrangements, which effectively resulted in a transfer of value from those investors that did not take up their options to the new investors that took up shares as a result of the underwriting arrangements. Bailador Technology Investments (ASX:BTI) had 24.5 million of its 31

March 2016 options underwritten, or 39% of the total options issue. The arrangement resulted in Washington Soul H. Pattinson becoming a 20% shareholder in BTI. The shares were issued at a large discount to NTA and we estimate the total dilutive impact of the options to be about 8%. Glennon Small Companies Fund (ASX:GC1) had 57% of its 18 August 2016 options underwritten with the new shares issued at a 16% discount to its prior month pre-tax NTA. We estimate the dilutive impact of these options to be about 6%.

Another reason LICs issue options is that it provides a potential opportunity for the manager to increase the size of the LIC if the options are exercised. In the case of a one-for-one option issue, the LIC size will double if all options are exercised, resulting in a higher fee base for the manager. Managers argue that a larger share base is also beneficial for LIC investors as it increases the market liquidity of the stock and reduces the potential for the LIC to trade at a discount to NTA.

Table: LIC Options*

Company	ASX Code	Option Expiry Date	O/standing Options - m	Current Shares - m	Option Price 28-Feb-17 ($)	Exercise Price ($)	Share Price 28-Feb-17 ($)	Pre-tax NTA 28-Feb-17 ($)
Argo Global Listed Infrastructure	ALI	31-Mar-17	142.9	143.4	n.a.	2.00	1.68	1.95
Platinum Asia Investments	PAI	15-May-17	292.5	293.2	0.002	1.00	0.96	1.01
Future Generation Global Inv. Co.	FGG	15-Sep-17	272.5	277.2	0.009	1.10	1.04	1.13
Monash Absolute Inv. Company	MA1	29-Sep-17	52.5	52.5	0.002	1.00	0.77	0.88
WAM Leaders	WLE	17-Oct-17	334.8	382.1	0.041	1.10	1.14	1.14
Absolute Equity Performance Fund	AEG	16-Nov-17	70.5	92.4	0.015	1.10	1.05	1.01
Contango Income Generator	CIE	30-Mar-18	33.9	81.1	0.005	1.00	0.95	0.99
Ellerston Global Investments	EGI	10-Apr-18	33.6	75.7	0.056	1.00	0.98	1.13
Henry Morgan	HML	31-Aug-18	5.9	29.5	0.560	1.00	1.55	2.04
Antipodes Global Inv. Co.	APL	15-Oct-18	284.8	284.8	0.047	1.10	1.13	1.13
Duxton Water	D20	31-Oct-18	64.0	64.0	0.037	1.10	1.04	1.07
Watermark Global Leaders Fund	WGF	16-Nov-18	82.8	82.8	0.032	1.10	1.04	1.08
Ryder Capital	RYD	10-Dec-18	36.8	36.8	0.050	1.25	1.07	1.16
Ellerston Asian Investments	EAI	28-Feb-19	65.2	114.7	0.027	1.00	0.87	0.96
Fat Prophets Global Contrarian Fund#	FPC	22-Mar-19	44.1	44.1	Not listed	1.10	n.a.	n.a.

Source: Companies/ASX
* Outstanding options for LIC IPOs since January 2013
#FPC Loyalty options which do not vest until 22/3/18

Conclusion: the 'free' option may not be a free lunch

LIC investors need to understand that so called 'free' options may not necessarily end up delivering them with any value as the historical experience has shown many options expire worthless. Investors who sell IPO options on listing may lock in a gain that helps offset IPO costs, however, they forgo any potential upside if the LIC succeeds in growing NTA before the option expiry date. When buying LIC shares on-market, check to see if there are any options on issue and whether the exercise price is at a discount to NTA. If so, this will result in dilution when the options are exercised. The market price of LICs with large option overhangs can tend to trade at a discount to NTA until the options are exercised or lapse. The table above shows options outstanding for all new LICs listed since January 2013. This is not a comprehensive list of all LIC options outstanding as some existing LICs, including WAM Active (ASX:WAA) and Westoz Investment Company (ASX:WIC) have issued shareholders with bonus options.

The final word goes to Gareth Brown of Forager Funds Management. Forager listed its Australian Shares Fund (ASX:FOR) on the ASX in December 2016. As a listed investment trust, we have not included it in our study above. However, we note that it did not issue options to its investors. In response to investor questions as to whether it would be issuing options, Gareth wrote an article highlighting the key issues surrounding options and reminded investors that, "There is, after all, no such thing as a free lunch."

Peter Rae is Supervisory Analyst at Independent Investment Research. This article is general information and does not consider the circumstances of any individual.

Lessons from one of the most famous shareholder activist battles

Annabelle Symons

In today's world of proxy advisers, divestment campaigns and 'two-strikes' voting, shareholder activism has become mainstream. That wasn't always the case, and Jeff Gramm's *Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism* provides a fascinating account of how this trend developed over the past century.

One of the most famous was Carl Icahn's pursuit of Phillips Petroleum, and even today it provides lessons for boards, management and shareholders.

During America's merger wave of the 1980s, 22,000 merger and acquisition (M&A) deals were brokered, but the small percentage of hostile acquisitions garnered the lion's share of attention. It was different to the previous waves because it was driven by the rise of Drexel Burnham and Michael Milken, who used the large, highly liquid niche market in junk bonds to fund hostile takeovers.

One such takeover was of oil company Phillips Petroleum (now a combination of ConocoPhillips and Phillips 66). In 1984 Phillips was trading in the mid-to-upper $30 range. After becoming the largest individual shareholder in Phillips Petroleum, corporate raider T. Boone Pickens launched a hostile tender offer to buy an additional 15% of the company at $60 per share. Phillips management counter-proposed with a complicated recapitalisation plan. It would pay Pickens $53 per share, entrench current management and commit Phillips to asset sales to fund a reduction in debt, increased dividends and an additional $1 billion in share repurchases.

The result? Management remained in place, Phillips' share price fell 18% to the low $40s and Pickens walked away with $53 a share in cash and all expenses covered.

Enter Carl Icahn. His activism strategy centred on taking large positions in what he saw as undervalued businesses, seeking control then attempting to realise the valuation gap. One of his key motives for going after these companies was to highlight a lack of accountability at the board level.

Icahn knew that Pickens was an astute energy investor who was prepared to pay $60 per share. This, combined with an enraged minority shareholder base whose investment value had dropped to $45 per share, gave Icahn an opening, but he needed a lot of cash. Enter Milken, who raised $4 billion for Icahn and claimed he was 'highly confident' Drexel could raise more if needed.

Armed with the Drexel cash, on 4 February 1985, Icahn sent a letter to the Chairman and CEO of Phillips Petroleum, William C. Douce. Apart from announcing that he owned 5% of the company, making him one of the largest shareholders, he said the recapitalisation plan was 'grossly inadequate'. He said that if Phillips did not offer $55 each for the outstanding shares, he would use a leveraged buyout to buy Phillips for $55 a share: $27.50 in cash and $27.50 in subordinated notes. If Phillips were to reject the two options, Icahn would wage a proxy war to defeat the recapitalisation and make a hostile tender for the company.

Use of the poison pill

In an offensive / defensive two punch, Phillips promptly sued Icahn for violating proxy solicitation and anti-manipulation rules. At the same time, Phillips' management sweetened the proposed recapitalisation to feature a new preferred stock dividend and a cash repurchase plan.

In a move that reverberates today, Phillips also introduced a 'rights plan' – one of the first versions of what we now know as a poison pill. If a buyer crossed the 30% ownership, other stockholders would convert each share into $62 worth of senior debt in Phillips paying 15% interest. The buyer would be left owning a dangerously over-leveraged company with $7 billion of short-term debt. As Gramm puts it: "…it served as a sharp repellent".

Douce underestimated Icahn. The next day Icahn sent a letter announcing his intentions to initiate a tender offer for 25% of Phillips common stock. This, along with his 5% stake, would trigger the poison pill. On 13 February 1985 – less than three months after Pickens had put Phillips in play - Icahn commenced the tender for Phillips at $60 per share, contingent on shareholders voting down the recapitalisation plan. According to the New York Times, 'Without using the word, Icahn said he would not accept greenmail, that is, would not sell his stock to the company unless the same offer was made to all shareholders.' Shareholders believed Icahn and voted the plan down.

Less than a month later, Phillips announced it had lost the recapitalisation plan entirely. It settled with Icahn, eliminating the plan to put shares in the employee trust and covering Icahn for $25 million in expenses. Icahn walked away $50 million wealthier in just 10 weeks. He had avoided the poison pill by leaning on shareholders to accept his version of the truth.

How is the Phillips case relevant for investors today?

Pickens and Icahn realised that management's actions were affecting Phillips' market valuation, creating an anomaly that could be exploited. Pickens believed the anomaly was so large that he offered around a 55% premium for the stock. The same is true today. If the market doesn't recognise the intrinsic value of a company, then a businessperson can - in the form of a corporate action like a takeover.

Although lawyers and company management can do their best to fend off what they may see as corporate raiders, poison pills and other protective measures may not be effective if the board doesn't have the support of shareholders. If shareholders don't feel that value is being maximised they won't give the company their support.

Finally, corporate raiders like Icahn were helped by Milken but they were also assisted by a larger group of passive, institutional investors, who failed to act against management decisions that would leave shareholders worse off. With more money flowing into index and passive investment vehicles now, it means active, institutional managers need to monitor their investments in businesses more carefully. They should not simply outsource corporate governance issues to proxy advisers, but think about the calibre of the management team and board of directors steering the capital allocation decisions in the business. If there is a lack of accountability for bad decisions then institutional managers need to step up and question the board and management.

It is bad enough when active managers run portfolios that resemble the index. It is worse when they behave just as passively in matters of corporate governance.

Annabelle Symons is an Analyst at PM Capital*. This article reflects the opinions of the author as at the time of writing and may change. PM Capital may now or in the future deal in any security mentioned. It is not investment advice.*

The meaning of life and real estate portfolio construction

Adam Geha

When constructing a property portfolio, you will frequently be confronted with the tricky question: which asset should I acquire (or dispose of) next?

What I've discovered over the course of my investment career is that this is not so much a tricky question as it is a trick question. It's akin to someone asking you: "What is the meaning of life?"

What started as a straightforward question didn't seem so straightforward after all …

Chess and complexity

Allow me to digress. Recently my son has taken an interest in chess, so in trying to avoid the embarrassment of regular defeat to a seven-year-old, I've begun to immerse myself in a game I know little about.

There are about 10^50 potential combinations on a chess board, a number so astronomical that it's equal to about 60% of the sum total of atoms in the known universe. So, chess combinations are a plausible proxy for the complexity of the real world, though the latter is indubitably more complex still.

Fitting therefore that Victor Frankl, a Viennese Holocaust survivor and psychiatrist, makes use of the chess analogy in his brief but brilliant book: *Man's Search for Meaning*. Frankl argues that asking someone "What is the meaning of life" is akin to asking a chess grand master "What is the best move I can make in chess?" This is self-evidently a nonsensical question: the grand master will respond by asking for the position of the various pieces on the chess board.

And since every human life is a unique combination of genetics and the "thousand natural shocks that flesh is heir to", the question should not be "What is the meaning of life?" but rather, "What is the meaning of life for me in this situation?"

The answer will vary considerably from one person to the next. Which is why awe-inspiring meaning for one person may seem redundant, distasteful or outrageous to another.

The fanatics among us will no doubt be dismayed. For them, there is always one right answer and it conveniently applies to all, no exceptions. Black and white answers for a world of infinite shades. "The whole problem with the world", Bertrand Russell once observed, "is that fools and fanatics are always so certain of themselves, and wise people so full of doubts."

Enough digression. What does all this have to do with the arcane art of real estate portfolio construction? Answer: it's far less interesting than the meaning of life but the principles applying to both are the same.

Two weeks ago, I was asked by a cashed-up overseas private investor what I would recommend as a real estate investment strategy in the current market. I responded by saying that anyone who provided an immediate and authoritative answer to that question should be treated with extreme suspicion. They were likely either a fanatic or a fraud.

Ask some fundamental questions

First, I needed to know where all the pieces were on his chess board. I said I would need to ask him some fundamental questions before I could even begin to answer his question (11 questions, but who's counting?):

1. What is the quantum he is looking to invest and how quickly?
2. What is the term of investment? Are there any hard limits on the term or is there some flexibility?
3. What is the target rate of return? Is there a minimum return requirement?
4. What is the tolerance to annual volatility in returns or to negative returns?
5. What are the likely liquidity requirements over the term of investment? Is there a minimum annual distribution requirement?
6. Does he currently own any real estate in Australia or overseas? If so, what is the current and historic performance of that portfolio?
7. Does he have any preference or expertise or contacts in a particular sector of the real estate market, such as logistics or office or shopping centres?

A zealot will peddle the same deal to all regardless of circumstance, but the right answer is unique to each investor.

Next time someone asks you what real estate deal you would recommend they invest in – smile, lean in and whisper with a hint of irony: "So, pray tell me, what is the meaning of life?"

Adam Geha is CEO and Founding Director of real estate fund manager EG. See original article here. This article is for general information only and does not consider the circumstances of any individual.

Four tips on what makes a good commercial property

Damian Collins

Direct investment in commercial property is typically better suited to experienced investors who have built a residential portfolio and want to diversify their assets. However, many investors fail to consider some of the most basic principles of commercial property investment.

Here are four general tips that will help to identify a good commercial investment property that delivers higher and more consistent returns.

1. Favourable lease agreements

Commercial property leases can be between three and 20 years, depending on the size of the premise and type of tenant. Therefore, investors acquiring a tenanted commercial property need to be particularly aware of the conditions of the lease agreement.

Properties may be marketed with a ’10-year lease’. However, clauses in the contract may allow the tenant to vacate sooner without penalty, or there could be rolling optional exits every three years, for example.

2. Multi-tenant properties

Acquiring a multiple-tenant property mitigates disruptions to cash flow in the event of vacancies. For example, take a commercial premise that can only be leased to one tenant. If that single tenant leaves, the owner will need to manage without rental income until the premise is re-leased. For example, owning premises with three separate retail spaces with three separate tenants means if one tenant were to leave the owner would still receive rental returns from the two remaining tenants.

3. Look past the headline rental returns

Ensuring the property provides high returns might seem obvious, but many investors fail to understand the total yield a property will deliver. For example, a property may have a headline yield of 8%, but rental reviews could be linked to the tenant’s performance, meaning rent increases may only occur if the tenant is recording a certain amount of revenue. This could weigh heavily on investor returns if the tenant’s business is underperforming.

Investors also need to consider incentives paid to the tenant, vacancy periods and outgoings not recoverable from the tenant. These items will all have an impact on the final yield that a property delivers.

4. The quality of an existing tenant

A high-quality tenant provides peace of mind that the tenant will pay their rent on time. National franchises, large publicly-listed companies or multi-national corporations are good examples as they are typically well-established and profitable businesses. Do your homework on the tenants as part of your due diligence when buying a property.

While there are many factors to consider when buying commercial property, these are a few key considerations for investors.

Damian Collins is Founder and Managing Director of property investment consultancy Momentum Wealth. This article is general information and does not consider the circumstances of any individual.

What Luxembourg and UCITS now offer Australian investors

Pierre Oberlé

Luxembourg, a small European country nestled between France, Belgium and Germany, has become the second-largest investment fund centre in the world after the United States. This article explains how the country has reached this position and explains what it can offer to Australian asset managers and investors.

UCITS: a spectacular European success story

The European fund industry is characterised by the success story of a truly European idea: UCITS, the acronym of Undertakings for Collective Investments in Transferable Securities. What started in 1985 as a European Directive with the modest ambition of defining a single framework for investment funds within the European Union ended up as a strong global brand for investment funds that is now recognised around the world.

This directive gave a tremendous boost to the European investment fund industry. UCITS started to flourish in the late 1980s, in particular Luxembourg, which was the first country to implement the directive into its national legislation in 1988. It was the start of a long and steady development. Today, assets under management by Luxembourg-domiciled funds have reached €3.7 trillion (AUD$5.3 trillion) with some 14,594 investment funds units domiciled in Luxembourg.

UCITS were initially intended only to be marketed across the European Union and saw the creation of a new concept called the 'European Distribution Passport', which implies that a fund domiciled in one European country can be sold easily to investors located in all the other countries of the European Union. Since then, a growing number of countries in Asia, Latin America and the Middle East have accepted UCITS because the UCITS framework provides a stable, high-quality, well-regulated investment product with significant levels of investor protection. For example, in Latin America, Chilean, Peruvian and Columbian pension funds invest heavily in Luxembourg UCITS. For them, this is the most efficient way to get international diversification while offering a high level of investor protection.

Investor protection within the UCITS framework is a key concern of European policy-makers, with rules on diversification, risk management and capital requirements.

To date, UCITS is the only such fund model to achieve this international recognition. About 65% of all cross-border UCITS registrations belong to Luxembourg funds, which are distributed in more than 70 countries around the globe. Luxembourg gained a first mover advantage and attracted international fund promoters, and a professional and diversified asset servicing industry developed which in turn attracted more promoters. From a South Korean promoter selling Luxembourg UCITS to Hong Kong to a Brazilian promoter gathering retail investors from several European countries, UCITS have become truly international.

A major new development for Australia

Australia's investors can now get easier access to Luxembourg UCITS. The Association of the Luxembourg Fund Industry (ALFI), the official representative body for the Luxembourg investment fund industry, has successfully negotiated with ASIC an exemption from the obligation to hold an Australian Financial Services Licence (AFSL) to provide financial services in Australia. The exemption, which came into force in November 2016, applies to certain financial services providers regulated by the Luxembourg financial supervisory authority, the CSSF. It should increase the range of funds, including alternatives and global infrastructure, offered by overseas fund managers to Australians, circumventing the need to apply for an AFSL in Australia.

Pierre Oberlé is Senior Business Development Manager at ALFI. This article is general information that does not consider the circumstances of any individual.

About the AFS licence relief: *The Australian financial services regulator, the Australian Securities and Investments Commission (ASIC) has issued ASIC Corporations (CSSF Regulated Financial Services Providers) Instrument 2016/1109 which sets out the conditions of this AFS licensing relief. It came into force on 16 November 2016. A copy of the Relief Instrument is available here.*

Disclaimer

This Newsletter is based on generally available information and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider obtaining financial, tax or accounting advice on whether this information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

For complete details of this Disclaimer, see http://cuffelinks.com.au/terms-and-conditions. All readers of this Newsletter are subject to these Terms and Conditions.