They want yours

Reinvesting in property syndicates? Beware of false profits, argues Mark Story

By Mark Story, Auckland

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You've got a cash windfall looking for a better return than a bank deposit. Where to go? Our share market still seems flat. US funds seem poised to be "corrected". How about property? The market's awash with higher earning syndicated property offerings — all you have to do is decide which one offers the highest yield, right?

Wrong, Tim Storey, a partner with law firm Bell Gully, says this approach could see you lose your savings faster than wagering the house on a mate's tip for the Auckland Cup. If the fund becomes insolvent, you'll join a long line of creditors.

The recent gulf between anticipated property yields and interest rates has seen investors commit an estimated $1 billion to syndicates, unit trusts and listed property company trusts.

The key attraction of property synd-ications are higher returns, access to better quality and higher value real estate and more diversity than a single asset, without the responsibility of managing it all.

But most capital market analysts claim unlisted syndicated properties don't stack up as a favourable option on three fronts: poor quality buildings, poor capital protection and higher risk. So how do property syndicates actually work?

Investors in unlisted syndicates don't hold direct interest in the property. They do so by acquiring a percentage of equity (shares) and the balance in some form of debt security. In the case of recent syndicated offerings from companies like St Lawrence, Waltus or Farmers' Mutual Group, they're typically offered in minimum $5000 parcels, divided between 1000 shares at $1.00 each and $4000 in mortgage bonds.

These syndicates undertake to repay the capital at the end of their term and a forecast return at certain dates. The investment is typically offered for a fixed term, but can be sold to another investor.

However, Storey says finding someone to buy an unlisted property parcel on the liquid secondary market, Share Mart, is a significant downside. "Investors buying into an unlisted syndicate must accept that it may not be easy to exit without loss. there might not be any buyers, especially if declining yields reduce the underlying property value below purchase price," says Storey.

He warns investors to test prospectus figures to ensure all the assumptions and projected returns are realistic, especially where returns are expressed as yields. Achieving stated yields over the short-term should be assured for the life of the current lease. But what happens to this yield if quality tenants don't renew and refurbish — will management/trustee fees and other costs drag down profitability?

Ord-Minnett says raising yields by pushing up the debt levels is a relatively simple exercise. But there's a danger that yields might be higher than the value of the net asset. "The promoter and its directors will normally qualify all statements about expected profits saying they're projections. While they can be liable for some matters, the promoter usually carefully limits its liability so that it does not guarantee the income," says Storey.

This is one reason why some publicly-listed property stocks, like PFI, prefer to express the projected return as an average internal rate of return (IRR). What's the difference? A headline yield is based on a spot estimate of income and asset value. But an IRR works out a discounted cash flow based on 10-year forecasts — in most cases well beyond the current lease term.

The Securities Act ensures property syndicates are above board on most fronts. But Storey says New Zealand Stock Exchange (NZSE) regulations provide investors with the added safeguards of a more rigorous compliance regime. Other benefits public listings have over their unlisted counterparts include:

- Greater liquidity: **w**hen you want to exit, there's a public market to sell in.

- Capital gains: **w**hen the share price goes up, investors share in a capital gain as well as an income stream.

- Risk/return ratio: **p**roperty sector offers reasonable yields at low risk.

Ord-Minnett's property index (listed stocks) shows income returns of 8.3% gross. Shopping mall owner St Luke's Group provided a return of 7.5% gross and Kiwi Income Property Trust (KIPT) 9.7% gross return. By comparism unlisted Waltus showed an aggregate on all portfolios in 1998 of 10.3%.

What's attracted investors to these property stocks is the quality of the asset class, exposure to prime central business district buildings and major retail property and capitalisation. For example, with a capitalisation of $537 million, KIPT ranks as the 25th largest company behind the St Luke's Group and the AMP Office Trust.

Storey says investors should expect a capital gain as well as an income stream from property investments. But the lack of dynamics within the property market means these sorts of results only go to star performers. The latest BOMA property index shows that with the exception of shopping malls (0.03%) all other classes of commercial property achieved negative capital returns over the six months to December 1998.

Storey warns investors not to overlook a basic investment strategy — to spread risk. "The quality of the building or buildings and their tenants is critical for syndicated property offerings to succeed. The risk attached to a single tenant at a single location is significantly higher than a range of buildings at different locations."

Property press

10 ways to scrutinise a syndicated property prospectus

1. Is it really a good-quality building with a good tenant profile?

2. Is the tenant lease in standard form or does it include unusual provisions?

3. If the investment is in just one building, who'll meet continuing costs if the tenant fails?

4. Will deferred maintenance affect proposed dividends?

5. If the property was bought from the promoter, how much did it originally pay?

6. Does the promoter retain securities in the company entitling it to dividends?

7. What costs are borne by the company and consequently the investor?

8. How do costs incurred by the promoter/ongoing property manager affect cash flow?

9. Who decides when to sell the actual property investment?

10. How easy and quick is it to exit the investment and what are the penalties?

Working rich

Who are the world's 10 most wealthy workers?

A cliché perhaps, but it's true: the rich just keep getting richer. And there are more of them.

In compiling its annual world's richest list, *Forbes* magazine was forced to restrict itself to 200 billionaires — and working ones at that. Inheritance — pah! These fellows are the hardest working of the fat and famous: creating wealth, jobs and products and services like you'd only dream about.

The full list can be found at www.forbes.com/tool/toolbox/billnew/1998.asp#1. Included is a useful guide to the location of the world's tycoons. Seventy of the bunch are Americans; Europeans number 52; Asians, 41; Australians, 3 — Rupert Murdoch not included.

Forbes then selected 10 of the 200 who aren't necessarily the richest, but whom it thinks are the smartest entrepreneurs of the group.

New Zealanders failed to make *Forbes'* list on the basis that "they're not interesting enough", so *Forbes* told *NBR*'s Graeme Hunt, compiler of our local rich list. Hunt says the Todd family, with $US800 million in assets, would qualify but aren't active enough investors. Here are New Zealand's top four individuals.