

# Investing in property

NZFUNDS

August 2009

New Zealand Funds Management Limited is considering making an offer of securities to the public in the Global Property Portfolio. No money is currently being sought and no application for securities will be accepted or money received until the subscriber has received an Investment Statement.

## Positioning of Portfolios within the advice framework

Needs category	Portfolio	Core / Tilt
Cash Needs	Money Market Portfolio	Core
Near Term Spending Needs	Core Income Portfolio	Core
Maintaining Capital	Mid Term Growth Portfolio	Core
Future Growth	Balanced Growth Portfolio	Core
	Diversified Growth Portfolio	Core
	Wealth Appreciation Portfolio	Core
	Dividend Yield Portfolio	Tilt
	Credit Opportunities Portfolio	Tilt

## Introducing the proposed Global Property Portfolio

### **New portfolio**

- The Global Property Portfolio is scheduled to be launched in November.

### **Investment objective**

- The investment objective of the proposed Global Property Portfolio is to protect investors' future spending from the effects of inflation. This objective is consistent with that for the Maintaining Capital Investment Category.

### **How is this achieved?**

- The manager intends to achieve this objective by investing in a diversified range of income producing assets and growth assets, including listed property securities.
- Property performs well in periods of inflation as:
  - Rental rates generally rise in line with inflation.
  - Property values also generally increase due to building cost inflation.
- Risks of investing in property will be minimised by:
  - Active management of share market risk;
  - Rent rolls are a consistent and stable stream of income;
  - Property is diversified across regions and types.

## Two distinct approaches to property investing

### **Direct property**

- Unlisted property trusts, property syndicates and investment properties are all examples.
- Liquidity is sporadic and uncertain in good times, and non-existent in difficult times when direct property vehicles have to be frozen.
- Value of the property is generally an estimate by a third party, often a valuer, which changes gradually and infrequently.

### **Listed property**

- Real Estate Investment Trusts (REITS) and Property Trusts are examples.
- Highly liquid investment that can be sold every business day of every year.
- Value of listed property trusts is subject to share market volatility, and can change quickly and sharply.

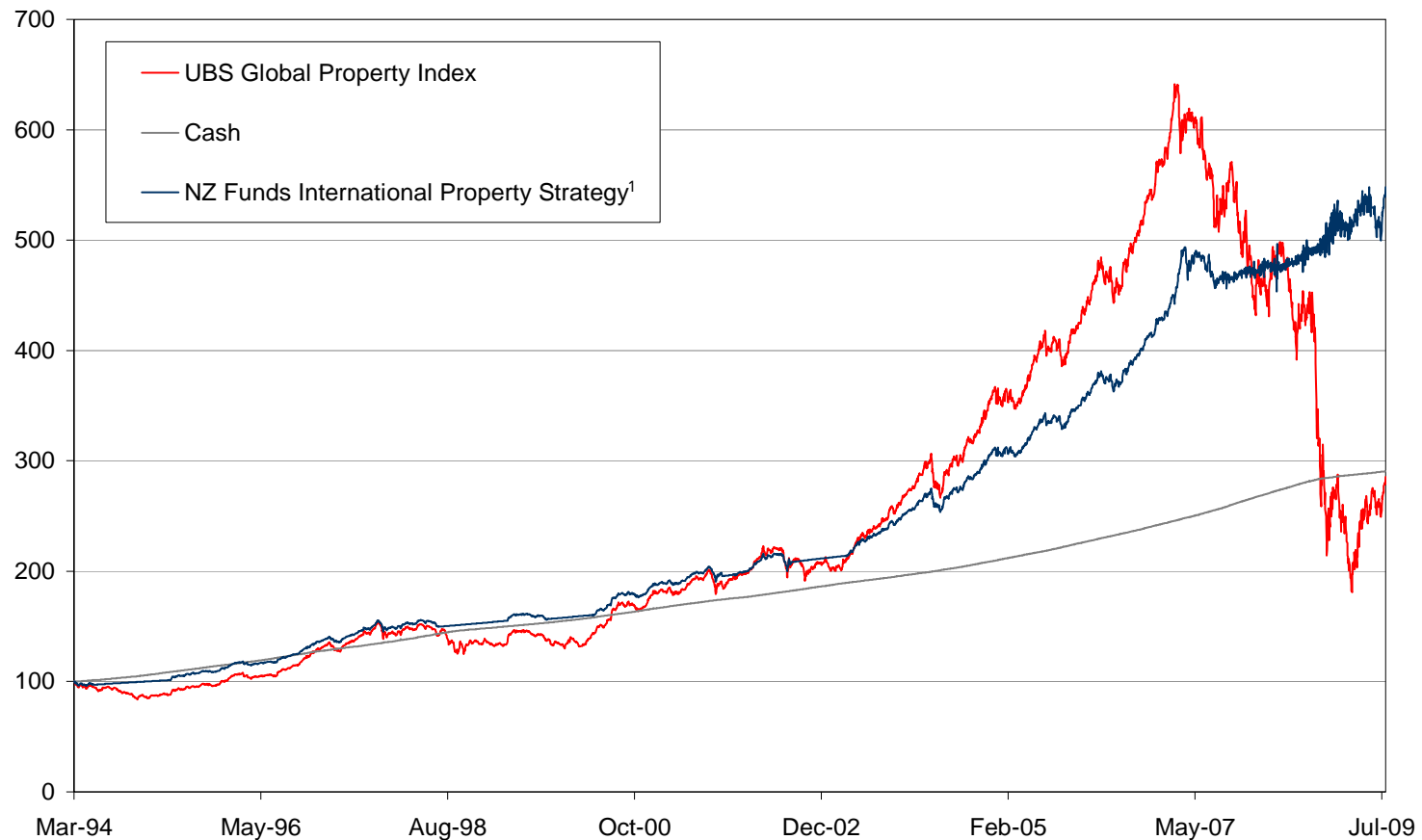
# Proposed Global Property Portfolio

International property trusts' performance for the past 15 years



# Proposed Global Property Portfolio

Making international property trusts attractive by controlling share market risk



Source: Bloomberg. (1) This return series is a simulation based on the implementation of NZ Funds International Property strategy. It is based on a combination of the UBS Global Property index, cash, Resolution Capital's Global Real Estate Securities Fund, Challenger/Heitman's Global Listed Property Fund and the Proshares Ultrashort Real Estate ETF during the period shown. It does not represent a fund return or a return projection.

## Making international property trusts attractive by controlling share market risk

### **NZ Funds International Property strategy manages share market risk**

- Allows the attractive attributes of property to dominate.
- Reduces risk and the size of drawdowns.
- Liquidity is continually maintained.

### **For international property trusts it is intended that the Portfolio will be invested in:**

- International property trust exposure (67%)
  - 54% managed by Resolution Capital and 13% managed by Challenger/Heitman.
  - This constant allocation gives access to these managers' ability to outperform throughout the cycle.
- Hedging share market volatility (33%)
  - 33% invested in an exchange-traded fund that removes share market volatility or 33% in cash if so indicated by the share hedging strategy.
  - This allocation hedges out share market volatility to give a constant exposure to the stability of the underlying property.

## Approved specialist international property trust manager: Resolution Capital

Resolution Capital stands out as a clear leader in its field. Its focus, insight, history and track record is second to none and it will manage the majority of the international property trust exposure.

Founded in 2004 and based in Sydney, Resolution is a specialist listed-property manager. With A\$1.5 billion in assets under management it is one of the world's most successful managers in this sector. It is owned and run by the senior members of the investment team whose incentives are aligned with the interests of the clients whose money they manage. This team, which is headed by Andrew Parsons, first worked together at Lend Lease where they managed investments in Australian property trusts. During their time at Lend Lease, the larger Australian property trusts such as Westfield began to invest in American and European properties. This meant that the team started to travel extensively to maintain their in-depth knowledge of all the assets in the portfolio. As a result, they became exposed to international property trusts and recognised the breadth and depth that was on offer to a international investor. Also, during their time at Lend Lease, Andrew Parsons was twice ranked Australia's number one fund manager by Reuters Surveys.

Their commitment to research continues to uncover trusts with unique property portfolios located in markets with strong underlying fundamentals. If these trusts also have appropriate and sustainable capital structures and are run by disciplined management teams, then they are attractive investments to Resolution. This process has yielded excellent results. For example, it was 16% ahead of its international benchmark for the 12 months to June 2009.

### Top 10 securities as at 12 August 2009

Name	Country	Holding	Market Cap (US\$M)	Dividend Yield
Simon Property Group	United States	10%	17,772	3.1%
Unibail-Rodamco	France	7%	16,028	5.9%
The Link REIT	Hong Kong	6%	4,787	5.3%
Westfield Group	Australia	6%	32,329	7.8%
Vornado Realty Trust	United States	5%	10,342	4.1%
Land Securities Group	United Kingdom	5%	7,848	4.5%
Federal Realty Invs Trust	United States	5%	3,690	4.3%
Aeon Mall	Japan	3%	4,273	0.9%
British Land Co	United Kingdom	3%	6,963	5.1%
Boston Properties	United States	3%	8,214	3.7%

Source: Resolution Capital.

## Approved specialist international property trust manager: Challenger/Heitman

In 2006, Heitman and Challenger formed a joint venture to manage international property trusts. Heitman is a Chicago-based specialist property manager with US\$18 billion in assets under management. Of this, US\$1.5 billion is invested in property trusts. Challenger is one of Australia's largest financial services companies with A\$2 billion of its assets in property.

The combination of these two creates a highly experienced team with real depth and a consistent history of exceeding the benchmark. Heitman look after the US and European property trust investments and Challenger look after the Australian and Asian property trust investments. They communicate frequently to ensure that the overall portfolio created is a cohesive one that reflects their views and has the desired risk characteristics.

The teams have a very systematic approach to property trust selection which ensures that the entire property trust universe is continually assessed. The securities are ranked by risk and return measures using in-house research. The highest ranking securities are then chosen for the portfolio.

The Challenger/Heitman approach to listed-property investing creates a portfolio that has consistent performance, both in terms of risk and return. Consequently, it was not surprising to see them achieve good returns as they were ahead of the international property benchmark by 4.7% for the 12 months to June 2009. This reliability provided by their performance makes them an ideal way to access a portion of the international property trust exposure.

### Top 10 securities as at 30 June 2009

Name	Country	Holding	Market Cap (US\$M)	Dividend Yield
Westfield Group	Australia	9%	32,816	8.0%
Simon Property Group	United States	5%	17,724	6.6%
Unibail-Rodamco	France	4%	16,028	4.1%
Digital Realty	United States	3%	3,424	4.5%
Public Storage	United States	3%	12,548	4.1%
British Land Co	United Kingdom	3%	6,963	7.8%
Federal Realty Invs Trust	United States	3%	3,686	7.2%
Health Care REIT	United States	3%	4,548	5.1%
RioCan REIT	Canada	2%	3,509	2.0%
AvalonBay Communities	United States	2%	5,320	5.7%

Source: Challenger/Heitman.

# Proposed Global Property Portfolio

## Case study of international property: Examples of international property trusts' assets



The iconic and irreplaceable GM Building in New York, pictured above, is part of Boston Properties' portfolio of buildings. Boston Properties is one of the securities held by approved international property manager Resolution Capital



The map above shows the 30 buildings (2 million square metres) owned by Mitsubishi Estate in the exclusive Marunouchi precinct of downtown Tokyo. A good example of one of those buildings is the Shin Marunouchi Building pictured on the right. Mitsubishi Estate is one of the securities held by approved international property manager Resolution Capital



## New Zealand property trusts

### **Similar to international property trusts, but with added attractions**

- New Zealand property trusts are more conservative than most international property trusts.
- The trusts are firmly established names that will be familiar to most clients.
- As the trusts have performed differently to international property trusts, they compliment them well.
- Tax-efficient status following the introduction of the PIE regime.

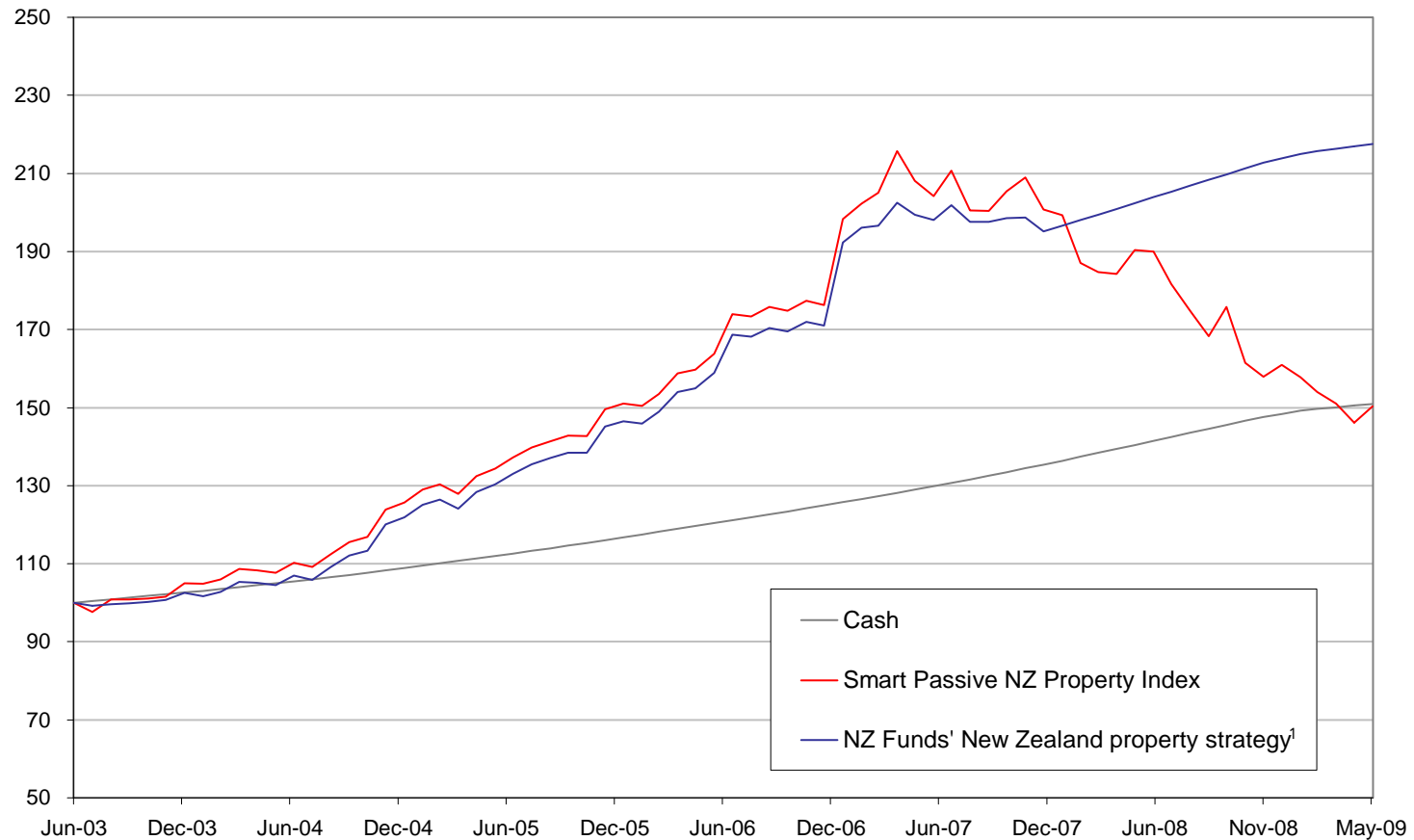
### **However, breadth and depth of New Zealand property trusts is restricted**

- There are 300 investable international property trusts compared to four investable New Zealand property trusts: Kiwi Income Property, AMP Office Trust, Goodman Property Trust and Property for Industry.
- The manager intends that these four trusts will be a modest allocation within the Portfolio as they are less readily tradable than their international peers.

### **Share market risk must still be managed**

- During episodes of share market risk it is intended that the investment property exposure be converted to cash.
- NZ Funds New Zealand Property Strategy uses a combination of momentum and value signals to do this in stages.

## Making New Zealand property trusts attractive through the cycle



Source: Bloomberg. (1) This return series is a simulation based on the implementation of NZ Funds New Zealand Property strategy. It is based on a combination of Kiwi Income Property Trust, AMP Office Trust, Goodman Property Trust, Property for Industry, Capital Properties and cash during the period shown. It does not represent a fund return or a return projection.

## Case study of New Zealand property trusts: Kiwi Income Property Trust

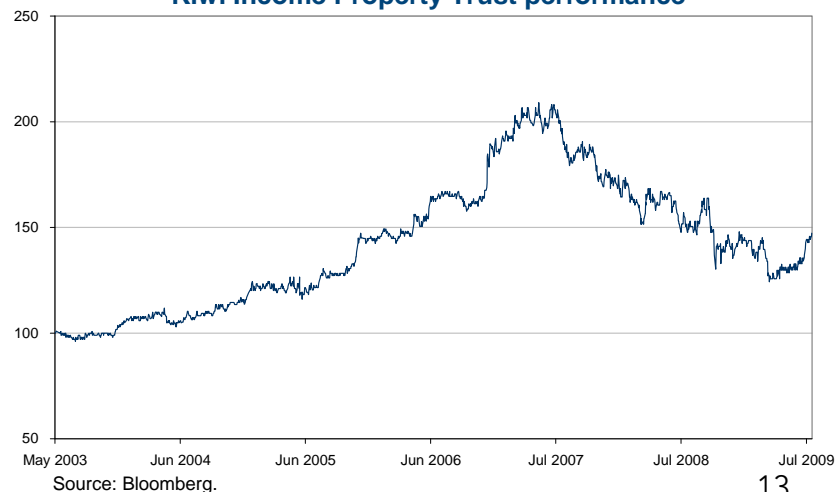
Kiwi Income Property Trust (Kiwi) became New Zealand's very first listed-property trust in 1993 when it moved onto the main board of the New Zealand Stock Exchange. Since that time Kiwi has remained consistent to its philosophy of developing, acquiring and managing retail and office properties around New Zealand. Its portfolio of assets has risen steadily and now stands at \$1.9 billion - 57% of this portfolio consists of retail assets, with the remaining 43% invested in office buildings.

With the majority of its exposure to retail focused at the premium end, this defensive positioning benefits Kiwi in more challenging times. The best example of premium retail in New Zealand is Sylvia Park. Kiwi purchased the bare land in 1996 for \$9.75 million and has since developed the site to its current value of \$450 million. This value lies in the power of Sylvia Park to retain its tenants throughout the cycle. People will spend less money in times of economic hardship. However, what they do spend will be in shopping malls that are attractive places, with the right range of retailers and which are conveniently situated. So while retailers find unpleasant things happening to their margins, they know that they would have even less of shoppers spend by saving on rent and moving out to a lower-quality mall – from the frying pan into the fire

as it were. Hence, retail property assets are the best assets to own in economic slowdowns. This makes Kiwi an attractive property trust to invest in, especially with its dividend yield running at 9.2% and with it trading at a 27% discount to the net value of its assets.

An issue which could preclude Kiwi's inclusion in the New Zealand property strategy would be any concerns over its balance sheet. While in keeping with other property trusts, Kiwi has seen its bank debt to total assets ratio increase to 33%. This is a conservative level and a considerable distance from its banking covenant level of 45%.

**Kiwi Income Property Trust performance**



# Proposed Global Property Portfolio

## Combining the property strategies

Simulated performance since 2003	Cash <sup>1</sup>	International property <sup>1</sup>	NZ Funds International Property Strategy <sup>2</sup>	New Zealand property <sup>1</sup>	NZ Funds New Zealand Property Strategy <sup>3</sup>	NZ Funds Combined Property Strategy <sup>4</sup>
<b>Allocation</b>	5%	-	75%	-	20%	100%
<i>Risk and Returns</i>						
Annualised Return	7.3%	2.3%	15.5%	7.2%	14.2%	14.9%
Standard Deviation	0.4%	22.6%	6.5%	10.8%	7.2%	5.4%
<b>Risk to reward ratio</b>		<b>0.10</b>	<b>2.37</b>	<b>0.67</b>	<b>1.97</b>	<b>2.74</b>

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