

Listed Property Vehicles

The Price of Performance

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The level of both base and performance fees paid to external managers of NZ Listed Property Vehicles (LPVs) has been a contentious issue in the past. The current trend to internalise management better aligns management and investor interests in our view. That said, there is a cost to manage assets either internally or externally and it is the relative cost structures that impact on the attractiveness of LPVs. One of the surprises of the recent Goodman Property Trust (GMT) result was the scale of the performance fee earned. The potential for large performance fee payments is a key difference between internal and external management of LPVs. Five NZ LPVs remain externally managed and all have some sort of performance fee. These performance fees vary in payout mechanism (cash or units), return targets (relative or absolute performance), and benchmarks (shareholder returns or asset values). Our review of performance fees suggests that Investore (IPL) is likely to have incurred additional performance fees over 2H20, and Vital Healthcare Property Trust (VHP) incentives fees are likely to continue albeit at a lower level; we have adjusted our forecasts and target prices accordingly.

Performance fees likely to be a recurring feature for some LPVs

GMT (UNDERPERFORM): One of the surprises with GMT's FY20 result was the carried over performance fee balance of NZ\$89.5m. This balance resulted from significant outperformance vs. peers over FY20, with GMT +30% vs. the sector -3%. The balance is carried forward in perpetuity but can be offset by underperformance. Given the size of the carry over balance continuation of performance fees is likely over the near-term, however, as performance fees are paid in units this will only have a modest impact on GMT's cash earnings per share.

IPL (OUTPERFORM): IPL's carried forward return for the December quarter was +16.7% which would have more than offset the -3.1% total shareholder return that quarter, resulting in a performance fee payable. However, no performance fee was likely payable for the 4Q20 given March quarterly total return of -8.3%. It has been a solid start to 1Q21 with total returns of +4.9% YTD. **We have included a 3Q performance fee in our estimates, which lowers FY20 EPS by -1.7%, but our NZ\$1.85 12-month target price is unchanged.**

Precinct Properties (PCT, NEUTRAL): Due to recent underperformance PCT had a carried forward performance fee deficit of NZ \$4.4m at 1H20. YTD the index is down -15% vs. PCT down -12%, therefore, some erosion of this deficit has occurred but no performance fee is payable in quarters when total shareholder return is negative. At this stage **we have left our earnings forecasts unchanged** but remain cognisant of future performance fee payments once PCT has covered its carried forward deficit.

VHP (OUTPERFORM): VHP is the only NZ LPV that does not link incentive fees directly to shareholder returns. Incentive fees are based on the increase in net tangible assets (NTA). Therefore, VHP's total shareholder returns can underperform but incentive fees can still be paid if cap rate compression continues to lift asset values and NTA. Given the supportive backdrop for medical property **we have included modest incentive fees (previously zero) in our FY21/22 forecasts** which only has a minor impact on earnings per share (<1%) due to dilution from payment in units but **reduces our 12-month target price 2% to NZ\$2.70.**

Asset Plus (APL, UNDERPERFORM): Given its weight to retail and relatively high gearing APL has underperformed the sector by -22% YTD; as such we do not believe a performance fee is likely. Going forward, given its balance sheet constraints and capital hungry development pipeline, we view outperformance vs. the sector as challenging and therefore **leave our forecast unchanged with no performance fees paid over FY20-22E.**

Management fees

Figure 1. Management fee summary

	APL	GMT	IPL	PCT	VHP
Base management fees	0.50% of total assets (less cash) up to \$500m, plus 0.40% thereafter	0.50% of total assets (other than cash, debtors and development land) up to \$500m, plus 0.40% thereafter	0.55% of property value up to \$750m, plus 0.45% thereafter	0.55% of property value up to \$1,000m, plus 0.45% between \$1,000 and \$1,500, plus 0.35% thereafter	0.65% of average total assets up to \$1bn, plus 0.55% to \$2bn, plus 0.45% to \$3bn, to 0.40% thereafter
Performance fees	10% of performance above the S&P/NZX gross property index, capped at 5% of annual outperformance. Both outperformance and underperformance is carried forward (max 2 years)	10% of performance above the S&P/NZX gross property index, capped at 5% of annual outperformance. Both outperformance and underperformance is carried forward. (in perpetuity)	10% of total shareholder returns above 10% and below 15% with a cap of 0.2% of the value of investment properties. Both outperformance and underperformance is carried forward (max 2 years)	10% of total return outperformance above the S&P/NZX50 benchmark with a fee cap of 0.5% of market capitalisation. Both outperformance and underperformance is carried forward (max 2 years)	10% of the average annual increase in NTA of the Trust over the preceding two years. The management and incentive fees are capped at 1.75% of the gross value of the Trust
Performance fee benchmark	Relative	Relative	Absolute	Relative	Absolute
Performance fee payment	Cash	Paid in units	Cash	Cash	Paid in units
General additional services	Legal administration fees charged at applicable hourly rates (\$100-\$300) subject to a maximum amount of \$1,200 per deal	On agreed commercial terms	Accounting services fee of \$250,000 per year	Additional Services are not included within the base management fees. The fees for these services will be detailed within the Remuneration Report	Can charge other fees but this is subject to a cap of 1.75% of total assets
Property management fee	1.50% of gross property income	1.0% to 3.0% of gross annual rent depending on complexity of the property	10,000 per year per property	Separately agreed	1.0% to 2.0% of gross annual rent depending on the number of tenants at the property
Transaction fees	1.0% on purchase price for acquisitions only	Between 0% to 1%, agreed by independent directors	0.5% of the sale price	1.0% (where no agent is involved) and up to 1.0% when an agent is involved	1.5% on purchase price and 1.0% on the sale price less any third party agent costs
Leasing fees	12-15% of gross rental dependent on lease term (12% for less than 3 years, +1% for an additional year, up to 15%)	New leases: 13% to 19% of gross rental. Existing customers and renewals reduce to 50%, or 25% if an agent is involved	8.0% of the annual gross rental payable under new lease arrangements	New leases: 11% to 20% of annual rental income. Renewals: 25%-75% of the level for new leases based on the level of engagement	New leases: 11-20% of annual rental income. Renewals: 50% of the level for new leases Market Reviews: 10% of first year rent increase
Capital expenditure fees	3.5% of development cost	3.5% of the total project cost, plus a project management fee of up to 1.5% of total cost	4.0% of the cost of any development, project or other work of capital nature (includes R&M)	Up to 4.0% of development cost	4.0% of project cost less any third party development management fees

Source: Forsyth Barr analysis, Company reports

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