March 2018

Increased compliance for unlisted property funds will hurt retail investors: PFA

By Paul Healy, CEO, Property Funds Association

Treasury's proposal to increase regulation for retail financial products could see fewer unlisted property investments available to retail investors, and fewer choices for retirees and SMSF investors who target unlisted property's attractive income yields.

Treasury's proposed product design and distribution obligations apply to all retail financial products excluding ordinary shares and could be enacted into legislation this year. The same proposals include new product intervention powers for the financial regulator, ASIC.

The Property Fund Association (PFA) is concerned the increased compliance obligations may have the unintended consequence of encouraging fund managers to withdraw from retail investment and focus on wholesale investors only (wholesale investments are excluded from the proposed obligations). This would mean diminished choice for retail investors.

The proposed legislation shifts more risk to product providers. Key stumbling blocks include the need for product issuers to identify the 'appropriate target market' for their products.

Legislating a requirement to identify appropriate target markets and distributions channels places more risk on the issuer, and arguably shifts responsibility from the financial adviser to the product issuer.

Unlisted property funds will need to spend more on compliance, legal advice, and possibly consumer testing to satisfy these requirements. Those funds which do go ahead will be under pressure to pass these increased compliance costs on to investors.

The proposal will likely have a disproportionate effect on boutique managers. More boutiques will find the wholesale market easier to cater for due to its lower compliance obligations, and we could see greater consolidation among small-to-medium managers.

Australia's unlisted property trust sector is among the most reliable asset classes for retail investors and SMSF trustees, producing consistent above average yields and capital growth. It provides a valuable income source to retirees via tax-deferred distributions.

Unlisted property funds have produced an average total return of 8.1 per cent a year, and delivered an average income return of 6.9 per cent a year over the 10 years to the end of 2016, according to Atchison Consultants. Another key benefit to retail investors is unlisted property's low volatility compared to shares and listed A-REITs.

The PFA agrees investors must be protected but investors also benefit from product innovation, much of which comes via boutique providers. The PFA appreciates there is a balancing act between appropriate compliance measures and the freedom to bring new and innovative products to market.

Yet there are strong arguments to exclude simple or otherwise well-regulated products from the legislation: interests in managed investment schemes, particularly units in unit trusts, are arguably like shares in being well-known to investors and well-regulated under Chapter 5C of the Corporations Act and ASIC Act. With these powers, ASIC already has substantial tools available to protect unlisted property investors.

The PFA argues that if distributors and issuers of ordinary shares are not subject to the proposed design and distribution obligations, then neither should they apply to units in investment trusts as equivalent financial products.

There is strong demand among retail investors for unlisted property vehicles and we need to ensure industry can continue to bring appropriate, high performing products to this market.

Paul Healy is CEO of Property Funds Association, the peak industry body for the $125 billion Australian unlisted wholesale and retail property funds sector www.propertyfunds.org.au