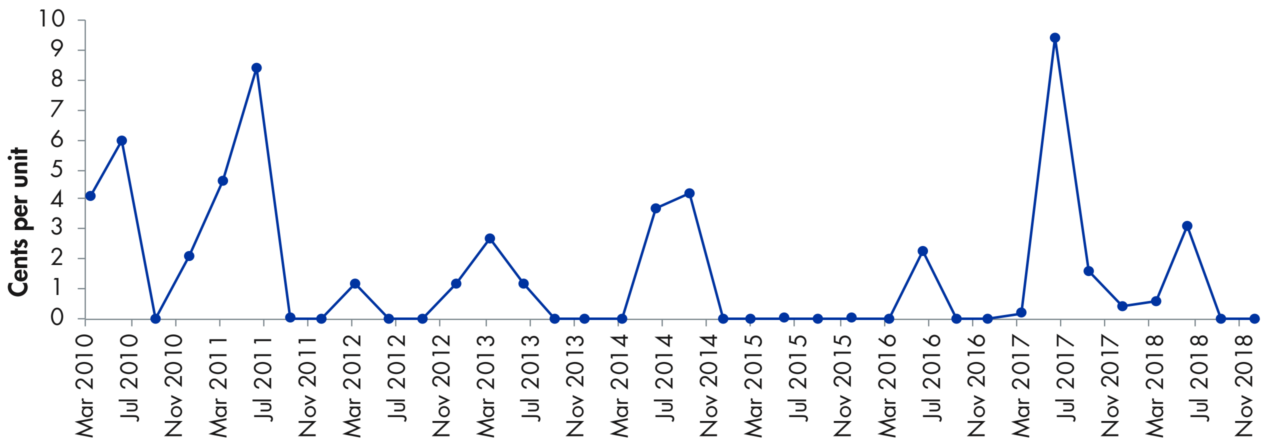
Property and infrastructure: How we keep the income flowing

One reason people invest in property and infrastructure is that they are looking for income that is relatively stable, while growing with inflation. But when you access these securities through a managed fund, the cash flow you receive can be disappointingly unstable. At VanEck, we have utilised our tax and legal expertise to ensure the best outcome for our clients.

Bumpy income can be an ugly look

This is a chart of the payment history of another popular fund manager's currency hedged global infrastructure securities managed fund. This fund is managed by one of the world's most respected fund managers.

Payment history for a currency hedged global infrastructure fund.



Source: Fund manager's website, March 2019

When you say you want income, what you are imagining is a regular deposit into your bank account of a consistent amount that grows slowly with inflation. It's hard for you to manage day-to-day living expenses when you are expecting a payment but nothing turns up.

An investor in the global infrastructure fund above experienced six quarters in a row that were zero. That was a year and a half with no income from their investment. Over thirty six quarters, seventeen paid zero. Almost half. That is more than just disappointing.

The explanation doesn't add up

A lot of the discussion by fund managers about income gets confused. The word 'income' means different things in different contexts and people are not always on the same page.

Fund managers spend too much time talking about what happens inside the fund. The investor only cares what income they are actually receiving from the fund. They are not concerned about which items in the fund's financial statements are income and which are capital. Most don't read the financial statements. A fund manager may also explain the distinction between something that is taxed as income and something that is taxed as a capital gain. Tax consequences are important, but they take a back seat to the investor's concern about a flow of income.

For an investor with bills to pay and groceries to buy, 'income from my portfolio' always means what you receive. It's the cash flow. VanEck will not bamboozle their clients. We aim to see things from your point of view.

Sometimes they blame the law

In the complicated world we live in, laws made for good reasons sometimes have secondary outcomes that are bad. The volatile payments shown in the chart above, are a secondary outcome of a rule to make the tax system more equitable. In this instance it's the timing rules in the taxation of trusts which have forced funds into payment flows that have jumped all over the place.

This has been even worse for funds that hedge their currency risk, such as the fund above. The tax law, until recently, didn't recognise hedging. The hedging instrument would be taxed at a completely different time to when the asset would be taxed, creating a mismatch that distorted the cash flow even further.

Parliament has modernised the tax rules, including introducing currency hedging rules. The Government specifically did this so that funds can operate the way their investors want them to. The bizarre disconnect between the investors' cash flow and the tax timing rules has been removed.

Not all fund managers have modernised

Despite the Government doing its part, most investors are yet to see any benefit. The new tax laws empower funds to pay a cash flow that meets their investors' needs but so many funds have just continued the poor practices of the past.

In particular, fund managers have found the hedging fixes in the tax law to be too difficult to implement. Most managers who should be using them, are avoiding them, even though those managers are being paid to provide expertise.

Many fund managers are failing to use the new laws in the way their investors need them to. VanEck has put in a lot of effort to adapt our systems to approach things in the new way intended to give our investors smoother income.

How to pick the right manager or fund

If you want stable income you can't just trust that you have chosen the right asset class. You also have to make sure that the fund you are putting your money into is going to deliver the cash flow you need out of it.

You just need a little more detail, then you can ask the right questions. Here it is:

The key change to the tax law is known as 'AMIT', generally pronounced 'ay-mit', which stands for the Attribution Managed Investment Trust rules. This is the change that removes the restrictions on cash flow.

So, the first question to ask a fund manager is whether they are using AMIT to smooth the flow of payments you will receive.

The other, slightly older, change is known as 'ToFA', generally pronounced similar to 'tofu'. This stands for the Taxation of Financial Arrangements rules, of which the hedging rules are a small subset.

AMIT can be used to smooth the payments without also needing ToFA, but ToFA is still powerful. ToFA smooths the tax liabilities for investors in a hedged fund. Without it, hedging can lead to tax shocks.

While you have the fund manager's attention, ask whether they are using ToFA to smooth the tax liabilities caused by hedging.

If you ask VanEck these questions, the answers for both questions in respect of all our hedged funds will be an emphatic YES!

Contact us

For more information

- vaneck.com.au
- 02 8038 3300
- Follow us
- @vaneck_au

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