



Why Australia?



Thunder from Down-Under

It's easy to make a case for including Australia at, or near the top of a list for investment. Some key macro factors supporting the 'Why Australia?' story are:-

- Australia is in its 23rd year of uninterrupted economic growth. This is unequalled by any other advanced economy;
- Australia is one of only a handful of countries to retain its Triple A Rating;
- Government net debt is less than 17% of GDP, compared with the USA at 81%, the UK at 85% and Japan at 140%;
- Quantitative easing was not needed following the Global Financial Crisis (GFC).

It is a common misconception that Australia's economy is based mainly on mining and agriculture, hence at risk of volatility from changes in commodity pricing. It is true though that the recent reduction (close to 50% from its high) in the price of iron ore as China reduces its post-GFC building spree is already impacting on Government revenue projections. However, while important, the resources sectors are far smaller parts of the Australian economy than many people realise.

In fact, the professional services sector represents about 80% of the country's GDP, employing 4 out of 5 Australians. Moreover, Australia's potential to further benefit from the growth in the Asian region has been given a boost through the recently secured Free Trade Agreements with China, Japan and Korea.

Most importantly though, McKinsey estimate that China could have a 630 million-strong middle class by 2022 accounting for 78% of urban households, up from 4% in 2000. As a result, this gives Australia hope that the uncomfortable process of weaning itself off the recent mining boom will be made easier by the new opportunities flowing from China's economic evolution.

And real estate? Well, Australia continues to rank as one of the world's most transparent markets and top in Asia Pacific, with strong corporate governance, open market data and robust legal frameworks. Australian office leases offer investors duration of 5-10 years (or more), with annual 'upwards only' rent reviews (market or fixed percentages as agreed) and no legislated security of tenure for tenants. It should come as little surprise therefore that both Sydney and Melbourne are ranked in St Bride's Top 20 World Cities.

JLL recently reported that the office investment market recorded a third successive year of record transaction volumes in 2014 (AUS\$1.7 billion). All buyer cohorts for core product (domestic listed, unlisted, private groups, offshore institutions, private groups etc.) have been active recently, with trophy transactions recorded in Sydney and Melbourne last year.

The competition for assets and a re-assessment of return expectations for core real estate has resulted in yield compression across the major markets. Indeed, prime equivalent yields in Sydney and Melbourne have now moved below 6% for the first time since 2008. But this is still high when compared to other world cities.

The problem investors are grappling with is finding real value in a market where return expectations are moving ahead of underlying demand from tenants and where leasing fundamentals are still patchy at best. Smart strategies for capturing value currently include student accommodation, green offices, re-zoning near new infrastructure and agriculture.

You may not be surprised to learn that EG Funds, part of the St Bride's Global Alliance, has current investment offerings in all of the above investment sectors!

With the domestic market being so tight, many of the larger Australian superannuation (or pension) funds are now looking at the case for diversifying into *global* real estate. Most funds have a 7% to 15% allocation to real estate, with 10% a common allocation. Most then invest a quarter to a half of this amount in listed real estate (global and domestic).

Of the allocation to direct real estate, the share going to offshore investment can be as low as 0% or as high as 20%.

This all means that the actual allocation to property outside Australia can be in the order of just 1% to 2% of a superannuation fund's overall asset base!

The good news though is that the numbers in the Australian superannuation system are large at AUS\$1.6 trillion. And this number is projected to continue to grow at around 15% pa. The high growth is due to the mandated superannuation guarantee for Australian employees, currently at 9.5% pa of salaries (and rising to 12% pa) plus invested fund earnings growth.

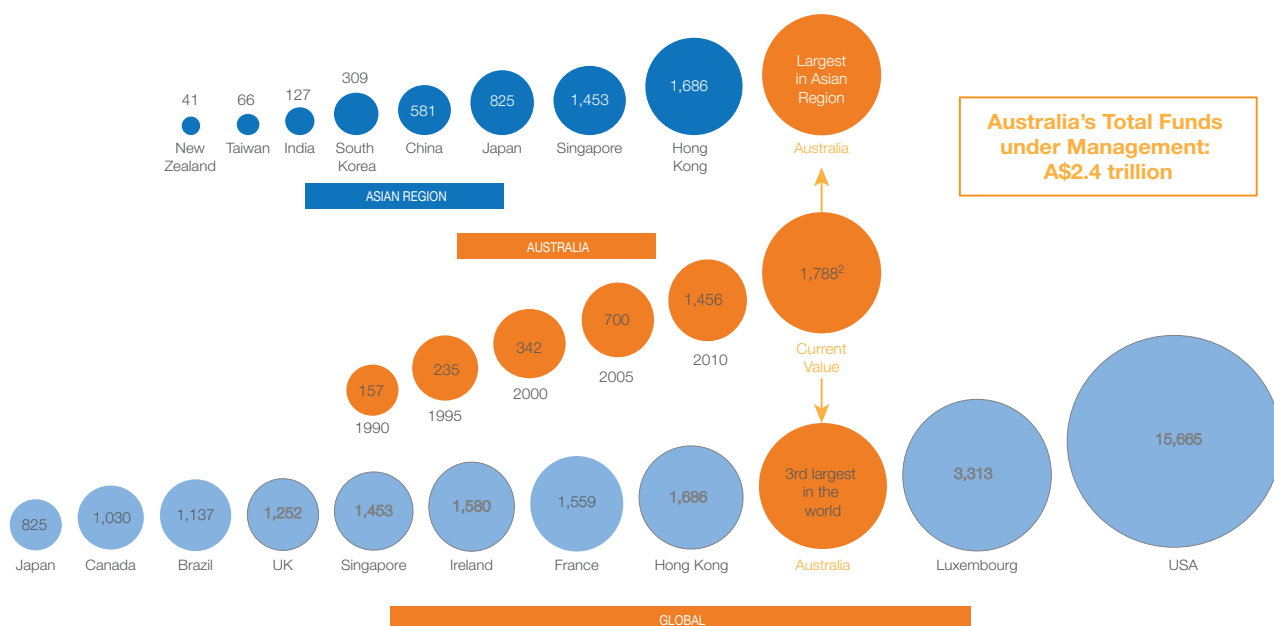
A recent projection indicates that Australian superannuation will be \$7.6 trillion in 20 years' time!

It is suspected that with this sort of growth the allocation to global real estate will have to increase, as the funds will struggle to find suitable stock in Australia to meet their allocations.

Australia has grown to have the largest investment pool in Asia and the third largest in the World.

Global Significance of Australia's Investment Fund Assets Pool

Investment fund assets¹, US\$ billion, June quarter, 2014



Note: Circles are not to scale. Data between countries is not strictly comparable.

1. Refers to home-domiciled funds, except Hong Kong and New Zealand, which include home and foreign-domiciled funds. Funds of funds are not included, except for France, Germany, Italy and Luxembourg. In this statistical release, 'investment fund' refers to a publicly offered, open-end fund investing in transferable securities and money market funds. It is equivalent to 'mutual fund' in the US and 'UCITS' (Undertakings for the Collective Investment of Transferable Securities) in the European Fund and Asset Management Association's statistics on the European investment fund industry.

2. Australia's investment funds in the Investment Company Institute survey only include consolidated assets of collective investment institutions.

Sources: Investment Company Institute, Worldwide Mutual Fund Assets and Flows, Hong Kong Securities and Futures Commission, Monetary Authority of Singapore, Austrade

So why isn't more Australian capital coming to the UK and other European markets right now? The conundrum the superannuation funds currently face is that in diversifying into major off-shore markets, such as the UK, their net initial returns are likely to be lower in say London offices than in Sydney. In addition, they incur tax and structuring costs, often higher fees and currency risk.

Diversification of the real estate allocation should make sense, but it comes at a cost. As a result, many funds take the step (consciously or otherwise) to go up the risk curve in foreign markets to get similar absolute returns (net of fees, taxes etc.) to those available in Australia. The trouble is that this has often led to poor performance in the past when things have turned down, as it did at the end of the noughties. And this bitter lesson is still remembered.

Give it time. They will come back... but not just yet.

Curiosity Corner

- Australia is as wide as the distance between London and Moscow.
- The largest cattle station in the world is Anna Creek Station in South Australia at over 34,000 square kilometres. It is larger than Belgium. And more interesting!
- Former Prime Minister, Bob Hawke set a world record as a student at Oxford University for sculling a yard of ale (2.5 pints) in 11 seconds.
- Saudi Arabia imports camels from Australia.
- Kangaroos and emus cannot walk backwards. This is one of the reasons that they're on the Australian coat of arms. Australia is one of the only countries where they eat the animals on their coat of arms.
- If you visited one new beach in Australia every day, it would take over 27 years to see them all.
- Wombat poo is cube shaped. Yes, there are pictures on Google to prove it!
- The Australian Alps receive more snowfall than Switzerland.
- The Box jellyfish has killed more people in Australia than stonefish, sharks and crocodiles combined.
- Some shopping centres and restaurants play classical music in their car park to deter teenagers from loitering at night.
- Over 200 different languages and dialects are spoken in Australia including 45 indigenous languages. The most common non-English spoken languages are Italian, Greek, Cantonese, Arabic, Vietnamese and Mandarin. Some taxi drivers speak English.



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