ROUNDTABLE

SPONSORS
AMP CAPITAL • BOUWINVEST REAL ESTATE INVESTORS • QIC • ROCKWORTH CAPITAL PARTNERS

Australia still the lucky country for property investors

An election win for the business-friendly Coalition and the prospect of fiscal and monetary stimulus has put a fresh smile on the faces of real estate investors, our Australia roundtable tells Mark Cooper

Australia has been a happy hunting ground for real estate investors over the past five years, but a sluggish economy and falling house prices have dampened sentiment. GDP growth fell to 0.2 percent in the last quarter of 2018 and rose to 0.4 percent in the first quarter of this year, imperiling Australia's recession-free record of 28 years and counting. House prices, which rose strongly in the five years to 2017, have since fallen by an average of 8.2 percent.

Commercial real estate investors, however, have had little grounds for complaint. Australia's all property annual total return was 10.4 percent in 2018, an index by Australian property body Property Council of Australia and data provider MSCI shows – a full 3 percent above the performance of the MSCI Global Real Estate Index.

Even so, sentiment has suffered, as has the market in 2018, with transaction volumes falling 2 percent to $28.8 billion, according to property transactions data provider Real Capital Analytics. Nevertheless, an unexpected election victory for the Liberal-National Coalition has brought the promise of interest rate cuts and fresh infrastructure spending.

Matthew Strotton, global director of capital for QIC's real estate business, says: "I see a great deal of positives coming out of the election. The correction in the housing market has affected consumer confidence, as has the recent political instability. However, there are signs that the election result has restored some confidence."

Carmel Hourigan, global head of real estate for AMP Capital, concurs, adding: "The election of the Coalition is a good outcome for the real estate message because it means more stability, particularly for international investors. We have had a lot of instability in our government in the past three years. There are positive policies as a result of the election too: tax cuts which could help consumer sentiment and plans to spend A$100 billion ($69.3 billion; €61.3 billion) on infrastructure."

Immediately following the election, Australian interest rates were cut 25 basis points to 1.25 percent, with another 25-basis-point cut expected later in the year. The fall in interest rates is expected to be accompanied by an upswing in bank lending, which could boost the housing market.

A long-term target

Australia remains a long-term target for foreign investors. Tjarko Edzes, Asia-Pacific director at Dutch investor Bouwinvest Real Estate Investors, says: "From a global perspective, Australia is an important market that should be part of any core portfolio. It's small relative to its stake in the investible universe, so I think most investors that have global portfolios are overweight Australia real estate, relative to the size of the market.

"That is really driven by the transparency of the market and the quality of the real estate and local management platforms that we have here. And over the last five to six years, it has really provided superior returns on a risk-adjusted basis."

Australia's investment in infrastructure is an attraction for overseas investors, says Lim Kin Song, chief executive at Singaporean manager Rockworth Capital Partners. "Infrastructure spending is an important driver of real estate investment, and prices tend to rise where there has been investment in roads, rail, et cetera."

"We like to invest where we see infrastructure being built, and Australia's major cities are all spending on infrastructure; for example, Sydney's Light Rail, Melbourne Airport Rail Link and the Cross River Rail in Brisbane. From our investment experience over the years, we have seen tremendous capital appreciation in our properties through such a macro strategy."

With Chinese investors largely out of

PHOTOGRAPHY: **JUSTIN MACINTOSH**

Tjarko Edzes

Director, Asia-Pacific, Bouwinvest Real Estate Investors

Edzes has held his role at Bouwinvest for five years. The Netherlands-based firm, which manages real estate for Dutch investors, in January opened an office in Sydney, Australia – its first outside the Netherlands – to increase its invested capital in Asia-Pacific markets. Bouwinvest currently has €11.3 billion invested capital globally.

Carmel Hourigan

Global head of real estate, AMP Capital

Hourigan has been in her role for four years, after working for Australian groups GPT, Lend Lease and Colonial First State. AMP Capital manages A$29 billion of real estate worldwide, with A$25 billion in Australian assets.

Lim Kin Song

Chief executive, Rockworth Capital Partners

Lim leads the Singapore-based manager, which invests in Australian real estate. Before setting up Rockworth in 2011, Lim worked for Frasers Centrepoint, Ascendas REIT and CapitaLand. Rockworth has around A$2 billion of gross assets under management in the Australian real estate sector.

Matthew Strotton

Global director of capital, QIC

Strotton has been with QIC for nearly 20 years, and spent 11 years running its US property investments. QIC's real estate business has A$27 billion of AUM in Australia and the US, 90 percent of which is invested in the retail sector.

> *"A weakening Australian dollar means investing back into Australia will rapidly become very attractive, and I expect more activity from Asia"*
>
> **MATTHEW STROTTON, QIC**

overseas markets at the moment, Singaporeans have emerged as the major foreign investors, with interest also coming from Hong Kong, Japan and South Korea.

Lim says: "There are different pockets of Asian capital targeting Australia; for example, high-net-worth [individuals] and family offices from Singapore, Hong Kong and China looking to spend A$100 million-A$200 million are still active and operating below the radar of the big domestic groups."

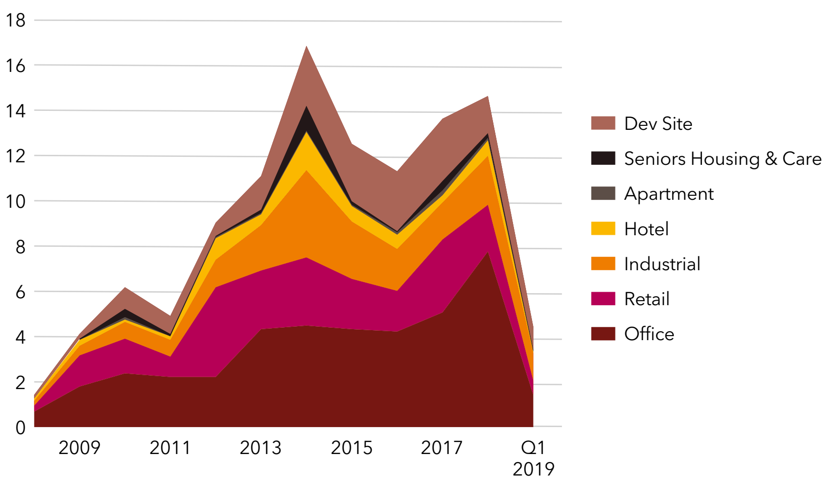
Hourigan notes that AMP Capital now has distribution capability in both Japan and Korea, such is the interest from those markets. "We are seeing very strong inflows into our funds. We raised over A$2.5 billion last year and A$500 million of that came from retail 'mum and dad' investors," she says.

Despite this, the strength of Australia's domestic capital acts as a barrier to entry for foreign investors, says Strotton, as 90-95 percent of the institutional capital in real estate is invested domestically. However, he says: "A weakening Australian dollar means investing back into Australia will rapidly become very attractive, and I expect more activity from Asia."

Strotton points out that the nature of Australia's market means it is overwhelmingly a core investment play, with relatively few opportunistic players. Therefore, Australia has been targeted by managers of pan-Asian core funds, all of which are heavily weighted towards the country.

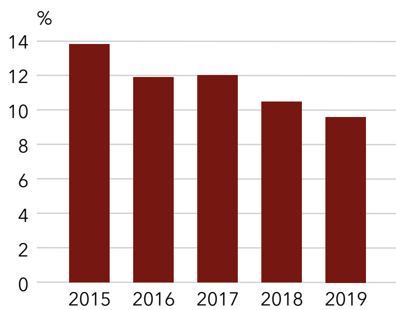
Hourigan raises the possibility that Australian investors might start to take a more global approach to real estate investing in the future. At present, only the very largest

Investment volumes in Australia by sector ($bn)



Source: Real Capital Analytics

Total returns according to the Property Council of Australia/MSCI Australia Annual Property Index (Unfrozen)



Property Council of Australia/MSCI Australia Annual Property Index (Unfrozen) published quarterly; all dates above as of 31 December unless otherwise noted

Source: MSCI

funds, such as superannuation fund AustralianSuper, invest overseas, but she says: "There's a really interesting trend in Australia, in that pensions groups are merging and seeking mergers. We could end up with 10 very large pension groups, which could build the scale required to go offshore."

The weight of capital targeting Australian real estate can be easily felt in the market. PCA/MSCI data show office yields have compressed by 2 percent over the past five years to 5.2 percent. The compression has been even more dramatic for industrial due to strong interest in the logistics sector. Average prime yields for industrial property were 5.8 percent in the first quarter this year, compared with 8.2 percent in the first quarter of 2014.

Hourigan says: "The traditional way the market looked at cap rates has changed. Maybe we all need to think about it a little differently than we have in the past. We see logistics assets changing hands at 4.5 percent, while shopping centers sell at 4.75 percent."

However, the market's – and the roundtable's – expectation is that further substantial yield compression is unlikely, even if interest rates are cut by 50 basis points this year, as expected.

Polarization of performance

Logistics and offices have been the "shiny sectors", Hourigan says, and there has also been a polarization of performance between the services-led economies of Sydney and Melbourne and the resources-led economies of Brisbane and Perth. Sydney's office sector in particular has been a dramatic outperformer; Savills data show Sydney capital values have almost doubled in the past five years.

As well as growth in the services sector, Sydney has benefitted from restricted supply. While the market has seen substantial supply from the new Barangaroo development, which brought nearly 3.3 million square feet to the market, a number of older buildings have been converted to residential, while others still have given way to infrastructure projects.

However, despite Sydney's top billing,

> *"Pension groups are merging and seeking mergers. We could end up with 10 very large pensions groups, which could build the scale required to go offshore"*
>
> **CARMEL HOURIGAN**
> **AMP Capital**

Melbourne saw the office deal of the year this year, with QIC's sale of a four-building complex at 80 Collins Street, which is still under development, to fund manager Dexus for A$1.476 billion, reflecting a yield of 5.3 percent. Melbourne capital values are somewhat above half those of Sydney, a feature that has been attractive to Asian buyers, which tend to be more focused on price per square foot than yield. Indeed, GIC Private, the Singapore sovereign wealth fund, was reported to be one of the bidders for 80 Collins.

With the resurgence in the resources sector, investor interest is growing in Perth's offices sector, which had been in the doldrums following a slowdown in mining. "We're seeing that investors are very interested in the office market in Perth, because they still see value," says Hourigan. "Rents have come off something like 30 percent in Perth, and there's been massive incentives paid. We've

Retail recovery

Investors have been lukewarm on Australian shopping centers in recent years, but there are signs that sentiment may be turning around

Like almost every retail market in the world, Australia has been struggling to adapt to the rapid adoption of e-commerce, coupled recently with a sluggish economy.

Over the last five years, Australian retail assets recorded annualized capital growth of 3 percent, compared with 5 percent for all property types, according to MSCI data. In 2017 and 2018, Real Capital Analytics recorded A$20.2 billion of retail transactions, compared with A$45 billion of office transactions.

It is too early to claim that Australia's retailers, or its economy, are out of the woods – retail sales fell in May, and GDP growth for the 12 months to March was 1.8 percent, compared with a long-term average of 3.5 percent – but investors are starting to take an interest in retail again.

Firstly, there is optimism that the economy is bottoming out and the new government will stimulate more growth this year and, secondly, Australia's retailers are learning to deal with the challenges of e-commerce.

With two of the country's largest retail property investors on the panel, the sector was a focus of interest. Hourigan says: "I think the retailers are far smarter and more sophisticated than they were five years ago. I think our whole retailing community is much stronger for the competition."

Strotton of QIC, which is 90 percent invested in retail assets, says: "The evolution of technology has been a structural change for the retail business and it is taking a while to play out. However, our retailers have developed their models to a far more advanced level compared with where they were even a year ago."

Westfield Burwood: Scentre Group sold a 50 percent stake in this Sydney shopping mall at a 4.1 percent premium to book value

Edzes counters, however: "I think the online service delivery model at the moment is not as developed in Australia as it is in some other markets, which actually creates an opportunity for managers of shopping centers to have a very efficient click-and-collect service that can compete with online retailing and continues to draw consumers to these centers, which are essentially community hubs."

Two major retail transactions, one just completed and another in the market, will provide a crucial barometer for the market. In May, Scentre Group sold a 50 percent interest in the Westfield Burwood shopping center in Sydney for A$575 million, which represents a 4.1 percent premium to its 2018 valuation and a yield of approximately 5 percent.

Meanwhile, Scentre is also selling a 50 percent stake in South Australia's only super-regional shopping center, Westfield Marion in Adelaide, which has a book value of A$735.5 million. The price at which Marion sells will be the real indicator of investor sentiment towards the retail sector.

Strotton says: "These deals could really tell us where the market is. The transaction in Sydney surprised people by going above book value, which maybe indicates the market turning. The other is probably not expected to go as well. If it does better than expected it would be a significant sign."

Hourigan adds: "We've got a retail sector which has been under pressure, so you've got people standing on the sidelines, waiting to see what's going to happen in retail and waiting to see where there's an opportunity to buy. There could be some really interesting opportunities in retail in this market over the next 12 months."

In the longer term, Australian retail landlords will need to continue to adapt to meet the evolving challenges of their business, which is likely to involve a move to a more Asian model.

Lim says: "When a retail center becomes an integrated development, combined with office towers, hotels and residential, the different uses work off each other and that reinforces and makes the retail element stronger. This type of development is common in Asia and we need to see more of it in Australia."

However, Australia's leading retail owners are alive to the challenge. Strotton says QIC "will be augmenting our real estate team with a broader urban unit, which will look at further enhancing our retail assets into microcities, adding more density and mixed uses which build and capture a local economy: commercial, accommodation, education, health and wellness, around each retail hub."

"There are different pockets of Asian capital targeting Australia; for example, high-net-worth [individuals] and family offices from Singapore, Hong Kong and China"

LIM KIN SONG
Rockworth

had quite a lot of leasing activity in the last 12 months, as tenants secure good deals."

Lim adds: "In Perth, apart from location, we see longer leases as a way to ride out the rental cycle. However, with the rental cycle bottoming, and resource sector recovering, well located assets with strong attributes, but existing leasing risks, also present interesting opportunities to capture certain value-add upside."

Edzes is more cautious about venturing into western Australia, saying: "We feel that for Perth it's still difficult to underwrite the real cashflow for that combination of rents and incentives. The headline yield may look attractive, but what is the real yield that you will get?"

Australia is not unique in seeing substantial yield compression in recent years and investors everywhere are searching for higher-yielding opportunities. One consequence is niche real estate sectors such as student housing and self-storage are now more popular than ever.

Edzes says: "What has surprised me somewhat is that local players have not targeted more niche sectors like student housing, as the education sector is a very important part of the Australian economy."

In 2016, Bouwinvest invested in Scape, an Australian student housing platform. "Three years ago, we saw an opportunity in this market, which was comparable to other student housing markets at a similar stage several years prior," he says. "And we're very happy that we made that investment. It's a great combination of universities being based in the city, students wanting to live in the city and being able to create unique living spaces for them."

Washington State Investment Board has put its A$2 billion Australian student accommodation business Urbanest up for sale. Backing up Edzes' point, many of the names mooted as potential bidders, including GIC, Brookfield Asset Management and Greystar Real Estate Partners, are foreign.

Both Lim and Hourigan expect an uptick of interest in hospitality real estate this year. She says: "We are getting a lot of queries about the hotels sector, especially from overseas investors and particularly with regard to the three-and-a-half star budget hotel sector."

Lim adds: "The growth in tourism from China is one of the region's big growth stories. According to Tourism Research Australia, China is Australia's largest source of inbound tourists. It is forecast that Chinese tourist figures will grow at an average rate of 11.9 percent over the next 10 years to 3.9 million Chinese visitors. Therefore, cities with good links to China, like Sydney, Melbourne and Brisbane, are set for growth in the hotel sector."

Brisbane native Strotton notes his hometown is developing a new casino, an attraction for Chinese gamblers who cannot indulge legally at home.

Edzes believes the next important niche in Australian real estate could be the build-to-rent sector, which is a significant part of Bouwinvest's pension funds' holdings globally. "I think for pension fund money it is a great asset class, longer term, to have exposure to," he says. "We feel that Australia has good potential for residential for rent to emerge, though it is important to take into account how local culture views renting relative to buying and also to have

"What has surprised me somewhat is that local players have not targeted more niche sectors like student housing, as the education sector is a very important part of the Australian economy"

TJARKO EDZES
Bouwinvest

Platform plays

It is tough for foreign investors in Australia's tightly-held real estate market, so buying a platform may be the way forward

A substantial proportion of Australia's commercial property is owned by the nation's real estate investment trusts and an even greater slice by its institutional investors. Both the listed and unlisted sides of the market are well capitalized with experienced management.

This means it is not easy for foreign investors and managers to get established. Hourigan says: "Australian real estate is pretty tightly held, so I think that the big overseas private equity players have found it hard to break into the market. Many of these players are very good at taking advantage of a downturn, but there hasn't been one recently in Australia for them to exploit."

Some groups have turned to mergers and acquisitions to gain a foothold in the market. Last year, Oxford Properties and Blackstone battled over the Investa Office Fund and Asian logistics specialist ESR bought Australia's Propertylink in a A$723.4 million deal. In April, Singapore's Rockworth Capital Partners bought an 18 percent stake in Elanor, an ASX-listed real estate investment manager.

Rockworth's Lim says: "For overseas groups, it can be difficult to get access to Australian assets and buy on a single-asset basis if you do not know the market and its intricacies well. I think this is why we have seen more M&A activity over the past one or two years, such as our strategic acquisition into Elanor and ESR's acquisition into Centuria and Propertylink, and why we could see more."

stronger support through government policies." Meanwhile, Hourigan says real estate debt – another en vogue sector globally – will be a growing part of AMP's business going forward. "We are interested in debt, so we are establishing a real estate debt platform, after acquiring a 25 percent interest in PCCP, a US-based real estate debt business, managing about $10 billion. We're establishing a debt platform in Australia, with a locally-recruited and locally-based team."

Overall, the roundtable expects this year to be quieter than 2018, partially due to market conditions and sentiment, but also because of a lack of stock. Sydney brokers joke that little is for sale right now because everything in the country's central business districts has been sold over the past three years. "We have seen transactions slow down across the markets due to a lack of supply of assets," Strotton says. "Partial shares in large assets keep changing hands, but you've got no forced sellers and, even with high pricing, domestic institutions are saying, where can we reinvest if we sell?" ■


“Having a local presence enables us to source the right investment opportunities”
Tjarko Edzes, Director Asia-Pacific Investments, Bouwinvest
In January 2019, Bouwinvest opened an Asia-Pacific office in Sydney, Australia – a first outside the Netherlands -- to spearhead the company's strategy to increase its invested capital in Asia-Pacific markets to € 1.5 billion in 2021. A priority of the Asia-Pacific Mandate is to team up with local partners, both operating managers and other institutional investors, to pursue this growth target. The Asia-Pacific Mandate will focus on investment opportunities that are backed by long-term demand drivers and provide relative value. For the future, Bouwinvest sees strong potential for the logistics and residential sectors in the region.
Want to learn more about our Asia-Pacific growth strategy? Go to Bouwinvest.com/asia-pacific or contact Tjarko Edzes at **t.edzes@bouwinvest.com** / **+61 401 568 879**.