

# Australia – Still An Attractive Destination Despite the Strong \$A

INSIGHTS

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The worst of the GFC has now passed and the Australian economy has emerged in reasonably good shape. A surge in the Australian dollar has not stopped foreign investors flocking to buy Australian non-residential real estate.

Foreign investors are seeing Australia as an ideal place to capitalise on the resurgent commercial real estate industry and the numbers speak for themselves. According to Jones Lang LaSalle, “off-shore investors accounted for 19.9% of commercial (office, industrial and retail) transactions (>\$5m) in 2010, the highest proportion of buyers since 1994.”<sup>1</sup> However, it was our office assets that were most in demand – Asian private equity groups, pension funds and sovereign wealth funds accounted for 40 per cent, or \$2.4 billion, of acquisitions last year.

Why is Australia on the radar despite a strong \$A?

Australia remains one of the most popular targets in the Asia-Pacific region. There are a number of reasons for this, including:

- ◆ the relatively strong performance of the Australian real estate market;
- ◆ Australia’s high transparency,
- ◆ the growth in pension fund capital;
- ◆ the growth in Asia-Pacific real estate capital flow; and
- ◆ changes to the tax treatment of certain offshore investments in Australia.

The Australian non-residential real estate market has performed well since the GFC. In the year to December 2010, Australian non-residential real estate generated a total return of 9.5% according to the PCA/IPD Australia Property Index.<sup>2</sup>

Australia was ranked no 1 globally in the 2010 Jones Lang LaSalle Transparency Index<sup>3</sup>. Australia’s stable political environment, strong regulatory system and high quality information on the underlying real estate markets are attractive to foreign investors.

Pension fund capital continues to grow. According to a report by the Asia Pacific Real Estate Association<sup>4</sup>, Asia accounts for 8 of the top 20 largest pension funds globally and dramatic growth is expected over the next 10 years, with assets expected to double to over \$4.3 trillion by 2020. Global pension funds typically invest 7-10% of their portfolio in real estate, yet for most of the Asian funds it is considerably less although this is changing.

1. Values, Vacancies and Transaction Volumes – Jones Lang LaSalle – March 2011

2. PCA/IPD Australia Property Index – IPD - December 2010

3. Global Real Estate Transparency Index – Jones Lang LaSalle - June 2010

4. The Significance of Real Estate in Asian Pension Funds – Asia Pacific Real Estate Association – September 2010

We are also seeing a strong increase in the number of Asia-Pacific real estate funds which include Australia as part of their mandate. According to DTZ's report on Global property flows – The Great Wall of Money , US\$329bn of capital is available for investment in direct real estate markets. Of which US\$104bn is targeted at the Asia-Pacific region, a 45% increase on the US\$71bn available in mid 2010. DTZ found "China and Australia remain the most popular targets in the Asia Pacific region. Both countries have a majority of markets rated as WARM or HOT."

Also, Australia's Managed Investment Trusts (MIT) regime has recently been amended to make Australia a more competitive and attractive destination for foreign investors. This supports Australia's aim to be stronger financial hub in the Asia-Pacific region. The key benefit to foreign investors who use an MIT compliant structure to invest in Australia is a significant reduction in the withholding tax to 7.5%.

Money is flowing to core "trophy real estate" – high quality assets, with relatively long lease terms - the sector most investors perceive to be the least risky alternative. This wave of capital coupled with competition from local A-REITs and superannuation funds has seen prime office and retail real estate prices well bid in the past twelve months. However, we question whether this is the optimal investment strategy at this stage of the cycle to generate the best risk-adjusted returns. We view the best investment alternatives are in those areas where capital is constrained – which in the case of Australia is currently not the trophy assets.

Some high profile foreign investors in Australian non-residential real estate include sovereign wealth funds - Government of Singapore Investment Corporation, Abu Dubai Investment Authority and the China Investment Corporation, pension funds such as the South Korea National Pension, the Canadian Pension Plan Investment Board (CPPIB) and the Dutch juggernaut - All Pensions Group (APG), and global real estate fund managers including LaSalle Investment Management, Pramerica and Cohen & Steers.

LaSalle Investment Management, one of the world's largest unlisted real estate fund managers with \$45bn in assets under management, is expected to allocate to Australia a significant part of the remaining funds in its LaSalle Asia Pacific Opportunity Fund III. Following on the heels of their recent investments in Australia including a 25% interest in ANZ's new Sydney headquarters, and the Wentworth Sofitel Hotel in Sydney, Ian Mackie, LaSalle's head of private equity for Asia Pacific, was recently quoted in Business Spectator saying the Fund has "several hundred million dollars.. and... we are very happy to allocate the significant part of the remaining capital to Australia."<sup>6</sup>

South Korea's National Pension Fund, a \$260bn powerhouse, has just purchased a 90% stake in 595 Collins St, Melbourne for around \$130m after acquiring the \$650 million Aurora Tower in Sydney in early 2010. The cashed up pension fund's first foray into Melbourne was advised by Pramerica, a US based global real estate fund manager with a significant Asian presence. Commenting on the deal, Pramerica's Asia-Pacific Chief Operating Officer said "with its prominent location in Melbourne's central business district this property represents the type of value opportunity we seek for our investors."<sup>7</sup>

We also expect to see more money flowing from China. As the number of wealthy Chinese continues to grow, more and more will look for avenues to invest their wealth and Australian real estate fits the bill perfectly.

Buying individual assets is not the only attraction for foreign investors in Australia. The recent privatisation of the \$2.6bn listed ING Industrial Fund, by a consortium comprising the Goodman Group, Canada Pension Plan Investment Board, All Pensions Group (APG) and China Investment Corporation confirmed Australia's listed A-REITs are also on the radar of foreign investors.

5. The Great Wall of Money – DTZ – 10 March 2011

6. LaSalle Eyes More Deals in Australia – Business Spectator - 4 March 2011

7. Korean Fund Swoops on Collins Street – AFR – 7 April 2011

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Less than 10 years ago, offshore investors in the listed A-REIT sector owned less than 10% of the sector, now it's closer to 40%. Foreign flows into the A-REIT sector have significantly increased in recent years, and these investors are now major players in the price movements of individual A-REITs.

A-REITs with significant offshore investors on their register include:

- ◆ GPT, Australia's oldest REIT, and owner of some of Australia's premium quality office towers and retail centres has the Government of Singapore Investment Corporation (11%) and the New York based fund manager Cohen & Steers ( 5%) as two of its largest investors;
- ◆ Cromwell recently did a placement to Redefine International, a listed property company that trades on AIM in London, taking their holding to 22%; and
- ◆ Abacus Property Group has a South African link with the Kirsh Group owning 33.9% of the stock.

With the Australian dollar forecast by many market commentators to remain high for some time, it's not expected to put the brakes on foreign capital flowing to Australia. However, the continued foreign interest will have significant implications for the pricing of Australian non-residential real estate and the listed A-REITs.

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Equity Real Estate Partners Pty Limited ABN 93 138 110 826 (AFSL: 340 990)

**Equity Real Estate Partners**  
Level 10, 60 Carrington Street  
Sydney, NSW 2000  
T: +612 8667 2800  
W: [www.equityrep.com.au](http://www.equityrep.com.au)