Observations on capital flows to Australia

What’s attractive about Australia?

Offshore investment into residential real estate

Cross border capital flows outlook and implications
OBSERVATIONS ON CAPITAL FLOWS TO AUSTRALIA
A FEW BASICS - AUSTRALIA IS A CAPITAL IMPORTING COUNTRY

Domestic Saving and Investment as % of GDP

- Mining investment boom
- Domestic savings rise post "GFC"

Foreign Capital Requirement % of GDP

Qu: What happens when Australia requires less capital but demand for assets is strong?

Source: ABS, CBRE Research
GLOBALISATION IN ACTION – RISING FOREIGN ASSET AND LIABILITY POSITION BUT NO PRESSURE ON THE OVERALL BALANCE

Foreign assets and liabilities as a proportion of GDP

Overall external position is fairly balanced relative to GDP so every dollar in equals a dollar out

Source: ABS, CBRE Research
GLOBALISATION – LOCAL ALLOCATIONS TO OFFSHORE HAVE Risen

Offshore Allocation across all Managed Funds in Australia
All asset classes

Implication for Australia’s property markets:

Domestic investors looking to diversify offshore

• AustSuper acquisition of share in Hawaiian shopping centre ($1.1b)

Local investors with mandated hurdle rates are squeezed out of market

Source: ABS
WHAT HAVE WE SEEN IN COMMERCIAL PROPERTY MARKETS?
FOREIGN PURCHASE ACTIVITY HAS INCREASED

The key question is whether this represented a shift in the net position or just more globalisation (rising cross border flows in both directions)

![Commercial Property Transaction Activity – by purchaser origin](chart.png)

Source: CBRE Research
FOREIGN INVESTORS HAVE BEEN NET ACQUIRERS OF COMMERCIAL PROPERTY SINCE 2007

Source: CBRE Research

Foreign Net Commercial Property Purchases
- Cumulative position since 2005

Retail
Industrial
Office

Source: CBRE Research
THE COMPOSITION OF THE ORIGIN OF FOREIGN INVESTORS HAS CHANGED

**Origin of Foreign Purchaser 2008-2012**
- APAC: 32%
- Americas: 17%
- EMEA: 51%

**Origin of Foreign Purchaser 2013-2015**
- APAC: 58%
- Americas: 21%
- EMEA: 21%

Source: CBRE Research
AND THERE IS NOW A VERY DIVERSIFIED MIX OF INVESTORS BY ORIGIN

Investment into Australia over the last 7 years led by Singapore...

- China overtook Singapore as source of capital in 1H 2015 and moves further ahead...Investa portfolio ~$2.4bn

- Total foreign purchases from 2007 to YTD-2015 = ~21% of total (but 33% in 2015)

Source: CBRE Research
WHAT’S ATTRACTIVE ABOUT AUSTRALIA?
HIGHER ECONOMIC GROWTH, INTEREST RATES AND YIELD SUPPORTED CAPITAL FLOW TO AUSTRALIA

- Higher growth/rates and yield structure
- Lower risk: AAA-rated sovereign
- Banks/Financial system lower risk; capitalised and credit risk managed

Source: CBRE Research
WIDE SPREADS TO BOND DON’T, BY THEMSELVES, MEAN GOOD VALUE BUT THEY AT LEAST MEAN FAIR PRICING

Property and equity looks fair value compared to bond rates

Asset Yields to 10 year bond spread

-15% -10% -5% 0% 5% 10%

High inflation/high growth
Low inflation/lower growth
Low inflation/high growth

Assets priced off growth have seen yields widen relative to bonds i.e. more “return” has to be delivered from yield rather than growth.

Hence, equities have corrected the most.

Property/equities look fair on this basis

Source: RBA, CBRE Research
RISING CONSUMPTION/INCOME PER CAPITA MADE AUSTRALIA ATTRACTIVE TO BUSINESS AS WELL

Strong relative performance...

- Australia’s population growth of 1.7% over last decade - 0.6% Advanced world economies; 1.0% Asia-Pacific

- Consumption per capita average growth of 4% in last 10 years v 2-2.7% in US/Europe/UK

- Over 40 foreign brands opened retail stores in Australia in 2014 (and 11 in 2015 to date)

Index: 100

Source: CBRE Research; Oxford Economics
MORE THAN JUST INVESTMENT CAPITAL – FOREIGN RETAIL BRAND PENETRATION IS GROWING – STILL SOME WAY TO GO

…retailers diversifying globally

![Foreign Retail Brand Penetration](chart.png)

*Number of foreign retailers operating in a country as identified by CBRE divided by total foreign retailers in APAC region

Source: CBRE Research, August 2015
OFFSHORE INVESTORS CAN SOMETIMES HAVE Misperceptions AS WELL

“Australian industrial is underperforming because motor vehicle manufacturing is being shutdown”

Myth ?: Fails to see that Motor Vehicle manufacturing represents just 5% of manufacturing (itself only 7% of the economy) or that 85% of vehicles consumed are already imported

“Housing bubble”

Myth?: Rising levels of building activity, high price to income ratio, prices haven’t fallen like they did in the US/Europe - in some cases these headlines miss the fundamentals of vacancy and rent.

“Mining bust”

Myth?: Term used loosely, without focus on the subtle difference between an “investment” boom and a “production” boom; often the regional concentration of this activity isn’t well understood.
OFFSHORE INVESTMENT INTO RESIDENTIAL REAL ESTATE
RISING RESIDENTIAL VALUE RELATIVE TO COMMERCIAL APPEARS TO BE DRIVING DEVELOPMENT AND CHANGE OF USE IN SOME MARKETS

Residential Prices versus Commercial Capital Value
Sydney

Source: CBRE Research, ABS
FOREIGN INVESTORS ARE PURSUING THESE DEVELOPMENT OPPORTUNITIES

Source: Real Capital Analytics; CBRE

Inner City Development Site Acquisitions
(Sydney, Melbourne, Brisbane) year to April

Comprising:

- Sydney (37) - average site price $65m
- Melboume (52) - average site price $20m
- Brisbane (26) - average site price $20m
FOREIGN INVESTMENT IN NEWLY BUILT DWELLINGS HAS RISEN

…the most significant market for foreign purchase activity is Melbourne

FIRB Approvals as % of state all residential turnover

% of offshore purchasers

Source: CBRE Research; RP Data; City of Melbourne Council, 2014.
Excerpt from recent CBRE Research Viewpoint, Aug 2015

“Foreign investment driving two tiered residential market”

Source: CBRE Research; RP Data City of Melbourne Council, 2014.
CROSS BORDER CAPITAL FLOWS OUTLOOK AND IMPLICATIONS
INTENTION TO INVEST ACROSS BORDERS HAS RISEN – AUSTRALIA ATTRACTING A LARGE SHARE

Cross–region investment intention by origin
% of survey respondents

Cross–region investment - preferred destination

Source: CBRE Global Investor Intentions Survey 2015, % of survey respondents
WHERE IS THE CAPITAL? FUNDING SOURCES FROM ASIA AND THE MIDDLE EAST ARE GROWING

Excerpt from CBRE Research “In and Out – Middle East” August 2015

Cross-regional capital flows into global commercial real estate increased to $125 billion in 2014, up 39% year-on-year. The Middle East was the third largest source of capital in 2014, with $14 billion invested outside the region.

Source: CBRE Research, Real Capital Analytics
In 1H 2015, Australia attracted over 25% of China’s real estate investment dollar.

CHINESE CAPITAL FLOWING INTO GLOBAL REAL ESTATE MARKETS HAS ALMOST TRIPLED SINCE 2012

Source: CBRE Research
CHINESE ONLY AT THE START OF INVESTMENT DIVERSIFICATION

...repeat of Japan looks less likely?

Foreign Investment in Australia - Japan and China

Japanese investment halted after 1990 during the “lost decade”

50% of Japanese investment into real estate

Major sectors

Mining
Manufacturing

Major sectors

Mining
Real estate (almost 50%)

Source: FIRB, ABS, CBRE Research
CHINESE CAPITAL – BACKED BY PEOPLE (AND BI-LATERAL TRADE)!

Sources of Migrants - Australia

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Source: ABS, CBRE Research
MORE CAPITAL EXPECTED TO BE ALLOCATED TO REAL ESTATE WHICH IS UNDERWEIGHT AMONGST APAC INVESTOR GROUPS

Source: Preqin, OECD, SWF Institute, and Various Central Banks and Insurance Associations, ANREV - The increasing importance of Real Estate in Asian pension funds; CBRE – Insurance Paper
FOREIGN INVESTMENT ADDS AN UNKNOWN TO TRADITIONAL ANALYSES OF “DOMESTIC REQUIRED RETURNS”

As foreign investors have a greater influence on the market; we may need to look beyond purely domestic fundamentals.

Implication: Creates a little less certainty about predicting the required return as need to factor in international expectation for return.

Source: RBA, CBRE Research

**Implied** growth is derived from the difference between IRR and observed market yields.
KEY POINTS IN CONCLUSION

1. Globalisation – Australia receiving a share of rising cross border activity

2. Relative performance of Australian economy and markets
   - more cyclical - Australia currently receiving an above weight share of investment interest

3. New capital sources are growing and diversifying
   - Australian funds also look offshore
   - Implication for local investment returns
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