



# Australian capital—is it really safer at home?

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**November 2015**

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- **8:28**

- Global liquidity
- Too late to the party?

- **Strategy what strategy?**

- Is it really safer to stay at home?
- Being paid to take risk

- **Why Europe, why now?**

- Illusive rental growth
- Where is capital scarce
- Exit liquidity

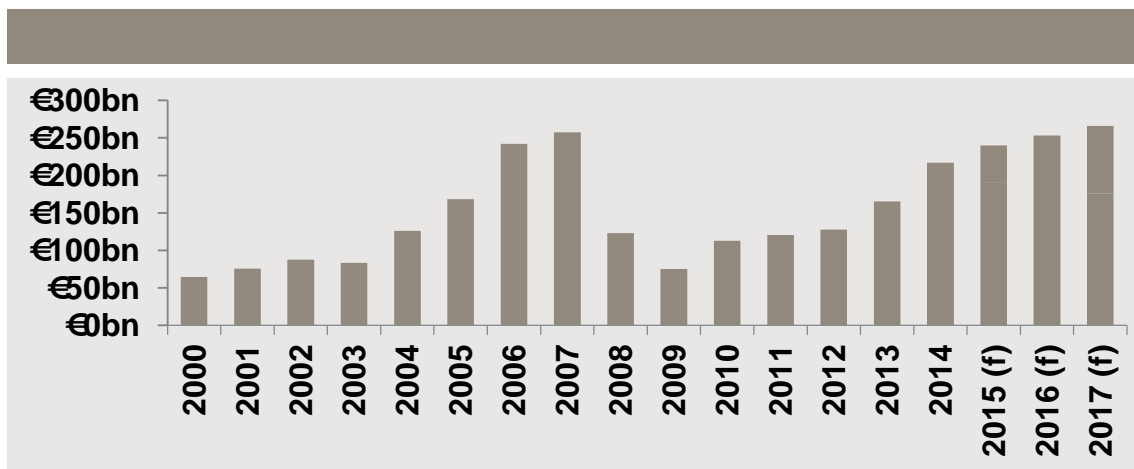
- **Summary**

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# Europe—investment transaction activity



## CURRENCY WARS (\$BN 1Q2015)

	Acquisitions	Dispositions	Net investment
<b>US</b>	10.1	5.5	4.6
<b>Middle East</b>	2.1	0.9	1.2
<b>Asia</b>	2	0.5	1.5
<b>Total</b>	14.2	6.9	7.3

Source: RCA and Bloomberg, March 2015

- Debt versus equity
- Increasing diversity of capital active in market
- Post QE flows from low yielding, fixed income products to real estate
- Financial deregulation in Asia
- The role of domestic institutional capital
- A new credit cycle—increased availability and use of debt
- Competitive currency wars

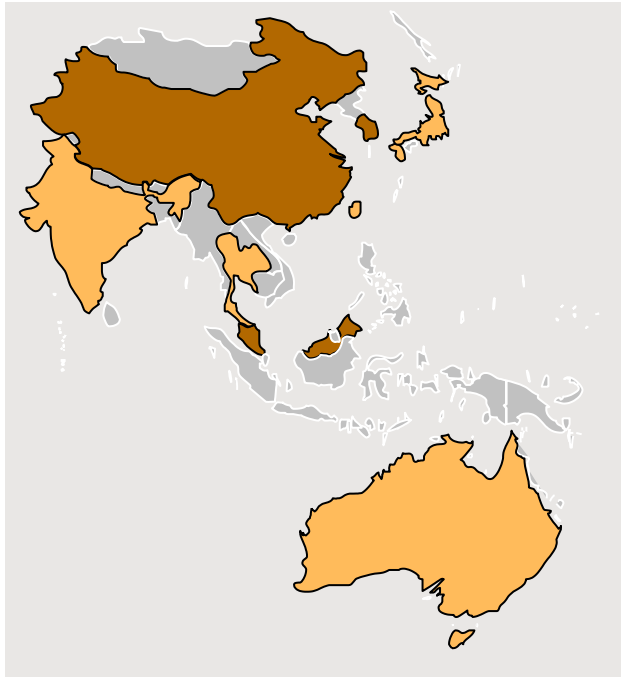
# Sources of real estate capital in Europe (€bn, 2007–14)

Investor group	Acquisitions	Dispositions	Net investment	Strategy	Implications for market
European institutions	279	219	60	Rationalisation	Key in terms of exit liquidity—net investors in the UK
Non-European institutions	108	69	39	Deregulation of financial services	Competition in Tier I markets will intensify further. Some investors will be tempted into Tier II markets
Global funds	96	58	38	High rate of capital raising & large number of funds exiting market	More capital will be raised into this sector and managers/investors will then be forced to take additional risk
REITS	131	147	(17)	Rationalisation	Dispositions may well fall due to booming equity market
High net worth individuals	14	7	7	Increased wealth	Liberalisation of personal savings market in China?
Sovereign wealth funds	40	6	34	Long term acquisition mode	Additional capital from new SWF's counterbalanced by falling/low oil prices. Little impact on the sector

Source: RCA , 2014

# Capital flows into Europe

## CAPITAL FLOWS INTO EUROPE



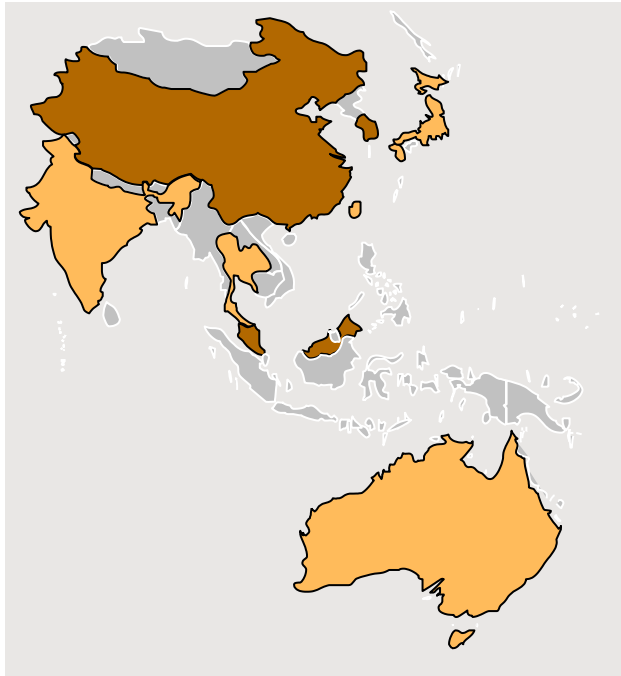
China	\$9.1	24%
Singapore	\$8.1	22%
Hong Kong	\$4.0	11%
South Korea	\$4.0	11%
Malaysia	\$3.4	9%
Taiwan	\$2.4	6%
India	\$2.1	6%
<b>Australia</b>	<b>\$1.4</b>	<b>4%</b>
Thailand	\$1.4	4%
Japan	\$0.9	2%
Other	\$0.8	3%
<b>Total</b>	<b>\$37.7bn</b>	<b>100%</b>

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Source: RCA 2015 (Direct transactions over last 2 years)

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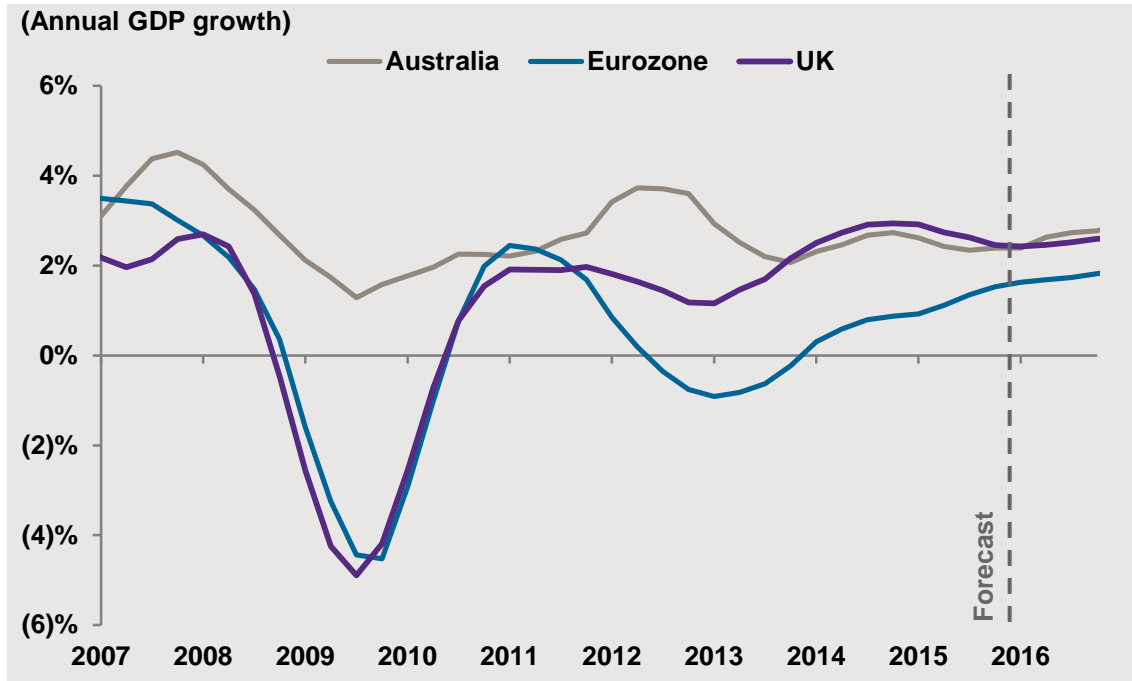
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*8 Australian investors acquired 28 assets  
Over the last 3 years.*

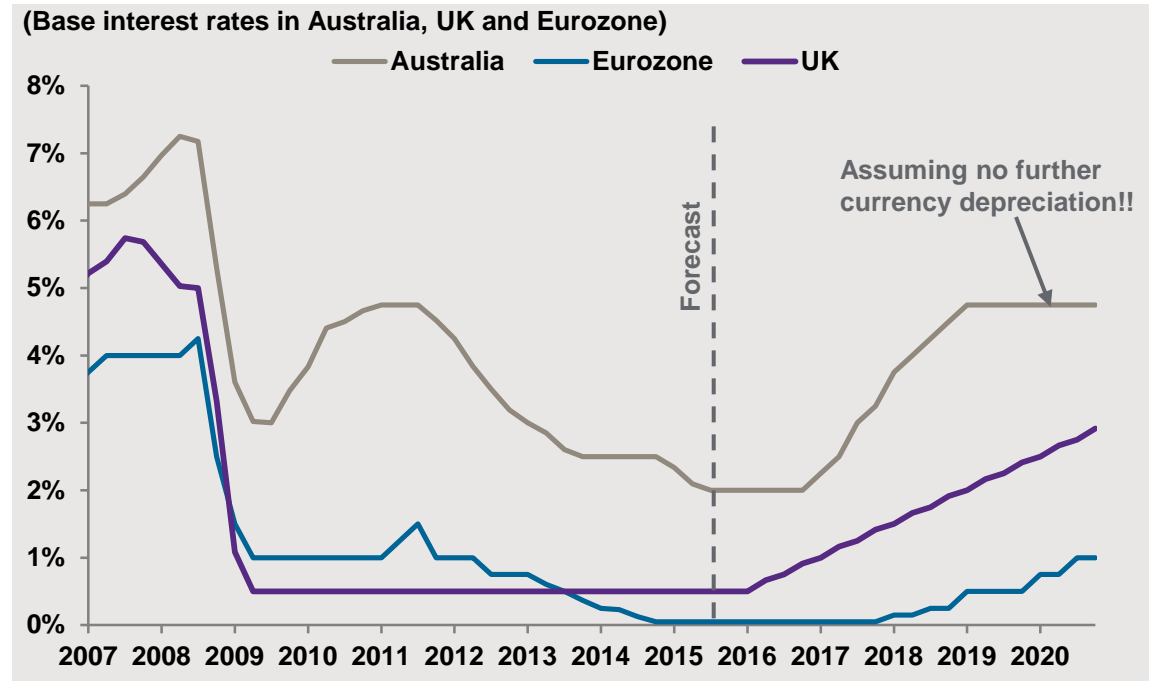
Source: RCA 2015 (Direct transactions over last 2 years)

# Australian economy and interest rates

## CONTINUED GDP GROWTH



## INTEREST RATES TO INCREASE RAPIDLY—IMPORTING INFLATION



Source: J.P. Morgan Asset Management, Oxford Economics as of October 2015



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# Strategy what strategy?

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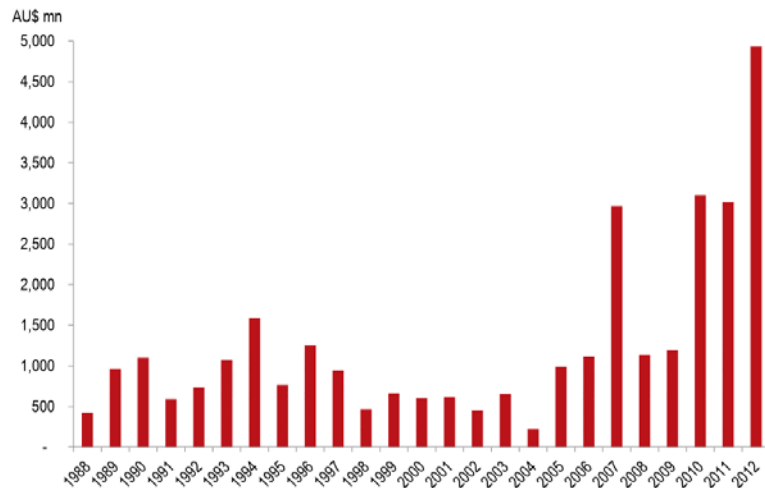
***“...Everyone’s got a strategy that works until  
they get punched in the face...”***

**Mike Tyson**

# Invest where capital is scarce...

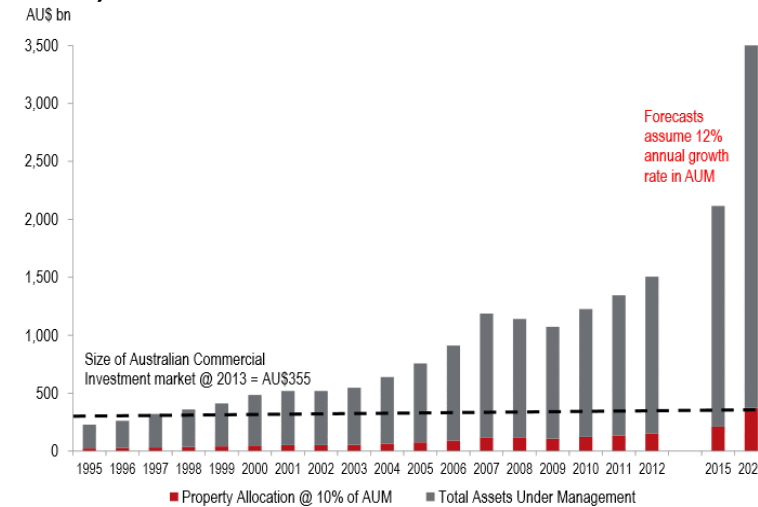
## LARGE CAPITAL INFLOWS

(Foreign real estate investment in Australia)



## SHARP INCREASE IN SUPERANNUATION MONEY

(AUM of superannuation funds and allocation to real estate)



## CAPITAL VERSUS INVESTMENT UNIVERSE

	Dry fire power (\$bn)	Size of investment universe (\$bn)	Capital/universe ratio
Europe	57.2	9,366	0.6
Australia	7.5	650	1.2

*“War chest of Superannuation funds increasing by AUD100bn p.a.*

*AUD100bn chasing domestic real estate market of AUD400bn.*

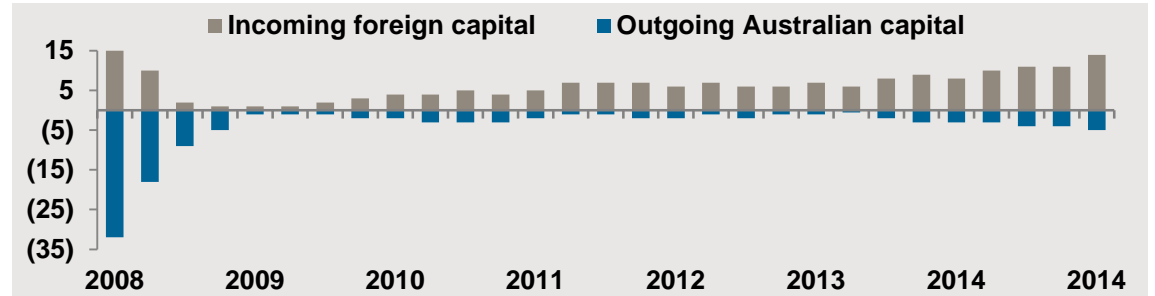
*4th largest superannuation pool in the world”  
- IPE 2015*

Source: J.P. Morgan Asset Management, JLL as of September 2015, IPE August 2015

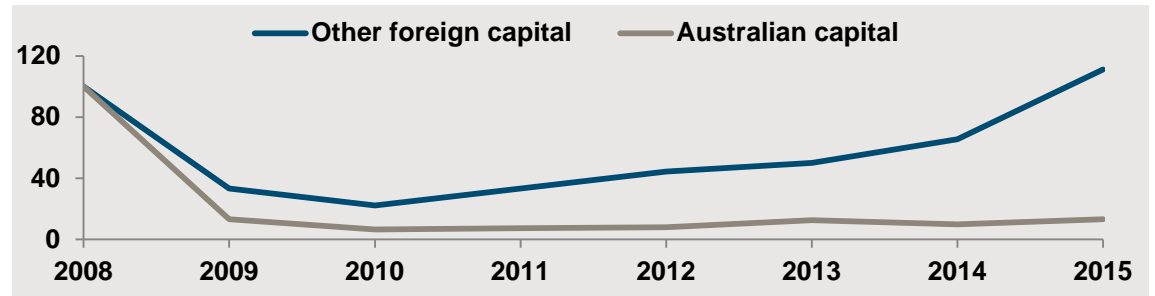
# The world of the brave... 10 year cycles, 5 year memories

- Focus on the domestic market and wait for the end of the commodity super cycle?
- Think about investing overseas only when domestic growth slows down and investment returns erode?
- Be forced to go up the risk curve when the domestic market slows down and, in so doing compound the level of risk by taking asset, currency and country risk all at the same time?
- Wait for competition to intensify from foreigner investors with substantially lower costs of capital?
- Wait patiently on the side-lines until all vestiges of value evaporate from US and European markets?

## NET REAL ESTATE CAPITAL FLOWS (\$BN)



## FOREIGN INVESTMENT INTO EUROPE



Source: J.P. Morgan Asset Management, RCA 2015

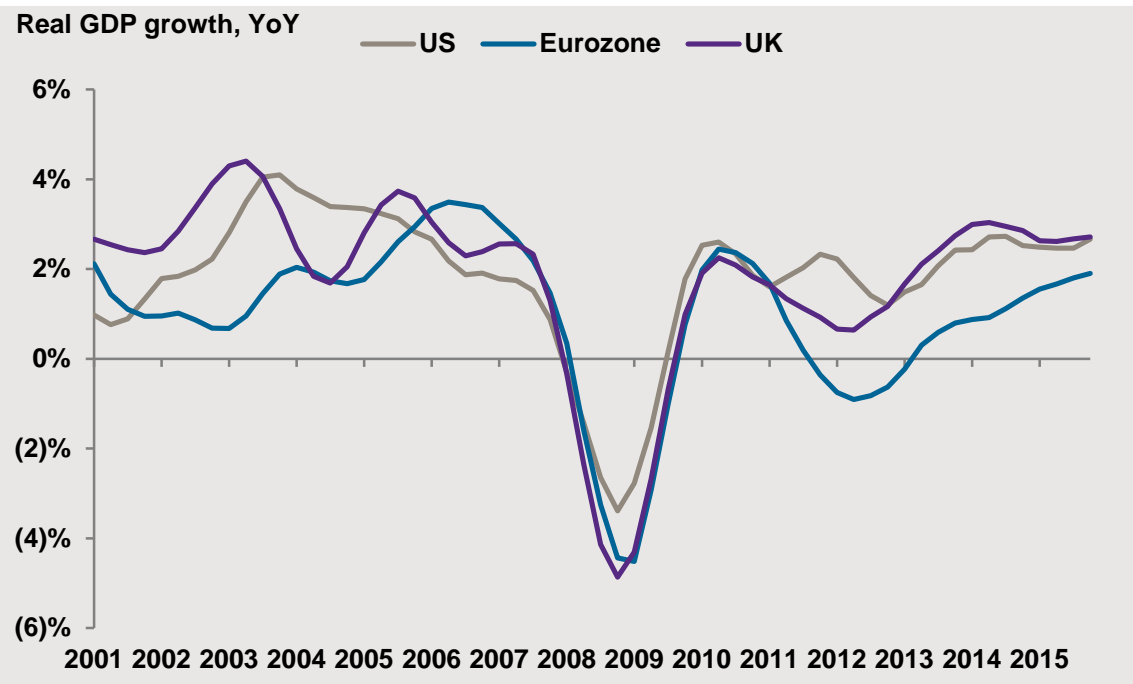
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# Why Europe, why now?

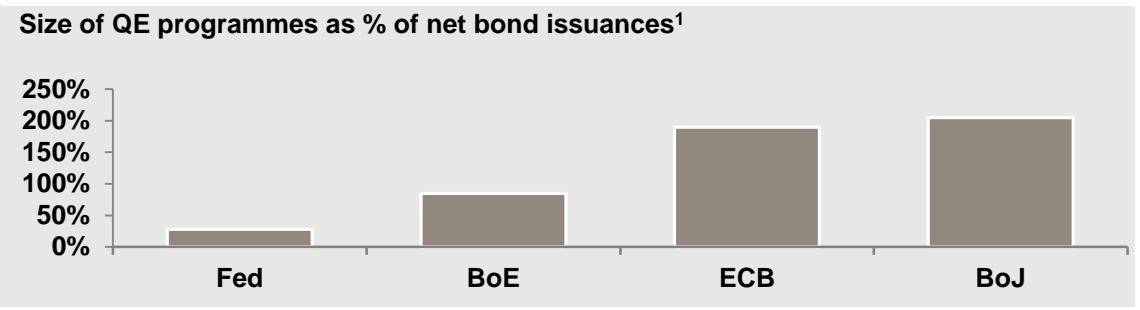
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# Economic recovery is gaining traction in Europe

## A DELAYED ECONOMIC RECOVERY



## PROPPED UP BY QUANTITATIVE EASING



## EXPECTED MONTHS TO FIRST INTEREST RATE HIKE—EUROZONE

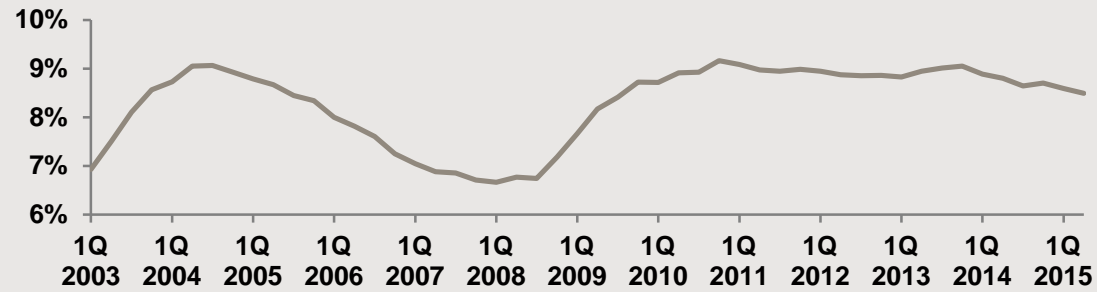


Source: J.P.Morgan Asset Management, Oxford Economics as of September 2015

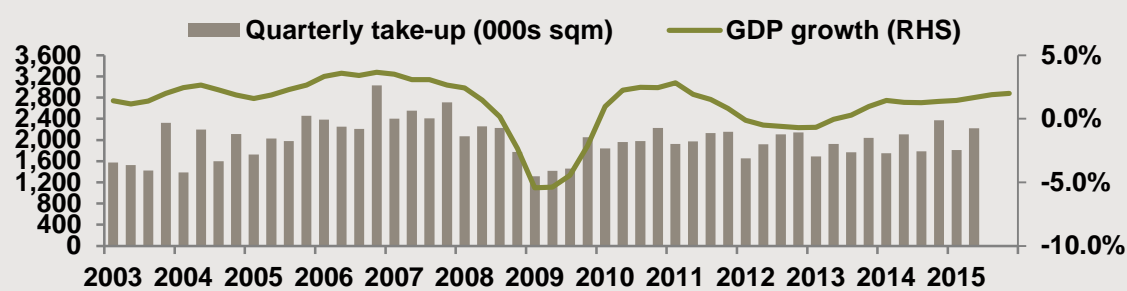
<sup>1</sup> Over the period from September 2008 to October 2014 for the Fed, March 2009 to June 2012 for the BoE, March 2015 to September 2016 for ECB, April 2013 to October 2015 for BoJ

# The search for rental growth

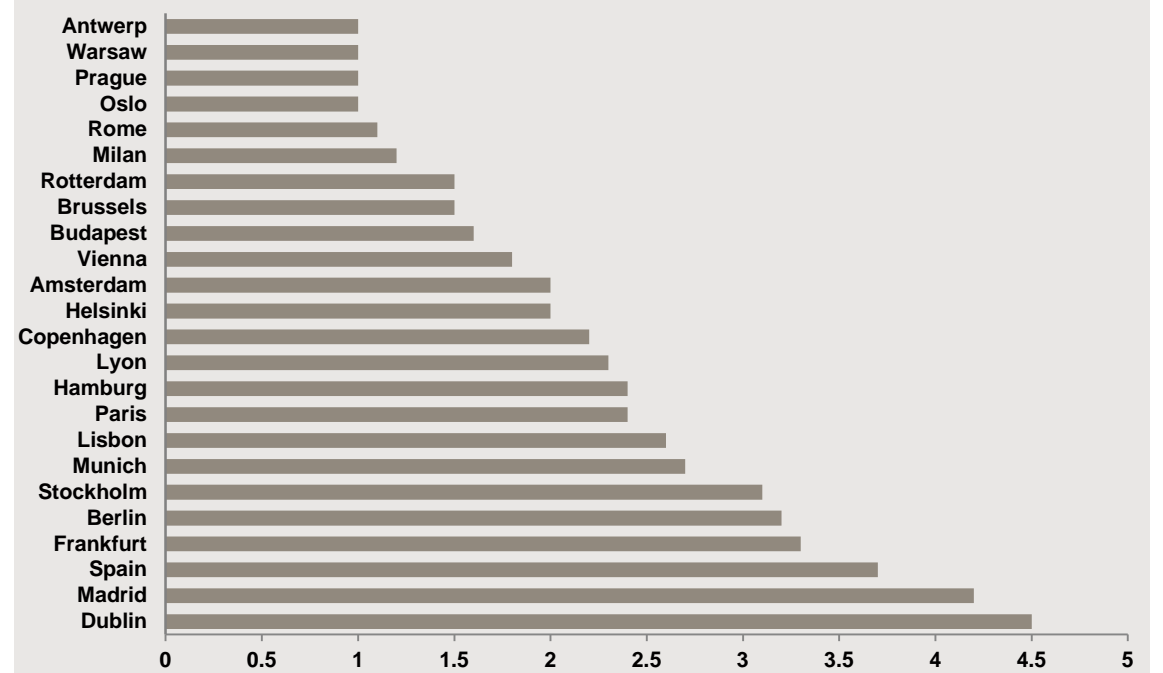
## EUROPEAN AVERAGE VACANCY RATES



## EUROPEAN GDP AND OFFICE TAKE-UP



## OUTLOOK FOR RENTAL GROWTH (% P.A. 2015–19)



Source: CBRE 2015

# European investment opportunity

	Prime markets	Institutional markets	Other
Trophy		Pricing	
Assets in suspended animation		Liquidity	
Other		Exit	

- Capital overhang vs. scarcity of capital?
- Leasing vs. capital markets
- Investment universe
- Global liquidity vs. domestic capital
- Exit liquidity
- The importance of timing

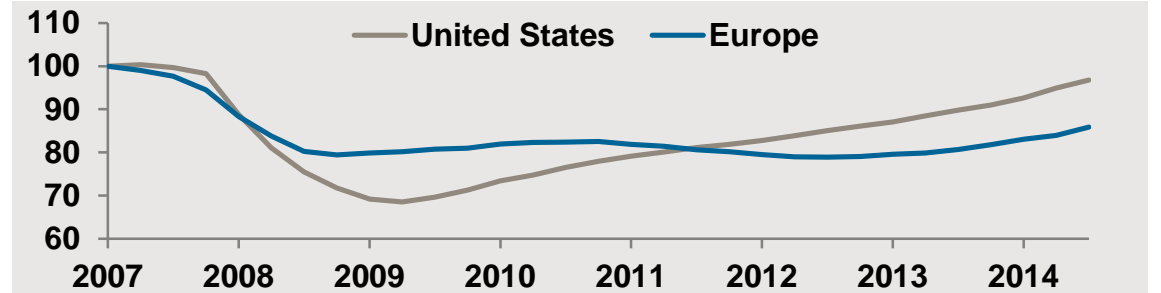
Source: J.P. Morgan Asset Management, 2015



# Fully priced markets?

	Prime markets	Institutional markets	Other
Trophy	Intense competition Scarce product Fully priced		
Assets in suspended animation			
Other			

## EUROPEAN PROPERTY VALUES STILL WELL BELOW THEIR PEAK

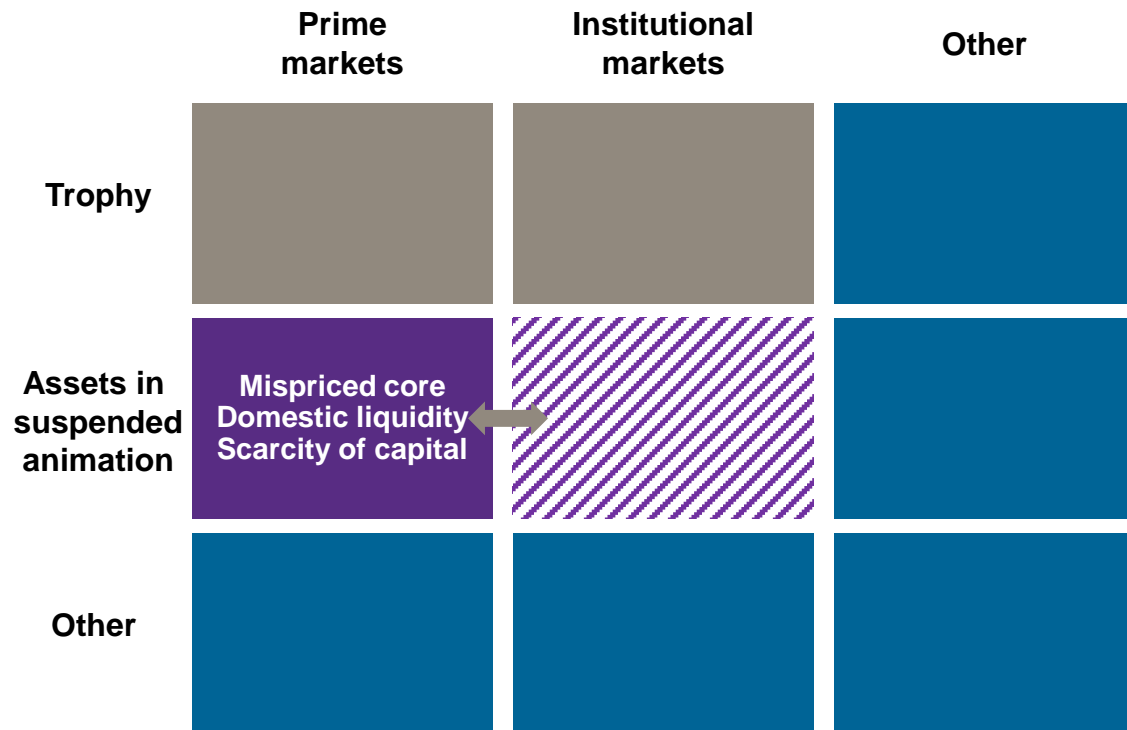


## OUTWARD SHIFT IN YIELDS—IMPACT ON CAPITAL VALUES

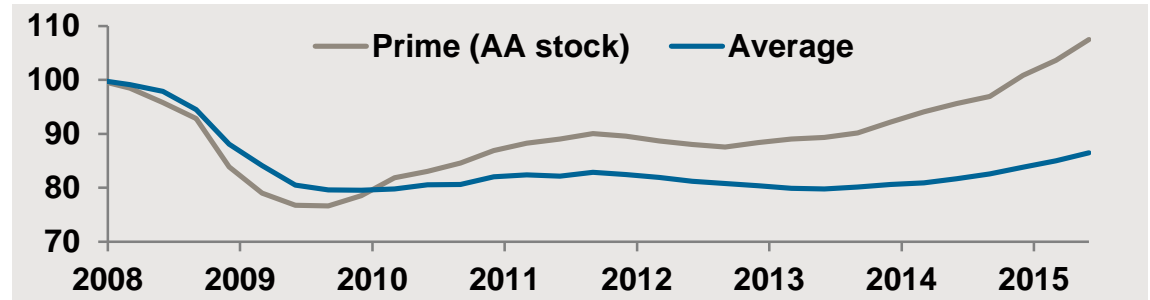
Prime Capital values (pa)	Prime yield constant	+50bps	+100 bps	+150 bps
London-West End	7.3%	5.0%	2.9%	0.4%
London-City	4.6%	2.6%	0.9%	(1.4)%
Paris	2.7%	0.4%	(3.9)%	
Frankfurt	9%	1.5%		
Madrid	9.0%	7.0%	3.0%	

Source: J.P. Morgan Asset Management, 2015

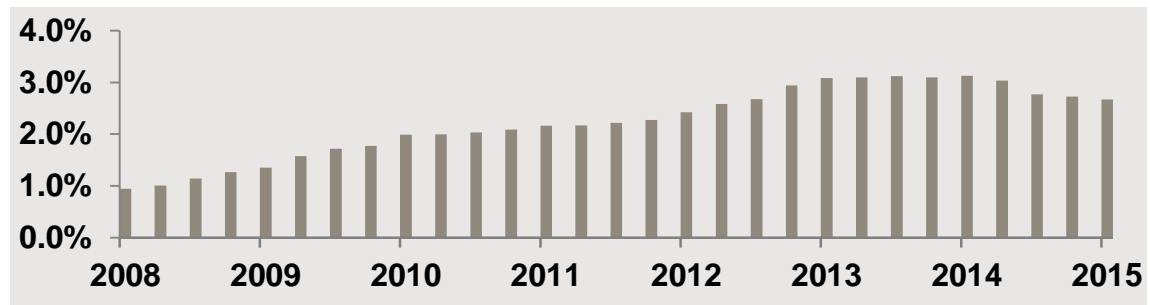
# Assets in suspended animation...



CAPITAL VALUES BELOW PREVIOUS PEAK

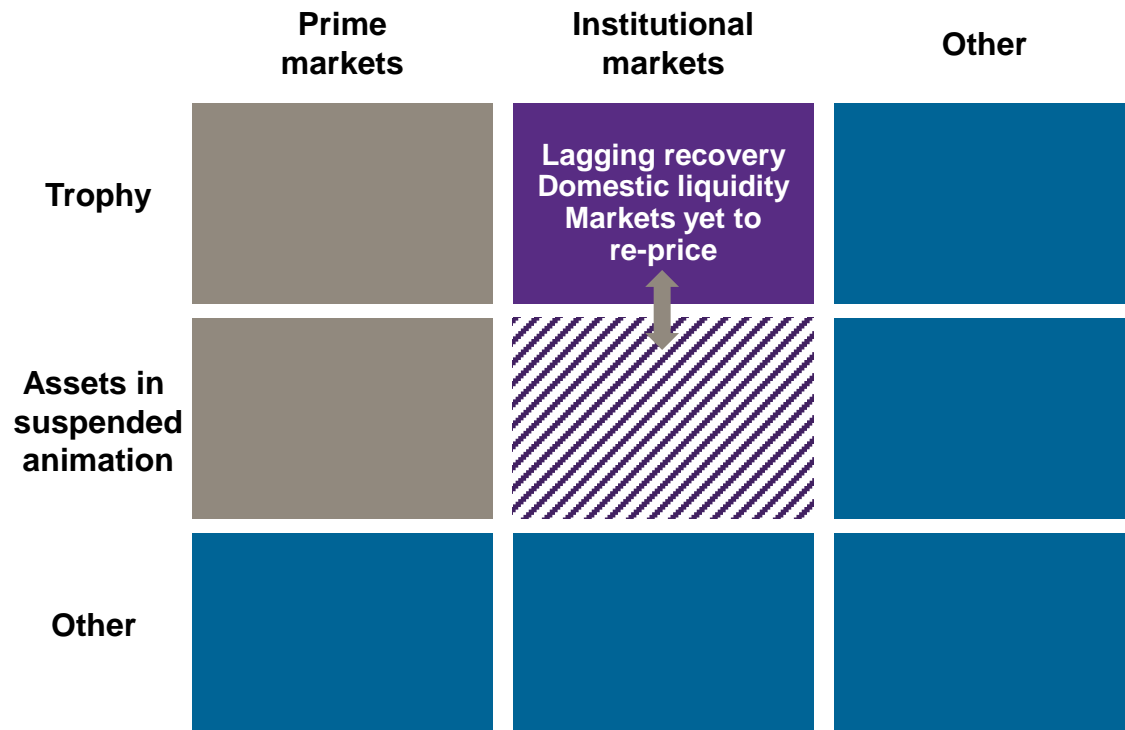


YIELD PREMIUMS REVERTING TO LT AVERAGE

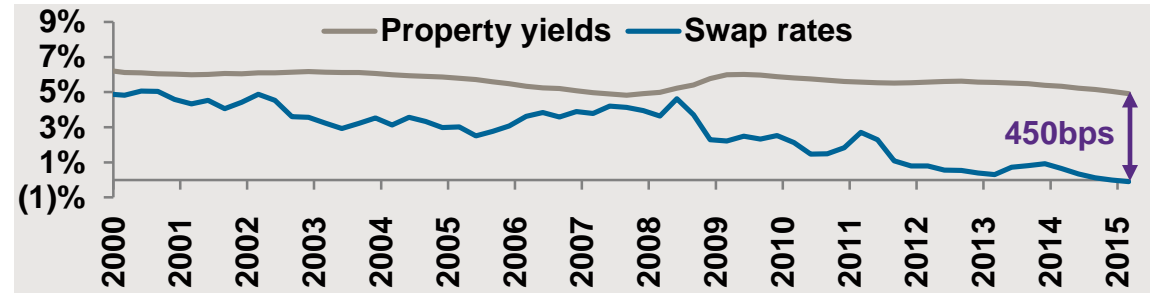


Source: J.P. Morgan Asset Management, 2015

# Late cycle recovery markets...



## LOW FINANCING COSTS (PROPERTY NET INITIAL YIELDS VS. 5 YEAR SWAP RATES IN THE EUROZONE)



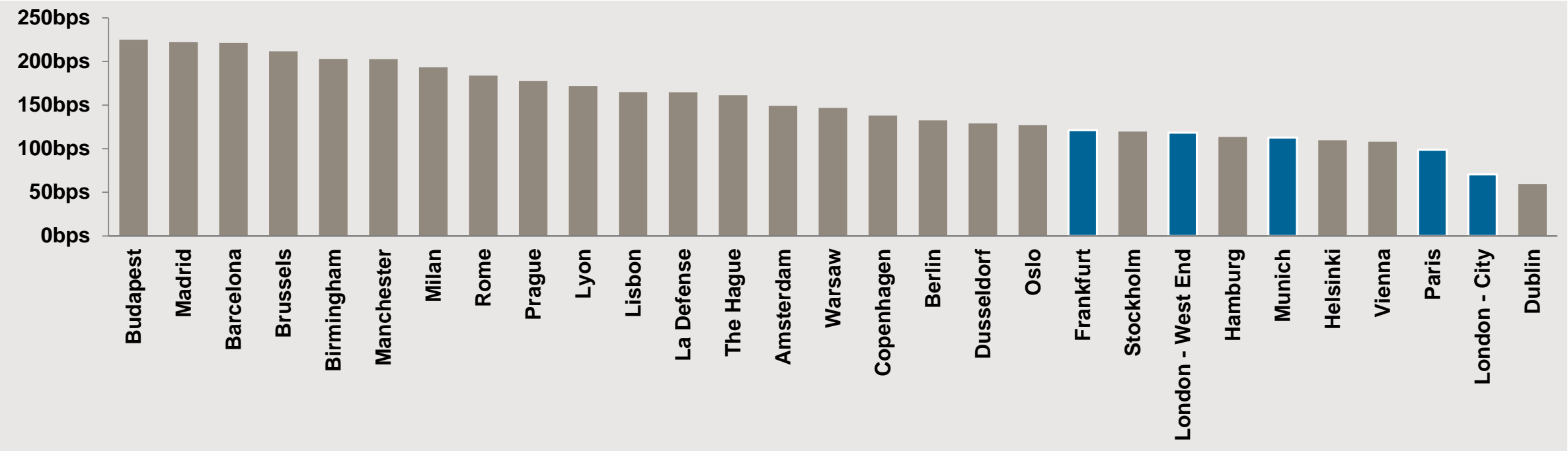
## ACCRETIVE LEVERAGE (LEVERED INCOME RETURNS BEFORE TAX IN THE EUROZONE)

LTV \ NIY	4.0%	5.0%	6.0%	7.0%	8.0%
20%	4.1%	5.4%	6.6%	7.9%	9.1%
30%	4.5%	5.9%	7.4%	8.8%	10.2%
40%	5.0%	6.7%	8.3%	10.0%	11.7%

Source: J.P. Morgan Asset Management, 2015

# Defensive real estate markets... what if?

## DOWNSIDE PROTECTION AGAINST AN INCREASE IN YIELDS

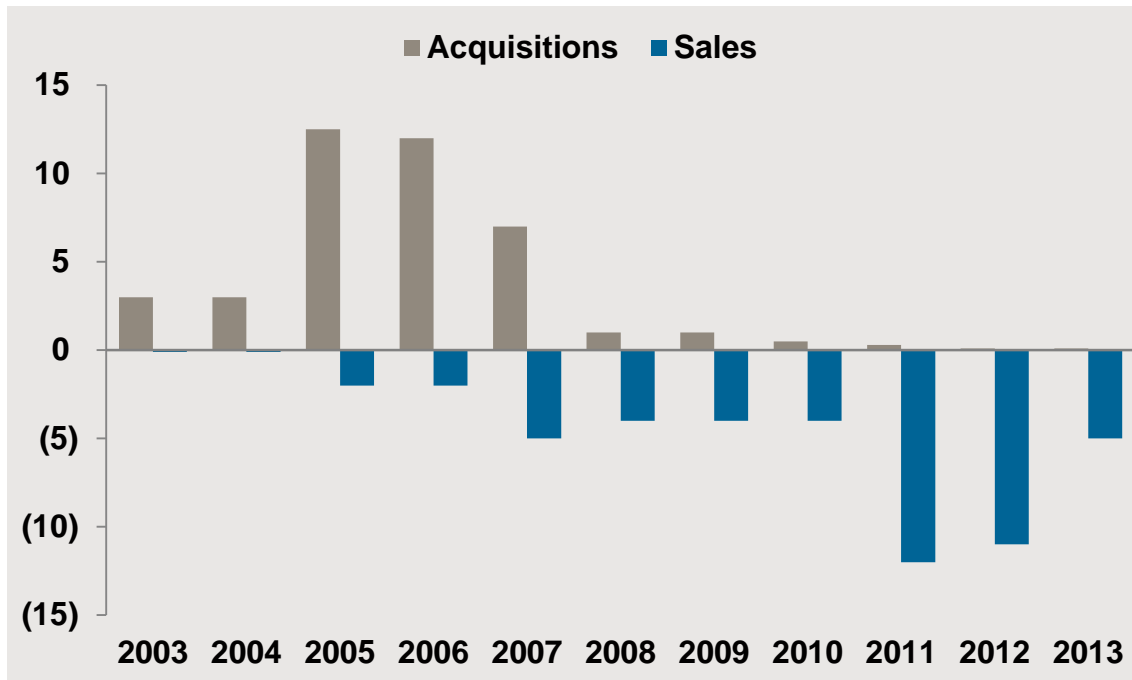


Source: JP Morgan Asset Management, 2015

Note: Outward movement of yields over next 5 years equal to the amount of capital accumulated plus income during the period

# Summary

## IT'S ALL ABOUT TIMING (\$BN)



Source: J.P. Morgan Asset Management, JLL as of September 2015

- Despite increased liquidity in Europe, there are entire institutional markets that have been starved of capital post-Lehman
- No investor will be rewarded for taking macro risk. Focus in the short term on core Europe
- Capital appreciation strategy focusing on assets with minor blemishes in institutional markets
- Income strategy in late cycle recovery markets taking advantage of accretive financing
- Capital deployment in smaller institutional markets can be challenging.
- How long is the window of opportunity?

# J.P. Morgan Asset Management

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