Private Equity Real Estate PIR Conference

15 October 2015

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Folkestone

THE REAL ESTATE SECTOR

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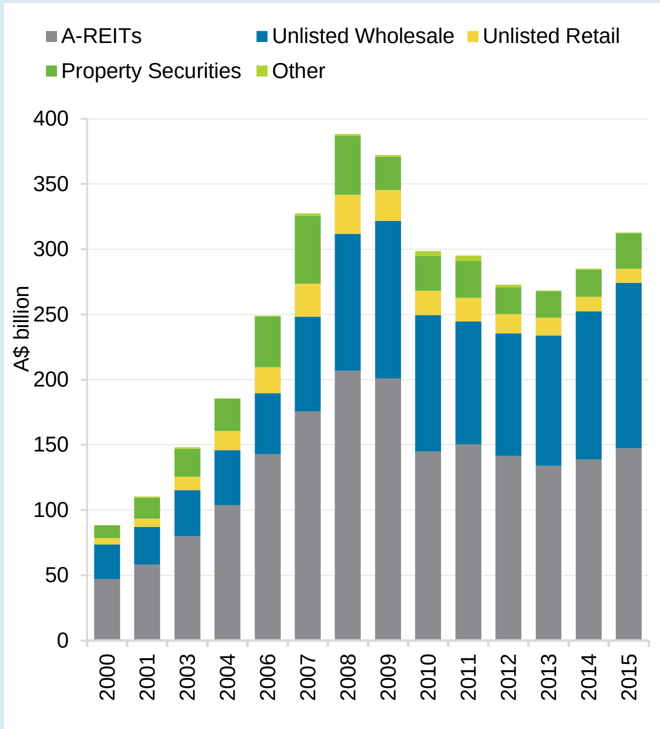
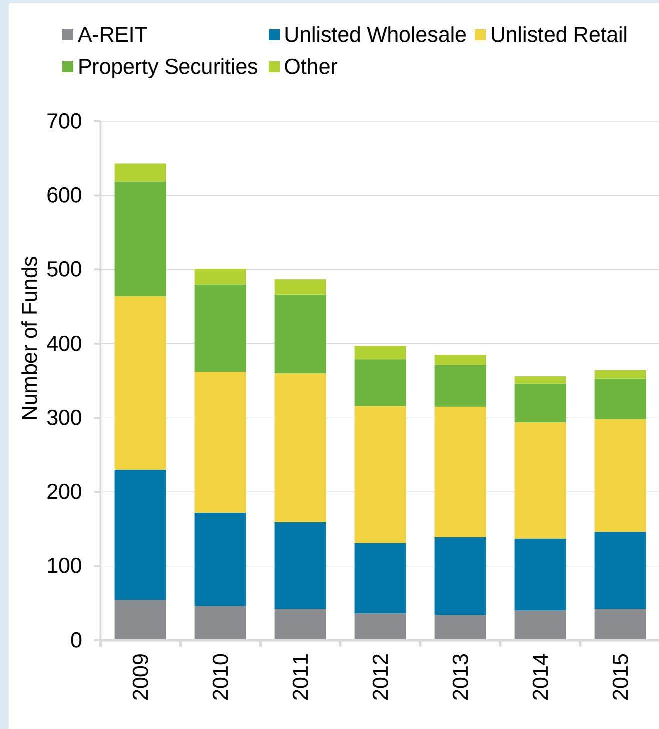
REAL ESTATE FUNDS IN AUSTRALIA

Property Funds by Sector: 2000 - 2015



Number of Funds by Fund Type: 2009 - 2015



Source: PIR

- A-REITs have traditionally dominated but have been losing market share to wholesale funds
- FUM split - A-REITs: 47%, wholesale unlisted funds: 41%, property securities: 9% and unlisted retail funds: 3%
- Unlisted retail funds have lost market share – both number of funds and assets under management fell 3% in past year

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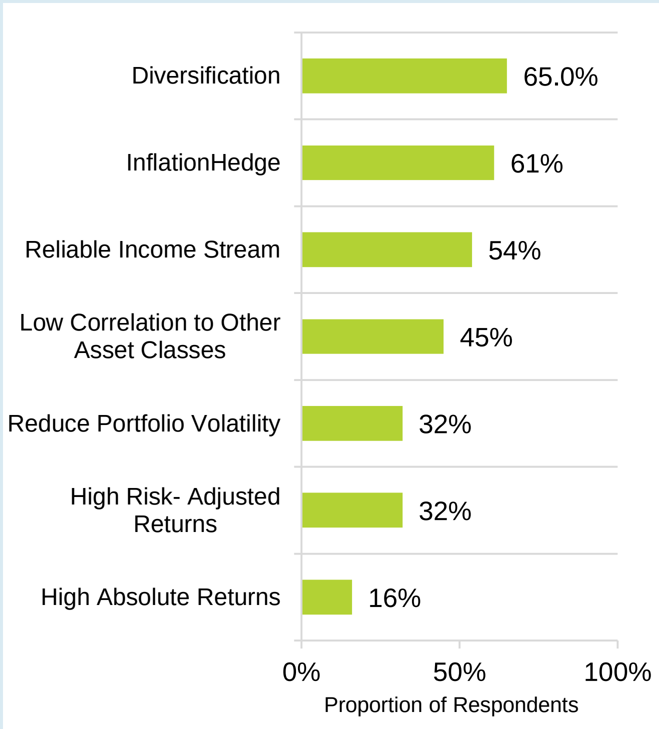
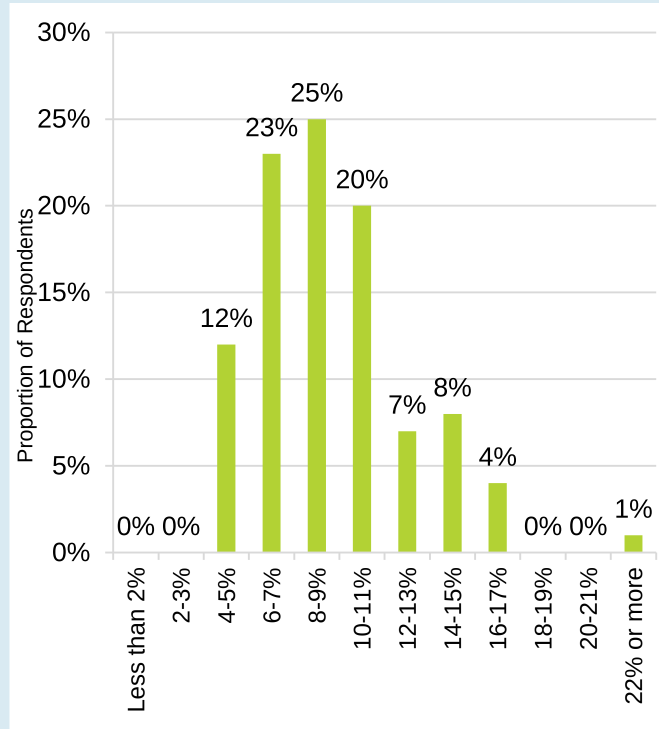
INVESTOR OBJECTIVES

Main Reasons for Investing in Real Estate: June 2015



Targeted Annualised Absolute Returns for Real Estate: June 2015



Source: Preqin Investor Interviews - June 2015

- There are a multitude of reasons why investors invest in real estate
- Preqin Survey of Major Institutional Investors - diversification the primary reason – the asset classes relative low correlation to equities and the diversity of real estate sectors (office, retail etc.), locations (domestic and global) and investment strategies (core, valued-add, opportunistic, debt or equity)
- 60% have a return target of below 9% reflecting the significant compression in global yields and low interest rates

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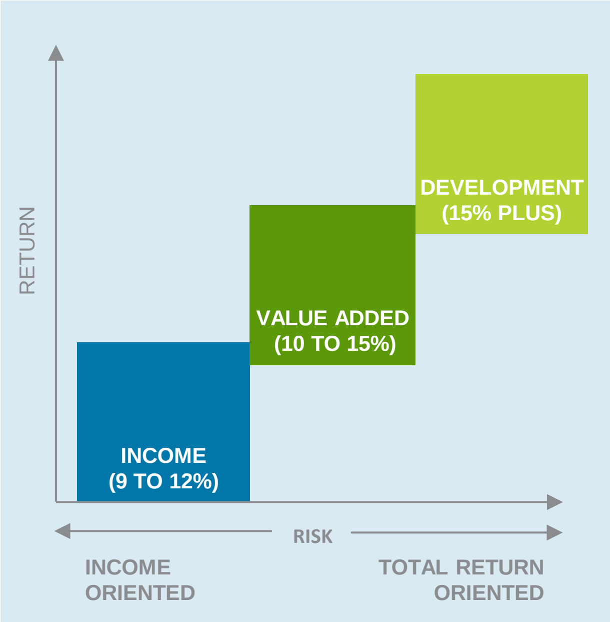
INVESTMENT STRATEGIES ACROSS THE REAL ESTATE SPECTRUM



	INCOME	VALUE-ADDED	DEVELOPMENT
RISK:	Low	Medium	High
TARGET RETURN (IRR – PRE TAX NET OF FEES):	9-12%	10-15%	15%+
SOURCES OF EARNINGS:	Current income (70%) + capital appreciation (30%)	Current income (50%) + realised capital appreciation (50%)	Current income (<20%) + realised capital appreciation (>80%)
HOLDING PERIOD:	5+ years	3-7 years	2-5 years
FINANCIAL LEVERAGE:	0-50%	30-70%	50-80%
BUILDING TYPE:	Quality assets with long leases and quality tenants, fully or almost fully occupied	Assets with upside potential through refurbishment, re-leasing and repositioning	Development assets, distressed assets

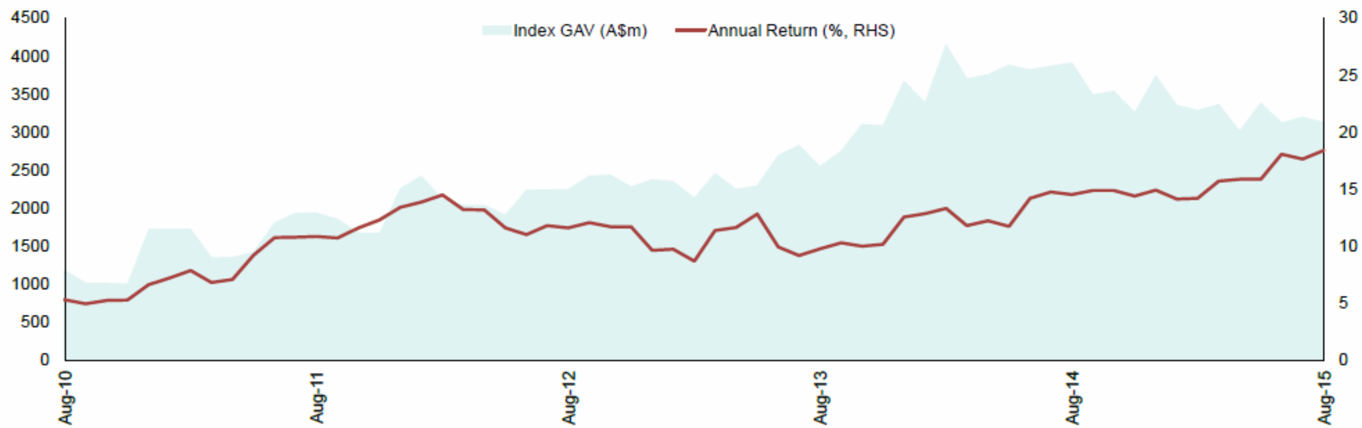
CORE RETAIL PROPERTY FUND

The Property Council/IPD Unlisted Core Retail Property Fund Index

MSCI

Results for the month to 31 August 2015

Historical Performance - 12 Month Total Return %



The Property Council/IPD Unlisted Core Retail Property Fund Index - Post Fee Total Return

	Total Return Index to Aug-15 April 2008 = 100	Total return (%) for 1M	3M	FYTD	12M	3Y	5Y	Distributed Income return (%) for year to Aug-15	Capital growth (%) for year to Aug-15
Core Funds*	161.7	1.1	7.2	1.5	18.3	14.1	13.0	8.0	9.7

* Core funds must have <20% development exposure, gearing <50%, >90% direct property exposure, must not capitalise interest and must be ASIC registered Managed Investment Schemes. Any fund not classified as a core fund is considered to be a non-core fund

Index Profile

	Size No of Funds	Value GAV $m	NAV $m	NAV in Index $m	Distribution Yield	Gearing (Debt/GAV)	Valuation Evidence (%)
Core Funds	28	3,126.0	1,799.0	1,799.0	8.2	42.2	2

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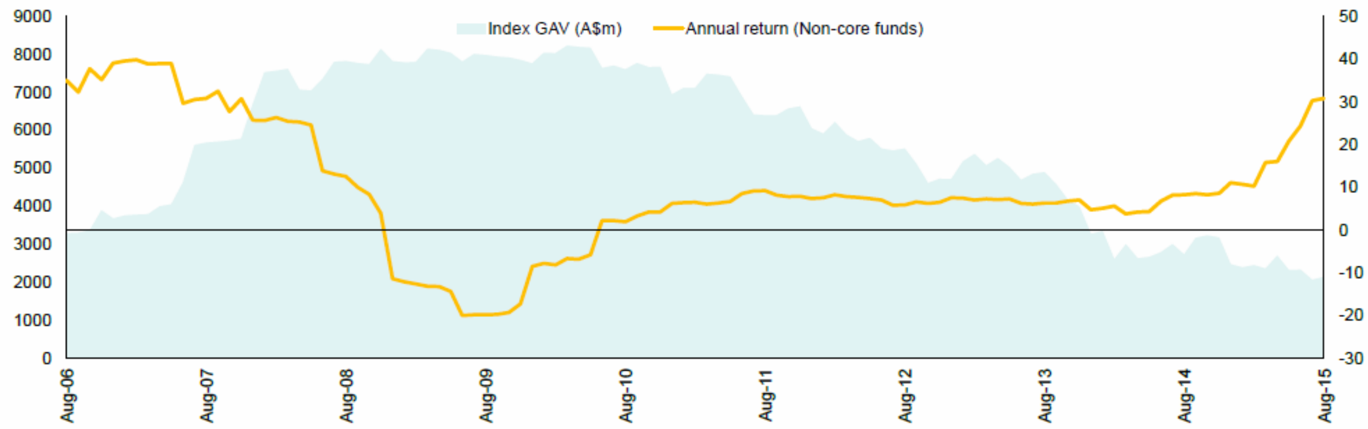
NON-CORE RETAIL PROPERTY FUND

The Property Council/IPD Unlisted Non-Core Retail Property Fund Index

MSCI

Results for the month to 31 August 2015

Historical Performance - 12 Month Total Return %



The Property Council/IPD Unlisted Non-Core Retail Property Fund Index - Post Fee Total Return

	Total Return Index to Aug-15 June 2004 = 100	Total return (%) for						Distributed Income return (%) for year to Aug-15	Capital growth (%) for year to Aug-15
		1M	3M	FYTD	12M	3Y	5Y		
Non-Core Funds*	334.5	1.0	12.5	6.7	30.8	14.6	11.7	7.4	21.9

* Core funds must have <20% development exposure, gearing <50%, >90% direct property exposure, must not capitalise interest and must be ASIC registered Managed Investment Schemes. Any fund not classified as a core fund is considered to be a non-core fund

Index Profile

	Size No of Funds	GAV $m	Value NAV $m	NAV in Index $m	Distribution Yield	Gearing (Debt/GAV)	Valuation Evidence (%)
Non-Core Funds	52	2,134.0	1,138.1	1,138.1	8.1	46.4	7

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CORE VS NON-CORE RETAIL PROPERTY FUND INDEX

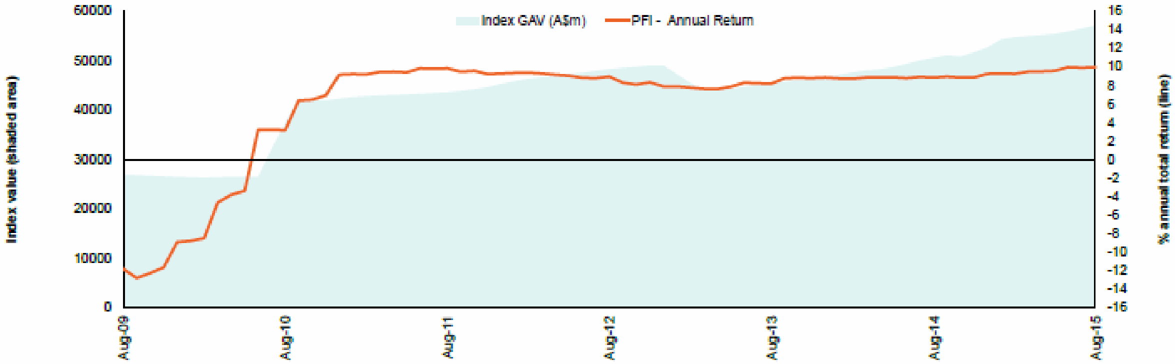
- IPD to be congratulated on finally distinguishing between core and non-core retail funds
- Core Retail Funds
  - less than 20% development
  - gearing less than 50%
  - greater than 90% exposure to direct property
  - must not capitalise interest
  - ASIC registered managed investment scheme
- Non-Core Retail Funds
  - any fund that does not meet one of the above criteria
- Why are there only 28 core funds yet 52 non-core funds?
  - fund managers pushing gearing above 50% to generate higher yields – more ‘non-core’ funds being launched
  - some managers chasing HNW investors and therefore not registering scheme with ASIC
  - some new core funds – quasi open-ended for 2 years then close (build scale in one fund rather than single asset funds)
  - number of new core funds launched in last year has fallen due to real estate yields firming making harder to “stack-up”

Mercer/IPD Australia Monthly Property Fund Index Core Wholesale

Results for the month to 31 August 2015

MERCER MSCI

Historical Performance - Annual Total Return %



The Mercer/IPD Australia Monthly Property Fund Index measures post fee NAV total returns to core unlisted wholesale funds within the Australian investment market

Mercer/IPD Australia Monthly Property Fund Index - Post Fee Total Return Performance

	Total Return Index to Aug-15 Jun 2007 = 100	Total return (%) for 1M	3M	FYTD	12M	3Y*	5Y*	Distributed Income return (%) Month Aug-15	Capital growth (%) Month Aug-15
All Funds	**160.4**	**0.6**	**2.8**	**1.0**	**9.9**	**9.0**	**9.1**	**0.4**	**0.2**
Office Funds	155.9	0.6	3.0	1.1	11.1	9.6	9.4	0.5	0.2
Retail Funds	177.4	0.7	2.6	1.1	9.5	8.6	8.7	0.4	0.2
Industrial Funds	145.6	0.6	2.9	1.2	11.8	10.6	9.9	0.6	0.0
Diversified Funds	161.5	0.5	2.9	1.0	9.6	8.9	9.3	0.4	0.1

*Annualised

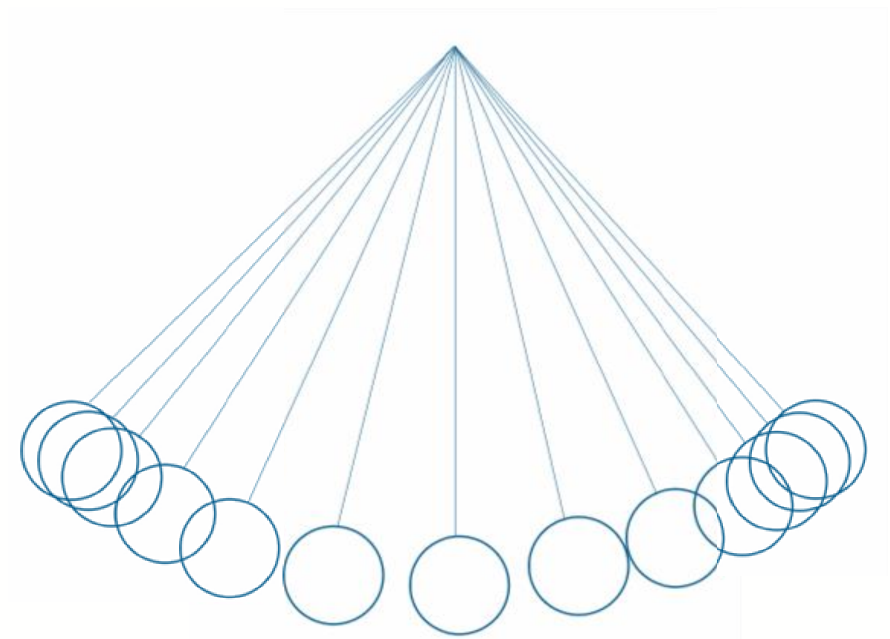
Index Profile

	Size No of Funds	Value GAV $m	NAV $m	NAV in Index $m	Distribution Yield	Gearing (Debt/GAV)	Valuation Evidence (%)
All Funds	**15**	**59,879.2**	**51,199.3**	**49,331.0**	**5.7**	**12.0**	**4**
Office Funds	5	15,179.8	12,155.8	12,155.8	6.0	16.9	1
Retail Funds	5	16,794.7	13,582.6	13,582.6	5.5	17.0	11
Industrial Funds	1	759.1	680.2	680.2	7.5	9.4	0
Diversified Funds	4	27,145.6	24,780.8	24,780.8	5.6	7.3	2

ADAPTING TO THE CYCLE

IS THIS CYCLE DIFFERENT FROM PREVIOUS CYCLES?

The Swinging Pendulum – Where Do You Sit?



“WILL WE REVERT TO THE MEAN”

OR

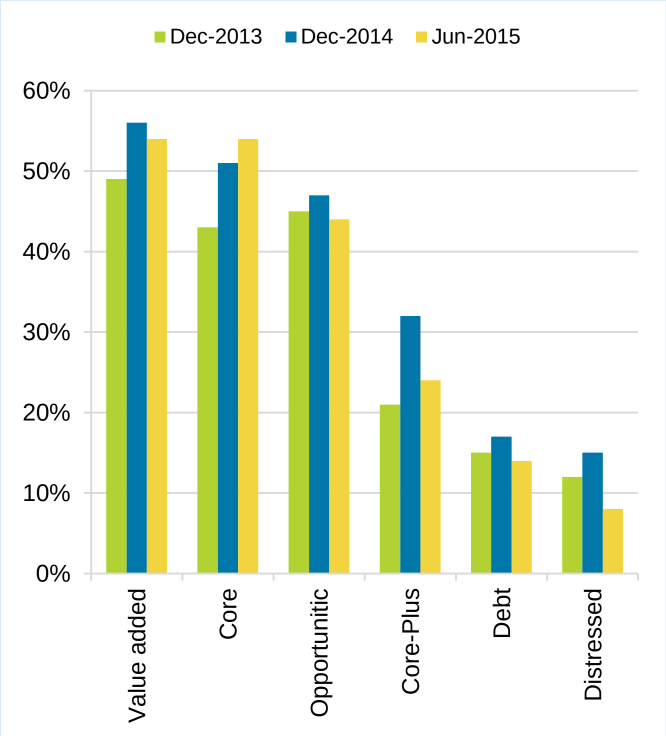
“IS IT DIFFERENT THIS TIME”

HEADING INTO UNCHARTERED WATERS

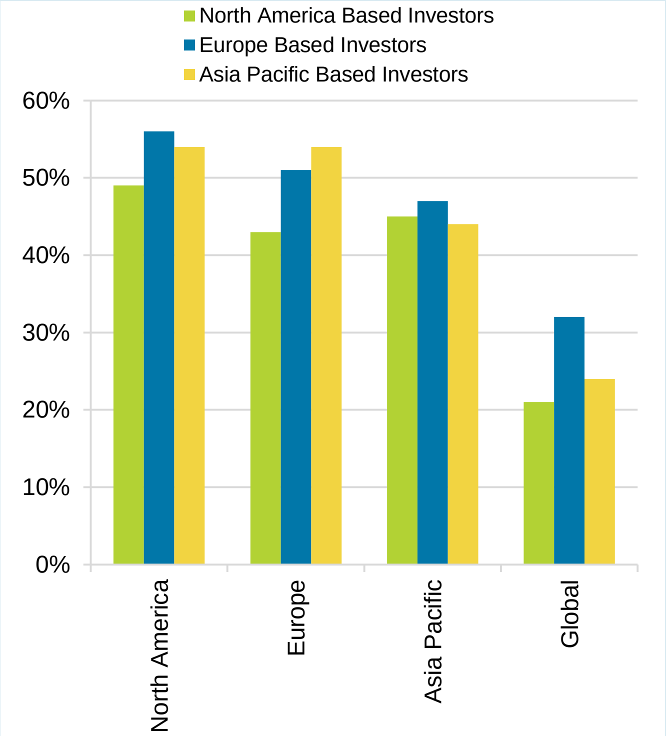
- Heading into unchartered waters – historical low interest rates, strong capital flows, below trend economic growth, weak demand and rental growth across most sectors and significant change underway in the marketplace
- Private real estate fund managers need more than ever to focus on how to underwrite, structure, finance and execute on their transactions whether it be acquisitions or dispositions
- The latest buzzword – "through the cycle investing" – isn't the panacea for every deal as not everyone has permanent capital
- As managers our job is to maximise the **risk-adjusted** returns of our investors - sometimes that means saying no this isn't the right time to invest or this isn't the right strategy for this point in the cycle
- Chasing secondary assets in secondary markets – debt costs are low so levered IRR's look great – the danger is focusing on the return without correctly pricing the risk
- Risk is coming to the fore but is it really understood – how do you define risk?, how do you quantify it? and how do you manage it?
- Complex structures are becoming increasing normal but as you add more complexity the risk of something going wrong increases

INVESTOR STRATEGIES

Strategies Targeted by Private Investors: Dec 2013 - June 2015



Regions Targeted by Private Investors by Location: June 2015 - June 2016



Source: PIR

- Core real estate still primary recipient despite significant compression in global core yields
- Institutions have moved up the risk curve - value-added and opportunistic are popular
- Majority of investors looking to invest in next 12 months have strong domestic bias but investors in all regions are looking to expand their exposure to non-domestic markets

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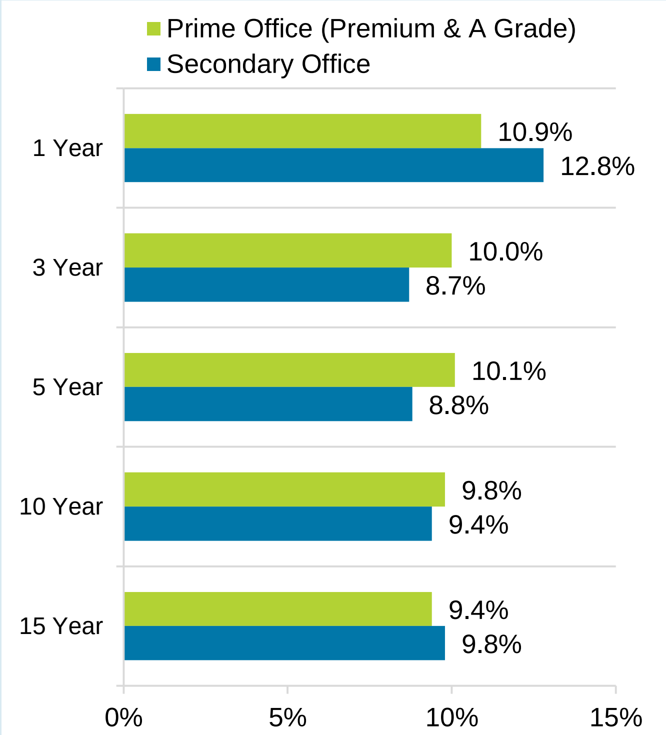
SOCIAL INFRASTRUCTURE GOES CORE

- Types of real estate social infrastructure
  - education –early learning, schools, tertiary/vocational, student accommodation
  - health – medical, hospitals, specialist centres
  - seniors living – manufactured housing, retirement villages, aged care
  - social housing
  - transport – bus & train stations, park & rides, car parks
  - government accommodation – police stations, court houses, prisons, etc.
- Benefits of real estate social infrastructure include
  - longer leases than traditional real estate assets
  - net or triple net leases (operator/tenant pays outgoings)
  - secure (often government backed) cashflows
  - low correlation to other real estate and non-real estate assets
- Drivers of demand for real estate social infrastructure
  - demographic and social changes
  - governments looking to private sector to fund
  - yields tend to be higher (although gap is narrowing)
  - some sectors have undersupply and/or existing stock is obsolete – opportunities to manufacture new product

VALUE-ADD STRATEGIES – SECONDARY ASSETS

- Acquiring non-core (secondary) assets
  - good returns may be generated by effectively manufacturing core assets with stable incomes by accessing well located secondary assets in need of leasing-up, refurbishing or repositioning
  - better quality secondary assets overlooked - starting to look attractively priced on a risk-adjusted basis
- Value-add strategy for secondary assets
  - lease vacant space – poor leasing campaign by vendor has hindered leasing of space
  - active management of the net operating income (NOI) and value engineering operating costs
  - enhance NABERS ratings
  - reconfigure and re-present the foyer
  - re-mix retail in medium term
  - work with neighbouring owners to promote the immediate precinct as desirable location

Prime vs Secondary Office: Total Returns: Annualised to June 2015



Source: IPD MSCI

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OPPORTUNISTIC STRATEGIES - DEVELOPMENT

- Manufacturing core product or generating higher returns
- Partner with quality developers with good developments who can't access finance or have limited equity
- Focus on smaller developments – finance easier to get, shorter timeframe, less pre-sales
- Critical in the current market to deliver right product at right price
- Retail Development
  - preference for neighbourhood centres
  - greenfield or in-fill locations
  - supermarket chains prepared to partner with developers to expedite their store roll-outs
- Residential Development
  - selective land and apartment markets are still offering attractive development returns
  - affordability an issue - focus on delivering product at or below around median price in each market
- Mixed-Use Development
  - being driven by a strong confluence of social, economic and political pressures
  - opportunity to mix residential/retail within in-fills locations near transport modes

THE CYCLE – LOOKING FORWARD

There are always opportunities in real estate but the nature of the opportunity changes depends on where you are in the cycle – when it's a great time to invest, the capital isn't always there and when there is an abundance of capital, it's usually a sign that things are nearing the peak as investors/advisers tend to focus on the immediate past rather than the future

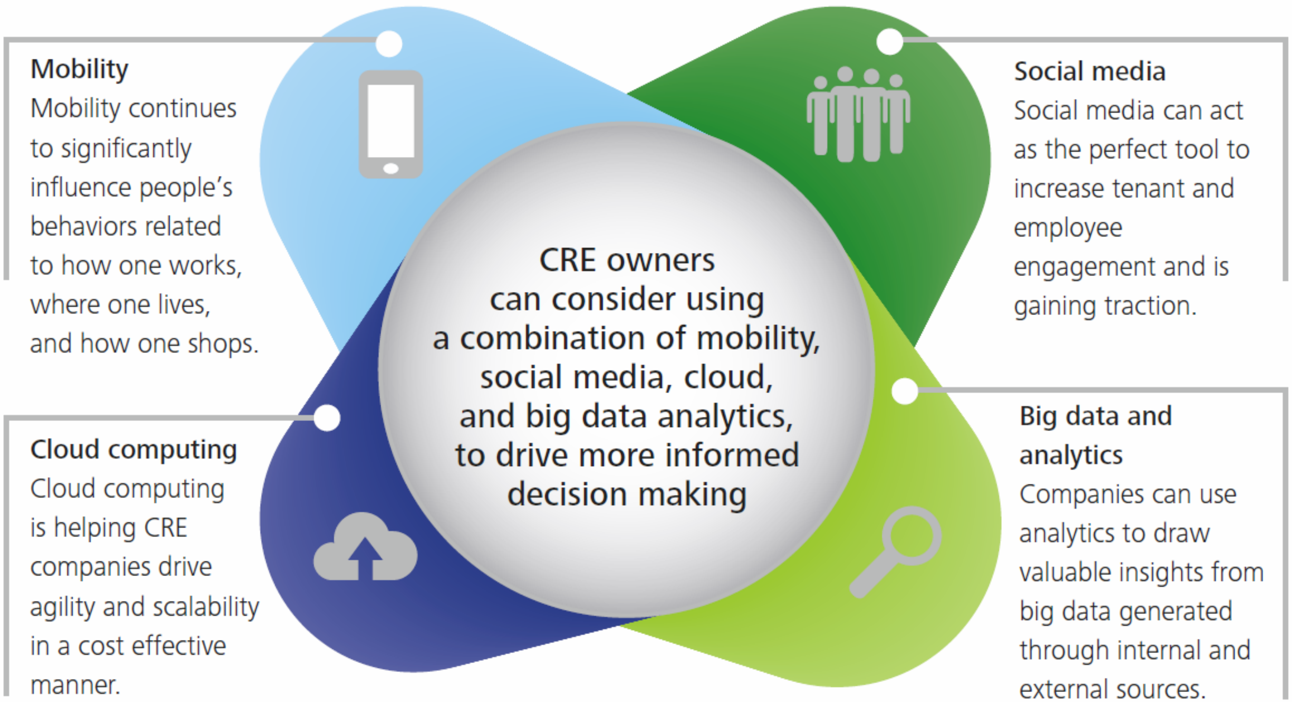
PRIVATE EQUITY REAL ESTATE FUNDS – THE FUTURE

REAL ESTATE FUND MANAGERS – THE FUTURE

- Market forces continue to re-shape the landscape of the real estate funds management industry
- Capital is changing - a greater array of investors
  - are we providing the right structures, investment strategies and risk/return profiles?
  - who and how will we attract and maintain capital from the new investors
- Innovation will be critical going forward
  - product design
  - capital raisings
  - data analysis
  - marketing and communication
  - reporting

SOCIAL AND DEMOGRAPHIC CHANGE

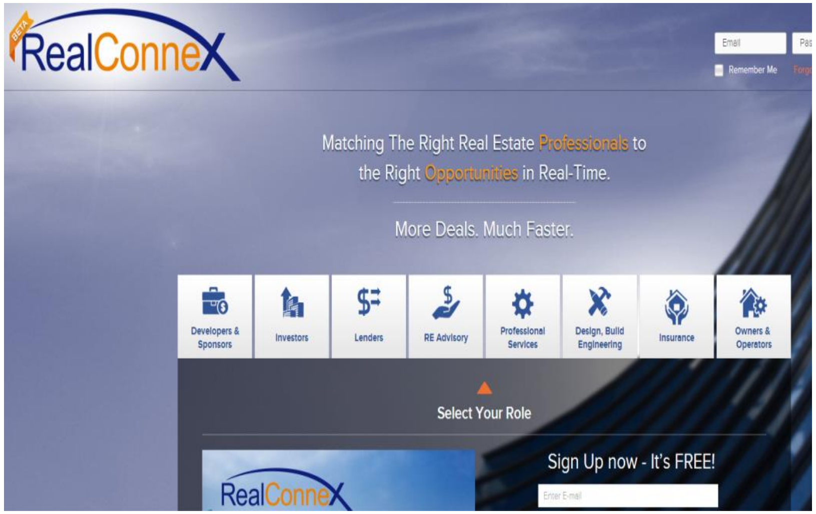
Disruptive Businesses and Technologies Are Changing the Way Business Operate



Source: Deloitte Centre for Financial Services

"Uber, the world's largest taxi company, owns no vehicles.
Facebook, the world's most popular media owner, creates no content.
Alibaba, the most valuable retailer has no inventory.
And AirNb, the world's largest accommodation provider, owns no real estate.
Something interesting is happening."
Tom Goodwin, Havas Media, Article in Techcrunch.com, 3 March 2015

TECHNOLOGY - VIRTUAL MARKETPLACES



Using Technology to Create Virtual Marketplaces

Connecting -

Managers with Investors
Landlords with Tenants
Property Professionals with Data
Borrowers with Lenders

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TECHNOLOGY - INNOVATION

IDC surveyed 320 real estate executives across the globe - US$1 trillion in AUM

Key Findings in the Research

- Nearly one-third of the global CRE industry is still using spreadsheets as their primary tool for asset & portfolio management functions. As a result, there is potentially US$11 trillion globally of CRE assets managed within inefficient and error-prone spreadsheets.
- Three quarters of CRE firms are operating with data silos, as a result of using multiple non-integrated solutions and/or spreadsheets to manage their various asset & portfolio management functions.
- Seventy per cent of the firms surveyed feel they either need more data or additional metrics to benchmark their performance against the market.
- More than two thirds of the firms surveyed say they would realize a significant impact on investment returns by improving their asset & portfolio management decision making effectiveness.
- More than two thirds of the CRE leaders surveyed agree that Big Data has the potential to substantially change the industry; but the biggest barriers to firms using more data are centered on data quality, regulatory/reporting issues, and lack of tools to assist with data capture and analysis.
- Seventy-seven per cent of the firms surveyed say they are prioritizing investment in technology and process improvement to support their asset & portfolio decision making.

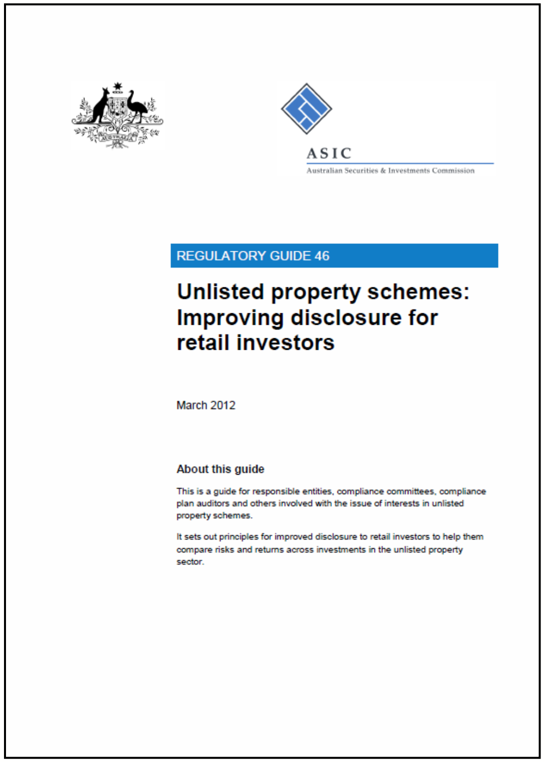
Source: IDC - Future Proofing the CRE Industry – Is Commercial Real Estate's Innovation Curve Moving Fast Enough? September 2015

BOUTIQUE VS SCALE

- Blackstone's recent US$15.4bn capital raising put spotlight on private equity real estate managers globally
- Arguments for scale
  - institutional investors getting bigger therefore capital commitments bigger
  - investors want fewer but stronger relationships
  - elevated regulatory and reporting requirements creating higher costs – large firms can absorb cost pressures
  - better placed to offer wealth creation opportunities to more staff – potentially able to recruit and retain the best people
  - global investment platforms need more resources
- Arguments for boutiques
  - can specialise in one investment strategy
  - more agile and less bureaucratic
  - managers have stakes in the business – more alignment of interest

Competition for capital and assets is intensifying.
Private real estate fund managers need scale or remain boutique - those caught in the middle face obsolescence

GOVERNANCE AND TRANSPARENCY


ASIC
Australian Securities & Investments Commission

REGULATORY GUIDE 46

Unlisted property schemes: Improving disclosure for retail investors

March 2012

About this guide

This is a guide for responsible entities, compliance committees, compliance plan auditors and others involved with the issue of interests in unlisted property schemes.

It sets out principles for improved disclosure to retail investors to help them compare risks and returns across investments in the unlisted property sector.

Table 1: Benchmarks and disclosure principles for unlisted property schemes in which retail investors invest

Gearing	*Benchmark 1* addresses a scheme's policy on gearing at an individual credit facility level. *Disclosure Principle 1* addresses disclosure of the gearing ratio of the scheme, the calculation of the ratio and its explanation.
Interest cover	*Benchmark 2* addresses a scheme's policy on the level of interest cover at an individual credit facility level. *Disclosure Principle 2* addresses disclosure of the interest cover ratio of the scheme, the calculation of the ratio and its explanation.
Interest capitalisation	*Benchmark 3* addresses whether the interest expense of a scheme is capitalised.
Scheme borrowing	*Disclosure Principle 3* addresses disclosure of the scheme's credit facilities, including the circumstances in which credit facility covenants will be breached.
Portfolio diversification	*Disclosure Principle 4* addresses disclosure of the scheme's assets, including specific information about development assets.
Valuations	*Benchmark 4* addresses the way in which valuations are carried out by a responsible entity in relation to the scheme's assets.
Related party transactions	*Benchmark 5* addresses a responsible entity's policy on related party transactions. *Disclosure Principle 5* addresses disclosure about related party transactions.
Distribution practices	*Benchmark 6* addresses a scheme's practices for paying distributions from cash from operations available for distribution. *Disclosure Principle 6* addresses where distributions are sourced from and whether forecast distributions are sustainable.
Withdrawal arrangements	*Disclosure Principle 7* addresses disclosure of the withdrawal arrangements within the scheme and risk factors that may affect the unit price on withdrawal.
Net tangible assets	*Disclosure Principle 8* addresses disclosure of the net tangible asset (NTA) backing per unit of the scheme.

Investors are more demanding of their managers when it comes to reporting, risk management processes, governance and succession planning

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RISK MANAGEMENT

- Don’t take the conventional wisdom approach to evaluating risk
  - no matter what you do in real estate, in some form or manner, you will be asked to evaluate risk
  - when you evaluate risk, expect the unexpected
  - think broadly and expansively about events that can impact your probable outcome
  - at times in our industry, there is a rush to herd mentality in pricing assets. The seemingly safest position today may actually be far riskier than might be perceived by the “herd” mentality. An example is core real estate in some of the gateway global cities is currently being priced to perfection

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THE BASICS STILL MATTER

- Hallmarks of top performing private equity real estate managers:
  - **disciplined and focused strategy for each fund** – clear and concise strategy/objectives with implementation that avoids ‘style’ drift
  - **strong alignment with investors** - co-investment, fee structures and/or exit strategies that put investors first
  - **delivering ‘active’ performance** – generating alpha through active management rather than relying on market beta
  - **adopting appropriate capital structures** – optimising the capital structure of transactions but at the same time avoiding over leverage to generate short-term returns
  - **focus on risk management** – implementing frameworks that identify, price and manage risk appropriately through the entire process from acquisition to management to disposition

The private equity real estate fund model is not flawed
but in every cycle
the management of some funds is flawed

CONCLUSION

- Challenging time to be putting money to work
- Private equity real estate funds managers need to closely examine both their real estate and business strategies
- Keys to successful real estate investing
  - good asset selection
  - properly pricing and managing risk
  - active asset or development management
  - adopting appropriate capital structures
  - selecting quality partners
  - timing of exit
- Keys to successful private real estate funds management businesses
  - understanding the key changes in the marketplace – economic, technology, social, demographic, environmental
  - enable innovation to capitalise on market changes
  - foster strong alignments with investors
  - best practice reporting, risk management processes, governance and succession planning
  - decide whether be large or boutique manager – caught in the middle could face obsolescence