BUSINESS UPDATE

MOELIS AUSTRALIA

JUNE 2017

WHERE TO FIND INCOME AND GROWTH

Record low global interest rates have continued to see strong capital inflows into Australia as investors search for yield. The good news is that in spite of the increased interest, a number of appealing opportunities exist. Here we explore some attractive opportunities in niche areas of the Australian commercial property market.

Where has the money been flowing?
The Australian commercial property market has seen particular interest, supporting prices and pushing capitalisation rates (rates of return) to all-time lows. All core sectors of the local property market – office, retail, industrial – have seen strong demand, reflecting their ability to provide stable income streams. Recent transactions have shown prime office assets trading on yields below 5%, neighbourhood shopping centres trading on yields of 5-7%, and core industrial assets trading on yields slightly above 6%. Reflecting these moves, the listed ASX200 A-REITs Index is now trading at a ~25% premium to Net Tangible Asset backing and offers investors a distribution yield of ~5%.

Will yields revert (increase) to historic levels?
Expectations of improving global growth and rising inflation have seen long bond rates increase marginally from their recent extreme lows both domestically and in the US. Australian 10-year government bond yields, for example, have risen ~80bps since 30 June 2016, but remain very low compared to their long-term average.

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The pace of global economic growth remains subdued; only a moderate acceleration, at best, is anticipated over the medium term. This suggests domestic interest rates are unlikely to increase significantly, if at all, supporting real estate valuations. Importantly, real estate offers a hedge against inflation, supporting rental growth in the event that bond rates do continue to rise.

Where can investors find yield today?

It's no secret that investors – both domestically and offshore – have been attracted by the quality and return potential of Australian residential property. But after years of uninterrupted price growth, it appears that prices in Sydney and Melbourne are likely close to a peak. Whilst we are not anticipating a major downward correction (assuming no significant changes to the economic outlook), some areas of the market – most notably CBD apartments in some States– do look a little inflated and some downside potential exists.

Lofty residential prices and yield compression in core commercial real estate sectors has prompted investors to broaden their investment horizons. Looking increasingly attractive are niche, non-traditional areas of the Australian commercial property market. Indeed, the past few years has seen the institutionalisation of 'alternative' REITs, including childcare, storage centres, manufactured homes, healthcare and pubs/hotels. These REITs typically offer higher yields and stronger earnings growth than core assets. The good news is that in spite of the increased interest, a number of appealing opportunities exist in these areas.

Let's have a closer look at some of Moelis Australia's alternative property investments offering favourable income and the potential for capital appreciation over time.

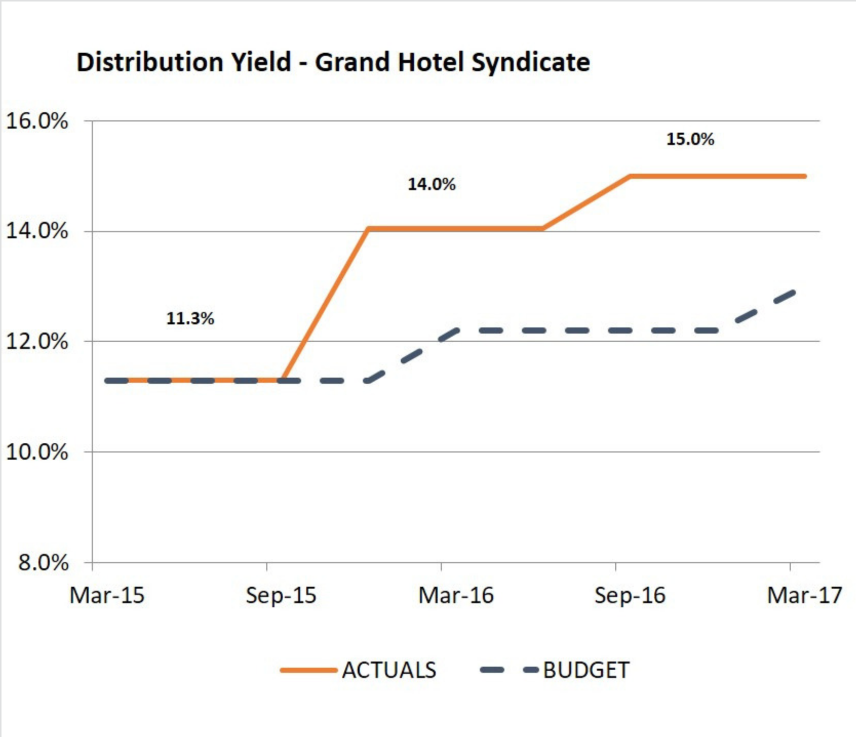
Case Studies

THE GRAND HOTEL SYNDICATE

The Grand Hotel was purchased by Moelis Australia Asset Management in December 2014. The property is one of NSW's top 50 gaming pubs, currently ranked 39th, and is the dominant gaming pub in Rockdale, one of Sydney's southern suburbs.

A property with appealing characteristics

- Greater Sydney location
- One of the highest quality gaming hotels in the area, with consistent and sustainable revenue streams
- Scope for higher revenues in gaming, food, beverages and accommodation
- Planned nearby residential development will increase local population
- A consistent income stream of 11.3% p.a. in the first year increasing to 14.7% by year five
- Targeted return in excess of 15% p.a.



Since our investment, the property has undergone a significant refurbishment, resulting in:

- An uplift in gaming revenues, from enhancements to the overall layout and the rollout of new gaming machines
- Rising accommodation revenues, following the introduction of an online booking system
- A reduction in expenses from new outsourcing arrangements and the introduction of tighter standard operating procedures
- An increase in yields to investors, which are ahead of budget as per the chart above.

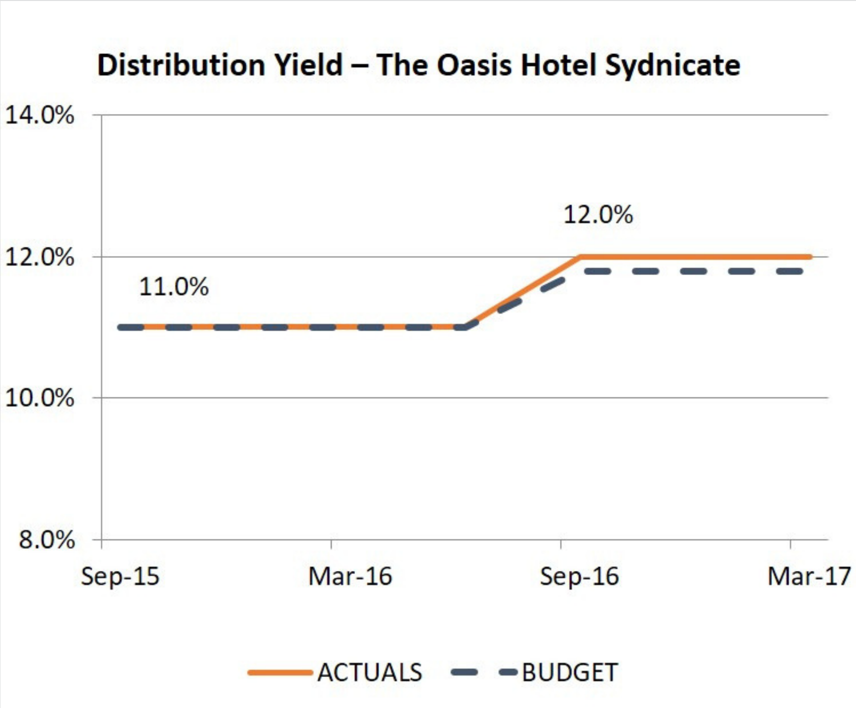
Recent investment opportunities

THE OASIS HOTEL SYNDICATE

The Oasis Hotel was purchased by Moelis Australia Asset Management in June 2015. The property is one of NSW's top 20 gaming pubs, currently ranked 15th, and is the dominant gaming pub in Canterbury/Campsie in Sydney's south western suburbs.

A property with appealing characteristics

- One of the highest quality gaming hotel properties in Campsie, with reliable and transparent cash flows
- Scope for operational improvements and increased revenues from gaming, food, beverages and accommodation
- Planned nearby residential developments will increase local population
- Adjacency to Campsie train station means high levels of foot traffic
- A consistent income stream of 11.0% p.a. in the first year, forecast to increase to 13.9% p.a. by year five
- Targeted return in excess of 13.9% p.a.



Again, a significant refurbishment program has been completed since our investment, resulting in:

- An uplift in gaming revenues from modifications to the gaming floor and modest, but incrementally positive, enhancements to the gaming offering
- Increased food revenues and bar revenues – a new Thai restaurant, for example, has proved popular with patrons
- A reduction in expenses across operations
- An increase in yields for investors, which are ahead of budget as per the chart above.

Recent investment opportunities

MOELIS AUSTRALIA CHILDCARE DEVELOPMENT FUND

Moelis Australia Asset Management recently raised $25 million from private clients to assist a Sydney based developer in the development of a pipeline of childcare centres across Australia. With the demand for Childcare increasing, the Fund has a forecast IRR of 13.8% p.a. over a three-year investment term. The Fund aims to generate a cash yield of 10.0% per annum.

The operator has an agreement is in place with Think Childcare (ASX:TNK), to purchase the underlying assets, once trading, for a pre-determined multiple. This agreement makes this particular vehicle quite unique and provides scope for capital growth on exit as well as an appealing distribution yield.

Success stories

MOELIS AUSTRALIA HEALESVILLE SHOPPING CENTRE SOLD

In August 2013, Moelis Australia Asset Management and private clients invested $21.1 million to purchase the Healesville Shopping Centre in the Yarra Valley, Victoria. Healesville is a modern, high quality shopping centre with a dominant position in the area. The centre currently has 100% occupancy. The centre is anchored by Coles supermarket, a National Australia Bank branch and a number of medium-sized stores including Baker's Delight and Liquorland. The initial return target for this Fund was an IRR of 13% p.a. with a cash yield of 7% p.a. In 2016, following significant interest, the property was on-sold to a private investor for $29.9 million. The final net return to investors will be 20.2% p.a..

Moelis Australia in the news

MOELIS AUSTRALIA FLOATS ON ASX

Moelis Australia (ASX:MOE) formally became a public company on Monday 10 April 2017. Under the new structure, 20% of Moelis Australia will trade on the ASX, with the remaining 80% owned by the Moelis & Company (global parent company) and Moelis Australia staff. Under the terms of the offer there is a six-year escrow period for senior staff. The additional capital raised is to be used for new investment opportunities to expand our asset base and to support our clients in their business ventures.

MOELIS AUSTRALIA HAS ACQUIRED ARMADA FUNDS MANAGEMENT

Established in 2006, Armada currently has ~$800 million in AUM across 10 unlisted single asset funds in the hotel, office and retail real estate sub-sectors. Armada has a strong track record of performance, with an average total return of ~15% p.a. across various funds including:

- Ingle Farm Shopping Centre – Adelaide
- Suncorp House – Brisbane
- Hollywood Plaza Shopping Centre – South Australia
- South Brisbane Office Fund – Brisbane
- Gateway Plaza Shopping Centre – Victoria
- Arndale Central Shopping Centre – Adelaide

The specialist skills and experience that Armada brings to Moelis Australia will ensure our clients continue to be offered high quality, yield focused investments, supported by the highest level of expertise in property management and operations.

Future opportunities

A NUMBER OF OPPORTUNITIES CURRENTLY UNDER ASSESSMENT

In line with our views on the property market, and our track record of delivering high quality investments, we are currently assessing a number of opportunities gaming hotels, aged care and retail shopping centre sectors. With the onset of further competition in the supermarket sector we still believe that retail shopping malls with non-discretionary stores will enable investors to capture an investment return in excess of 7.5% p.a..

To participate in future investments please join our mailing list.
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