AUSTRALIAN PRIVATE CAPITAL MARKET OVERVIEW:
A PREQIN AND AUSTRALIAN INVESTMENT COUNCIL YEARBOOK 2020

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AUSTRALIAN INVESTMENT COUNCIL

Contents

Data Pack

The data behind all of the charts and tables featured in this report is available in Excel format at no extra cost. This data may be used in marketing materials, presentations, or company reports with appropriate accreditation to Preqin.

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About This Report

Preqin and the Australian Investment Council are proud to present Australian Private Capital Market Overview: A Preqin and Australian Investment Council Yearbook 2020. This report tracks activity in the Australian private capital* industry. It is based on data contained in the Preqin Pro data platform, as well as on-the-ground information collected by both Preqin and the Australian Investment Council. Report content has been co-authored by Preqin and the Australian Investment Council.

- Analysis and quotes in this report are correct as of February 2020.
- Any reference to private capital refers to the private equity, venture capital, private debt, real estate, infrastructure, and natural resources asset classes.
    - Scope of assets under management (AUM), performance, and fundraising data for this report includes only private closed-end funds.
    - We track deals made by private capital fund managers and/or institutional investors.
    - Investor allocation figures to the respective asset class are generally a sum of allocations across three routes to market: direct, listed, and private funds.
- All $ currency units refer to Australian dollars unless otherwise stated.
- All annual figures correspond to calendar-year periods unless otherwise stated.
- Scope of data:
    - Australia focused: funds that have a predominant focus on Australia, regardless of manager headquarters.
    - Australia based: funds managed by domestic fund managers, regardless of fund geographic focus.

*For definitions of asset class-specific terms, you may refer to the full Preqin Glossary:
https://docs.preqin.com/pro/Preqin-Glossary.pdf

About Preqin

Preqin is the Home of Alternatives®, the foremost provider of data, analytics, and insights to the alternative assets community. From pioneering rigorous methods of data collection to developing a revolutionary platform, we have committed ourselves to furthering the understanding of alternatives for over 16 years. Through close partnership with our clients, we continuously build innovative tools and mine new intelligence to enable them to make the best decisions every day.

For further information, please contact info@preqin.com.

About the Australian Investment Council

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses, which when combined represents a multibillion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity, venture capital, and private credit funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal, and operational advisors.

For further information, please contact research@aic.co.

Foreword

We are very pleased to present the latest Yearbook Report, jointly produced and published by the Australian Investment Council and Preqin. The report covers activity data on funds, deals, and capital flows across the private equity, venture capital, private debt, real estate, and infrastructure & natural resources sectors in Australia. This continues the partnership that Preqin and the Australian Investment Council have developed in tracking, recording, and disseminating industry data to market participants and the business community in Australia.

2019 was a strong year for Australian private capital, with assets under management (AUM) rising to $68bn as of June 2019, up from $60bn in December 2018. Helping to drive this growth, AUM for private equity & venture capital rose to a new high of $33bn, up 16% on 2018; it is also pleasing to see strong flows of capital into the asset class, from both domestic and international investors. Compared to other developed jurisdictions, Australia's private capital market continues to display one of the most attractive risk/return profiles globally.

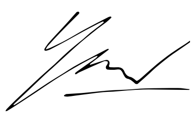
One of the other major positives in favor of Australia is the leadership position occupied in the area of ESG, with 150 of Asia-Pacific's 378 signatories of the UN Principles for Responsible Investment located in Australia. The size, scale, and influence of Australian superannuation funds – which make up 60% of the Australian signatories – working in collaboration with the private capital industry more broadly, are responsible for driving an ongoing focus on ESG across every dimension of investment strategy.

Despite 28 years of continuous economic growth – the longest recorded run of growth anywhere in history – a low unemployment rate, supportive regulatory settings, and a solid stockpile of $23bn in private capital dry powder, Australia is not immune to the impact of the global slowdown stemming from the COVID-19 pandemic. The build-up of dry powder provides Australia's private capital industry with the capacity to continue to fund investee businesses and projects, and to take advantage of opportunities arising from the economic downturn. However, like many markets, fundraisings in the period ahead could come under pressure as institutional investors look to re-weight their strategic asset and target allocations on the back of the downturn.

Private capital is well placed to withstand the disruptions of COVID-19 with strong fundamentals, a build-up of dry power, investments in sectors likely to respond well in a post-COVID-19 recovery (such as education and agriculture), and supportive government policies. Notwithstanding this, the period ahead will undoubtedly present some unique and interesting challenges for all corners of the industry.

We would like to thank all industry participants who have contributed their data to the report – your support ensures that we can report on the investment activities of the industry as comprehensively as possible. Private capital plays a vital role not only in delivering superior returns to investors, but also in furthering the development of the wider economy in Australia and around the world.

Preqin and the Australian Investment Council are very pleased to be able to share this report with you for 2020.



Mark O'Hare
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Executive Summary

In 2019, Australia's dynamic private capital industry – comprising private equity, venture capital, private debt, real estate, infrastructure, and natural resources – amassed a record-high of $68bn in total AUM[1]. This represents an increase of 119% from December 2010 (Fig. 1, page 9).

While this growth is modest compared to other key economic markets, Australia's private capital market presents one of the most attractive risk/return profiles globally. As seen in Fig. 2 on page 9, Australia-focused funds of vintages 2010-2017 generated the highest median net IRR of 15.0% and lowest median risk at 7.7% standard deviation of net IRR.

In addition to strong returns, each asset class offers a unique value proposition to mitigate risk and diversify investor portfolios globally. This report explores the latest data and emerging trends for each asset class in Australian private capital.

One of the largest private capital asset classes, Australia-focused **private equity & venture capital** (PEVC) grew by 16% in the year to June 2019. AUM hit a high of $33bn as of June 2019, marking three consecutive years of growth, with $13bn in dry powder. Similarly, total assets held by PEVC funds located in Australia continued to build on the record of $32bn set in June 2018, rising to $40bn as of June 2019.

Private Equity: At $778mn, fundraising in 2019 came off a record high in the previous year. But the Australian private equity market continued evolving. Capital flowed toward public-to-private transactions, which accounted for 53% of the total value of private equity-backed buyout deals in the year. While the overall number and aggregate value of buyout deals dipped from 2018, the consumer discretionary and healthcare sectors maintained strong levels of activity, bolstered by the $2.1bn privatization of education provider Navitas Limited in March, and the $5.7bn acquisition of hospital operator Healthscope in January respectively (see pages 10-13).

Venture Capital: As one of the world's top entrepreneurship ecosystems[2], it is no surprise that venture capital fundraising in Australia hit $632mn in 2019 – the second-highest annual total in the past 10 years. The five largest funds closed in 2015-2019 are all early-stage funds. Meanwhile, Series A to C rounds accounted for the largest proportion of total venture capital deal value last year. The AgTech sector, in particular, saw an exponential seven-fold increase in aggregate venture capital deal value from 2017 (see pages 14-17).

Private Debt: Regulators and regulatory changes in the Australian financial landscape are increasingly pro-innovation and pro-competition. This has helped alternative lenders expand into new segments of the private credit market, including areas previously dominated by the largest four domestic banks, commonly referred to as the 'Major Banks'[3]. Fund managers, including Tanarra Credit Partners and Revolution Asset Management, are also tapping into senior debt opportunities for downside protection (see pages 18-20).

Real Estate: At $2.5bn, managers raised 2.5x more capital in 2019 than in 2018, bolstered by increased offshore interest in Australian property. As population needs evolve, we see more and more investors

[1] Australia-focused private capital AUM as of June 2019.
[2] Australia was ranked fifth in the 2018 Global Entrepreneurship Index, https://thegedi.org/global-entrepreneurship-and-development-index/
[3] Australia and New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation

registering a preference for niche assets such as student accommodation (see pages 24-26).

Infrastructure & Natural Resources: The National Farmers' Federation forecasted that the Australian agriculture industry will grow to $100bn by 2030.[4] Asia's projected population boom has fueled demand for Australian agricultural produce and supporting infrastructure (see pages 28-31).

An expanding and evolving investor base is also helping Australia's private capital market to thrive. From 2015 to 2019, offshore institutions made up half of the universe of Australia-focused private capital investors – a huge leap from pre-2000 (18%). And local players have also stepped up their exposure to private capital to stay competitive. Superannuation funds, which represent the largest proportion (47%) of domestic investors, have also adapted their strategies to keep pace with an evolving private capital landscape. Industry consolidation among superannuation funds has created larger entities with a greater appetite for alternative structures such as co-investments and direct deals (see pages 36-38).

In fact, the influence of superannuation funds – and their offshore pension fund equivalents – cannot be underestimated. These investors are leading the charge in terms of ESG and have moved responsible investing into the forefront in Australia (see pages 32-33). ESG adoption in Australia outpaces the rest of Asia-Pacific, and ESG is on track to become even more integral to the country's private capital industry.

Australia's vibrant private capital market is increasingly diverse as global institutions and local players have stepped up their allocations to alternatives. In real estate, a well-established asset class, we have seen the emergence of niche property types such as student accommodation. Meanwhile the natural resources and infrastructure asset classes have been growing in size and importance, driven primarily by population growth in Asia, home to key export markets for Australia[5]. And in venture capital and private debt, investors have been expanding into new segments. While the economic impact of COVID-19 is creating challenges across the globe, the strong fundamentals in Australian private capital make it a market that investors are watching closely.

[4] Talking 2030, https://nff.org.au/wp-content/uploads/2020/02/Talking-2030.pdf
[5] Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES), https://public.tableau.com/profile/australian.bureau.of.agricultural.and.resource.economics.and.sci#!/vizhome/Trade_map/Dashboard1

Key Facts

\$68bn

Australia-focused private capital assets under management as of June 2019.

60%

Proportion of Australian private debt-backed deals in 2019 focused on senior debt.

60%

Proportion of Australia-focused signatories to ESG/ impact investing frameworks that are pension funds.

16%

Increase in Australia-focused private equity & venture capital assets under management from June 2018 to June 2019.

\$632mn

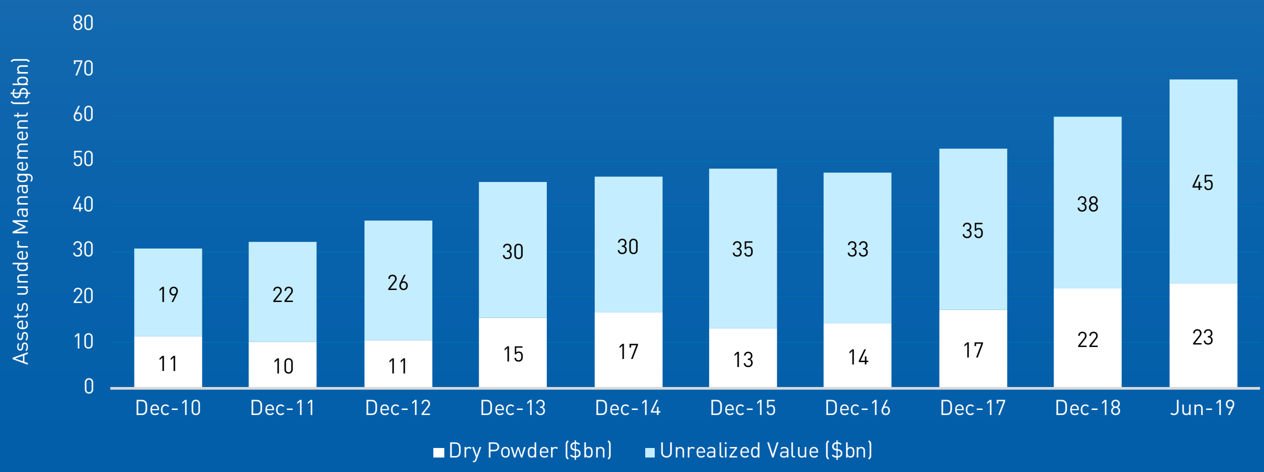
Total capital raised by Australia-focused venture capital funds in 2019.

\$2.5bn

Total capital raised by Australia-focused closed-end private real estate funds in 2019.

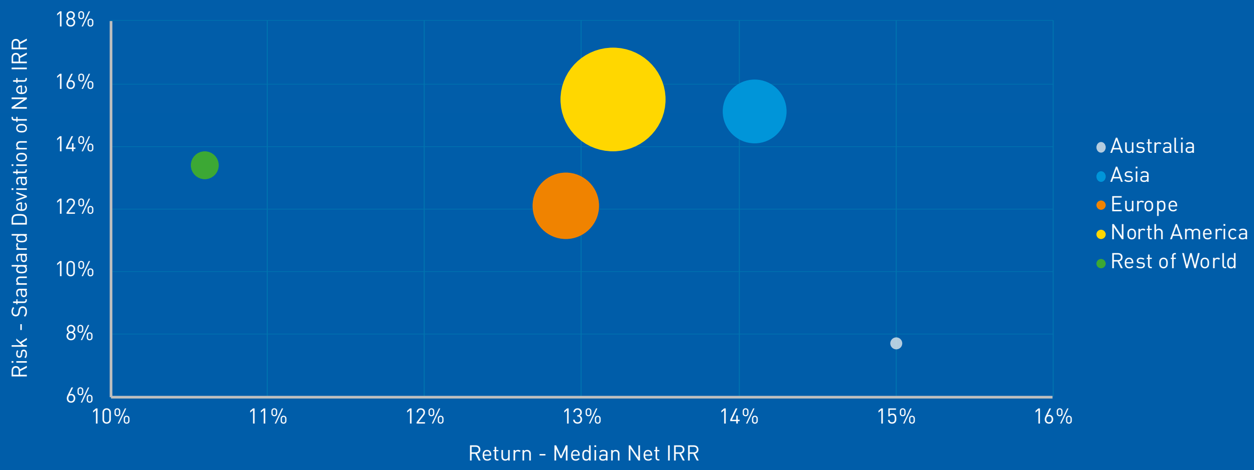
Private Capital in Australia

Fig. 1: Australia-Focused Private Capital Assets under Management, 2010 - 2019



Source: Preqin Pro

Fig. 2: Private Capital: Risk/Return by Primary Geographic Focus (Vintages 2010-2017)*



Source: Preqin Pro

**The size of each circle represents the capitalization of private capital funds used in this analysis. These funds are invested by Australian and/or global institutional investors.*

Public-to-Private Opportunities Dominate

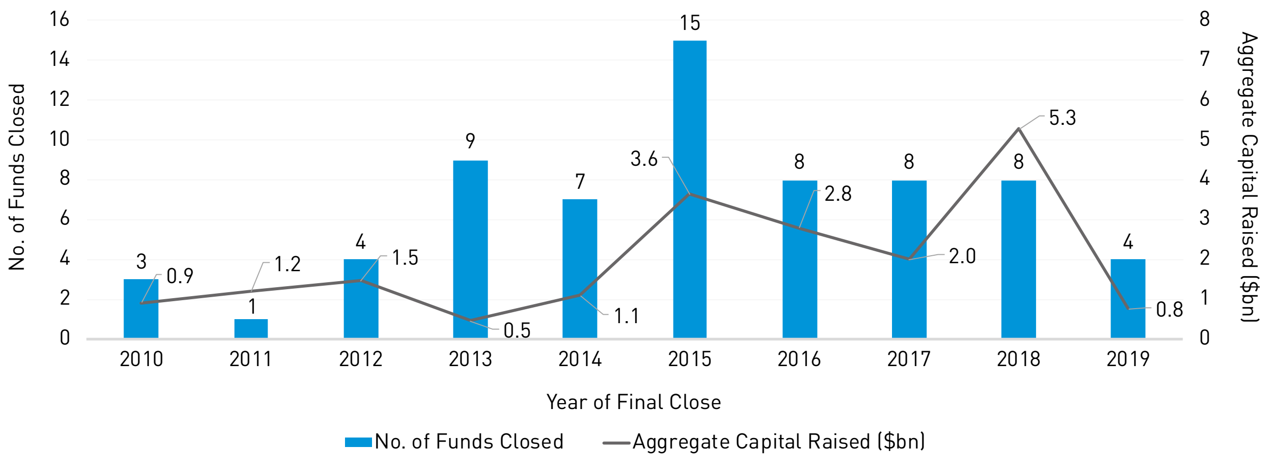
Australian private equity records its third consecutive year of growth as fund managers searched the public market for take-private transactions

Australia-focused private equity AUM increased markedly by 12% in a year to reach a new high of $25bn as of June 2019, representing the third consecutive year of growth. Elevated levels of capital raised over 2015-2018, averaging $3.4bn annually, led to a build-up of dry powder, which stands at $11bn as of June 2019. This puts global and Australia-based private equity fund managers in a strong position to support domestic investee business – which will be crucial in the challenging period ahead.

Australia-focused fundraising eased off in 2019. On the back of peak fundraising in 2018, institutional investors committed $778mn to private equity vehicles targeting Australia in 2019, down from $5.3bn the previous year (Fig. 3). In the decade until 2019, buyout funds contributed more than two-thirds of aggregate capital raised each year. What's more, in the period 2015-2019, the five largest private equity vehicles closed are all buyout funds (Fig. 4). Last year, however, growth funds raised the majority (51%) of capital.

Average deal value in 2019 hit a decade-high of $620mn, up from $444mn a year before. This is consistent with the global trend, where the average size of buyout deals has increased each year since 2016. However, both the number and aggregate value of private equity-backed buyout deals fell in 2019, dropping by 20% and 7% respectively from 2018 (Fig. 5). High valuations were a key driver behind this slowdown in investment activity, but act as a necessary evil: a measured leveling mechanism to ensure that

Fig. 3: Australia-Focused Private Equity Fundraising, 2010 - 2019



Source: Preqin Pro

investor expectations are managed and managers do not participate in bidding wars for new investment opportunities.

Majority of Capital Deployed in Take-Private Transactions

In search of value, fund managers looked to listed companies to source deals in 2019. Six public-to-private transactions accounted for 53% of total Australian buyout deal value in 2019 (Fig. 6). Transactions included the $5.7bn acquisition of hospital operator Healthscope and the $2.1bn buyout of education provider Navitas Limited, both among the five largest private equity-backed buyout deals announced in 2019 (Fig. 7).

In this take-private wave, fund managers looked to the middle market in particular, a segment that is gaining traction in the Australian buyout scene. Over the period 2018-2019, when the middle market accounted for a modest 2.1% of Australian businesses, the sector contributed over 20% of corporate tax revenue toward the country's economy[1], signaling the potential for high investment returns for buyout strategies.

Managers uncovered pockets of opportunities in the middle market. A Sydney-based private equity fund manager focusing on the lower middle market told us they experienced reduced competition for deals in 2019, "with trade acquirors becoming less aggressive in pursuing acquisitions and the IPO market slowing dramatically." They also felt that "the quality of deals seen in [H2 2019] has been better than usual."

Top Deals Reflected Wider Trends

Deal activity was also robust in both the consumer discretionary and healthcare sectors in Australia. Consumer discretionary represented the largest share (52%) of aggregate buyout deal value in 2019, up from 11% in 2018, followed by healthcare (37%), up from 30% the year before (Fig. 8). Four large-sized deals accounted for the bulk of financing in these sectors, such as the aforementioned acquisitions of Healthscope and Navitas in January and March

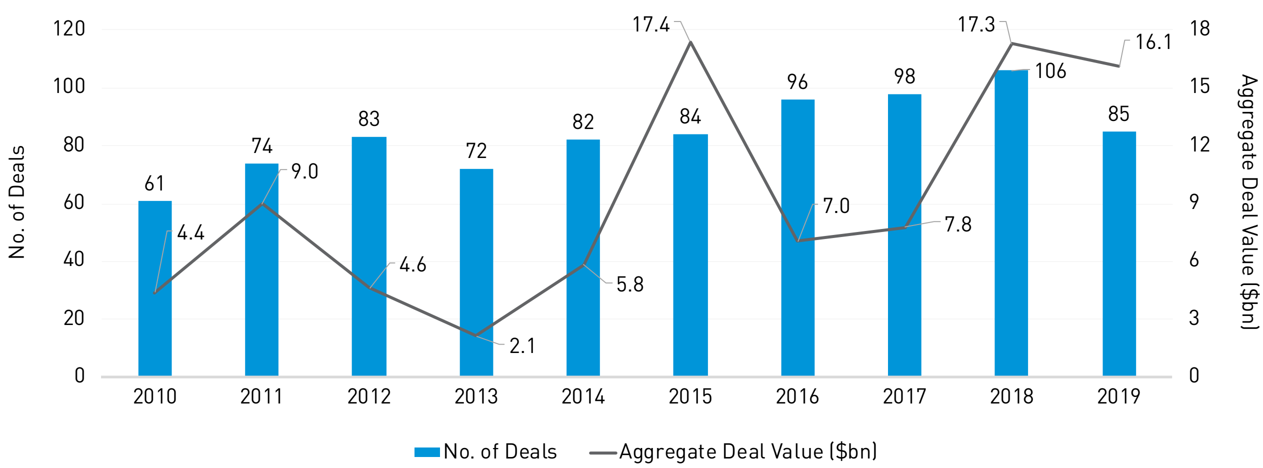
[1] *BDO Growth Index 2019 Report, https://www.bdo.com.au/BDO_AU/media/Insights/PDF/CM-19-042-Growth-Index.pdf*

Fig. 4: Largest Australia-Focused Private Equity Funds Closed in 2015-2019

Fund	Firm	Fund Size ($mn)	Fund Type	Final Close Date
BGH Capital Fund I	BGH Capital	2,600	Buyout	May-18
Pacific Equity Partners Fund V	Pacific Equity Partners	2,100	Buyout	Sep-15
Quadrant Private Equity No. 6	Quadrant Private Equity	1,150	Buyout	Dec-17
Quadrant Private Equity No. 5	Quadrant Private Equity	980	Buyout	Aug-16
Crescent Capital Partners VI	Crescent Capital Partners	800	Buyout	Aug-18

Source: Preqin Pro

Fig. 5: Private Equity-Backed Buyout Deals in Australia, 2010 - 2019



Source: Preqin Pro

respectively, and the $3.2bn acquisition of food producer Arnott's Biscuits Limited in July.

Such transactions demonstrate GPs' positive outlook for these sectors with high return potential. The healthcare industry in Australia is globally recognized as a hub for its world-class medical research, robust infrastructure, and strong intellectual property regime. While the food and beverage industry has been a consistent theme in the consumer discretionary sector, demand for Australia's education services has increased from Asia's growing middle class.

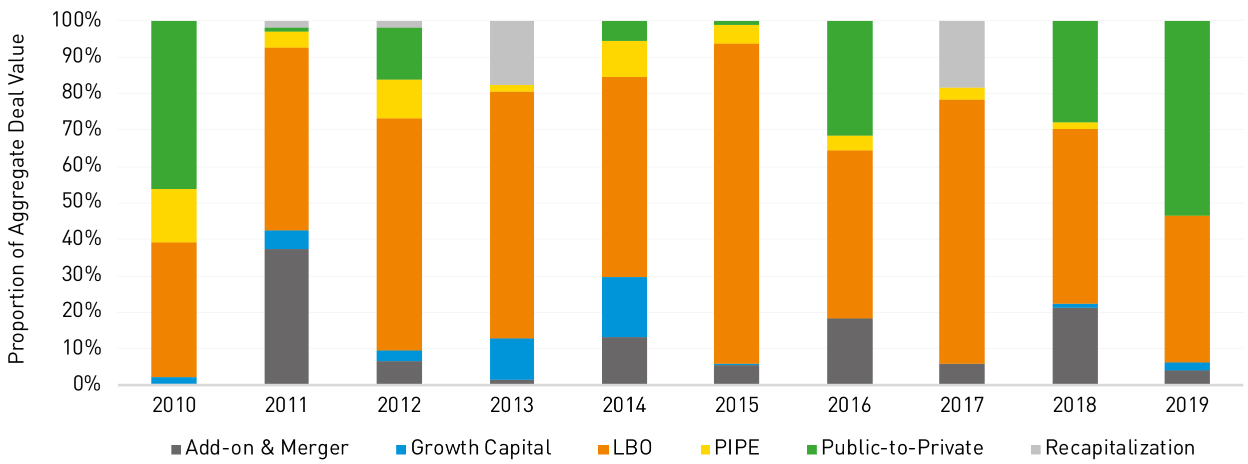
The takeover of Navitas also reflects the increasing involvement of superannuation funds at the buyout stage. The Navitas deal involved AustralianSuper partnering with BGH Capital to pursue an active investment target. Following this, the $188bn superannuation fund announced a greater appetite for completing direct deals in the coming years.[2] Given the increasing consolidation within the superannuation industry (see pages 39-43), we expect more big-ticket private equity transactions to involve superannuation funds going forward.

Private Equity Is a Resilient Asset Class

Australian private equity endured a slower rate of fundraising and deal-making in 2019, but remains an attractive value proposition in the long term. Australia's economy has enjoyed 28 years of economic expansion[3] and a period of low interest rates from 2012[4]. These conditions have helped Australia-focused private equity fund managers to distribute more than $4bn each year to investors from 2013 to 2018 – and data for H1 2019 also shows positive net cash flows (Fig. 9). Moreover, sectors with strong fundamentals, such as healthcare and education, have the potential to withstand disruptions from a global slowdown.

[2] *https://www.australiansuper.com/investments/investment-articles/2019/11/september-quarter-investment-update*
[3] *https://www.austrade.gov.au/International/Invest/Why-Australia/robust-economy*
[4] *Reserve Bank of Australia, https://www.rba.gov.au/chart-pack/pdf/chart-pack.pdf?v=2020-03-30-14-42-22*

Fig. 6: Aggregate Value of Private Equity-Backed Buyout Deals in Australia by Investment Type, 2010 - 2019



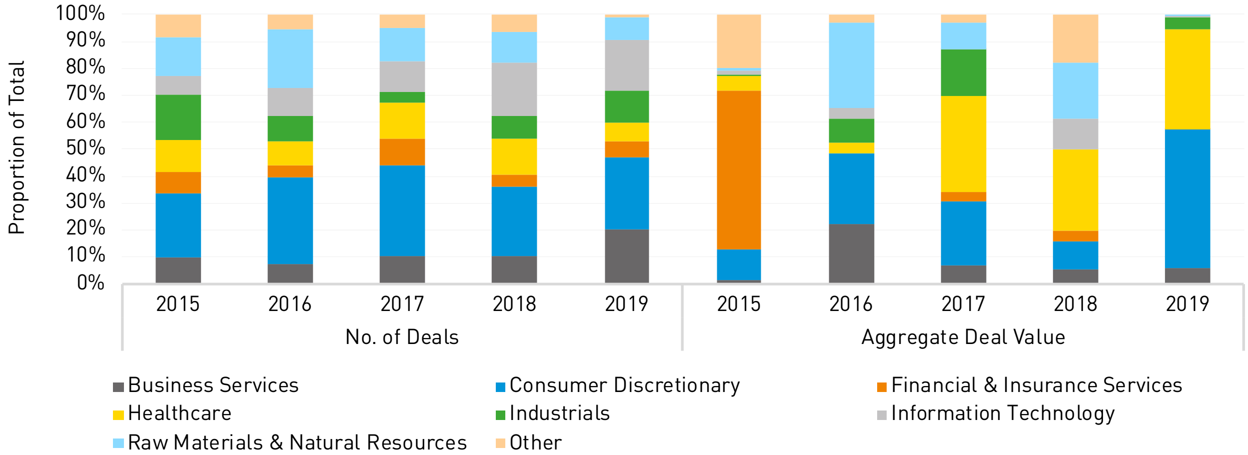
Source: Preqin Pro

Fig. 7: Largest Private Equity-Backed Buyout Deals in Australia in 2019

Portfolio Company	Investment Type	Investor(s)	Deal Size (mn)	Deal Status	Investor Location	Industry	Deal Date*
Healthscope Ltd	Public-to-Private	Brookfield Asset Management, CDPQ	5,700 AUD	Completed	Canada	Healthcare	Jan-19
Arnott's Biscuits Limited	Buyout	KKR	2,200 USD	Completed	US	Food	Jul-19
Navitas Limited	Public-to-Private	BGH Capital, AustralianSuper	2,087 AUD	Completed	Australia	Education/ Training	Mar-19
TEG Pty Ltd	Buyout	Silver Lake	1,300 AUD	Completed	US	Travel & Leisure	Oct-19
Craveable Brands Pty Ltd	Buyout	PAG	480 AUD	Completed	Hong Kong	Travel & Leisure	Jul-19

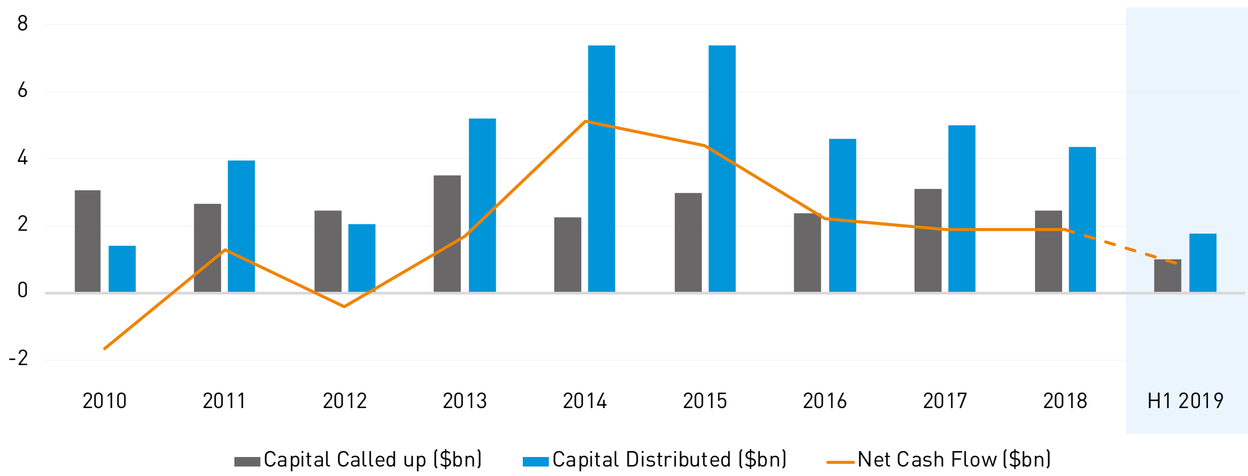
Source: Preqin Pro

Fig. 8: Private Equity-Backed Buyout Deals in Australia by Industry, 2015 - 2019



Source: Preqin Pro

Fig. 9: Australia-Focused Private Equity: Annual Capital Called up, Distributed, and Net Cash Flow, 2010 - H1 2019



Source: Preqin Pro

**Preqin Pro prioritizes the date the deal was agreed and announced (where it is subject to regulatory filings and customary closing conditions before completion) over its completion date. Therefore, as an example, the $1.6bn acquisition of MYOB by KKR is not reflected in this table (as it was announced in December 2018).*

Spotlight on Australia's Start-ups

Australia's vibrant start-up ecosystem has attracted global attention, and private capital has been flooding into early-stage vehicles

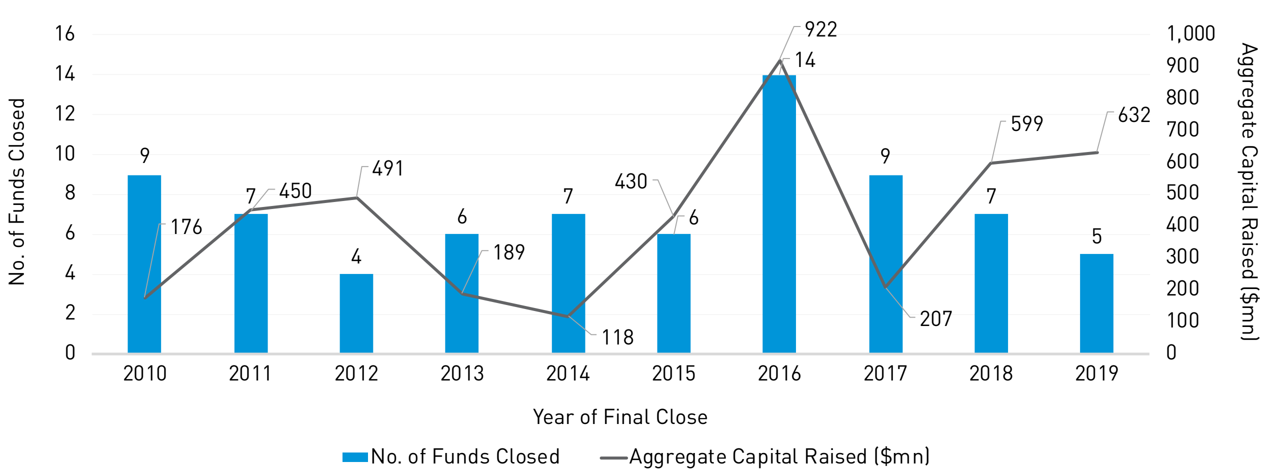
Australia's entrepreneurial spirit – the country was ranked fifth in the 2018 Global Entrepreneurship Index[1] – has lent itself to a lively venture capital scene. In 2019, venture capital funds raised a total of $632mn for investment in Australia, which marked the second-highest annual total in the past decade (Fig. 10).

Australian innovators and entrepreneurs are gaining international recognition, particularly in fields where there are strong synergies with Australia's traditional economic strengths. Some of these include AgTech, MedTech, fintech, cybersecurity, mining and resources technologies, and digital technologies.

From 2015 to 2018, the number of start-ups in Australia grew rapidly, increasing by an estimated 53%[2] in the period. Much of this growth occurred in the fintech sector, which is closely aligned with Australia's longstanding capabilities in financial services and fund management. According to Fintech Australia, 70% of fintech firms in Australia provide services to businesses in areas such as cybersecurity, fast payments, insurance, and automated financial advice. These include companies such as Athena Home Loans, AfterPay, Judo Bank, and Airwallex, which are among the top 100 fintech companies around the globe[3]. And venture capital certainly contributed to the

[1] *The Global Entrepreneurship and Development Institute - 2018 Global Entrepreneurship Index, https://thegedi.org/global-entrepreneurship-and-development-index/*
[2] *2018 Startup Muster Annual Report, https://www.startupmuster.com/*
[3] *KPMG 2019 Fintech 100: Leading Global Fintech Innovators, https://home.kpmg/au/en/home/insights/2019/11/2019-fintech-100-leading-global-fintech-innovators.html*

Fig. 10: Australia-Focused Venture Capital Fundraising, 2010 - 2019



Source: Preqin Pro

development of the industry: the aggregate value of Australian fintech deals jumped 190% from 2015 to $867mn in 2019.

Coupled with a supportive local regulatory system, capital has increasingly flowed into Australia's venture capital industry. In the five-year period 2015-2019, total venture capital fundraising averaged $558mn annually, nearly double the previous five-year annual average of $285mn (2010-2014). The deal-making landscape has also been active: the yearly average number and aggregate value of venture capital deals jumped by 169% and 520% respectively from 2010-2014 to 2015-2019 (Fig. 11).

Early-Stage Investment the Route of Choice

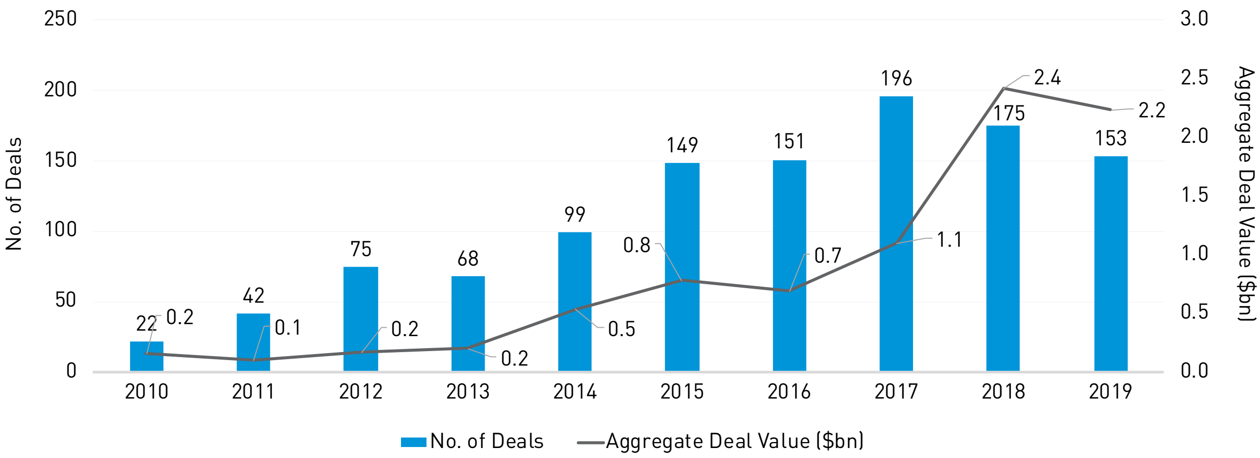
Early-stage vehicles are the most favored fund type in Australian venture capital. The five largest funds closed since 2015 are all early-stage vehicles (Fig. 12), and the strategy accounts for 15 of the 18 Australia-focused venture capital funds in market (as of February 2020). AirTree Ventures Fund III, which held a final close on $275mn in October 2019, is managed by Sydney-based AirTree Ventures and is the firm's third fund dedicated to supporting early-stage business in the Australasia region. The firm focuses on seed and Series A to C investments in start-ups.

Similarly, we have seen more capital being deployed in Series A to C financing rounds. Such deals accounted for 77% of total venture capital deal value in Australia last year, while Series D and later transactions made up just 8% (Fig. 13). Where later-stage deals traditionally account for a larger proportion of deal value on a global scale (Series D and later deals constituted 27% of global venture capital deal value in 2019), Australia's venture capital scene is younger, and therefore offers much opportunity for private capital seeking the exponential growth potential of earlier-stage investments.

Financial Services and AgTech Deals Stood out

Riding on the global digitization wave, the IT sector dominated in terms of the aggregate value (51%) and number (59%) of venture capital deals in Australia in 2019 (Fig. 14). Trailing the IT industry, the financial &

Fig. 11: Venture Capital Deals* in Australia, 2010 - 2019



Source: Preqin Pro

Fig. 12: Largest Australia-Focused Venture Capital Funds Closed in 2015-2019

Fund	Firm	Fund Size ($mn)	Fund Type	Final Close Date
AirTree Ventures Fund III	AirTree Ventures	275	Early Stage	Oct-19
MRCF5	Brandon Capital Partners	250	Early Stage	Jul-19
CSIRO Innovation Fund 1	Main Sequence Ventures	240	Early Stage: Start-up	Oct-18
MRCF BTF	Brandon Capital Partners	230	Early Stage: Start-up	Dec-16
MRCF3	Brandon Capital Partners	200	Early Stage	Apr-15

Source: Preqin Pro

**Figures exclude add-ons, grants, mergers, secondary stock purchases, and venture debt.*

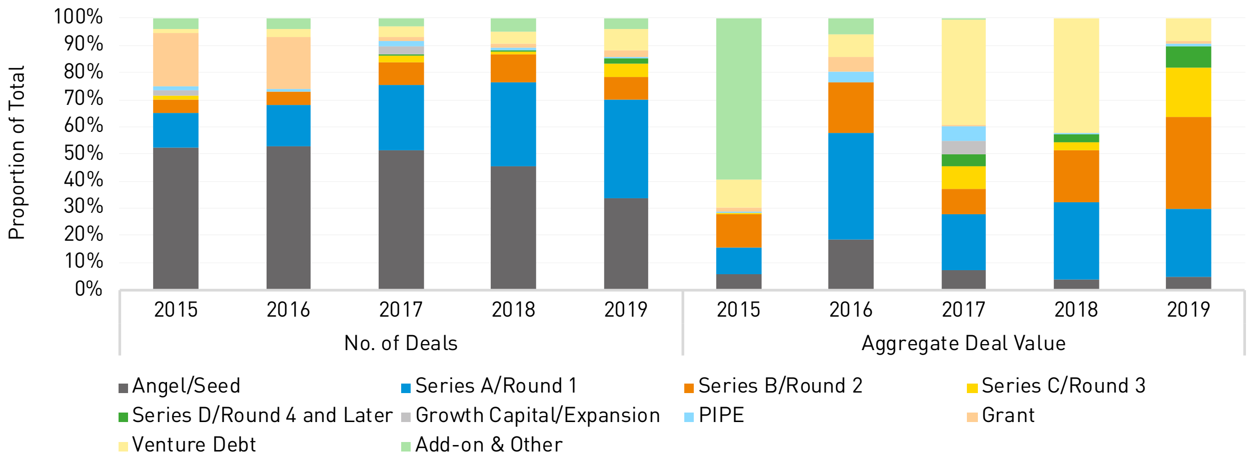
insurance services sector received the next-largest portion (22%) of venture capital funding in 2019, boosted by Judo Bank's $400mn Series B round. The Melbourne-based portfolio company provides business lending solutions – such as business loans, lines of credit, equipment loans, and finance leases – to small to medium-sized enterprises. With the latest round of backing from Abu Dhabi Capital Group, Ironbridge Capital, and Bain Capital Credit, Judo Bank is primed to strengthen its position as an alternative lender to the four 'Major Banks' in the Australian private debt space (see pages 18-20).

In recent years, agriculture development has become a significant contributor to Australia's GDP growth. Recognizing this, the National Farmers' Federation identified the AgTech sector as key in improving the industry's productivity growth rate to help meet its goal of $100bn in farm-gate output by 2030 (see pages 28-31). Unsurprisingly, since 2017, the annual aggregate value of AgTech deals has increased more than seven-fold from just $8.3mn to $60mn in 2019.

Net Cash Flow Has Made Positive Strides

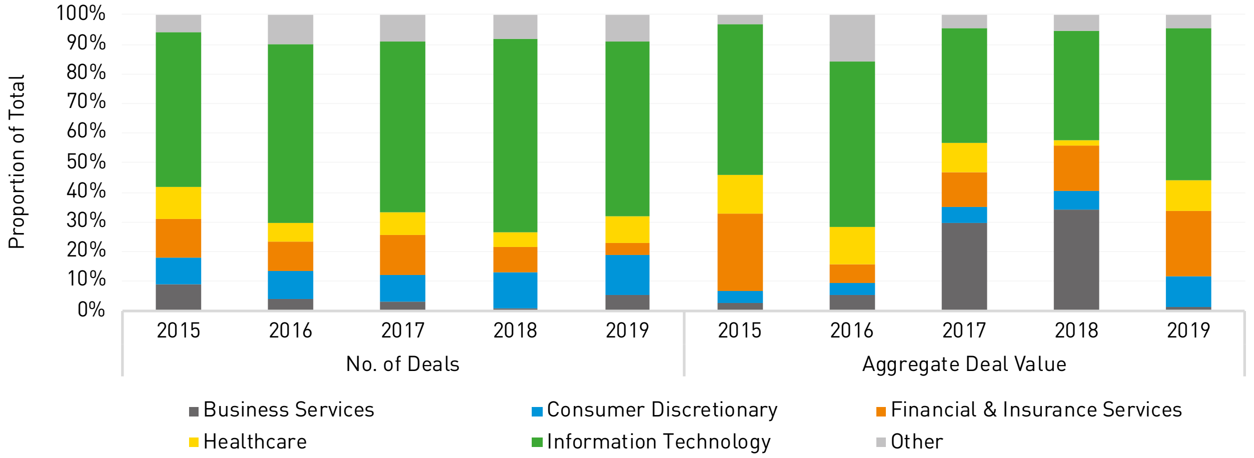
To fuel this active deal-making scene, capital called for venture investment increased year on year from 2015 to 2018, and has even outpaced distributions for the past two years (Fig. 15). That said, net cash flow increased slightly over H1 2019, setting up 2019 to potentially surpass 2018's cash flow and maybe even return to positive flows. This is good news for the industry as investors will likely recycle returned capital back into the venture capital space.

Fig. 13: Venture Capital Deals in Australia by Stage, 2015 - 2019



Source: Preqin Pro

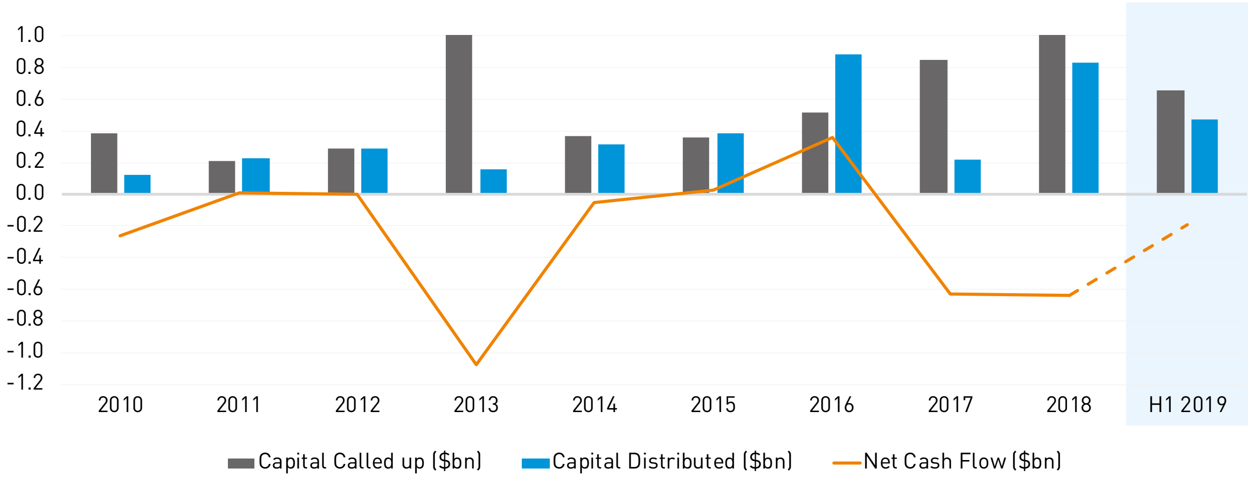
Fig. 14: Venture Capital Deals* in Australia by Industry, 2015 - 2019



Source: Preqin Pro

**Figures exclude add-ons, grants, mergers, secondary stock purchases, and venture debt.*

Fig. 15: Australia-Focused Venture Capital: Annual Capital Called up, Distributed, and Net Cash Flow, 2010 - H1 2019



Source: Preqin Pro

Private Debt Gathers Momentum

Private debt in Australia is taking flight as regulatory changes create opportunities for fund managers and investors alike

Private debt is fast gathering momentum in Australia. Alternative lenders, drawn to the potential for attractive risk-adjusted returns and a reliable income stream, are expanding into segments of the private credit market once the territory of banks.

A range of measures implemented by the Australian Prudential Regulation Authority (APRA) over recent years changed the playing field for private debt. Previously, the 'Major Banks'[1] dominated the Australian credit space, accompanied by several foreign banks, institutions, and accredited investors. In fact, where in the US and Europe banks covered 9% and 35% respectively of the lending scope, in Australia banks provided 98%[2] of domestic lending (as of December 2018). Higher capital charges and stricter lending

[1] *Australia and New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank and Westpac Banking Corporation*
[2] *Figure 1, https://www.ifminvestors.com/docs/default-source/insights/ifm-investors---the-australian-private-debt-opportunity.pdf?sfvrsn=78de2305_3*

Institutional private debt demand globally has typically followed private equity growth, and that has similarly proven true in Australia. Demand from private equity borrowers for more flexible capital as an alternative to traditional bank structures, coupled with increased regulatory bank capital requirements, has created a gap in funding markets which is being filled by institutional private credit funds. In Australia, and increasingly in Asia-Pacific as a whole, the prevalence of control transactions has also supported the development of private credit markets.

Peter Szekely
Partner, Tanarra Credit Partners

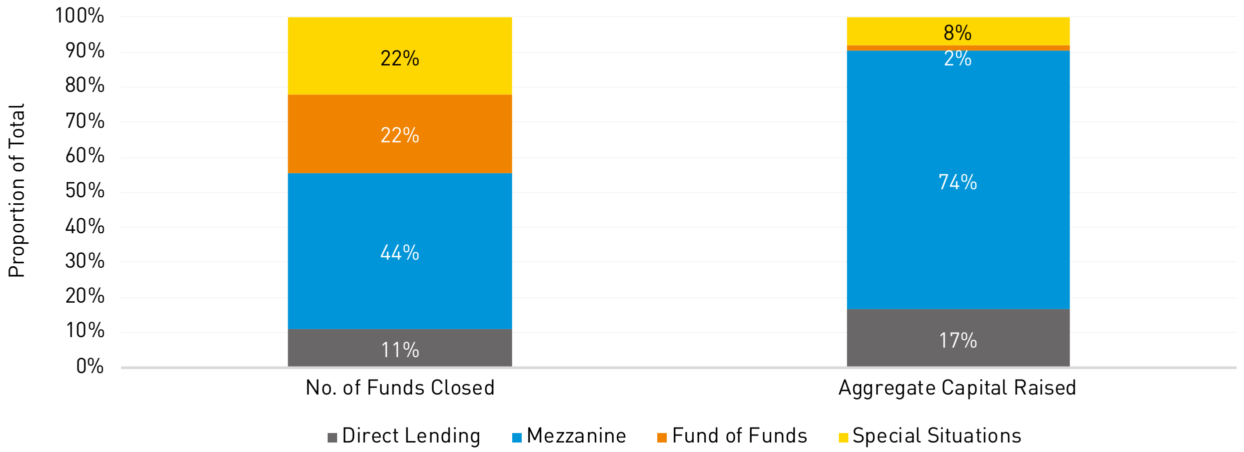
processes imposed by regulators subsequently reduced banks' lending activities, which in turn reduced the supply of credit for borrowers looking to finance their next stage of growth. This macroeconomic imbalance of rising demand and declining supply created a gap for alternative lenders, such as private debt funds, to step into.

Mezzanine Dominates Fundraising

Mezzanine funds constitute the largest proportion of all Australia-focused private debt funds ever raised, in terms of both the number of funds (44%) and aggregate capital raised (74%, Fig. 16). In Australia, where distressed and control-oriented investments in real estate and construction financing are prevalent, mezzanine funding is mainly utilized.

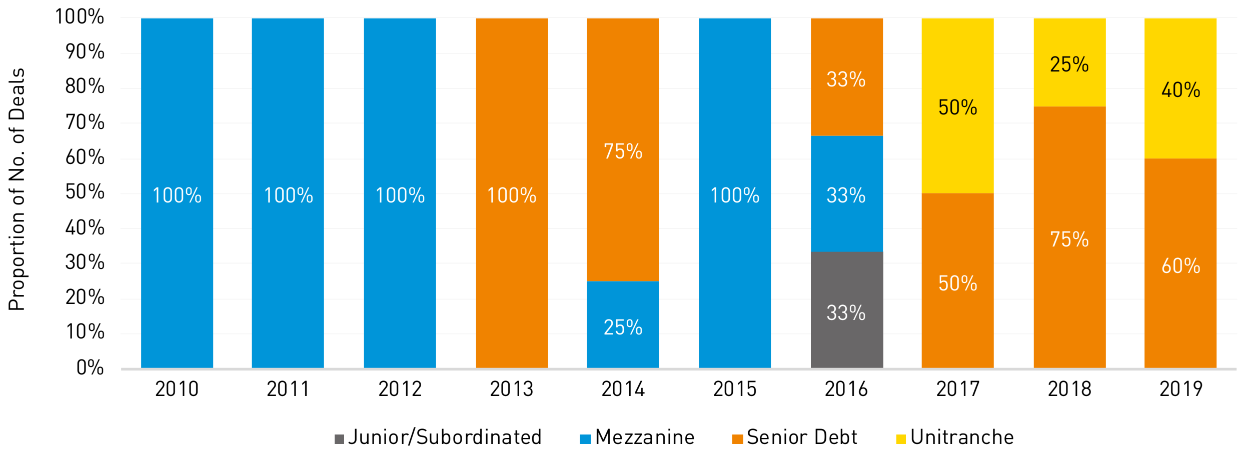
The direct lending sector has, however, garnered increasing interest in recent years. In fact, 80% of funds in market as of February 2020 are direct lending vehicles. In Australia, there is demand for lending in real estate and natural resources sectors. Revolution Private Debt Fund I, the largest Australia-focused commingled private debt fund raised in 2019, held a final close on $205mn. The fund, managed by Sydney-based Revolution Asset Management, targets commercial real estate debt and asset-backed securities. Grant Fleming, Partner at Canberra-based Continuity Capital Partners, is also seeing attractive private debt opportunities in the real estate sector, especially in smaller multi-unit projects and land subdivisions, and in the infrastructure and natural resources sectors, such as in specialist mining, industrials, and manufacturing.

Fig. 16: Australia-Focused Private Debt Fundraising by Fund Type, All Time



Source: Preqin Pro

Fig. 17: Private Debt-Backed Deals in Australia by Debt Type, 2010 - 2019



Source: Preqin Pro

Fund Managers Flock to Senior Debt

Senior debt is the most common debt syndicate in transactions. Since 2013, senior debt financings have generally represented the largest proportion of private debt-backed deals completed each year (Fig. 17). A defensive strategy, senior debt attracts managers for its ability to provide adequate downside protection for investors. At the end of 2019, when most in the industry felt the current cycle was at its peak, more investors were looking toward senior debt funds. Australian Catholic Superannuation and Retirement Fund, for example, has over $9bn in AUM and has committed to Revolution Private Debt Fund I and II – which focus on senior debt – to reduce overall equity risk and maintain robust returns.[3]

There is also growing demand for unitranche debt. The proportion of private debt-backed deals represented by unitranche debt financings increased by 60% from 2018 to 2019. Among the Australia-based fund managers that Preqin spoke to, Peter Szekely, partner at Melbourne-based Tanarra Credit Partners, noted that unitranche debt has been available at relatively high leverage levels, which has often negated the need for mezzanine structures.

Open-Ended Funds Gain Momentum

Our conversations with Australia-based GPs revealed that open-ended vehicles are increasingly common. Among open-ended funds on the road is Revolution Private Debt Fund II. The follow-on fund to Revolution Private Debt Fund I – a closed-end fund – the vehicle has the same focus on commercial real estate loans and asset-backed securities. Grant Fleming, Partner at Canberra-based private debt firm Continuity Capital Partners, told us that open-ended funds allow managers more flexibility in deploying and re-investing capital, with the added bonus of allowing investors – especially family offices – to better control their commitments and investment pace.

Private Debt Sought After in Turbulent Times

As companies seek fresh streams of capital amid the global economic uncertainty, private debt lenders are able to fill a gap. Australia boasts a healthy pipeline of agriculture and related infrastructure such as food production and freight transportation projects, which are in need of private capital for further expansion (see pages 28-31) – especially now at this challenging time. With traditional lenders stepping back from the credit scene, there is more demand for alternative funding sources. Australia's private debt sector is in an early stage of development compared to more established lending markets like the US and Europe, and has room for further growth in the next few years.

The private debt industry in Australia is still in its infancy. Track records are rare at the fund manager level, but are evidently present in individual deals. Real returns are rewarded to patient investors. Over time, the Australian private debt space should develop in the same way as the North American and European markets have.

Grant Fleming
Partner, Continuity Capital Partners

[3] *Revolution Asset Management: The Strategy, https://revolutionam.com.au/asset-management-strategy/*

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Australia's Private Debt Market Reaches a Pivotal Point

Australian investors are increasing their allocations to private debt, attracted by the wide range of credit issuances and the potential for higher returns

Angus St John
Head of Investor Client Management, Commonwealth Bank of Australia

Mark Wang
Executive Director, Global Capital Markets, Commonwealth Bank of Australia

Commercial banks have always been the bastion of buy-and-hold debt funding for Australian corporations and businesses. Banks dominate the supply of credit to corporates in Australia, accounting for some 98%. In comparison, banks supply just 9% of credit in the US and 35% in Europe.[1] But this is changing. A growing pool of patient capital, both in Australia and offshore, is now available for Australian and New Zealand companies through Australia's private debt market.

Investors Are Truly Diverse across Geographies, Type, and Size

A number of offshore players, including large financial sponsors, specialized credit managers, insurance managers, as well as leading Australian asset managers, have participated in Australia's private debt market for several years. Interest in Australian and Asian credits has risen markedly over the past three years. In 2019, 7% of all private debt raised focused primarily on Asia, up from 3% in 2016.[2]

Private equity firms globally are expanding into hybrid equity, senior debt, and private debt, while insurance companies now count among the largest groups (9%) of offshore investors looking for private debt opportunities across corporate Australia.

What further makes this a pivotal time for the private debt market in Australia is also the growing interest from Australia's superannuation funds. As of 30 September 2019, they managed almost AUD 3tn of funds[3], with continued growth assured by government-mandated pension contributions. Superannuation funds dominate Australia's AUD 3.87tn managed funds industry[4] and represent the world's fourth-largest pool of pension funds[5].

Currently only around 2% of private debt assets under management are controlled by Australasian investors.[6] However, these investors are allocating more funds and resources to private debt – the single biggest factor

[1] *APRA and IFM Investors December 2018; S&P LCD Leveraged Lending Review Q4-17; S&P Capital IQ Leveraged Commentary & Data, March 3 2018*
[2] *Preqin Pro*
[3] *Australian Bureau of Statistics, 2019, Managed Funds, Australia, Sep 2019, https://www.abs.gov.au/ausstats/abs@.nsf/mf/5655.0*
[4] *Australian Bureau of Statistics, 2019, Managed Funds, Australia, Sep 2019, https://www.abs.gov.au/ausstats/abs@.nsf/mf/5655.0*
[5] *Australian Trade and Investment Commission https://www.austrade.gov.au/news/economic-analysis/australia-has-the-fourth-largest-pension-fund-assets-in-the-world*
[6] *Preqin Pro*

driving growth and opportunity in Australia's private debt market.

Why Superannuation Funds Are Participating

Private debt adds diversification to investment portfolios by providing access to a larger universe of debt issuances than exists in the public bond market. These include unrated, unlisted, and non-investment grade companies. Higher-return opportunities are on offer through longer tenors, structured credits, and bespoke terms. Furthermore, the market facilitates broader strategic involvement across the capital spectrum: from senior, subordinated, and mezzanine debt through to equity.

Family offices are also entering the market. Sometimes they will invest in industries that they know particularly well, with property being a prime example. Usually though, they participate through a managed fund.

While banks have long had a stronghold on credit capability in Australia, superannuation funds and other large institutional investors are rapidly building out their credit expertise, including hiring experts from specialist credit teams at banks or overseas.

An Opportunity between Banks and Public Bonds

As a result of the expanding private debt market, a sizable proportion of Australian companies have a new source of debt funding. It isn't a substitute for the domestic public bond market. Nor does it replace banks. Rather, it is a complementary market that provides a huge pool of patient capital managed by a diverse range of highly skilled domestic and offshore investors.

The private debt market's flexibility, in terms of structures, tenor, leverage, and breadth across the capital spectrum, can't be overstated. This is one of its most valuable features. In addition to accommodating a wide array of structures and tailored solutions, private debt investors engage at a strategic level and commit for the long term. Moreover, the market can be accessed by a broad universe of Australian companies and businesses.

Corporate Australia to Benefit over the Long Term

Banks, with their distribution capabilities and extensive coverage of the Australian corporate landscape, are committed to helping establish a highly functioning private debt market as an alternative source of debt funding and solutions for business and institutional clients.

It is worth noting that the growth of private debt investment has been in the context of a historically benign credit environment. The real strength of this market will only be tested when there is a macro-dislocation or a significant increase in interest rates. To ensure investors are well positioned for when this time comes, consistency of terms and pricing, plus a disciplined approach to investing, are paramount.

Private debt investors have managed portfolios through previous credit cycles, though, and therefore understand how to price and structure transactions to withstand macroeconomic dislocations. Their consistency and discipline will ensure the market's sustainability beyond the current benign credit conditions and amid unprecedented volumes of capital searching for investment opportunities.

Australian companies will benefit from this newly available pool of non-bank capital. New structures and solutions will bring better outcomes.

Commonwealth Bank of Australia

Commonwealth Bank of Australia (CBA) is a leading provider of personal banking, business and institutional banking, and share broking services in Australia. With total assets exceeding $979bn (as of 31 December 2019), CBA is among the world's 15 largest banks by market capitalization (as of August 2019).

Headquartered in Australia, and with offices in Europe, the US, and Asia-Pacific, CBA is strategically positioned to work with clients across global markets. As custodian of Australia's largest customer transactional dataset, CBA connects global clients to Australian opportunities backed by data-generated insights.

www.commbank.com.au

Real Estate Dominates Fundraising in 2019

Real estate funds raised the most capital of any private capital asset class in 2019, and foreign GPs raised 40% of the total

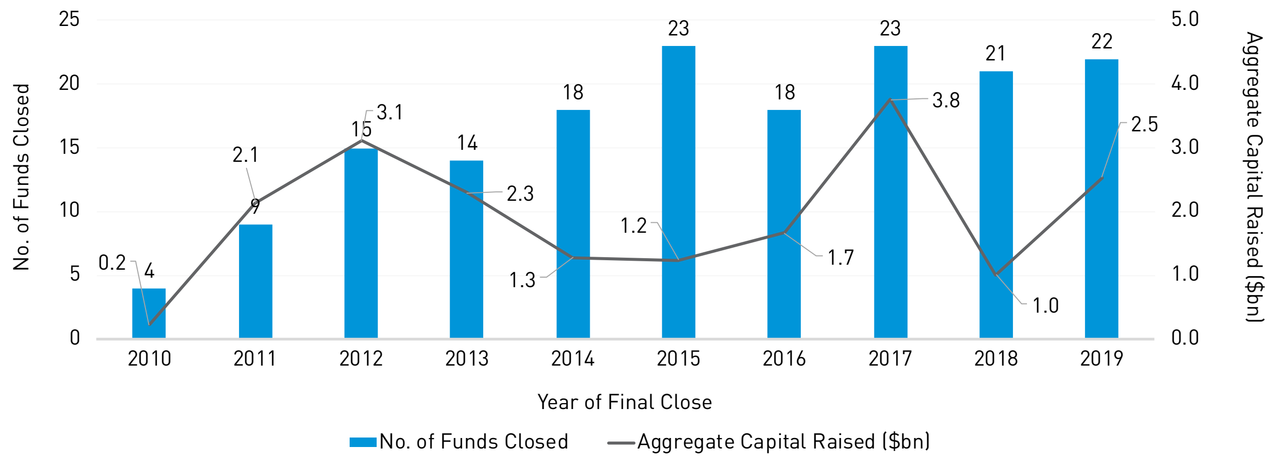
Real estate in Australia is highly sought after by both local and offshore institutional investors, boasting a steady pipeline of high-quality assets. While real estate accounts for 14% of private capital AUM globally and only 7% in Asia, it makes up 37% ($25bn) in Australia. Real estate funds secured $2.5bn in 2019 – more than double the amount secured in the previous year and the most of any private capital strategy (Fig. 18). Average fund size also tripled from the previous year to $169mn in 2019, buoyed by four large fund closures (Fig. 19).

Offshore Investment on the Rise

Global institutions have been keen to tap into the real estate opportunities on offer in Australia. Indeed, two of the largest funds closed in 2019 – MASCOT Private Trust and Wee Hur PBSA Master Trust – are managed by foreign GPs. Despite raising Australia-focused vehicles for the first time, the two firms collectively secured $1bn – 40% of real estate total fundraising in 2019. And we expect significant offshore participation to continue: 24% of Australia-focused funds in market as of February 2020 are managed by overseas GPs, located namely in Singapore, Hong Kong, Germany, and the US.

Australian private equity real estate (PERE) deal activity was also robust in 2019: the aggregate value of transactions increased by one-third from the previous year. In the face of high asset valuations, fund managers called up more capital than they distributed in H1 2019, and for the first time in four years cash flow turned negative (Fig. 20).

Fig. 18: Australia-Focused Closed-End Private Real Estate Fundraising, 2010 - 2019



Source: Preqin Pro

Student Accommodation in the Spotlight

Australia is the most investible market globally for student accommodation assets.[1] The number of international student enrolments in Australia was at an all-time high of over 950,000 in 2019, following eight consecutive years of increase.[2] What's more, Australia's university-aged population is forecasted to grow even further[3], and the international education sector's contribution to export earnings is expected to double in the coming years. All this will fuel demand for student housing.

Three of the largest real estate funds closed in 2019 target student accommodation assets. Cedar Pacific Student Accommodation Fund II, managed by Brisbane-based Cedar Pacific Investments, held a final close on $500mn in February 2019. This is the firm's second fund that focuses on student housing projects across Australia and New Zealand.

On the deal front, student accommodation, which is categorized in the niche sector of PERE, has seen its share of the aggregate value of PERE deals in Australia increase since 2015 (Fig. 21). From 2018 to 2019, niche real estate's share increased by 1.8x.

Despite student housing making up a small fraction of total PERE deals in Australia, the stable growth in student numbers and steady rental yields[4] are attracting foreign institutions.

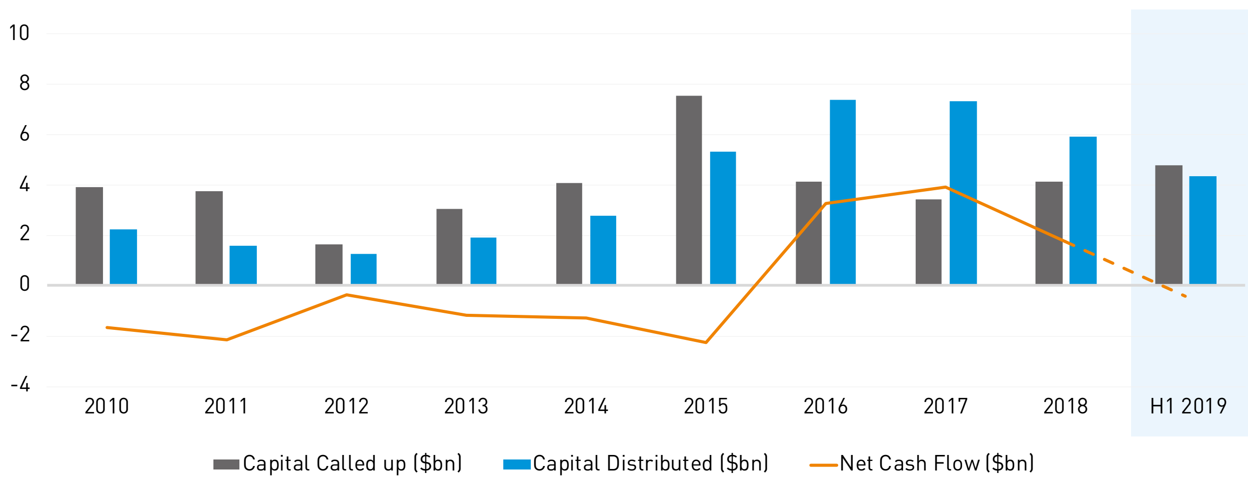
[1] *Savills Global Living 2019 Report, https://pdf.euro.savills.co.uk/global-research/report-global-living-2019.pdf*
[2] *Australian Government, Department of Education, Skills and Employment*
[3] *Australian Trade and Investment Commission, Growth and Opportunity in Australian International Education report, https://www.austrade.gov.au/Australian/Education/Services/Australian-International-Education-2025/growth-and-opportunity*
[4] *Mapletree and GIC snapping up student housing to lift returns, https://www.straitstimes.com/business/mapletree-and-gic-snapping-up-student-housing-to-lift-returns*

Fig. 19: Largest Australia-Focused Closed-End Private Real Estate Funds Closed in 2018-2019

Fund	Firm	Headquarters	Fund Size ($mn)	Fund Type	Property Type	Final Close Date
MASCOT Private Trust	Mapletree Investments	Singapore	654	Core	Office	Nov-19
Cedar Pacific Student Accommodation Fund II	Cedar Pacific Investments	Australia	500	Opportunistic	Niche	Feb-19
Scape Joint Venture 2 Fund	Scape Australia	Australia	500	Core	Niche	Mar-19
Wee Hur PBSA Master Trust	Wee Hur Capital	Singapore	350	Opportunistic	Niche	Jun-19
Qualitas Food Infrastructure Fund	Qualitas	Australia	205	Value Added	Industrial	Mar-18

Source: Preqin Pro

Fig. 20: Australia-Focused Closed-End Private Real Estate: Annual Capital Called up, Distributed, and Net Cash Flow, 2010 - H1 2019



Source: Preqin Pro

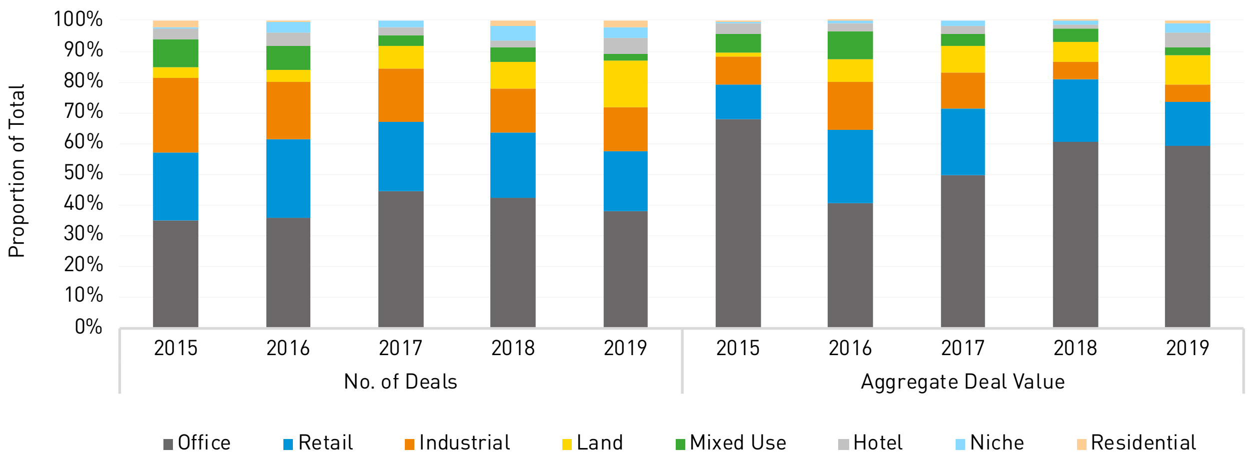
Wee Ping Goh, CEO of Singapore-based Wee Hur Capital, noted that US and UK markets are "well established" in the student accommodation sector, but "yields have begun to show compression." In comparison, Australia is just in its starting phase and there are abundant investment opportunities, with the country "projected to overtake the UK as the second most popular study destination in the next few years."

Goh is positive about the robust growth of the sector: "In 2019, we witnessed the increasing popularity of the sector, [and] there will be a continued compression of capitalization rates and uplifts in valuations. With the underlying structural undersupply of PBSA beds and increasing international student growth, there is ample room for more players." Wee Hur PBSA Master Trust, managed by Wee Hur Capital, which closed on $350mn in June 2019, employs an opportunistic strategy to invest in purpose-built student accommodation. The fund plans to develop over 5,600 beds across key cities in Australia. The completed portfolio targets a stabilized valuation of more than $1.2bn.

Long-Term Value in Australian Real Estate

Disruptions from the COVID-19 pandemic will present challenges to raising capital and completing deals in the short term, but Australia's real estate sector is well placed to thrive over the longer term. With niche sectors hungry for funding and a diverse base of local and offshore participants, the asset class is a compelling opportunity for private capital – and student accommodation properties are the jewel in the crown. As investors and fund managers continue to deploy capital in the asset class, Australian real estate will become an increasingly integral part of their investment portfolios.

Fig. 21: PERE Deals in Australia by Primary Asset Type, 2015 - 2019



Source: Preqin Pro

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Cashing in on Australia's Crops

With Asia's population expected to cross five billion by 2050, Australia's agriculture and infrastructure sectors are in a strong position

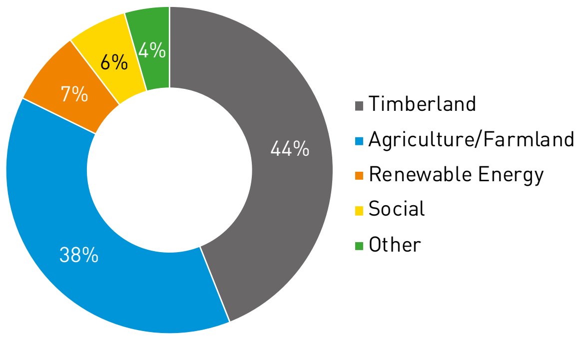
Natural Resources: The Agriculture Appeal

Australia's agriculture sector is about to play a bigger role in the Asian Century. The United Nations projects Asia's population to grow by 15% in the next 30 years to 5.3 billion[1], accounting for 55% of the world's population. Population growth drives food consumption, and Australia is well positioned to meet the growing demands in this area. Asia is home to seven of Australia's top 10 agricultural export markets, to which Australia exported $28bn worth of produce in 2018-2019[2]. Australia has the second largest agricultural land area in the world and offers counter-seasonal production to the Northern Hemisphere. Consumers trust the high quality of Australian produce, and the continent's proximity to Asia provides an advantage over other major food-exporting countries like the US.

To capture this growing economic opportunity, the National Farmers' Federation (NFF) announced its goal to increase farm-gate output to $100bn by 2030, representing a 3% industry growth rate annually. Access to capital and the AgTech sector are some of the key industry pillars identified in the 2030 roadmap[3] to improve productivity. And private capital is able to meet those needs.

Agriculture/farmland funds account for a significant proportion (38%) of aggregate capital raised in unlisted infrastructure and natural resources between 2010 and 2019 (Fig. 22). Three of the five largest Australia-focused infrastructure and natural resources funds closed in the past five years are agriculture/farmland-focused vehicles (Fig. 23). These funds raised a total of $1.5bn, constituting 29% of aggregate capital raised in the past decade.

Fig. 22: Aggregate Capital Raised by Australia-Focused Unlisted Closed-End Infrastructure & Natural Resources Funds Closed in 2010-2019 by Primary Industry



Source: Preqin Pro

Bolstering fundraising in the sector for 2019, MIRA Agriculture Fund secured $1bn at final close in Q4 2019. The fund targets investments that improve on-farm efficiency and reduce carbon emissions through

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[1] World Population Prospects 2019, https://population.un.org/wpp/
[2] Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES), https://public.tableau.com/profile/australian.bureau.of.agricultural.and.resource.economics.and.sci#!/vizhome/Trade_map/Dashboard1
[3] Talking 2030, https://c715c9c2-cbcd-41bd-957f-403b34d81598.filesusr.com/ugd/f0cfd1_26dbb49eea91458d8b1606a0006ec20e.pdf

sustainable farm management practices. Managed by Australian-headquartered Macquarie Infrastructure and Real Assets (MIRA), the fund is the largest Australia-focused natural resources vehicle ever raised, dwarfing domestic funds.

Australian agriculture investments have also generated attractive returns. According to the US-based National Council of Real Estate Investment Fiduciaries (NCREIF), Australian agricultural investments have returned a total annualized 14% from March 2015 to September 2019. During the 12-month period to Q3 2019, the NCREIF Australian Farmland Index returned 14.37%, which outperformed the 6.82%[4] total return by the US NCREIF Index. More than just offering an inflation hedge and low correlation to other asset classes, agriculture investments have appealing risk/return profiles and are valuable additions to institutional portfolios.

But the sector has its own unique set of challenges. The Australian market faces the highest volatility in agriculture output value when compared across 15 countries, including the Netherlands, New Zealand, and the US.[5] Due to the region's highly variable climate, there is lower mean rainfall and higher rainfall variability than in other nations. And climate change only exacerbates these risks: 2019 was the driest and hottest year in Australia[6] since records began, and the 2019/2020 bushfires were the largest in recorded global history – more than 12 million hectares of bush, forest, and parks across Australia burned[7]. These extreme weather events destroyed farmland and crops, and reduced forecasted crop production in the affected areas.

Despite these difficulties, fund managers are unfazed and continue to seek opportunities in Australian agriculture. As of February 2020, there are eight Australia-focused agriculture/farmland funds on the road, targeting $2.3bn in investor commitments. And we see a healthy appetite for the sector from offshore players. Some of these funds in market are managed by China- and UK-based fund managers, which are targeting Australian agriculture for the first time.

A major trend we expect to see is the ongoing development of higher-value agriculture production systems in regions with access to reliable long-term water resources. These production systems will most likely be focused on commodities that provide access to not only the Australian consumer base but also the middle class of Asia and the sub-continent. While Australian agriculture will not be immune from the effects of COVID-19 economic disruption, we believe it will be more resilient than many sectors.

Michael Blakeney
Managing Partner,
Riparian Capital Partners

Infrastructure: The Agriculture Enabler

To grow the agriculture industry to the NFF's $100bn goal, more infrastructure is needed. As identified in NFF's 2030 roadmap, infrastructure's role is to ensure an efficient supply chain from farm to market. And with Australia experiencing rapid population growth,

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[4] National Council of Real Estate Investment Fiduciaries
[5] Australian Bureau of Agricultural and Resource Economics and Sciences, Snapshot of Australian Agriculture, https://www.agriculture.gov.au/abares/publications/insights/snapshot-of-australian-agriculture#around-two-thirds-of-agricultural-output-is-exported
[6] 2019 was Australia's hottest year on record – 1.5C above average temperature, https://www.theguardian.com/australia-news/2020/jan/02/2019-australia-hottest-year-record-temperature-15c-above-average-temperature
[7] Australia fires: A visual guide to the bushfire crisis, https://www.bbc.com/news/world-australia-50951043

particularly in fast-growing cities including Sydney, Melbourne, Brisbane, and Perth, the country's existing infrastructure is under increasing pressure[8].

The Global Infrastructure Hub (GIH)[9] forecasts investment needs of $1.1tn across transportation assets including road, rail, airports, and ports from 2016 to 2040[10] (Fig. 24). This accounts for almost half of total infrastructure investment needs in the country in the same period.[11] With infrastructure deals[12] in Australia completed from 2016 to 2019 representing a mere 5% of the country's total investment needs as projected by GIH, this means there is still huge opportunity for private players to tap into, and rewards for investors to reap.

Australia's agriculture and infrastructure sectors are hungry for private capital. Despite the inherent risks presented by climate change, the growth of the population and the abundance of investment opportunities mean Australia is an attractive proposition for both offshore and local institutions investing in real assets.

[8] An Assessment of Australia's Future Infrastructure Needs - The Australian Infrastructure Audit 2019, https://www.infrastructureaustralia.gov.au/sites/default/files/2019-08/Australian%20Infrastructure%20Audit%202019.pdf
[9] A G20 initiative that compares infrastructure investment forecasts across seven sectors including transport, telecoms, electricity, and water.
[10] Global Infrastructure Hub Outlook, https://s3-ap-southeast-2.amazonaws.com/global-infrastructure-outlook/countrypages/GIH_Outlook+Flyer_Australia.pdf
[11] Investment needs figures in Fig. 24 converted from USD using exchange rate of AUD 1: USD 0.7306.
[12] Preqin tracks infrastructure transactions involving private entities and investors globally.

Fig. 23: Notable Unlisted Infrastructure & Natural Resources Funds Closed in 2015-2019

Fund	Firm	Headquarters	Fund Size ($mn)	Primary Strategy	Final Close Date
MIRA Agriculture Fund	Macquarie Infrastructure and Real Assets (MIRA)	Australia	1,000	Agriculture/Farmland	Oct-19
Australia New Zealand Forest Fund 3	New Forests	Australia	873	Timberland	Nov-17
Laguna Bay Agricultural Fund I	Laguna Bay	Australia	313	Agriculture/Farmland	Jan-18
Lighthouse Solar Fund	Lighthouse Infrastructure Management	Australia	160	Renewable Energy	Sep-17
Growth Farms Australia Fund 1	Growth Farms Australia	Australia	150	Agriculture/Farmland	Oct-16

Source: Preqin Pro

Fig. 24: Aggregate Private Infrastructure Deal Value vs. Projected Infrastructure Investment Needs by Asset Type

<table>
<tr><th></th><th>Road</th><th>Rail</th><th>Airports</th><th>Ports</th><th>Other</th><th>Total</th></tr>
<tr><td>Investment Needs (2016-2040)*</td><td>600</td><td>235</td><td>44</td><td>226</td><td>1,222</td><td>2,327</td></tr>
<tr><td>Aggregate Deal Value (2016-2019)**</td><td colspan="4">51</td><td>68</td><td>119</td></tr>
</table>

Source: Preqin Pro

**Figures provided by Global Infrastructure Hub (all figures in $bn).*
***Infrastructure deals data from Preqin Pro (all figures in $bn).*

> Agriculture is still unfamiliar and underinvested in institutional portfolios, but that is changing. Interest is growing as investors realize the returns are real and uncorrelated. Agriculture is a defensive asset class, being classified as an essential service during COVID-19 shutdowns. We have all seen empty supermarket shelves. Agriculture is essential for society.

Tim McGavin
Chief Executive Officer, Laguna Bay

> Farmland continues to perform well in 2020 despite the turmoil in global equity and bond markets. When you look back at previous economic shocks, farmland has outperformed due to its low correlation to financial assets. It really is a great diversifier in any portfolio; put simply people need to eat regardless of what's going on in Wall Street.

Daniel Hough
Managing Partner, Gunn Agri Partners

Pension Funds Push the ESG Agenda in Australia

ESG adoption in Australia outpaces the rest of Asia-Pacific – and pension funds are the drivers behind it

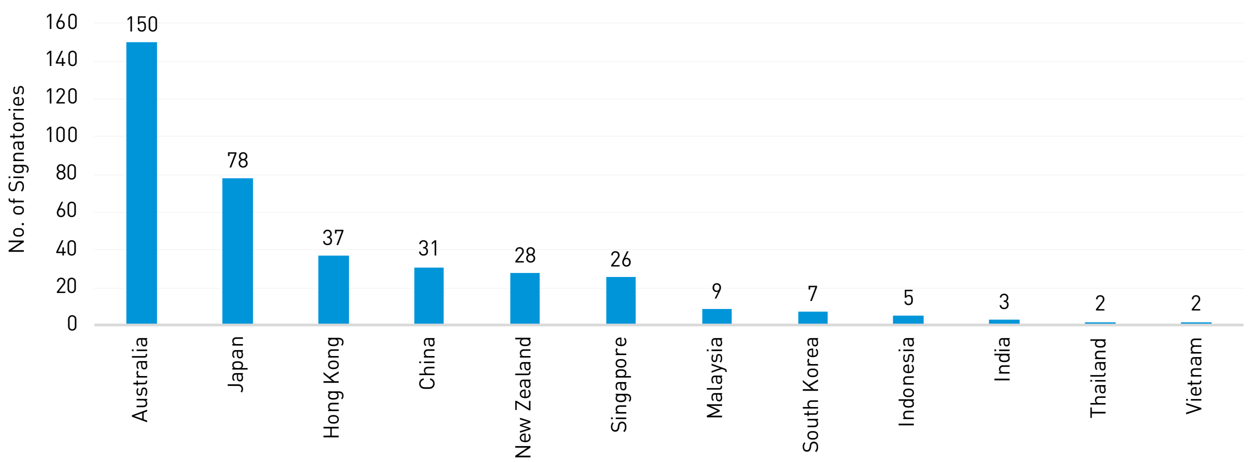
ESG integration in Australian private capital is gaining momentum. Presently, Australia has 150 signatories[1] to the UN Principles for Responsible Investment (PRI)[2]. While total PRI signatories in Asia-Pacific (378) lag Europe (1,479) and North America (659), Fig. 25 shows that Australia surpasses its Asia-Pacific counterparts. One of the main reasons for this is a growing conviction that companies that address ESG issues can achieve better growth, cost savings, and profitability, while strengthening stakeholder relations and improving their brand and reputation.

Pension funds are taking an active role in driving sustainable investing practices. They are some of the largest proponents of ESG investing in Australia, representing 60% of all Australia-focused signatories to ESG/impact investing frameworks (Fig. 26). The 10 largest superannuation funds in Australia by AUM all have ESG policies in place (Fig. 27), which address various aspects of impact and socially responsible investing.

By way of example, AustralianSuper, which has $187bn in AUM, is one of a number of Australian superannuation funds that offer a Socially Aware investment option to members. The option was launched partly in response to feedback from members, many of whom want to invest in a way that

[1] *PRI data as of February 2020.*
[2] *The Principles for Responsible Investment were established by the United Nations (UN) to support investor signatories in incorporating ESG factors into their investment decisions.*

Fig. 25: Asia-Pacific-Based Investor Signatories to the UN PRI by Location



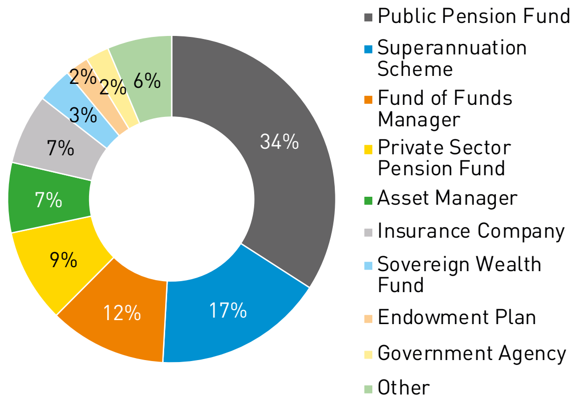
Source: UN PRI

reflects their environmental and social values. These portfolios adhere to strict ESG standards, which exclude investment in companies with ownership of coal, oil & gas, or uranium, or in companies with single-gender boards.

Beyond the positive contributions to society, investing responsibly has also paid off in terms of returns for AustralianSuper. The Socially Aware option generated a five-year annualized average return of 8.51%[3] as of June 2019, which is comparable to the portfolios of top performing superannuation funds[4] without an ESG focus. This demonstrates the potential of ESG-focused funds to produce results akin to the best, or better than many.

Responsible investing is off to a strong start in Australia, and we expect that it will continue to grow. The Australian Government aims to reduce carbon emissions to 26-28% of the 2005 level by 2030, and has set up a Direct Action Plan[5] to guide its commitment. Furthermore, global investor sentiment suggests that responsible investing will continue to gather momentum worldwide: 71% of investors surveyed[6] globally at the end of 2019 felt that ESG was already an integral part of the alternative assets industry, or that it would become more integral by 2023. We are therefore likely to see an increase in ESG uptake in Australia.

Fig. 26: Australia-Focused Investor Signatories to ESG/Impact Investing Frameworks by Type



Source: Preqin Pro

[3] AustralianSuper Socially Aware Option, https://www.australiansuper.com/investments/your-investment-options/pre-mixed-investment-choice
[4] Top 10 superannuation funds as of 31 December 2019, balanced investment option, https://www.superratings.com.au/top-10-super-funds/
[5] Parliament of Australia, Direct Action Plan, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Environment_and_Communications/Direct_Action_Plan/Report/c05
[6] Preqin Investor Interviews, November 2019.

Fig. 27: Top 10 Superannuation Funds Investing in Private Capital by Assets under Management

Firm	AUM ($bn)	Type	Allocation to Private Capital (As a % of AUM)	Active ESG Policy?
AustralianSuper	187.6	Industry	22.1	Yes
QSuper	113.3	Public Sector	25.2	Yes
First State Super	100.0	Public Sector	22.8	Yes
UniSuper	82.4	Industry	9.0	Yes
Sunsuper	70.0	Industry	22.3	Yes
Retail Employees Superannuation Trust	57.2	Industry	15.7	Yes
Construction and Building Industries Superannuation Fund	54.0	Industry	25.0	Yes
HESTA	50.0	Industry	27.5	Yes
Commonwealth Superannuation Corporation	48.6	Public Sector	18.2	Yes
HOSTPLUS	45.6	Industry	35.3	Yes

Source: Preqin Pro

Supercharging ESG to Lower Emissions

As the transition to a low-carbon future gathers momentum, it is time for private capital to sharpen its focus on achieving meaningful outcomes

Rory Lonergan
Executive Director and Equity Investment Lead, CEFC

ESG investing is moving into the mainstream. The green agenda is increasingly embraced by investors, managers, regulators, and communities. In Australia alone, the value of the responsible investment market grew 13% in 2018, with the most recent Responsible Investment Benchmark Report[1] showing responsible investment funds are now outperforming mainstream funds.

As a purpose-investor with a keen focus on emissions reduction, the CEFC of course welcomes this momentum. But two questions weigh on our minds. First, will this increasing focus on ESG make a meaningful difference to our pressing emissions problem? For us, the answer is: potentially. And second, can we work smarter to ensure we direct this growing investment pool to accelerate our transition to a low-carbon future? The answer is: definitely.

As we begin a new decade, the time is right for investors to sharpen their focus on ESG as a 'paradigm-shifting' investment tool. The goal must be meaningful emissions reduction, with the rewards measured in attractive fund performance and progressive economic development.

Efforts toward a Low-Carbon Future Insufficient

Achieving a low-carbon future requires concerted effort across all areas of economic activity. Regrettably, progress remains slow.

Despite Australia's global leadership in rooftop solar, the latest government data[2] shows renewable energy contributing just 19% of total electricity generation. While more electric vehicles are available, the National Greenhouse Accounts show that transport-related carbon emissions continue to rise, influenced by increasing economic output, growing freight volumes, and higher diesel use.

The trends are similar in agriculture, manufacturing, and waste. The switch to cleaner electricity, investment in more energy-efficient equipment, and the belated introduction of proven waste management technologies are all welcome, but are insufficient to stem the forecasted growth in emissions.

And, of course, just stemming the growth in emissions cannot be the end goal. We need to cut emissions to below 2005 levels to avoid the worst-case-scenario climate outcomes. With access to almost $1tn in funds, Australian impact investors have an increasingly critical role to play.

The Pressing Financial Risks of Climate Change

ESG is a broad definition – which is perhaps both a strength and a weakness.

In our work with the market, it is evident that the interpretation of the 'E' in ESG is not consistent among responsible investors; and by stretching across

[1] https://responsibleinvestment.org/wp-content/uploads/2019/07/RIAA-RI-Benchmark-Report-Australia-2019-2.pdf
[2] https://www.energy.gov.au/data/renewables

numerous issues, it becomes a weak substitute for an effective focus on emissions.

For the CEFC, the 'E' in ESG relates particularly to climate, and specifically to how and where we should invest to accelerate emissions reduction and address the very real challenges of climate change.

We are not alone in prioritizing climate-related action as a core ESG focus. In February 2020, Reserve Bank of Australia Governor Philip Lowe spoke of the financial stability implications of climate change, the certainty of stranded assets, and the need for financial institutions to understand those risks.

The Australian Prudential Regulation Authority and the Australian Securities and Investments Commission – key financial regulators – have also commented on the very real financial risks posed by climate change. These sentiments are echoed offshore by the Bank of England, the Financial Stability Board, and others.

In fact, Preqin data[3] shows that more than a third of investors have rejected a fund because of inadequate ESG policies. At the same time, almost 80% of investors surveyed believe ESG funds perform the same or better than non-ESG funds.

Leverage and ESG: The CEFC Approach

The CEFC is increasingly using our capital to challenge the market to set ambitious carbon reduction targets. We want potential emissions impacts to be given appropriate weight in the decision-making process, alongside other investment drivers.

This means we do not invest in a fund or with a manager that does not have an acceptable environmental approach to its assets. And we channel our capital into paradigm-shifting emissions reduction opportunities, confident that ESG investments can become the new norm.

[3] *Preqin Investor Interviews, November 2019*

It is a model that could be embraced by other ESG investors as we seek to supercharge the emissions impact of our capital.

Impact, Innovation, and Investment

Cleaner, greener homes
CEFC commitment: up to $60mn
New homes built today will be in use for decades to come. We want those homes to have the strongest energy efficiency and deliver the smallest carbon footprint possible. Our first green home loan, delivered via Bank Australia, includes discounted finance for qualifying builders and home buyers.

Big battery gets bigger
CEFC commitment: up to $50mn
The world's largest battery, Hornsdale Power Reserve, is being expanded by 50% to improve grid security and maximize the benefits of renewable energy. The Hornsdale project, which uses Tesla Powerpacks, saved electricity consumers more than $50mn during its first year of operation.

Cleantech leadership
CEFC commitment: $70mn
The CEFC is Australia's largest dedicated 'cleantech' investor, backing innovative technologies and businesses that are critical to carbon reduction. Through the Clean Energy Innovation Fund, our venture capital has helped companies raise more than $200mn of additional investment capital.

Clean Energy Finance Corporation (CEFC)

The Clean Energy Finance Corporation (CEFC) was established to increase investment in Australia's transition to a low-emissions economy. As an ESG investor, the CEFC works alongside fund managers who are aligned to our low emissions goals, encouraging them to preference low-carbon assets and technology solutions.

www.cefc.com.au

Two Key Investor Trends in Australia

Australian private capital has drawn more global investors, while consolidation among superannuation funds has created fresh appetite for direct and co-investments

Since the 2000s, international investors have gradually injected more and more capital into Australia. And their presence in the local private capital market has grown (Fig. 28 Traditionally dominated by local institutions (82%), Australia now has a diverse base of global investors that have been increasing their private capital activity over the past five years.

Of all Australasian private capital markets, infrastructure and natural resources are the most attractive to investors globally. Preqin surveyed investors worldwide in June 2018 and June 2019, and the proportion of respondents that felt Australasia presented the best opportunities in infrastructure ballooned over 6x between each year, reaching 32% in June 2019 (Fig. 29). And for natural resources, the increase was 3.5x to 29% in June 2019. Aside from the draw of Australia's stable economy, both asset classes have strong demand-drivers over the longer term which investors can capitalize on – see pages 28-31 for more information on the attraction of Australian infrastructure and natural resources.

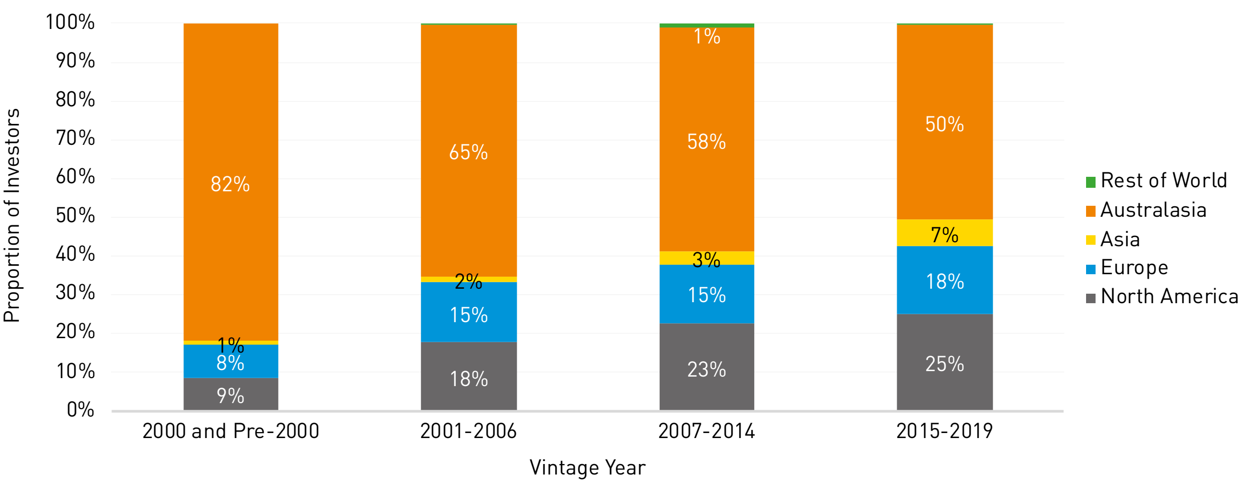
Super Funds: The $2.9tn Opportunity

While global interest in Australian private capital has been rising over the years, domestic institutions such as superannuation funds have remained integral to the market. Preqin tracks close to 300 Australia-based investors, of which superannuation funds make up nearly half (47%) and hold approximately $2.9tn in AUM (Fig. 30).

Australia has one of the most successful pension markets globally[1], primarily because of its competitive institutional model. To improve the performance of smaller superannuation funds and deliver only the best

[1] *Global Pension Assets Study 2020, https://www.thinkingaheadinstitute.org/en/Library/Public/Research-and-Ideas/2020/01/Global-Pension-Asset-Study-2020*

Fig. 28: Active Investors in Australia-Based Funds by Location and Vintage Year



Source: Preqin Pro

benefits for members, the country's financial services regulator – APRA – released in December 2018[2] a list of consultations to strengthen superannuation member outcomes. The consultations were based on the finding that members' benefits are best optimized when a superannuation fund has achieved a sizable amount of AUM.

In the year since, merger activity in the superannuation industry has greatly increased. Several merger announcements were made in 2019. These included a deal[3] between Sunsuper and QSuper which, once completed, will result in a combined superannuation fund with approximately $182bn in AUM. The fund could also potentially rival the nation's largest, AustralianSuper ($188bn). First State Super and VicSuper also announced their merger in December 2019, which will potentially bump their combined funds under management up to $130bn – see pages 39-43 for our interview with First State Super exploring the synergies that have emerged from this.

Growing Interest in Direct and Co-Investment

We have also seen an uptick in alternative investment structures offered to investors. As shown in Fig. 31, the proportion of superannuation funds recording a preference for co-investing has increased considerably over the past three years. Back in 2018[4], Preqin spoke to several superannuation funds that told us that, although co-investments offered reasonable fee structures, they also required significant scale and in-house capability to manage underlying assets. Small and mid-sized funds were therefore unable to conduct the due diligence required for private capital fund investments, much less co-investments. Two years on, as more superannuation funds consolidate and expand their capital base, it has become necessary to shift at least some investment capability in-house.

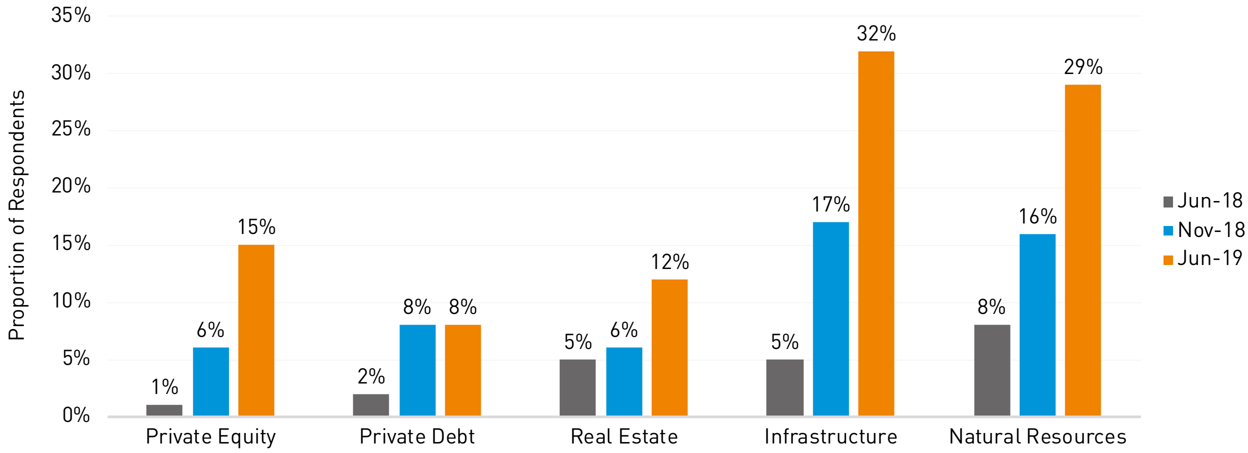
The Role of Private Markets in Supers' Portfolios

Looking more closely at the types of superannuation funds active in Australia, industry funds[5] have a greater propensity to allocate to private markets compared to public sector funds[6]. Industry funds, on average, allocate 9.6% to real estate and 8.1% to infrastructure (compared with 7.9% and 6.8% for public sector funds, Fig. 32). This distinction is likely due to industry funds' strong cash flows and more stable membership base. Representing over a quarter of all superannuation funds' AUM ($768bn), industry funds have a median private market[7] allocation of approximately 18.2%.

We expect to see private markets play a more pivotal role in superannuation funds' investment portfolios going forward. Australia has the fourth-largest pension pool globally. The pension pool has a compound annual growth rate (CAGR) over 10 years of 9.2%[8] (in local currency), which is among the highest globally

[2] *Consultation on proposed changes to strengthen superannuation member outcomes, December 2018, Australian Prudential Regulation Authority*
[3] *QSuper and Sunsuper in merger talks, November 2019, Investment Magazine*
[4] *Australian Superannuation Funds in Alternatives, November 2018, Preqin*
[5] *Industry funds were originally established by trade unions to provide superannuation benefits to employees in the respective industries. These funds are typically non-profit and operate on a members-first ownership model.*
[6] *Public sector funds are superannuation funds created for employees of Federal and State government departments.*
[7] *Private Markets include Private Equity, Real Estate, and Infrastructure.*
[8] *Global Pension Assets Study 2020, Willis Towers Watson*

Fig. 29: Investors that Believe Australasia Presents the Best Opportunities in Private Capital by Asset Class, 2018 - 2019

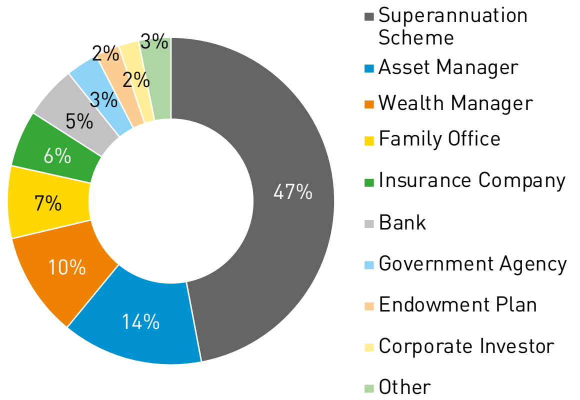


Source: Preqin Investor Interviews, June 2018 - June 2019 and exceeds the global CAGR average of 6.3%. This is principally due to strong population growth[9] expanding the size of the workforce with mandatory contributions to their pensions. Furthermore, given that most superannuation funds in Australia are defined-contribution schemes, these investors generally have the flexibility and patience to target investments with higher-risk/return potential. In this climate of low interest rates, and as more alternative investment structures are offered, superannuation funds are able and likely to deploy more capital across a variety of private capital assets.

These two key trends – increased participation from global institutions and consolidation in the superannuation industry – are shaping the investor universe in Australia. The extensive merger activity among supers will likely result in fewer players with larger capital bases, and as a result, more sophisticated or alternative investment strategies will emerge. We expect the market of the future to be more diverse than ever.

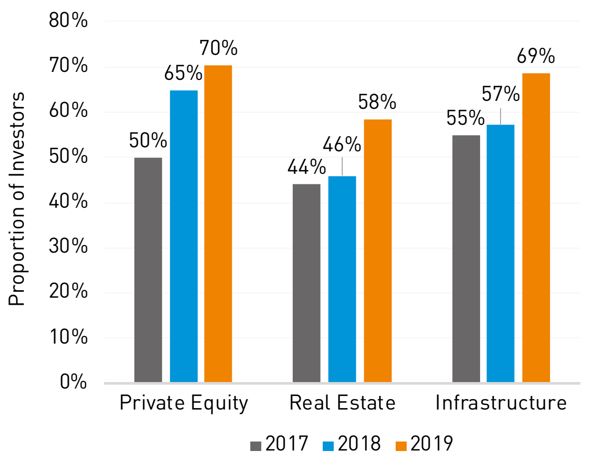
[9] World Bank – Australia's population growth in 2018 was 1.6%, outpacing North America (0.7%), the EU (0.2%), China (0.5%), and India (1.0%). https://data.worldbank.org/indicator/SP.POP.GROW?locations=AU&most_recent_value_desc=true

Fig. 30: Active Australia-Based Investors by Type



Source: Preqin Pro

Fig. 31: Australia-Based Superannuation Funds with a Preference for Co-Investments by Asset Class, 2017 - 2019



Source: Preqin Pro

Fig. 32: Median Current Allocation (As a % of AUM) to Private Markets by Pension Fund Type

	Australia		Global
	Industry Funds*	**Public Sector Funds****	**Global Pension Funds**
Private Equity	2.9	5.0	4.3
Real Estate	9.6	7.9	8.2
Infrastructure	8.1	6.8	2.2

Source: Preqin Pro

**Industry funds were originally established by trade unions to provide superannuation benefits to employees in the respective industries. These funds are typically non-profit and operate on a members-first ownership model.*
***Public sector funds are superannuation funds created for employees of Federal and State government departments.*

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The Evolution of Private Capital in a Super's Portfolio

Declining interest rates, rising geopolitical uncertainty, and slowing global economic growth are key challenges that Australian superannuation funds face

Preqin and the Australian Investment Council asked the investment team at First State Super about the superannuation fund's private capital portfolio. Damien Webb, Liza McDonald, Jenny Newmarch, Mike Cowell, Alek Misev, and Mark Hector share how the fund is positioning its investments amid the regulatory and macroeconomic uncertainty both locally and globally, and discuss the opportunities available for institutional investors.

Damien Webb

Head of Income and Real Assets, First State Super

Liza McDonald

Head of Responsible Investments, First State Super

Several superannuation funds have announced mergers recently, First State Super's merger with VicSuper in December among them. What are the biggest synergies you see coming out of such mergers?

The past 12 months have seen unprecedented merger activity in the Australian superannuation industry. In December 2019, First State Super and VicSuper announced our merger, which will create a fund serving more than 1.1 million members and increase funds under management to more than $130bn. As our industry grows and matures, so too must the superannuation funds that manage the retirement savings of all Australians. The needs and expectations of our members are changing rapidly, and we must ensure our products and services continue to provide our members with the best possible retirement outcomes. To do that, size and scale matter. With mergers come the benefits of greater scale, both in terms of dollars and also team size and sophistication of governance. As a result, we have been increasing our capability to invest directly in opportunities in Australia and the wider region, such as in social infrastructure, land registries, retirement villages, private loans, and private equity.

Direct investments and the broader, more diverse investments enable our fund to better withstand fluctuations in the market, and deliver strong, sustainable, and long-term returns to our members. Through economies of scale, we can drive down costs for members both in terms of administration fees and additional services such as insurance. As a larger entity, we are able to attract and retain some of the best talent, which allows us to deliver innovative products and services to help our members to achieve the retirement they deserve, while also positively impacting our community.

However, not all mergers are equal or make sense. A strong alignment in terms of values and culture, member base and strategic direction – together with a clear focus on whether the financials align from a member perspective – are all critical components of a successful merger.

Macroeconomic uncertainty remains one of the main challenges in today's markets. How will First State Super position its overseas exposure over the coming years to minimize the impact on the Super's portfolio?
Portfolio diversity remains key: as we expand, the role of overseas markets in balancing our portfolio will also grow. As we think about our overseas allocations, we will continue to evolve our approach to listed markets (both passive and active), currency management, and building internal capabilities in both listed and private markets. We will also consider whether having resources overseas, particularly in private markets, is in the best interests of the fund. However, this will be a long-term journey, should we decide to establish offices overseas. As such, working with fund managers on origination, due diligence, and asset management will remain a key component of the strategy for many years to come.

With some supers proposing a 0/10 fee structure and RG97[1] – the obligation to disclose fees and costs in managed investment products – recently being finalized, there is concern about whether the new standard will deliver consistency and transparency. What is First State Super's approach to fees when awarding mandates to fund managers?
We seek value for money and look to demonstrate scale benefits to members. As we grow from $100bn to $200bn, members expect to see a size dividend. As such, when supporting closed-end funds, we expect to be granted co-investment rights to balance the fee load.

We seek flexibility in awarding mandates to fund managers as we grow and are more involved in asset management and governance. For example, we will continue to value origination networks and the fund manager's ability to achieve outcomes in management-intensive business cases.

We have seen fee arrangements reflect the changing nature of and workload required on the underlying assets. And we prefer tiered fee scales to support the growth of the mandate. Performance fees remain a reasonable feature and we have participated in structures that function around achieving operational milestones, i.e. business transformation or EBITDA targets in business cases as opposed to market-based performance alone.

First State Super has developed its own proprietary ESG policy and framework when screening investments. What are the key challenges that investors should prepare for when incorporating ESG into their investment decision-making process?
Integrating an ESG framework into our investment due diligence process has been a focus for us since we joined the UN Principles for Responsible Investment (PRI) in 2008. Our framework is designed to identify ESG risks and opportunities across all direct investments. When appointing fund managers, we consider their individual ESG policies: resources, integration approach, stewardship activities, transparency, and alignment.

So, for an investor looking to integrate ESG, the challenge often is where to start. Focusing on what is fit for your organization's purpose and investment approach is key. Investors should not be afraid to use the tools and resources that are available, such as the PRI's integration guides. There are many ESG factors to consider; the challenge is to focus on what is material to the investment you are considering, so keeping materiality as a reference point can assist.

Another critical challenge is the lack of quality data. While environmental data has improved it is not always consistent or up to date. Investors need to seek data from several sources to get the quality of information that they need. There are also challenges associated with the variety of methodologies used by data providers and rating agencies.

There are significant gaps in social data. To mitigate this, we are working with companies to improve their disclosures particularly in relation to indicators such as modern slavery and supply chains; conduct & culture and safety; diversity and discrimination.

[1] Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements, https://download.asic.gov.au/media/5396837/rg97-published-29-november-2019-updated-4-december-2019.pdf

Jenny Newmarch

Portfolio Manager, Private Equity,
First State Super

Private Equity/Private Debt

In a period of slow global growth, what strategies is First State Super pursuing for its private equity mandate to maintain current returns/insulate its portfolio from external shocks?

Historically, our mantra in private equity is 'manager selection is king.' While we still think this is a critical factor, in the current environment of slow growth and excess capital, we need to think thematically and place as much importance on sectors and markets as we do on manager skill. Our portfolio is predominantly in sector-specialist funds, where we tend to support skilled managers to invest in sectors such as technology, healthcare, and aerospace. We have also been increasing exposure to emerging markets where manager skill is still developing but growth is more abundant.

The local private equity industry raises a significant proportion of its new capital commitments from offshore institutional investors. Do you see a future where local managers will move back to a domestic focus in their fundraising?

We believe there are push and pull factors to this dynamic. The Australian market has always been laggard in private equity allocations through cycles. While a number of local institutions are increasing their private equity targets now, many were slowing investments substantially in the period 2009-2016, which meant that local managers had to look elsewhere to raise capital.

We believe that this dynamic has changed and there is more capital available for local managers in Australia. However, the consolidation of the super fund industry means that many local funds are simply too small for supers. Hence, they need to deploy outside Australia to get meaningful check sizes to work.

Mike Cowell

Acting Portfolio Manager, Credit Income,
First State Super

Given the disintermediation of banks post-GFC, what type of private debt opportunities does First State Super see in both domestic and international markets? And how will the Super fund seek to access such investments – direct lending, co-investments, or via fund managers?

We view the opportunity to invest directly in the loans of Australian and New Zealand companies as a comparative advantage and well suited to the evolution of local capital markets. We recently surpassed the $1bn mark in commitments to 15 direct senior loans including credits such as Harris Farm Markets, Visy Properties, and Healthscope.

Over time, we expect to have at least one-third of the portfolio in direct loans. The other two-thirds will remain invested with fund managers in the overseas traded and private credit markets of corporate, securitized, property, and infrastructure lending. Seeking a consistent, floating-rate income stream is a key return diversifier and an important building block of our future retirement income strategies.

Real Estate

Preqin data shows Australia-based investors' median allocation to real estate has largely remained stagnant since 2015. How does First State Super seek to position its real estate portfolio in the next 3-5 years?

We look to continue investing in real estate over the next 3-5 years with a key focus on our 'build to core' strategy. It will target sustainable new-generation assets that cater to 'tenants of the future' and be resilient through the cycle.

We are also looking to expand our offshore investments from 15% to 40% in order to achieve better portfolio diversity and reduce the concentration risk in Australia. Key focus will be on developed markets with an opportunistic approach to emerging markets.

Another important part of our real estate strategy is to build out our platform investment strategy offshore with a focus on developed markets (US, Europe, and UK) and diversifying away from the traditional sectors (industrial, office, and retail) that are still dominant in our portfolio.

Finally, we plan to undertake direct stakes in listed property stocks in order to: take advantage of a potential price arbitrage in listed vs. unlisted markets, access sectors that are not accessible through the unlisted market, and execute take-private opportunities where possible.

Alek Misev

Portfolio Manager, Property, First State Super

First State Super entered into a joint venture with Lendlease last year to invest in US multi-family properties. What other key real estate sectors are on the radar for the Super fund?

We focus on sectors that will benefit from long-term thematic tailwinds (demographics and technology) such as industrial/logistics, multi-family/affordable housing, repurposed (new-generation) retail, retirement, healthcare, data centers, and other alternative sectors.

The FSS portfolio entered the COVID-19 crisis in good shape. As a business our portfolio asset allocation and our liquidity position is solid. Our underlying private markets portfolio in private equity, infrastructure, property, and credit are demonstrating resilience. While we are being cautious at present and observing conditions, we expect to be a provider of liquidity in the coming months and into the remainder of 2020 and are seeking investment opportunities with attractive pricing.

Mark Hector

Portfolio Manager, Infrastructure and Real Assets, First State Super

Infrastructure/Natural Resources

Infrastructure investments are long term in nature. Factoring liquidity requirements, what is First State Super's approach to allocating between closed and open-ended vehicles?

Our infrastructure focus is on unlisted investments as diversifiers to the listed exposures within the fund. Such unlisted investments are, by their nature, illiquid irrespective of whether they are made in closed or open-ended vehicles or in direct investments (which is our growing focus). We have an overall illiquidity tolerance level for private market investments across various sectors including infrastructure.

Accordingly, we tend not to materially assess closed or open-ended vehicles based on liquidity requirements. So, while open-ended vehicles tend to have more structured liquidity windows compared to closed-end funds, we are comfortable considering selective closed-end vehicles.

We are a long-term investor suited to owning infrastructure assets for long durations and open-ended vehicles can therefore be notionally attractive. But we are not averse to considering appropriate closed-end funds. The decision to support fund vehicles is based on broader factors, such as overall fees and expected returns (including fee-free co-invest rights), manager alignment mechanisms (noting open-ended funds can potentially encourage an accumulation of assets at the expense of optimizing risk/reward for investors), manager skill, and particular geographies/asset classes that complement our direct investment program.

In the current low-yield environment, what type(s) of infrastructure/natural resources investments typically fit into First State Super's risk/return profile? And which regions will you target for such opportunities and to achieve the desired returns?

Our portfolio and pipeline include vanilla infrastructure as well as infrastructure-related investments, together with real assets such as agriculture. We are comfortable managing a range of low- to high-risk investments, provided the overall portfolio stays within risk tolerance levels. This includes managing 'look-through' concentration of common risks across assets.

Real assets provide a desirable diversifier to infrastructure investments, typically uncorrelated in their return drivers. We are able to take long-term macro and strategic views, riding out shorter-term volatility and cycles.

We have found success investing in emerging sub-sectors and infrastructure-related asset classes, such as land registries, to find value for members away from mature sectors. And we are open to investing in Australia and in OECD and emerging markets within defined ranges, providing flexibility across the short and long term to locate optimal risk/reward for members.

First State Super incorporates ESG considerations into all of its investments. We naturally look to make climate-change-friendly infrastructure investments as part of the transition away from fossil fuels.

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