Trilogy

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ANGLE

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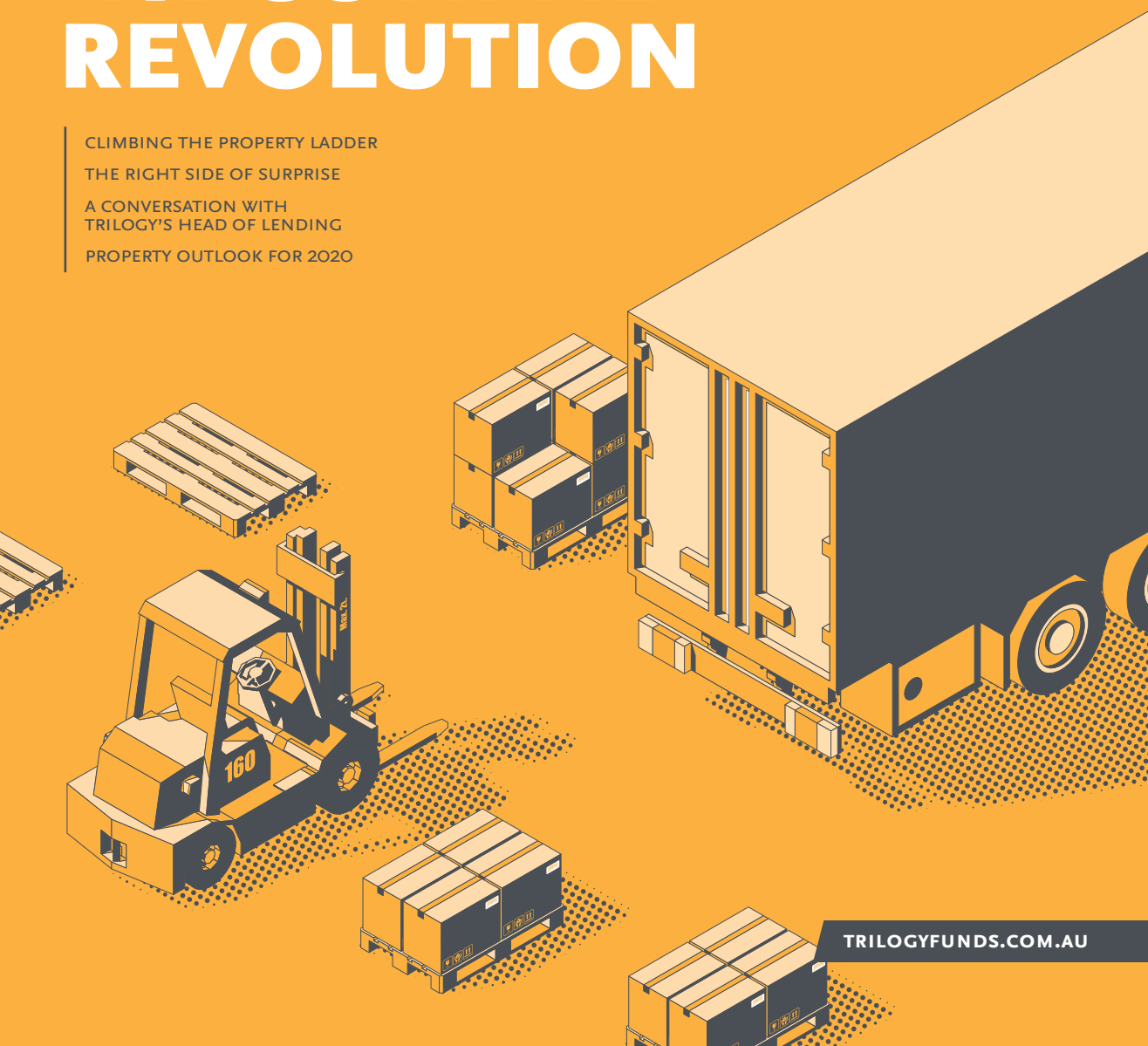
A NEW INDUSTRIAL REVOLUTION



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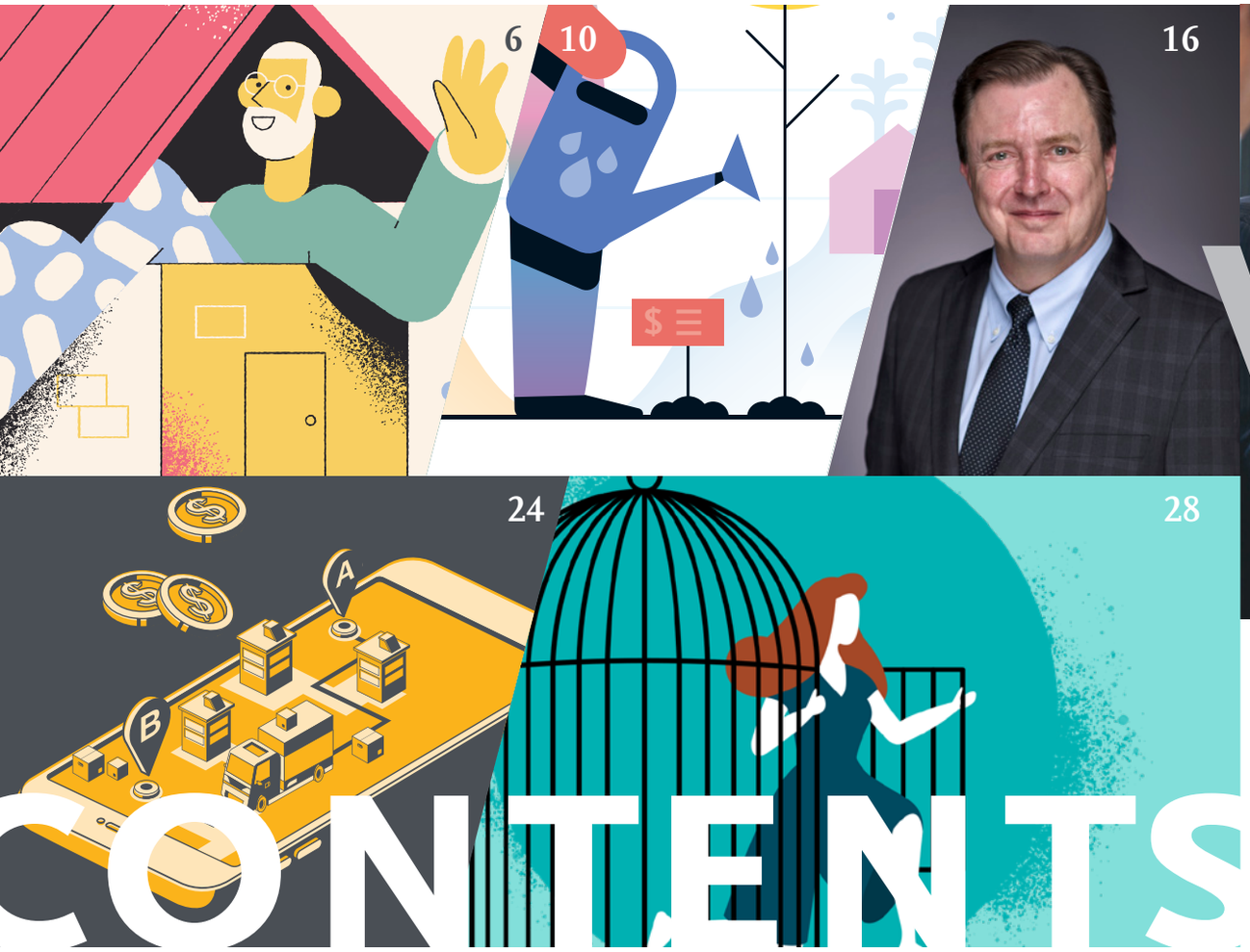

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WELCOME

Welcome to the fourth edition of Angle.

Since our last edition of Angle, the conversation around portfolio diversification remains a strong talking point. In today's market, the desire to diversify for SMSFs in order to generate a competitive income is a growing concern.

Throughout 2019, there's been numerous shifts to encourage first home buyers to take their first step. However, is it too hard to climb the property ladder when the first step seems out of reach?

Since opening our industrial trust in 2018, we've seen strong demand for this asset class. What was once a boring back of house asset has evolved into a new kind of Industrial Revolution. We discuss more on page 24.

We invite you to enjoy this edition of Angle.

If you have any questions or would like to discuss an article in this edition, we welcome your call on 1800 230 099 or email investorrelations@trilogyfunds.com.au.

I hope you enjoy the read.

Philip Ryan
Managing Director
Trilogy

Despite popular opinion, your first step doesn't have to be a giant leap. Millenials may be able to get a foot in the door while avoiding the fright of the property ladder.

It appeared everyone caught the fever as prices initially crept, then leapt, closer towards 2017 record levels at the end of 2019. First homebuyers seemed to lead the charge, with the data showing they started coming back to buy in droves from the middle of 2019.

With so much wealth tied up in Australian housing, it seems like a practical choice for young Australians to start looking to climb the property ladder and build wealth.

However, buying a house doesn't have to be the first step. What's more, other types of "set and forget" strategies may be more rewarding from a financial point of view.

While the Morrison Government detailed its first homebuyers' policy, in the 2019/2020 Budget the Reserve Bank of Australia executed a succession of rate cuts to stimulate the economy again.

The public sector is wrestling with the private sector, claiming employers aren't doing enough to boost wages, employment and consumption, and the central bank is pointing its fingers at the public sector for being too slow to move forward with fiscal stimulus and policy reform.

Talk, as they say, is cheap. But the figures speak for themselves.

As the Federal Government was putting the wheels on the First Home Loan Deposit Scheme (FHLDS), the median house price in Sydney, as an example, rose to $875,000 over the June quarter. A first homebuyers' scheme was first announced as a pre-election sweetener back in May. It looked geared towards encouraging first home buyers to take the first step. Since the Federal Election, according to SQM Research, sale prices are up by over 6 per cent.

However, Pete Wargent, co-founder and CEO of AllenWargent property advisory, doesn't see the introduction of the FHLDS on 1 January 2020 as a market-changing move. It may make a difference "at the margin", even more so geographically speaking, but it will have little impact on the central group of first homebuyers.

"There's 110,000 first homebuyers in a typical year and the scheme is capped at 10,000 so it won't necessarily be a big deal," Wargent tells Trilogy.

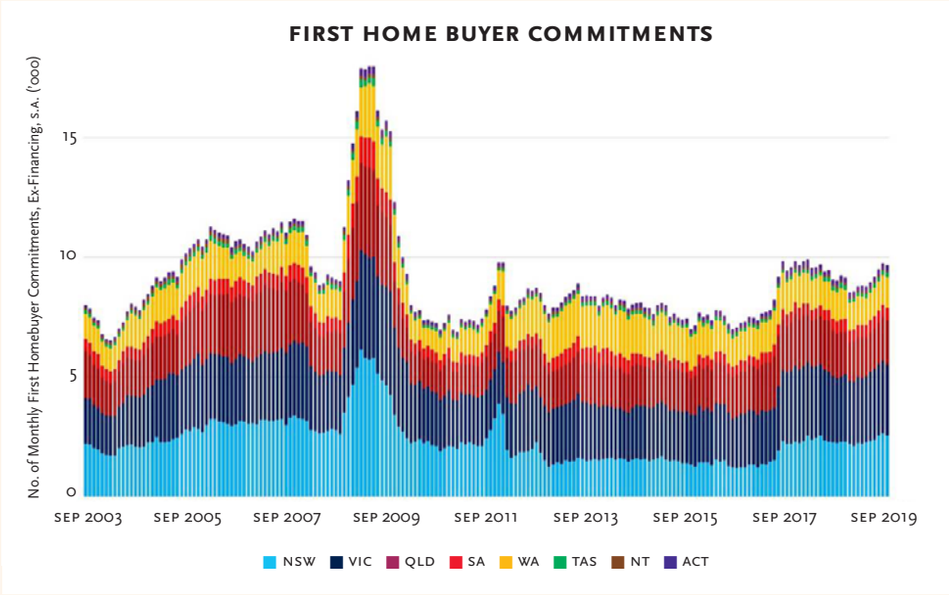
"However, I said that publicly when the scheme was announced, and within probably two hours, the government made an announcement that if the scheme was fully subscribed, they could extend the cap. So there's a big unknown if it's oversubscribed and to what extent it could be extended."

In any case, Wargent says the scheme has more potency through regional Australia and the apartment market, not the detached housing market in our major capital cities.

With the FHLDS, first homebuyers only need a 5 per cent deposit. The Government, rather than the famous bank of mum and dad, then guarantees the remaining 15 per cent.

It sounds appealing, based on the deposit and candidate thresholds. First homebuyers can tap into a limited scheme for a low upfront cost.

However, the FHLDS can only be used to purchase properties up to $700,000 in Sydney, and in Melbourne, up to $600,000. In Brisbane and other large regional centres in Queensland,



SOURCE: ABS

Talk, as they say, is cheap.

But the figures speak for themselves.

for instance, the scheme extends to properties up to $475,000. First homebuyers in South Australia must contend with the lowest price cap of them all at $400,000 while outside of Adelaide and other large SA regional centres, the scheme extends to properties only worth up to $250,000.

Those figures alone though, don't show where the scheme will get first homebuyers the most 'bang for their buck'. After all, the arbitrary Sydney price cap is well below the city's median house price, while the regional SA cap may be more in line. (The SA Government indicated a $265,000 median house price in non-metro major towns for the September 2019 quarter.)

Wargent points out that first homebuyers in November 2019 were making up towards 30 per cent of home loans, citing stamp duty changes in NSW and Victoria, interest rate cuts and the election as key drivers. The ACT also introduced a first homebuyer stamp duty concession relief on July 1, which Louis Christopher from SQM Research adds may explain the soft demand numbers just prior to this period.

People will wait for concessions, but only if concessions make a material difference.

First homebuyer demand is growing, with the chart above telling that story, but that doesn't mean the FHLDS could, or even should, meet that demand.

"Government interventions just create new distortions, especially when you have arbitrary price caps where people are more inclined to bid up to a certain level and it just solves one problem by creating another," says Wargent.

"Quite often when we have seen first homebuyers grants in the past, the benefit goes to the vendors, not the buyers. It's kind of a quick fix solution."

Independent property advisor Monique Sasson is concerned about the message the policy sends to young Australians.

Sasson is an independent property advisor. In 1995, she co-founded Wakelin Property Advisory where she remained as managing director for 20 years. In Sasson's own words, she has gained a reputation for being "constructively controversial".

She's worried the FHLDS is too controversial for its own good. Sasson believes the scheme encourages first homebuyers to focus on borrowing at the expense of developing savings habits.

"The psychological notion of encouraging people to borrow, not save, concerns me a lot," explains Sasson.

"A policy like this seems very high risk especially coupled with interest rate drops over consecutive months. It was flagged during a soft and sustainable downturn, a downturn that was completely in order."

"We can't scream about affordability then in the same breath scream about the fact the property market is falling. I think there's a lack of responsibility in housing policy when we turn to things like artificial stimulus."

Government intervention can work, such as the case of the UK in recent years, but in the mid-2000s in the US it had the opposite effect.

Sassoon also thinks there's elevated risk because first homebuyers often don't have an equity buffer. Despite the initial proposed cap at 10,000 borrowers, in combinations of couples or singles earning up to certain amounts, Sassoon thinks push-pull factors could place the scheme among the riskiest of any previously introduced in Australia.

Others are more optimistic.

"Would they be buying at the top of the market?" Louis Christopher questions, "It depends which city we're talking about. Sydney and Melbourne we're forecasting some big price rises next year. They would be buying into a very strong market next year."

Christopher goes on to say this Sydney and Melbourne boom "is very likely to be one that will not last as long nor record such magnitude of gains of the 2013 to 2017 boom".

"For starters, Sydney and Melbourne have bottomed out at an overvalued point on our measurements. This will stretch those who are buying into this new cycle like never before.

"It is likely the new upswing will end in the same way the last boom ended – with APRA placing additional lending restrictions on the market."

For perspective, says Christopher, Sydney house prices to nominal GDP are currently overvalued by 21 per cent.

"And for now, Sydney dwelling prices could go a lot higher. We think there is at least a year in this new upturn. Maybe more, but we don't think it will last as long as the last recovery (2013 to 2017). No, it's likely to just be a two-year recovery than five."

Melbourne is buoyed by even stronger population growth than Sydney. Since 2012, the city has grown by one million people, with five million people now calling Melbourne home. These days, it's the big smoke, not the home among the gum trees, capturing the hearts of most young Australians.

It's important to consider the impact of a first homebuyer firecracker at the macroeconomic level. And of course, whether the FHLDS is worth taking up at the microeconomic level is another question altogether.

It's hard to climb the property ladder when the first step seems out of reach.

There are other lesser-known steps that young Australians can take to reach their financial goals. Trilogy Enhanced Cash may be suitable for younger investors depending on their individual situation. Trilogy Enhanced Cash is a cash-style product with approximately 30 per cent exposure to the Trilogy Monthly Income Trust, a pooled mortgage fund.

SMART INVESTORS UNDERSTAND THAT A CASH ONLY INVESTMENT PORTFOLIO WON'T GET THEM VERY FAR. HOWEVER, HOLDING CASH ALONG WITH OTHER VARIATIONS OF FIXED INTEREST INVESTMENTS, PROPERTY AND SHARES MAY BETTER ROUND OUT THEIR PORTFOLIO.

As if self-managed super funds (SMSFs) hadn't been under the spotlight enough in recent years, now they're facing a new hurdle – the "lower for longer" dilemma.

LOWER FOR LONGER IS A REAL DILEMMA.

BUT IN LIFE, AND MARKETS, THERE'S ALWAYS AN ELEMENT OF SURPRISE. HERE'S HOW TO STAY ON THE RIGHT SIDE OF SURPRISE.

We're talking interest rates. The pressing question is how low can Philip Lowe, the Reserve Bank of Australia Governor, actually go in lowering the cash rate.

The great cash rate debate is heating up. It's hard not to focus on the problem at hand – that is, a slowing global economy – but the possible solutions to generate competitive income in this environment.

As such, the SMSF movement has been losing fans, according to statistics produced by the Australian Prudential Regulation Authority (APRA).

SMSFs grew funds under management by just 1.65 per cent in the last financial year. Retail funds fared even worse, growing business by only 0.5 per cent. That was during a year when industry funds increased funds under management by more than 13.8 per cent.

The number of SMSFs in Australia increased from 583,853 to 599,679 over that same period, a rise of just 2.7 per cent. That's much slower than the average growth for the last decade for the sector.

What happened to the super darling that once was?

Perhaps more investors tossed super in the 'too hard basket' after the Royal Commission. With so many red flags raised across the industry, and more regulation and red tape, wealth management is now harder to navigate for those unadvised.

Two hours a week is reportedly what it takes to keep on top of an SMSF. That's according to the SMSF Association. The peak body landed on that figure after sponsoring a survey that canvassed trustees and would-be trustees earlier this year.

In percentage terms, that's a little more than one per cent of the week. Less time than that possibly spent watching Stan or Netflix. Maybe slightly less enjoyable, but certainly a more productive use of time.

Now, let's ask that classic question. Besides Stan and Netflix, what keeps SMSF trustees up at night?

Topping the list, coming in at 27 per cent, was keeping on top of changes in rules of regulations. That was closely followed by choosing investments, at 26 per cent. The impact of regulatory changes (21 per cent), paperwork and administration (18 per cent), and understanding changes to rules and regulations (18 per cent) all ranked highly in terms of concerns too.

With all this in mind, we're seeing more cases of 'analysis paralysis'. SMSFs held $171 billion of cash as at March 2019, out of a total of $747 billion in assets. That's nearly 23 per cent of fund assets in cash. With cash earning very little, some of this allocation may not be attributable to choice. It's simply too big a basket of cash to put it down to that.

Often, investing is illustrated as a basket of goods. Rather than make you hungry, it's supposed to encourage you to diversify your investments. If you make a trip to the supermarket, you probably won't leave with bags of potatoes alone, even if you're making a potato salad. You get a mix of ingredients. Cash, like potatoes, is only one ingredient in an investment portfolio.

IN A LOWER-FOR-LONGER WORLD, THE BEST SMSF TRUSTEES CAN DO, IS REMEMBER WHY THEY STARTED THE JOURNEY IN THE FIRST PLACE.

THE DESIRE TO DIVERSIFY.

DIVERSIFICATION IS YOUR BEST CHANCE AT CATCHING SURPRISE UPSIDE AND MANAGING EXPECTED DOWNSIDE.

Shares, as the saying goes, do help you eat. However, shares alone don't make for a balanced diet either. A healthy, balanced portfolio is a mix of different investments.

Diversification has historically been cited as a key reason for opening up an SMSF. What's most interesting, and prior statistics provide a solid prelude into this, is that SMSFs are currently no more diversified than industry or retail funds.

APRA regulates industry, retail, corporate and public sector super funds, while the Australian Tax Office regulates SMSFs. Through this we know that APRA funds are more heavily invested in overseas equities, whereas SMSFs have a marginal, albeit real, bent towards Australian equities.

As we said before, in the post-Royal Commission world, SMSFs are more caught up in reporting and regulation than ever before. Investors are more time-poor, with less capacity to scour the market for opportunities. As a result, there's a chance some are over-indexing on high-visibility investments, such as passive ETFs, blue-chip shares and cash. Holding the ASX 20 doesn't make for a diversified portfolio, only diversification across a single asset class. Neither does investing in a fund that tracks the US stock market, despite its many industries, sectors and sub-sectors.

Here's the thing. If the Reserve Bank of Australia and other central bankers are correct, this 'lower for longer' cash rate environment is the precursor to low-growth era. In these times, it's important to be the right mix of diversified and the right kind of defensive.

SMSFs still represent the biggest individual sector in the super landscape, with a total of $747.6 billion invested, followed by industry funds with $718.7 billion. Retail funds come in third with $625.7 billion. That's a lot of power to the people, should the people know where to direct their efforts.

Smart investors understand that a cash only investment portfolio won't get them very far. However, holding cash along with fixed interest investments, property and shares may better round out a portfolio. We offer Trilogy Enhanced Cash, a fund that aims to set investors up to do just that.

Approximately 70 per cent is invested in cash and cash-style products, and the remainder in the Trilogy Monthly Income Trust.

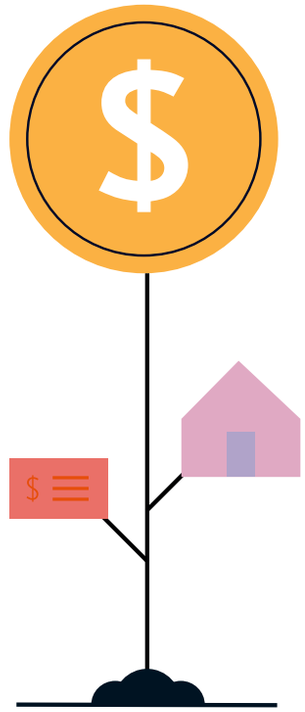
There are solutions to the 'lower for longer' problem, sometimes found in places investors are least likely to look.

Again, take last financial year as an example, when term deposits were generating record-low returns as other fixed interest investments produced double digits.

Across the 2019 financial year, bond sector returns ranged from 6.5 per cent to 10.3 per cent, from government bonds, Australian and international fixed interest, and corporate debt. Again, these strong returns came from an asset class considered the next 'safest' to cash. This was the right kind of defensive.

Just like investment downside, this example highlights that upside can equally catch investors, well, offside.

In a lower-for-longer world, the best SMSF trustees can do is remember why they started the journey in the first place. The desire to diversify. Diversification is your best chance at catching surprise upside and managing expected downside. A



A conversation with

Clinton Arentz

If there's a quality site to develop or opportunity to lend, you can count on Clinton Arentz to be there going through the details with a fine-tooth comb.

Clinton is the head of lending and property development at Trilogy. He has a wealth of experience across Queensland, New South Wales and even the Northern Territory. While time has been kind, Clinton got his start in the property industry more than 30 years ago.

Clinton began his journey at a critical juncture for Australian property. Soon after starting at Jones Lang La Salle in 1988, the market turned for the worse. It was the 1989 downturn. The downturn loomed large over Melbourne for several years, or close to a decade, while Sydney and Perth felt a short, sharp pinch. Clinton was based in Brisbane, which he still calls home today, and cushioned from the worst of the blow yet close enough to the impact zone to learn the hard lessons of market cycles. Clinton showed resolve through these tough years to progress quickly up the ranks before moving on to run Winston Group.

Trilogy welcomed Clinton into the family in 2017. He brings a diverse skillset that ranges from start to finish project delivery in residential, commercial and industrial, as well as urban renewal and infill. From a logistics facility in Adelaide, to a medium density apartment block in Brisbane, Clinton knows how to structure deals in a way that delivers the best result to investors, at any time in the market cycle.

Trilogy prides itself on looking outside of its hometown and sourcing opportunities all around Australia. Can you tell our readers more about the areas we currently have exposure to?

We operate in Queensland, New South Wales and Victoria, with dedicated portfolio managers in each of those capital cities. Primarily, we are lenders on construction projects as opposed to long-term investments or projects for domestic purposes. Each of our borrowers must be a

corporate entity, and the project must be one that can be built and leased and/or sold, so there must be a clearly identified exit strategy. We are spread neatly between those three states right now.

We've been strong in Queensland for the last 22 years, active in New South Wales for the last 10 years and developed a focus in Melbourne over the last year or so. Both the Sydney and Melbourne markets are growing exponentially for us at the moment because we are coming off a lower market share base. In Queensland we are a relatively dominant player both in market share and construction funding.

What kinds of projects are piquing your interest within these regions?

We tend to limit our projects to small-to-medium sized projects, up to $25-30 million in value, so that could be land subdivision projects or apartment projects up to 40-50 units in size. We stay away from long-term construction projects and apartment towers. That low-rise focus means we mitigate the type of risk we've seen arise in construction in markets such as Sydney recently. We're also liking middle-ring suburbs, so infill projects in existing or established residential areas, perhaps areas where land use patterns are changing or redundant buildings making way for new buildings. We tend to do a lot more of that on the fringe of the city.

There has clearly been a shift in development financing in Australia over the last couple of years. Bank funding has dried up for some developers, with the banks finding their hands tied in more situations than before. As a lender, what does due diligence look like to you, and how do you stress test?

We employ experts with general market awareness as well as specialised understanding about the nuances of individual markets. I have a heavy construction delivery focus and development background and I'm supported by a team of people who are ex-bankers, ex-valuers and ex-surveyors, so all of our skill sets are contingent on development, construction and lending. Each and every property is taken on its own merit, on a case-by-case basis. We do a SWOT analysis (strengths, weaknesses, opportunities, threats) for each project with a range of criterion built up from our past experiences.

One impotant point is, we only lend on a registered first mortgage basis, so our funds are relatively secure in that sense. And we usually only lend to about two-thirds, but no more than 70 per cent, of the valuation of the end project. That is the independent gross realisable value of the project estimated at commencement, and prior to us writing our loan, rather than after the project has commenced, although updated valuations may be required from time to time. There's already an equity buffer in there from the borrower's perspective, and, our position is secure on a registered first mortgage basis. We work quite closely with the borrower, have them report their progress monthly, as well as an independent quantity surveyor reviewing cost claims should we need any of the costs for construction claim payments. Everything is checked on a cost to complete basis so we know there are sufficient funds still held in the loan account to service the ongoing construction job through to completion.

How do you feel about the current market environment, given record-low interest rates and uncertainty across the board? Have you experienced anything like this before?

The market travels in cycles, and in saying that, there will always be another cycle around the corner. But this one is a little different to past cycles as we have seen a downward trend globally in interest rates, and of course, Australia included. An interesting thing, the interest rate market is very benign now, which helps developers save money on interest they can otherwise invest into project finishes, marketing and other business improvements. It's a good thing that we don't have the high interest rate environment we had in the past. Often what has upset property markets in previous cycles was rising interest rates, so arguably here, with falling interest rates, or a relatively flat yield curve, home loan affordability has been increased and a wide range of projects stack up. In that sense, the trend in the current cycle is quite virtuous. We're constantly alert on a broader level as to how markets are shifting around the world. Australia is arguably in a really good place. It has held up well over the last 20-30 years and we believe it will continue to do so going forward.

As you have mentioned, there are several push-pull factors at play here, and they aren't all of equal weight. How optimistic are you about the near-term outlook?

We are very optimistic going forward as a lot of the adjustments have already been made. For example, we saw a lot of adjustments coming out of the Hayne Royal Commission around type of practice and bank lending standards. It did precipitate a slowdown, and we saw that in Sydney and Melbourne at the beginning of 2019, but it was probably a healthy adjustment because the markets were a bit toppy. Brisbane, on the other hand, has experienced a relatively flat market cycle over the last 10-15 years.

There's positive population flows into all three of those cities as well as significant infrastructure investment. Brisbane is seeing a doubling of airport capacity, and with Queen's Wharf and Howard Smith Wharves, the Cross River Rail too, you have some fairly major projects in south east Queensland and this continues to drive growth. In Sydney you have a whole new airport being built at Badgerys Creek, so that's opening up entire new areas and land releases in Sydney for more affordable housing, and the big problem in Sydney has been affordability. And we are seeing similar in Melbourne as well. There is an enormous amount of regional development. There are always pockets for us to explore.

Queensland has been a great state but it hasn't gone through the big cycles of strong capital growth like its southern neighbours so it's really had to grow the hard way. At Trilogy, we only expanded into Sydney and Melbourne once we built sufficient scale in Brisbane where most of our back of house operations are based.

Trilogy's advantage from a lending perspective is speed to market. A borrower can approach us with a properly made submission and can expect an offer 24-48 hours after. That's very quick compared to the banks, which may take some time. The banks have stepped away from that space, and of course, we've always been in that space, so that just gives us the opportunity to grow market share further in a positive way.

Looking to 2020, we can't claim to have 20/20 vision, but the clouds seem to have cleared.

The future looks brighter than the recent past. At least that's the word on the street, from Australian main streets to high streets, up the office towers, and everywhere in between.

Many investors tiptoed into 2019, carefully treading on uncertain ground. Market pricing suggested Labor would win the Federal Election come May 2019 as the Coalition kept losing steam. Meanwhile, the big banks looked shaky as they geared up for a Royal Commission. The Australian Prudential Regulation Authority's (APRA) was being credited as orchestrating a "soft landing" for the housing market through introducing macro-prudential measures to curb lending.

The year that was

A Labor Government would have meant changes to franking credits and capital gains tax, having implications on both the property and share markets, respectively. Investors waited in anticipation. Volatility prevailed.

One only needs to glance at the performance of the ASX 200 over the course of 2018 to understand this truly was a year of two halves. As Wall Street was making new record highs, a little over 12 months ago the ASX started to come undone.

It looked like a late-cycle bull market, with few market strategists going into 2019 saying anything different. However, unlike other late-cycle markets around the world, Australia seemed to have fewer attractive pockets left. While not classified as defensive, financial services are expected to hold up better through the end stages of a bull market.

Add a fragile Australian property market to the mix, which accounts for almost 70 per cent of household wealth, and a shadow loomed large over 2019 on the investment front.

By the second quarter of 2019, Sydney and Melbourne house prices had capped double-digit falls for the year. Prices were back to mid-2016 levels in both cities, and about 20-25 per cent off their levels seen five years before in 2014.

From the September 2017 peak, national house prices were down nearly 10 per cent. Beyond the nervousness in the air, investors found their hands tied when it came to purchasing property as banks were forced to tighten lending criteria.

Trilogy managing director Phillip Ryan says business confidence and GDP growth reflects just how tough that period was.

Then the clouds started to clear.

The Federal Coalition stayed in power. Against the odds of market strategists, global markets continued their upward trajectory. Having prepared for the worst, the big banks emerged from the Royal Commission better than expected. Sydney and Melbourne led the housing market recovery. After sitting on its hands for a record-long stretch, the Reserve Bank of Australia started a rate-cutting cycle.

While risks remain, and global affairs always hang overhead, there's a sense that 2020 is starting in a better way than 2019. Particularly for the property market.

On the home stretch, heading into the final quarter of 2019, credit ratings agency Moody's published a report with its near-term outlook for the property market. Here, A-REITs are used to gauge the health of the property market.

Moody's claimed strong performance in the office and industrial segments were partially offsetting weaker conditions in the retail and residential segments. This was supporting the overall credit profiles of Moody's rated A-REITs.

While weakness in the residential segment may level out on the back of supportive changes to lending and interest rate cuts, the strength in office was starting to face headwinds from increasing supply and slowing demand, claimed Moody's.

In terms of credit metrics, financial leverage decreased across rated A-REIT portfolios, largely reflecting temporary debt reductions from the proceeds of large equity issuances and asset sales by several rated issuers. Moody's expected that net debt and leverage will increase over the next 12-18 months as these proceeds are eventually deployed to fund growth. That's across the board.

Going further, office conditions are expected to weaken post-2020 on a new wave of supply, a weaker macroeconomic backdrop and lower business confidence. Residential is stabilising, if not recovering, but sales volumes are still yet to pick up materially despite increasing enquiries and auction clearance rates following a series of rate cuts. Meanwhile, retail remains under pressure on cyclical factors including weakness in consumer sentiment and the structural trend of a shift to ecommerce.

On that note, one sector is left to round out the four, and many market strategists now see it as top shelf to them all.

Trilogy's managing director Philip Ryan regards interest rates as a key driver.

"At the end of the day industrial doesn't return the same rate as commercial in rate per square metre, but if the land cost is relatively low and the build cost, given most industrial assets are sheds one way or another, things start checking out," says Philip.

A new Industrial Revolution seems to be here, with industrial property attracting more attention than it ever has before. In an ever-changing world, retail's problems could become industrial's opportunities.

Through the lens of A-REITs once again, Moody's sees the desire to increase weighting to industrial as coming at the expense of retail. However, going forward, this may be difficult to achieve given limited transactions and availability of well-located land in the middle rings of our capital cities. In Sydney and Melbourne, industrial supply is simply struggling to keep up with demand.

There's a view that industrial occupancy will remain at high levels with improving net operating income (NOI) growth. This metric fast picked up speed over the last financial year, with like-for-like NOI growth increasing 4 per cent, versus 3.1 per cent the year prior.

Given the delicate nature of supply and demand, just like we saw with residential at the top of the housing boom in Sydney and Melbourne, industrial could then become a renter's paradise. That would ring the alarm on income focussed fund managers. This is why selecting a quality fund manager is critical.

Here come the words of caution. A push to increase weighting to the industrial sector could lead to developers building, and investors acquiring, more cyclical secondary assets.

"Occupancy remained high, but declined slightly to 97.3 per cent (versus 98.1 per cent last year). We expect steady demand to keep occupancy near current levels," said the Moody's team.

"Increasing willingness to develop on a speculative basis, given strong demand, may cause volatility in occupancy levels."

As touched on earlier, the challenge for property markets does not seem to be a cyclical correction, but adjusting to long-term structural shifts. Technological disruption is quite literally changing the face of property markets. Warehouses and distribution centres have replaced shopping malls in investor hearts and minds.

Considering the sliding dollar, Australian commercial property should be more attractive on a global currency basis, but as Philip notes, something is getting in the way.

"Ordinarily with the lower dollar you would start to see international interest, but there's a lot weighing against foreign ownership at the moment, particularly in terms of legislation," says Philip.

"One of the things the government has moved in Queensland is doubling the land tax for foreign owners. It gets to a point where people are persuaded against buying. Don't forget, the world is such a place these days where people will look elsewhere. We are spoilt by choice."

With greater access to capital, prices have been rising higher. This is a new normal, believes Philip, though we're only just settling in.

He takes a leaf out of Reserve Bank of Australia governor Philip Lowe's book. We may not be looking at a few years of low rates, but a few decades.

"My view has always been, having grown up in high inflation/high interest times, is that rates are only lower for a short period of time. If the new norm is a cash rate of effectively zero, people will start living off capital, not interest.

"You will have a lot of capital chasing assets so over time yields will get chased down. It just makes no sense to me for the risk premium to be so high in industrial. We are going to see compression as rates continue to decline. In fact, I really think one of the big issues going forward is finding assets. It's incredible at the moment to find assets still providing this rate of return.

"When you look at times of the past, there has always been a correlation of industrial property yields and official cash rate to a degree, more in the order of 3-4 per cent rather than 7 per cent.

"It's an extraordinary turn of events from time's past." AI

A new Industrial Revolution seems to be here, with industrial property attracting more attention than it ever has before.

In an ever-changing world, retail's problems could become industrial's opportunities.

A NEW INDUSTRIAL REVOLUTION

INDUSTRIAL PROPERTY WAS ONCE A BORING BACK OF HOUSE ASSET.

It got the job done, didn't ask for much in return – nor did it provide much in returns – and mostly stayed out of the spotlight. Slowly, but surely, the world started to change. Industry shifted. Property prices climbed, ecommerce took over from physical retail, and the new world required more research and development, more data centres, and fundamentally, more space to build the future. This is a new kind of Industrial Revolution.

As an asset class, industrial property covers refrigeration facilities, data centres, research and development buildings, showrooms, and of course, warehouse, distribution and manufacturing facilities too.

In a report summing up the 2019 financial year, credit ratings agency Moody's noted the operating environment for retail and residential remained weak, but office and industrial continued to support A-REIT credit profiles.

When it came to industrial, Moody's had observed continued strong tenant and investor demand along the east coast. Moody's also noted a plan for A-REITs to increase weighting to the sector over the next 2-3 years based on e-commerce, infrastructure and population growth.

At the top end of town, Mirvac and Stockland are both focused on increasing allocations to the industrial sector. Dexus, which traditionally had an office bent, is actively trying to boost its industrial development pipeline too.

At Trilogy we launched a new industrial property trust in early 2018, with the aim to diversify across at least 10, preferably 20, different properties. In terms of returns, the goal is to provide a competitive yield with potential capital gains.

Managing director, Philip Ryan, believes the target return is within reach because of Trilogy's top-down approach.

"We look at areas and geographies we want to invest in first and have a pretty broad philosophy about what goes into industrial," says Philip.

"We like the idea where we can value-add to tenants, spot an opportunity that might have some vacant land adjacent, and might present some upside where we can do something for the tenant such as upgrading facilities."

Philip says the beauty of industrial property is tenants are typically locked into longer-term leases. This aligns with the income-first philosophy of Trilogy.

From Queensland to South Australia, Philip believes the industrial opportunity is ripe for the picking.

"Mackay suffered through the mining downturn but is now seeing a resurgence through increased commodity prices, so you are seeing interest in a town that was hammered, particularly in the residential space," says Philip.

"We bought in there a few years ago at what we think was a great time in the mining cycle. Overall though, the goal is to have exposure to all things industrial rather than just mining, so we have some insulation from sectors having their time in the sun and then others that may be floundering.

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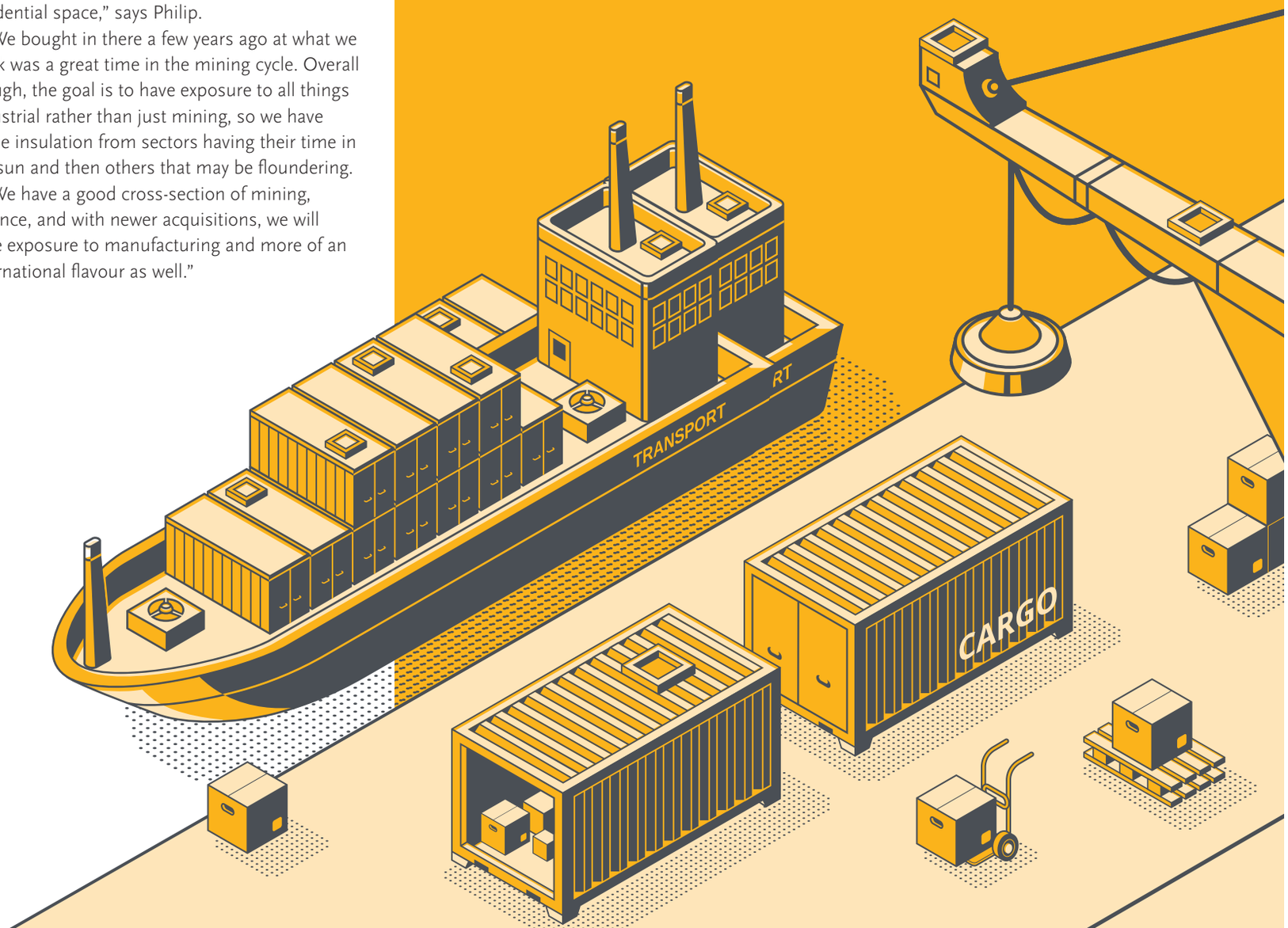


NOT A MANUFACTURED OPPORTUNITY

With so many use cases, industrial property is hard to pinpoint as an asset class. Industrial traditionally kept a defensive profile. As an asset class, it has historically benefitted from a risk-off trading environment, but these days its profile is becoming more mixed.

Philip describes capital appreciation as "simply a bonus" for industrial property, although he realises some investors are now placing a greater emphasis on capital growth.

There are plenty of reasons industrial property is a hot sector. Some of these reasons tie back to the Australian climate in general.

It goes without saying, industrial property benefits from imports and exports, which the Australian economy is reliant upon.

Amid the tension of the US-China trade war, and the fact Australia may be caught in the middle, our progress with free trade seems to be forgotten. We have announced more than 10 free trade agreements since 2000, far greater than most other nations.

Whether onshore or offshore, manufacturing forms a critical part of the industrial property story.

Manufacturing, as measured by Purchasing Managers Indices (PMIs), started slowing around the world at the beginning of 2019. Some consider this a leading indicator for the global economy. Manufacturing is a relatively small part of most developed nation economies, but it has multiplier effects.

However, Australia benefits from looking to the US, and at the same time, non-manufacturing data in the US remained strong, with copper prices holding too. Copper is a widely trusted barometer for economic growth.

This suggests the manufacturing slowdown may be a trade-weighted blip on the radar, stemming from US-China relations. News events tend to distract from long-term narratives.

THE CHANGING RETAIL OPPORTUNITY

Ecommerce is a major driver of the industrial trend. Despite Australia leading the way with fast fashion online retailers, ecommerce still hasn't penetrated middle Australia or the convenience sector.

For perspective, in terms of how much Australians spend online compared to physical retail, we're currently about half that of the US. If Australia does follow their lead, we will have close to 10 per cent online sales within the next five years. That could translate to significant growth for the industrial sector.

Beyond purchasing ecommerce facilities, this represents a unique opportunity for redevelopment too.

More retailers will require industrial assets to be retrofitted in a specific way to allocate space for returns and reprocessing. That looks different to a traditional warehouse. Add automation to the mix, as retailers and third-party logistics providers increasingly are, and the shed is transformed into a state-of-the-art facility.

Malcom Tyson, Head of Industrial at Colliers International, says this is interesting, considering the trend away from specialisation over the last 15 years.

Manufacturing moving offshore meant a move to stock-standard retrofitting, where a tenant could leave one day for another to move in the next. This smoothed out volatility in the asset class due to more stability from a cashflow perspective.

"Investors now really need to get into the latest generation facilities, which can cater for ecommerce, that are slightly larger and have enhancements to their design that allow for high volumes of trucks coming and going," says Tyson.

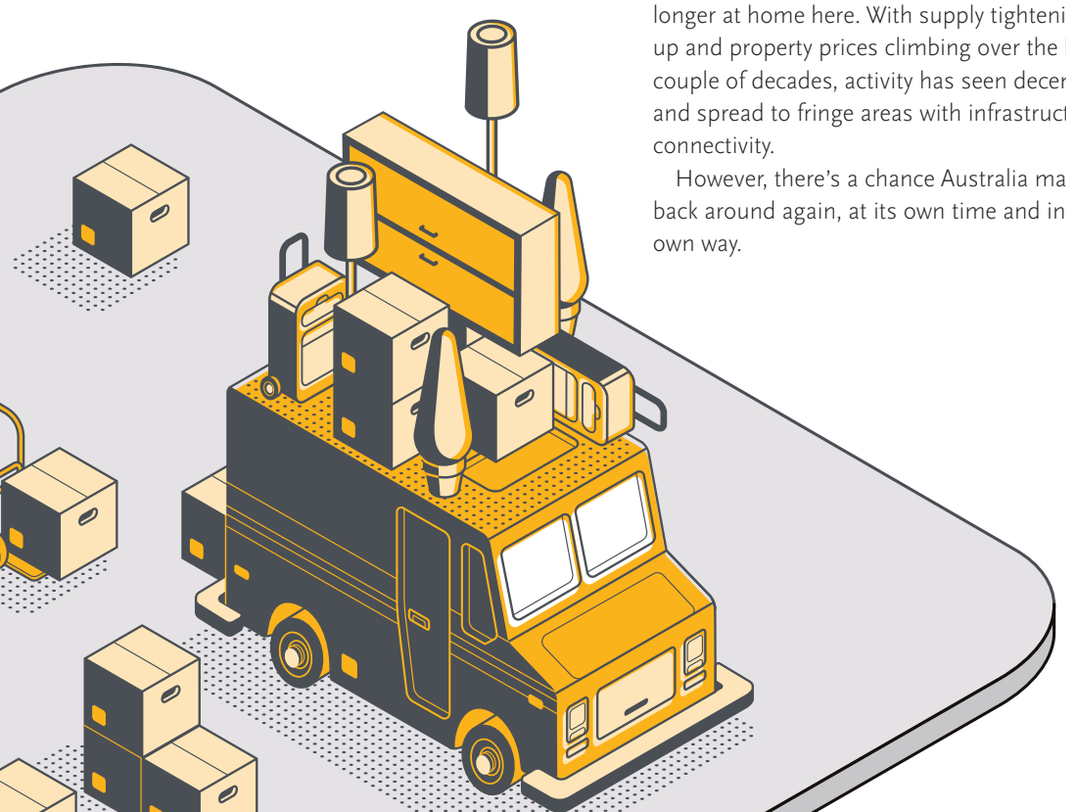
"The other opportunity here, a lot of these older facilities in inner suburbs could be a solution to this last-mile problem. You want to be at a 30-minute delivery point particularly in the peak hour of the day."

Last-mile delivery is becoming the norm in parts of Asia as well as the UK and US.

There's a view that last-mile delivery is miles out for Australia based on the density of our cities and sprawl of our nation. Heavy cargo doesn't move well through inner-city Sydney or Melbourne, plus, land values also get in the way.

Despite industrial being born out of working class communities in our capital cities, it's no longer at home here. With supply tightening up and property prices climbing over the last couple of decades, activity has seen decentralised and spread to fringe areas with infrastructure connectivity.

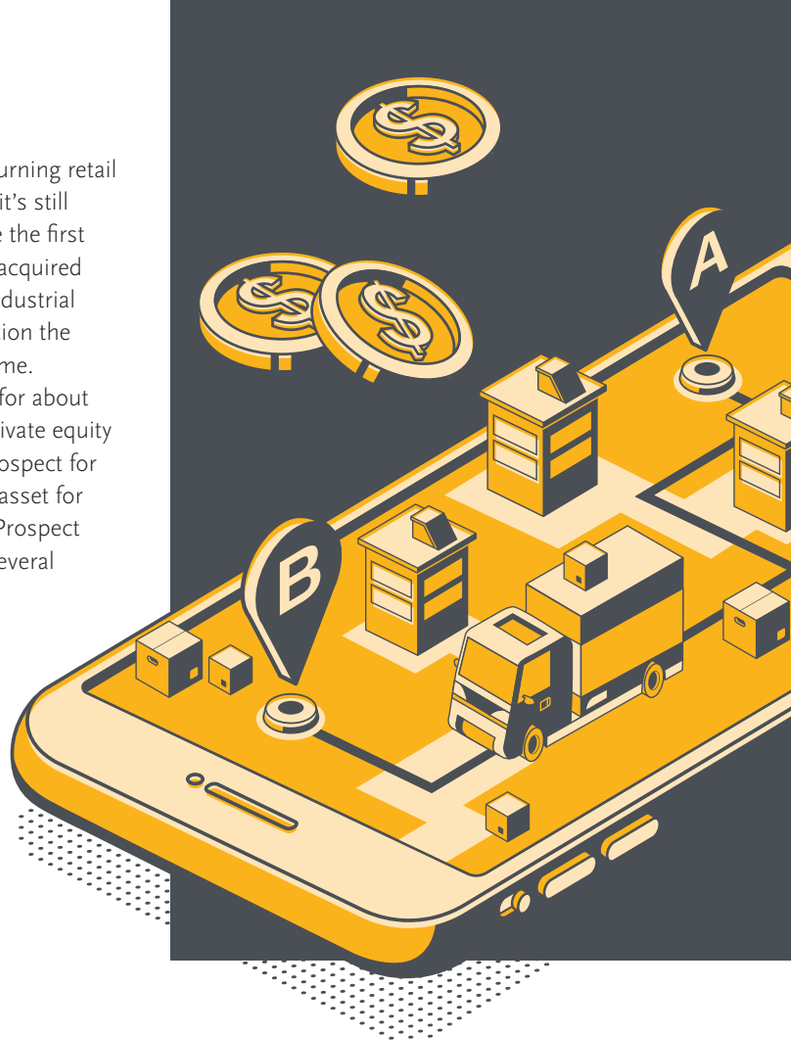
However, there's a chance Australia may come back around again, at its own time and in its own way.



Around the world, developers are turning retail assets into industrial property. While it's still early days in Australia, Dexus became the first local mover in October 2019 when it acquired a shopping centre in Blacktown for industrial refurbishment. Dexus plans to transition the centre, Homemaker Prospect, over time.

Homemaker Prospect was bought for about $65 million on a 7 per cent yield. A private equity real estate firm listed Homemaker Prospect for sale in early 2018, having bought the asset for $40.45 million in 2013. Homemaker Prospect is anchored by The Good Guys and several mattress specialists.

Sass J-Baleh, head of industrial research at JLL, claims this marks an Australian first. Overseas, struggling department stores are starting to be repurposed into ecommerce fulfilment facilities. That's a possibility in an Australian context, given average prime industrial rents in our major capitals are about the same as department store rents right now.



TOPPY... OR JUST TOP PROPERTY?

It's not the assets, but the land, which may warrant a closer cause for concern, believes Tyson.

A lack of stock available for purchase is driving up industrial land prices. Occupiers are then facing additional occupancy costs because of that, limiting their ability to pay additional rent to the owner.

"So we will see some substantial increases through occupancy costs, land tax and power as well. That puts a drag or restriction on their ability to tolerate massively high rents."

Mega-trends are playing into industrial's hands. That alone, though, won't put to rest the idea that industrial property may be a "toppy" market.

However, as Tyson tells Trilogy, this is only compared to what we've seen in the past. As stated before, these days it's a rare industrial asset to perform like a traditional standard investment.

"You need to consider it from a loyalty basis and where you are getting capital from," says Tyson.

"The capital coming into the industrial asset class at the moment is essentially global capital, originating from Australia, but that capital still has a global mandate typically where they will consider investing offshore as well.

"You look at Sydney and Melbourne, and Sydney in particular is one of the top 25 destinations for industrial growth, globally. That's just based on natural yield, not even on a currency basis. In addition to buying the ecommerce story, we're quite a transparent economy with good government and a proxy to China to a degree."

"ONLY THE EDUCATED ARE FREE"

wrote Epictetus, a Greek stoic philosopher who primarily believed people are responsible for their own actions, even if they can't control the outcomes.

We're not equipping people with the tools to capitalise on the freedoms.

The Barefoot Investor, Scott Pape, says we need money school.

Australia is a free country with its fair share of intellectuals, and yet, we're failing at a fundamental level. Like much of the developed world, we're not producing financially literate people. We're not equipping people with the tools to capitalise on the freedoms.

The Barefoot Investor, Scott Pape, says we need money school.

Pape believes financial literacy is a worthy enough cause to give up his subscription-based investment business Barefoot Blueprint. Pape is pounding the pavement on a mission to give young Australians "skills to pay the bills". Foxtel will follow Pape as he rolls out the Barefoot Money Movement through schools in 2020. Money School will simply teach financial literacy.

It's simple, but it's hard to define, and that's where many researchers begin on the topic of financial literacy.

As researchers will point out, there's a lack of measurement benchmarks that make assessing financial literacy quite difficult. There's no litmus test. It's led some to dedicate work to simply defining the term. To this day though, no concise review of Australian financial literacy material currently exists.

The more we learn about financial literacy, the better off we will be.

Bond University researchers found in April 2019 that financially illiterate people are more likely to have financial concerns and cut back on spending, seek more job opportunities, increase debts, and downsize or sell their residence.

The research involved more than 3400 members of National Seniors Australia. The over-55s were also asked three questions to gauge investment literacy.

Worryingly, one-third of respondents got all three questions wrong.

Adrian Gepp, Associate Professor of Statistics at Bond University, says this came as a surprise, even to someone like him, who researches problems of economic and social importance for a living.

"I thought financial literacy would have measured better and I was a little shocked people couldn't answer these questions, especially the question about whether 'growth' is more risky than 'conservative' as an investment," Gepp tells Trilogy.

"We need programs targeted at that from both sides of the fence, for education and investing, even specific products from institutions. If there is a whole suite of financial products, be clear with choice, which is where super life stage funds also come into play.

"People at or nearing retirement want to maximise the use of their time, they don't really want to sit through a seminar for a couple of hours. Apps and gamification may be good solutions."

Among other things, the Bond University researchers observed the older someone is, the less financially literate they are likely to be.

However, just like the definition of the term is blurred, the literacy line isn't so cut and dried.

Women are half as likely to be sucked into credit card 'prestige' programs.

WOMEN SPEND AROUND $50 LESS THAN MEN ON UNNECESSARY PURCHASES PER WEEK AND FORK OUT FAR LESS ON HIDDEN PURCHASES PER MONTH.

MINDING THE RESEARCH GAPS

Around the same time Bond University published its research, the Economic Society of Australia put out a paper suggesting that age and education among other "human capital variables" are not important in explaining the gender gap in financial literacy. Instead, it comes down to 'labour market variables' which includes sector, occupation and industry.

Two researchers, Alison Preston and Robert Wright, combed through micro-data from the benchmark Household, Income and Labour Dynamics in Australia (HILDA) Survey to conclude that job market forces explain around 16 per cent of the gap.

The elephant in the room, of course, is that leaves a very large and unexplained gap. This gap couldn't be traced back to human capital or labour market variables. Are some people just born with it? Is financial literacy gendered?

A crop of studies naturally appeared around the topic of financial literacy in the years following the introduction of compulsory superannuation in 1992. By way of measuring super's effectiveness, the studies looked into engagement rates. Many of these studies, published between 1994 and 2002, considered gender as a variable.

Researchers at Australian National University used this body of work as a starting point for their own research. They surveyed 165 students at the University of Western Sydney in 2004.

Results suggested females were slightly more financially literate than males. In a statistically significant way, the female students better understood the concepts of "conservative investment" and "balanced investment". Male students had a better grasp on "gearing" and "advantages of home ownership".

It paints an interesting picture, but there are gaps in the frame. The entire sample was drawn from the same source. ANU may not be the best representation of the Australian population. Around 16 per cent of respondents had prior experience working in finance, which was significantly higher than the broader population.

The Global Financial Literacy Excellence Centre built on this and much more when it measured financial literacy rates across the world in 2017. The study posed four questions around interest, compound interest, inflation and risk diversification. What's $100 plus 3 per cent? Is it safer to invest in one business or several? Australia came runner-up to Canada in the prize that no one wanted to take – the financial literacy gender gap.

For what it's worth, Australians were doing a far better job than others at engaging with financial institutions. We ranked well for both saving and borrowing money. (Our household debt to income ratio recently hit another record high of 190 per cent.)

Each piece of research has its limitations. However, like rote learning for a test, what's clear is that many of us are going through our "money motions" with little thought process.

WOMEN AND MONEY

In the UK, Ann Boden, boss of leading British fintech Starling, recently led a study into women's magazines and found that nearly two-thirds framed their readers as "excessive spenders".

As Boden said to The New York Times after the fact, "Women's magazines focus on saving money and deal hunting, while the men's talk about money in terms of power and luxury". In essence, encouraging a fixed mindset rather than a growth mindset. Many women have been led to believe they can only manage their situation, not improve their situation. Doubt sets in.

And yet, women seem to understand money better, on a more practical level.

According to statistics from comparison site Finder.com.au, women are half as likely to be sucked into credit card "prestige" programs. Women spend around $50 less than men on unnecessary purchases (random online shopping purchases) per week and fork out far less on hidden purchases (purchases hidden from their partners) per month.

The practicality may come from experience in balancing the household budget. Often, it's women doing the grocery shop, working out whether there's too little or not enough. More men may win the bread, though more women seem to be buying the bread.

As Bond University's Adrian Gepp explains to Trilogy, women were more in control of household finances than men in his research. The number of men in control came in at 23 per cent, women at 32 per cent, and together, about 42 per cent.

That goes with saying, life priorities tend to drive women's financial decisions, according to separate research conducted by RMIT commissioned by the Australian Research Council in 2016. This means prioritising day-to-day household financial decisions above long-term investment decisions.

"Of course, men can have those priorities too, but I think that there are differences in gender identities and gender roles," says Roslyn Russell, Professor of Household Finance at RMIT's School of Economics, Finance and Marketing.

The study looked at women's "financial self-efficacy" (FSE), which loosely translates to financial literacy, particularly the ability to manage finances. Women aged 40 to 59 had the lowest levels of FSE and were most worried about running out of money in retirement. This is concerning considering the low-income environment in which we live.

COOL TO BE KIND

"Kinder content" is the key to engaging hard-to-reach consumers, such as women and younger people, on a deeper level. That's according to The Dubs, a content marketing agency for the finance sector. The Dubs counts Commonwealth Bank, Westpac and Macquarie among its clients.

"Rather than making millions of people feel ashamed and hopeless, we need to inspire and enlighten. We need to come from a place of empathy and goodwill," says Susan Burchill, author at The Dubs.

Financial products shouldn't be sold on fear. In fact, so deceptive some of the tactics of the past have been that high-profile leaders are going on the public record to do things differently now.

Consider Sallie Krawcheck as an example. After an illustrious career in traditional financial services, where she led Merrill Lynch, Smith Barney and Citi Private Bank as CEO, Krawcheck is now building a financial services company of a different variety. Krawcheck is the CEO and co-founder of Ellevest in the US, a digital financial adviser for women.

Money has been masculinised, says Krawcheck, through tripe stereotypes. In the process, this has patronised women to a point where they are taught to feel shame in life's simple pleasures, like buying a latte. No word yet on what Krawcheck thinks of all that Aussie smashed avocado talk.

Language is powerful. We need a better, more complex, narrative around financial literacy. It needs to be real talk. Financial literacy won't improve if we're stuck comparing men versus women and young versus old. From product design to educational programs, the conversation clearly needs to evolve.

TRILOGY

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