MELBOURNE'S STRENGTHENING LINKS WITH ASIA

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Melbourne has enjoyed a long relationship with Asian-based investors; it could be argued as far back as the Gold Rush of the 1850s, when mainland Chinese immigrants came in search of fortune throughout the Goldfields of rural Victoria. From humble beginnings, the first 'investors' established the foundations for a mutually prosperous relationship between Melbourne and Asia, which is now reflected across all aspects of Melbourne's economic, social and cultural life.

As the global economy attempts to overcome structural uncertainty, a paradigm shift is occurring in favour of the East. There is widespread consensus that we are entering the 'Asian Century', and Melbourne's strong relationship with Asia has her well positioned to take advantage of the increased power and influence of Asian capital. Despite a perception that this structural change is well advanced, it remains in its relative infancy and we are living through an exciting fundamental shift in global economic and social norms. Beyond the influence of the resources boom supporting Western Australia and Queensland, and the global city context of Sydney, Melbourne is bearing witness to the increased power and influence of Asian capital, particularly in the CBD and Central City Region (CCR) apartment market. The depth of influence of Asian capital in Melbourne is widely acknowledged, however the majority of investment is commerce related and not 'visible' to the general population. The real estate sector is, however, a visible example of the increased influence of Asian investment, and worthy of examination.

Melbourne has always had an active, diversified and entrepreneurial local Asian-heritage development sector, however Charter Keck Cramer (Charter) has (via its exposure to the CCR apartment market) identified a significant increase in the quantum of Asian based capital injected into residential and mixed use developments (particularly the CBD and Central City Region (the CCR defined as including the CBD Grid, CBD North, Docklands, Southbank and St Kilda Road) precincts). Commencing with compact development site acquisitions by local developers of Asian heritage and financial backing, the trend is towards more strategic opportunities. Charter research indicates that 10 of the last 18 sites transacting for more than $5m to offshore entities, or developers with offshore heritage.

An increasing number of CBD projects are being undertaken by Asian based investors/developers, local developers with immediate Asian heritage or second generation Asian developers supported by offshore capital. Of a total of 21 active residential projects in the Melbourne CBD (defined as projects either currently marketed or under construction as at July 2011), 8 are being undertaken by Asian based/backed entities, representing 3,058 (52%) of the 5,877 active apartments. A further project is under construction to be held by the developer upon completion, several other sites controlled by Asian interests are under active commencing preparations, and local developers are seeking Asian equity/debt capital to support other active projects seeking finance.

The majority of Asian capital has been placed via the conventional development context, through site acquisition and development under the direct control of the investor, or via a local development manager. However as investors are seeking to diversify exposure (and structured funds without a development mandate enter the market) inbound equity is increasingly being placed in the form of joint ventures, mezzanine and primary debt finance, demonstrating the increased sophistication of the role of Asian capital.

Initially demonstrating a preference for CBD and inner urban development, Asian investors are now seeking opportunities beyond the city core, recently acquiring sites in St Kilda Road, Southbank and South Yarra. As Melbourne matures toward a World City and the emerging issues surrounding housing affordability, private and public, infrastructure and social harmony mirror those of global cities, the opportunities and fundamental demand for infill development will strengthen, and capital will likely follow the inevitable long term trend to medium density development.

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The apartment development sector is however only a minor component of the overall housing market, and the potential for major capital inflow to the residential land market cannot be ignored and is perhaps the next 'logical step' for many entrants. A mature, robust and highly structured market, the lower risk paradigm and longer term investment horizon of the land sector will appeal to Asian investors as they branch beyond the apartment market in which they have been inherently more comfortable to date.

The historically strong recent activity in the Melbourne 'off the plan' (OTP) apartment market has coincided with commensurate strength in the financial positions of Asian investors, creating supportive conditions for capital migration. Private developers and structured funds have exported capital to diversify geographic and political risk, with structured funds (without a direct development mandate) doing so via joint ventures, mezzanine and senior debt. Interestingly, Asian based capital has not only found a home within projects sponsored by Asian developers, but is also starting to be placed with local developers seeking funds in a debt-constrained, post GFC environment.

Joint ventures, mezzanine and senior debt investment is still a 'growth' sector for Asian capital placement, not populating to the extent initially anticipated due to the Australian domestic banks supporting (against popular perception) the development sector through the post-GFC recovery phase. Despite lending criteria having tightened significantly, Charter's Strategic Research Group confirms approximately 84% of CCR and City Fringe projects that have commenced construction from 2008 have been sponsored with senior debt from local major banks. Only 9% of apartments under construction have been funded by local private capital (institutional) and only 7% by offshore senior debt. As sites acquired by Asian developers progress to construction, and local developers seek alternate joint venture, mezzanine and senior debt sources, the proportion of stock funded by offshore entities is anticipated to increase.

Access to Australian financial services is relatively unencumbered to foreign investors, although in the real estate development context it is constrained by the propensity for risk of local financial institutions. Rigorous due diligence of development sponsors is undertaken by domestic banks, and it is incumbent on the inbound developer to be willing to meet local funding market metrics, particularly in terms of equity contribution and active development de-risking, and potentially providing local funders with necessary recourse to offshore capital reserves. The willingness of local banks to support qualified offshore developers is demonstrated, with three of the eight active projects within the Melbourne CBD sponsored by Asian investors currently under construction, all funded by domestic banks. The avenues to debt are therefore available to foreign developers, although subject to the willingness of the project sponsor to actively participate fully in the debt securing process.

The strongest rewards are likely to be for patient capital, particularly investors seeking long term entrenchment in the local market. An understanding of the nature and status of the market through due diligence, education and research is required to establish frameworks under which a successful development can be commenced. Patient capital will also seek local expertise to provide strategic advice, acting as a 'guiding hand' as either a primary consultant to the project, or alternatively audit representations/advances made by local stakeholders to protect the interests of the inbound entity. Local advice should not be restricted to site due diligence and acquisition only, but across the entire development cycle. This is particularly relevant in the commencing preparation period, when project concept, design and documentation is undertaken, and the framework for project success is established, and the construction phase where stringent management and supervision is fundamental to project delivery.

Melbourne has clearly opened her arms to Asian developers and investors, and the opportunities for foreign interests will strengthen as Australia's political, economic and social structures are increasingly, and inevitably, linked to Asia. Charter's experience, real time research capacity and market exposure places the firm in a unique position to assist the strategic decision making process of inbound investors and developers.

For further information on how Charter can assist your needs through the entire development cycle please feel free to contact Sam Nathan, Director Residential Projects - sam.nathan@charterkc.com.au

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