

Introduction

Building up a resilient and strong-performing real estate portfolio, over the long term, requires investors to identify the most attractive, sustainable cities. These cities and sectors are likely to ride the sail of megatrends that underpin Tomorrow's World's real estate market. Against the backdrop of a quite challenging investment climate in many traditional real estate markets globally, such as elevated pricing, lack of investable assets, and low yields, one sector looks particularly attractive: the education and student accommodation sector in Australia.

Australia is one of the most developed, competitive and diversified economies in the world, and many Australian cities are among the most sizeable, productive and liveable. The rise of the middle class across many regional economies, such as India, China and Vietnam amongst others, over the coming decade posit that Australia's highly-regarded education sector will continue to draw in overseas students, on top of a robust domestic student population from very supportive demographics.

In our view, the purpose-built student accommodation sector in Australia ranks among one of the most attractive asset classes today and in Tomorrow's World. Sturdy and rising secular demand, against limited competitive high-quality supply, provide the income security that can allow investors to invest through and past cycles and thus, over the long term, generate attractive and diversified portfolio risk-adjusted returns.

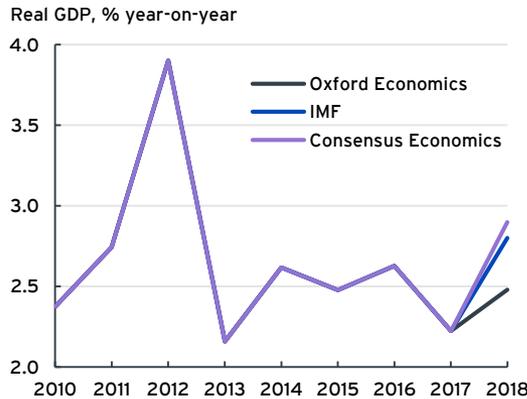
An economy doing well, which should improve in 2018

Alongside Japan, we believe the Australian economy is going to be a standout performer within Asia Pacific this year. While growth in 2017 has been somewhat overshadowed by a softness in household consumption (a

reflection primarily of weak wage growth and high house price capping on disposable income and spending), the strength in other sectors of the economy has outperformed better than expected. While consumer spending is unlikely to reverse its trend and is likely to only contribute marginally to overall real GDP growth, the other economic engines are likely to gather steam to position Australia for higher growth in 2018.

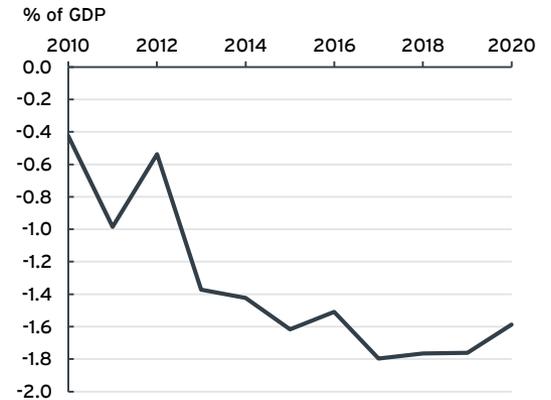
Overall monetary conditions will also continue to underpin growth, in light of subdued inflation and below-trend operating capacity. The Reserve Bank of Australia (RBA) is not expected to tighten policy until late 2019, leaving it behind the Federal Reserve and many OECD central banks, and, consequently, suppressing on the AUD and underscoring growth. Most consensus forecasts are looking at a jump in growth to around 2.8% in 2018 (based on Consensus Economics), up from an estimated 2.2% in 2017 (Fig.1).

Fig.1: An economy gaining strength



Source: Various, TH Real Estate, 2018

Fig.2: A stabilising output gap



Source: Oxford Economics, 2018



Student accommodation in Australia is a great example of a resilient strategy: fundamentally strong and secularly positive.



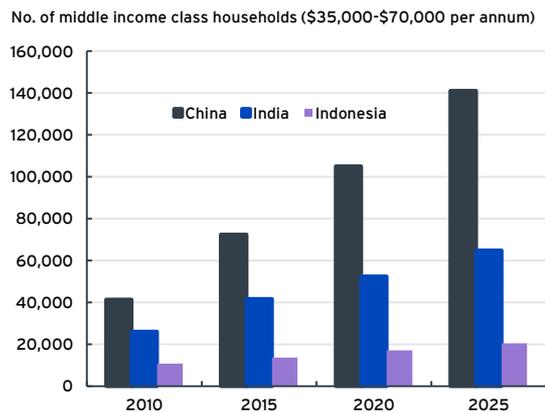
Alice Breheny
Global Head of Research

Following through from late 2017, we believe the key boosts to headline growth this year will likely come from:

- An ongoing improvement in business investments: one of the more remarkable features of the Australian economy, since the Global Financial Crisis (GFC), has been a quick turnaround away from mining into other high-value added industries. Recent capital expenditure surveys suggest that an ongoing pick-up in machinery and equipment capex will persist, reinforced by strong government spending on infrastructure, alongside the solid build-up of corporate balance sheets over the past few years.

Business surveys also corroborate an optimistic outlook for private investments, although new dwelling construction is likely to stay soft due to a pullback in investor activity from tighter bank lending conditions and the imposition of taxes on foreign buyers. Although a significant output gap remains, the build-up

Fig.3: The rise of the middle class

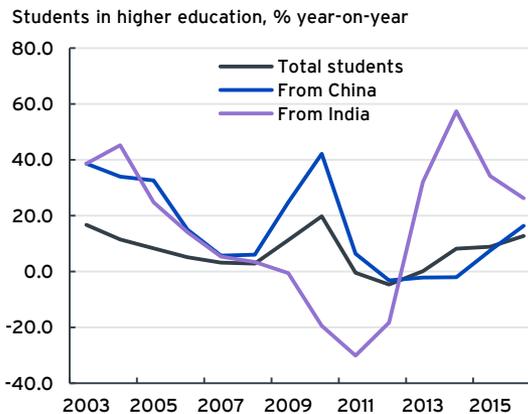


Source: Oxford Economics, 2018

in inventories in response to capacity tightening should supplement overall growth in 2018 (Fig.2). In turn, productivity growth is expected to reverse the slight drop last year, to rise by 0.9% and 1.5% in 2018 and in 2019.

- The steady pick-up in global growth, and ongoing recovery in the commodities market, on top of the weak AUD, could help drive a solid merchandise and services export growth performance in 2018. If an unexpected slowdown in China occurs this year and poses downside risks to the export outlook, it is worth noting that overall commodities prices have recovered smartly from the 2016 trough and should still continue to buttress the net export contribution to growth, especially as rather soft consumer environment continues to limit import demand.

Fig.4: The merit of education



Source: CEIC, 2018

Secular support to student accommodation

At the epicentre of megatrend: The purpose-built student accommodation sector in Australia fits in squarely with the key themes that underlay our Tomorrow's World investment approach. In the coming decade or so, Asia Pacific will lead the ongoing shift in economic power from West to East: growth will continue to outpace world averages, led by the rise of the middle class and consequent pent-up consumer demand, including high-quality education. Australian universities, geographically and to a lesser extent culturally, sit right next to the epicentre of the wave of pent-up demand.

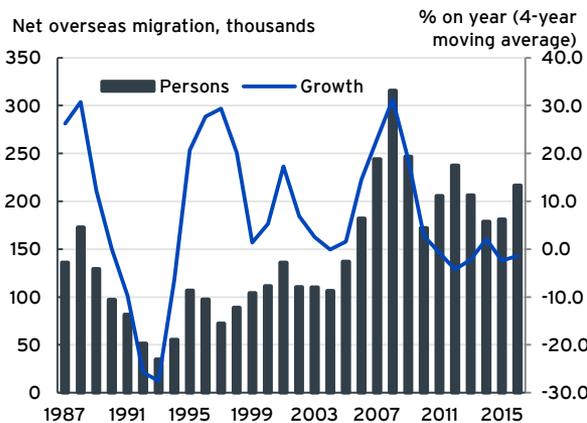
To put into context, the number of middle-class households, with annual income of \$35,000-\$70,000, in three of the biggest overseas student markets in Australia, for example China, India and Indonesia, is expected to grow at a CAGR of 5.9% over the next decade to 226 million. This represents more than the entire population of the UK, France and Germany combined (Fig.3). The number of students from China and India alone accounted for slightly more than half of the total student population enrolled in higher education in Australia in 2016, growing at a CAGR of 8.8% and 5.2% respectively (Fig.4).

Untapped demographic dividend: Unlike many developed economies, the positive demographic trend in Australia will also continue to drive local demand for educational services in the coming years. The country's total population has grown by an average of 1.7% over the past 10 years, outstripping fellow OECD countries Japan and South Korea and marginally-below Singapore, another pro-immigration country. While natural population growth has been falling since 2010, strong immigration flow has helped to offset, and will continue to boost, the overall population size in the years ahead (Fig.5).

Equally important, Australia, by virtue of its high immigration, has also one of the most youthful populations within Asia Pacific. For many years, just under 20% of the overall population is younger than 14 years old, which will also supplement the total number of students heading to higher education in the coming years, which is already growing at 5.6% CAGR over the past decade (Fig.6).

High-quality education, great lifestyle and relatively more affordable: Australian universities are generally highly ranked globally: according to The Times Higher Education World University Rankings 2016-2017, 35 Australian universities ranked among the top 950 globally, with six ranking among the top 100, led by the University of Melbourne at 33, followed by the Australian National University at 47. With 37 Australian universities among the Top 1,000, the QS World University Rankings 2018 ranked the Australian National University at 20, followed by University of Melbourne at 41. Furthermore, the weakness of the AUD also meant that the cost of education (*ceteris paribus*) is also cheaper than an education in the US (Fig.7).

Fig.5: Welcome to Australia



Source: CEIC, 2018

The depreciation of the GBP post-Brexit meant that a British education is now more competitive for overseas students vis-a-vis Australia, notwithstanding the school fees and cost of living.

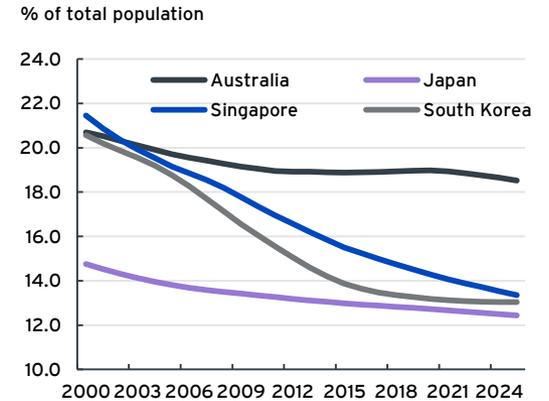
According to the Mercer Cost of Living rankings, Sydney, the most expensive city in Australia, ranks behind American cities such as New York, San Francisco and Los Angeles. It is only slightly more expensive than London, the most expensive UK city. The quality of living in many Australian cities is also well-touted. According to Mercer, five cities are ranked among the Top 30 globally, led by Sydney and followed by Melbourne, Perth, Adelaide and Canberra - ahead of the highest rank US city, San Francisco, as well as London.

Purpose-built student accommodation: Wind beneath its wings

There are strong justifications investing into the purpose-built student accommodation (PBSA) sector in Australia. Being highly cosmopolitan, Australia not only sits next to a big secular wave of higher education demand from Asia Pacific countries, but also provides the employment opportunities and quality of life post-graduation.

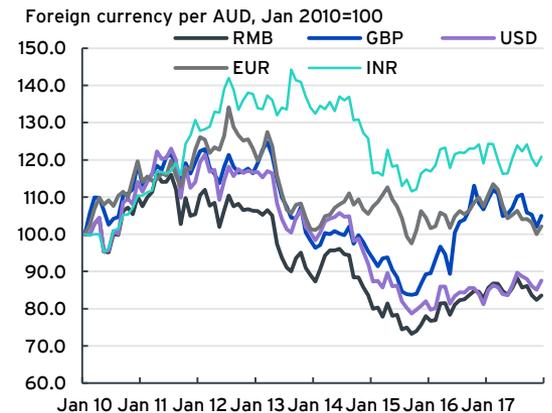
Over the past decade, enrolment numbers have been rising across many Australian states, with New South Wales and Victoria drawing in the most overseas students (Fig.8). Total student numbers over the past 10 years to 2016 rose by a CAGR of 5.6%, led by Australia Capital Territory (8.5%), Victoria (6.5%) and Queensland (5.4%). Excluding the Northern Territories and Tasmania (due to the low base), South Australia and Australia Capital Territory posted the biggest jump in student numbers since 2002, even as New South Wales and Victoria continued to draw in the most higher education enrolments from China (Fig.9).

Fig.6: A more youthful population (>14 years)



Source: Oxford Economics, 2018

Fig.7: Relatively cheaper

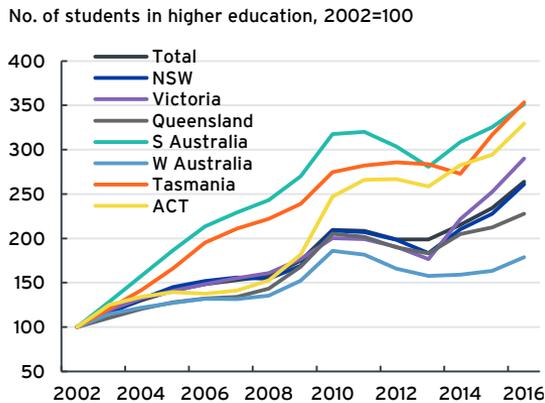


Source: CEIC, 2018

At a national level, the number of beds provided through PBSA across the country remains low, at 6% provision rate (calculated as number of beds as a percentage of total enrolled students, Fig.10). While transactions are scarce, it is estimated that the initial yield for PBSA is also relatively attractive vis-a-vis other markets, providing decent spread against the 10-year government bond (Fig.11).

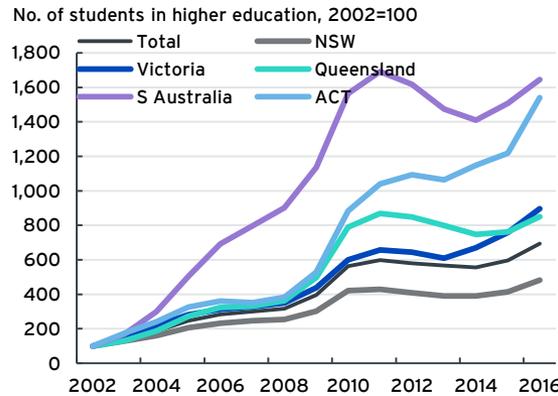
Even as supply continues to grow in the coming decade to cater to the overwhelming student demand, it is estimated that the number of PBSA beds will stay under-provided for, especially those that are well-managed in attractive locales (Fig.12). The secular and fundamental drivers of the PBSA sector in Australia is clearly positive. An opportunity to invest in the PBSA sector is not to be missed, and we believe investors should consider jumping on the bandwagon now (Fig.13, 14 and 15).

Fig.8: Rising enrolments



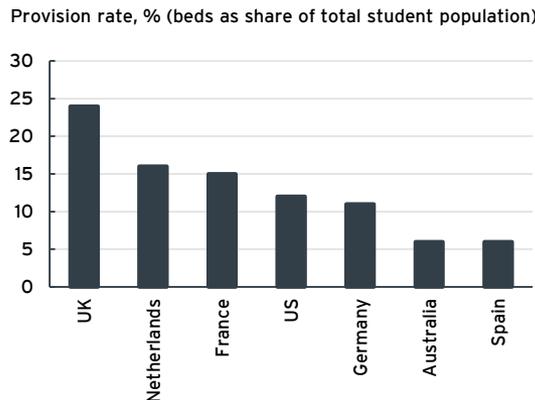
Source: Oxford Economics, 2018

Fig.9: Where are the Chinese heading to?



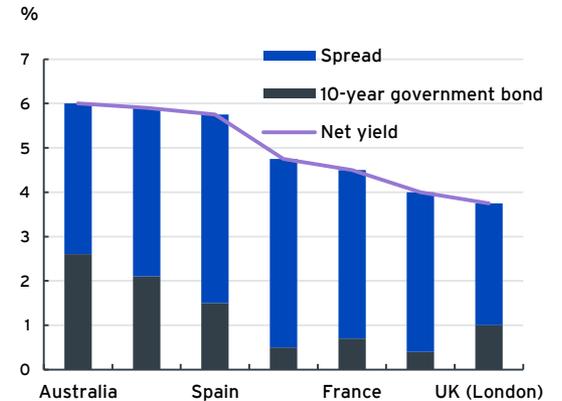
Source: CEIC, 2018

Fig.10: Undersupplied



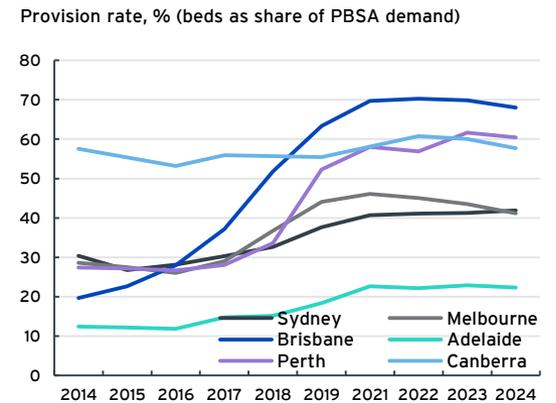
Source: Savills, 2018

Fig.11: Attractive income returns



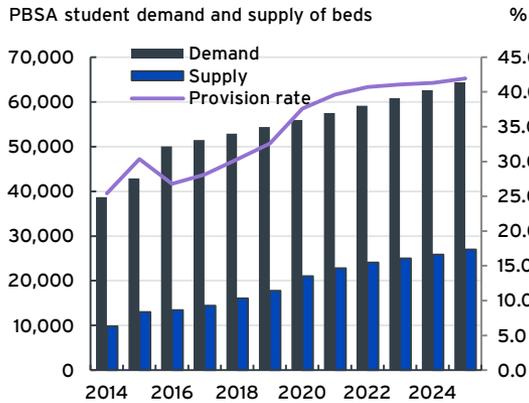
Source: Savills, 2018

Fig.12: Room to grow rents



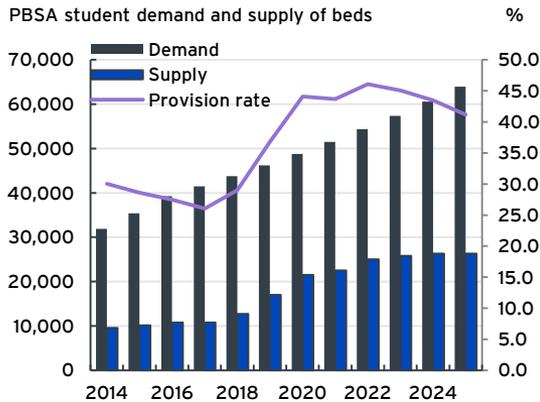
Source: Savills, 2018

Fig.13: The case of Sydney



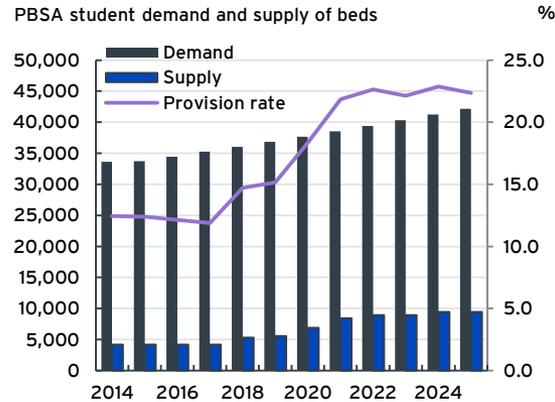
Source: Savills 2018

Fig.14: The case of Melbourne



Source: Savills 2018

Fig.15: The case of Adelaide



Source: Savills, 2018

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