

AustralianSuper's unlisted assets

To meet the wealth accumulation needs of members saving for retirement, AustralianSuper invests in a variety of assets – both listed and unlisted.

AustralianSuper uses multiple asset classes to achieve the return objectives of investment options while taking an appropriate amount of investment risk. These asset classes include exposure to both listed and unlisted assets. Unlisted assets are an integral part of member investment options as they provide diversification, relative return stability, better risk adjusted returns and a long-term focus.

What are unlisted assets?

Unlisted assets are investments that are not listed on an exchange. They can include infrastructure (roads, power grids and airports), property (large office buildings and shopping centres), private equity (investments in private companies) and private credit. Although unlisted assets are often categorised together, there are significant differences between the types of unlisted assets and their role in a diversified portfolio.

Infrastructure

Infrastructure investments provide capital to develop or maintain assets that are essential services or facilities such as transportation, communication, sewage and power services. These types of investments can improve living standards as well as a country's economic development. Infrastructure projects often rely on substantial initial investments.

Property

Property investments involve directly acquiring property assets such as shopping centres, office buildings or industrial warehouses. Returns can be generated from increases in property value from development and price appreciation or rental incomes. Prudent management enables an owner to enhance the value of the property and improve income generation.

Private equity

Private equity investments provide capital for private companies that are not listed or publicly traded. The most common categories of private equity include venture capital, growth capital and leveraged buyouts. Private equity investments require a commitment to specialist fund managers that drive value in their portfolio of companies through sophisticated governance and financial and operational management.

Credit

Private credit is a general term that describes non-investment grade debt such as corporate loans, infrastructure debt and real estate debt. These types of securities are regarded as illiquid investments.

Unlisted assets have historically proven to be a great long-term investment for AustralianSuper's members.



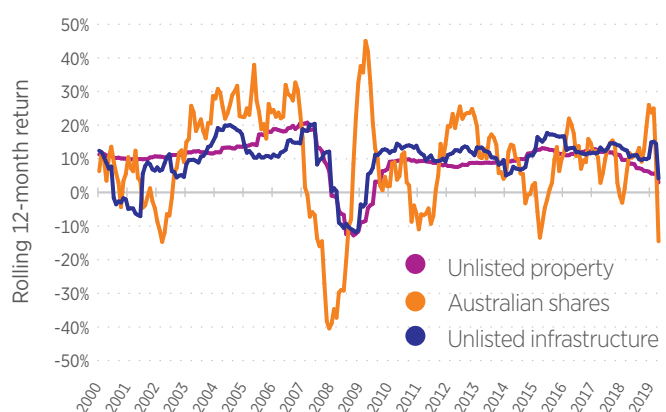
Comparison of listed and unlisted asset returns

Unlisted assets can exhibit less volatility when compared to listed markets.

The returns for unlisted infrastructure and property were less volatile in 2008 when the GFC had a major impact on listed equity returns.

Benchmarks: Unlisted Infrastructure: AustralianSuper Infrastructure Benchmark (Frontier), Unlisted Property: MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index (post fee), Australian Shares: S&P/ASX 300 Index
Data to 31 March 2020

Listed and unlisted benchmark returns



Why invest in unlisted assets?

Unlisted assets have been a valuable part of AustralianSuper's portfolio due to their lower correlations with listed markets and distinct characteristics which provide benefits to a balanced portfolio.

With respect to most unlisted asset classes these characteristics include:



Diversification

Allocating to multiple asset classes with lower correlations to each other diversifies portfolio risk. Unlisted asset returns can be relatively uncorrelated to the business cycle and less exposed to short-term market volatility. The use of unlisted assets to diversify returns through market cycles can provide a ballast in the portfolio during listed share market downturns, potentially resulting in greater return stability in comparison to listed share market returns.



Better risk-adjusted returns

Unlisted assets have historically generated superior risk adjusted returns when compared to many other asset classes. This involves measuring an investment return in relation to the amount of risk taken to achieve that return. Historically, some unlisted assets were positioned on the risk/return curve between fixed-income investments and listed shares, enabling an investor to extract additional return for the level of risk taken.



Relative return stability

Unlisted property and infrastructure can generate steady income streams. For example, income can be earned from rents locked in over a fixed term contract period or returns from a power station or toll road subject to a long-term agreement. Due to their long-term investment horizon and less frequent valuations, unlisted assets are less subject to short-term market volatility, in normal market environments. From a total return perspective unlisted property and infrastructure assets tend to display less volatility than their listed counterparts.



Long-term focus

The longer term investment horizon for unlisted assets is aligned with the long-term time horizon of superannuation funds. Unlisted infrastructure, property and private equity investments are generally held for the long-term. This enables asset owners and governing bodies (boards) to make development decisions to improve the long-term value of unlisted assets. In contrast, listed boards can sometimes be pressured into making shorter term decisions which can affect long-term value.



Premium on returns

Investing directly into unlisted assets has high barriers to entry which historically has provided a return premium over listed assets. The return premium is derived from the complexity of transacting in unlisted assets as well as their illiquidity. Investing in unlisted assets requires specialised expertise and has large transaction costs. Having sufficient resources to analyse and evaluate unlisted opportunities, as well as negotiate and implement contractual terms, requires adequate scale to justify the allocation of resources to execute at a reasonable cost. Unlisted assets also require large capital outlays and an extended time horizon for investment. These factors provide an illiquidity return premium for patient investors that can allocate long-term capital to invest in unlisted assets.



King's Cross Estate - London, UK

Consideration when investing in unlisted assets

The benefits of investing in unlisted assets do come with a trade-off, based on their illiquidity. Unlisted assets are considered illiquid as they can be harder to trade or find buyers willing to transact at a given price. Illiquidity is defined as not being able to sell an asset at its fair value within three months. In some situations, the valuation of unlisted assets can change sharply as they are typically valued infrequently, relative to listed instruments such as shares. During distressed market environments, it may not be possible to sell unlisted assets at a fair or reasonable price. AustralianSuper places limits on the amount of illiquid assets that are included in the PreMixed investment options to help manage liquidity risks.

We engage with asset managers to understand the physical and transition risks of climate change on each investment

AustralianSuper and its managers are actively involved in adding long-term value to assets as owners through the consideration of environmental, social and governance topics. We embed these factors into the analysis of investments to ensure that assets are appropriately valued. We also engage with management to understand potential risks and encourage positive behaviour. This is especially important for unlisted investments that have significant physical assets. Among environmental factors, climate change poses two significant risks to businesses that we incorporate in our analysis: physical and transition risks.

Physical risks

An asset's geographic location can make it susceptible to risks such as physical changes in the environment caused by climate change. These can include severe events such as cyclones, floods and bushfires or the impacts of longer term shifts in climate patterns such as rising sea levels. For example, AustralianSuper needs to make sure road infrastructure assets we invest in are designed and built to withstand future environmental changes.

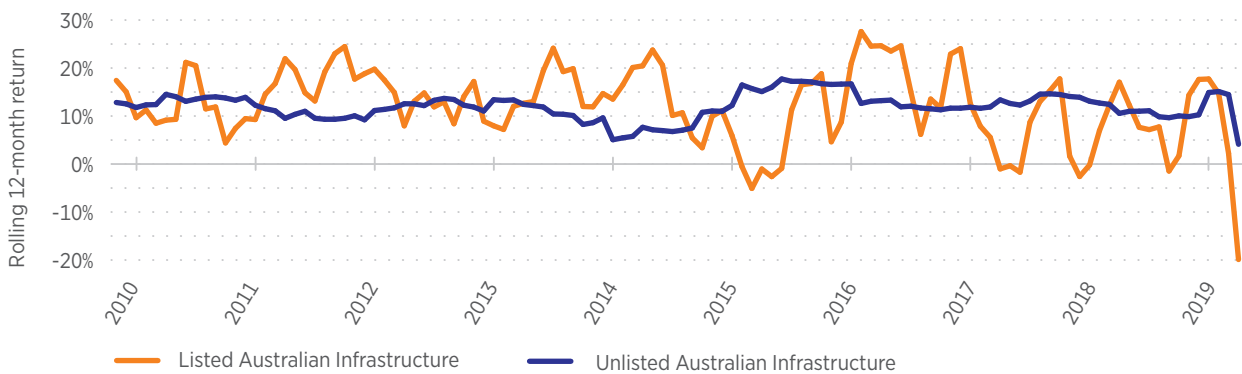
Transition risks

Regulation, technology and consumer behaviour are changing as the economy shifts from being fossil fuel dependent to a low carbon economy. For example, a shift to electric cars and a renewables generated electricity grid may impact a business. A smooth transition for workers and businesses to a low carbon economy could provide economic benefits as well as improve investment outcomes.

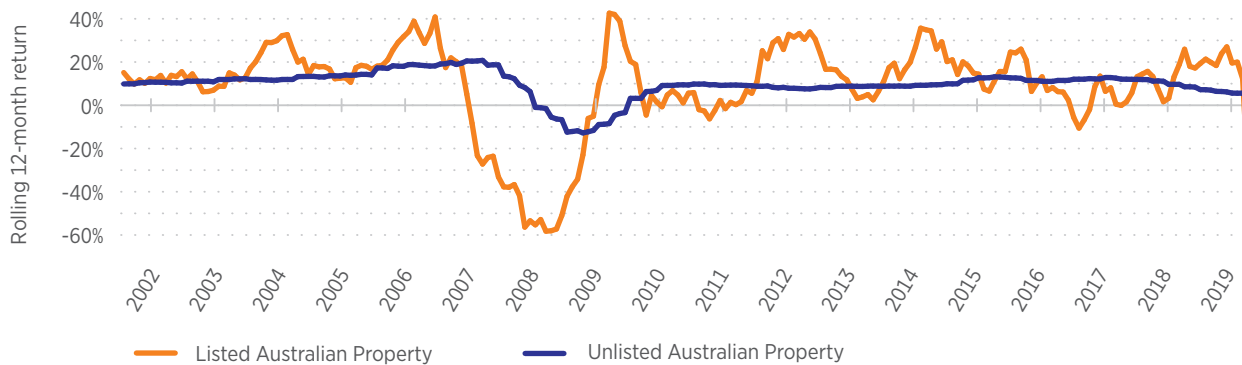
More stability in returns from unlisted property and infrastructure

The charts below compare listed and unlisted rolling 12 month returns for infrastructure and property. These charts demonstrate an increased level of variability in the returns from listed property and infrastructure, compared to unlisted property and infrastructure.

Comparison of listed and unlisted infrastructure benchmark returns



Comparison of listed and unlisted property benchmark returns



Benchmarks: Unlisted Australian Property: MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index (post fee), Listed Australian Property: S&P/ASX 300 A-REIT Index, Unlisted Australian Infrastructure: AustralianSuper Infrastructure Benchmark (Frontier), Listed Australian Infrastructure: S&P/ASX Infrastructure Index

Data to 31 March 2020

What is the regulator's view on unlisted assets?

Unlisted assets are a well-established component of the investments made by superannuation funds on behalf of their members. Australian Prudential Regulation Authority (APRA), the prudential regulator for the superannuation industry, requires a sound investment governance framework in place to select, manage and monitor investments, including the appropriate monitoring and management of investment risk. APRA considers it important to give particular consideration to the inclusion of unlisted and illiquid assets in an asset allocation, given their unique characteristics.

While APRA does not prescribe specific valuation methodologies for unlisted assets, it provides guidelines to superannuation funds on the principles for valuing unlisted or illiquid assets. AustralianSuper's Investment Valuation Standard is aligned with the requirements of APRA Prudential Standard SPS 530 – Investment Governance and Prudential Practice Guide SPG 531 – Valuation. Fund assets are also valued in accordance with approved accounting standards AASB 1056 'Superannuation Entities', which requires that all assets shall be measured at fair value at each reporting date.

AustralianSuper adheres to the guidelines established by APRA for the valuation of unlisted assets.



WestConnex - NSW, Australia

What is the valuation process?

AustralianSuper has established an Investment Valuation Standard to value internally managed directly held assets on an equitable and consistent basis. The Investment Valuation Standard outlines the process, frequency and methodology to ensure the accurate and timely valuation of internally managed directly held assets.

Valuation process

The valuation process ensures the basis of valuations are reasonable, verifiable and consistent. Underpinning the process is the selection of independent valuers to be part of the Fund's valuer panel. These valuers are chosen for their expertise and local knowledge and are rotated across assets at intervals of not more than three years. AustralianSuper will also ensure that the value of assets reflects current business or market events.

Valuation frequency

Valuations are updated regularly to hold assets at fair value in the portfolio. The Fund adopts the most recent valuation for investment assets so that equity amongst members is maintained through the daily crediting rate process. The greater the exposure that an asset has in an investment option, the more frequently the asset is valued. This is based on the asset's weight in the investment option with the largest exposure to the asset.

- › Assets with higher weights are valued quarterly. About 90%, by value, of AustralianSuper's internally managed directly held assets in property and infrastructure are valued quarterly.
- › Assets with lower weights are valued semi-annually or annually.

Valuation methodology

Valuers use accepted valuation methodologies that are most appropriate for each asset considering:

- › asset size
- › characteristics
- › domicile.

Relevant assumptions such as the discount rate are determined by the valuer and adjusted to reflect the current consensus view of economic conditions and asset specific drivers. Asset specific inputs such as lease rates or tenant lists come from the investee companies.

Valuation methodology examples:

- › Methodologies for the valuation of property and infrastructure assets can include income capitalisation, discounted cash flow, trading and transaction earnings multiples, direct sales comparison or net asset value.
- › Methodologies for the valuation of private equity investments can include cost of investment or market value approach, in accordance with the valuation policies of external managers.
- › Credit assets are valued based on the type of loan. Syndicated loans use market-based prices from vendors, while bi-lateral or illiquid loans are assessed by a specialist valuation agent or valued at cost less impairments.

Valuations of wholesale investment funds, (i.e not internally managed directly held assets) are determined by the fund manager. For property and infrastructure, these managers (e.g. IFM, ISPT and QIC) use a panel of independent valuers to determine the value of individual assets held in their funds. These valuers are rotated on a regular basis.

The current environment

To understand why AustralianSuper continues to believe unlisted assets remain a valuable part of the overall portfolio, it is worth looking at the impact of some of these factors in detail.

Pricing factors

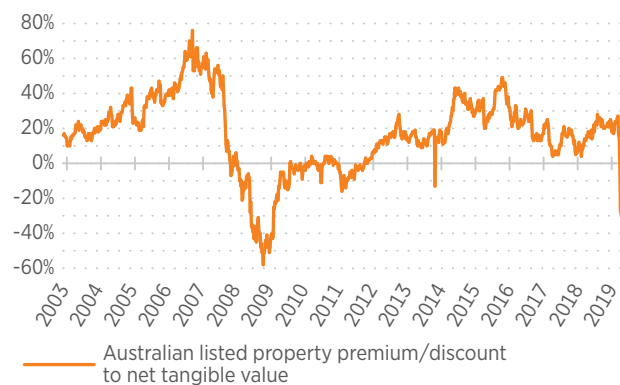
Market sentiment

The general attitude of investors towards the prospects of future returns in the markets can result in large swings in the perceived valuation and subsequently the price of listed securities. Unlisted assets are not influenced by this market sentiment to the same degree as listed assets since their valuations are often based on net asset value. This means the fair values of unlisted assets are generally unlikely to fall by a similar extent to that reflected by price falls in the listed sector. While unlisted assets went through a devaluation cycle during the GFC, it was nowhere near the levels seen in listed assets.

Australian listed property values have a long record of volatility

Australian listed property behaves more like an equity investment and can therefore be more volatile than unlisted property. The chart shows the historical volatility in the level of premium or discount to net tangible asset values in Australia's listed property market. Net tangible asset values are based on the underlying values of the assets of listed property trusts, as independently valued on a periodic basis.

Australian listed property benchmark premium/discount to net tangible value



Source: Bloomberg using S&P/ASX 200 A-REIT Index
Data to 31 March 2020

Interest rates

Lower interest rates can benefit a number of types of infrastructure and property assets by allowing the entities to refinance their debt at lower rates, resulting in lower costs of financing to the benefit of equity shareholders. The lower rate environment also lowers the discount rate for valuing unlisted assets, which has increased asset valuations in recent years. Monitoring the future path of interest rates will impact how unlisted assets are valued and their comparative performance relative to listed assets.

Direct credit investments are providing higher yielding alternatives to government and corporate bonds. Competitive returns can be obtained from investing opportunistically in credit securities that benefit from the current market conditions of low inflation and accommodative central bank policies.

Gearing

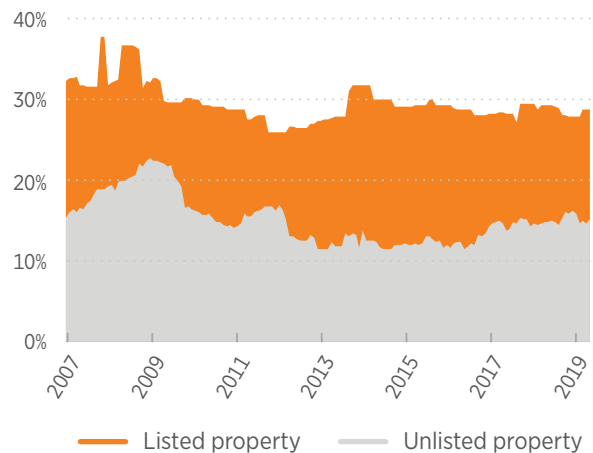
Property

The gearing level (the level of debt held) of unlisted property assets is very different to the level in the listed sector. Unlisted property tends to have a far more modest level of gearing. This allows a property investment to have more available cash flow after interest expenses to meet ongoing capital requirements, pay down debt or distribute income to investors. This increased flexibility reduces a property's risk of not being able to refinance its existing debts. The average gearing level for AustralianSuper's core unlisted property portfolio as at 31 December 2019 was 19.2%.

Gearing levels in listed and unlisted property

This chart demonstrates that listed property has had a higher level of gearing over time compared to unlisted property.

Gearing levels in listed and unlisted property benchmarks, debt to total assets



Benchmarks: Listed Property: S&P/ASX 200 A-REIT Index, Unlisted Property: MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index
Data to 31 March 2020

Infrastructure

Gearing levels in infrastructure assets tend to be higher than that observed for property assets as they have predictable revenues and cash flows, especially in highly regulated sectors such as electricity and water utilities. This gearing is typically long-term with tenures ranging from three to 30 years. The gearing level for AustralianSuper's unlisted infrastructure assets varies depending on the individual asset, from 30% for assets with some link to economic growth, up to 90% for assets with secure long-term government guaranteed revenues.

AustralianSuper's investment approach

AustralianSuper uses a One-Portfolio approach that:

- › leverages the skills and insights of a multi-asset class platform to maximise investment outcomes for members
- › enables the investment team to efficiently utilise resources, share insights and prioritise the most attractive investment strategies.

Within the One-Portfolio approach, AustralianSuper's investment team uses specialist funds and direct investment to access unlisted assets. These approaches provide three main benefits to deploying capital by:

- › providing an appropriate investment allocation into multi-billion dollar unlisted asset deals that may be too large to own in their entirety
- › accessing large scale investments through syndicated or co-investment deals
- › using internal investment capability to source, evaluate and implement new investment opportunities.

Infrastructure and property funds employ portfolio managers with significant experience and expertise in a particular market segment. Advantages of investing with these funds include access to their existing scale and the ability to diversify across sectors and geographic regions. Examples of these investments include:

- › Industry Superannuation Property Trust (ISPT) funds
- › QIC Property Fund
- › Industry Funds Management (IFM) infrastructure funds

AustralianSuper invests in private equity through specialist funds managed by high quality private equity managers, while building strong relationships with those managers to co-invest and co-underwrite alongside them.

Direct investment requires a deep understanding of the market environment and local factors. AustralianSuper's program of internalising investment management and investing directly into unlisted assets has been effective in lowering costs and efficiently deploying capital.

Having a local presence and building strong relationships with investment partners promotes the origination and implementation of investment deals. AustralianSuper's global expansion with an investment presence in the UK, and from 2020 in the US, provides further opportunities to diversify direct investment holdings across regions and seek the most attractive investment strategies in infrastructure, property, private equity and credit.



Gateway Motorway – Queensland, Australia

AustralianSuper's largest direct unlisted investments as at 31 March 2020

Property

Asset	Property type	Location
King's Cross Estate	Mixed use development	London, UK
Ala Moana Shopping Centre	Super & major regional shopping centre	Honolulu, USA
Washington Portfolio	CBD Office	Washington, US
Centre: Milton Keynes	Super & major regional shopping centre	Milton Keynes, UK

Infrastructure

Asset	Property type	Location
Ausgrid	Energy T&D	Australia
Transurban Queensland	Toll road	Australia
WestConnex	Toll road	Australia
NSW Ports	Seaport	Australia

The allocation to unlisted assets held by AustralianSuper varies over time, as determined by the Fund's trustee board. As at 31 March 2020, the overall exposure to unlisted assets (infrastructure, property, private equity and credit) was about 22% of the total Fund.

Summary

Unlisted assets have historically proven to be solid investments for AustralianSuper's members. Their long-term value, relative return stability and contribution to portfolio diversification has helped to deliver strong retirement outcomes for members. The ability to invest in unlisted assets highlights the benefits of AustralianSuper's size, scale and direct investment capability, which enables investments in attractive large scale opportunities at a reasonable cost. The favourable contributions of unlisted assets to the risk and return profile of AustralianSuper's investment options supports our continued commitment to include these assets in the portfolio.



Investment returns are not guaranteed. Past performance is not a reliable indicator of future returns. The asset allocation and other investment information is current at the dates referenced. AustralianSuper may change asset allocations and investments from time to time to suit market circumstances.

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