



AUSTRALIAN PRIVATE  
CAPITAL MARKET  
OVERVIEW:  
**A PREQIN AND AUSTRALIAN  
INVESTMENT COUNCIL  
YEARBOOK 2021**

JUNE 2021



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# Foreword

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

Emerging from the depths of a very challenging year for the entire global economy, the Australian private capital market showed resilience in 2020. Industry assets under management (AUM) rose steadily to a record \$77bn as of June 2020, up from \$71bn in December 2019 – growing a robust 8.4% over the period.

Supporting this climb in assets was ample demand for alternative investments from both domestic and international players. Indeed, Australia-focused fund managers were able to secure a staggering \$8.3bn in aggregate capital in 2020, the second-highest annual total in the last decade. This is despite only 37 funds reaching final close. When taken together, this brought the average size of funds closed to a new record last year.

Standing out above other asset classes were private equity & venture capital funds, which raised more than \$5.6bn in 2020. Already an impressive achievement, given the impact of the pandemic and social distancing measures on the fundraising environment, this sum is surprisingly almost 2.5x the total capital secured by such funds in 2019.

Through a very trying time, we were pleased to witness such strength in the Australian private capital market. These facts highlight the rising maturity, sophistication, and adaptability of the industry, but they also speak to the country's growing appeal as a global hub for institutional investment. Facing slowing growth and a low interest rate environment, international allocators are on the lookout for new opportunities to bolster the risk-adjusted returns of their portfolios.

In this respect, Australia's private capital market continues to display one of the most attractive risk/return profiles globally – giving further credence to the continued internationalization of investors active in the market. Furthermore, Australia leads the rest of Asia-Pacific in the incorporation of ESG criteria into investment processes, with 173 signatories to the UN Principles for Responsible Investment (PRI), up from 150 last year. As sustainable investment practices become more mainstream around the world, Australia will play a leading role in delivering solid returns and satisfying growing investor demand for strategies that drive positive impact.

In last year's report, we acknowledged that Australia would not be immune to the global economic crisis brought on by the COVID-19 pandemic. Indeed, in Q2 2020 Australia faced its first economic contraction after almost 30 years of continuous growth.<sup>1</sup> The single-digit downturn, however, the worst seen by the market since the Second World War, was short lived and the subsequent recovery rapid. Coordinated fiscal and monetary policy, as well as an effective public health response, helped Australia's economy weather the crisis better than many of its developed market peers.

Going forward, the future looks positive, as the economy recalibrates and moves back into action. The International Monetary Fund (IMF) has significantly upgraded the domestic economic outlook and

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<sup>1</sup> <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/dec-2020>





forecasts Australia's economy to grow by 4.5% in 2021.<sup>2</sup> In addition, the unemployment rate returned to pre-pandemic levels in February, at 5.8%,<sup>3</sup> beating consensus expectations and hitting a milestone that remains out of reach for many other countries.

As Australia continues its journey to renewed growth, the government is preparing the next stages of its Economic Recovery Plan. These include tax cuts, business investment incentives, and significant direct investment in skills and training, as well as infrastructure. In concert with these initiatives, the Australian private capital market will come to play a larger role in the continued recovery of the economy, and in its future development. The industry's capacity to assume this important responsibility has never been deeper, with a record \$27bn stockpile of dry powder and an expanding universe of sophisticated fund managers to lead the way.

We would like to thank all industry participants who have contributed their data to this report, as well as the contributors that have shared their expert insights with readers. Your support helps ensure we can provide a comprehensive review of the private capital industry. It also promotes greater transparency, knowledge-sharing, and development across the alternative investment landscape. Preqin and the Australian Investment Council are very pleased to share this report with you for 2021.

**Mark O'Hare**  
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**Yasser El-Ansary**  
Chief Executive, Australian Investment Council

<sup>2</sup> <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/imf-significantly-upgrades-australias-economic>

<sup>3</sup> <https://www.rba.gov.au/media-releases/2021/mr-21-04.html>

# About This Report

Preqin and the Australian Investment Council are proud to present the 2021 edition of our annual Australian Private Capital Market Yearbook. The report tracks activity in the Australian private capital industry using data contained in the Preqin Pro platform, as well as on-the-ground information collected by both Preqin and the Australian Investment Council. The report also shares expert insights from leading practitioners operating in Australia, to whom we are very grateful. Written content has been co-authored by in-house experts at Preqin and the Australian Investment Council.

- Analysis and quotes in this report are correct as of March 2021.
- Any reference to 'private capital' refers to the private equity, venture capital, private debt, real estate, infrastructure, and natural resources asset classes.\*
  - Scope of assets under management (AUM), performance, and fundraising data for this report includes only private closed-end funds.
  - We track deals made by private capital fund managers and/or institutional investors.
  - Investor allocation figures to the respective asset class are generally a sum of allocations across three routes to market: direct, listed, and private funds.
- All \$ currency units refer to Australian dollars unless otherwise stated.
- All annual figures correspond to calendar-year periods unless otherwise stated.
- Scope of data:
  - Australia focused: funds that have a predominant focus on Australia, regardless of manager headquarters.
  - Australia based: funds managed by domestic fund managers, regardless of fund geographic focus.

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

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## About the Australian Investment Council

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

# Executive Summary

## The Australian private capital market showed resilience in 2020, highlighting a deeper and more sophisticated industry for institutional investors

By many measures, 2020 will likely be remembered as one of the most challenging years for the global private capital market – a true black swan moment. However, the year can also be defined by the adaptability and resilience showcased by the entire industry, which adjusted quickly and effectively to the constraints of social distancing measures and rapidly evolving stakeholder demands.

For the Australian private capital market – comprising private equity, venture capital, private debt, real estate, infrastructure, and natural resources – this strength manifests in the record-breaking \$77bn in total industry assets under management (AUM) as of June 2020. This marks a rise of more than 148% in assets held by private funds focused on the domestic market over the past decade, and an 8.4% increase in just six months from December 2019 (see page 11).

This growth has been driven by more domestic and international investors seeking exposure to potential opportunities in the market. Prior to 2000, foreign institutional investors made up less than 21% of all investors active in Australia-based funds, but this figure surges to 48% for 2015-2020 fund vintages (see page 40).

Indeed, a more diverse investor base has also resulted in a much deeper and more stable fundraising environment for GPs. Despite the global economic crisis brought on by the pandemic, Australia-focused private capital fund managers secured \$8.3bn in 2020 – an increase of more than 20% from the previous year and the second-highest total in 10 years (see page 12).

What could be motivating such positive outcomes in Australian private capital? Especially through a challenging period like last year. The answer, although complex and multifaceted, comes down to two key variables.

### The Right Climate

First, Australia's stable economic and political backdrop has offered a consistently accommodative investment climate for GPs and LPs alike. This has been readily backed up by a robust corporate governance landscape and proactive legal system. These elements are not only cultivating a thriving alternative investment industry, but are helping set the country apart from some of its regional peers.

With the onset of the COVID-19 pandemic, the Australian Government held steadfast to these defining characteristics, stewarding the domestic economy out of its first contraction in almost 30 years and back toward growth. Following decisive monetary and fiscal policy action – which included direct support for individuals via initiatives such as JobKeeper and JobSeeker, as well as an effectively coordinated public health response<sup>1</sup> – Australia's economic growth forecast for 2021 has been upgraded from 3.2% to 4.5% by the OECD<sup>2</sup>. And in 2022, the economy is set to grow a further 3.1% off the back of strong recovery momentum.

For public and private market participants, these results have likely improved their long-term confidence in future investment prospects. This bodes well for the continued expansion of the Australian alternative investment industry into the future.

### An Attractive Profile

The second variable is a matter of relative performance in a rapidly globalizing private capital industry. Australia's private capital market offers one of the most attractive risk/return profiles globally. Comparing the performance of Australia-focused funds of vintages 2011-2018 against other regions, we find they generate the second-highest median net IRR, at 13.3% – just shy of the 13.5% offered up by Asia-focused funds (see page 12). More importantly, perhaps, in this increasingly

<sup>1</sup> <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/collaboration-in-crisis-reflecting-on-australias-covid-19-response>

<sup>2</sup> <https://www.oecd.org/newsroom/the-need-for-speed-faster-vaccine-rollout-critical-to-stronger-recovery.htm>





volatile global investment market, Australia-focused funds showcase the lowest median risk, at 10.4% standard deviation of net IRR.

Taken together, the investment case is clear for global allocators struggling to identify both diversification and enhanced returns in a chronically low-yield environment for their rapidly expanding portfolios.

### Unique and Growing Markets

This report explores the latest data and emerging trends in the Australian private capital industry. Each of the asset classes examined in this report presents a unique value proposition and growing opportunity set for global allocators. We expect each to continue drawing rising interest over the long term, as the entire alternative investment industry matures and evolves to meet new investor demands.

For the Australian market, the mantle for largest private capital asset class by AUM stays with private equity & venture capital (PEVC), which commands a record \$37bn at June 2020 – registering four years of consecutive growth (for the first time in the past decade) and almost \$14bn in dry powder.

**Private Equity:** Fundraising in 2020 was robust despite economic headwinds. At \$4.3bn, aggregate capital raised was almost 2.8x the total secured in 2019 (\$1.55bn). This outcome was supported by a handful of blockbuster fundraises, the largest of which was Pacific Equity Partners Fund VI in July, which at \$2.5bn became the second-largest Australia-focused private equity fund to close since 2016.

On the deals front, total transactions were down 20%, as deal-makers grappled with significant pandemic-induced uncertainty. However, aggregate deal value declined by only 12% on 2019, propped up by notable deals in the consumer discretionary and natural resources sectors (see pages 14-16).

**Venture Capital:** Australia's venture capital industry boomed in the second half of 2020 on the back of a global acceleration in digitalization trends and growing interest in new technology-driven business models. Fund managers raised \$1.3bn in 2020, the largest sum ever and almost double the \$735mn recorded in 2019.

More interesting, perhaps, was where capital was deployed by managers. Of the \$2.4bn in venture-backed deals transacted in 2020, one-quarter by value were in later-stage Series C investments, up from only 8% in 2019. In fact, Series C and later-stage rounds made up 36% of aggregate deal value – their highest share yet. The sectoral composition of deals is also changing. Despite information technology making up 51% of total transactions and 41% of aggregate deal value over the past 10 years, its dominance has ceded in favor of financial services and insurance-related start-ups (see pages 18-20).

**Private Debt:** The Australian private debt landscape has evolved significantly in recent years, supported by regulatory moves aimed at developing a vibrant and highly competitive lending market. In 2020, the asset class continued to grow, as investors from around the world combed the globe in search of higher yields. But not every top-level strategy was successful. Mezzanine





has continuously dominated private debt in Australia, accounting for 67% of the total capital raised in the asset class; smaller or more niche strategies across direct lending, venture debt, and special situations make up the rest.

The picture is very different on the private debt-backed deal front, however. Mezzanine and senior debt deals – and even unitranche more recently – have traded leadership positions over the years, as ever-more sophisticated allocators have diversified their exposures. Coming out of the COVID-19 crisis, the Australian private debt market is well positioned to adapt to new regulatory changes and market dislocations caused by the pandemic (see pages 24-25).

**Real Estate:** With close to \$29bn in Australia-focused AUM, private real estate is the second-largest asset class in the country. Its absolute size, however, was not enough to stymie the negative impact of the global pandemic on fundraising. The number of funds reaching final close in 2020 fell 63% compared with 2019, while aggregate capital raised fell 54% to \$1.5bn. Still, domestic fund managers secured some massive fundraising wins. For example, real estate major Gresham raised \$756mn for its debt-oriented Property Fund No. 7 – the second-largest fund closed in the past two years.

Deal activity fared reasonably well in 2020, but investment demands are shifting beyond core office and retail sectors in favor of property types experiencing demand regardless of the wider economic environment, including those in the sheds, meds, and beds arena (see pages 28-30).

**Infrastructure & Natural Resources:** Australia is one of the largest net food exporters and leads the world in hectares of organic certified farmland. It also benefits from a unique position as a highly competitive counter-seasonal producer to the Northern Hemisphere, as well as close proximity to the densely populated and rapidly growing Asian markets. It is therefore no surprise that agriculture/farmland funds accounted for a significant proportion (34%) of aggregate capital raised by unlisted infrastructure and natural resources funds between 2010 and 2020. For investors, Australian farmland offers diversification, a hedge against unexpected inflation, and attractive real cash yields.

Supporting infrastructure, primarily in the renewable energy space, once again recorded the most activity by deal count in 2020, and the pipeline for opportunities looks set to expand. Australia-focused infrastructure funds raised a healthy \$1.1bn last year, up from \$149mn secured in 2019. Private capital now has a strong foothold to help bridge the gaps in government infrastructure funding (see pages 33-35).

#### **A Bright Future for Australian Alternatives**

Australia is home to a vibrant private capital market that is increasingly diverse – and maturing at a steady rate. This was apparent in the industry's ability to weather a truly unprecedented time for the global economy surprisingly well. While the economic scarring of the pandemic remains, the industry's adaptability and resilience will ensure the future stays bright for alternatives in Australia.

# Key Facts



**\$77<sup>bn</sup>**

Australia-focused private capital assets under management (as of June 2020)



**\$8.3<sup>bn</sup>**

Aggregate capital raised by Australia-focused private capital funds in 2020



**169%**

Increase in aggregate capital raised by Australia-focused private equity funds in 2020 compared to 2019



**\$2.4<sup>bn</sup>**

Aggregate value of Australian venture capital deals\* completed in 2020



**50%**

Proportion of Australian private debt-backed deals in 2020 focused on senior debt



**\$29<sup>bn</sup>**

Total assets managed by Australia-focused closed-end private real estate funds (as of June 2020)

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

# Overview of Private Capital in Australia



**8.4%**

Increase in Australia-focused private capital AUM from December 2019 to June 2020



**\$27bn**

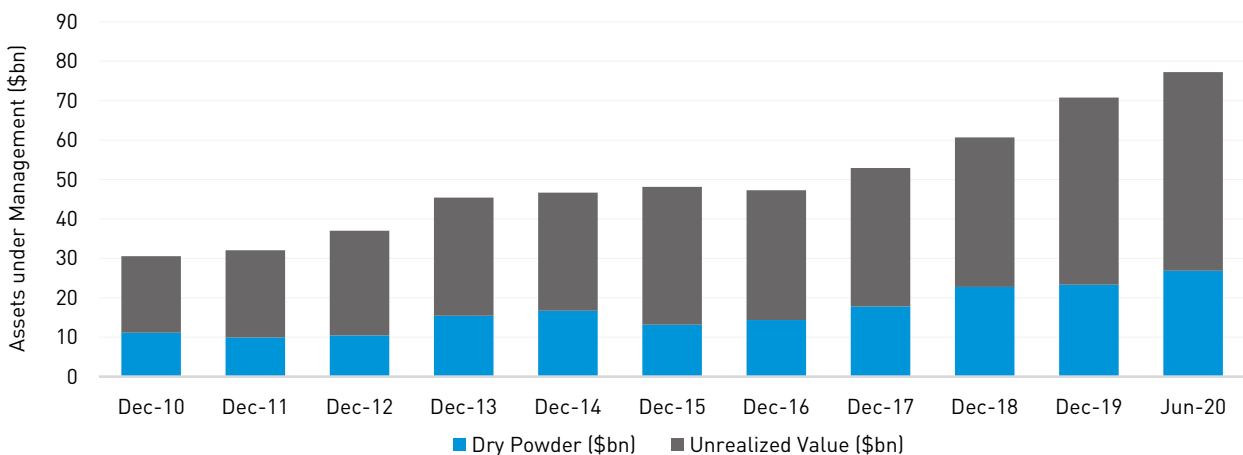
Total dry powder held by Australia-focused private capital fund managers (as of June 2020)



**\$14bn**

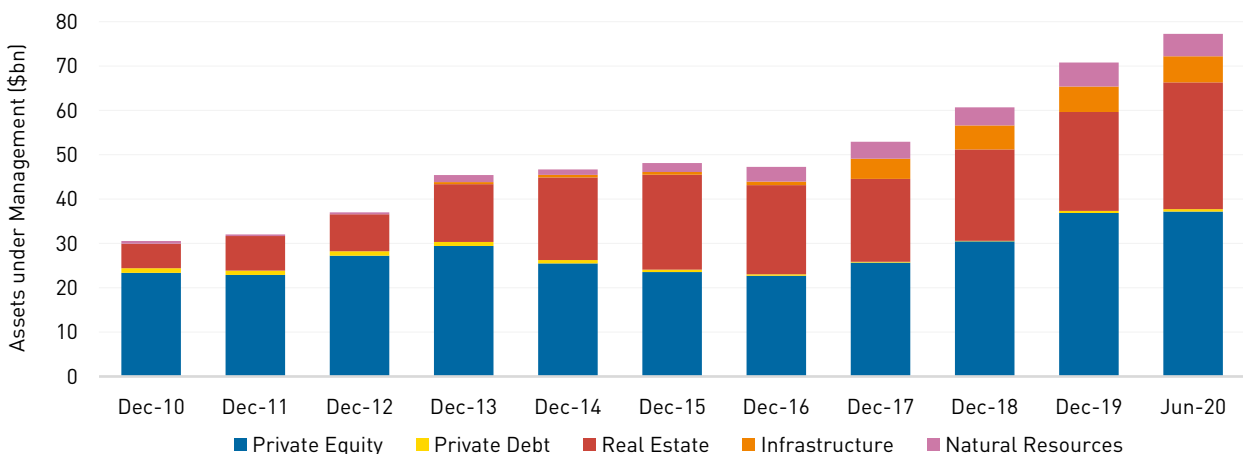
Total dry powder held by Australia-focused private equity & venture capital firms at the end of H1 2020, a new record

**Fig. 1: Australia-Focused Private Capital Assets under Management, 2010 - 2020**



Source: Preqin Pro

**Fig. 2: Australia-Focused Private Capital Assets under Management by Asset Class, 2010 - 2020**



Source: Preqin Pro



**20%**

Increase in total capital raised by Australia-focused private capital funds in 2020 compared with 2019, despite fewer funds reaching final close



**\$224mn**

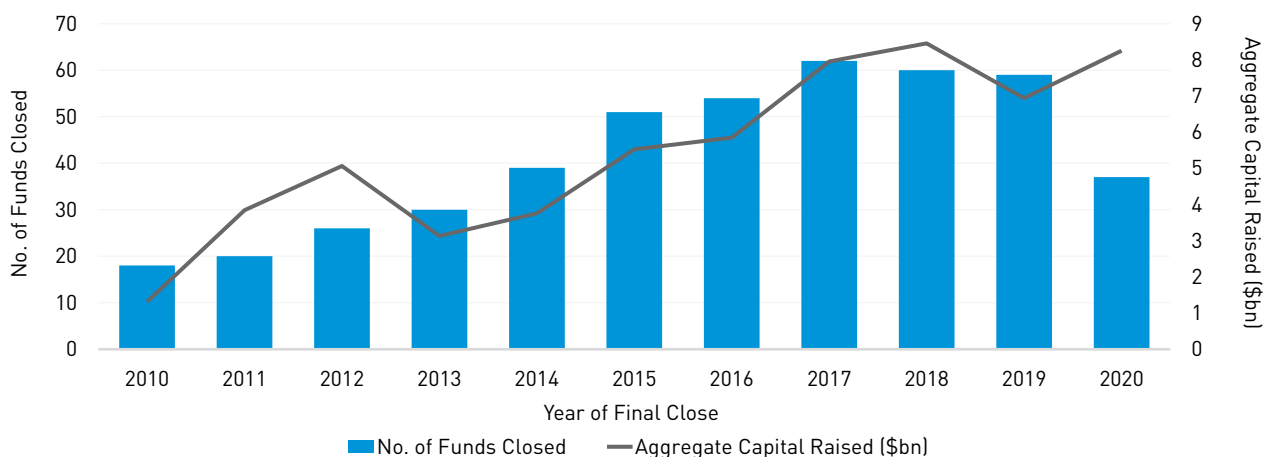
Average size of Australia-focused private capital funds closed in 2020



**13.3%**

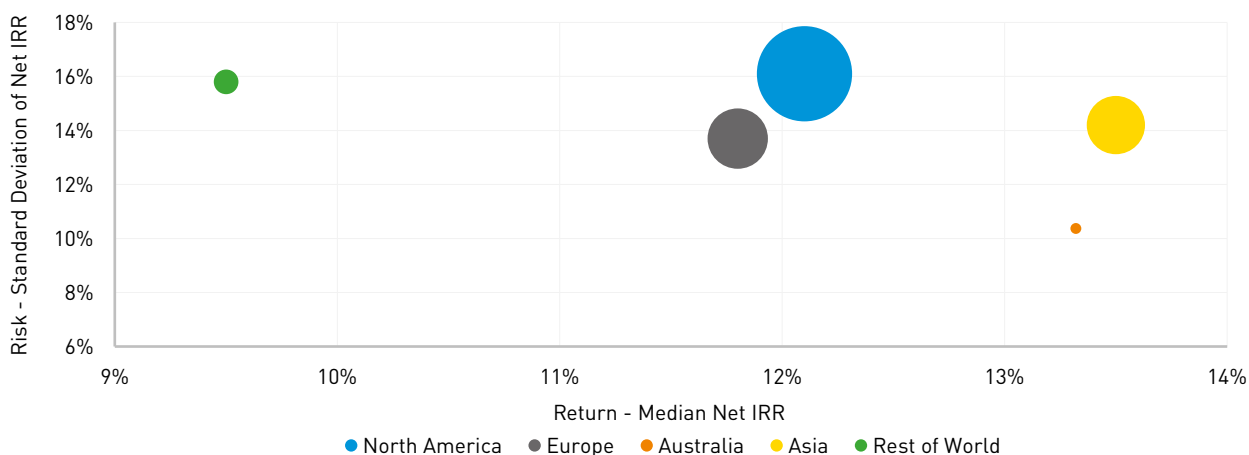
Median net IRR of Australia-focused private capital funds (vintages 2011-2018)

**Fig. 3: Australia-Focused Private Capital Fundraising, 2010 - 2020**



Source: Preqin Pro

**Fig. 4: Private Capital: Risk/Return by Primary Geographic Focus (Vintages 2011-2018)\***



Source: Preqin Pro. Most Up-to-Date Data

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





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# Private Equity: Resilient in a Pandemic

## Fundraising increased from 2019, and several mega deals made it over the line

The Australian private equity industry withstood the challenges of COVID-19 very well. Despite the fierce sell-off in global risk assets in Q1 2020, AUM grew by a modest \$300mn in the first six months of 2020, to reach \$37bn as of June. By contrast, the ASX 200 public equity index was still in the process of recovering, but regained most of its losses by the end of the year.

Investors continued to allocate capital to private equity throughout 2020. In fact, fundraising increased on the previous year, albeit through a smaller number of funds. A total of \$4.3bn was secured via seven funds, up 2.7x on the amount of capital raised in 2019 (Fig. 5). Among the largest funds raised were Pacific Equity Partners' sixth fund, which closed with \$2.5bn in July, and Quadrant Private Equity's seventh fund, closing on \$1.2bn in December (Fig. 7).

The initial COVID-19-induced slowdown in exit activity played a role in maintaining high AUM levels. In the first half of 2020, only two exits were sales to other GPs – these amounted to \$0.3bn. Travel restrictions and overall market uncertainty no doubt affected the capacity of managers to complete exits. Exit activity returned in earnest in Q4 2020, however, with 17 exits valued at a combined \$3.5bn.

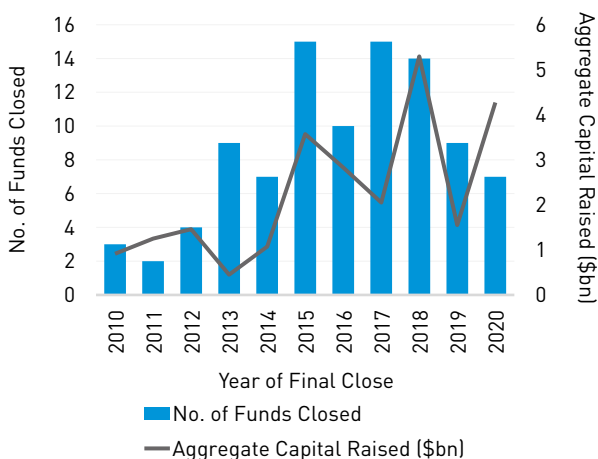
While there were 20% fewer private equity-backed deals in 2020 compared with 2019 (Fig. 6), the average deal size increased. The total deal value for the year declined slightly, by 12%. Australian private equity firms also stand ready with more than \$11bn of dry powder ready to deploy.

### US Managers Help Large Deals over the Line

Travel & leisure was one of the industries most impacted by the pandemic, and the recapitalization of Virgin Australian Airlines in June was the single largest buyout of 2020 (Fig. 9). Bain Capital and Bain Capital Credit were both key investors in the deal, along with Virgin, which supplied \$3.5bn to help shore up the company's finances.

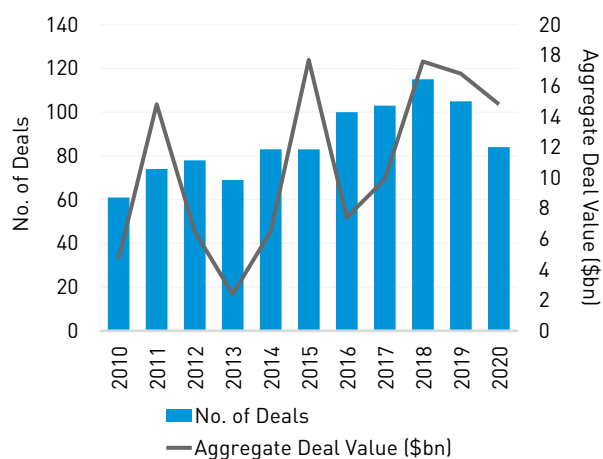
Despite the depressed public equity markets during Q2 2020, private equity firms were not able to take advantage of listed equity valuations, given the speed of the recovery. Public-to-private deals had been rising in prominence in recent years, but dropped from 51% of total deals in 2019, to 9% in 2020. This may, in part, reflect government efforts to tighten foreign investment laws.

**Fig. 5: Australia-Focused Private Equity Fundraising, 2010 - 2020**



Source: Preqin Pro

**Fig. 6: Private Equity-Backed Buyout Deals in Australia, 2010 - 2020**



Source: Preqin Pro

### Foreign Investments More Closely Reviewed

To help protect Australian companies from depressed asset prices following the outbreak of COVID-19, the Australian Government enacted temporary measures in March 2020 to curb foreign acquisitions of domestic assets. These measures included removing the minimum monetary threshold for investments requiring Foreign Investment Review Board (FIRB) approval, and extending potential approval times. The government later made permanent changes to the Foreign Acquisition and Takeovers Act (FATA), effective from January 2021, strengthening enforcement powers and introducing a new national security test for foreign investment transactions.

As these geopolitical dynamics play out, global private equity firms have an opportunity to increase their exposure to the Australian market. After all, international LPs have an essentially passive investment in buyout deals through funds, and in some cases are able to apply for exemption from FIRB requirements.

### A Permanent Capital Shift

More large GPs globally are making strategic acquisitions of financial services businesses to increase their supply of permanent capital. Typically, this is achieved by acquiring insurance companies. In these types of transactions, both parties appear well placed to benefit. Managers can significantly increase their financial firepower in the market by investing some of the investment holdings of the insurance company, while insurance companies or pension funds benefit from the specialist expertise of the manager at a time when they are typically looking to increase exposure to private equity and other private capital asset classes.

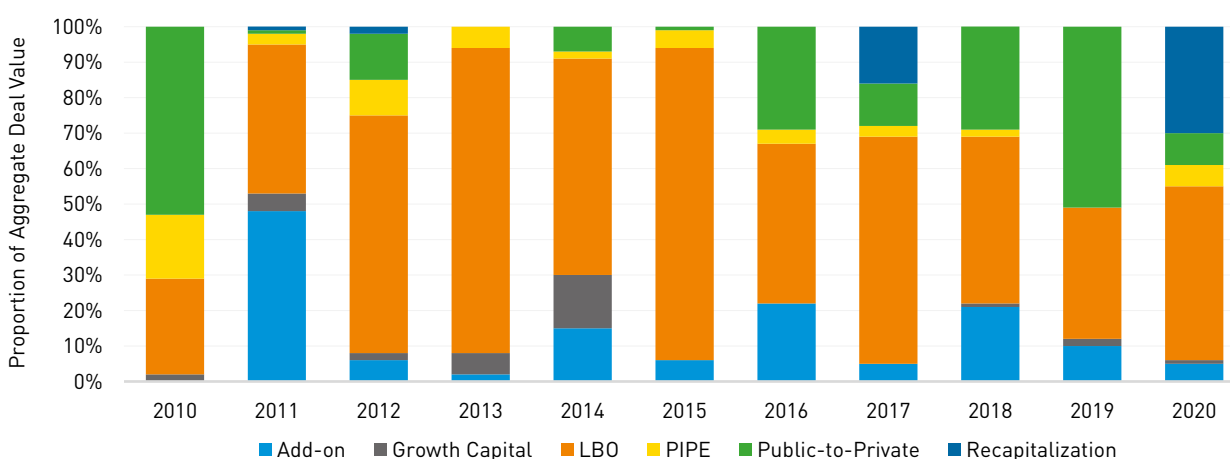
In the fallout from the Hayne Royal Commission into banking and financial services, Australian banks are focusing more on their core businesses and divesting their financial advice and superannuation businesses. An example is KKR pursuing the acquisition of a 55% share of wealth management group Colonial First State; the remaining 45% stake will be retained by the group's former owner, Commonwealth Bank. Time will tell whether this move mirrors strategic financial services investment decisions taken in other markets.

**Fig. 7: Largest Australia-Focused Private Equity Funds Closed in 2016-2020**

Fund	Firm	Fund Size (\$mn)	Fund Type	Final Close Date
BGH Capital Fund I	BGH Capital	2,600	Buyout	May-18
Pacific Equity Partners Fund VI	Pacific Equity Partners	2,500	Buyout	Jul-20
Quadrant Private Equity No. 7	Quadrant Private Equity	1,240	Buyout	Dec-20
Quadrant Private Equity No. 6	Quadrant Private Equity	1,150	Buyout	Dec-17
Quadrant Private Equity No. 5	Quadrant Private Equity	980	Buyout	Aug-16

Source: Preqin Pro

**Fig. 8: Aggregate Value of Private Equity-Backed Buyout Deals in Australia by Investment Type, 2010 - 2020**



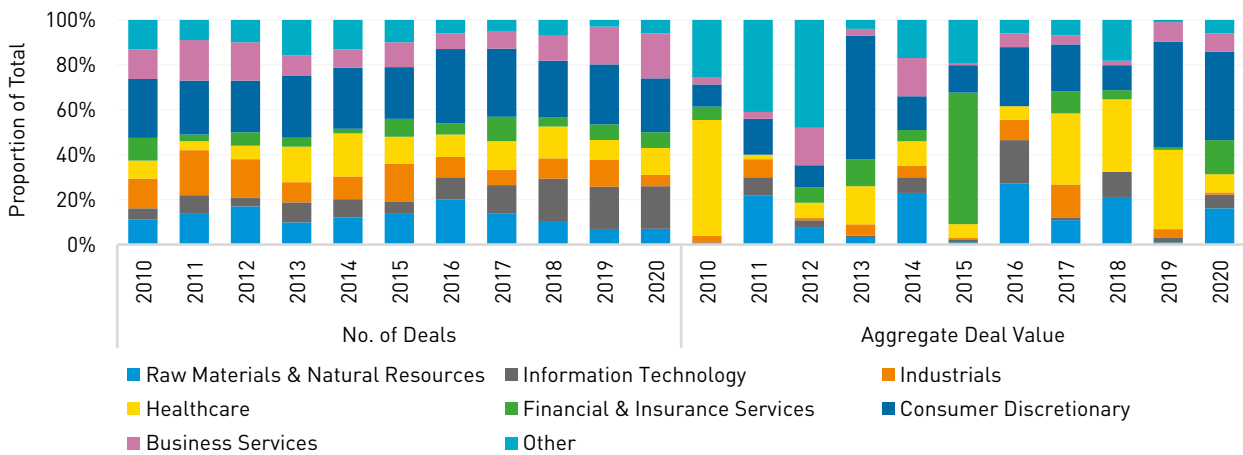
Source: Preqin Pro

**Fig. 9: Largest Private Equity-Backed Buyout Deals in Australia in 2020**

Portfolio Company	Investment Type	Investor(s)	Deal Size (mn)	Deal Status	Investor Location	Industry	Deal Date*
Virgin Australia Airlines Pty Ltd.	Recapitalization	Bain Capital, Virgin	3,500 AUD	Completed	US, UK	Consumer Discretionary	Jun-20
Thiess Pty Ltd.	Buyout	Elliott Management	2,200 AUD	Completed	US	Raw Materials & Natural Resources	Oct-20
Colonial First State Investments Limited	Buyout	KKR	1,700 AUD	Announced	US	Financial & Insurance Services	May-20
Village Roadshow Limited	Public-to-Private	BGH Capital	758 AUD	Completed	Australia	Consumer Discretionary	Jul-20
Speedcast International Limited	Recapitalization	Centerbridge Partners	500 USD	Completed	US	Telecoms & Media	Aug-20

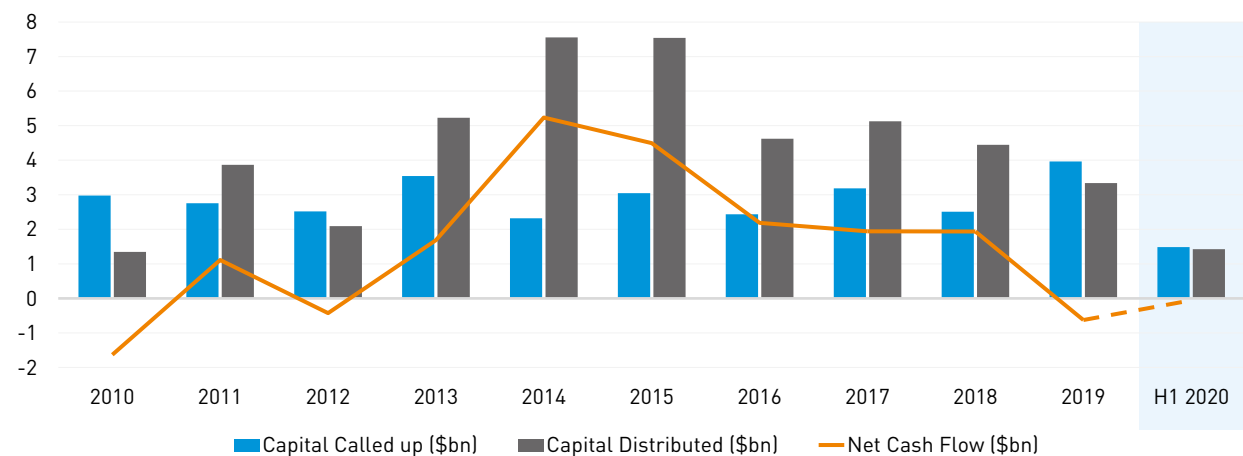
Source: Preqin Pro

**Fig. 10: Private Equity-Backed Buyout Deals in Australia by Industry, 2010 - 2020**



Source: Preqin Pro

**Fig. 11: Australia-Focused Private Equity: Annual Capital Called up, Distributed, and Net Cash Flow, 2010 - H1 2020**



Source: Preqin Pro

\*Preqin Pro prioritizes the date the deal was agreed and announced (where it is subject to regulatory filings and customary closing conditions before completion) over its completion date. Therefore, as an example, the \$1.6bn acquisition of MYOB by KKR is not reflected in 2019 data (as it was announced in December 2018).



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# Venture Capital: Fundraising Hits New Record

## Fundraising and deal value held up well amid the pandemic, with e-commerce and fintech emerging as attractive new sectors for investment

The global venture capital industry has been booming since the second half of 2020, and Australia is no exception. The pandemic disrupted financial markets as a whole in Q1 2020, but the venture capital industry was more adept at getting activity back on track and adopting new tech-driven solutions to business models and work patterns.

The outbreak of COVID-19 drew a sharp distinction between those companies able to capitalize on the short- and long-term shifts created by the pandemic, and those that will lose out. It quickly became apparent that the ability to embrace digitalization, or mobilize existing tech capacity, was the key determinant here.

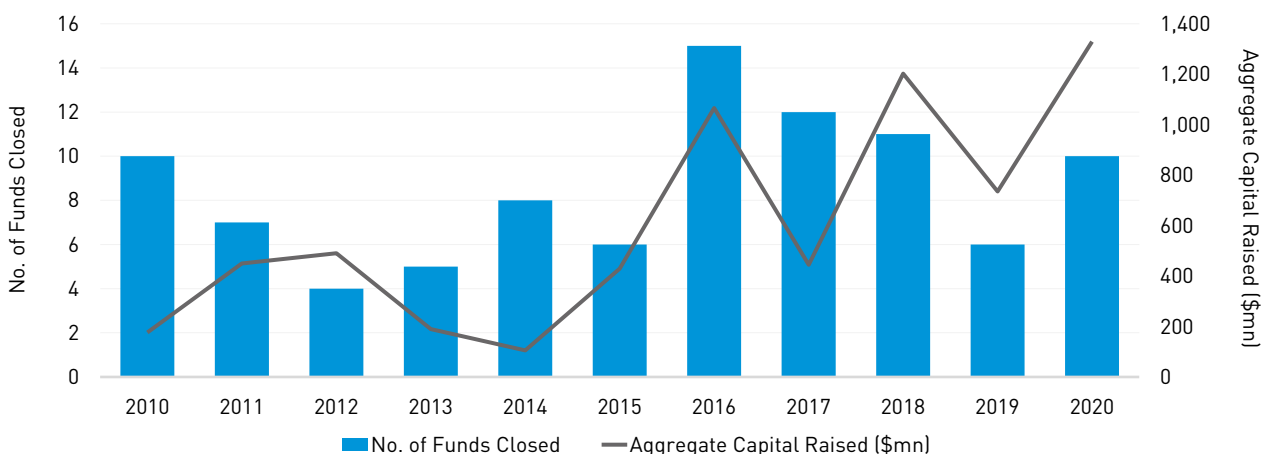
The rate of adoption of existing technological trends, such as e-commerce and electronic payments, has been accelerated by several years. For companies benefiting from these strong tailwinds – a large portion of which are relatively early stage and still in receipt

of venture fundraising – valuations have soared as a result. While a flood of liquidity from central banks globally has also supported valuations, the risk of pockets of excess valuations in certain areas has increased. The RBA has been consistent with the global trend, unveiling a \$100bn quantitative easing program in 2020; the knock-on effect for Australia's venture industry will have been positive.

Australia is fifth in the Global Entrepreneurial Index (GEI)<sup>1</sup>, and remains a highly entrepreneurial market with a vibrant venture capital ecosystem. The attraction of the domestic market as a hub for innovation investments held firm through the depths of the pandemic. In fact, Australia-focused venture capital fund managers secured a record \$1.3bn in new commitments for 2020, across 10 funds (Fig. 12). To put this into perspective, the sum is almost double the total raised in 2019, before the onset of COVID-19. The largest vehicle to reach final close last year amid the

<sup>1</sup> <https://thegedi.org/global-entrepreneurship-and-development-index/>

**Fig. 12: Australia-Focused Venture Capital Fundraising, 2010 - 2020**



Source: Preqin Pro

turbulent market environment was Blackbird Venture's 2020 Follow-on Fund, which raised a total of \$417mn in December 2020.

Deal value was also resilient, increasing slightly to \$2.4bn from \$2.3bn in 2019 (Fig. 13). While the number of deals fell by 21%, the prevalence of later-stage fundraising rounds has cemented the innovation pipeline. Series C rounds raised 25% of total capital, compared with 8% the previous year (Fig. 15). Meanwhile, Series A financings raised 10% of total capital, down from 28% in 2019. For future deals, Australian venture capital firms are ready with \$2.2bn of dry powder to deploy.

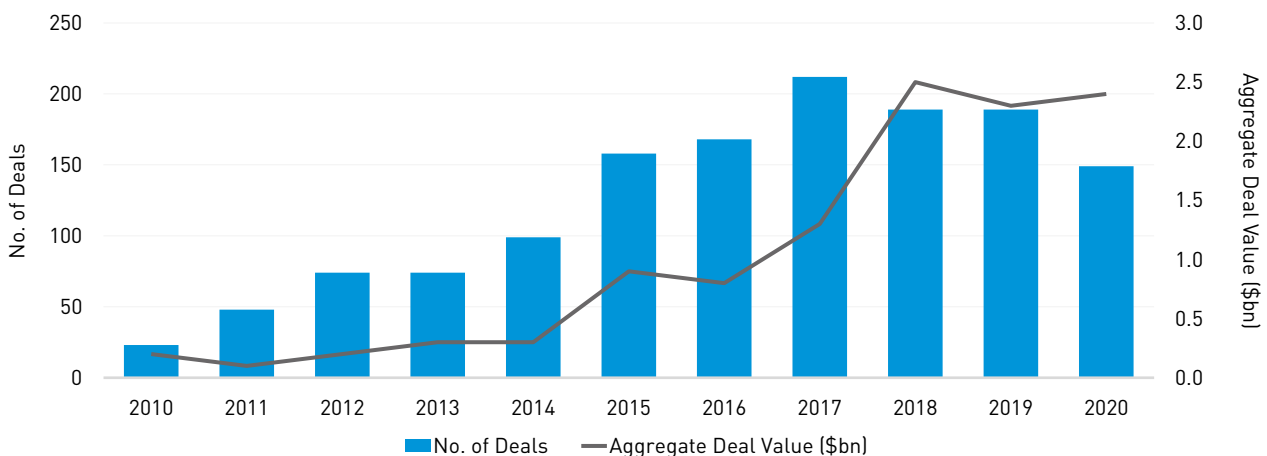
The information technology (IT) sector has long dominated the Australian venture capital scene. Since 2010, IT deals have comprised 51% of total transactions and accounted for 41% of aggregate deal value (Fig. 16). In 2020 the dominance of IT receded slightly, to 38% of total transactions, with activity in financial and insurance companies climbing to 37% of deals.

Payment technology is one area undergoing radical transformation. In 2018, 12% of Australians were utilizing digital payment solutions, but this is expected to accelerate rapidly to 70% by 2023<sup>2</sup>, as consumers adapt to the new, post-pandemic reality. New 'buy now, pay later' platforms have dominated aspects of the financial services market over recent years, and in 2020 it became apparent that the likes of Humm and Latitude would be competing head-on with established incumbent Afterpay.

Fintech banks are also threatening to disrupt the dominance of the nation's top four lenders. Judo Bank was busy raising \$830mn in venture debt and \$514mn through Series C and D rounds in 2020, with investors including Myer Family Investments, Magnetar Capital, Bain Capital Credit, and Citibank. The bank is focused on retail deposits and lending to SMEs. These sizable funding rounds, among others in the sector, highlight the increasing opportunities in the domestic fintech industry and the growing need for venture financing in Australia.

<sup>2</sup> <https://www.intheblack.com/articles/2020/06/01/cashless-payments-spike-in-fight-against-covid19>

**Fig. 13: Venture Capital Deals\* in Australia, 2010 - 2020**



Source: Preqin Pro

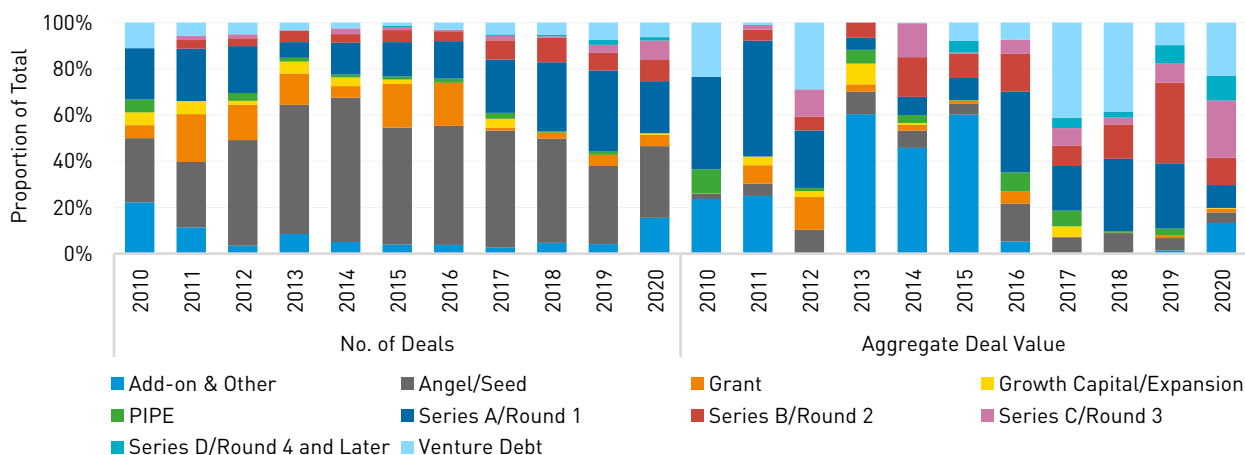
**Fig. 14: Largest Australia-Focused Venture Capital Funds Closed in 2016-2020**

Fund	Firm	Fund Size (\$mn)	Fund Type	Final Close Date
Blackbird Ventures 2020 Follow-on Fund	Blackbird	417	Expansion/ Late Stage	Dec-20
Square Peg Capital Fund 3	Square Peg	355	Early Stage	Dec-20
Square Peg Capital Fund 2	Square Peg	333	Early Stage	Dec-18
AirTree Ventures Fund III	AirTree Ventures	275	Early Stage	Oct-19
Medical Research Commercialisation Fund 5 (MCRF 5)	Brandon Capital Partners	250	Early Stage	Jul-19

Source: Preqin Pro

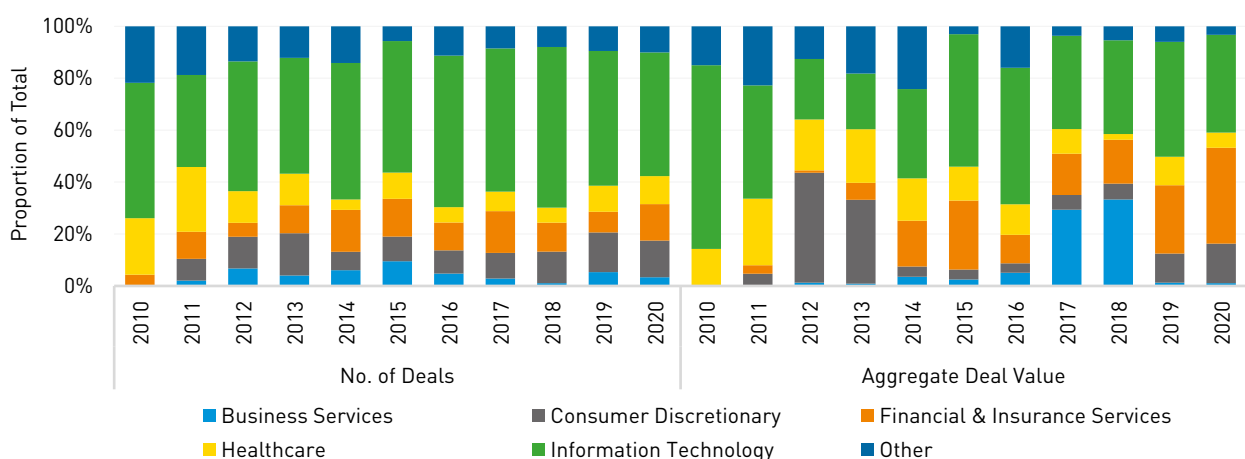
\*Figures exclude add-ons, grants, mergers, secondary stock purchases, and venture debt.

**Fig. 15: Venture Capital Deals in Australia by Stage, 2010 - 2020**



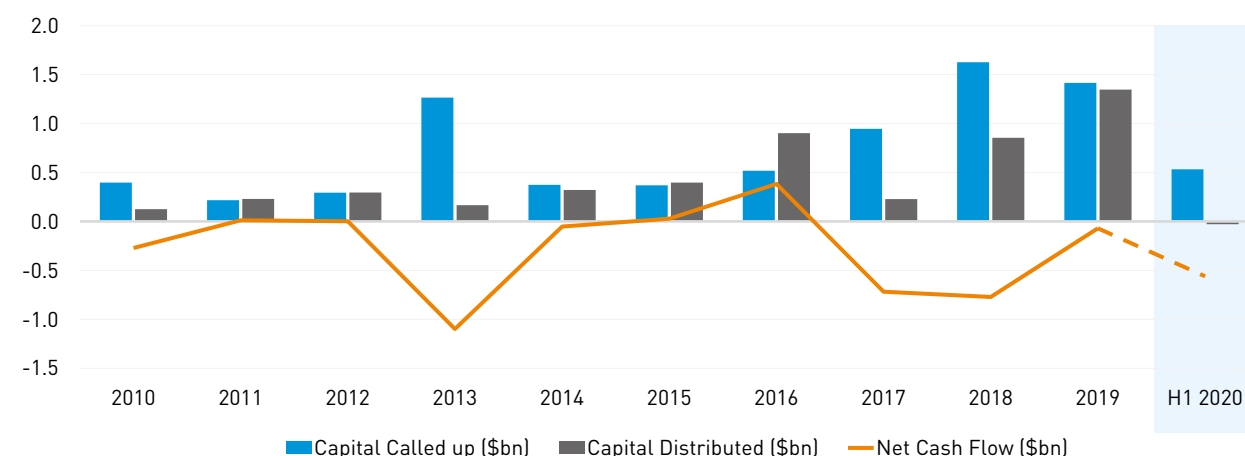
Source: Preqin Pro

**Fig. 16: Venture Capital Deals\* in Australia by Industry, 2010 - 2020**



Source: Preqin Pro

**Fig. 17: Australia-Focused Venture Capital: Annual Capital Called up, Distributed, and Net Cash Flow, 2010 - H1 2020**



Source: Preqin Pro

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



# Significant Upside Potential for Private Markets

**The forces driving success in private markets are aligned in The Lucky Country. Alexandre Schmitz, Managing Partner and Head of APAC at Capstone Partners, explains how stability, sophistication, and growth have created a unique opportunity**

Australia has enjoyed 29 years of sustained macroeconomic growth, with GDP expanding at a CAGR of 3.2% between 1990 and 2019. Growth has surpassed all other developed economies, owing mostly to its proximity to the powerhouses of China and Southeast Asia.

A robust pandemic response has enabled the country to minimize economic disruption. Bolstered by a furlough scheme and wage subsidies, the Australian Government implemented a stimulus package equivalent to 18% of GDP. This sizable fiscal stimulus kept GDP contraction to a minimal 1.1% in 2020, which is in stark contrast to the falls seen in the US (-3.5%), the eurozone (-7.6%), and the UK (-9.9%). At the same time, the vast majority of the population has adhered to stringent and rapidly evolving lockdown measures, as well as systematic tracking and tracing procedures, helping to slow the spread of the coronavirus and keep fatality rates low.

Looking ahead, what Australian intellectual Douglas Horne called “The Lucky Country” anticipates a more robust economic recovery than the rest of the world, capitalizing on strong financial markets, a highly educated population, sound legal framework, and a propensity for continued innovation.

## A Compelling Buyout Market

Australia is one of the few countries in the Asia-Pacific region where investors can put their money to work in private equity control transactions. The country counts over 15,000 businesses that could be candidates for a private equity investment, mainly in the lower middle market. Many of these private companies will experience



**Alexandre Schmitz**  
Managing Partner and  
Head of APAC

**Capstone Partners**  
[www.csplp.com](http://www.csplp.com)

Founded in 2001, **Capstone Partners** is a leading independent placement agent focused on raising capital for private equity, credit, real assets, and infrastructure firms from around the world.

**Alexandre** leads the firm’s Asia-Pacific operations and is responsible for distribution and client origination in Asia-Pacific.

managerial transition in the coming years, given the demographic profile of their shareholders. More family-owned business founders are looking to private equity as an efficient way to access liquidity options for wealth and succession-planning matters.

Smart buyout managers are adapting to offer tailored solutions, often with a two-stage exit strategy. A partial buyout allows the founding family to monetize part of its wealth in a primary transaction, and then to stay invested alongside a professional investor for a 3-5 year hold

period before a final exit to the most viable acquiring entity, either via an international trade sale, listing on the stock exchange, or an auction process with larger secondary buyers. This maximizes the total price of their stake, while reducing the risk. During their tenure, buyout managers may transform the company to boost its strategic value by hiring new executives, improving ESG practices, and optimizing the go-to-market and pricing strategies; and, if meaningful, they may make a few add-on acquisitions.

With such a concentration of closely held family businesses for fund managers to tap into, deal activity in Australia and New Zealand tends to be dominated by primary investments negotiated on a bilateral basis. This is particularly true for the lower middle-market segment where uncontested opportunities can still be identified at attractive valuations. Avoiding lengthy auction processes and secondary transactions means more reasonable EV/EBITDA entry multiples and lower leverage to achieve targeted returns – factors increasingly difficult to manage in the US and European buyout markets. That said, the upper end of the Australian market is characterized by steeper competition; local GPs compete against bigger regional or global buyout firms from a limited pool of fewer than 200 businesses valued at \$1bn or more.

The deal flow of buyout managers has evolved substantially over the past few years, in line with the growth of the Australian economy. Although the bulk of buyout transactions from 2000 to 2015 were invested in industrial and cyclical businesses, the past five years have witnessed a sharp uptick in buyout deals for asset-light and fast-growing businesses in the software, proven technology, healthcare, and education spaces. Benefiting from the deployment of private capital, Australia has successfully become home to many innovative businesses with substantial growth potential.

### A Dynamic and Changing Investor Base

Led by superannuation funds, Australian LPs are some of the most established and most experienced investors in the world. The supers played an instrumental role in actively participating in domestic and international private markets over the past two decades and setting up proper ESG and diversity & inclusion standards.

But market forces are driving change in this crucial financing market. Over the past decade, the number of superannuation funds has significantly decreased following industry consolidation. This has led to larger institutions being able to reach the critical size needed to have internal teams in charge of alternative investments. Furthermore, following the release of the Cooper Report, supers have been advised to focus on the fees paid to third-party managers rather than the net performance adjusted for risk of the underlying investment strategies. Most of the smaller institutions have decreased their exposure to private equity funds, while larger supers have been pushed to do more direct investments, especially in the infrastructure segment. This trend is expected to continue in the foreseeable future and will force Australian managers to raise more funds from international LPs.

Over the same period, family offices have substantially increased their exposure to private equity investments. We estimate that more than 100 multi- or single-family offices are actively investing in the private markets in Australia. This appetite for private assets will flourish as investors seek more international exposure in their capital allocations. Despite its remote location, Australia is more than ever on the map of fund managers targeting an international LP base.

# Private Equity & Venture Capital: Industry Voices



The pandemic has caused a step-change in the way the world will function in the future, impacting certain sectors irreversibly (e.g., retail) and positioning technology to meaningfully power the return to work and pre-pandemic consumption levels. However, not all technology is equal, and VCs are well positioned to identify the most valuable opportunities. Companies struggling to achieve compelling product-market-fit will be significantly more visible than previously as there is no appetite for 'nice to have' software solutions. An increased emphasis has been placed on a solution that sits close to the transaction value of its customers, driving a meaningful revenue uplift. The current environment has also helped identify standout founders – strong leaders capable of swift and (often difficult) decision-making and able to maintain an adapted yet unwavering vision to inspire investors, customers, and employees.

**Andrea Kowalski**

**General Partner**  
**Tidal Ventures**



The private equity industry has showcased adaptability and responsiveness over the past year. While a global pandemic is not a usual occurrence, it highlights that change is accelerating and that the ability to adapt and respond to it is an advantage. Most markets are increasingly becoming customer led, and the ability for 'challenger businesses' to gain market share through outcompeting on the customer proposition has never been greater. On the fundraising environment front, it has been mixed and challenging for us during 2020. We are an emerging business looking to establish new relationships, and from that perspective the past 12 months have created a challenging fundraising environment for new partnerships. Although there is this challenge, existing investor relationships have only strengthened during the pandemic. We see strong interest from high-net-worth and sophisticated investors. Private equity investments are becoming an increasingly important part of their portfolio and they are progressively more aware of the opportunities that exist outside of the traditional listed and fixed-income environment. As always, the potential for private equity to deliver outsized returns is a key driver for investors. This will only come from backing high-quality companies in industries and markets with tailwinds and well-structured deal terms.

**Nick Miller and Nick Dignam**

**Partners**  
**Fortitude Investment Partners**



# Private Debt: A Changing Market

## 2020 marked the return of mezzanine and the start of a new chapter in Australia's private debt market

The debt market in Australia has evolved significantly in recent years. It has endured various regulatory shifts and cycles – some have benefited the private markets, and some have helped the Australian 'major banks' (Australia's largest four banks). Through all of this, the Australian debt market has continued to grow, capturing the attention of many international players in a world where allocators will go from one side of the globe to the other in search of higher yields. Not every top-level strategy has been successful, however.

### An Uneven Fundraising Market

Although mezzanine dominates the space, with a 67% share of total capital raised (Fig. 18), all four top-level strategies – direct lending, venture debt, and special situations making up the rest – have found their place in the Australian market.

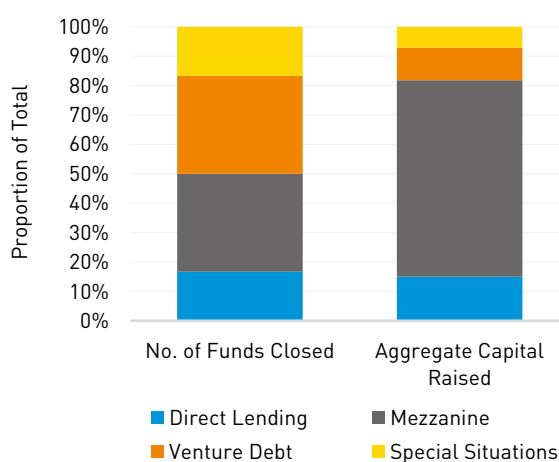
Special situations is generally considered a niche category and usually attracts the smallest portion of capital in debt markets globally; Australia is no exception, with 7% of the capital raised allocated to special situations. Venture-backed companies constantly require working capital, which is often funded by venture debt. This market is still developing in Australia, with 11% of capital raised captured by venture debt funds.

Direct lending, which offers greater security to investors, is considered an attractive category in many markets, but pales next to mezzanine, its closest competition. Direct lenders have absorbed 15% of capital raised, compared with 67% for mezzanine, a strategy that is generally considered riskier than direct lending but promises higher yields to investors. That said, senior debt has captured the increasing interest of market participants in recent years.

### The Evolution of Private Debt Deals

Although mezzanine dominates the fundraising market, the deals landscape in Australia paints a different

**Fig. 18: Australia-Focused Private Debt Fundraising by Fund Type, All Time**



Source: Preqin Pro

picture. Allocators have gone back and forth between senior debt and mezzanine, and in more recent years to unitranche deals. Prior to 2015, mezzanine deals dominated, but this trend shifted: between 2016 and 2020, on average, 51% of the deals fell under senior debt and 26% under unitranche (Fig. 19). The likely explanation for this is that allocators have attempted to diversify their private debt exposures as they have grown more sophisticated and experienced.

2020 changed all the calculations for allocators in every market in Australia. The government and the Reserve Bank of Australia (RBA) injected billions of dollars into the economy and created facilities to help businesses survive the fallout from the pandemic. The RBA set up a three-year \$90bn funding facility to encourage banks to continue providing affordable lending to businesses. However, not every business was able to obtain bank funding, which created an opportunity for mezzanine lenders to back some of the attractive deals in the market. In fact, 50% of private debt-backed deals in 2020 were mezzanine.



### Then and Now

The Australian market has endured various regulatory changes over the years. Post-Global Financial Crisis and Royal Commission, regulations essentially forced Australian banks to implement more conservative lending requirements; this created unique opportunities for private debt firms to have a place in the market. For instance, while structuring private asset-backed securities used to present an attractive serviceable market for domestic banks, regulatory pressures have forced them to focus on the provision of higher-quality loans – leaving a gap in the market for private debt managers to fill. Some funds used the opportunity to service lower trenches, and to offer secured revolving lines that enable a non-bank originator to build up a pool and fill a vacuum in the capital structure.

In the COVID-19 crisis, the Australian Government strengthened bankruptcy protections, putting in place a temporary insolvency moratorium through the Coronavirus Economic Response Package Omnibus Act. On 1 January 2021 this moratorium expired, and most limits returned to pre-COVID-19 levels. The temporary restructuring relief and protection from personal liability for insolvent trading also expired on 31 March 2021. This means that defaults and insolvencies may pick up throughout 2021 and create opportunities for distressed and special situations managers. At the time of writing, the government was in the process of constructing further reforms to support small businesses in financial distress.

Other terms have resurfaced in recent months in an attempt to keep the market afloat with liquidity. Among them are the National Consumer Credit Protection Act

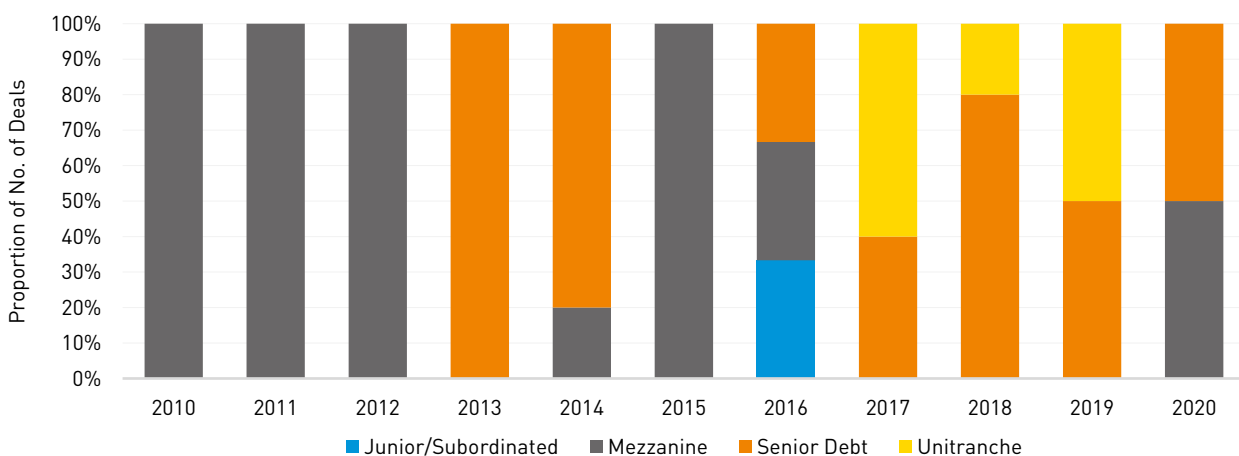
of 2009 and Responsible Lending Obligations (RLOs), as the government looks to maintain the flow of credit in the domestic economy. If passed, it will reshape the way small businesses access credit and might not be viewed favorably by non-bank lenders. The government has argued that the changes will reduce the time it takes for small businesses to access credit in the post-COVID environment and streamline the lending process. This will ultimately soften the suitability requirements and could potentially benefit the banks in the credit market.

### Interest Is Rising

Without a doubt, private debt is attracting increasing attention in Australia. For instance, Queensland Investment Corporation, the investment arm of the Queensland State Government, announced in January 2021 that it is launching a direct capability to originate, analyze, and manage private debt. The growing interest from institutions, asset managers, and family offices seeking income due to low yields is also creating demand pressure in the market. Schrodgers is the latest big-name asset manager developing a private debt function in Australia to benefit from the debt opportunities arising as market participants gradually move away from the banks.

As allocators plan for the post-COVID-19 environment, the Australian private debt market is transitioning under the impact of regulatory changes and dislocations caused by the pandemic. Although currently considered small on a global scale, the market is attracting a lot of attention and has the potential to grow rapidly as more local and international allocators alike search for higher yields.

**Fig. 19: Private Debt-Backed Deals in Australia by Debt Type, 2010 - 2020**



Source: Preqin Pro

# Australian Private Credit Opportunities for Global Investors

**We spoke with Andrew Lockhart, Managing Partner at Sydney-headquartered Metrics Credit Partners, about the rising investment case in Australia's private credit market**

## **What makes the Australian private debt market a unique opportunity for investors?**

The growth of the corporate debt market in Asia-Pacific has been impressive. Corporate bond and syndicated loan issuances reached USD 886bn and USD 680bn respectively in 2019 – easily eclipsing Latin America, Middle East, Central Asia, and Africa combined. Australia makes up a sizable and attractive component of this rapidly expanding debt market. In 2019, for example, domestic corporate bond issuances topped USD 5bn and loans touched an impressive USD 76bn. For Australian companies, the loan market is the primary debt market to access financing. From an investment perspective, this means it is significantly larger, more diversified, and more liquid compared with onshore and offshore corporate bond markets.

The private debt market has always been dominated by banks. In Australia, most companies are still unrated – a hurdle to tapping bond markets – and have limited access to sources of non-bank capital financing. Non-bank financial institutions, particularly those operating in fund formats, have traditionally focused on funding higher-yielding opportunities such as private equity sponsor transactions, property mezzanine, or distressed lending, leaving a significant gap in meeting corporate borrowers' financing needs.

This gap has only widened as Australia's domestic banks have gradually vacated part of the corporate debt space. Rising regulatory pressure has continued to drive up the cost of funding for these institutions, making it very difficult to generate the required return on equity from corporate lending activities – necessitating more disintermediation. This has created an expanding opportunity set for experienced players, like Metrics, who are large enough to effectively compete with and work alongside banks, but also have the capacity and flexibility to invest across a broader range of private credit instruments, situations, borrower types, and industries.



**Andrew Lockhart**  
Managing Partner

**Metrics Credit Partners**  
[www.metrics.com.au](http://www.metrics.com.au)

**Metrics Credit Partners** is a leading Australia-based alternative asset management firm specializing in direct lending to Australian, New Zealand, and Asian companies. We are an active participant in the private credit market and manage more than \$7bn of investments across listed and unlisted investment funds. We manage a range of unique and innovative investment products, designed to provide investors with access to portfolios of private credit investments generating regular cash income and capital stability.

A common misconception of foreign investors is that Australia is solely a commodities-based economy – but it's much more than that. From time to time, sectors or industries may fall out of favor, creating market dislocations, or what I like to call mini-credit crunches, or, more commonly, capital mismatches, where very attractive risk/return opportunities can be actively pursued. Australia also tends to be lumped together with the rest of the Asia-Pacific region in terms of investment profile, which distorts the truth.

Australia has some of the most creditor-friendly corporate insolvency laws globally – if not the most accommodative. Enforcement and insolvency processes

can be undertaken without court involvement, meaning quicker times to resolution compared with the US and UK, and a greater emphasis on preserving the rights of secured creditors. Furthermore, secured creditors have the ability to appoint their own receiver who collects and realizes the secured collateral to repay the debt owed. This is not possible in the UK, and is very limited in the US. These sorts of creditor protections, coupled with generally stronger lending terms and more proactive controls in lending agreements than many Western markets, presents a unique investment case for international allocators.

#### **How did the pandemic impact the domestic private debt industry last year?**

It was a challenging year for the economy as a whole, and no less concerning for the private debt market. Looking back to February last year, Australia was facing a dire trifecta of declining asset prices, rising unemployment, and increasing levels of corporate default. But by April, the picture had started to change. Government policy became highly accommodative, with programs like JobKeeper or JobSeeker and broad-based support for businesses announced. A significant, coordinated response by the Australian Government and the RBA on both the fiscal and monetary front steadied what could have been a protracted period of volatility for capital markets and declines in economic activity.

Interestingly, across the businesses that we lend to, management teams are forecasting stronger performance this year than 2019. Moreover, more than 90% of companies reporting to us are exceeding these impressive 2021 numbers so far. Because of lower interest rates driving demand, performance has been stronger than expected across our commercial real estate borrowers – residential and industrial sectors in particular are standing out positively. This reflects the combination of government policies, RBA market support, and reductions in interest rates, against a backdrop of growing optimism from the roll-out of the COVID-19 vaccine and rising equity and property market asset prices.

#### **What should investors consider when selecting fund managers?**

In today's persistently low interest rate environment, manager selection is key to unlocking yield. First and foremost, investors need to tap into managers that have extensive direct-origination capabilities. This is vital to building quality private debt portfolios through active management of the negotiation process. We also believe that sustainable, long-term relationships with the companies we lend to drive better outcomes

for investors. This open communication between fund managers, borrowers, and investors has become even more important after the pandemic.

Second, you need to identify a team with a strong track record through various economic situations. Investors can be comforted by a manager's deep understanding of intricately complex cash flow and cash conversion cycles. It can also mean that portfolio risk management capabilities are robust, with a manager leveraging these insights to conduct critical stress-testing across different instruments, industries, and borrowers.

Lastly, scale is a key differentiator. The relatively intimate and maturing nature of the domestic private debt market offers significant advantages to fund managers with the size, scale, and capacity to directly originate deals, and can demonstrate value to a borrower.

#### **Looking forward, how do you see the industry evolving?**

Competitive dynamics are changing on the back of the industry's growth and maturation. In 2013, when we launched our first fund, the industry was in its infancy. Since then, we have seen local competitors come to market, raising capital from domestic investors offering similar sources of funding to companies. These teams are typically quite small, and most are highly reliant on banks for deal origination – but they are growing.

At the other end of the spectrum, a rising number of offshore managers come to Australia to focus on the traditional, higher-yielding private debt areas: special situations, distressed, and private equity sponsor funding. As banks continue to cede market share in the lending environment, a larger provision of debt financing will need to come from non-bank financial institutions, so there is still significant room to grow. However, the barriers to entry are material and require scale, meaning consolidation among private credit firms could become more important going forward.

Another material driver for the reallocation of capital within Australia's private debt market is the rising investor concern around ESG. This has always been a large component of what we do when assessing investment opportunities and credit risk as long-term investors, and Metrics became a signatory to the UN Principles for Responsible Investment in 2019. Private lenders more generally need to do deep analysis around environmental, social, and, in particular, governance risks to understand their exposures – it's fundamental to credit risk management. Our asset class has a natural affinity for adopting comprehensive ESG practices in line with growing investor demand globally.

# Real Estate: Pandemic Impact Clear to See

## Australian real estate rode out the COVID storm, but longer-term changes are underway in fundraising and deals

Throughout 2020, Australia implemented a range of restrictions to reduce the spread of COVID-19, which included mandatory quarantine for anyone entering the island nation. This was likely a key driver of the decline in closed-end real estate fundraising last year – the number of funds closed fell by 63% on 2019 (Fig. 20). With strict rules in place, some international investors without an on-the-ground presence appeared cautious toward the Australian market.

Despite the slowdown, fundraising far from stopped altogether. During 2020, 14 Australia-focused real estate funds reached final close, down 63% compared with 2019; aggregate capital raised fell by a marginally lower 54%, to total \$1.5bn.

Fundraising trends over recent years show demand for Australia's fast-growing real estate market is increasing – the largest fund closed in 2020 highlights the scale of this change. Gresham Property Fund No. 7 raised a substantial \$756mn and will target real estate debt opportunities (Fig. 22). The fund was, in fact, the biggest to close in the past two years.

In general, the majority of the top-table closings during the past two years were either core or opportunistic funds, targeting office or niche sectors. This juxtaposition plays out in the deals data, too, where the landscape is shifting.

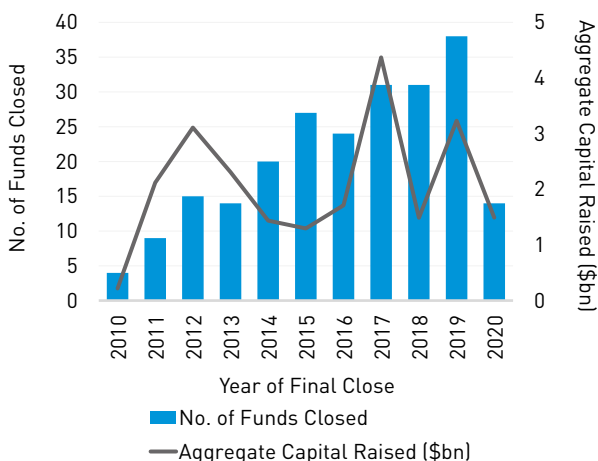
### Niche (Core) Deals Stand out

In a similar pattern to fundraising, private equity real estate (PERE) deal activity in Australia declined in 2020 from a near record high in 2019. Deal numbers fell by 43%, to 161, while aggregate transaction value dropped by 46%, to \$16bn.

The office sector dominated activity, recording \$6.5bn in aggregate PERE deal value in 2020, but its share of total value dropped by 15 percentage points year on year to 42% (Fig. 23). This is where the contrasting fundraising trends begin to make sense. Niche deals experienced the largest increase during 2020, with 17 deals accounting for 10% of the total aggregate value of transactions – up from just a 1% share in 2019.

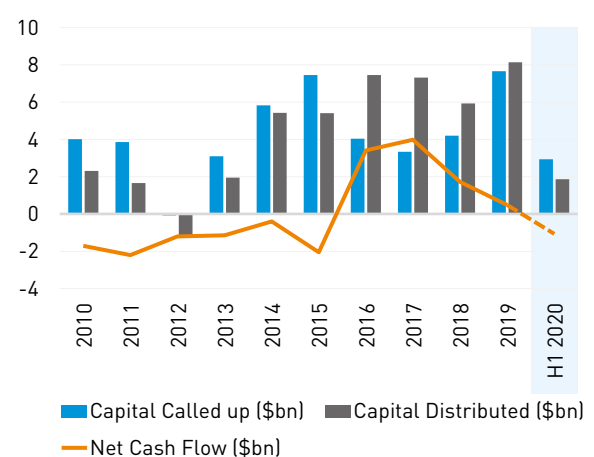
The largest deal in the niche category was the \$446mn acquisition of The Australian Bragg Centre, also known

**Fig. 20: Australia-Focused Closed-End Private Real Estate Fundraising, 2010 - 2020**



Source: Preqin Pro

**Fig. 21: Australia-Focused Closed-End Private Real Estate: Annual Capital Called up, Distributed, and Net Cash Flow, 2010 - H1 2020**



Source: Preqin Pro

as the South Australian Health and Medical Research Institute (SAHMRI), and represents a core quality asset in a niche sector. The asset is located within BioMed City in Adelaide and involves a significant redevelopment. According to CBRE, this under-construction development has a pre-commitment level of 77% and a Weighted Average Lease Expiry (WALE) of 21.9 years upon completion in 2023.

Student accommodation is another standout sector within the niche category. Significant deals in 2020 included the \$269mn acquisition of 18 Leicester Street in Melbourne and the \$190mn acquisition of 500 Swanston St in Melbourne. Student accommodation is a fast-maturing asset class which has gathered significant momentum in recent years. International student numbers stood at 686,000 as of December 2020, according to Austrade data.<sup>1</sup> Although down from 756,000 in 2019, it marks a significant increase on the 401,000 international students in Australia at the end of 2012.

To its end, the government is making steps to allow overseas remote learning to count toward what would have been Australia-based study, providing a potential path for overseas students to return in future. Australia remains an attractive destination for education; while the pandemic has undoubtedly hit the flow of international students into the country, this is unlikely to become a permanent barrier to growth.

#### A Tough Year for Offices, but Late 2021 Could Be a Turning Point

The most immediate impact of the pandemic on employment practices has been the widespread realization that decentralized work, remote working, and more digitally enabled work processes can be effective alternatives to traditional working arrangements. These

trends have been discussed for decades, but technology has finally caught up and made what was once a dream, a reality. However, this is hitting demand for office space across the world – it is not simply an Australian phenomenon.

Some Australian capital cities are potentially being hit harder than other locations, as the development pipeline has played its part to increase supply at an inopportune time. Within Sydney CBD, vacancy rates more than doubled from 3% at the end of 2019 to reach 7.7% at the end of 2020, according to CBRE data.<sup>2</sup> Melbourne CBD fared even worse, with vacancy increasing from 2.0% in 2019 to 7.9% in 2020. Of the major capital cities, only Adelaide saw vacancy decline year on year, albeit marginally, from 11.3% to 11.2%.

Higher vacancy is also hitting net effective rents, with incentives increasing over the past year in an attempt to secure tenants. In Sydney CBD, net effective rents fell by 15%, with incentives at almost 30%. In Melbourne CBD, prime incentives are at 34.7% – up 221bps quarter on quarter.

With such a move in net effective rents and higher vacancy yet to fully play out – 2021 is likely to see the peak – it is unsurprising that transaction activity has slowed as some investors sit on the sidelines. Those investors still active are favoring prime assets, at the expense of secondary assets (both in terms of quality and location). Until the occupier and rental outlook improves, this preference is unlikely to change.

Given the speed at which real estate markets move, it is unlikely that there will be a significant increase in investor demand for office assets in the short term. When investor appetite for offices does return at scale, it could be a story for later in 2021.

<sup>1</sup> <https://www.austrade.gov.au/Australian/Education/Education-data/Current-data/summaries-and-news>

<sup>2</sup> <https://www.cbre.com/research-and-reports/Australia-Office-MarketView-Q4-2020>

**Fig. 22: Largest Australia-Focused Closed-End Private Real Estate Funds Closed in 2019-2020**

Fund	Firm	Headquarters	Fund Size (\$mn)	Fund Type	Property Type	Final Close Date
Gresham Property Fund No. 7	Gresham Property	Sydney, Australia	756	Debt	Diversified	Jun-20
MASCOT Private Trust	Mapletree Investments	Singapore, Singapore	654	Core	Office	Nov-19
Cedar Pacific Student Accommodation Fund II	Cedar Pacific Investments	Brisbane, Australia	500	Opportunistic	Niche	Feb-19
Scape Joint Venture 2 Fund	Scape Australia	Sydney, Australia	500	Core	Niche	Mar-19
Wee Hur PBSA Master Trust	Wee Hur Capital	Singapore, Singapore	350	Opportunistic	Niche	Jun-19

Source: Preqin Pro



### Houses Are the Favorite

Australia's residential market remained resilient throughout 2020, which could come as a surprise to many. Consensus view at the height of the pandemic was that there could be a fall of 10% or more in national dwelling values, with some variation among housing types and the state markets. While houses and apartments varied as expected, the ultimate depth of the decline was less severe than initial predictions.

In fact, the median house price in the Greater Sydney area increased by 6.8% in the year to end September 2020, reaching \$1,154,400.<sup>3</sup> The median house rent increased by 4% over the year, to reach \$520 per week. Units, on the other hand, faced a mixed year. While the median unit price was 4.3% higher over the year, median rents declined by 5.7%, to \$500 per week. This highlights the movement within the city, with the inner and middle suburbs the hardest hit. The shift toward houses and away from units was so pronounced that the median house rent exceeded the median unit rent for the first time since 1997.

In addition to these pricing swings, another movement has been taking place as residents head to commuter towns and the more affordable state capitals. Moves to regional Australia are at their highest level in the past 10 years, according to ABS data. Net movement to regional Australia breached 10,000 people per quarter in June 2020, higher than the recent peak of around 8,000 in early 2018.

Whether this move will prove to be a long-term effect remains to be seen, but the short-term impact upon (all) housing vacancy rates is clear. In Sydney the rate increased from 3.3% at the end of September 2019

to 4.3% at the end of September 2020. Over the same period, vacancy in Melbourne increased from 2.2% to 3.7%, while in Perth there was a decline of 1.6% year on year to 0.9%, highlighting the resources-driven strength in Western Australia.

### Sheds, Meds, and Beds Are in Demand

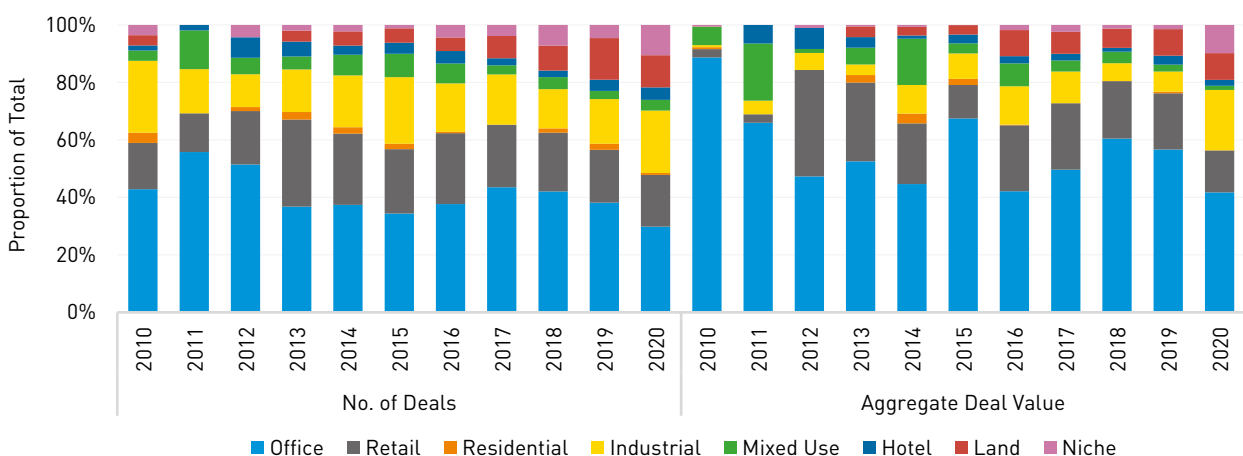
While Australian real estate investments have fared well during the global pandemic, this masks some underlying trends, which could take longer to play out. Occupier demand may continue to weaken, just as supply continues to be delivered; but this could well be a 2021 story – investors are likely to look further along the time horizon.

As Preqin data shows, demand for assets outside of the core office and retail sectors continues to grow. Much of this demand stems from the fact that assets in niche sectors can benefit from growth drivers independent of the wider economic cycle. This is also likely to benefit managers with experience in deploying capital at scale in niche or emerging sectors. Industrial and logistics assets can be included within this category, too, given the long-term secular growth drivers. Demand for industrial and logistics assets is evidenced by the \$3.8bn acquisition of Blackstone's Milestone portfolio by ESR Australia, in partnership with GIC, announced in April. Over the next 12-18 months, it is likely that PERE transactions within the sheds, meds, and beds sectors will continue to feature heavily.

The outlook for Australian real estate is positive, despite the short-term challenges. This is likely to continue attracting both domestic and international investors to what is generally considered one of the most liquid and transparent real estate markets in the world.

<sup>3</sup> <https://www.cbre.com.au/research-reports/Australia-Residential-MarketView-Q4-2020>

**Fig. 23: PERE Deals in Australia by Primary Asset Type, 2010 - 2020**



Source: Preqin Pro

# Real Estate: Industry Voices



Fundraising across the real estate industry remained strong as the low interest rate environment and post-COVID bounce resulted in growing appetite for yield from investors. Indeed, the prospect of rising inflation has been a popular talking point lately. The Reserve Bank of Australia (RBA) has indicated that interest rates will remain at very low levels through 2024. This will result in investors continuing to hunt for yield and make commercial property a very attractive opportunity. Going forward, despite changes to Foreign Investment Review Board (FIRB) processes, which slowed the acquisition activities for offshore groups, capital inflows and demand for deals remains strong.

Global investors are very keen on industrial assets, but there is also growing appetite for large format retail (LFR), particularly when taking into consideration the strength of tenants and the resilient footfall coming out of the pandemic. Furthermore, we expect LFR assets to be strongly positioned longer term to take advantage of the current structural changes in logistics. LFR tends to have large site areas in strong locations on major arterials, which over time should fit into many retailers' last-mile distribution strategies.

We are also starting to see a reversal in work-from-home strategies implemented by corporates last year. Corporates have found offices serve a fundamental role in setting corporate culture, employee collaboration, and general wellbeing. We are witnessing many corporates 'leasing locally' to provide employees with improved work-life balance that can better accommodate a hybrid working model. It will be interesting to see how funds adapt their office holdings to better fit a post-COVID operating environment, all while addressing legacy issues.

**David Schwartz**  
Managing Director  
Primewest





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# Natural Resources and Infrastructure: Opportunities Keep Coming

**The structural growth story for Australia's farmland assets remains intact, while private capital is expected to play a bigger role in funding infrastructure needs**

## The Real Yield Farming

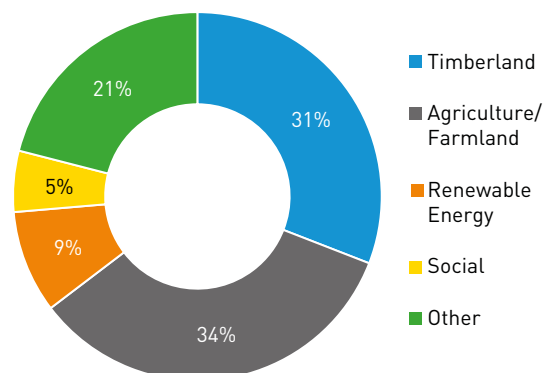
Australian farmland continues to attract strong interest from institutional investors in search of portfolio diversification and a hedge against unexpected inflation that also delivers real cash yields. Indeed, agriculture/farmland funds accounted for a significant proportion (34%) of aggregate capital raised in unlisted infrastructure and natural resources between 2010 and 2020 (Fig. 24).

Australia is one of the largest net food exporters, and also leads the world in hectares of organic certified farmland. Underpinning demand for Australian food production is the nation's key position as a competitive counter-seasonal producer to the Northern Hemisphere, as well as its proximity to high-growth Asian markets where populations are rising.

Returns from Australian farmland have also been resilient during COVID-19, despite labor shortages and lockdowns. In the third quarter of 2020, the ANREV Australian Farmland Index returned 12.35% on a 12-month rolling basis<sup>1</sup>, down slightly from 14.37% in the third quarter of 2019. The index, compiled by ANREV, tracks the income and capital appreciation performance for managed investments in Australian farmland.

While extreme weather events, such as the bushfires in early 2020, remain a risk to farmland investors, Australian rural producers have consistently proven to be capable of adapting to adverse seasonal conditions. Colliers notes: "Adaptive technologies including short-rotation cereal varieties and drought-tolerant pasture

**Fig. 24: Aggregate Capital Raised by Australia-Focused Unlisted Infrastructure & Natural Resources Funds Closed in 2010-2020 by Primary Industry**



Source: Preqin Pro

species, as well as increased efficiencies in farm mechanization and soil management, are continually implemented across different farms in Australia.”<sup>2</sup>

Trade tensions between Australia and China, Australia's largest agricultural trading partner, will remain a challenge for Australian exporters in 2021. Australian barley, beef, wine, and timber were among the industries facing trade restrictions after the Australian Government backed the US in its call for an independent investigation into the origin of COVID-19 and China's early handling of the virus.<sup>3</sup> But this could be beneficial

<sup>1</sup> <https://www.anrev.org/en/market-information/indices/anrev-australia-farmland-index/>

<sup>2</sup> <https://www.colliers.com.au/en-au/research/agribusiness-rfr-2020>

<sup>3</sup> <https://www.abc.net.au/news/2021-01-26/australian-economy-coping-well-after-chinese-trade-restrictions/13090436>

for Australian exporters over the longer term if they move quickly to diversify into markets like Indonesia and Vietnam, which are poised to grow faster than China by 2030.

The recent review of foreign capital inflows could also impact deal activity going forward. Effective from the end of March 2020, all foreign investments in Australian farmland require approval from Australia's FIRB. Previously, approval was only required for deals exceeding \$15mn in value. While market-watchers are still awaiting the release of government figures to see how transaction levels have been impacted, analysts expect Australian farmland – which has found a following among Canadian and American pension funds in recent years – to remain popular with foreign investors due to its relatively cheap pricing and resilience as an asset.<sup>4</sup>

No Australia-focused farmland funds closed in 2020, but this is no surprise – Macquarie Infrastructure and Real Assets (MIRA) had closed its \$1bn MIRA Agriculture Fund fairly recently in October 2019. This close alone was more than double the amount raised by three separate funds in 2018.

#### A Deep and Mature Infrastructure Market

While investor appetite for Australian infrastructure remains strong, opportunities to invest in traditional core infrastructure assets that are protected by economic regulation (such as utilities networks) have dwindled over the years. As a result, some investors have been moving up the risk curve to invest in assets that are subject to a higher degree of contracting risk, such as renewable energy assets and data centers. This is reflected in the largest deals of 2020. In April, MIRA

acquired a majority stake in hyperscale data center firm AirTrunk for \$3bn (USD 2.1bn). AirTrunk was Australia's second-largest infrastructure deal of 2020.

The renewable energy sector, however, once again recorded the most activity by deal count in 2020, led by greenfield solar power projects and followed closely by wind power projects in the secondary stage. In December, Singapore's Keppel Corp paid \$540mn for a 45% stake in Harlin Solar, the vehicle undertaking to build a 500 W solar farm 100km northwest of Brisbane.

The Australian Securities Exchange also remains a fertile hunting ground for infrastructure plays. In August last year, Spanish energy giant Iberdrola emerged as the winning bidder for Infigen Energy in a deal that valued Australia's largest listed renewable energy player at \$893mn. In December, a consortium led by CPE Capital and MIRA launched a \$2.3bn bid for Bingo Industries, which operates the largest network of recycling and resource-recovery centers across New South Wales and Victoria.

#### Fundraising Success

Appetite for Australia-focused infrastructure funds remains healthy. In 2020, three funds closed raising an aggregate \$1.1bn, compared with \$149mn secured by two funds in 2019. Still, new fund strategies may have found more support from investors if not for the pandemic.

Pacific Equity Partners Secure Assets Fund is the first unlisted infrastructure vehicle managed by Pacific Equity Partners; it raised \$360mn and is 54% invested, while the co-invest of \$300mn is 66% deployed. The fund targets energy, transportation, telecoms, and

<sup>4</sup> <https://www.commercialrealestate.com.au/news/australian-agricultural-land-to-remain-popular-with-foreign-investors-991337/>

**Fig. 25: Notable Australia-Focused Unlisted Infrastructure & Natural Resources Funds Closed in 2016-2020**

Fund	Firm	Headquarters	Fund Size (\$mn)	Primary Strategy	Final Close Date
MIRA Agriculture Fund	Macquarie Infrastructure and Real Assets (MIRA)	London, UK	1,000	Agriculture/Farmland	Oct-19
Australia New Zealand Forest Fund 3	New Forests	Sydney, Australia	873	Timberland	Nov-17
Morrison & Co Growth Infrastructure Fund	H.R.L Morrison & Co	Wellington, New Zealand	580	Diversified	Aug-20
Pacific Equity Partners Secure Assets Fund	Pacific Equity Partners	Sydney, Australia	360	Energy	Jun-20
Laguna Bay Agricultural Fund I	Laguna Bay	Brisbane, Australia	313	Agriculture/Farmland	Jan-18

Source: Preqin Pro



utilities assets that have secure cash flows and are located predominantly in Australia and New Zealand. The fund will not invest in assets that have exposure to commodity prices, and seeks to generate returns in the mid-teens.

The largest fund closed last year, Morrison & Co Growth Infrastructure Fund, raised \$580mn at final close in August, missing its \$1bn target (Fig. 25). Launched in 2018, the fund has an allocation commitment of at least 75% to Australia, and targets greenfield, brownfield, and secondary-stage projects across a wide array of industries, including renewable energy, cleantech, connectivity, medical facilities, senior homes, water, and waste management. It targets gross returns of 13-15% per annum.

### Private Capital to Bridge the Financing Gap

In response to the COVID-19 crisis, the Australian Government's focus has been to stimulate an infrastructure-led recovery, and there is room for private equity to participate. In the 2020-2021 Budgets delivered by Australia's Federal, State, and Territory Governments, nearly \$225bn was allocated for general government sector infrastructure funding over the four years to FY2023-2024 – a 26% increase on the previous year.<sup>5</sup> The government has also committed to fast-track 15 major projects, worth \$72bn, as part of the Federal Government's JobMaker scheme.<sup>6</sup>

To get these projects off the ground, superannuation funds are under increasing pressure to invest in domestic infrastructure, and could partner with private equity players to do so. In July last year, industry super-owned IFM Investors proposed a new infrastructure investment model – the Building Australia Model<sup>7</sup> – to address the problems with the current procurement

model for large infrastructure projects, which relies on attracting large constructors while limiting the role for local medium-sized constructors and long-term equity owners.

According to IFM, bidding consortia tend to be dominated by participants that exit and earn their profits shortly after construction is complete. This represents a misalignment with public interests since these consortia are not invested in the asset's long-term operational performance. IFM and industry super funds are reluctant to invest on these terms, and the Building Australia Model proposes that governments bring in a well-capitalized, aligned long-term equity partner early on in a project, selected through a competitive public tender process.

Transport infrastructure is an area where supers could really make a difference. The sector is massively underfunded: the Global Infrastructure Hub (GIH)<sup>8</sup> forecasts investment needs of \$1.1tn across transportation assets including road, rail, airports, and ports from 2016 to 2040<sup>9</sup> (Fig. 26). This accounts for almost half of total infrastructure investment needs in the country in the same period. With infrastructure deals completed in Australia from 2016 to 2020 representing a mere 5.7% of the country's total investment needs, as projected by GIH, this means there is still huge opportunity for private players to help bridge the funding gap.

<sup>5</sup> <https://infrastructure.org.au/budget-monitor-2020-21/>

<sup>6</sup> <https://www.minterellison.com/articles/part-2-investment-and-ma-trends-in-the-infrastructure-industry>

<sup>7</sup> [https://www.ifminvestors.com/docs/default-source/insights/ifm-investors-insight---building-australian-model.pdf?sfvrsn=a802305\\_3](https://www.ifminvestors.com/docs/default-source/insights/ifm-investors-insight---building-australian-model.pdf?sfvrsn=a802305_3)

<sup>8</sup> A G20 initiative that compares infrastructure investment forecasts across seven sectors including transport, telecoms, electricity, and water.

<sup>9</sup> Global Infrastructure Hub Outlook, [https://s3-ap-southeast-2.amazonaws.com/global-infrastructure-outlook/countrypages/GIH\\_Outlook+Flyer\\_Australia.pdf](https://s3-ap-southeast-2.amazonaws.com/global-infrastructure-outlook/countrypages/GIH_Outlook+Flyer_Australia.pdf)

**Fig. 26: Global Aggregate Private Infrastructure Deal Value vs. Projected Infrastructure Investment Needs by Asset Type**

	Road	Rail	Airports	Ports	Other	Total
Investment Needs (2016-2040)*	600	235	44	226	1,222	2,327
Aggregate Deal Value (2016-2020)**			51		82	133

Source: Global Infrastructure Hub and Preqin Pro

\*Figures provided by Global Infrastructure Hub (all figures in \$bn).

\*\*Infrastructure deals data from Preqin Pro (all figures in \$bn).

# Power Struggle in Australia: The Problem and the Opportunity

**Despite an apparent lack of federal support, there is enormous opportunity for private capital investment in renewables in Australia, driven by the need to replace the continent's aging coal fleet**

Could there have been a more unfortunate representation of Australia's climate ambitions than our Prime Minister wielding a lump of coal in parliament, beseeching the public to have no fear? Thankfully, that parliamentary pantomime doesn't represent reality in the Australian energy market. Advancements in energy efficiency technology and engineering, supportive state-led policy frameworks, and sound project economics are driving the shift away from fossil fuels.

The opportunity for private capital to invest in renewable energy is more attractive now than ever before. Many new solar and wind projects are already undercutting the cheapest of existing coal-fired power plants<sup>1</sup>, and Australia stands out as a world-leading renewables market with a bright future. Today, India and Australia are the only markets in Asia-Pacific where the levelized cost of electricity for renewables is cheaper than new-build coal, according to Wood Mackenzie, which predicts that renewables power in Australia will be 47% cheaper than new-build coal by 2030.<sup>2</sup>

This unique cost advantage will further support Australia's energy transition which has been underway for some time. Despite Australia's abundant coal reserves, the repeal of a carbon price mechanism that would have put a price on Australia's carbon pollution<sup>3</sup>, and the lack of a nationalized electricity feed-in-tariff program<sup>4</sup> to accelerate renewable energy investments, there has not been a coal-fired power station commissioned in the National Electricity Market (NEM) in 14 years. I doubt there will be another, absent direct



**Stephen Panizza**  
Head of Renewable Energy

**Federation**  
**Asset Management**  
[www.federationam.com](http://www.federationam.com)

**Stephen Panizza** is a founding member of **Federation Asset Management**, a Sydney-based private equity firm that invests in sustainable infrastructure. Previously, Stephen was the Chief Investment Risk officer at the Clean Energy Finance Corporation of Australia. Prior to that, Stephen was a senior member of Macquarie Capital's Principal Investment division, and led that division in Asia. He has over 25 years of experience in the financial services industry.

government intervention. In March, Australia's third-largest power retailer announced that it would shut its aging 1,450 MW Yallourn power station four years early.<sup>5</sup> Other early coal closures such as Liddell (2,000 MW) in 2023 are positive proof that thermal generation can no longer compete with renewables.

<sup>1</sup> <https://www.irena.org/publications/2020/Jun/Renewable-Power-Costs-in-2019>

<sup>2</sup> <https://www.woodmac.com/press-releases/renewables-in-most-of-asia-pacific-to-be-cheaper-than-coal-power-by-2030/>

<sup>3</sup> <http://www.cleanenergyregulator.gov.au/Infocentre/CPM/About-the-mechanism#:~:text=The%20carbon%20pricing%20mechanism%20was,price%20on%20Australia's%20carbon%20pollution.&text=This%20covered%20approximately%2060%20per,industrial%20processes%20and%20fugitive%20emissions.>

<sup>4</sup> <https://www.energymatters.com.au/rebates-incentives/feedintariff/>

<sup>5</sup> <https://www.reuters.com/article/australia-clp-holdings-powerstation/update-1-energyaustralia-to-shut-yallourn-coal-fired-plant-in-2028-build-giant-battery-idINL1N2L800T>

### Staying Ahead of Coal Retirements

The stated core objective of the federal government's energy policy is to lower energy prices in Australia. The only feasible way of achieving this is to increase renewable penetration. Yet, the NEM remains reliant upon coal-fired power stations. The coal fleet is old, unreliable, and expensive. Therein lies the problem and the opportunity: 15 GW of coal fleet is approaching the end of its life and must be replaced by 2040. In reality, this will happen much sooner, as the coal fleet is losing money due to low-cost renewable energy entering the market.

The Australian Energy Market Operator (AEMO) estimates that 60 GW of renewable energy capacity<sup>6</sup> will need to be built in the next 19 years to replace the coal fleet. That will require more than A\$150bn in capital expenditure on generation alone. Major upgrades to grid and distribution infrastructure will increase this requirement substantially, and we have learned that we need to be in front of retirements. Australia's first major coal plant closure – that of the Hazelwood power station in 2017 – has already alerted us to the disruptive consequences of sudden and unplanned coal exits, namely, spikes in electricity prices and higher risks of blackouts during periods of extreme demand.

While the task is challenging, our course is clear. A great deal has been learned from the teething problems in integrating solar, wind, and other Variable Renewable Energy (VRE) into legacy grid assets. AEMO's Integrated System Plan is a recognition of the need to carefully orchestrate grid augmentation alongside renewable generation installation.

### Integrating Clean Energy into the Electricity Market

Climate leadership at the state government level is promising; it has resulted in the enactment of favorable policies in support of the energy transition. For example, the establishment of Renewable Energy Zones with clear planning of grid augmentation to support generation is well developed, in New South Wales and Queensland in particular. However, to take VRE penetration from the current 25%<sup>7</sup> to 50% and beyond, more storage capacity is required, and at scale. The federal government has sponsored the Snowy 2.0 pumped hydroelectric storage and generation project, which will add 2 GW of long-

duration energy storage, but this will come online in 2027, at best. We don't have that long to wait.

This presents a major opportunity for Battery Energy Storage Systems (BESS). Australia is a leader in large-scale BESS – the Hornsdale Power Reserve project in South Australia is the largest lithium-ion battery in the world. State governments and major energy retailers alike are showing leadership in BESS. Each of the three largest thermal generators have committed to large-scale BESS investment ahead of coal decommissioning.

Windlab, an Australian wind farm developer, conducted a study on the amount of storage that would be required to support very high renewable penetration in the NEM. The study drew upon actual data from the 14-day periods in 2017 and in 2018 with the lowest VRE generation. Windlab concluded that the NEM could support 94% renewable penetration, with additional storage comprising Snowy 2.0 (2 GW / 350 GWh) plus an additional 8.6GW / 13.8 GWh in BESS or other storage technologies.

The opportunity for wind generation in Australia is particularly attractive. Solar generation in the NEM is highly correlated; while the grid is 5,000km long, it's not wide east to west, meaning that practically all of the solar generation comes onto the system at the same time.<sup>8</sup> Furthermore, household rooftop solar installation is expected to continue at pace, rising from the 5 GW installed today to 20 GW forecast by 2036.<sup>9</sup> This will exacerbate our so-called 'duck curve,' which reflects the timing imbalance between energy production and peak demand. Under these circumstances, wind has several advantages over solar. Wind resources across the NEM exhibit a lower generation correlation than solar, and a low – sometimes negative – diurnal correlation with solar. Wind farms also have higher net capacity factors (now approaching 50% onshore<sup>10</sup> vs. maximum 28% for solar). Wind farm operators therefore command higher generation-weighted prices than solar power operators in the NEM.

Australia has long been recognized as a leader in private infrastructure investment, both within our borders and around the globe. Let's build on this legacy in the A\$150bn energy transition that lies ahead.

<sup>6</sup> AEMO Integrated System Plan 2020; forecast of 60 GW renewables assumed at A\$2.5m / MW capex requirement <https://aemo.com.au/-/media/files/major-publications/isp/2020/final-2020-integrated-system-plan.pdf?la=en&hash=6BCC72F9535B8E5715216F8ECDB4451C>

<sup>7</sup> Clean Energy Council 2020

<sup>8</sup> There is approximately 30 minutes of dispersion in solar generation across the NEM

<sup>9</sup> <https://aemo.com.au/en/energy-systems/electricity/national-electricity-market-nem/nem-forecasting-and-planning/forecasting-and-planning-data/nem-electricity-demand-forecasts/2017-electricity-forecasting-insights/key-component-consumption-forecasts/rooftop-pv-and-battery-storage>

<sup>10</sup> <https://reneweconomy.com.au/new-australian-wind-farms-reach-nearly-50-capacity-factor-99179/>



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# Natural Resources & Infrastructure: Industry Voices



Australia is a unique combination of a developed economy with a relatively high level of expected economic expansion, which underpins growth in demand for infrastructure. On top of this, many businesses in the energy and telecommunications sectors need to make a transition to the new economy, which requires large capital investment. We are seeing a rise in investor interest in the more operationally intensive infrastructure, and an increased willingness by large investors to co-invest in these spaces alongside a sponsor. We expect to see significantly more sponsor-led co-invest in these types of deals in 2021.

**Evan Hattersley**

**Managing Director  
Pacific Equity Partners**



Perhaps the most significant change we've seen in the Australian infrastructure market in the last year is growing investor demand for assets that combine resilient long-term contracted cash flows with exposure to multi-decade growth drivers. This trend was accelerated by the macro impacts of COVID-19 which left everyone searching for infrastructure assets that were protected from both GDP shocks and regulatory intervention. It's been most evident in the renewable energy and digital infrastructure sectors, where asset values have been boosted by falling discount rates for contracted cash flows and rising willingness to pay up front for future development options.

The challenge for investors like Morrison & Co will be to determine when we should take advantage of this to monetize the assets and options we've built up over years, and how we should redeploy the capital in a competitive market environment. I expect we'll still see great opportunities in our favored themes of decarbonization, digital infrastructure, and healthcare infrastructure, but we're going to have to maintain a highly proactive origination strategy to stay ahead of competition.

**Paul Newfield**

**Head of Australia and New Zealand  
Morrison & Co**





# Superannuation Funds: Consolidation Set to Accelerate

## Co-investment appetite grows and regulatory changes increase the focus on fund performance

Investors in Australia's private capital industry have fared reasonably well during the pandemic. Despite the sharp sell-off in risk assets across the world in Q1 2020, most investors were well placed with sufficient liquidity, and avoided having to sell illiquid alternative investment positions to bolster cash reserves.

This had been a concern for some industry practitioners as the crisis unfolded, especially after the government announced in April that it would permit early redemptions of \$20,000 in pension fund balances in response to COVID-19. However, details of the early release scheme, which was announced in March 2020 and ran to December, made it clear it would apply to a limited number of pension holders with very specific circumstances.<sup>1</sup>

As it turned out, there was no widespread evidence of institutional pension funds scrambling to find liquidity. In fact, with Australian private capital AUM in June

2020 up more than 9% compared with the end of 2019, it appears fund managers have grown their assets surprisingly well. This jump in AUM was driven by ample investor demand for Australia-focused fund managers, who raised \$8.3bn last year - the second-highest annual total in the past 10 years. After a year defined by social distancing and unprecedented economic uncertainty, things seem to be looking up for the private capital industry.

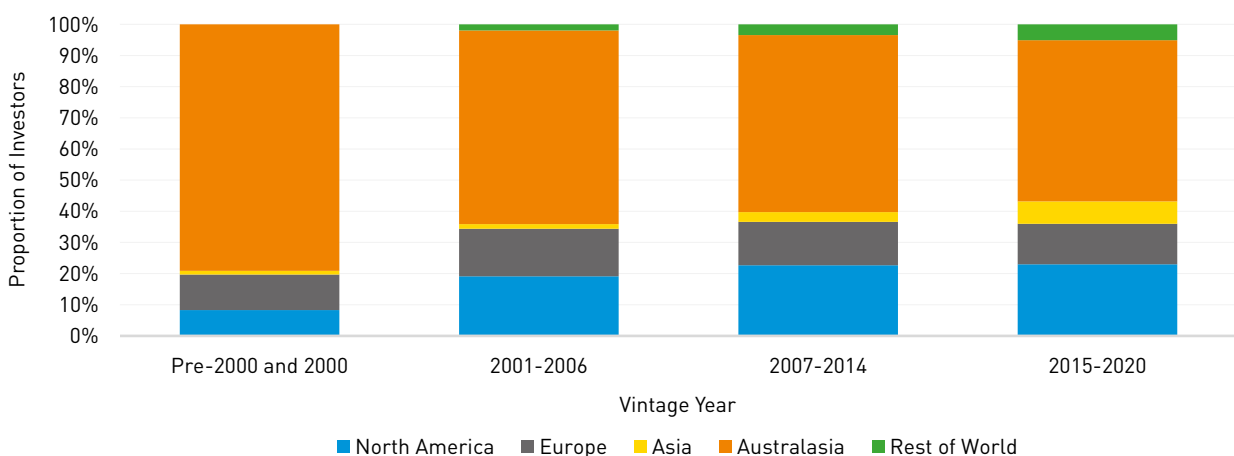
Looking beyond the difficulties caused by the pandemic, the attention of Australia's domestic institutional investor base has now likely returned to the broad structural changes that are taking place in the superannuation industry.

### APRA Heatmap May Weigh on Allocations

The launch of the MySuper Product Heatmap by the Australian Prudential Regulation Authority (APRA) at the end of 2019 has put more pressure on the domestic

<sup>1</sup> <https://www.ato.gov.au/individuals/super/withdrawing-and-using-your-super/early-access-to-your-super/>

**Fig. 27: Active Investors in Australia-Based Funds by Location and Vintage Year**



Source: Preqin Pro

asset management industry. Aiming to offer greater transparency and enhanced outcomes for savers, the Heatmap highlights underperforming and high-fee funds and encourages better-informed retirement decision-making.<sup>2</sup> Implementing this change has caused growing pains for existing players, however.

Amid these regulatory changes, superannuation funds have been consolidating to unlock economies of scale and enhance their competitive advantage. In 2020, First State Super and VicSuper merged to form Australia's second-largest super fund at the time, Aware Super – a combined entity which manages more than \$125bn in assets on behalf of more than 1.1 million citizens.<sup>3</sup> That said, there is room for more deals in the industry. Preqin is currently tracking 158 superannuation funds in Australia and New Zealand. While the consolidation trend may have the desired effect of providing cost savings to clients, it could also give superannuation funds more power when negotiating with investment managers.

Further consolidation will have an impact on the size and scale of investors, which could put downward pressure on the fees charged by private capital funds in Australia. The APRA Heatmap is adding another level of scrutiny on the fees charged to superannuation funds by investment managers. Higher returns may drive increased allocations to outperforming private capital funds, while their higher fees may have a dampening effect.

### Co-Investment Appetite Is Growing

Increasing consolidation within the superannuation industry may also impact the way in which investors gain access to private capital. We expect traditional fund structures to remain the dominant method of access, but co-investment and direct investment are likely to become more prevalent going forward.

In recent years, superannuation funds have displayed increasing interest in co-investments across major private capital asset classes, which correlates with their growth in size and sophistication. In 2018, 65% of Australian-based supers had a preference for co-investments in private equity, and 46% in real estate (Fig. 30). By 2020 these figures had swiftly climbed to 74% and 66% respectively. This is consistent with a broader global shift that is taking place, as investment teams develop their expertise in the industry and look to get closer to the underlying assets.

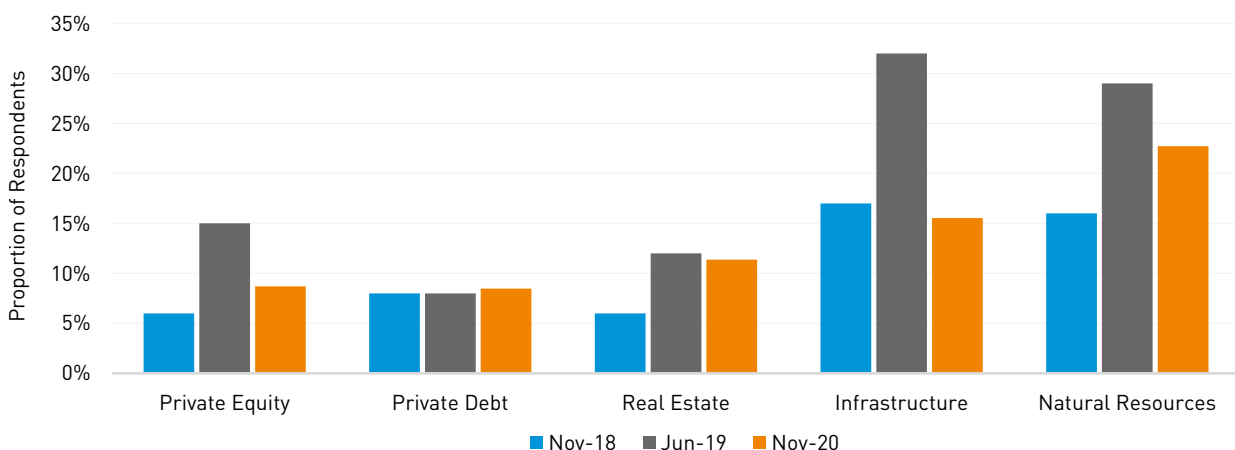
Preqin analysis<sup>4</sup> finds a 'sweet spot' for co-investment among investors with AUM of between \$1bn and \$10bn, on a global basis. More than a third (34%) of investors in this AUM band are currently co-investing, with a further 40% actively considering it; the combined preference is almost double any other size of investor. There are currently 59 superannuation funds occupying this sweet spot, but mergers with or acquisitions of the 47 funds with \$100mn-\$1bn of AUM could swell the ranks of funds that are large enough to make meaningful co-investments, but small enough for it to make a difference to their return and fee profiles.

<sup>2</sup> <https://www.apra.gov.au/mysuper-product-heatmap>

<sup>3</sup> <https://www.vicsuper.com.au/marketing-campaigns/merger-update>

<sup>4</sup> <https://www.preqin.com/insights/global-reports/2021-preqin-global-private-equity-and-venture-capital-report>

**Fig. 28: Investors that Believe Australasia Presents the Best Opportunities in Private Capital by Asset Class, 2018 - 2020**



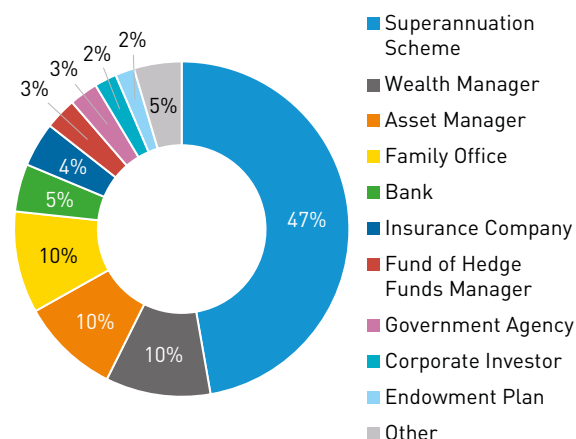
Source: Preqin Investor Surveys, November 2018 - November 2020

### International Interest Likely Undeterred by New Rules

Offshore investor interest in Australian private capital funds has increased steadily over the years. International investors made up only 21% of active investors in Australia-based funds before the year 2000, but this figure reached 48% in the period between 2015 and 2020. This was no doubt aided by Australia's stable economic and political backdrop, which provides a more suitable environment for buyout investors. Comparatively strong corporate governance and a robust legal system are also key attractions. Regional managers based out of Singapore and Hong Kong in particular have increasingly favored Australian private capital, attracted by the lower level of competition compared with home and US markets.

Against this backdrop, the government has tightened foreign investment rules to make it more difficult for offshore investors to acquire Australian assets at depressed valuations. The move was likely motivated by elevated concerns around maintaining financial stability and national security during the pandemic – understandable given similar worries among developed

**Fig. 29: Active Australia-Based Investors by Type**



Source: Preqin Pro

market peers. The impact of these legal changes may disproportionately impact foreign government investors (FGIs). Fortunately, private capital funds with international LPs are less likely to be caught in this net, as they are unlikely to be considered FGIs.

**Fig. 30: Australia-Based Superannuation Funds with a Preference for Co-Investments by Asset Class, 2018 - 2020**



Source: Preqin Pro

**Fig. 31: Median Current Allocation (As a % of AUM) to Private Markets by Pension Fund Type, Australia vs. Global**

	Australia		Global
	Industry Funds*	Public Sector Funds**	Global Pension Funds
Private Equity	3.5	5.1	4.3
Real Estate	9.6	7.9	8.0
Infrastructure	7.4	7.6	2.2

Source: Preqin Pro

\*Industry funds were originally established by trade unions to provide superannuation benefits to employees in the respective industries. These funds are typically non-profit and operate on a members-first ownership model.

\*\*Public sector funds are superannuation funds created for employees of federal and state government departments.

# Pressure Mounts for Super Funds to Champion ESG Agenda

## ESG adoption in Australia outpaces the rest of Asia-Pacific, but superannuation funds need to close the gap between ESG commitment and implementation

Incorporating ESG criteria into investment processes is becoming more mainstream in Australia. Assets managed in accordance with responsible investment principles now represent 37% of Australia's total \$3.14tn AUM.<sup>1</sup> Presently, some 173 signatories<sup>2</sup> to the UN Principles for Responsible Investment (PRI)<sup>3</sup> are based in Australia, up from 150 a year ago. This is more than any other market in Asia-Pacific (Fig. 32).

Australia's \$2.9tn superannuation industry leads the nation in ESG adoption (Fig. 33); each of the country's 10 largest super funds has an active ESG policy in place (Fig. 34).

When we look at how ESG is operationalized across each super fund, however, a performance gap emerges between commitment and implementation. In 2018 and 2019, only a quarter of super funds had quantifiable performance targets in place to ground the implementation of their responsible investment policies, according to the latest study from the Responsible Investment Association Australasia (RIAA).<sup>4</sup>

Notably, decarbonization was a key goal for those funds that did set ESG targets. These included Australian Ethical, which aims to achieve net-zero portfolio emissions by 2050 by shifting capital from fossil fuels

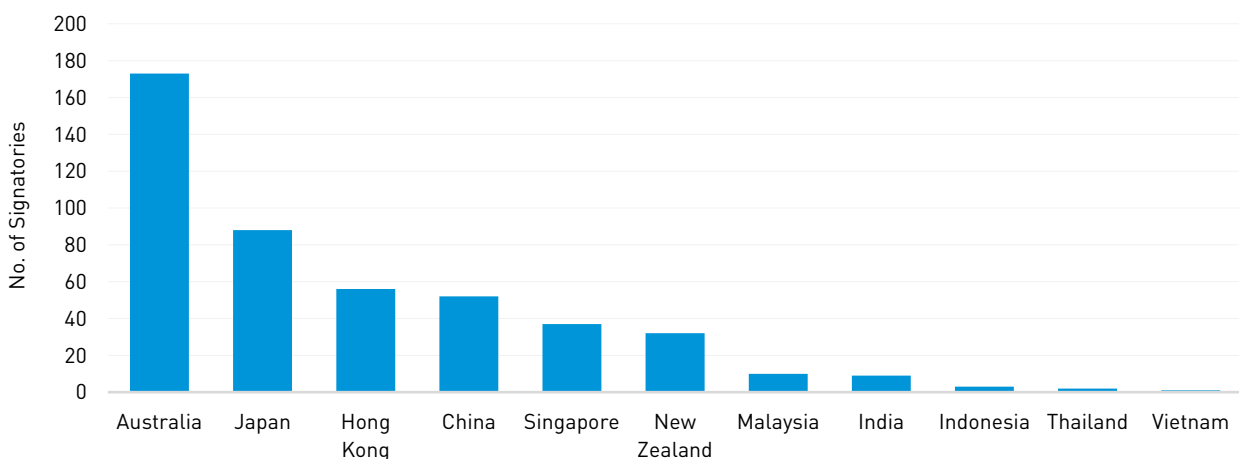
<sup>1</sup> [https://responsibleinvestment.org/wp-content/uploads/2020/11/RIAA-Briefing-Note-COVID-19-and-performance-of-responsible-investments\\_Nov-2020.pdf](https://responsibleinvestment.org/wp-content/uploads/2020/11/RIAA-Briefing-Note-COVID-19-and-performance-of-responsible-investments_Nov-2020.pdf)

<sup>2</sup> PRI data as of February 2020

<sup>3</sup> Principles for Responsible Investment was established by the United Nations to support investor signatories in incorporating ESG factors into their investment decisions

<sup>4</sup> <https://responsibleinvestment.org/wp-content/uploads/2019/12/RIAA-Responsible-Investment-Super-Study-2019.pdf>

**Fig. 32: Asia-Pacific-Based Signatories to the UN PRI by Location**



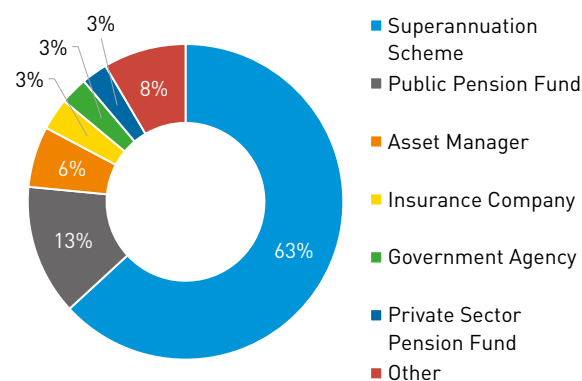
Source: UN PRI

to renewables, and Cbus, which has a zero-emissions target for property by 2030, and for its whole portfolio by 2050. Cbus also has a 1% investment allocation to climate change solutions.<sup>5</sup>

Growing concerns around the climate crisis are catalyzing greater ESG adoption. Following the devastating bushfires in late 2019 and early 2020, pressure is mounting for super funds and other asset managers to pull their weight when it comes to environmental issues and shaping the national dialogue around ESG. In one survey conducted in the wake of the wildfires, three-quarters of Australians said they would consider moving their banking, super, or other investments to another provider if they found out their current provider was investing in companies engaged in activities not consistent with their values.<sup>6</sup>

In a landmark move last November, the Retail Employee Superannuation Trust (Rest) said that it would start to measure, monitor, and report outcomes on its climate-related progress and actions in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This came after one super fund had to settle a lawsuit brought by a member for allegedly breaching its fiduciary duties owed to them by failing to adequately consider climate change risks. And in February last year, the Australian Prudential Regulation Authority announced it intends to develop a prudential practice guide focused on climate-related financial risks.<sup>7</sup>

**Fig. 33: Australia-Focused Fund Commitments by ESG-Affiliated Investors by Type**



Source: Preqin Pro

ESG integration among super funds has delivered proven benefits to investors. According to analysis by the RIAA in 2019, super funds comprehensively applying responsible investment practices across their entire fund have outperformed their mainstream peers over one-, three-, and five-year timeframes.<sup>8</sup>

As more of Australia's super funds embark on the journey to embed ESG considerations into their investment decision-making and portfolio management, opportunities abound for those GPs that can combine ESG objectives with financial returns.

<sup>5</sup> <https://www.cbussuper.com.au/content/dam/cbus/files/governance/reporting/Responsible-Investment-Supplement-2020.pdf>

<sup>6</sup> <https://responsibleinvestment.org/wp-content/uploads/2020/03/From-Values-to-Riches-2020-full-report.pdf>

<sup>7</sup> <https://www.apra.gov.au/news-and-publications/apra-outlines-plans-for-climate-risk-prudential-guidance-and-vulnerability>

<sup>8</sup> <https://responsibleinvestment.org/wp-content/uploads/2019/12/RIAA-Responsible-Investment-Super-Study-2019.pdf>

**Fig. 34: Largest Superannuation Funds Investing in Private Capital by Assets under Management**

Investor	Assets under Management (\$bn)	Type	Allocation to Private Capital (As a % of AUM)	Active ESG Policy?
AustralianSuper	209.2	Industry	16.4	Yes
Aware Super	130.0	Industry	22.3	Yes
UniSuper	83.0	Industry	14.0	Yes
QSuper	82.1	Public Sector	24.7	Yes
Colonial First State FirstChoice Superannuation Trust	80.3	Retail	9.1	Yes
Sunsuper	79.0	Industry	23.4	Yes
Retirement Wrap (BT)	68.4	Retail	7.6	Yes
Super Directions Fund (AMP)	58.5	Retail	8.3	Yes
Retail Employees Superannuation Trust	55.5	Industry	19.4	Yes
HESTA	54.5	Industry	16.0	Yes

Source: Preqin Pro



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