Fact sheet
Comparing listed and unlisted assets

A close look at AustralianSuper's unlisted assets

To meet the wealth accumulation needs of members saving for retirement over an extended period of time, superannuation funds invest in a variety of assets – both listed and unlisted.

Every trustee board takes a different approach depending on the fund's member profile and long-term objectives.

AustralianSuper has included unlisted assets among its investments for many years, as these assets perform a valuable role in ensuring the Fund has a well balanced and diversified investment portfolio.

While not as liquid as some other asset classes, unlisted assets have proven to be solid long-term investments.

To appreciate the role unlisted assets play within a well-balanced portfolio, it is important to understand the subtle differences and issues involved in investing in listed and unlisted assets.

What are unlisted assets?

Unlisted assets are investments that are not listed on the stock exchange. They can include property (large office buildings and shopping centres), infrastructure (roads, power grids and airports) and private equity (investments in start-up or existing private companies).

Listed assets are valued daily by the stock market, while the values of unlisted assets are based on their net tangible asset value (or the underlying value of the asset).

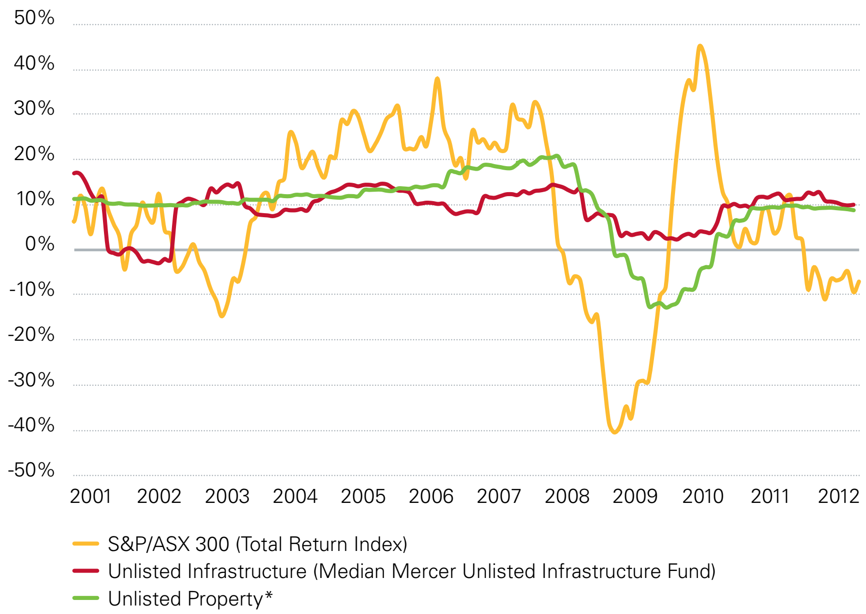
Although unlisted assets are often lumped together as a group, there are significant differences between unlisted property, infrastructure and private equity. For this reason, AustralianSuper invests in all three asset classes.

In addition, listed assets tend to perform very differently to their unlisted counterparts, as they are affected by market sentiment, which can be very volatile.

Key point: Unlisted assets are solid long-term investments that have proven to be a great investment for AustralianSuper's members.

Returns from listed assets have been more volatile than returns from unlisted assets

This chart compares the rolling 12-month returns of the Australian share market to those of Australian unlisted property and infrastructure assets. To date, the Australian share market has had much more volatility in it's return than unlisted property and infrastructure assets.



* Mercer Unlisted Infrastructure Index until June 2007, Mercer/IPD Australian Pooled Property Fund Index from June 2007.

Why invest in unlisted assets?

Superannuation funds have a long history of holding unlisted assets in their portfolios. Unlisted assets have formed part of AustralianSuper's portfolio since 1993. While unlisted assets can fall in value in some economic conditions, their inclusion provides significant benefits to a fund's overall portfolio and helps diversify returns to members. Typical unlisted assets have a longer investment horizon which matches that of a superannuation fund.

Diversification

Assets linked to local and international equity markets tend to be highly correlated in their returns and are strongly influenced by trends in those markets.

Investing in unlisted assets provides some protection against falls in listed markets as they have historically not been highly correlated with the listed market. This gives them a valuable role in diversifying risk and increasing the efficiency of the overall investment portfolio.

Relative return stability

Unlisted property and infrastructure can generate steady, secure income streams (for example through rents locked in over a fixed term contract period or returns from a power station or toll road subject to a long-term agreement), in contrast to the more unpredictable income returns from listed assets.

Even within listed markets, property and infrastructure assets tend to display less volatility than the overall market, but more than their unlisted counterparts.

Better risk-adjusted returns

Unlisted assets tend to have superior risk-adjusted returns compared to many other asset classes. This involves measuring an investment return in relation to the amount of risk taken to achieve that return.

Unlisted assets sit on the risk/return curve between fixed-income investments, such as bonds, and shares. Over the long-term, core infrastructure and property assets provide a level of risk closer to bonds than shares because of their steady income streams.

Often high returns are achieved by taking high risks. The value of calculating risk-adjusted returns is that it reveals whether the returns from the investment are due to good investing or excessive risk-taking.

Unlisted assets are increasingly a performance differentiator between super funds and a reason why AustralianSuper's Balanced option (our default option) is 'overweight' in unlisted assets compared to the average balanced super fund strategy.

Long term focus

Unlisted property and infrastructure assets are generally held for the long term. This enables the owners and governing bodies (boards) to make decisions to enhance the long term value of the asset. In contrast, listed boards can sometimes be pressured into making shorter term decisions which can affect long-term value.

One area where AustralianSuper and its managers have been able to be actively involved in adding long-term value to assets as owners, is through the consideration of environmental, social and governance issues.

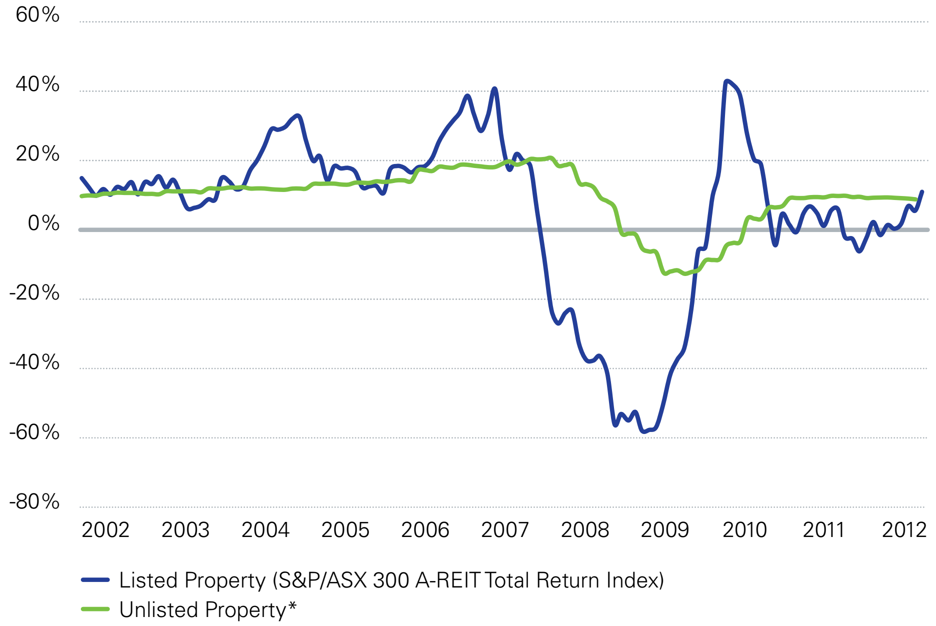
Photo courtesy of Pacific Hydro

More stability in returns from unlisted property and infrastructure

The charts below show there is a high level of variability in the returns from most listed asset classes, while unlisted property and infrastructure tend to be much less volatile and far more stable in the investment returns they provide.

Listed and unlisted property

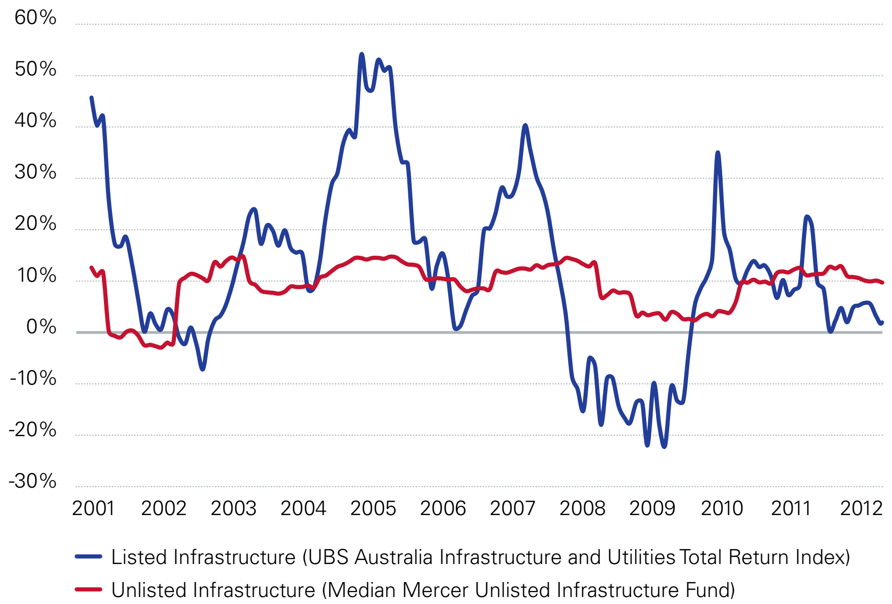
Rolling 12-month returns from listed and unlisted Australian property.



* Mercer Unlisted Property Index until Jun 07, Mercer/IPD Australian Pooled Property Fund Index from Jun 07

Listed and unlisted infrastructure

Rolling 12-month returns from listed and unlisted Australian infrastructure.



What are the key differences between listed and unlisted assets?

While listed and unlisted property and infrastructure both involve investing in similar underlying assets, being listed means they are very different investments. These differences mean the valuations and investment returns from listed and unlisted assets do not necessarily move in tandem.

Key point: Although the underlying assets are the same, the different structures used in listed and unlisted investments mean they are fundamentally different investments.

Differences between listed and unlisted assets

Listed assets	Unlisted assets
Priced daily by the equity market	Priced monthly, quarterly, six-monthly or annually by professional valuers. More stable valuations.
Price can be influenced by market sentiment, future developments and outlook for the sector	Price based on estimated capital value of the asset held (net tangible asset value) and similar market transactions
Often complex investment structure (e.g. stapled securities* with bolted-on corporate entities and additional activities)	Mostly simpler unitised investment structures
Opaque management structure (e.g. listed property vehicles often feature layers of management entities)	Transparent management structure
Higher gearing levels (ie. levels of debt held against the assets)	Lower gearing levels for property Higher gearing levels for infrastructure
Higher level of liquidity	Lower level of liquidity
New capitalisation raisings at risk of market price and market demand	New capitalisation raisings at net asset value

* A stapled security is one that has been listed on the ASX on the basis that it cannot be traded independently of an asset that is linked to it.

Photo courtesy of the Port of Brisbane Pty Ltd

What is the valuation process?

AustralianSuper's unlisted assets are valued regularly, with around 94% valued at least every quarter, 1% valued at least every six months and 5% valued annually. When the valuations are received they are immediately reflected in the Fund's daily crediting rates.

The professional valuers used by AustralianSuper utilise the generally accepted valuation methodologies for each asset class. These include:

Property	Valued using Australian Property Institute guidelines. The assumptions used are updated to reflect current assessments of discount and capitalisation rates.
Infrastructure	Valued using discount rates and cash flows adjusted to reflect the current consensus view of economic conditions and asset-specific drivers.
Private Equity	Valued using a cost of investment or market value basis in accordance with the valuation policies determined by the Australian Private Equity and Venture Capital Association (AVCAL)

To cross-check their methodology and resulting valuations, the appointed valuers also analyse recent property and infrastructure sale transactions. For private equity investments, they analyse the performance of comparable companies to confirm their assessments. This process takes into account current market conditions and ensures the valuation accurately reflects fair market value.

Under the Australian Financial Accounting Standards, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts.

Superannuation funds are obliged to follow Australian Accounting Standard 25 (AAS25) *Financial Reporting by Superannuation Plans* in valuing many of these assets.

Who values the assets?

AustralianSuper uses a variety of valuation firms depending on the specific unlisted asset to be reviewed. The fund currently has service arrangements for valuation work in place with respected accountancy firms and valuation consultants.

Where AustralianSuper holds investments in wholesale investment funds, the valuations are determined by the fund manager. These managers (e.g. IFM, ISPT, Hastings and QIC) use a panel of independent valuers to determine the value of individual assets held in their funds. These valuers are rotated on a regular basis.

Key point: 94% of AustralianSuper's unlisted assets are valued at least every quarter by independent valuers.

Casselden
Photo courtesy of ISPT

What about in the current environment?

Considering the differences between listed and unlisted assets, it is not surprising their performance has diverged over the last few years. To understand why superannuation funds continue to believe unlisted assets remain a valuable part of their overall portfolio, it is worth looking at the impact of some of these factors in detail.

Pricing factors

Market sentiment – The current pricing of listed assets reflects not only the value of the underlying asset but also market sentiment (the general attitude of investors towards the prospects for good returns from the markets), which has been up and down over the last 12 months.

The prices of listed investments (particularly Australian real estate investment trusts or A-REITs) rose strongly during the boom, then fell dramatically during 2008 and early 2009 as the nature of the debt levels surrounding the assets became evident. Performance for the sector has continued to be volatile with the S&P/ASX 300 Property Trusts Accumulation Index outperforming the broader share market over 1 and 3 years, but underperforming over 5 years to the end of June 2012.

Conversely, the values of unlisted assets are not influenced by market sentiment to the same degree and were always based on their net asset value. This means the values of unlisted assets are generally unlikely to fall by a similar extent to that reflected by price falls in the listed sector. While unlisted assets went through a devaluation cycle during 2009, it was nowhere near the levels seen in listed assets. Solid earnings and improving valuations have seen stronger returns from unlisted assets since 2010.

As a result of the global financial crisis (GFC), many listed property companies went through a period of being 'distressed' sellers, or sellers who need to consider whatever price they are offered to dispose of assets, due to their inability to access credit for ongoing financing. Assets in the unlisted sector, however, are generally priced on a 'willing buyer, willing seller' basis, or the assumption that market participants are willing but not anxious to transact, and there were very few distressed sales of unlisted assets as a result of the GFC.

Investment structure – During the past decade, many listed entities, for example A-REITs, changed from being simple, passive Australian-based vehicles designed to collect rentals from contracted tenants into stapled securities based on expansion into foreign property assets and non-core activities such as property development and third-party funds management. Over this period many listed entities also developed complex structures with layers of related entities and increasingly complex fee arrangements. Since the GFC, a number of A-REITs have disappeared or consolidated, with those remaining working on simplifying their structures and returning to core Australian property management activities, which has been reflected in better performance over the last three years.

Unlisted property trusts, have generally retained a straightforward unitised structure (where assets are valued and traded in terms of their net asset value), utilising professional management expertise to focus on long-term 'buy and hold' property investing.

Income security

While many listed vehicles are returning to income generation predominantly through secure rental income streams, this remains the foundation of most unlisted assets.

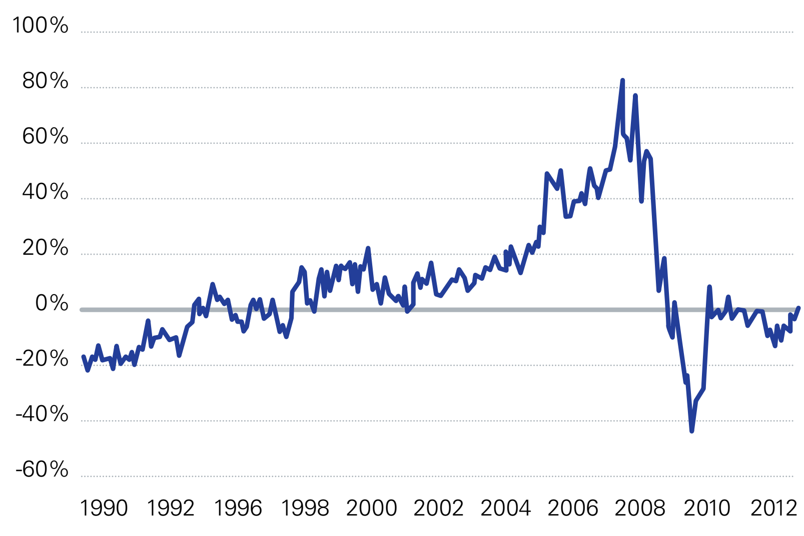
The quality property assets typically found in unlisted vehicles usually feature securely leased, strongly-rated tenants and experienced professional management teams.

In the case of infrastructure, high quality unlisted assets also have predictable revenue streams, particularly if they are based around a long-term contract (often with government) or regulated charges. Prior to the GFC many listed infrastructure funds adopted the practice of paying income to investors from the increase in the value of the assets rather than the free cash flow generated by the assets.

In a world where investors are still concerned about economic stability and the ongoing issues around the availability of credit, there is a continuing flight to 'quality' investments. These investments are increasingly being defined as those that are not impacted by the movements of listed markets and offer access to strong and reliable income streams.

Australian listed property values have a long record of volatility

This chart shows the historical volatility in the level of premium or discounts to net tangible asset values in Australia's listed property market. Net tangible asset values are based on the underlying values of the assets of listed property trusts, as independently valued on a periodic basis.



Source: UBS Estimates, AustralianSuper

Gearing

Property – The gearing level (the level of debt held) of unlisted property assets is very different to the level in the listed sector. Unlisted property tends to have a far more modest level of gearing. This allows a fund to have available cash flow after interest to meet ongoing capital requirements, pay down debt or distribute income to investors. This increased flexibility reduces a fund's risk of not being able to refinance its existing debts.

Many listed property assets had high debt levels, coupled with layers of gearing. In a tight credit environment, many had to restructure their investments, reduce debt and access funding through asset sales and capital raisings via the share market. Most listed managers are now holding gearing at more manageable levels.

The average gearing level for AustralianSuper's core unlisted property portfolio as at 30 June 2012 was 9.5%.

Infrastructure – High gearing levels are common in infrastructure assets as they have predictable cash flows due to their monopoly position within the market (eg electricity and water utilities).

As this gearing is typically long-term, debt for terms ranging from five to 20 years, with smaller amounts to be refinanced over many years, these assets face a lower refinancing risk in the current economic environment.

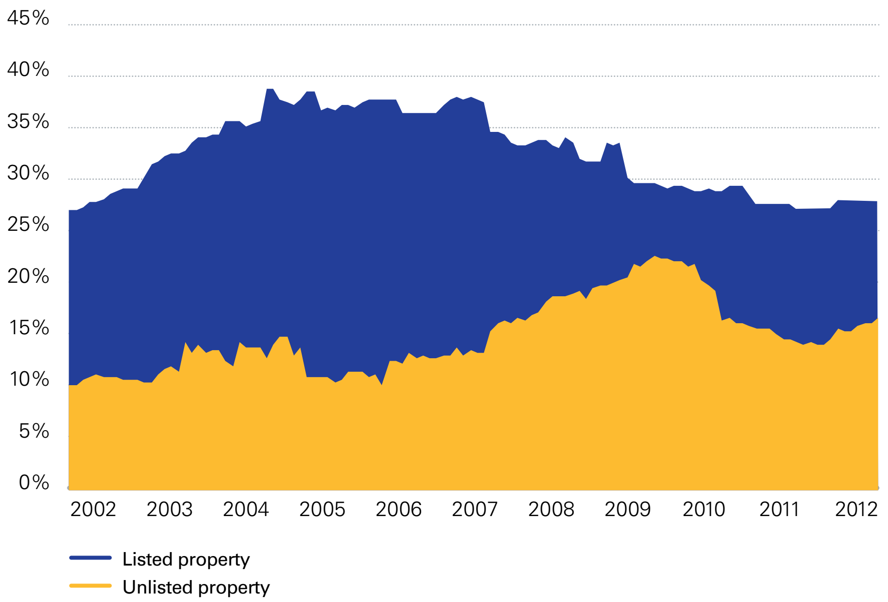
The gearing level for AustralianSuper's unlisted infrastructure assets as at 30 June 2012 varied depending on the individual asset, from 30% for assets with some link to economic growth, up to 90% for assets with secure long-term government guaranteed revenues.

Historically higher gearing levels in listed property

The chart at right provides a comparison between the historical levels of gearing in Australian unlisted and listed property investments.

Key point: Unlisted assets play an important role in a well balanced investment portfolio and help boost long-term investment returns to members.

Gearing levels in Australian unlisted and listed property



Sources:
Unlisted property: Mercer Australia Direct Property Index Gearing
Listed property: MSCI Thomson /Financial DataStream, UBS estimates

What are AustralianSuper's unlisted assets?

AustralianSuper's unlisted investments are mainly in specialist funds that invest in diversified portfolios of commercial property, infrastructure and private equity assets. These are managed by specialist investment managers with significant experience and expertise in their particular market segment.

One advantage of investing with specialist managers is scale. Some billion dollar infrastructure assets are too large for even the biggest Australian super funds to own directly. Owning one large retail property asset can be more than some funds have allocated to property and could significantly reduce the diversification and increase the risk of a larger property portfolio.

The majority of AustralianSuper's unlisted property assets are held through Industry Superannuation Property Trust (ISPT) and QIC Property Fund. The fund's infrastructure assets are mainly held through Industry Funds Management (IFM) and the Utilities Trust of Australia.

AustralianSuper also co-invests with other institutions directly into some unlisted property and infrastructure assets.

Two of AustralianSuper's largest unlisted investments are:

ISPT – an unlisted direct property vehicle which undertakes a full independent valuation of the entire Core Fund portfolio every three months.

IFM – unlisted infrastructure and private equity funds which undertake quarterly independent valuations of most assets.

Through the unlisted infrastructure and property funds AustralianSuper invests in, its top 10 underlying unlisted assets are:

AustralianSuper's top 10 unlisted assets as at June 2012

Investment	Main Business Activity
1. Pacific Hydro	Renewable energy in Australia, Chile and Brazil
2. Melbourne Airport	Melbourne airport operator
3. Perth Airport	Perth airport operator
4. Brisbane Airport	Brisbane airport operator
5. Anglian Water Group	Water utility based in the UK
6. Port of Brisbane	Seaport, Brisbane Qld
7. Essential Power	Gas fired energy generation
8. Castle Towers	Super regional retail centre, Castle Hill NSW
9. Colonial Pipeline	Company US oil pipeline
10. Dalkia Polska	Direct heating, Poland

The amount of unlisted assets held by AustralianSuper varies over time, as determined by the Fund's trustee board. As at 30 June 2012, the overall exposure to unlisted assets (property, infrastructure and private equity) was 25% of the total fund.

AustralianSuper asset allocations as at 30 June 2012

The table below shows AustralianSuper's actual asset allocations at the end of June 2012 in each of its multi-sector investment options, with the allocations to unlisted assets highlighted.

Asset Class	High Growth Option	Balanced Option	Sustainable Balanced Option	Conservative Balanced Option	Stable Option
Australian Shares	36.1%	31.9%	32.3%	25.0%	13.5%
International Shares	28.5%	20.9%	21.4%	17.4%	8.7%
Direct Property	**11.0%**	**11.3%**	**11.2%**	**11.0%**	**10.8%**
Private Equity	**8.1%**	**4.6%**	**4.5%**	**0.0%**	**0.0%**
Infrastructure	**14.2%**	**13.1%**	**13.3%**	**12.2%**	**8.9%**
Absolute Return Strategies	0.0%	0.1%	0.1%	0.0%	0.0%
Global Bonds	0.0%	12.8%	12.2%	22.6%	31.7%
Cash	2.1%	5.3%	4.9%	11.7%	26.3%

Key point: AustralianSuper's unlisted assets are managed by experienced investment professionals and they play an important role in the fund's overall portfolio.


Southern Cross Station
Photo courtesy IFM

What is the regulator's view on unlisted assets?

Unlisted assets are a well established component of the investments made by superannuation funds on behalf of their members.

The prudential regulator for the superannuation industry, the Australian Prudential Regulation Authority (APRA), accepts the use of regular professional valuations as normal practice for unlisted assets.

While APRA does not prescribe specific valuation methodologies for unlisted assets, it provides clear guidelines to funds on the frequency and independence of valuations of assets not traded on a regular basis, such as unlisted property.

All superannuation funds are required to comply with APRA's Superannuation Circular No.IID.1 Managing Investment and Investment Choice which states, "the periodic valuation should be independent and updated regularly (especially in times of market volatility) … independent valuations should be undertaken no less frequently than every three years".

APRA has recently stepped up its monitoring of the activities of superannuation funds in this area and as part of its normal supervision process has asked funds to justify their year-end valuations of unlisted assets.

To further clarify the valuation process, the regulator requires trustees to document how they determined the valuations for specific assets within their fund.

What is AustralianSuper's experience?

Over the years, unlisted assets have proven to be solid investments for AustralianSuper and continue to provide members with a number of valuable benefits.

As long-term assets, they are a good fit with the Fund's objective of assisting members to save for their retirement over an extended period.

Unlisted assets provide good returns adjusted for the level of risk taken and provide a valuable alternative source of return to the listed assets within the Fund's investment portfolio.

Valuations of the Fund's unlisted assets are conducted regularly by independent valuers who take current economic conditions into account. The valuation process is in keeping with industry practice and the expectations of the regulator.

The significant benefits provided by the special characteristics of unlisted assets means AustralianSuper remains committed to including these assets in its portfolio in the years ahead.

Key point: APRA has established guidelines for the valuation processes used by superannuation funds with unlisted assets.

For more information

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