ACTIVE VIEWPOINT

MARTIN CURRIE
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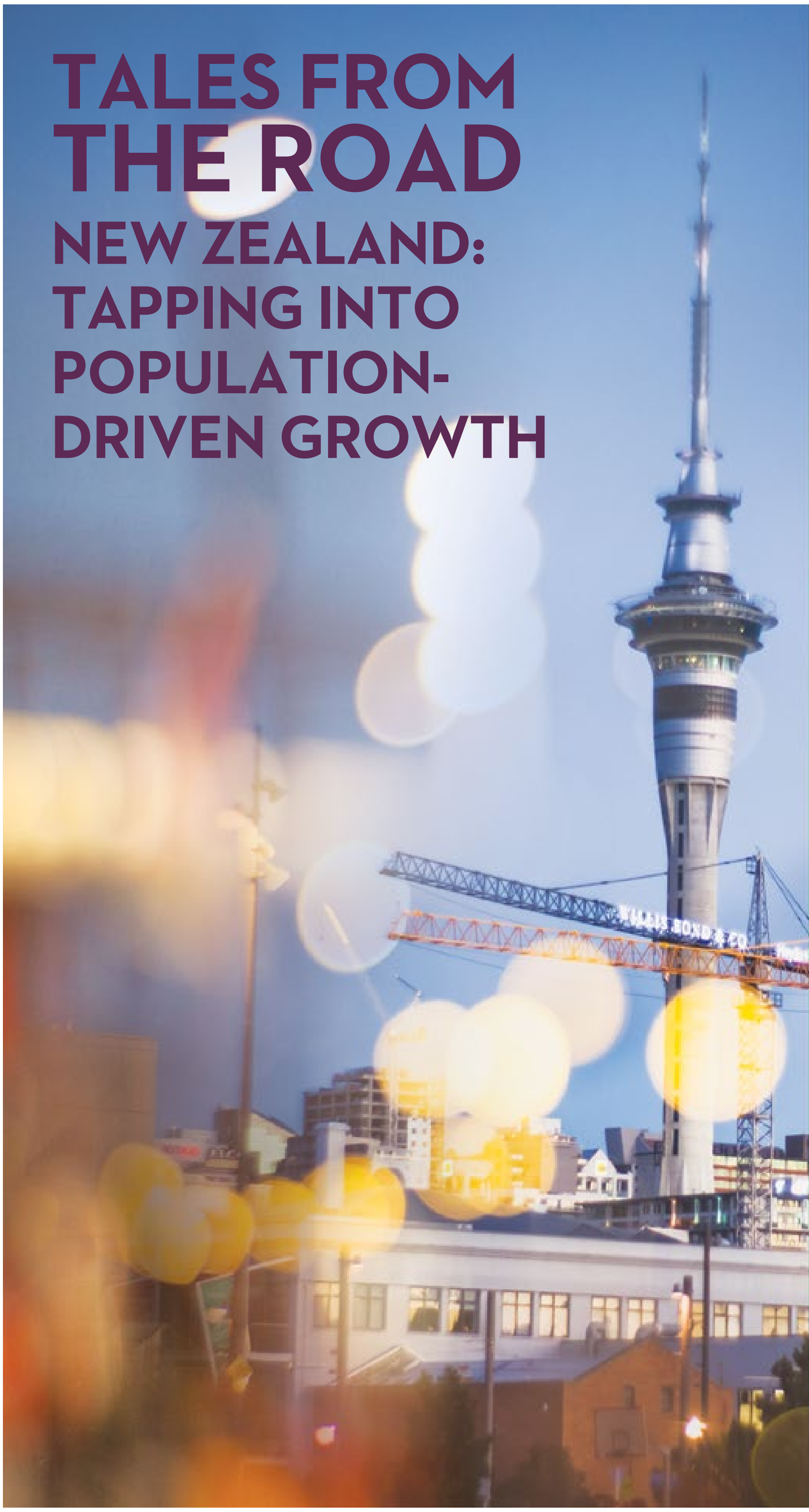
MARTIN CURRIE AUSTRALIA REAL INCOME STRATEGIES

NOVEMBER 2018 FOR PROFESSIONAL CLIENTS ONLY



TALES FROM THE ROAD

NEW ZEALAND: TAPPING INTO POPULATION-DRIVEN GROWTH

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Walking around central Auckland, change is evident everywhere. Despite my trip being mid-week, the streets were bustling with construction, and the restaurants full. The city is transforming from a distant regional centre into a cosmopolitan city on the world stage.

"My recent trip to Auckland highlighted that New Zealand's largest city is fast becoming on a par with other cosmopolitan cities across the world."

BIG CHANGES

When I last visited Auckland, getting from the airport to the city was quite slow and painful (even off peak) due to outdated and inadequate road transport infrastructure.

My recent journey was instead surprisingly pleasant, with works recently completed at and around the airport – in particular significant road-transport infrastructure upgrades between the airport and the Auckland city centre.

On this trip I visited a range of real asset companies, giving me a first-hand look at what the changing demographics and landscape means for the New Zealand-exposed real assets in the investible universe for our Martin Currie Australia Real Income and Asia Pacific Real Income portfolios.

HIGH MIGRATION AND FERTILITY RATES

In the last 20 years, New Zealand's population has grown by approximately 1.2% per annum, from 3.8 million to 4.9 million people[1]. The country has one of the highest developed world migration rates, while its average fertility rates also remain healthy at just over two births per woman[2].

Recent gains can be partially attributed to a decline in the number of New Zealand citizens departing overseas (particularly to Australia), while more are returning (again, particularly from Australia) to take part in the construction boom that was stimulated by the growing population.

With new and returning migrants showing a preference to live in the major cities, Auckland has had much greater than average population growth, particularly in recent years, and is projected to account for more than half New Zealand's population growth between 2013 and 2033[3]. Auckland currently accounts for 33% of the total population[4] and 38% of GDP[5].

ATTRACTIVE PLACE TO LIVE AND WORK

Talking to a number of New Zealand peers, locals and businesses during my trip, some key themes cemented as to why New Zealand is proving to be an attractive place to live and work:

- good wage growth, hence higher disposable income, due to a shortage of workers created by the construction boom
- much lower personal tax rates than Australia
- good government services such as schools and healthcare
- no State Government in New Zealand, therefore no state bureaucracy or taxes.

However, some concerns were raised around the challenges of migration-led strong house price growth, and talk from the new coalition government of a potential capital gains tax.

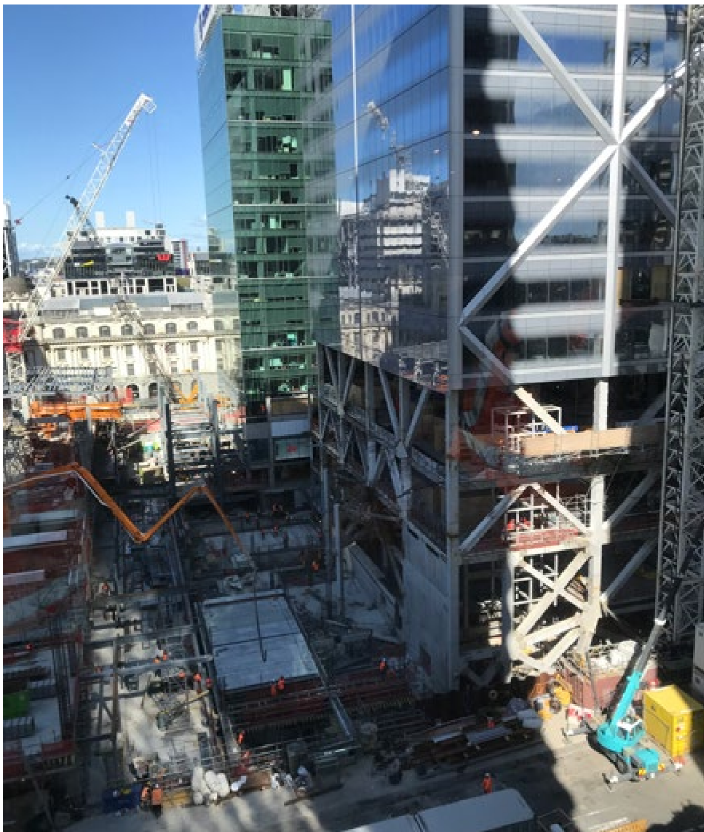
Building materials company **Fletcher Building** (not held)[6] expects cost pressure to keep rising in foreseeable years. It has seen labour costs rising 10% per annum, and materials costs at 3-4% p.a.

Management commented that there is a risk that the government's new KiwiBuild program (a multi-billion-dollar work programme set to deliver 100,000 homes for first home buyers over the next decade) could over-stimulate the market and result in even higher costs for materials and labour.

INFRASTRUCTURE PLAYING CATCH UP

The Auckland CBD and inner suburbs are rapidly evolving to cater for this population-driven demand, with significant construction activity across a wide range of infrastructure, office, hotel, residential, and shopping-centre projects.

However, despite the significant construction boom in Auckland, a lot of the building work carried out to date feels like it is still just playing catch-up with the growth of the last 20 years, and a lot more still needs to be done.



[1]Source: Stats NZ; estimated resident population of New Zealand; as at 30 June 2018. [2]Source: Stats NZ; total fertility rate; 10-year average as at 19 February 2018.
[3]Source: Stats NZ: Subnational population projections; as at 8 March 2017. [4]Source: Stats NZ; Population of Auckland Region and New Zealand: 2013 Census.
[5]Source: Stats NZ; Regional gross domestic product: year ended March 2017.

[6]The information provided should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any of the security transactions discussed here were, or will prove to be, profitable.

Management at inner-city business space developer **Precinct** (not held)[7] also see construction costs rising significantly, and supply not keeping up with demand.

The company believes the Auckland office and hotel market will remain undersupplied until at least 2023.

Its management team commented that construction capacity constraints are preventing significant office build, and they have also seen some office withdrawals for better uses (such as residential).

DEMAND FOR LAND FROM BOTH INDUSTRIAL AND RESIDENTIAL PUSHING LAND PRICES

This demand is having a flow-on effect to industrial property. Feedback from various industry meetings and industrial property groups was that vacancy in Auckland's industrial property was less than 1%, despite the addition of significant new space in recent years.

Auckland International Airport (held in Asia Pacific Real Income)[7] has a strong investment pipeline. Interestingly, much of this development will be for its industrial portfolio, which currently has no vacancies and many sites under rented.

The airport has a large landbank that is only one-third built. The benefit of this land is the good existing supporting infrastructure relative to the rest of Auckland, meaning it will be less expensive to develop.

However, new land opportunities are tightly held and difficult to secure, due to competition from residential developments, and infrastructure is still playing catch up in many areas. Demand for new space should outstrip supply for many years to come.

Industrial and business space provider **Goodman Property Trust** (held in Asia Pacific Real Income)[7] management commented that the area around Auckland is more land constrained than equivalent Australian markets.

While a lot of mixed use land is currently used for industrial sheds, the company is now competing with the booming residential markets, resulting in the exit of some industrial stock from the market, and increased land values.

WEAK DOLLAR NOT A BURDEN

The New Zealand dollar has weakened significantly against the US dollar this year, and mildly against the Australian dollar. However, there was no noticeable sign of any concerns or impact in New Zealand. In fact, business feedback during my trip, and recent comments from the Reserve Bank of New Zealand suggests the country is quite happy with the recent softening of the currency, as it has improved the competitiveness of various export industries and the tourism sector.

TOURISM ALSO DRIVING DEVELOPMENT

It's not just the permanent population that is booming, the tourism sector is also taking off. Auckland Airport's annual passenger volumes are now running at around 21 million per annum, compared with the 16 million per annum three years ago[8]. To cater for the growing passenger volumes, a second runway is being built.

Shopping-centre developments are also tapping into the tourism market, titling their tenant mix towards higher-end retail.

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[8]Source: company reports.

During my trip I met local management of ASX-listed **Scentre Group** (held across all Income portfolios)[9], and toured two of its New Zealand assets, including the premium Newmarket redevelopment shopping centre development and the Albany shopping centre.

Newmarket has an inner Auckland high-income catchment with good population growth of 1.9% in catchment. Management says that demand for space has been strong from both international retailers and major domestic tenants, with the inbound tourist market a key factor.

The Albany region is one of the three areas identified by the Auckland council as an area to facilitate growth outside the city centre. Population growth in the Albany corridor is also running at around 2%, and according to Scentre, retail spend is 11% above the New Zealand average. The site has a significant landbank, some of which is currently used for parking.

The new CEO of **Kiwi Property Group** (held in Asia Pacific Real Income)[9] is ex-Westfield USA, and he mentioned that the key attraction for him was development opportunities within the portfolio, particularly mixed-use opportunities.

We toured Sylvia Park, a key asset and mixed-use retail/office site which benefits from rail connections as well as great bus and road connections, and development potential.

While Sylvia Park is not positioned as a luxury centre, the CEO sees Scentre's Newmarket stimulating overall international retailer demand and which will benefit Sylvia Park's tenant mix.

The CEO also mentioned that floor space per capita in New Zealand is very low relative to the US and even Australia, and the strong population growth justifies all the new space coming into NZ. A very different story to declining US Malls. New Zealand malls are also not fashion-heavy so they are much better diversified.

TAPPING INTO UNDER-APPRECIATED GROWTH

My recent trip to Auckland re-affirmed that New Zealand's largest city is fast becoming on a par with other cosmopolitan cities across the world.

From an investment point of view, the growth that has been seen here in recent years is exciting.

The spot yields for New Zealand real asset securities are attractive on a global and regional basis. However, in my opinion, the market is underestimating the dividend-growth prospects that are backed up by the ongoing population and construction booms.

My trip has given me increased confidence in the companies which are already held in our Real Income strategies, as well as presenting a range of potential new investment opportunities to be dissected by the team back home.

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