

An aerial photograph of a city at sunset, with a warm orange and yellow glow over the skyline. The city features a mix of residential and commercial buildings, with a prominent bridge visible in the background.

HOW OVERSEAS DEVELOPERS CAN BUILD A SUSTAINABLE PROPERTY BUSIENESS IN AUSTRALIA

A PERSPECTIVE

How Overseas Developers can build a sustainable property business in Australia

Abstract

Australia is an attractive and mature market for foreign investment in property development due to numerous push and pull factors. According to a study report by KMPG and University of Sydney, 36% of all Chinese Overseas Direct Investment is in real estate, with 76% of that coming from private company investors. Incumbent developers should focus on developing capability in project execution, deploy local Asia-capable people, and invest in brand building and industry reputation through design-driven projects.

An ideal method of business expansion is to acquire a stake in a young and growing property business in Australia to gain immediate access to intellectual capital, industry relationships and on the ground experience. The software (people, processes, networks and brand) and hardware (project pipeline) must work hand-in-hand for a business to grow sustainably. Adopting an asset-light and professional service approach to development will result in 4 advantages - ensure risk is diversified across projects, capital is deployed effectively, relationships are forged with external parties and the “software” can develop with a solid project pipeline

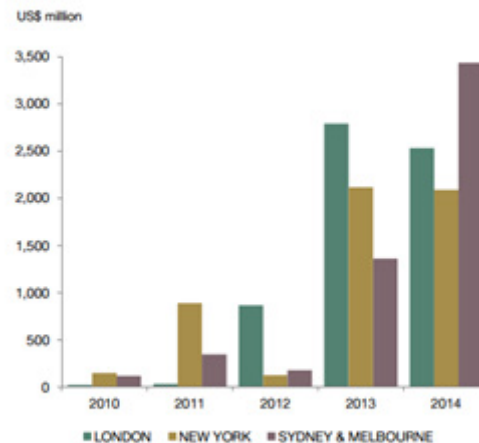
In the Short Term, it is recommended to focus on local market design-driven residential projects. In the medium term once sufficient local capability has been developed, focus on land banking larger commercial or mixed-use sites with holding income and with long term re-development, rezoning or amalgamation potential.

The Context

The Australian real estate market has seen a huge influx of foreign investment in the past few years, especially from Chinese developers and investors looking to grow their business and project pipeline in this mature and stable economy. Developers and investors of all sizes and scale are capitalizing on a number of global macroeconomic factors and focusing on Australia as an outbound investment option, with Sydney and Melbourne being the primary focus cities for most overseas developers. According to Knight Frank, the combined Chinese investment in Sydney and Melbourne in 2014 well exceeds that of New York and London.

We identify a number of push and pull factors promoting this expansion.

Chinese outward real estate investment in the gateway cities Past 5 years



Source: Knight Frank, RCA
NB. Excluding residential and multi-family dwellings

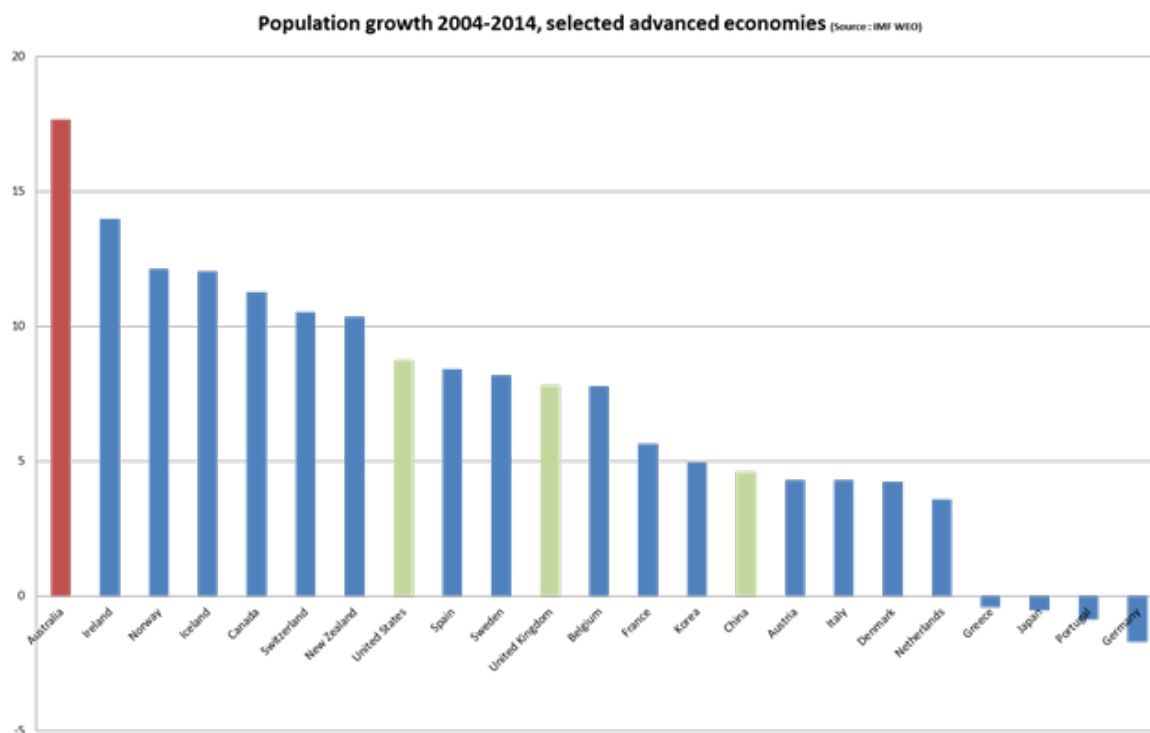


- Risk Diversification with offshore exposure with lower funding costs and higher returns
- Mature, liquid and transparent markets – clarity of rules and regulations
- Strong macroeconomic fundamentals
- International brand building
- Personal preference driven – quality of life attraction, capital appreciation
- Slowing Domestic Economic Growth
- Excess Supply – Fierce Price Competition
- Reduced appetite for further development projects in China
- Maturing and well-funded Chinese Developers looking to develop a global footprint
- Earlier Government policy to promote foreign investment esp insurance companies

Why Real Estate in Australia?

The fundamental driver of the real estate sector is population growth – through natural births and net migration. According to the IMF, out of all OECD advanced economies, Australia boasts the highest population growth rate from 2004 till 2014, at 18% per annum growth rate. A majority of this is due to a solid birth rate, inbound migration from China, India, NZ and UK and Australia being an attractive place to live and work.

From a pure numerical perspective, Australia needs to build another city the size and scale of Sydney in the next 25 years, just to accommodate the anticipated population growth in the future. Despite any short term property cycles, this places severe strain on the demand for residential and commercial real estate in key capital cities.



Some key facts making Australia an attractive place for real estate investment:

1. Australia boasts four of the top 10 most liveable cities in the world (The Economist)
2. Australia boasts 25 years of uninterrupted economic growth and is rated AAA by all three global rating agencies
3. The real estate market is highly resilient and relatively shielded from global economic shocks with dwelling values increasing in value in a steady manner for the past 20 years. Between 1992 and 2015, Australia also has the highest real GDP growth out of all advanced economies



Property Development Context in Australia

For any overseas developer or investor hoping to enter Australia, it is essential to appreciate the nuances and local particularities of developing real estate in Australia. We outline below some of the specific characteristics of each stage of the development cycle to provide an initial glimpse of nature of the Australian market which may differ from that in Asia.

Stage	Nature of the Australian Market
Site Acquisition	<ul style="list-style-type: none"> • Parochial Market – Public Information widely shared • Highly Competitive, Transparent and market-driven process – Auction, Public Tender, highest price wins • 99% - acquired at or above market price
Town Planning	<ul style="list-style-type: none"> • Highly process driven and transparent • Strong element of public consultation and design consideration • Emphasis on urban design impact on neighbours
Detailed Design and Documentation	<ul style="list-style-type: none"> • High industry professionalism and self-regulation • Private building certification and documented approval • Clearly written codes and standards
Pre-Sales and Leasing	<ul style="list-style-type: none"> • Well-defined pre-sales process and rules on deposits, trust accounts, legal protection for both sides • Mature legal and banking system • Developer and Architect Profile and branding
Financing	<ul style="list-style-type: none"> • Mature and competitive financial system • Availability of alternative capital – funds, private equity • Conservative banks – qualifying pre-sales, past local experience, financial strength, relationship
Construction	<ul style="list-style-type: none"> • Turnkey Construction – Main Contractor • Lower efficiency in construction • Statutory and HSE hurdles during construction • For larger projects, union impact on projects

So, what does this imply for overseas developers? Our perspective is that overseas developers will need to adopt a back-to-basics approach to development, one that is reliant on professional expertise and execution capability. In essence, there are three key areas in which incumbents should focus their efforts on:

1. Developing strong capability in project execution and delivery through disciplined project management practices, rapport building with industry counterparts, and developing strong internal QA processes and business systems
2. Building a competent locally based team with local expertise, industry networks and operational and financial decision making authority. The head office will responsibility for strategy and relationship building
3. Investing in building the corporate brand and growing industry reputation by focusing on delivering design-driven projects which appeal the broader local market and contribute to public urban affairs

These may appear common sense, but one may be surprised to

see how many developers focus solely on project selection and profitability over these “softer” operational aspects of capability building. Pure focus on project site selection and chase for profit may result in short term financial success, but we believe this is not a sustainable long term strategy. It is through the above measures that overseas developers can grow a truly sustainable property business, and not merely a portfolio of profitable projects.

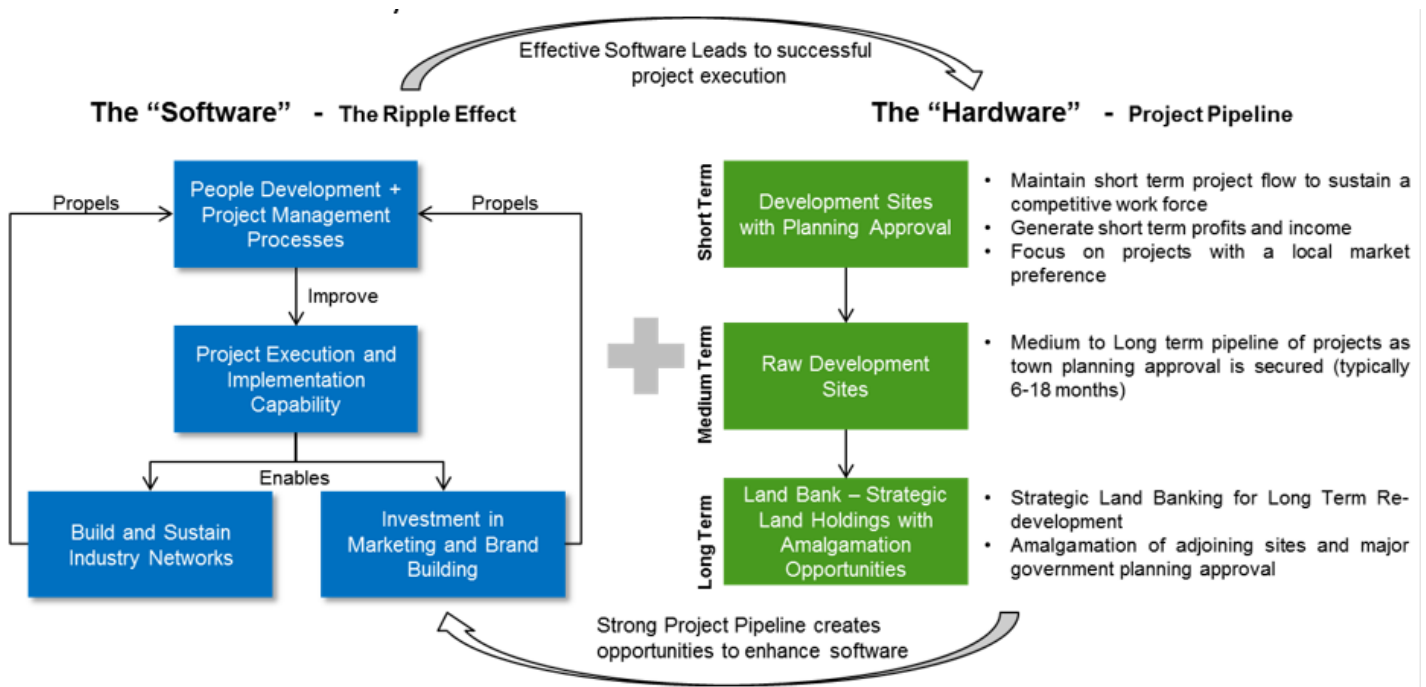
Deploying an Asia-capable and trusted local leader is key to executing this approach – one who is able to bridge the communication gap between the east and west and also someone who has a local presence and in-depth knowledge to operate an Australian business.

Strategically, there are four options to pursue this growth, each with its pros and cons. We are of the opinion that acquisition of an equity stake in a young but growing property business in Australia is the optimal approach. This approach enables the incumbent to immediately tap into local resources and networks at a relatively low initial capital cost with the concurrent opportunity to continually grow and control the company at an early stage.

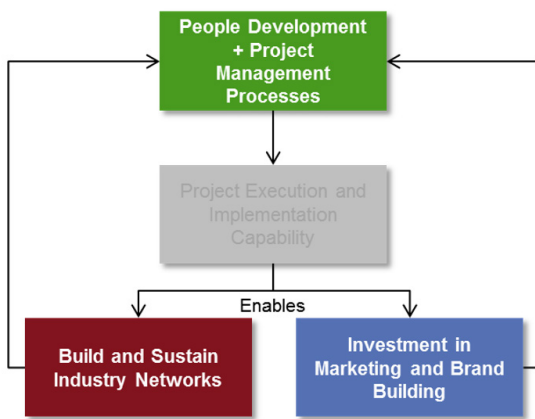
	Description	Pros	Cons
Build A New Business From Ground Up	<ul style="list-style-type: none"> Start a new company in Australia Hire local management team to operate business and seek development opportunities Form industry reputation, networks and build brand over time 	<ul style="list-style-type: none"> Full control of business operations and strategy Build a new brand from scratch with no past legacy 	<ul style="list-style-type: none"> Time – need to build a brand and hire competent local staff Slower growth in early years Unrecognised brand and past experience in Australia, inability to obtain external debt finance
Passive Investor and JV with Experienced Developers	<ul style="list-style-type: none"> Act as major equity partner in major development projects Partner in Joint Venture with established and experienced developers or development manager companies 	<ul style="list-style-type: none"> Immediately leverage local Australian development expertise Low up front capital costs in establishing full business operation – only minimal management staff is required Quicker financial returns 	<ul style="list-style-type: none"> Not a sustainable approach – pure investor rather than building a true business in the long term Pure project focused and opportunistic – not sustainable Intellectual capital and branding rests with developer; Investors acts as passive party
Acquire Equity Stake in a Young but Growing Business	<ul style="list-style-type: none"> Acquire an equity stake in a young but growing development business with a strong future potential and leadership team Provide capital to further grow the business and project pipeline by also investing in projects concurrently Build internal capability and industry brand in a sustainable manner 	<ul style="list-style-type: none"> Tap into experienced local people, resources and industry relationships Ability to control and participate in growing a sustainable business Relative low cost to invest in majority stake in a young company 	<ul style="list-style-type: none"> Require foresight in order to realise future potential and full value in young business Require trust and aligned cooperation with founder to grow the business together
Full Acquisition of an Established Development Business	<ul style="list-style-type: none"> Acquire an established and experienced development business Continue to operate business, bringing in capital, resources, relationships and best practices Retain company leadership and founder as direct staff 	<ul style="list-style-type: none"> Immediate access to strong development capability, people, resources and relationships (at a cost!) Stronger and more immediate financial returns 	<ul style="list-style-type: none"> Much higher upfront capital cost to acquire assets and goodwill Limited ability to impose major changes - High business risk if significant changes are imposed Higher investment risk Potential cultural clashes

Creation of a Sustainable Property Business in Australia

A sustainable property business requires harmony between the “software” (the development of people, processes networks and brand), together with the “hardware” (maintaining a project pipeline in the short, medium and long term). They work hand in hand and form a vicious cycle.



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The hardware involves physical projects themselves. The property Industry is a project-based industry with long durations and unstable and long cash flows, placing pressure on working capital requirements. Maintaining a strong pipeline of projects is crucial to creating a sustainable long term business. A strong pipeline will also attract industry talent, maintain continual cash flow, and build our brand and sustain industry and government relationships.

An Asset Light Model is ideal to optimise capital deployment, diversity risk, grow external relationships and develop the “software”. This arrangement typically involves:

- JV with other investor equity partners and/or property funds together with bank debt finance
- Example - 65% Bank Debt, 25% JV Equity, 10% Equity, 50/50 profit sharing arrangement
- Professional fees (PM and Sales Commission) earned during development to maintain cash flow, and development profit realised at completion for re-investment

People Development and Process Initiatives

- Technical capabilities
- Understanding of evolving local market characteristics
- Design Driven Approach
- Innovation capability development
- Professional service approach – QA, systems, technology
- ISO9001 and ISO14000 certification

Industry Network Building Initiatives

- Leading Industry Associations as active members (PCA, UDIA, API)
- Proactively seek speaking opportunities
- Build Intellectual Capital through publications and insights
- Grow a close trusted circle of external consultants, agents, developers and local government

Marketing and Brand Building Initiatives

- Delivery quality projects with a local market target
- Monthly newsletter and publications
- Seek speaking opportunities
- Hold training courses
- Holistic branding approach

In terms of project type, there are three main types of freehold development sites in Australia:

- Unpermitted sites – these are “raw” sites with no planning approval and higher risk planning risk. Typically, there will be an existing residential or commercial property on the land with some income generating potential. Overall project timing on this type of project will be at least 6-12 months longer due to the need to obtain statutory approval
- Permitted sites – these are approved development sites with much lower development risk, but will come at a premium to market value. These provide quicker returns and an immediate pipeline of projects and overall timing can be as quick as 12 months depending on project size
- Strategic land holdings – land banking on key commercial sites will create a longer term project pipeline and also the potential to amalgamate adjacent sites land holdings

A combination of the above project types is essential to maintain a long term pipeline and ride any future property cycles.

A potential project investment strategy in the short to long term is to focus on a combination of design-driven projects with a local market focus.

Short Term (Year 1 – 3)

- < 80 boutique design focus **mixed use apartment** projects in infill suburbs within 15km from CBD with close access to public transport and lifestyle amenities
- Modern terrace type medium density **townhouse** projects (double or triple storey) within 15km from CBD with close access to public transport and schools



Medium Term (Year 1 – 5)

- Strategic **Commercial Land Holdings** with holding income and re-development or amalgamation potential in CBD or CBD fringe infill locations
- Secure planning approval for larger scale residential or mixed use projects
- Negotiate for amalgamation opportunities



Long Term (Year 5 +)

- Land Bank approach
- **Mixed Use Hotel and Commercial** Projects in urban centres (CBD or suburban town centres) for long term investment
- Partner with other operators
- Opportunity to diversify into complementary businesses (retail, entertainment, F&B, facilities management)



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About STM Developments

STM Developments is a property development and real estate advisory business based in Melbourne, Australia. We are founded on one principle - to share our passion for property with everyone that reside or invest in our properties. We consult our client's property needs through our unique insight and deep industry expertise. **We Consult, Develop, Manage, Market and Sell.**



STM Developments

YOUR TRUSTED AUSTRALIAN DEVELOPMENT PARTNER

OUR CAPABILITIES



SITE ACQUISITION

Solid pre-acquisition due diligence and sourcing of the best on and off market development sites is the first step to a successful project.



PROJECT FEASIBILITY

Thorough market research, detailed risk assessment and a robust project feasibility analysis will provide comfort for a successful acquisition.



DEVELOPMENT MANAGEMENT

Leading and managing all project consultants and stakeholders and securing the best planning approval is a crucial first step in the development process.



PROJECT MANAGEMENT & FINANCING

Disciplined project management, design and documentation management and cost control within feasibility limits will ensure projects are completed on time and to budget.



INVESTOR REPRESENTATION

On larger scale joint ventures or projects, negotiating development agreements, undertake commercial and technical due diligence and representing investors throughout the project will ensure their interest and risks are managed.

ABOUT US

STM Developments is a property development & advisory business based in Melbourne, Australia.

We work alongside developers and investors, providing site acquisition, feasibility analysis and project management services for residential and commercial projects. We initiate and participate in property development joint ventures as project proponent. We also act as investors' independent representatives as their point of contact for their co-investment projects and joint ventures.

Founder and Managing Director Simon Lee has more than 17 years of professional experience in all major facets of the development industry in Australia. He has successfully designed, led and managed major commercial, retail, mixed use and residential projects in Hong Kong and Australia ranging in value from \$4 million to \$20 billion. Simon is also an occasional guest lecturer and tutor at the Faculty of Architecture University of Melbourne.

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