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THE UNIVERSITY OF
SYDNEY
CHINA STUDIES CENTRE

Demystifying Chinese Investment in Australia

Featuring commercial real estate
analysis by Knight Frank

May 2015 Update

kpmg.com.au



About our reports

KPMG and The University of Sydney formed a strategic relationship to publish research and insights on doing business with Chinese investors. Our first report was launched in September 2011, with this representing the tenth Demystifying Chinese Investment report in our series.

This report examines Chinese investment in Australia for the calendar year 2014. Given the unprecedented increase in commercial real estate investment during this time, we have partnered with leading global real estate advisory and agency firm, Knight Frank, to provide a more detailed account of Chinese commercial real estate investment activity in Australia.

The catalyst for our report series is the historic lack of detailed factual information about the real nature and distribution of China's outbound direct investment (ODI) in Australia. Without this information, there is disinformation and speculation. Our reports seek to set the record straight and debunk the myths associated with Chinese investment in this country.

Methodology

The dataset is compiled jointly by KPMG and The University of Sydney Business School and covers investments into Australia made by entities from the People's Republic of China through M&A, joint venture and greenfield projects. The dataset also tracks Chinese investment by subsidiaries or special purpose vehicles in Hong Kong, Singapore and other locations. The data, however, does not include portfolio investments such as the purchase of stocks and bonds, which does not result in foreign management, ownership or legal control.

Our database includes completed direct investments recognised in the year in which parties enter into legally binding contracts and if necessary, receive mandatory FIRB and Chinese Government investment approvals. In certain instances, final completion and financial settlement may occur in a later year.

For consistency, the geographic distribution is based on the location of the Chinese invested company and not on the physical location of the actual investment project. Completed deals which are valued below USD 5 million are not included in our analysis, as such deals consistently lack detailed, reliable information. Unless otherwise stated, the data referred to throughout this report is sourced from the KPMG/University of Sydney database, and our previously published reports¹.

The University of Sydney and KPMG team obtains raw data on China's ODI from a wide variety of public information sources which are verified, analysed and presented in a consistent and summarised fashion. In line with international practice, we traditionally record deals using USD as the base currency. However, for 2014 we use Australian dollars for our detailed analysis given the effect of exchange rate fluctuations.

We believe that the KPMG/University of Sydney dataset contains the most detailed and up-to-date information on Chinese ODI in Australia.

1. Includes Australia & China Future Partnership, September 2011; The Growing Tide: China ODI in Australia, November 2011; Demystifying Chinese Investment, August 2012; The Energy Imperative: Australia-China Opportunities, 25 September 2012; Demystifying Chinese Investment in Australia, March 2013; Demystifying Chinese Investment in Australian Agribusiness, October 2014; Demystifying Chinese Investment in Australia, March 2014; Demystifying SOE Investment in Australia August 2014; Chinese Investors in Australia Survey, November 2014.

Chinese investment in Australia in 2014: What you need to know

Chinese ODI was USD 8.35 billion (AUD 9.46 billion), falling from USD 9.19 billion in 2013. Underlying the 9.1 percent decrease are dramatic structural changes to the composition of Chinese investment:

46%



For the first time, **nearly half** of Chinese investment was concentrated in **commercial real estate transactions** (up from 14 percent in 2013).

FOUR

mega sized

transactions with values over AUD 500 million

(totalling AUD 3.9 billion) occurred in new areas such as construction (John Holland), leisure (Hoyts), major port infrastructure (Newcastle) and mining (Aquila Resources).



Significant increase in private investment

For the first time, **Chinese private sector investment** in Australia exceeded **state owned enterprise investment** in number of deals (85 percent of total) as well as in total value (66 percent, AUD 6.23 billion) in 2014. Fifty-one private deals were recorded in 2014, compared to 25 in 2013.



2013

2014



Investment has trended towards

Infrastructure **Commercial real estate**

and away from mining, driven by more global competition for profit-driven Chinese investment.

A dark blue circle containing text and two icons. The 'Infrastructure' icon shows three orange circles connected by lines. The 'Commercial real estate' icon shows two orange buildings of different heights.

2nd

Australia maintained its position as the second largest recipient country of aggregated global Chinese direct investment between 2007 and 2014, behind the United States in first position.

A dark blue circle containing a white map of Australia. An orange circle with the number '2nd' is overlaid on the map. Below the map is text in white and orange.

Chinese outbound direct investment increased 11 percent in 2014. We expect further investment by Chinese companies into:

Infrastructure **Commercial real estate** **Food**

A dark blue circle containing text and three icons. The 'Infrastructure' icon shows three orange circles connected by lines. The 'Commercial real estate' icon shows two orange buildings. The 'Food' icon shows an orange knife and fork.

Globally, Australia remains a major destination for Chinese outbound investors

In 2013, Australia narrowly lost its mantle as the world’s top destination for Chinese outbound direct investment but stayed ahead of Canada, Brazil and the United Kingdom. According to Rhodium Group, Chinese investment in the United States (USD 12 billion in 2014) was higher than Chinese investment in Australia, but also recorded a bigger drop from its historical height of USD 14 billion in 2013.

Comparison of Chinese Investment in Australia and the United States 2013-2014

	2013 (USD billion)	2014 (USD billion)	Growth rate
Australia	9.19	8.35	-9.1%
United States	14.00	12.00	-14%

Source: KPMG/The University of Sydney database and The Rhodium Group China Investment Monitor.

According to the Australian Bureau of Statistics, China now ranks as Australia’s fifth largest investor with 4 percent of investment stock, behind the United States (24 percent), the United Kingdom (13 percent), Japan (10 percent) and the Netherlands (6 percent), equal to Singapore (4 percent) and ahead of Canada (3 percent)².



Chinese investment in a global context

For the first time, China became a net foreign investor in 2014 as China's ODI overtook inward foreign direct investment into China. Based on China's Ministry of Commerce estimates, the total ODI volume for 2014 stands at around USD 120 billion, representing an 11 percent increase from USD 108 billion in 2013.

As China shifts the emphasis of its economic growth model from rapid 'quantity growth' to sustainable 'quality development', Chinese companies are investing in new sectors beyond resources extraction. These include high technology, agriculture and food, real estate and services.

Among China's top 10 outbound M&A deals globally in 2014 there was only one large mining sector deal while in 2010 there were six oil & gas deals and one mining deal. Nine out of the top 10 outbound M&A deals by value in 2014 were completed in developed countries, compared with only four in 2010.

TOP industry sectors attracting Chinese overseas M&A investment, by deal value



Source: Dealogic, accessed 4 January 2015, KPMG analysis



Vaughn Barber
Partner, Head of Outbound,
KPMG in China

“With USD 1.25 trillion in ODI predicted over the next decade, China seems set to enter the fast lane as a ‘global investor’. Overseas investments are helping more Chinese companies from more sectors access new markets, and acquire the experience, technology, brands and human capital necessary to become more competitive.

With more deals being done in more sectors, it is not surprising to see that Chinese companies' investment destinations are also changing: from resource rich developing countries to developed countries providing access to advanced technologies, established brands, extensive industry experience and worldwide distribution networks. While the trend away from resources has led to a decline in Chinese investment in Australia, the trend towards advanced technologies, food and services works in Australia's favour longer term.

China's President Xi Jinping in his speech at the APEC Forum in Beijing in 2014 stated that accumulated Chinese outbound investment had reached USD 660 billion in 2013 and will reach USD 1.25 trillion over the next decade. Considering that Chinese total ODI in 2014 had reached USD 120 billion, the figure of USD 1.25 trillion only represents a relatively small increase over the 10-year period, but it indicates a long term commitment to outbound investment and trade that will perpetuate China's role as Australia's most important trade partner and increasingly important investment partner.



Source: Dealogic, accessed 4 January 2015, KPMG analysis

Recipient countries are also benefiting from the capital, experience, cost-competitive inputs to the production process and expanded market opportunities that Chinese investors bring. There is an increasing recognition that Chinese companies can achieve success in areas like infrastructure and agribusiness by 'partnering' with incumbent players in key target markets."

Chinese investment in Australia declined 9.1 percent in 2014

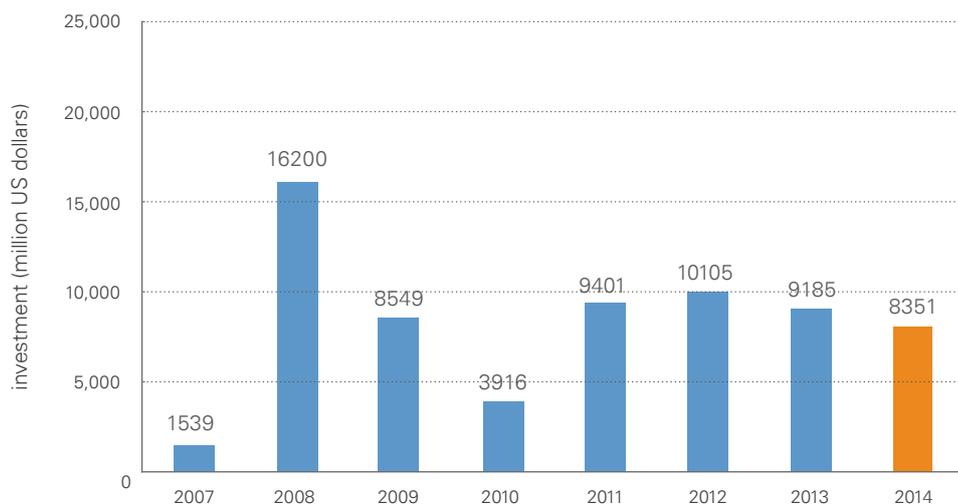
Chinese investment in Australia decreased by 9.1 percent in USD terms during 2014, against a backdrop of an overall global increase in Chinese outbound investment of 11 percent during the year.

Based on the KPMG / University of Sydney database, total Chinese ODI in Australia in 2014 was USD 8.35 billion (AUD 9.46 billion), down from USD 9.19 billion in 2013, a further drop from USD 10.1 billion in 2012.

The major reason for reduced Chinese investment in Australia was a downward trend in mining and energy sector investment. In 2014, Chinese investment in mining and energy combined was AUD 1.66 billion and accounted for only 18 percent of the total investment volume.

The relative depreciation of the AUD has increased the AUD equivalent result in 2014.

Historical trend of Chinese investment in Australia by value (USD billion)

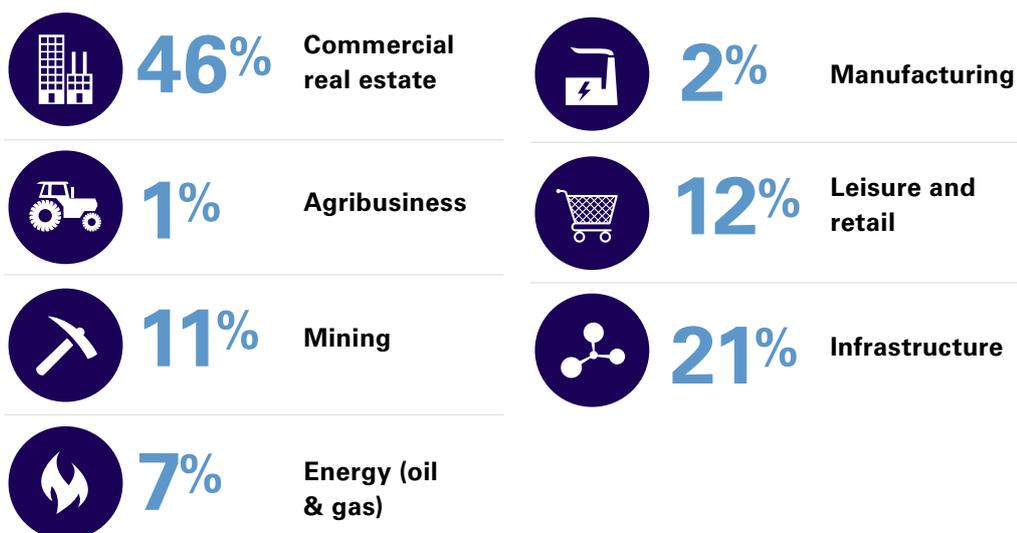


Source: KPMG/University of Sydney database

Chinese investment in Australia by industry

Chinese direct investment in Australia in 2014 was mainly focused on commercial real estate, infrastructure and for the first time, a material investment in the tourism and leisure sectors.

Chinese ODI by Industry in 2014 (AUD)



Industry	Value (AUD million)	%
Commercial real estate	4,372.08	46
Infrastructure	2,025.00	21
Leisure and retail	1,101.00	12
Mining	992.30	11
Energy (oil & gas)	667.00	7
Manufacturing	164.90	2
Agribusiness	140.30	1
Total	9,462.58	

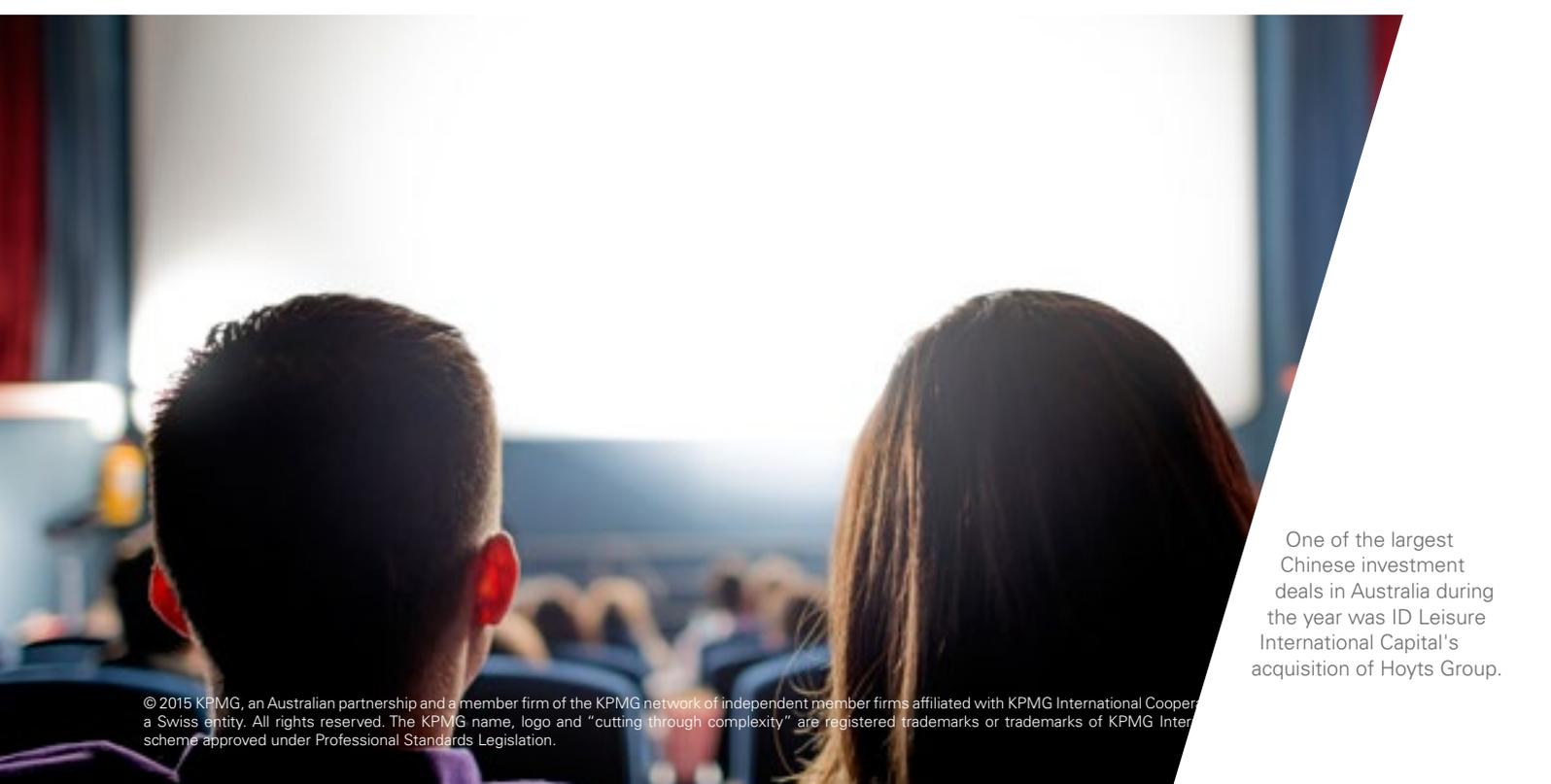
Source: KPMG/University of Sydney database

- i) Given the significant depreciation of the AUD against the USD during 2014, our detailed analysis is presented in AUD.
- ii) The FX conversion rate applied is the spot rate on the transaction signing date generally, otherwise the average monthly or annual rate.

Selected major Chinese investments in 2014

Target Name	Acquirer Name	Industry Sector	State	Transaction Value (AUD m)	Transaction Value (USD m)
John Holland Group	CCCC International Holding Limited (CCCI)	Infrastructure	NSW	1,150.0	946.92
Hoyts Group	ID Leisure International Capital	Leisure	NSW	1,000.0	823.41
Aquila Resources Limited	Baosteel Resources/Aurizon Holdings	Mining	WA	910.0	854.13
Port of Newcastle (99 year lease)	China Merchants Group /Hastings Funds Management (50-50 JV)	Infrastructure	NSW	875.0	813.97
Roc Oil Company Limited	Fosun International	Oil	NSW	489.0	455.24
Sheraton on the Park, Sydney	Sunshine Insurance Group Corporation	Commercial real estate	NSW	463.0	400.51
Gold Field House, 1 Alfred Street, Sydney	Dalian Wanda Group	Commercial real estate	NSW	425.0	349.95
175 Liverpool Street, Sydney	Shimao Property	Commercial real estate	NSW	392.7	339.70

Source: KPMG/University of Sydney database



One of the largest Chinese investment deals in Australia during the year was ID Leisure International Capital's acquisition of Hoyts Group.

Commercial real estate



2014 saw a dramatic increase in commercial real estate investment, accounting for 46 percent of the total 2014 value – up from 14 percent in 2013. Chinese investment volume in commercial real estate has nearly quadrupled in one year to AUD 4.37 billion.

Given the material trend increase in commercial real estate investment during the year, we have partnered with Knight Frank to provide a more detailed account of Chinese investment activity in the sector.



Chinese outward real estate investment globally and into Australia: after the initial waves, what's next?

Contributed by Knight Frank

There has been a tremendous surge in Chinese outward investment in overseas real estate in recent years. What started as sovereign funds making exploratory investments has proliferated into investment sprees by Chinese developers, banks, ultra high net worth individuals (UHNWI's) and institutional investors such as insurance companies.

This surge has been fuelled by a combination of push and pull factors, with a number of key domestic economic and policy variables contributing. One of the most powerful drivers has been the continued consolidation of China's residential real estate market. Fierce domestic competition, combined with government curbs on home purchases and rising borrowing costs over the past 2 years, has led to developers actively looking elsewhere for new opportunities. Government incentives, such as the relaxation of real estate investment regulations for insurance companies have also resulted in billions of dollars in extra funding for overseas investment.

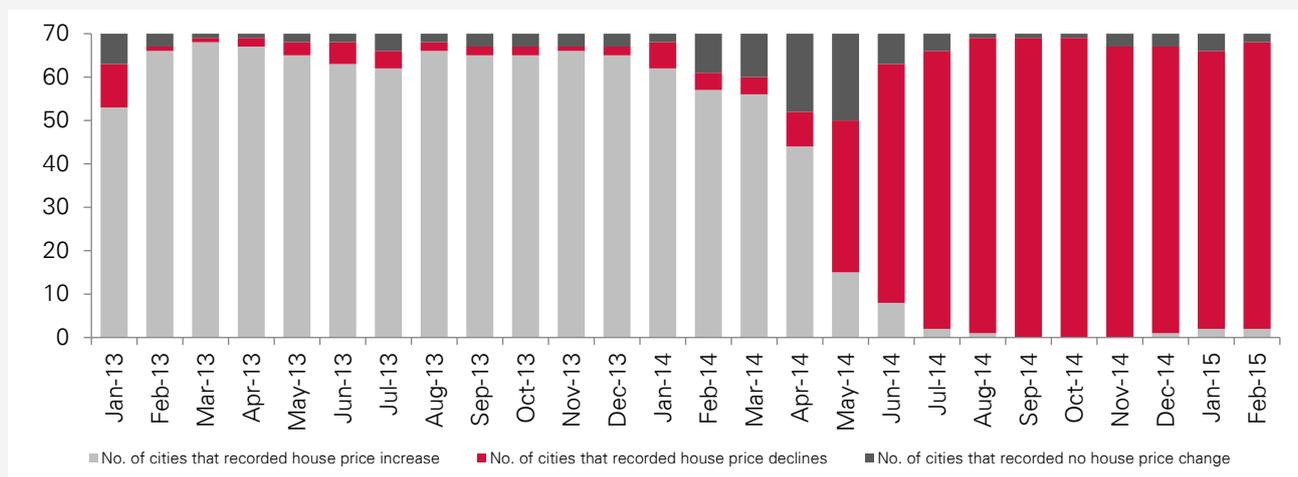
One of the push factors for outward investment comes from the slowing economic growth and consolidation of China's residential market. As a result of rampant construction, vacant residential floor space increased by over 80 percent since 2010. It is estimated that existing inventory nationwide will take at least 2 years to absorb. This oversupply has sparked cut-throat competition amongst developers, which has helped fuel buyers'

expectations of further price cuts. China property prices began falling during the second half of 2014 and have continued to fall into 2015. In February 2015, 66 of the 70 major Chinese cities recorded house price falls month-on-month, compared to February 2014, when only four cities saw a decline (see Figure 1). This downward trend has improved slightly from the worst point in October 2014, when 69 of the 70 cities recorded house price declines, which was the highest percentage since 2010.

Despite recent cuts to lending rates and the Reserve Requirement Ratio (RRR), in addition to the PBoC/Ministry of Housing and Urban-Rural Development (MOHURD) relaxing mortgage down payments, we expect property prices to remain under further pressure in 2015. Prices are unlikely to rebound while developers continue to clear inventory and pull back on new projects. While this remains the case, we believe this will impact on developers' future investment strategies, making offshore expansion a viable option over at least the short to medium term.

Figure 1: 66 out of 70 cities saw house price decline in February

Monthly residential price change in 70 major Chinese cities

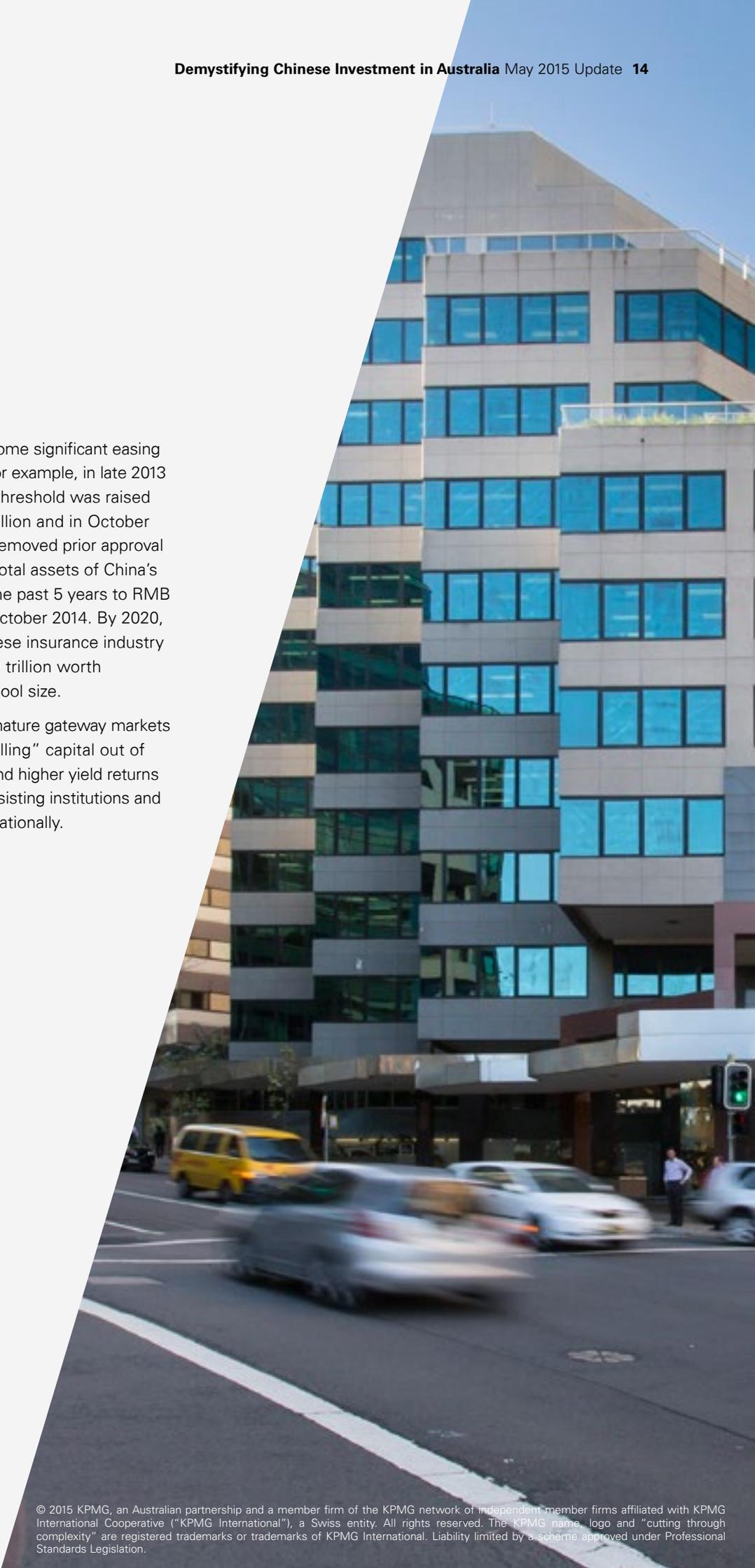


Sources: National Bureau of Statistics, Knight Frank

Another major push comes from some significant easing of overseas investment policies. For example, in late 2013 the outward investment approval threshold was raised from USD 100 million to USD 1 billion and in October 2014, the Ministry of Commerce removed prior approval for most foreign investment. The total assets of China's insurance industry doubled over the past 5 years to RMB 9.6 trillion (USD 1.6 trillion) as at October 2014. By 2020, authorities estimate that the Chinese insurance industry will accumulate a further RMB 20 trillion worth of premiums, tripling the current pool size.

Meanwhile, the attractiveness of mature gateway markets in the UK, US and Australia is "pulling" capital out of China, providing quality products and higher yield returns with diversification benefits and assisting institutions and developers build their brand internationally.

Hong Kong Stock Exchange listed Fosun International purchased this office building at 73 Miller Street, North Sydney, for AUD 116.5 million in January 2015.



There are a number of pull factors at play fuelling investment in overseas markets:

- As these investors and developers already have extensive domestic exposure, offshore investments help them diversify risk into markets that offer better returns and lower funding costs. Funding costs in Shanghai and Beijing are very high, notwithstanding recent cuts, often at above 8 percent. In contrast, funding costs can be as low as 4 percent in Australia and an easing cycle is underway.
- Deep, liquid and transparent markets with scale – clarity of rules and regulations.
- The quality of life, weather, clean air and world class education institutions all act as a magnet to Chinese developers and migrants alike.
- Overseas acquisitions help Chinese institutions build their brands internationally.
- Owner occupiers (eg. big banks) use investments to help manage their future occupation costs. Banks such as CCB, Bank of China, Agricultural Bank of China and Commercial Bank of China have all been active in the commercial market globally over the past year.

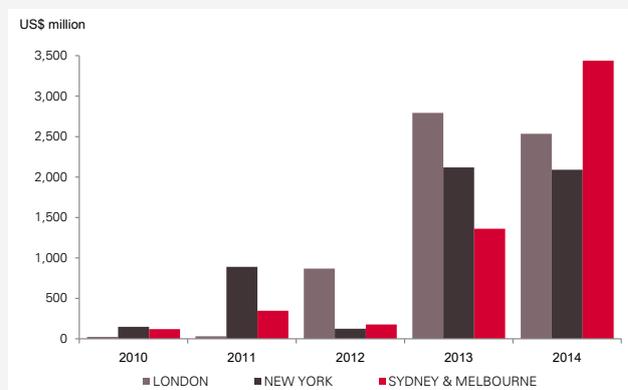
China's outward investment into real estate

Targeting gateway cities in mature markets, such as Australia

As a result, the total value of Chinese outward commercial real estate investment skyrocketed from USD 0.6 billion in 2009 to USD 16.9 billion in 2014. Over USD 7.8 billion has transacted in the first 4 months of 2015. If this activity was to continue, 2015 is likely to be another record year for Chinese outward investment, both globally and into Australia, with the potential for more than USD 20 billion transacting.

So far the majority of the Chinese outward investment has been focused in gateway cities of Australia, the US and the UK. In 2014 Australia has seen the strongest growth in inbound real estate investment from China, with particular focus on Sydney and Melbourne.

Figure 2: Chinese real estate investment into the gateway cities



Source: Knight Frank, RCA
NB data excludes residential dwellings and multi-family

Chinese high net worth investors and developers are looking to new destinations offering discounts on prime property such as Miami in the US; and in Australia, Brisbane, Gold Coast, Adelaide and regional suburbs of NSW and Victoria will start to gain more traction.

Chinese real estate investment activity into Australia

The gateway cities of Australia, namely Sydney and Melbourne, have been the most active markets for Chinese investors. With their relative geographic proximity, relatively higher yields, market stability and liquidity, total Chinese real estate investment volume in these two cities outstripped both London and New York in 2014.

Australia has recorded exponential growth in investment over the past few years, culminating in just over USD 4 billion invested into the country by Chinese investors, across both commercial and development sites. This has exceeded the total Chinese inbound real estate investment which occurred over the prior 5 years combined (2009-2013).

China and Australia signed a Declaration of Intent for a Free Trade Agreement (FTA) on 17 November 2014, which raised the threshold for private, non-state-owned investment from China in non-sensitive sectors (such as property) to go to the Foreign Investment Review Board from AUD 248 million to AUD 1.08 billion. The FTA is expected to accelerate the flow of Chinese investment funds into the Australian property market.

**Table 1: Select recent Chinese buying activities in Australia – 2014/15**

Date	Purchaser	Property Name	Location	Property Type	Consideration (AUD million)
Jan 14	Fu Wah International	Park Hyatt	East Melbourne	Hotel	135.0
Jan 14	Bridgehill Group	52 Alfred St	Milsons Point, Sydney	Office/Dev Site	80.0
Mar 14	Greenland	Leichhardt Green site	Leichhardt, Sydney	Dev site	47.1
Mar 14	Greenland	225-235 Pacific Hwy	North Sydney	Dev site	56.0
May 14	Aqualand	Melrose Park site	Melrose Park, Sydney	Dev site	135.0
May 14	Chinese Private	Campsie Centre	Campsie, Sydney	Retail	67.0
Jun 14	Chinese Private	299 Elizabeth St	Sydney CBD	Office	45.0
Aug 14	Dalian Wanda^	Jewel development project	Gold Coast	Hotel/Resi	c 300.0
Aug 14	Aqualand	CSIRO Site	North Ryde, Sydney	Office/Dev Site	170.0
Aug 14	Yuhu Group	221 Miller St	North Sydney	Office/Dev Site	56.0
Sep 14	Glorious Sun	231-235 Swanston St	Melbourne CBD	Office/Retail	25.3
Oct 14	3L Alliance	350 Queen St	Melbourne CBD	Office	130.0
Oct 14	Xiang Xing Developments	58-68 Dorcas St	Southbank, Melbourne	Office	35.0
Oct 14	Private Chinese Family	617-621 Pacific Hwy	St Leonards, Sydney	Dev site	c 40.0
Nov 14	Kingold Group	75 Elizabeth St	Sydney CBD	Office	67.0
Nov 14	Shimao Group	175 Liverpool St	Sydney CBD	Office	392.7
Nov 14	Chinese Private	695-699 George St	Sydney CBD	Office	41.0
Nov 14	Sunshine Insurance	Sheraton on the Park	Sydney CBD	Hotel	463.0
Nov 14	GH Properties	20 Walsh St	Milton, Brisbane	Dev Site	10.3
Nov 14	GH Properties	Ashmore/Mitchell Roads	Alexandria, Sydney	Dev Site	c 380.0
Nov 14	Guangzhou R&F Property Co.	1 Cordelia St	South Brisbane	Dev Site	46.0
Nov 14	Visionary Investment Group	233 Castlereagh St	Sydney CBD	Office	156.0
Dec 14	Visionary Investment Group	338 Pitt St	Sydney CBD	Office	102.0
Dec 14	China Poly Group	Cambridge Office Park	Epping, Sydney	Office/Dev Site	110.0
Dec 14	Wanda One (Dalian Wanda)	1 Alfred St	Sydney CBD	Office/Dev Site	425.0
Jan 15	Wanda One (Dalian Wanda)	Fairfax House	Sydney CBD	Office	73.0
Jan 15	Aqualand	168 Walker St	North Sydney	Office	157.5
Jan 15	Fosun International *	73 Miller St	North Sydney	Office	116.5
Jan 15	Lee Shing Hong Ltd	300 Adelaide St	Brisbane CBD	Office	47.5
Jan 15	Chiwayland	14-20 Parkes St	Parramatta, Sydney	Dev Site	27.0
Feb 15	Ryan Ouyang	Greenwood Business Park	Burwood, Melbourne	Office	69.5
Feb 15	Jiyuan Li	Prince of Wales Hotel	St Kilda, Melbourne	Hotel/Dev Site	45.0
Feb 15	Aoyuan (HK based)>	130 Elizabeth St	Sydney CBD	Office/Dev Site	121.0
Mar 15	Huayu Group	Sofitel Broadbeach	Gold Coast	Hotel	62.0
Apr-15	Chinese Private	Compass Centre	Bankstown, Sydney	Office/Retail/Dev Site	45.0

Source: Knight Frank

NB. Many of above have been purchased for potential residential development

* JV with local group Propertylink

^ JV with existing owner of site Ridong Group

> JV with Ecove

Somewhat dichotomously the Federal Government has proposed changes to the foreign investment framework or private residences in Australia, announced as part of an “options paper” released on 27 February 2015.

This may impact Chinese commercial investment flows. However, even if implemented in their entirety, it is unlikely to deter the large scale development and investment into commercial and residential markets.

For many wealthy Chinese, the risk of buying property in unfamiliar overseas markets such as Australia can be offset by buying projects offered by Chinese developers. This provides a sense of both familiarity and pride. However, our recent conversations with several pioneering Chinese developers revealed that they are increasingly realising the need not just to cater for Chinese buyers, but to tailor project design elements and marketing strategies to the broader local markets.

They are no longer distinguishing buyers by nationality or relying primarily on demand from Chinese buyers. Robust local sales conditions have become one of their most commonly stated criteria for project screening. They aim to expand and leverage their brand identity overseas and to take advantage of this demand. Chinese developers, however, have the added advantage of being able to attract a significant pool of Chinese buyers, who often purchase off-plan, which helps to de-risk their development projects.

A few major Chinese developers have already begun aggressively expanding into Australia. For example, Greenland has invested heavily into Australian development

projects, tapping predominately into cities such as Sydney and Melbourne. Dalian Wanda Group, one of China’s largest mixed-use developers, is developing major hotel and residential projects in Sydney and the Gold Coast.

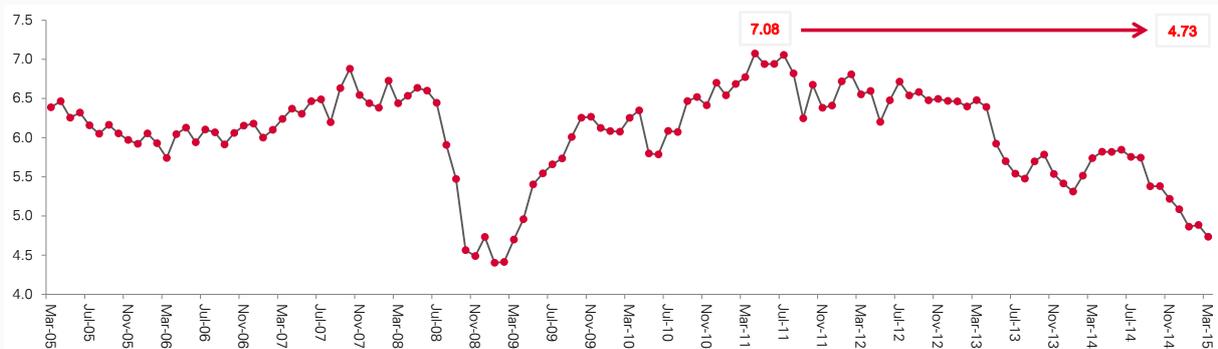
Currency play

Since the end of 2007 and the onset of the GFC, the Renminbi (RMB) has appreciated considerably against a basket of major currencies, including 37 percent against the British Pound, 38 percent against the Euro, 15 percent against the US dollar and 26 percent against the Australian dollar. This has largely strengthened the purchasing power of Chinese investors, as overseas investment has become relatively cheaper. Many Chinese investors see this as a good opportunity to acquire foreign assets.

In the face of a cooling Chinese economy, RMB appreciation is expected to slow down in the coming years. Currency fluctuation is a double-edged sword for Chinese investors. Since Greenland’s acquisition of their Melbourne site, the Australian dollar has depreciated roughly 18 percent against the Renminbi. On the flip side, this devaluation now favours any Chinese investors who buy into this and any other residential schemes.

The stronger buying power of the Chinese and the weaker AUD will undoubtedly continue to support capital inflow. With the potential for further interest rate cuts in Australia over the remainder of 2015, coupled with a seemingly more entrenched US recovery leading to interest rates rising there in H2 2015, the AUD will remain under downward pressure.

Figure 3: AUD / RMB Exchange Rate – last 10 years



Source: RBA, Knight Frank



After the initial waves: what's next?

The emergence of new fourth-wave of investors

The first wave of Chinese capital outflow saw sovereign wealth funds, banks and private funds investing in core, trophy assets with examples including CIC and Bright Ruby Group acquiring core office assets in the Sydney CBD. Large developers followed, looking to diversify with an overseas presence. Currently, the third wave of equity investors and insurance firms are seeking core, value-add and yield-driven opportunities.

A new group of entities is quickly emerging as a fourth wave of capital outflow. This group constitutes not only big-name companies, but also UHNWIs, small- to mid-cap SOEs, and smaller, private developers. UHNWIs are exploring Australian investment opportunities mainly for secured income, capital appreciation, risk diversification, personal interest and to link with the strong education sector. Their investment strategies are far ranging, and they are open to different asset classes, with interests ranging from smaller shopping centres, such as the

Campsie Centre, to offices such as 299 Elizabeth Street in the Sydney CBD, residential units and lifestyle properties.

The introduction of the Significant Investor Visa (SIV) scheme in late 2012 intended to target the migration of high net-worth individuals to Australia and required an investment of at least AUD 5 million into complying investments in Australia for a minimum of 4 years before becoming eligible for a permanent visa. This has predominately been taken up by Chinese investors. This process was refined during 2014/15, with a Premium Investor Visa (PIV), offering a more expeditious, 12 month pathway to permanent residency for those meeting an AUD 15 million threshold and will be formally introduced on 1 July 2015. This will be another driver of increased capital flow into Australia more broadly from UHNWIs over the course of 2015/16.

Amongst the big-cap players, as Table 2 highlights, only four of the top 10 Chinese insurance companies have made offshore investments so far, although the remaining six are considering overseas expansion. Sunshine Insurance Group's purchase of the Sheraton on the Park Hotel in Sydney for a record AUD 463 million in November 2014 was followed up by acquiring the Baccarat Hotel in Manhattan, New York for circa USD 230 million.

Table 2: Major Chinese insurance companies and developers and their outbound investment status.

Insurance Companies					
Rank	Insurance company	Premium income (US\$ billion)	Already made investment into Australia	Already made investment offshore	Expressed interest to invest offshore
1	China Life	52.9		●	
2	PICC	44.4			●
3	Ping An	40.4		●	
4	CPIC	26.3			●
5	NCI	16.9			●
6	China Taiping	13.9			●
7	Taikang Life	10.1		●	
8	Sunshine Insurance	5.7	●	●	
9	China Post Life	3.8			●
10	Sino Life	3.5			●
Developers					
Rank	Developer	Total Assets (US\$ billion)	Already made investment into Australia	Already made investment offshore	Expressed interest to invest offshore
1	Poly Real Estate	82.3	●	●	
2	Vanke Group	81.8	●	●	
3	Wanda Group	74.9	●	●	
4	Evergrande Group	68.7		●	
5	Greenland Group	57.5	●	●	
6	CR Land	48.7			
7	China Overseas	42.6		●	
8	Country Garden	39.5	●	●	
9	Shimao Property	32.4	●	●	
10	R&F Properties	27.1	●	●	

Chinese developers, however, have been more aggressive, with eight of the top 10 players having already made offshore investments, seven of which have been active in Australia, and other developers are contemplating such a move. Greenland Group, one of Shanghai's largest state-owned enterprises, has purchased numerous development sites in Sydney's CBD and other metropolitan markets in Sydney and Melbourne. Other developers currently actively developing product include Country Garden, Chiwayland, Bridgehill, Aqualand, Golden Age, JQZ, R&F Properties, Golden Horse and Dalian Wanda (Wanda One). We expect to see more debuts from these companies and other private developers in the coming years.

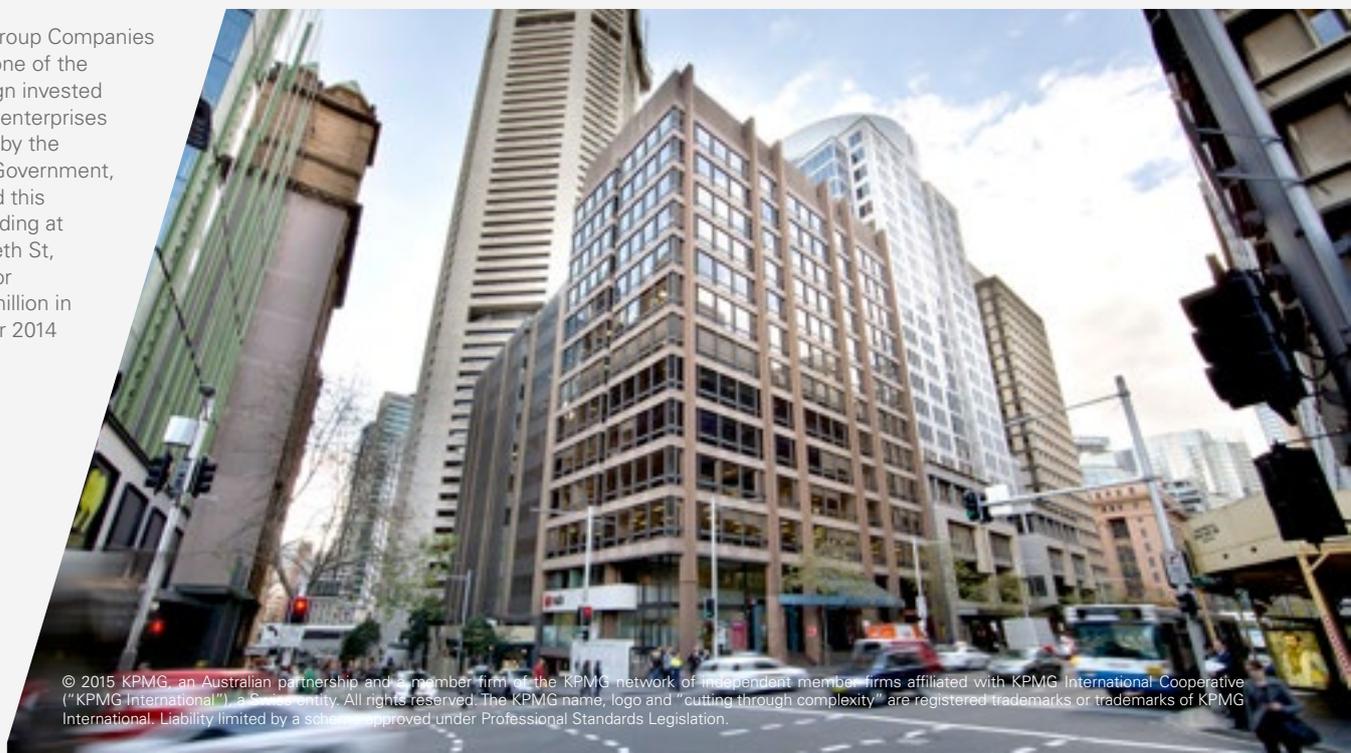
Increasingly, we will also see small- to mid-cap state-owned enterprises and private developers actively seeking different options in small- to medium-scale development opportunities in core and non-core markets in Australia. Given their relative lack of international exposure, their efforts to evaluate their overseas strategy and growth targets will follow a steep learning curve. One of their challenges in gaining market entry is that they typically take a longer period to learn about the market and carry out due diligence, given their corporate structure and scale. Partnering with trusted property and tax/financial advisors, providing local expertise and long-term professional support is critical in the process.

Where to invest next?

After heavy investment in prime office buildings and subsequent yield compression in gateway cities, Chinese investors have begun to look increasingly at opportunities in other key cities and other property sectors and importantly in suburban locations in metropolitan Sydney, Brisbane and Melbourne, not just within the CBD and fringe markets. Whereas investors traditionally targeted the core office and residential development sector, they are now also targeting a more diversified group of real estate assets, from hotels and leisure to industrial to student accommodation. Brisbane and the Gold Coast have begun to capture more residential development interest from Chinese investors and developers. There has been increasing activity in non-core areas of Brisbane, such as Newstead and Fortitude Valley, and this is expected to broaden to more metropolitan sites and to the Gold Coast, where Wanda has co-invested in an AUD 1 billion beachfront site. These markets are underpriced relative to Sydney and Melbourne, and we expect Chinese developers to continue to seek entry to these markets. Adelaide and more satellite or regional suburbs of NSW and Victoria will start to gain traction/interest from Chinese and we should see some stronger price growth occur also.

In the commercial sector, retail and hotels will start to garner more interest following relatively subdued activity over the past few years relative to office and residential development sites.

Kingold Group Companies Limited, one of the first foreign invested approved enterprises approved by the Chinese Government, purchased this office building at 75 Elizabeth St, Sydney, for AUD 67 million in November 2014





Risks: Chinese market conditions and Australian policy intervention

There is an expectation that Chinese investors and developers will continue to expand into real estate markets overseas and Australia's major gateway cities have been the greatest beneficiary of this over the past year. As the Chinese market continues to underperform, we expect to see active overseas expansion by these firms. Given the distinctive policy-driven nature of the Chinese market, however, we should equally be aware of the risk of policy reversals over time.

Despite China relaxing government restrictions and easing monetary policy, Chinese house prices have continued to slide, and an early rebound in the sector is unlikely. An accelerated worsening of the Chinese market may be a double-edged sword. While we may see more players in a relatively strong financial position sustain their overseas investments and in fact continue to seek safe-haven markets like Australia, we may also see some cash-strapped developers and investors finding it difficult to continue their expansion efforts, creating problems such as distressed properties in the host countries.

In Australia, housing prices have risen by about 8 percent nationally in Australia over the past year and closer to 14 percent in Sydney, driven by rising investor demand. The Reserve Bank of Australia recently stressed the importance of maintaining rigorous standards on loans

to property investors and flagged macro-prudential intervention. This is being watched closely, as will a formal policy on the foreign investment framework, where the 'options paper' was put out for community feedback, however the proposed changes need to be legislated. The Government will introduce legislation into Parliament from August 2015 with the intention that the reforms will commence on 1 December 2015.

The Australian Government is proposing the introduction of fees to be levied on all foreign investment applications. For residential properties valued at AUD 1 million or less, foreign investors are likely to pay a fee of AUD 5,000. Higher fees will apply to more expensive residential properties, as well as business, agriculture and commercial property applications. The exact fee structure for properties above AUD 1 million has not been formalised, nor has information relating to any discount for multiple applications.

Additionally, the Victorian State Government has also announced two new taxes that may impact foreign buyers. This announcement in the lead up to the budget was not expected by the market. The first is that from 1 July 2015, foreign investors will be taxed 3 percent of the purchase price and secondly, foreign owners of property which remain vacant will be charged an extra land tax of 0.5 percent. Both are yet to be passed by the parliament. These state-based taxes will be in addition to the above mentioned federal taxes.

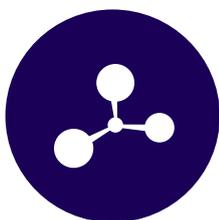


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Infrastructure



The Federal Government's policy of privatisation and capital recycling for infrastructure projects has sent a strong signal to the market and many large and experienced Chinese companies have shown genuine interest in investing in this sector. Three major infrastructure sector deals accounted for 20 percent of the total 2014 investment value. Two deals mark new trends in Australia-China business integration:

- The largest single Chinese investment in 2014 was the acquisition of John Holland by CCCI for an enterprise valuation of approximately AUD 1.15 billion, which received final FIRB approval in April 2015. CCCI is a wholly-owned subsidiary of China Communications Construction Company (CCCC), the fourth largest global EPC construction company by revenue. CCCC has a market capitalisation of approximately AUD 23.5 billion and is listed on the Hong Kong and Shanghai stock exchanges. The acquisition of John Holland marks a new stage of globalisation of the Chinese construction industry as it gains access to a wide range of construction services provided by John Holland. In addition to providing a channel for CCCC to bring its competitive advantages to the Australia market, through its partnerships with CCCC, John Holland will get access to significant new market opportunities outside Australia including China's 'one belt, one road' strategic initiative.
- China Merchants Group's co-investment with Hastings Funds Management in the 99 year lease rights to the Port of Newcastle for AUD 875 million (China Merchant's investment share) is an example of a Chinese company joint venturing with an Australian partner to bid for and win a major infrastructure project.

Leisure and retail



Another new trend reflecting China's domestic reorientation towards social consumption and consumer oriented services is outbound investment in the leisure sector. Twelve percent of Chinese direct investment has been recorded in Australian leisure and retail in 2014. The size of the largest deal in this sector shows the global scale and ambitions of the Chinese leisure industry.

During the year ID Leisure Pty Ltd, a company owned by a major shareholder and associate of Dalian Wanda Group, one of China's largest property companies, completed a takeover of Hoyts Group, one of Australia's largest and established cinema and cinema advertising companies. Dalian Wanda also owns the largest cinema operation in China and in 2012 acquired AMC cinemas in the US.

Mining, energy, oil & gas



Over the past decade Chinese investment into Australian mining and gas has accounted for the large majority. In our country in 2014, investors have focused on delivering existing projects and paused to understand global price trends and domestic Chinese demand patterns.

The proportion of investment in mining continued to decline from 23 percent of total value in 2013 to 11 percent in 2014. Mining investment was dominated by Baosteel's AUD 910 million investment in Aquila Resources (with Aurizon).

The decline in mining investment was in line with the slump in global commodity prices that affected Australia's major export commodities in 2014. The commodity price falls for iron ore, thermal coal and coking coal in 2014 were dramatic to say the least. The response to such bearish markets was a wait-and-see approach towards investment, including by Chinese investors.

China's own domestic circumstances have impacted this downturn in the global commodity market and reduced outbound investment in the mining sector. The correction of China's property market, the slowing-down of new infrastructure construction and weaker overall demand for raw materials are making investment in upstream resources assets less attractive. Manufacturing industries in China, including steel mills, cement plants, glass factories and non-ferrous metals smelters report significant overcapacities. China's air pollution crisis is also putting pressure on industries to restructure.

As a result, overall demand on energy and resources is decreasing with little prospect for major growth.

In this environment, Chinese investors are continuing to make strategic acquisitions internationally. In the energy sector, Shandong Landbridge's take-over of West Side Corporation demonstrates investor confidence in Queensland's coal seam gas industry.

Fosun's takeover of ROC Oil is part of the ongoing diversification of real estate based Fosun and their extension into the oil & gas industry. ROC has operations in China, Australia, UK and Malaysia.

Agribusiness



In 2014, we saw increasing interest from Chinese investors in Australia's agriculture sector following strong growth in trade. This market is developing slowly, despite newspaper headlines announcing new deals. There has only been a limited number of completed sizeable transactions amounting to just 1 percent of Chinese total investment for the year.

Deals included private businesses, provincial SOEs and high-net-worth individuals investing into small beef and dairy farms, vineyards and abattoir businesses:

- Taihua Food signed a joint venture agreement with Churchill Abattoir to raise AUD 35 million to upgrade the plant to export status and increase processing volume.
- Hailiang Organic Farming Company invested over AUD 40 million in cattle and cropping land in Southern Queensland.
- A private Chinese company bought a cattle station in the Northern Territory covering 205,000 ha of land with a total amount of initial investment around AUD 22 million.

Beyond deals of this nature, there were no landmark agriculture investments completed with Chinese companies despite the strong interest and obvious demand for premium safe food from consumers in China.

Among the reasons contributing to this are:

- Profitability of Australian farms. This a concern for inexperienced agri sector investors, who are used to high rate of cash returns in China. High input prices, domestic supply, unfavourable climate patterns, under investment in infrastructure, lack of market access and perceived risks over live animal exports have contributed to low profit margins. Investment into farm land entails high capital and maintenance costs and the investors themselves face ongoing media scrutiny and political attention.
- Lack of suitable investment targets in Australia. Many Australian agriculture business are family-owned businesses with limited financial information available for potential investors whose initial research is normally through desk-top analysis. Small scale investments are not suitable for corporate and financial investors from China who look for economies of scale to build the balance sheet at their group level.
- Investors have limited capabilities to assemble agricultural assets of the scale required for integration in Chinese supply chains. Many of the potential investors from China are not agricultural players but real estate developers and conglomerates who are looking to diversify and seek new growth opportunities. These businesses lack the capabilities and capacities to aggregate and build viable assets in Australia's agricultural sector. Some state owned investors are very cautious with risks and inflexible with their investment strategies.



Despite ongoing community interest, there were only a handful of small-to-medium sized agri sector investments during the year, accounting for only 1 percent of the annual total. 2015, however, looks like it could be a more active and promising year.

However, there are encouraging signs of change in this sector with announcements of cooperation and investment plans. On 17 November 2014, Prime Minister Abbott and President Xi announced the conclusion of negotiations for the China-Australian Free Trade Agreement (ChAFTA). This historic agreement will create significant trade and investment opportunities for the Australian agriculture sector.

Some major announcements have already been made:

- New Hope will invest up to AUD 500 million in Australian dairy farms and processing plants in partnership with Freedom Foods.
- Federal Trade Minister Andrew Robb witnessed the establishment of the Beijing Australia Agricultural Resources Co-operative Development Fund in a joint venture with Yuhu Agriculture Investment.
- Andrew Forrest lead the establishment of the ASA100 (Australia-Sino 100 year Agricultural and Food Safety Partnership, which aims to have 50 members from Australia and 50 members from China to promote cooperation in the sector between the two countries).
- Greenland Group's chairman announced that his property company will also invest into the Australian agriculture sector including dairy, beef, vineyards and food companies.
- Private Chinese meat processing business, Grand Farm, announced its joint investment plans with V&V Walsh to export boxed beef to China.

Looking forward, we expect some large scale investments in beef cattle and agriculture food companies, particularly those which are large in size and have experienced management teams. Chinese investors have spent some years learning about the sector and establishing contacts in Australia including with advisors enabling them to progress to a more mature investment stage.

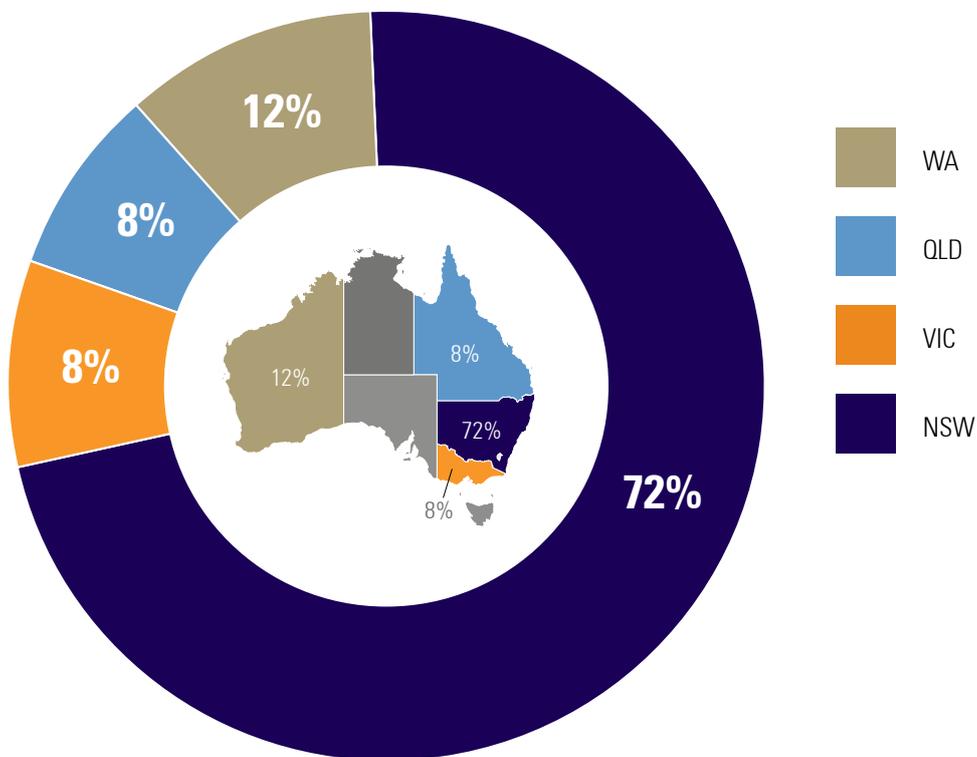


Chinese investment in Australia by geography

NSW stood out as the top destination for Chinese direct investment in 2014, attracting 72 percent of Chinese investment. Investment was concentrated in commercial real estate, leisure and retail, infrastructure and energy. Seven of the eight largest completed deals in 2014 were NSW domiciled.

The combined share in Chinese direct investment of Queensland, Victoria and Western Australia dropped from 87 percent in 2013 to 28 percent in 2014.

Chinese investment by state and territory – 2014

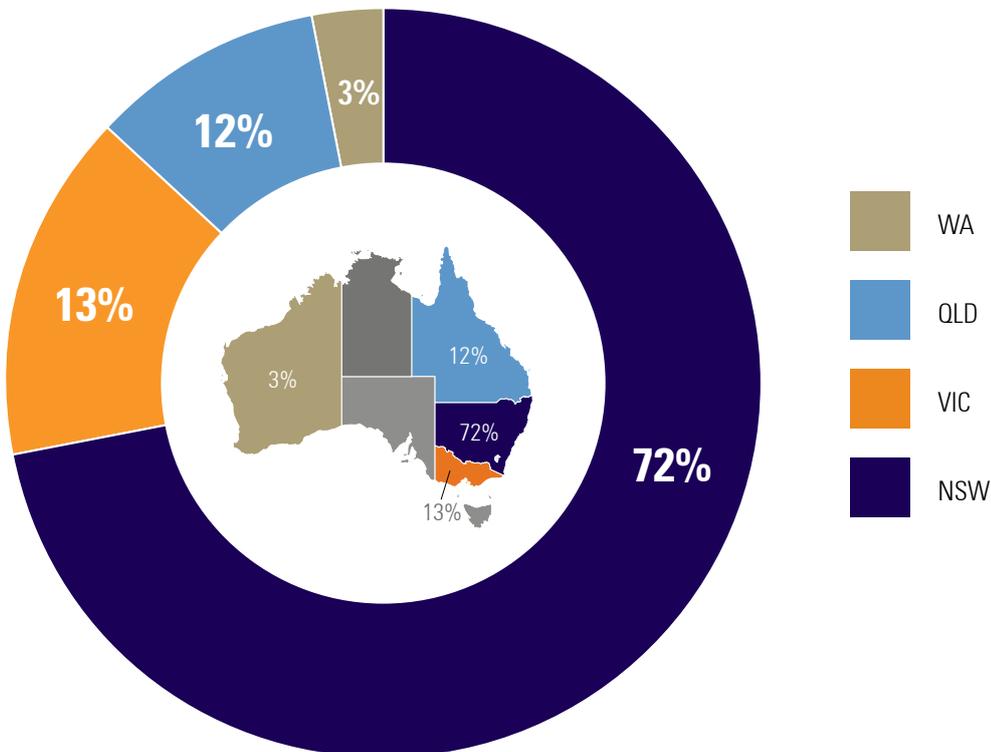


Source: KPMG/University of Sydney database



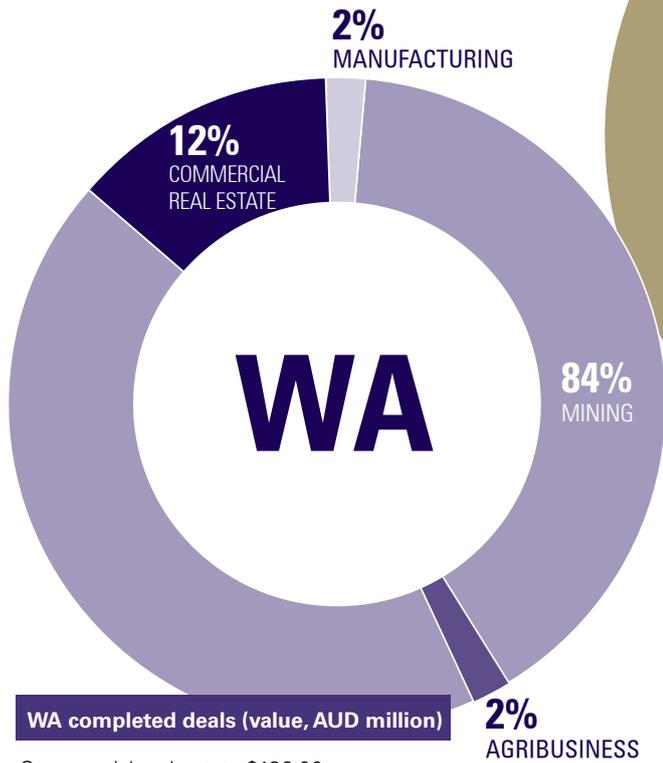
72 percent of commercial real estate investment was concentrated in NSW, followed by Victoria (13 percent), Queensland (12 percent) and Western Australia (3 percent).

Commercial real estate investment – 2014

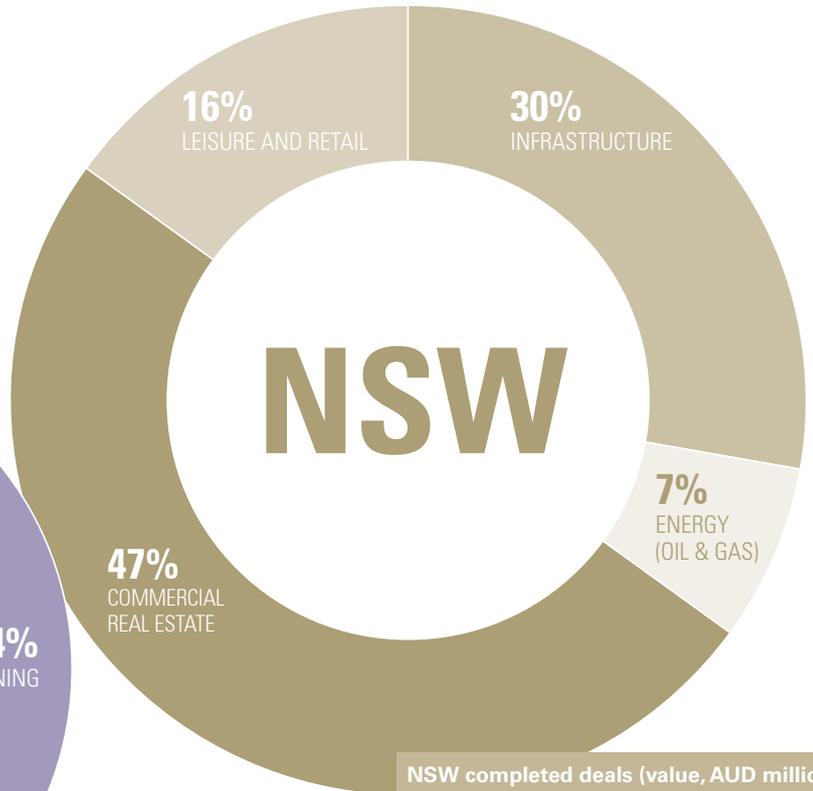


Source: Knight Frank

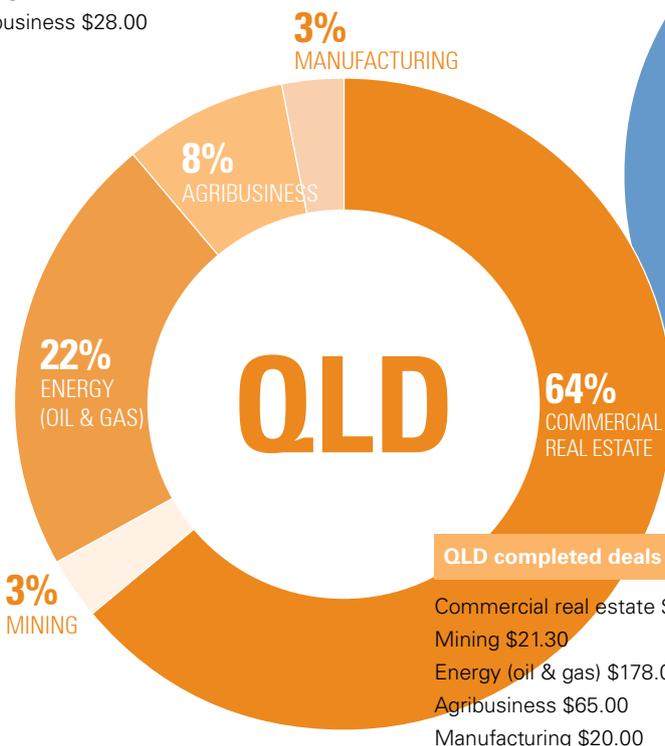
Total completed deals by state and industry



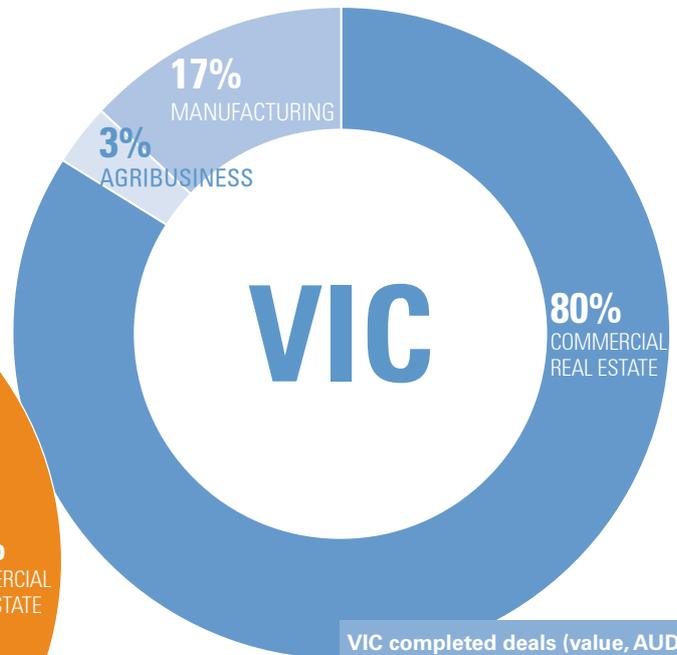
Commercial real estate \$136.00
 Manufacturing \$27.70
 Mining \$971.00
 Agribusiness \$28.00



Commercial real estate \$3,156.78
 Leisure and retail \$1,101.00
 Infrastructure \$2,025.00
 Energy (oil & gas) \$489.00



Commercial real estate \$514.30
 Mining \$21.30
 Energy (oil & gas) \$178.00
 Agribusiness \$65.00
 Manufacturing \$20.00

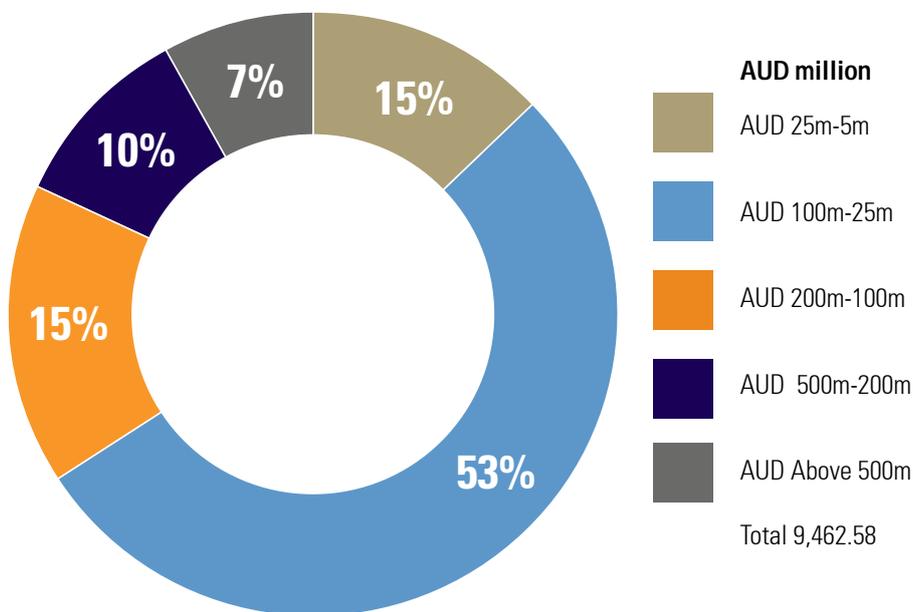


Commercial real estate \$565.00
 Manufacturing \$117.20
 Agribusiness \$25.30

Chinese investment by deal size

In 2014, there were four mega-sized deals above AUD 500 million which contributed materially to the overall investment result. Mega-sized deals traditionally occurred in the mining and resources sector. The fact that in 2014 these mega-deals were also concluded in construction and leisure sectors is a sign of maturing and globalising investment from China which bodes well for Australia as an investment destination.

At the same time, we continue to observe a growing proportion of smaller sized deals between AUD 25 -100 million. In 2014, over half of the transactions (by number) fell into the category of AUD 25-100 million, accounting for 17 percent of the total transaction value. By comparison, only 35 percent of the transactions fell into the size of AUD 25-100 million in 2013.



Size of Deal (AUD)	number of deals	%	Value (AUD mil)
AUD 25m-5m	9	15	140.90
AUD 100m-25m	32	53	1,613.38
AUD 200m-100m	9	15	1,323.50
AUD 500m-200m	6	10	2,449.70
AUD Above 500m	4	7	3,935.00
Total	60	100	9,462.58

Source: KPMG/University of Sydney database

Chinese investment in Australia **by ownership**

For the first time, 2014 saw investment from China’s private enterprises exceed investment from state owned enterprises (SOEs) by number of deals as well as in total deal value.

The new consumer driven sectors are firing up with the private sector leading the charge, while the traditional mining resources sector has paused to digest past investments and to adjust to economic and political conditions at home in China. The slow-down in the Chinese economy, the

interruption on new investment decisions from structural reforms and corruption investigations and significant global price volatility for natural resources and currencies have together impacted new investment in Australian resources by the big state owned companies.

2014 deals by ownership

Ownership	Investment Value (AUD million)	%	Number of deals
SOE	3,228.40	34	9
Private	6,234.18	66	51
Total	9,462.58	100	60

Source: KPMG/University of Sydney database



Selected Chinese SOE investments in 2014

Target company	Acquiring company	Sectors	State	Value (AUD mil)
Lucent, North Sydney	Greenland	Commercial real estate	NSW	58.0
Kolotex Factory, Leichhardt	Greenland	Commercial real estate	NSW	45.0
Port of Newcastle (99 year lease)	China Merchants/ Hastings Funds (50-50 JV)	Infrastructure	NSW	875.0
Aquila Resources Limited	Baosteel Resources/ Aurizon Holdings	Mining	WA	910.0
John Holland	CCCC International Holding Limited (CCCC)	Infrastructure	NSW	1150.0
Cambridge Office Park	Poly Real Estate Group	Commercial real estate	NSW	110.0

Source: KPMG/University of Sydney database

A joint venture between China Merchants and Hastings Funds Management acquired the Port of Newcastle in one of the year's largest infrastructure investments.



Conclusion: The new normal for Chinese direct investment in Australia

In our 2013 annual update report, we observed that Chinese direct investment in Australia had reached a turning point, away from resources towards real estate, infrastructure and consumer sectors. This trend has continued in 2014.

In 2014 we have arrived at the 'new normal' in Australian-China investment relations. Australia's attraction as a destination for investment in mining and resources has declined in line with the phasing out of the resources construction boom. However, in 2014 we have noted some highly significant structural changes paving the way for Australia as a long-term destination for investment in commercial real estate and a range of more diversified industries including infrastructure, agribusiness and services.

Australia still has so much to offer China in these sectors and, beyond that, a number of innovative and important platforms have evolved in the past 12 months to ensure Australia remains an attractive destination:

1. China Australia FTA

China and Australia signed a Declaration of Intent for a Free Trade Agreement (FTA) on 17 November 2014, which raised the threshold for private, non-state-owned investment from China in non-sensitive sectors from AUD 248 million to AUD 1.08 billion. This FTA is expected to become effective in mid-late 2015 and accelerate the flow of Chinese investment funds into the Australia. President Xi's visit to Australia and address to leaders at Parliament House in Canberra was enormously important in cementing the landmark platform which also generously acknowledged Australia's "most favoured nation status" with China for future trade and investment.

Lower tariffs on Australian exports to China will drive greater investment activity from Chinese investors, particularly in the food and services sectors.



Based on Australia's historical share of Chinese global investment, Chinese companies are expected to invest over USD 90 billion into Australia in the next decade across mining, infrastructure, real estate, leisure and tourism, technology services, food and agribusiness.

2. A depreciating Aussie dollar and low cost of debt

The stronger buying power of the Chinese RMB and the weaker AUD will undoubtedly continue to support capital inflow and base interest rates for local AUD borrowings are at all-time lows of 2 percent.

3. Attractive visa programs

People to people links are improving between Australia and China which is critically important and Australia offers a visa scheme that most other countries don't. The Significant Investor Visa (SIV) is now attracting larger numbers of high net-worth Chinese individuals to Australia with a minimum investment of AUD 5 million into complying investments for a minimum of 4 years before becoming eligible for a permanent visa.

This visa was refined during 2014/15, with a Premium Investor Visa (PIV), offering a more expeditious, 12-month pathway to permanent residency for those meeting an AUD 15 million threshold and will be formally introduced on 1 July 2015.

This will be another driver of increased capital flows into Australia more broadly from ultra high net worth individuals in the future.

More work to be done by all to build the long term platform

Chinese investors are still relatively new and many, particularly the SOEs, remain largely misunderstood and misrepresented in Australia. Although they are publicly welcomed, there remains concerns surrounding the intentions and actions of Chinese controlled companies and assets in Australia.

Much progress has been made in recent years to address concerns and revisit policy settings, but there is still a clear need for deeper mutual understanding and much better communication generally from both sides.

This takes time and, as former Australian Ambassador to China, Dr Geoff Raby regularly puts it "a disproportionate effort" at all levels by our leaders and our people.

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