Firstlinks
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Editorial

There are five ways to get very wealthy, so wealthy that you don't have to worry about money for the rest of your life: a highly paid career, having equity in a business or businesses, family money, luck, or a combination of these. Let's go through them:

1. A highly paid career

This is the least likely to get you exceptionally rich. Sure, CEOs at leading ASX companies get paid well. Macquarie Group's Shemara Wikramanayake got paid more than $30 million last year, the highest of any ASX CEO. That just topped Lovisa's Victor Herrero who earned $29 million. And there are plenty of companies outside the ASX 300 where CEOs also get paid generously.

Top paid ASX CEOs for 2023

Company	CEO	Pay	% YoY Change	Sector
Macquarie Group Ltd	Shemara Wikramanayake	$30,404,240	28%	Financials
Lovisa Holdings Limited	Victor Herrero	$29,092,606	39%	Consumer Discretionary
Kogan.com Limited	Ruslan Kogan	$17,179,674	13%	Consumer Discretionary
Goodman Group	Greg Goodman	$14,163,551	-10%	Real Estate
Qantas Airways Ltd	Alan Joyce	$11,919,000	114%	Industrials
BHP Group Ltd	Michael Henry	$11,122,661	-1%	Materials
Amcor Ltd	Ronald Delia	$10,849,413	-26%	Materials
Aristocrat Leisure Ltd	Trevor Croker	$9,157,963	29%	Consumer Discretionary
Santos Ltd	Kevin Gallagher	$8,745,969	-4%	Energy
a2 Milk Company Ltd	David Bortolussi	$8,283,175	3%	Consumer Staples

Source: CEO Salary 2023 Report by Open Director and Odgers Berndtson Australia

How do people reach these CEO positions? They often make it to CEO from being Chief Financial Officers (CFOs) or Chief Operating Officers (COOs). These positions are occupied primarily by those with commerce and legal backgrounds, with university qualifications and MBAs to back them up.

There aren't many human resource or marketing employees that make it to CEO. Recently, the widely respected former CEO of Mirvac, Susan Lloyd-Hurwitz said it's a pity that more leaders don't have human resources or marketing experience as being a CEO required generalist skills and 90% of the job was dealing with people. I agree.

There also aren't many employees who rise from the bottom of a company to the top. Woolworths incoming CEO Amanda Bardwell is one exception, having been at the company for 23 years, and starting in retail at the age of 15.

Suffice to say, the chances of becoming a CEO are low. The top 500 current ASX companies CEOs come from a pool of 14.2 million Australian workers.

Outside of company leadership positions, there aren't many roles or professions that offer life-changing pay packets. There are the obvious ones of being a leading doctor or lawyer. These roles are well paid because they offer essential services that are in high, and often urgent, demand. People can't wait for an essential medical operation or a top lawyer for a high-profile legal case, so they'll pay up to get them. And supply of doctors and lawyers is limited, deliberately so in the case of doctors via university admission and medical board entry requirements.

The odds of becoming a leading doctor or lawyer are certainly a lot better than those of rising to be a CEO. However, the ranks of the nation's mega rich aren't filled with doctors and lawyers.

Besides these roles, are there others that can deliver highly paid careers? It's possible, though I can't think of many. Perhaps, specialist technology roles have offered high pay in the past, though that has receded since the tech downturn of 2021. Plus, the real money in tech was made through employees owning shares in the company they worked for rather than through salaries.

2. Family money, or winning the genetic lottery

The second way to become very wealthy is through family money, or the Bank of Mum and Dad. You'd be surprised how many 'rich listers' come from family money. In Australia, there are the likes of James Packer, Gina Rinehart, Anthony Pratt, Harry Triguboff, and Jerry Schwartz.

I must admit to a personal bias for the wealthy person who's come from nothing, versus those who've built off the back of family money. In my experience, it's much easier to make money when you've already got money, than if you start from scratch.

With skyrocketing asset prices during the past four decades, more wealth is now being passed down from parents to children. The Productivity Commission estimates $3.5 trillion will be transferred from Baby Boomers to their children in Australia by 2050.

3. Equity in a business or businesses

This is the most common way to become wealthy. In the US, close to 90% of the nation's millionaires own businesses. Of the top 10 richest Americans, all of them own businesses.

Top 10 richest Americans

	Net worth (US$ bn)	Source
Elon Musk	251	Tesla, SpaceX
Jeff Bezos	161	Amazon
Larry Ellison	158	Oracle
Warren Buffett	121	Berkshire Hathaway
Larry Page	114	Alphabet
Bill Gates	111	Microsoft
Sergey Brin	110	Alphabet
Mark Zuckerberg	106	Meta
Steve Ballmer	101	Microsoft
Michael Dell	72	Bloomberg

Source: Forbes, Firstlinks

Warren Buffett is a fascinating case study – is he a businessman or an investor? I think he's both as he's succeeded by owning whole businesses and parts of businesses. He started off his first fund in 1956 with just US$100 of his own money and raised US$105,000 from seven others. Four years later, he'd turned his stake into US$1 million or more than US$9 million today. He took control of Berkshire Hathaway in 1965, and his full ownership of insurance companies since then has helped fuelled much of the growth of the company. Insurance has given Buffett access to a low-cost source of funds that's allowed him to subsequently buy minority stakes in leading companies such as Coca-Cola, American Express, and Apple.

The US story of billionaires having their own businesses is also true of Australia. Here, nine of the top 10 richest people has sourced most of their wealth from owning businesses.

Top 10 richest Australians

	Net worth (US$ bn)	Source
Gina Rinehart	30	Hancock Prospecting
Andrew Forrest & family	22	Fortescue
Harry Triguboff	16	Meriton
Mike Cannon-Brookes	14	Atlassian
Scott Farquhar	14	Atlassian
Anthony Pratt	10	Visy
Cliff Orecht + Melanie Perkins	9	Canva
Bianca Rinehart + siblings	9	Bank of mum and dad
John, Alan, and Bruce Wilson	7	Reece Group
Frank Lowy	7	Westfield

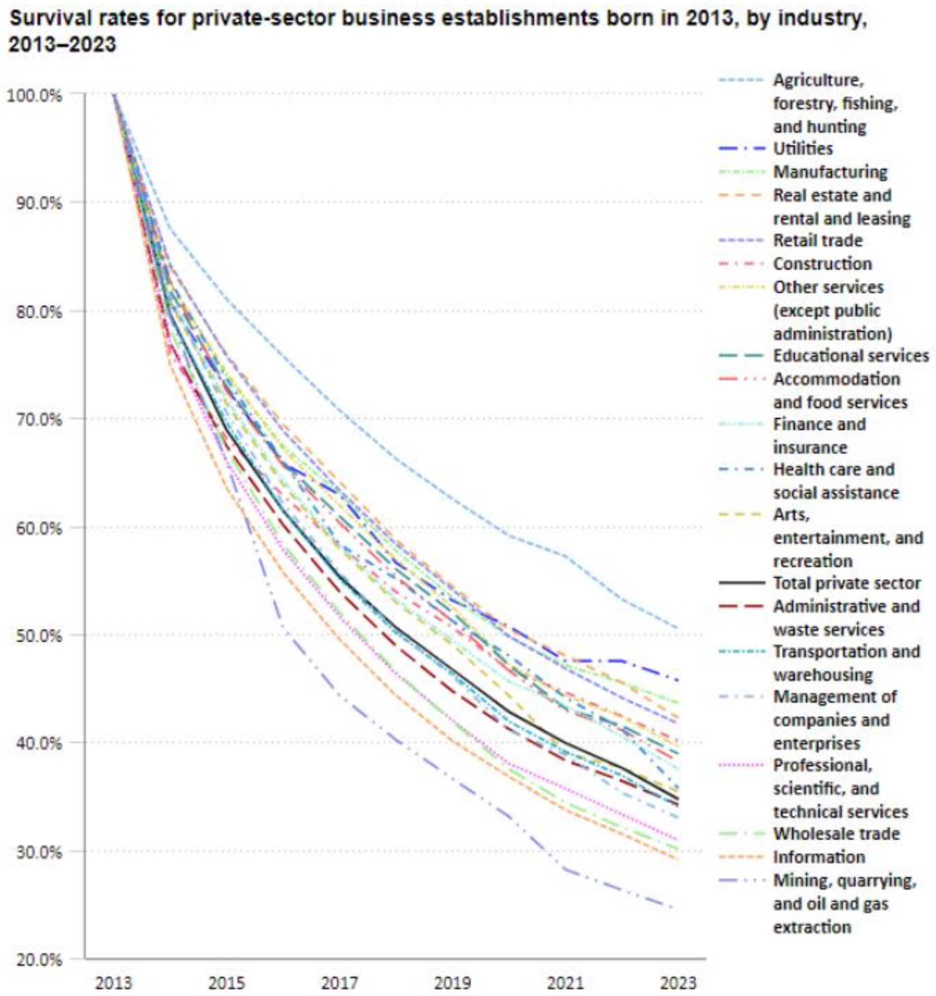
Source: Forbes, Firstlinks

Billionaire entrepreneurs are rightly lauded for starting and growing their businesses. Yet for every one entrepreneur that makes it big, there are thousands that fail. The media highlights the successes, though the failures are largely hidden from the public eye.

The US has better statistics than Australia on small business failure rates, and the Bureau of Labor Statistics there suggests that of the small businesses started in 2013, only one third survived thorough to 2023.

In Australia, the ABS says that 23% of businesses fail within their first year, and 48% don't make it to the fourth anniversary.

That means becoming wealthy through starting a business comes with large risks along with large potential rewards. It shouldn't surprise that wealthy entrepreneurs can come with big egos, given the confidence and resilience required to get a business off the ground.



4. Luck

Luck can be a source of wealth. We've all heard of the lottery winners taking home tens of millions of dollars. The problem is that the odds of being a winner are incredibly small.

Here are the chances of winning from various gambling activities in Victoria.

Bet	Odds of winning
Poker machines – getting five black rhinos on black rhinos machine (top prize) ($1 bet per line)	1 in 9,765,625
Tattslotto – winning first division (getting all six numbers correct)	1 in 8,145,060
Powerball – winning first division (getting all seven numbers and the Powerball correct)	1 in 76,767,600
Set for Life – winning first division (getting all eight numbers correct)	1 in 38,608,020
Super 66 – winning first division (getting all six numbers correct)	1 in 1,000,000
Oz Lotto – winning first division (getting all seven numbers correct)	1 in 45,379,620
Trackside – horse number 1 wins race ($1 bet)	21 in 100
Trackside – horse number 12 wins race ($1 bet)	2 in 100
Casino: roulette (single zero) – winning straight up (correct bet on a single number) ($5 bet)	1 in 37
Casino: roulette (single zero) – winning black/red, high/low or odd/even ($5 bet)	18 in 37
Casino: big wheel – getting the joker (pays 47–1) ($5 bet)	1 in 52

Source: Victorian Government

Luck can come in other ways, though. I agree with Nassim Taleb who suggests that luck plays a huge, often unacknowledged role, in success and wealth:

"Hard work will get you a professorship or a BMW. You need both work and luck for a Booker, a Nobel or a private jet."

Malcolm Gladwell, in his book Outliers, details the role that luck played in the rise of Bill Gates and Microsoft. Gates was born and raised in Seattle to wealthy parents, who sent him to a private high school, which happened to be the only one in America with a computer terminal in 1969. The University of Washington happened to be across the road from his high school, and it had an even more sophisticated computer. At the university, he met Paul Allen, who went on to become his business partner. Later, his mother's social connection with IBM's chairman helped him to gain a contract from the then-leading PC company that was crucial for establishing his software empire.

Gladwell says of Gates and other 'outliers':

"These are stories … about people who were given a special opportunity to work really hard and seized it, and who happened to come of age at a time when that extraordinary effort was rewarded by the rest of society. Their success was not just of their own making. It was a product of the world in which they grew up."

5. A combination of factors

Getting wealthy invariably involves a combination of the above factors. For instance, Gina Rinehart had family money that led her to own the Hancock Prospecting empire, which has benefited from her nous and an iron ore boom to propel her into being the richest Australian.

Harry Triguboff also came from money. He turned to property development in the early 1960s just as Australia was about enter a decades-long housing boom. His almost sixth sense for property eventually led him to build the hugely successful apartment and hotel brand, Meriton.

Others have done it in different ways. David Di Pilla went from being an investment banker to running UBS in Australia to then building his own business, HMC Capital. Di Pilla is credited with putting together the proposed merger of Chemist Warehouse and Sigma, and he's already made a lot of money from the deal.

Roman philosopher, Seneca, perhaps sums it up best: "Luck is what happens when preparation meets opportunity".

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Graham Hand's article last week understandably struck a chord with readers. It wasn't just his battle with brain cancer. It was also his revelations of struggling with not being able to work, and in some ways, of losing his personal identity.

It brought home that in debates about retirement or semi-retirement, there's a lot of focus on the financial aspects, but less attention is paid to the psychological challenges of retirement, which can be even more demanding. In my article this week, I outline these challenges and what can be done to overcome them.

James Gruber

Also in this week's edition...

Australia's population will increase by 3.7 million over the next decade, the equivalent of three Adelaides. Yet, the growth won't be evenly distributed. Over 85s will see the fastest growth, while the number of younger people will barely rise. **Simon Kuestenmacher** says this will have a significant impact on future housing demand and consumption patterns.

Dr. Ken Henry has again made headlines with calls for tax reform, this time at the launch of a new book by **Paul Tilley**, *Mixed Fortunes: A History of Tax Reform in Australia*. Tilley is a former economic adviser to governments and in an extract from his book, he outlines a brief history of tax reform and explores the pathway forward.

Clime Asset Management's **Paul Zwi** has written a great article on one of the major, yet little talked about, macroeconomic developments of recent years: the rise of America as a global energy superpower. Paul looks at how it came about and its global implications.

Japan is the flavour of the month among international fund managers as corporate governance reforms lead to a surge in optimism, coinciding with the share market reaching all-time highs. **Antipodes Partners' Alison Savas** says Korea is now following the Japanese reform playbook and that may bode well for its stock market.

The real estate sector isn't renowned for being forward thinking when it comes to technology. But **Cromwell's Colin Mackay** says now is a critical juncture, as the emergence of AI is likely to transform the industry, by changing the way that people live, work, and play.

Tax time is fast approaching. **Rachael Rofe** says that with impending Stage 3 tax cuts incentivising people to bring forward future tax deductions while tax rates are higher, it's a good time to explore how to bolster your tax savings and community impact through structured charitable giving.

Finally, in this week's whitepaper, 'divergence' is the key theme for **VanEck's** latest update as 2024 heralds a de-syncing of central banks, which had been following a similar approach to monetary policy for the last few years.

The challenges of retirement aren't just financial

James Gruber

Graham Hand's update last week, five months on from his cancer diagnosis, understandably struck a chord with readers. It wasn't just his battle with brain cancer. It was also his revelations of struggling with not being able to work, and in some ways, of losing his personal identity.

It brought home that in debates about retirement or semi-retirement, there's a lot of focus on the financial aspects: income, tax, estates, wills, superannuation, and the like. Less attention is paid to the psychological challenges of retirement, which can be even more demanding.

In response to Graham's article, one subscriber helpfully pointed to a book addressing some of these challenges called, 'The Four Phases of Retirement: What to Expect When You're Retiring' by Dr. Riley Moynes.

What are the four phases of retirement?

Moynes, a former educator and financial adviser, wrote the short book after his own struggles in retirement and subsequent interviews with other retirees.

He believes that there's a predictable and identifiable pattern to retirement, and it involves four phases:

Phase one: vacation time

Moynes is Canadian so you'll have to forgive his use of 'vacation' instead of holiday. Phase one, in the initial months and years of retirement, is like a holiday. You get to do the things that you wouldn't normally do. You get to fulfill bucket list wishes, such as extended travel to places that you've always wanted to visit, like the south of France or Tuscany, or buying a new toy that you've always wanted, like a Porsche or boat.

At first, this phase is exciting. The unstructured time, being your own boss, and *freedom*. Yet, after a while, it can get boring and a little egocentric. Put simply, you overextend your holiday.

Moynes says you know when you're in phase one when:

- You feel a sense of relief, exhilaration, and accomplishment about your just completed working career.
- You appreciate having no set routine for the moment.
- You are regularly making travel plans.
- You are serious about improving your golf/tennis/bowling game.
- You're considering a 'trophy' purchase such as a sports car, sailboat, yacht, or a holiday property.
- You look forward to spending more time with your spouse.
- You look forward to spending more time at the holiday house or puttering around home.

Phase two: feeling loss and feeling lost

The move from phase one to phase two involves the stark realization that the life that you knew for decades no longer exists. Most people work for +40 years, climbing their way up the corporate/career ladder. They may achieve a certain level of success, responsibility, and even prestige. They may even have people report to them.

When retiring, by choice or circumstance, all of that suddenly disappears. The influence or power that you have at work, part of your *identity*, is gone. Moynes calls this the "plunge into the abyss of insignificance".

Retirement not only impacts your identity but your routines and structures. Work imposes a routine and structure. Without it, you lose that, and the friendships that accompany work. It can make you feel alone and vulnerable.

And you must spend much more time at home with your spouse, which can have its challenges. I've noted in a previous article how research has revealed that the happiest retirees are women who get divorced between the ages of 60 and 65. On this, retirement researcher, Dr. Michael Finke, says:

"I think that relates to a problem that very often happens in a relationship when people retire. And that is that men tend to have a more limited social network and oftentimes that social network revolves around their work. And women tend to do a better job of investing in relationships that they can then draw from in retirement outside of the workplace. And so, what that means is that women oftentimes want to be able to maintain those relationships in retirement. Men all of a sudden become far more – in an opposite sex couple, they become far more reliant on their relationship with their wife. And the wife is often struggling to be able to manage her existing relationships and this perceived obligation that she has to her husband. And oftentimes they may not have developed the capabilities to spend all day with each other. They get married, and they see each other for breakfast and dinner, but not necessarily for lunch."

In phase two, Moynes says you suffer five unavoidable losses:

- Structure
- Identity
- Relationships
- A sense of purpose
- A sense of power

Phase two can led to bouts of depression, alcoholism, family breakdown, anxiety, and other stressors.

Moynes notes there is a group of people (10-15%) where phase two is less of a problem. These people have created structure and meaning outside of work, and the transition to retirement is more seamless.

However, for most, suffering the five unavoidable losses can be traumatic. And you can either go into your shell or push forward.

Phase three: trial and error

This phase is about finding new meaning and purpose, and it often involves trialling different things to see what works.

Moynes recalls his own efforts, from considering going to law school, to undertaking courses in mediation, and helping his son out with his magazine business.

He says that you know when you're in phase three when:

- You begin to ask yourself, "How can I still contribute?"
- You explore options that will allow you to make contributions and feel good about them.
- You commit to a specific venture.
- You are prepared to go back to the drawing board when your venture of choice doesn't work out.

Phase four: reinvent and repurpose

Moynes says that not everyone reaches phase four. Some people stay in phase one where they are happy to satisfy their own needs – the 'it's about me' phase – and there's nothing wrong with that. Others don't get through the struggles of phase two. Others reach phase three, yet when trialling different things doesn't work out, they step back to phases two or one.

Moynes believes that it's important for you to be able to identify which phase of retirement you're in. And that when you reach phase three, it's crucial to ask questions about what you want to get out of the next phase of life and what you want to become.

In Moynes' experience, for those who are most successful in breaking through to phase four, it almost always involves some level of service to others. That can be via a volunteer role or offering services for a fee.

Moynes thinks that you need to look at your unique skills and experiences, and how they might be best used to help others. That can provide renewed purpose and a 'sweet spot' for retirement.

That conclusion might not come as a revelation. It's the type of advice that you get *during* your working career. Yet things change, especially as you get older, and it may be worth following Moynes' guidelines to make the most of your retirement.

James Gruber is an assistant editor at Firstlinks and Morningstar.com.au.

Is Australia ready for its population growth over the next decade?

Simon Kuestenmacher

Today we are looking at my favourite chart when analysing the next ten years ahead.

It's a decidedly simple chart that tells us about the future of Australia. Today we will quickly see what this chart tells us about future housing demand and shifts in consumption patterns.

We are comparing the current Australian population by single year of age, with the projected population ten years from now.

The data comes from the Centre for Population – that's a bunch of demographers sitting in Canberra who provide Treasury with data to put into the budget papers. It's rock-solid data that also integrates the latest Australian Bureau of Statistics research.

Forecasting the population ten years into the future is much more precise an exercise than you might think.

We have a very clear idea of the number of babies that will be added to the nation year after year and deaths are also very predictable. Since two thirds of population growth in Australia comes from migration that's the harder to predict figure.

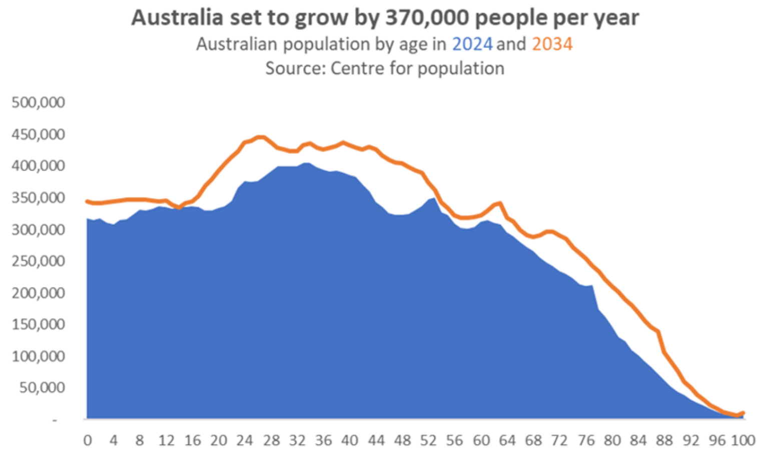
That said, as a nation we set migration targets and essentially dictate the migration intake. We wouldn't be off by more than a few hundred thousand people in our migration forecasts.

Since about three quarters of migrants are aged between 18 and 39, we know that the population forecast for the 50 and over cohort will be correct – any variation from the forecast would largely impact people in their 20s and 30s.

What the population will look like in aggregate

Let's see what the future holds. The first observation is that we will see growth, lots of it.

Australia will grow its population by 14%. That's more than 3.7 million people (or roughly three Adelaides). We must feed, shelter, educate, care for, and entertain 30.9 million souls by 2034.



Source: The Centre for Population

The growth won't be evenly distributed across the full age spectrum.

There won't be many more children

We will be adding relatively few children (0-17). The segment grows by less than 6%. That means we must add more childcare facilities, schools, and sporting infrastructure but at a lower rate than total population growth.

As I explained [in a previous column](), we will still be running out of teachers though.

Young adults (18-25) will grow by 16%. That growth is heavily driven by international students. If we were to close our borders, this segment would be slowed the most. That of course won't happen.

International students are too important a funding source for our universities. With fewer international students, fees for local enrolments would need to go up or we would need to collect more tax dollars.

Neither option is remotely feasible. Expect massive growth in international student accommodation. Most members of this age group live in the inner suburbs as renters and will drive demand for apartments. Our inner suburbs will densify even more.

Early career professionals will be slow growers

Early career professionals (25-34) are only growing by 11%. In the past decade, the massive Millennial generation occupied the 25-34 segment.

Therefore, despite many migrants adding to this cohort growth will stay below the national average.

This cohort will still overwhelmingly be renting and will not have had kids yet. About half of them will work in knowledge jobs located in the CBDs of our big cities.

They will want to live centrally to frequent hospitality venues, visit events, and minimise commuting time. As they start coupling up, they will operate as dual income households without children and have cash to spare. A great cohort to be selling too.

Millennials will see a healthy rise

Millennials will be occupying the 34-51 segment. All kids in childcare and primary school will have Millennial parents. This cohort sees growth of 16%, which is slightly above the national average.

Considering the extremely high female workforce participation rate of Millennial women, the demand for childcare will be higher than ever. The current system couldn't cope with such increases.

Millennial families will have moved to the urban fringe since this is where the lion share of family-sized houses were for sale. Councils on the urban fringe must prepare now for the very predictable increase in demand for such services.

Gen X'ers will be outnumbered

The 52-64 segment sees humble growth of 6%. Almost all people in this age segment are already in Australia. Migration isn't topping up the population over 50 years of age.

Baby Boomers occupied this segment in the recent past and now hand over the impactful 50s to the poor forgotten Gen Xers. These are the upgraders, the parents of teenagers that want a larger home. It remains to be seen how many large enough homes at the right price point will enter the market.

If current market conditions remain, this cohort will stay largely put.

A larger army of grey nomads

The 65 and over cohort grows by 29% – that's two times the rate of the national average rate. Caravan parks will be booming as the army of grey nomads swells to record size.

In many respects the 65-74 segment is the best consumer cohort. They have time, money, and energy. All other cohorts tend to miss at least one of the three.

Downsizing will start becoming a mass-phenomenon by the 2030s as older Baby Boomers see their health decline and the family home becomes a nuisance to manage (or even a physical hazard). Baby Boomer homes are located in the middle suburbs of Australia.

Throughout the 2030s, these homes will enter the market and many of them will be bulldozed to make room for three townhouses – densification of the middle suburbs is all but guaranteed.

Over 85s will boom

The most dramatic growth occurs in the 85+ segment which will increase by a massive 68% to 974,000 (up from 580,000). Half of the 85 and over segment needs care.

If you've been to an aged care home recently, you will know that we import care workers from overseas. The 85+ cohort alone guarantees a continuation of our high migration approach. Also, anyone operating a business in aged care, healthcare, or funeral homes will have a lucrative decade ahead.

This is just the top-level overview of what type of forecasting can be done with this simplest of charts.

Demographer Simon Kuestenmacher is a co-founder of The Demographics Group. His columns, media commentary and public speaking focus on current socio-demographic trends and how these impact Australia. His latest book aims to awaken the love of maps and data in young readers.

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The mixed fortunes of tax reform in Australia, part 1

Paul Tilley

This article is based on edited extracts from Paul Tilley's book, Mixed Fortunes: A History of Tax Reform in Australia, published by MUP https://www.mup.com.au/books/mixed-fortunes-paperback-softback.

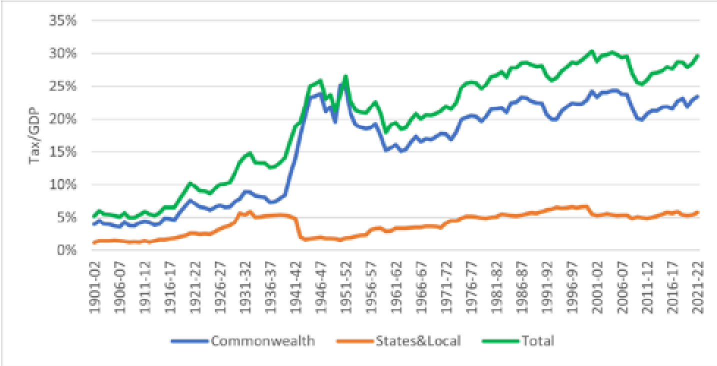
A country's tax system has a quasi-constitutional character in that it establishes how a community shares the burden of funding government services and substantially remains in force over long periods. Major tax reform exercises, therefore, should be few and far between. On occasion, though, a government needs to fundamentally rethink aspects of its tax structure which have become flawed or outdated. We now face one of those occasions.

Australia's tax reform fortunes, though, have been mixed. While there have been numerous tax reviews at the Commonwealth and state levels, most have not resulted directly in substantive tax reforms. This two-part series looks at that history and explores the pathway forward. Part one will look at the history of the Australian tax system and the issues it now confronts. Part two will look at specific tax reform episodes and contemplate 'where to from here'.

Development of the Australian tax system since Federation

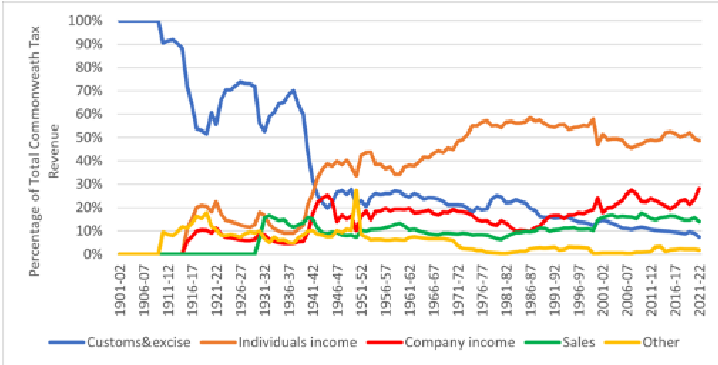
At Federation in 1901, the newly formed Commonwealth Government was given exclusive constitutional access to customs and excise. The Commonwealth subsequently used its dominant constitutional and economic position to also monopolise broad-based income and consumption taxes, leaving the states and territories with an eclectic mix of taxes, including payroll tax, stamp duties and land tax, most of which suffer from design flaws accentuated by interstate competition.

Chart 1: Tax/GDP since Federation



The development of the Australian tax system has featured a ratcheting up of the tax take in times of crisis. As Chart 1 shows, from around 5% of GDP at Federation, the tax burden stepped up in WW1, the Great Depression, and WW2. It then increased steadily in the post-war period to 25-30% by the 1980s, and has been around that level since.

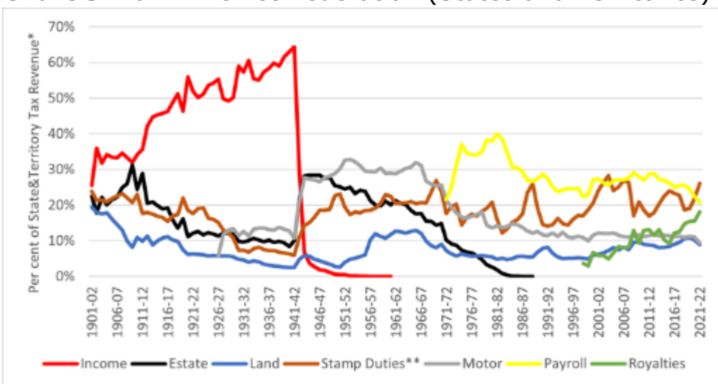
Chart 2: Tax Mix since Federation (Commonwealth)



Commonwealth tax mix

The main driver of these changes has been income tax. Chart 2 shows the transition at the Commonwealth level from an initial reliance on customs and excise duties to income taxes. A striking feature of this chart is that individuals' income tax has been broadly steady at around half of total Commonwealth tax revenue for the past 50 years.

Chart 3: Tax Mix since Federation (States and Territories)



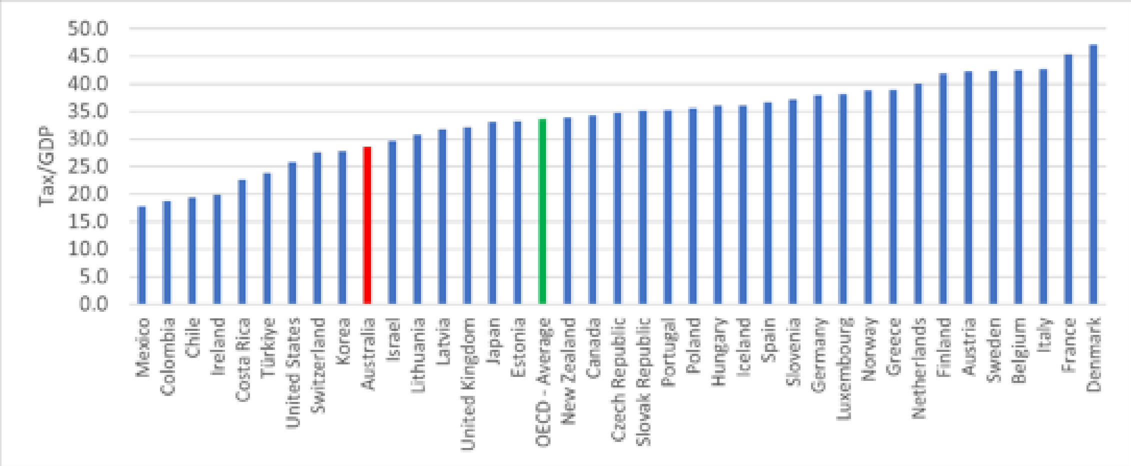
State tax mix

The Commonwealth dominance of income taxes and broad-based consumption taxes left the states and territories with an eclectic mix of other taxes. As Chart 3 shows, after the Commonwealth forced the states out of income tax, they have been reliant on a collection of limited tax bases. Payroll tax and stamp duties now dominate, with royalties also important for some states.

International comparison

As Chart 4 shows, Australia's overall tax burden is lower than the OECD average. This observation needs to be tempered, though, by the nature of Australia's Superannuation Guarantee payments which are private, but given the compulsory contribution and preservation requirements they have some similarity to the European-style social security payments which are classified as taxes.

Chart 4: Total Tax Revenue as a Proportion of GDP, OECD Countries, 2020



Australia has a higher proportion of income taxes in its tax mix than most OECD countries, although this observation also needs to be tempered by the non-inclusion of social security contributions in that measure which make up a quarter of total tax revenue on average in OECD countries.

Assessment of the Australian tax system

Aspects of Australia's taxes remain arcane and sorely in need of reform. A real estate agent would describe the Australian tax system as a renovator's delight. We are not well positioned for the challenges that lie ahead, including the possible need to increase the overall tax burden in the face of large spending pressures in areas such as disability support, age care, health and defence.

At the Commonwealth level, the heavy reliance on personal income tax is problematic as an aging population means future generations of workers will need to shoulder an increased burden, with worrying intergenerational equity consequences. Ken Henry refers to this as an intergenerational tragedy of our own making. Likewise, the future of the company income tax system warrants reconsideration in a world where the cost of capital is set in international markets.

At the state level, the continued use of outdated and inefficient transaction taxes creates economic disincentives and impediments, while potentially efficient tax bases, such as land and payrolls, are in need of repair.

Income taxes

Individuals' income tax remains Australia's largest tax and the one that most fully meets the general tax policy criteria of revenue adequacy, efficiency, equity and simplicity. That said, there are several potential reform issues.

Individuals' income tax is broadly based for labour income but provides some significant concessions and inconsistencies in the taxation of savings vehicles, such as superannuation, housing and capital gains generally. These tax concessions generally favour higher income individuals with concerning equity implications. Other issues include the work disincentive effects of high effective marginal tax rates that result from the interactions with the transfer system, and the ever-present bracket creep.

Company income tax is vulnerable in the global economy in which large businesses substantially operate. Australia's company tax rate of 30% is high by international standards, raising questions about the implications for attracting internationally mobile foreign capital. However, it is also significantly below the top individuals' income tax rate of 47% (even more so for smaller companies with a 25% rate), creating opportunities for tax avoidance practices.

Going forward, with company income tax vulnerable and other tax bases either inefficient or constrained in various ways, increased weight will likely fall on personal income tax levied on future generations of workers. Thus, the intergenerational inequity on a large scale.

Rent taxes

Taxes on economic rents are relatively efficient, as by only applying above the normal rate of return they should not influence investment decisions. While resource rent taxes have a difficult history in Australia, more consistent resource rent tax arrangement in the Federation, possibly replacing existing royalty arrangements, is an obvious area of focus for a future tax reform exercise.

Goods and services tax

Australia's GST is levied by the Commonwealth using its constitutional power, but with the revenue passed to the states. The Australian GST, though, applies to only half of consumption and operates at a significantly lower rate than most OECD countries, presenting obvious reform opportunities.

While GST reform options are constrained by equity considerations, an increased GST rate could replace further inefficient state taxes such as the remaining stamp duties. The requirement for all nine governments to agree on any changes to the GST, though, makes reform politically difficult.

Excise duties

Australia's system of excise duties applies additional taxation to areas of consumption with substantial externalities or other public good characteristics, in particular the so-called 'sin' taxes on tobacco, alcohol and petrol.

Fuel excise warrants consideration, though, with the switch to electric vehicles requiring consideration of how to charge for congestion and road use/damage aspects. A broad system of road-user charges may ultimately be necessary.

Payroll tax

A broad-based payroll tax is relatively efficient, with similar incidence to a broad-based consumption tax. The state payroll taxes, though, have substantial exemptions for smaller businesses which narrow the bases, compromising their efficiency. While governments have not been prepared to extend payroll tax to smaller businesses, there have been successful efforts to harmonise aspects of the payroll tax bases and definitions between jurisdictions.

Stamp duties

Stamp duties are generally considered to be relatively inefficient transaction taxes and considerable efforts have been made to remove them over recent decades. The remaining stamp duties continue to raise substantial revenue, however, and so further reductions or removal will require the identification of alternative revenue sources.

The largest, and most contentious, remaining stamp duty is on property conveyances. It is a volatile source of revenue and a disincentive to housing turnover, thus acting as a restraint on mobility and an inequitable impost on individuals who do need to move more often. A tax mix switch from conveyance duty to land tax, preferably broad-based, is therefore an obvious reform direction.

Land tax

A broad-based land tax is a potentially efficient tax given the immobility of land. The existing state land taxes are generally levied at progressive rates on unimproved land values, but with exemptions for owner-occupied housing and primary production land. Levying the taxes on unimproved land avoids creating a disincentive for development, but the progressive rates discriminate against larger parcels of land.

Property rates

Property rates are applied by local governments, under delegated authority from state governments, as a broad-based land tax. They have been assessed as Australia's most efficient tax and are well suited to funding local government services.

Where to?

With so many fundamental tax reform issues across the federation to address it is hard to know where to start. Incremental reform efforts have failed to make major in-roads, and indeed at times have gone backwards.

A major tax reform exercise would require the commissioning of a formal tax review. This approach has underpinned the major tax reform packages that Australia has achieved in the past. The three most notable of those are the Curtin government's 1942 income tax unification, the Hawke government's 1985 income tax base–broadening package, and the Howard government's 2000 consumption tax base–broadening package. Sadly, though, many other tax reviews have only delivered partial reforms, at best.

Part two of this series will look at the main tax reviews Australia has undertaken and explore the question of what are the key ingredients that make a tax reform exercise work, or not.

This article is based on edited extracts from Paul Tilley's book, Mixed Fortunes: A History of Tax Reform in Australia, published by MUP https://www.mup.com.au/books/mixed-fortunes-paperback-softback.

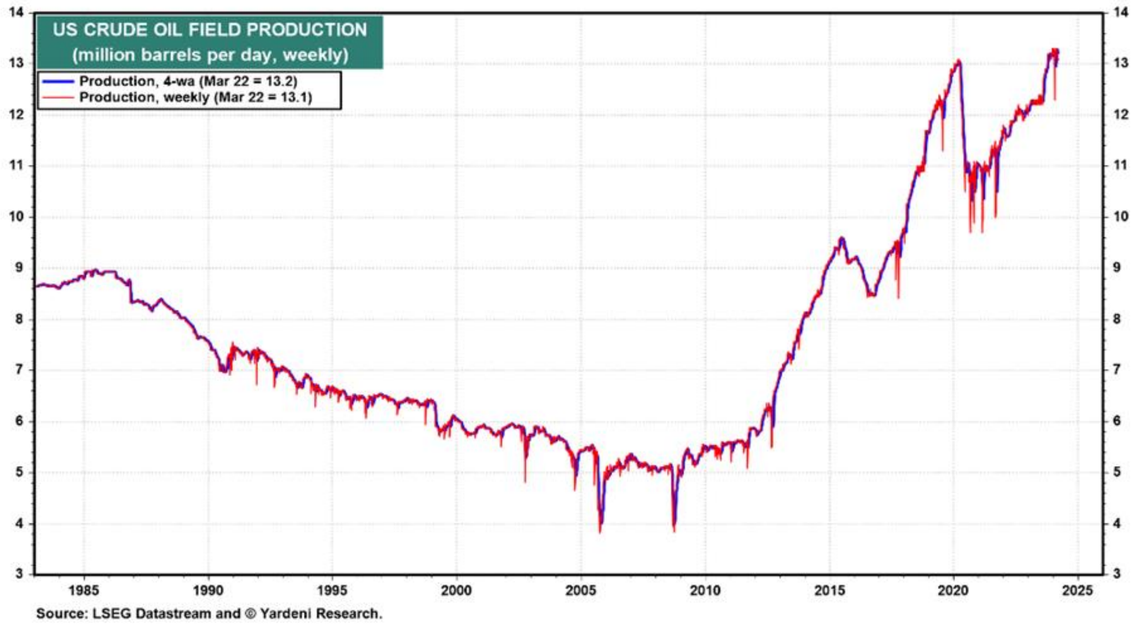
Paul Tilley was an economic policy adviser to governments for thirty years, working mainly in Treasury but also the Department of the Prime Minister and Cabinet, the Treasurer's Office, and the Organisation for Economic Co-operation and Development. He is a Visiting Fellow at the Australian National University's Tax and Transfer Policy Institute, and a Senior Fellow at the Melbourne Law School.

America, the world's new energy superpower

Paul Zwi

After having to import massive amounts of foreign energy for most of its modern history, the United States became energy independent in 2019, thanks to the fracking and shale revolution. In a paradigm-shifting development, the US has become the global energy superpower, combining production, technology and capital in a way never quite previously achieved – a development sure to have global implications for decades to come.

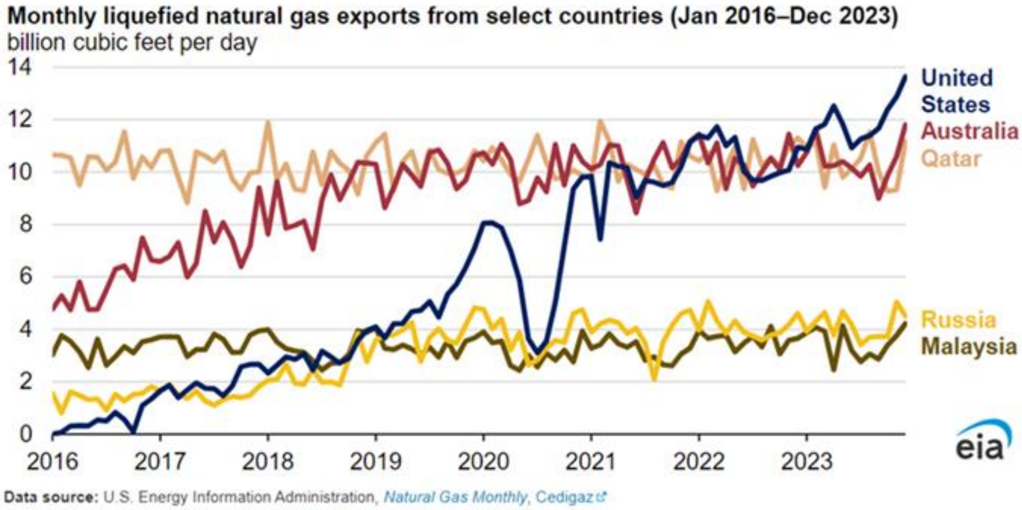
A few years ago, US oil and gas production dipped briefly during the pandemic as global demand collapsed, but it quickly bounced back. Today, the US is the largest crude producer in the world by a long shot, pumping out over 13 million barrels per day and accounting for nearly 20% of the world's total oil production. Indeed, the US is now producing more oil than any country in history.



Source: Yardeni Research

It's a similar story for US natural gas production, which has also been setting record highs since recovering from the pandemic in 2021. As of 2022, the US exported far more natural gas than it imported – the bulk of which has been converted to liquified natural gas (LNG) and gone to Europe to ease the energy shortage created by the cut-off of Russian supplies following Putin's invasion of Ukraine. Last year, the US overtook Australia and Qatar as the world's largest exporter of LNG, and the country's export capacity is set to continue growing.

The United States was the world's largest liquefied natural gas exporter in 2023



Source: US Energy Information Administration

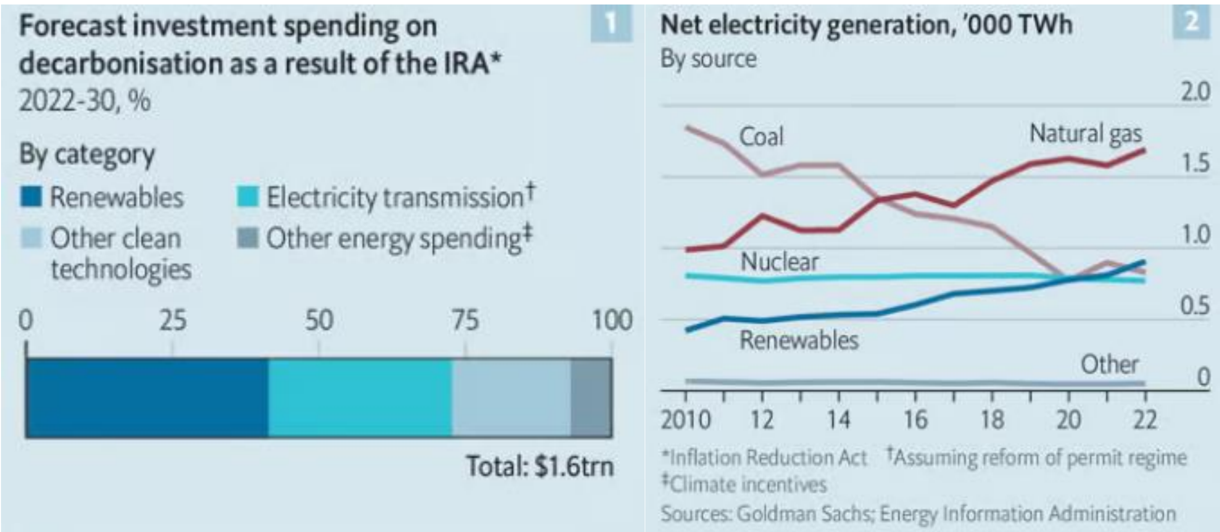
The United States has become the clear leader in the discovery of new energy technologies. It has started to build upon its manufacturing leadership in areas such as oil, gas, and power turbine equipment, and is exploring new energy technology manufacturing. New technology advances have been particularly meaningful in leading to major increases in energy production. For example, inventions in drilling including 3D seismic imaging, directional drilling, and hydraulic fracturing, reliable wind turbines, solar photovoltaics, the lithium-ion battery chemistry, and many others. Almost all of this technology discovery was driven in the United States.

No country comes close to US energy capabilities

This combination of largest producer, access to innovative energy extraction technology, plus capital market expertise, creates a commanding power which no other country possesses. For example, Saudi Arabia is strong in oil production, Qatar in LNG, Russia is a smaller player in both, China leads in some renewables, building materials processing and power equipment manufacturing capacity, and the UK is strong at capital markets. But none of these competitors have the combined strengths of the US energy profile.

Thanks to three laws introduced by the Biden administration, the Bipartisan Infrastructure Law, the Chips Act and the Inflation Reduction Act (the IRA), US corporates have committed to more than $200 billion in energy-related investments (including batteries, electric vehicles, renewables and hydrogen). While President Biden came into office with an anti-fossil-fuel stance, concerns about energy security have led to a far more open position towards Big Oil and Big Energy, albeit one that is not much spoken about.

The US dominates capital raising for investments. The IRA's climate-related provisions provide some $370 billion in tax credits and government funding over the next decade for energy and infrastructure. Some of the



Source: The Economist

tax credits (such as for clean hydrogen) are uncapped by Congress, so if investors flock enthusiastically from around the world (e.g. Australia's Andrew Forrest), the IRA's public climate spending could exceed $800 billion. Add in the likely impact on private capital and the figures could rise to $1.6 trillion in decarbonisation investments over that period, according to Goldman Sachs.

Meanwhile, the US continues to deploy renewables, such as solar power and battery storage, at a significant rate. Together, these sources are expected to make up around 80% of all new electric-generating capacity in the US this year. Such growth is thanks to the decline in the cost of these technologies, and expectations that they are going to get even cheaper as they get deployed further, in turn boosting adoption, getting more competitive, in a virtuous cycle.

Implications from America being an energy superpower

In short, the US has become the world's top energy superpower. The consequences are far-reaching:

- The US has become the global leader in increasing energy production.
- This is generating energy price deflation from its technology innovation.
- The US is leading the world in reduction of tons of emissions (on a tons-per-year reduction basis).
- America is now the global leader in providing energy market stability and security.

These energy strengths of the United States imply a new geo-political paradigm, which is yet to be fully understood. For example, the US relationship with the large Middle Eastern oil and gas producers was historically an extremely delicate one, with American diplomacy built around indulging behaviours on the global sphere it usually would not tolerate. Perhaps in the near future, the reality of global energy superpower status will force some re-thinking. As expressed in the Hoover Institution's recent paper by Paul Dabbar, "*Most current US energy diplomacy is still moored to the previous energy posture of weakness*".

America's growing market share deprives Russia, Saudi Arabia, Iran, and other petro-states like Venezuela of pricing power and geopolitical leverage, lowering energy prices and boosting geopolitical stability. US oil supply growth has also kept oil prices relatively low in the face of OPEC production cuts designed to prop them up.

Even with the "OPEC+" additions, the cartel currently controls less than half of the global supply of oil (and shrinking). Lower energy prices stimulate the global economy and help ease inflationary pressure.

US energy abundance could usher in a new era of US technological advancement and productivity growth that increases living standards. If this seems like tremendous news for America, that's because it is. Perhaps yet another reason for US stock markets to be at record all-time highs.

Energies Reach New Highs

IEO ETF tracks a market cap weighted index of companies in the US oil and gas exploration and production space according to Dow Jones. Also, it is a solid choice for representative exposure to the oil & gas exploration & production segment in the US. The price is reaching a new all-time high as it breaks above the resistance of the ascending triangle.

Source: Chart Advisor, Investopedia

Sources

- *The Hoover Institution, Stanford University: "US Energy Superpower Status and a New US Energy Diplomacy" by Paul Dabbar.*
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Could Korean corporate reform trigger a Japan-style market rally?

Alison Savas

It's not uncommon to find conglomerate businesses in Korea and Japan with a large dominant shareholder (often a family), cross shareholdings, inefficient balance sheets with loads of cash or investments weighing on returns on equity, and low payout ratios.

In Korea, the Chaebols (a handful of family run conglomerates) dominate the business landscape, and cross shareholdings amongst the family's business interests can resemble a Jackson Pollack painting.

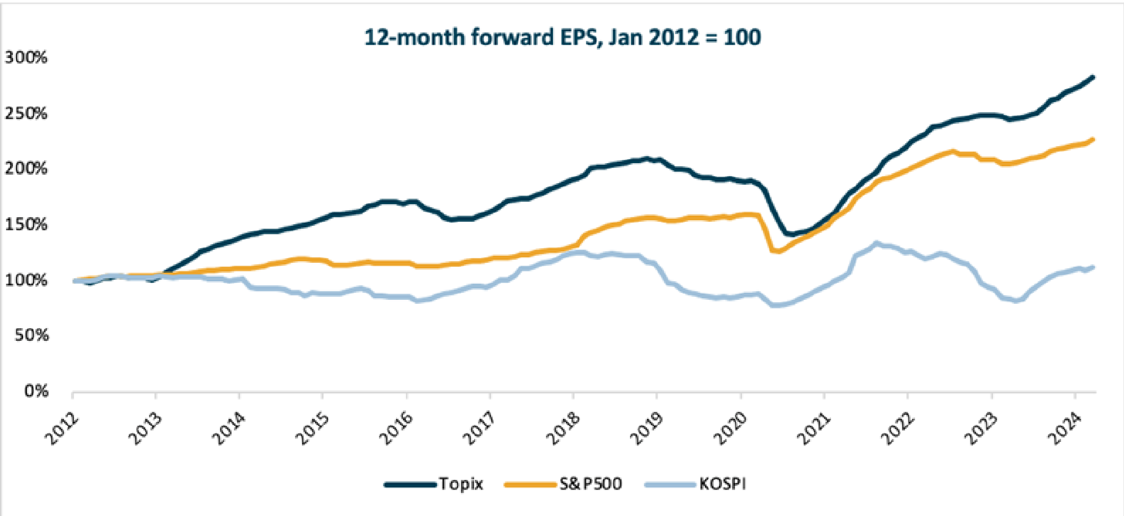
Japan's moves to lift company returns

Japan has been on a pathway of reform for the last decade, but the pressure to lift corporate governance intensified in 2023 when the Tokyo Stock Exchange (TSE) set its sights on companies with an ROE of less than 8% and valuation of less than 1x book – almost half the stocks listed in Japan. These companies have been told to provide a plan of how they will, amongst other things, increase capital efficiency, returns and shareholder value via distributions – and lift price to book above 1x.

There's no legal enforcement but Japanese companies are responding to the TSE's threat to 'name and shame'.

Today, more companies are communicating shareholder return targets, introducing return on capital and excess return KPIs, and are increasing diversity on their boards. The earnings growth of Japanese companies has been building for some time (Figure 1 – even outperforming US equities!) and now dividends and buybacks are also increasing.

Figure 1: TOPIX EPS growth has outperformed S&P over the last ten years



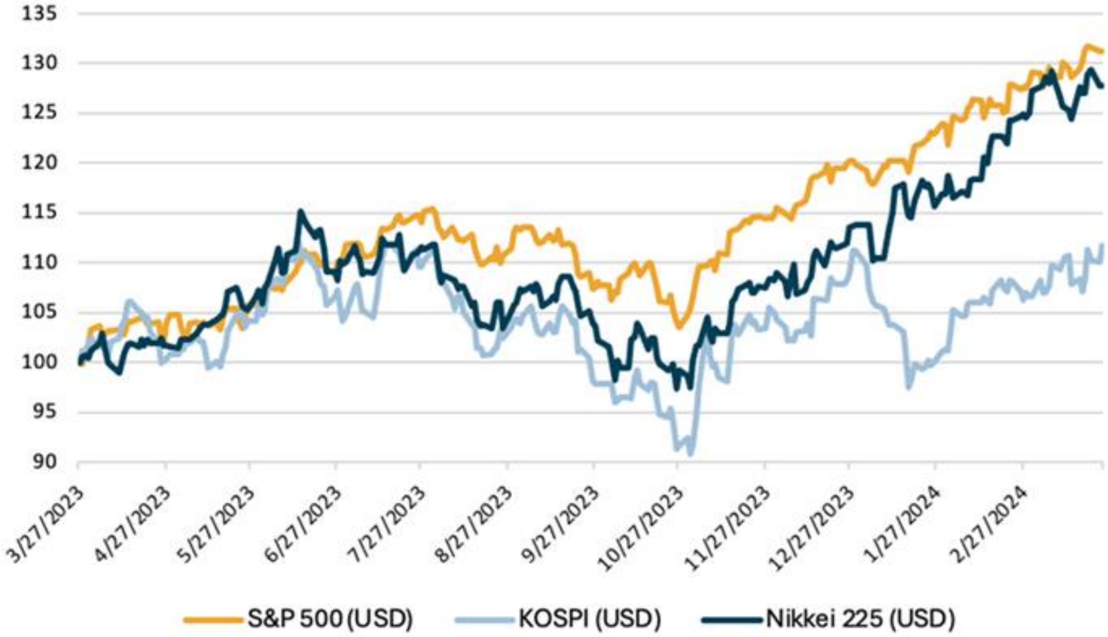
Source: Factset

But Japan has had a phenomenal run in the 12 months since the TSE announced its carrot and stick policy – up 45% in local currency at writing.

The Nikkei has finally breached its previous all-time high set 35 years ago!

And even removing the benefit of the weak Yen, the Nikkei's performance is only a whisker behind the S&P 500's in USD-terms, without the benefit of Nvidia (Figure 2).

Figure 2: Pressure on corporate governance reform has driven Japanese equities



Source: Factset

As Figure 2 shows, Korea (the KOSPI index) is being left behind its neighbour. And it's not just the last 12 months. The KOSPI has underperformed the Nikkei over the last decade despite a higher economic growth rate.

Is Korea set to follow the Japanese playbook?

With 70% of KOSPI constituents priced at less than 1x book, Korean regulators look like they may be following the path carved by Japan with the recent announcement of their Value Up program.

In a similar vein, the rationale is to incentivise better use of capital, reduce cross shareholdings and improve shareholder returns. Korea's Finance Minister has indicated tax incentives for corporates that increase dividends and/or cancel treasury shares will be implemented in 2024, as well as potentially cutting income tax on dividends for investors – another powerful incentive for the formidable Chaebols to increase distributions.

Also in discussion is a reduction in inheritance tax, which is known to be a key impediment to unwinding complex family crossholdings within the Chaebols. Any progress here, along with evidence that the National Pension Service is putting its weight behind the scheme, would be significant positive catalysts - The National Pension Service owns 10% of the Korean equity market.

Like Japan, Korean regulators have suggested they may publish a list of friendly and unfriendly companies, and non-compliance may ultimately risk de-listing – but time will tell how this policy unfolds, and how it will be enforced.

We must acknowledge there have been false starts around corporate governance reform before, and while it's dangerous to think this time is different the regulator appears to be acting more forcefully. And maybe the performance of the Nikkei over the last 12 months is the kindling to start the fire.

A stock example: Hyundai Motor

We look for companies that are mispriced relative to their business resilience and their growth profile and we assess a company's resilience based on 'Multiple Ways of Winning' – the more ways we can win from owning an investment, in all likelihood, the better the quality of the business franchise. Business resilience is a spectrum -

some of our investments have more ways of winning than others – but we do have a minimum threshold. We won't buy stocks with binary outcomes because that risks capital destruction.

To be blunt we're not putting all our eggs in the Value Up basket. Instead, we're focusing on companies with solid investment cases where Value Up represents another way we can win.

Hyundai Motor is a good example of this.

Source: [Morningstar]

The first element to consider for any global cyclical is where we are in the cycle. Demand for autos has been strong, and assuming no negative macro shocks we remain constructive around the cycle. As economies reopened after COVID we saw consumers, flush with fiscal transfers, wanting to buy cars but unable to do so due to supply chain constraints. On our forecasts, auto demand was curtailed by up to 30 million units, a material figure compared to pre-COVID global auto sales of around 90 million units. This supply-driven consumption deferral can continue to support auto demand, and autos are typically beneficiaries of falling short-term rates as financing becomes more affordable.

Hyundai with its strong mass market brand has taken market share over the last few years and is strengthening the brand further via new product launches (such as pushing into SUVs) and attractive designs in the premium segment. The company is well-positioned for decarbonisation with competitive EV technology and a compelling hybrid offer. This is important as hybrids today are proving more popular with consumers as they are more affordable than full battery electric vehicles without the anxiety over driving range. EVs and hybrids account for around 15% of Hyundai Motor's total volumes giving them one of the highest electrified mixes of the incumbent automakers. The company derives around 40% of its profits from the US and has relatively little exposure to China, where domestic supply has significantly increased.

We expect some normalisation in price and mix across the industry as supply chains have fully normalised, but this is already discounted into valuations across the sector. At 5x earnings and 0.5x book, Hyundai Motor is cheap relative to peers.

Finally, Hyundai Motor shareholders will benefit from any enforcement of the Value Up initiative given the idle assets on the balance sheet. The company has more than 25% of its market cap in cash as well as investments in related entities and property assets. Any progress here would lift the company's ROE (currently 7% through the cycle) and with it, the valuation. The company can also easily lift distributions to shareholders from the current 25% payout ratio.

Alison Savas is Investment Director and a Portfolio Manager at Antipodes Partners. Antipodes is affiliated with Pinnacle Investment Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

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How AI will transform the real estate sector

Colin Mackay

The real estate industry, traditionally characterised by its cautious adoption of new technologies, is now at a pivotal juncture. The emergence of AI, with its open-ended and self-evolving nature, promises to fundamentally change the way we live, work and play.

Investors, managers, and occupiers find themselves sitting atop mountains of data, proprietary and third party, about properties, communities, and market dynamics. This wealth of information can be harnessed to tailor AI tools for real estate-specific tasks. Imagine lightning-fast identification of investment opportunities, efficient analysis of ESG data, revolutionary building and interior design, personalised marketing materials, and seamless customer journeys. The potential value creation is staggering with estimates suggesting that AI could generate between $168 – $275 billion for the real estate industry[1].

AI adoption

AI has been transforming a range of industries from financial services to healthcare, revolutionising processes, enhancing decision-making, and creating new opportunities. Currently, it is mainly used to streamline processes, improve accuracy, and enable data-driven decisions. Some examples include:

Automated content creation: AI systems proficiently generate content, including emails, articles, and press releases. For instance, AI-powered tools can draft initial investment memorandums, providing a solid starting point for further refinement.

Legal document drafting: Litigation-related disclosure obligations were a gateway for AI to enter the legal world by transforming mass document review and enabling greater standards of compliance. Law firms now also leverage AI to draft legal documents, such as sale and purchase agreements and lease summaries. These AI systems analyse existing templates, extract relevant clauses, and generate customised contracts, streamlining the legal process. Law firm BCLP has used AI to develop a lease reporting tool which the firm claims will save its employees 25% of their time[2].

Predictive analytics: AI algorithms analyse historical data to predict market trends and property values. Real estate professionals can make informed decisions based on these insights.

Virtual assistants and chatbots: AI-powered virtual assistants handle inquiries, schedule property viewings, and provide property information. With regards to leasing and property management, a case study from Elise AI claims they were able to increase their conversion rate by 112% and increase appointment bookings by 317%, whilst saving on average two hours each day[3].

The real estate industry has accumulated vast amounts of data. Historically, there have been persistent questions regarding how to efficiently analyse this data and leverage it for research, operations, and investment management.

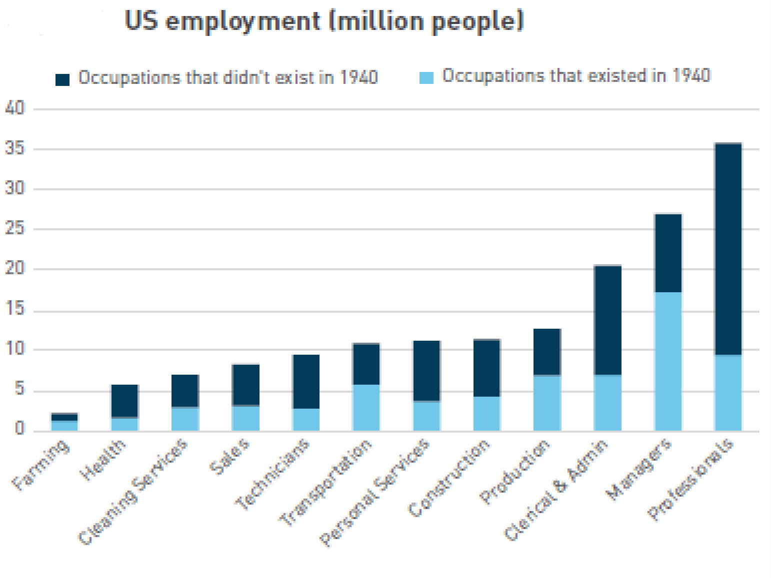
Now, with AI and AI-powered tools, we are witnessing a transformative shift. For example, AI enables organisations to efficiently track, analyse and report on ESG-related data, which is crucial for making informed decisions and meeting regulatory requirements. A KPMG survey stated that 58% of organisations plan to improve ESG data collection using AI[4].

Shifting occupier markets

A less discussed perspective is AI's potential influence on occupier behaviour and how their space usage and demands may evolve. Understanding shifts in occupiers' location, asset type and amenity preferences is crucial to optimising allocation decisions and driving investment returns.

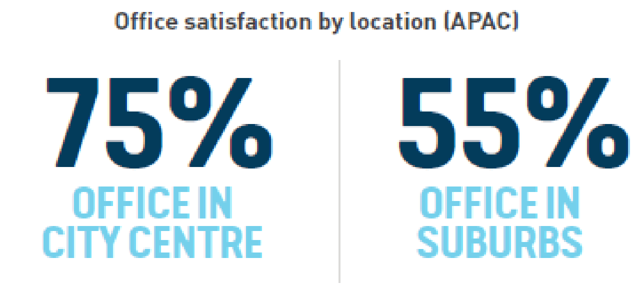
1. Offices

One of the key concerns regarding AI and office markets is the prospect of automation displacing swathes of jobs, reducing demand for space. After all, ChatGPT doesn't need a desk! But the long list of examples through history of technological advancements and their impacts on the workforce show the reality is generally multifaceted – some jobs are displaced, others are altered, and many are created. Analysis of US employment finds that 60% of workers today are employed in occupations that didn't exist in 1940. While AI-related net job losses are possible, the historical experience and adaptability of society over time suggests economic and employment growth is the more likely outcome of AI-related innovation[5].



Source: Goldman Sachs Research, 2023

However, the composition of the labour force and the nature of many roles are likely to shift significantly. While the capabilities of AI have improved dramatically, it is still well suited to repetitive tasks with well-defined parameters such as data analysis, administrative reporting and assisting in content creation[6], but is less proficient than humans when it comes to relationship management, innovation, and strategic decision-making. As AI shoulders a greater load of the 'grunt work', humans will be able to allocate more of their time to high value tasks that are interpersonal, collaborative, and complex in nature. For example, a software engineer may spend less time programming and more time understanding client requirements and discussing solutions.



Source: Why Asia Pacific offices are different and now is the time to invest, CBRE 2023

A shift in the balance of tasks could see the nature of roles become more suited to a collaborative environment and reinforce preference shifts and space usage changes that have occurred since the pandemic. The purpose of the office has shifted towards performing human-centred, collaborative tasks[7], while workers are undertaking more of their 'focused' tasks at home. Occupiers are therefore prioritising centralised, rather than distributed or satellite locations[8], to maximise in-person interactions. This is supported by a greater proportion of office footprints being allocated to collaborative and activity-based working environments, such as meeting and conference rooms, stand-up areas, and communal spaces rather than desks[9].

Organisations will continue to strive to make their office footprint as efficient as possible, a trend which has been underway for decades. Dynamic desk management can be used to coalesce employees and reduce energy consumption where desks aren't being utilised, with AI providing additional "smarts" to further optimise existing systems. This kind of management system is more likely to be adopted by larger occupiers, given their workforce and office floorplate can be more easily flexed, and they have a greater propensity to rationalise their footprint, compared to smaller occupiers.

Ultimately, the ingredients for success will remain largely the same. Assets in the best central locations, offering diverse amenity and high-quality space for a suitable price, will outperform those that are less aligned to the preferences and needs of occupiers.

2. Logistics and industrial

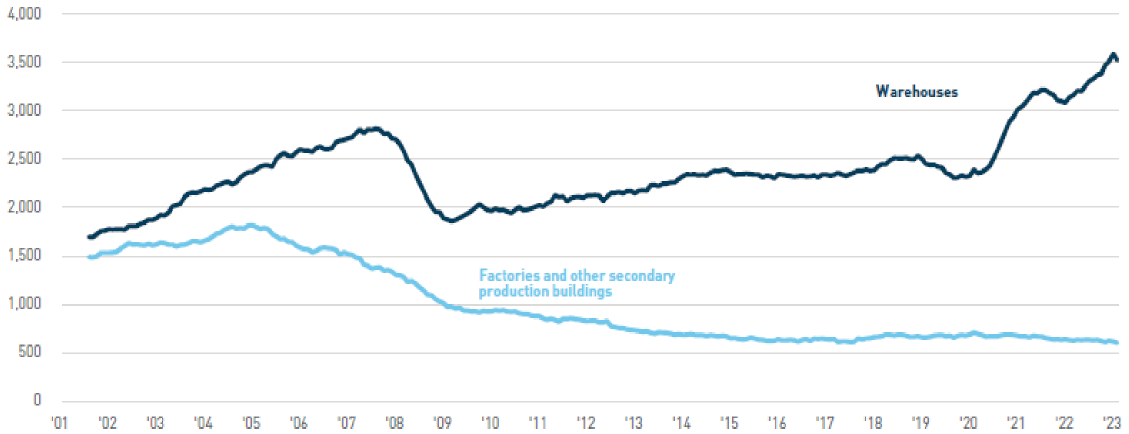
Many occupiers are already leveraging AI in their facilities, for example by using intelligent autonomous robots to store and pick items, or by calculating optimised routes for human workers trying to navigate thousands of products. Given the pre-existing utilisation of automation and AI, we don't foresee recent advancements driving major changes to occupier space requirements at the asset level. However, it may drive a proliferation of automation adoption, and a more rapid replacement of ageing stock which is not fit-for-purpose, for example due to inadequate slab strength or larger power requirements.

We expect the most significant implications for logistics and industrial assets will stem from improvements made in supply chain management. Demand forecasting, inventory requirements and transport routes can all be enhanced by AI's ability to process vast amounts of data across various formats in real-time and advise accordingly, enhancing resilience and service[9]. This could lead to footprint rationalisation, whereby occupiers prioritise large, centralised warehouses combined with smaller urban logistics units in close proximity to customers, with less reliance on medium-sized, intermediate facilities as they can better predict demand. This type of model, which historically would have been challenging due to its complexity and inability to respond to local supply or demand shocks, could provide the scale and control benefits of a centralised hub, with the agility and speed-to-customer of last mile fulfilment.

An important byproduct of a more intelligent and efficient supply chain is cost reduction. The pandemic highlighted the shortcomings of global supply chains; however, most are still aligned to the lowest cost countries. If the cost of logistics falls, or efficiency improves significantly, this could alter the cost-risk trade-off and encourage more occupiers in developed economies to onshore a greater proportion of operations, boosting industrial real estate demand.

It is worth noting that 'industrial real estate' is a broad term. Not all occupier types will engage with AI in the same way or see the same outcomes. The strengths of AI suggest the biggest changes will be experienced by logistics-focused occupiers, managing the complex movement of materials and products across multiple markets at scale, particularly via standardised big-box warehouses. In contrast, light and medium industrial uses often incorporate both logistics and manufacturing elements. These occupier types, particularly those of smaller scale, may continue to be more reliant on human input and see little change in their operations. This part of the market continues to be more fragmented than 'big box' logistics and has witnessed less of a supply response, offering some compelling opportunities for investors.

Number of Australian industrial building jobs approved (rolling 12 months)



Source: ABS; Cromwell Property Group Q1 2024

3. Retail

In retail, physical and digital channels continue to converge. Retail stores strive to match the low friction and 'endless aisle' online experience while e-commerce platforms endeavour to offer the product trial and social interactivity available in person. Outperformance is accruing to omnichannel retailers as a result[10].

While not everything can be replicated, we expect AI to further narrow the gap between shopping channels. AI will improve e-commerce product discovery by delivering personalised recommendations and engaging conversations with digital shop assistants. Virtual product trial will improve as augmented reality and AI technology combine to showcase furniture in your own home, or a new outfit as you move around. In the physical world, friction will be reduced as checkout-free shopping becomes more ubiquitous and shoppers are guided individually through malls and shops.

> *CASE STUDY*
> *In Australia, major supermarket chain Woolworths has started opening micro fulfilment centres attached to stores. Called eStores, these sites have a normal retail shopfront accessible to the public, as well as a mini warehouse or dark store which can efficiently fulfil online orders for the surrounding catchment.*

Like the industrial market, we expect these shifts to lead to a bifurcation of retailer footprints and performance. The success of a physical retail store in an AI-enabled world will require having a genuine point of difference and leveraging inherent strengths which cannot be replicated online.

At the discretionary end of the market (i.e. major malls), this means providing tactile, immersive social experiences – being a leisure destination for people to connect, rather than just shop. Typically, larger assets with leading brands and the latest store formats, a night-time economy and higher foot traffic volumes are better placed to succeed in this experiential segment of the market.

For convenience-oriented centres, the value of an asset as a last-mile fulfilment node will become more important, in addition to its strength of connection to the local community. Sites that can double as a retail shopfront and local fulfilment centre, with proximity to customers, access to transport networks and a conducive physical structure and land envelope, will be preferred.

In this environment, middle-market assets that don't lead on an experiential or convenience basis and lack the community-centricity of a smaller asset may underperform. A key challenge for assets in general will be evolving the retail offer to match the pace of technological change – and effectively managing the resultant capital expenditure.

4. Enabling Infrastructure

While many of the non-traditional real estate sectors will be influenced by AI, data centres are clearly the most intertwined. The explosion of data storage and computing power required to leverage AI will likely mean greater demand for data centres. As low latency becomes more critical for some use cases, there could also be a shift towards edge data centres, potentially resulting in the creation of new markets closer to end users (e.g. mining in Port Hedland, Australia).

A key constraint in delivering the required new supply will be power. This is already an issue across the sector, and some markets have implemented soft or hard caps on development to protect the energy grid and maintain supply for other uses. These supply restrictions benefit existing asset owners, but limit those seeking to capitalise on AI tailwinds. The power and cooling requirements associated with AI exceed the capabilities of many current assets, meaning there will be heightened demand for new developments, skewed towards less crowded markets with more attractive energy costs and access[11].

[1]McKinsey & Company, 2023
[2]Legal futures, 2024
[3]Artificial intelligence – implications for real estate, JLL, 2023
[4]ESG survey, KPMG, 2023
[5]Future of Jobs Report 2023, World Economic Forum, 2023
[6]Australia's Generative AI opportunity (Tech Council of Australia & Microsoft, 2023)
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Colin Mackay is a Research and Investment Strategy Manager for Cromwell Property Group. Cromwell Funds Management is a sponsor of Firstlinks. This article is not intended to provide investment or financial advice or to act as any sort of offer or disclosure document. It has been prepared without taking into account any investor's objectives, financial situation or needs. Any potential investor should make their own independent enquiries, and talk to their professional advisers, before making investment decisions.

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Charitable giving and tax deductions

Rachael Rofe

With the impending Stage 3 tax cuts incentivising taxpayers to bring forward future tax deductions while tax rates are higher, it’s a good time to explore a more strategic way to bolster your tax savings, and your community impact, through structured giving. Tax time in Australia is not just about crunching numbers; it's also an opportune moment to amplify your generosity and fortify your future giving.

How to structure charitable giving

There are many ways to make a charitable gift, but structured giving via a sub-fund in a public ancillary fund is becoming the method of choice for donors looking for flexibility and longevity from their giving. A sub-fund can be used to frontload multiple years of tax deductions from charitable donations into a single tax year to maximise tax deductions when a donor needs it most. The fund then allows donors the flexibility to distribute gifts to their favourite charities over time.

It’s a strategy as popular for its simplicity as it is for its tax efficiency. A sub-fund can be easily set up in one day, offers flexibility for donors to support their favourite charities on their own timeline and extends the pleasure of giving well into the future.

You receive an immediate tax deduction for the amount that you contribute to your sub-fund. For example, a donation of $50,000 comes with a $50,000 deduction that you can claim in full in the year in which you make your donation or spread over a period of up to 5 years. This flexibility in claiming the deduction is helpful for donors unsure of their exact income position ahead of 30 June. In the event you have overestimated your assessable income, you can carry forward the unused portion of the tax deduction into future tax years.

Your donation is allocated to your own named sub-fund, your charitable giving account, within the broader umbrella of the public fund. From your sub-fund balance, you recommend gifts to charities over time, with a requirement to distribute at least 4% of the balance annually. The trustee of the public fund takes care of processing and paying your recommendations, along with overseeing all operations of the fund. This allows you to focus solely on selecting the charities you want to support, and with over 22,000 eligible recipients, flexibility of choice is not likely a problem.

There are several scenarios where frontloading your giving into a sub-fund might make sense:

You’re a beneficiary of the Stage 3 tax cuts

If you're among the majority of taxpayers set to benefit from the Stage 3 tax cuts, consider bringing forward future years of charitable giving and make a lump sum donation into a sub-fund before 30 June. You will secure a larger tax deduction now while your marginal tax rate is higher, but the flexibility to gradually distribute the balance to charity over time and on a schedule that suits you.

A windfall of income such as selling a business or investment property

If you've recently sold an asset with a significant capital gain or received a substantial bonus, your accountant might advise considering a substantial charitable donation to help offset some of that income. While the notion of using philanthropy to minimise taxes is appealing, the prospect of making a large lump sum donation to any single charity can be daunting, especially if pressed for time in the dying days of June. In situations such as business exits or bonuses, using a sub fund for charitable donations can effectively help mitigate your tax liabilities while offering the flexibility to allocate gifts to charity thoughtfully over time.

Business exits are a particularly smart time to think about making charitable contributions. The year a business owner sells their business is typically the biggest tax event of their lifetime. They can fund charitable giving potentially for the rest of their lifetime by establishing a sub fund.

Prefund to sustain your giving through retirement

Just as you've wisely prefunded your retirement with superannuation savings, consider extending this principle to prefund your charitable giving. If your intention is to support charities throughout your retirement, consolidate several years of future giving into a single lump sum contribution now. This enables you to receive a tax deduction while you're still earning taxable income. Then you can enjoy the pleasure of supporting your preferred charities gradually throughout retirement from the balance of your sub-fund.

Streamline tax reporting

A giving fund simplifies donors' charitable contributions by consolidating them into a single account. If you typically donate to 5-10 different charities annually, managing these donations can be hassle. At the end of the year, you're tasked with tracking down each gift and locating receipts for your accountant.

A sub-fund creates a more efficient way for donors to do all their charitable giving in one place. You receive one receipt for your donation to the sub-fund, while enjoying the flexibility to support multiple charities from your fund every year without the additional administration.

While donors consider the charities they want to support from their fund, the trustee invests the balance for growth. The investment returns are tax-free and eligible for full franking credit refunds. With solid investment expertise supporting the public fund, the potential to grow the fund while giving can significantly amplify the impact of the initial donation. Chris Cuffe AO, founder of Australian Philanthropic Services and portfolio manager for its flagship public ancillary fund, the APS Foundation, says the structure's 'give and grow' model has garnered significant popularity among donors attracted to creating an enduring source of income for the community. As Cuffe points out, "Donors who set up a giving fund with $50,000 in the APS Foundation a decade ago have distributed nearly half of their initial donation to charity, and yet the fund's balance has grown to over $76,000 ready to be distributed to the community".

With options for structured giving starting from $40,000, it's a strategy accessible to a wide range of individuals, not just ultra-high-net-worth donors. Providers range from not for profit to corporate so donors should pay close attention to fees, post-fee investment returns, timeliness of reporting, and the ability to transfer the balance of your fund between providers.

For those looking for added control over investment decisions, private ancillary funds offer similar tax and giving advantages. However, they require more active management than a public ancillary fund and are recommended for donors with at least $1.5 million to contribute. Establishments of a private ancillary fund also take time, so if you are thinking of a deduction this financial year, it is time to get moving.

Rachael Rofe is Head of the APS Foundation, a Public Ancillary Fund offered by Australian Philanthropic Services.