Firstlinks
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Editorial

Traditionally, bond markets are dull affairs, though not lately. In April, a fascinating thing happened: stocks markets tanked and bonds also fell. Traditionally bonds have offered a haven in plummeting equity markets - though not this time. Soon after, Moody's downgraded the US' sovereign credit rating.

This has caused some introspection among investors who are grappling with questions such as:

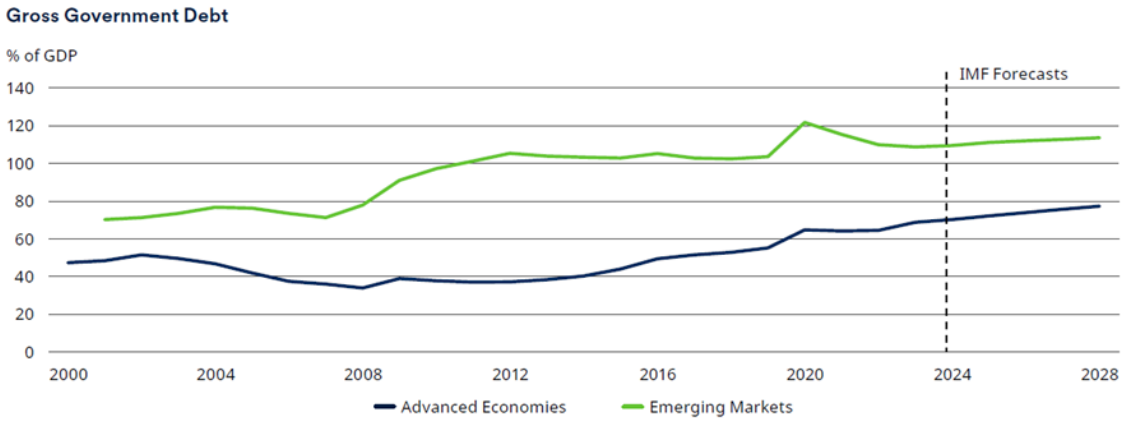
What's behind these bond market ructions?
Why is government debt back on investor radars?
Why now?
Will bond market wobbles continue?
Is US debt really at risk?
Could bond market woes eventually impact stock markets?

The backstory

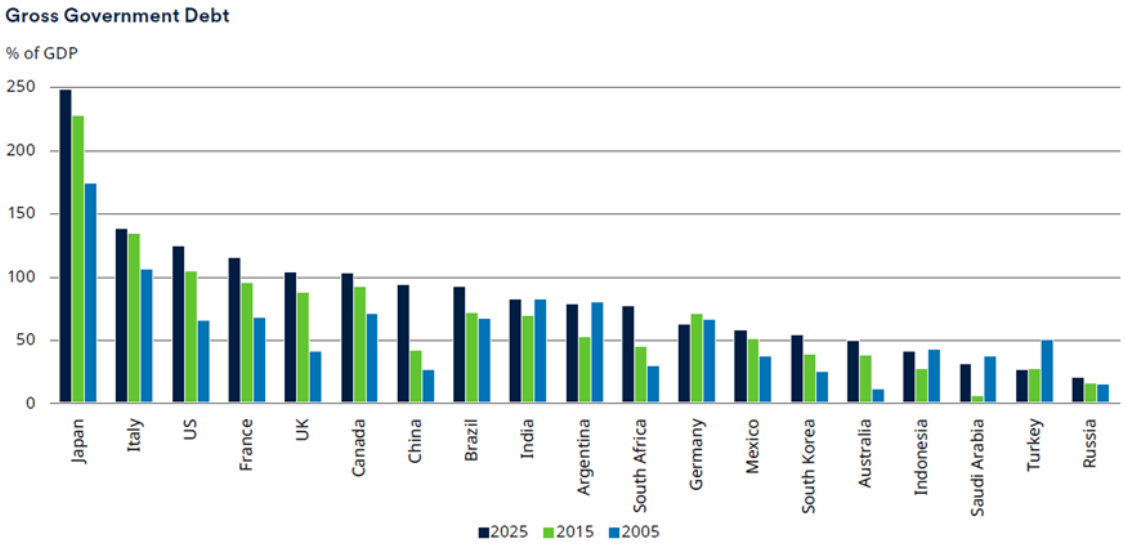
To get answers, it's important to understand the context to recent events.

Government debt around the world has skyrocketed since the Global Financial Crisis. In 2008-2009, governments took on huge amounts of private debt to help save the financial system. A deflationary bust post that made it difficult for countries to grow their way out of this debt. And public debt levels had another leg-up during Covid as lockdowns and healthcare required huge additional spending.

With many major countries running large budget deficits, the IMF expects government debt to climb further in the years ahead, to about 100% of global GDP.



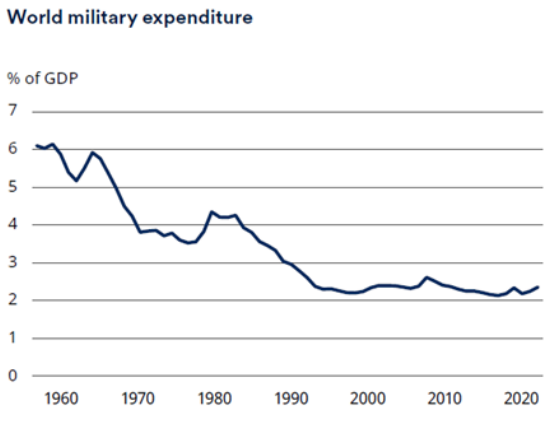
Source: LSEG Datastream, IMF, Schroders, 3 June 2025.



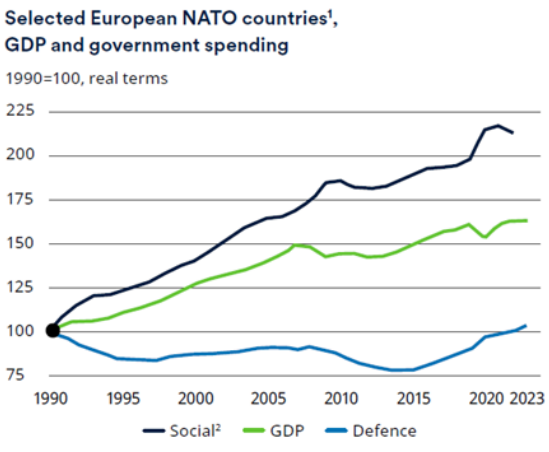
Source: LSEG Datastream, IMF, Schroders, 3 June 2025.

It's not hard to see why the IMF believes budget deficits and government debts will continue to rise. Healthcare and social spending have ramped up significantly in recent years and as populations age across most major economies, it's difficult to see this slowing down. It will not only pressure spending but also drain tax bases too.

Global defence spending is also expected to significantly increase to fund Ukraine's resistance against Russia and plug the gap from America's withdrawal from geopolitical hotspots. Lately, Europe has spent less than 2% of GDP on defence but the IMF and others think this could soon rise to 4-5%.



Source: World bank, Schroders Economics Group, 3 June 2025.



Source: The Economist, The IFO Institute, Schroders, as at 22 February 2022.

In an article last week, I outlined how Australian government spending jumped 9% last financial year, and that growth was unlikely to abate given the increasing health care and pension needs of our ageing population, the ever-expanding NDIS program, and forecast rises in defence expenditure from relatively low levels. That's expected to result in growing budget deficits over the next decade.

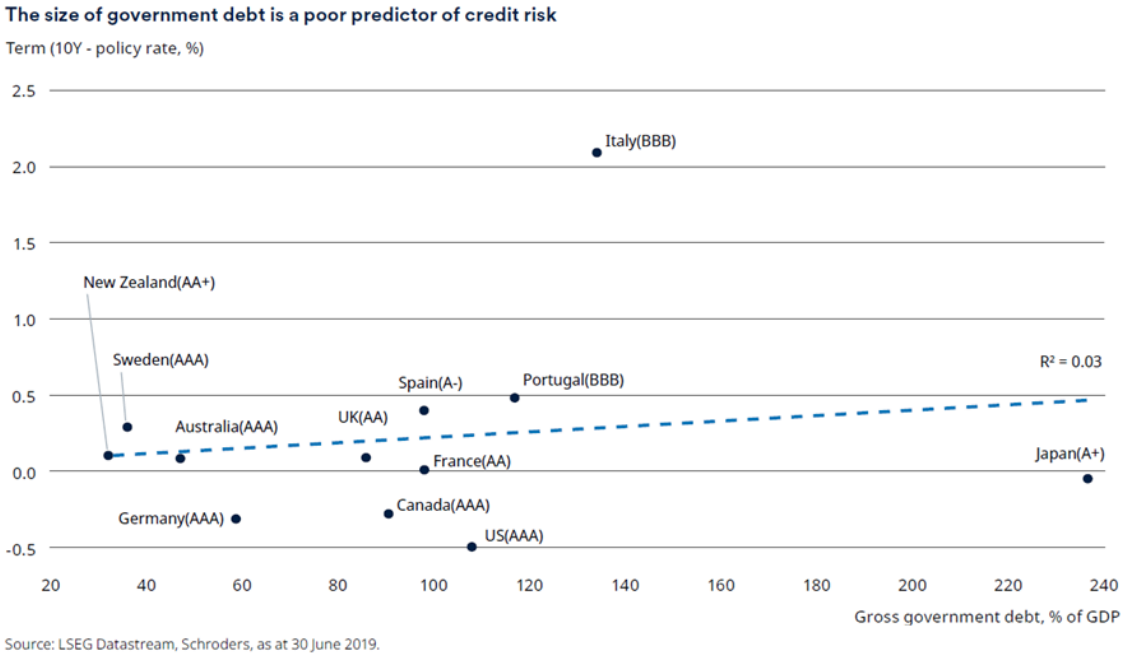
Why are bond markets just waking up to sovereign debt risks?

Why are bond markets reacting now? After all, government debt in many major countries has been high for some time.

It can be put down to a combination of the following factors:

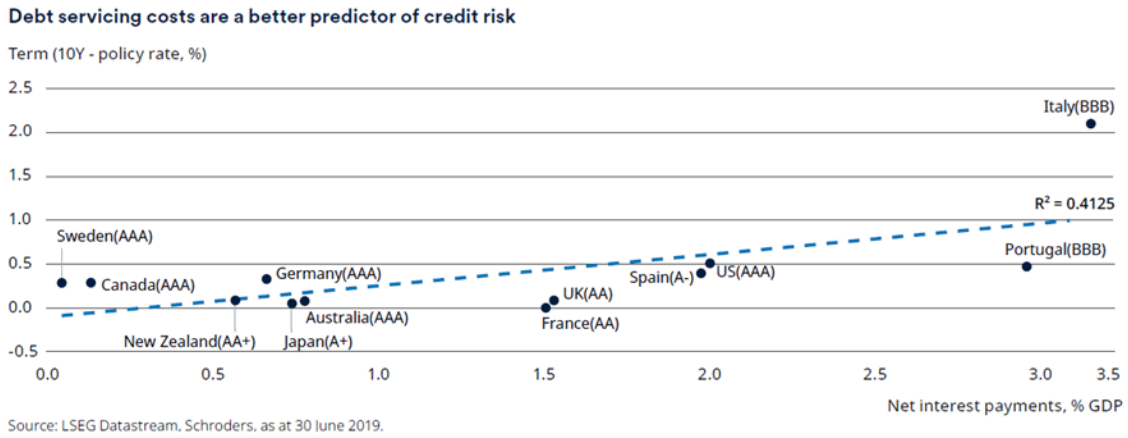
- The return to more normalized interest rates has pushed up interest costs on government debt and further increased budget deficits in the likes of the US.
- Trump's tariff policies have fuelled concerns about the potential for inflation to reverse course and move higher again.
- Trump's proposed tax and spending bill has added to market concerns about the large US budget deficit.
- US influence over the global economy means that rising Treasury yields are leading to higher yields elsewhere.

Markets haven't been worried about government debt until now because this factor alone isn't a precursor to a sovereign debt crisis. It was a good indicator for Sri Lanka's crisis in 2022, when debt exceeded 100% of GDP. Yet, Argentina collapsed in 2001 with much small debt ratios of below 50% of GDP.



Source: LSEG Datastream, Schroders, as at 30 June 2019.

Schroders believes that other factors such as debt servicing costs and reliance on foreign funding are better predictors of credit risk. Because of that, it says markets are right to be concerned about higher interest rates and the strains that will put on government balance sheets.



The debt risk scorecard

What's the best way to assess government debt risk? Schroders has come up with a framework of four key components with 12 indicators.

The four components are:

- Macroeconomic - whether debt as a share of GDP is growing or shrinking.
- Debt dynamic – three indicators assessing current debt position, interest burden, and forecast spending for next financial year.
- External vulnerability/liquidity – three indicators to determine each economy's vulnerability to the external environment.
- Political and demographic risks – capturing non-quantitative risks such as months to the next election to incorporate the potential for populist policy change as well as the old-age dependency ratio as an indicator of future budget pressure risk.

Here is Schroder's final scorecard for the G20 countries (next page). Each country is ranked from one to 19 (there are 19 countries in the G20 – go figure) in each category, and that adds up to a final score and overall rank.

The first thing to note is that of the top four countries with the worst score, four are developed markets – the US, France, Italy, and Australia. Of emerging markets, only Brazil makes the list. Developed markets may be the new emerging markets, it seems.

Why is the US deemed the biggest sovereign debt risk? Schroders says it's primarily because of large, twin current account and budget deficits that mean the US is reliant on foreign capital inflows to sustain its debt pile. The firm notes America's score would have been worse if not for solid nominal economic growth. And the relative strength in political and social factors for the US may be misleading given the newly elected Trump administration has created huge policy uncertainty, while its anti-immigration policies are likely to worsen the old-age dependency ratio over time.

Sovereign debt risk – scorecard

	Macro	Debt dynamic			External vulnerability/liquidity			Political & other risks				
	Rolling 12m nominal GDP Growth (%) minus 10y government bond yield	Debt/GDP (%)	Interest burden share GDP (%)	Primary budget forecast 2025 (% GDP)	Current account balance, 4Q average (%)	Net international Investment Position (% GDP)	REER (Z-score)	Months to next election	Months incumbent in power	Old-age dependency ratio 2030	Total Score	Overall Rank
US	9	17	14	16	19	19	19	12	4	12	141	1
Brazil	19	12	19	7	18	18	4	19	11	7	134	2
France	13	16	10	17	8	14	7	18	14	16	133	3
Italy	14	18	15	3	6	10	7	16	12	18	119	4
Australia	8	5	8	10	16	16	15	15	13	11	117	5
UK	11	14	11	13	17	12	12	7	6	13	116	6
Turkey	15	2	12	12	14	15	6	15	15	6	112	7
India	3	10	16	11	15	11	17	9	16	3	111	8
China	4	13	7	19	5	8	16	#N/A	#N/A	9	101	9
Mexico	17	7	18	2	10	17	11	4	7	5	98	10
South Africa	16	9	17	8	13	7	3	9	8	2	92	11
Indonesia	5	4	13	6	11	13	13	11	9	4	89	12
Japan	6	19	4	15	3	1	1	13	5	19	86	13
Russia	18	1	5	4	4	6	14	5	17	10	84	14
Argentina	1	11	9	1	7	9	10	17	10	8	83	15
Germany	12	8	6	14	1	2	7	11	3	17	81	16
Canada	10	15	3	9	12	4	5	6	2	14	80	17
Saudi Arabia	2	3	2	18	9	3	18	#N/A	#N/A	1	76	18
South Korea	7	6	1	5	2	5	2	4	1	15	48	19

Source: Schroders

There are caveats to this negative view, though:

> *"… the US has historically been a special case. It benefits from having the world's reserve currency, a vast store of assets, and the most dynamic financial markets. There is speculation that the erratic nature of US policymaking has dampened the appetite of foreign investors to buy US assets. But so long as it lasts, this "exorbitant privilege" will continue to allow the US to sustain deficits and debt levels that would trigger crises in other countries."*

It shouldn't come as a shock that France and Italy feature high up on the scorecard.

However, Australia ranking fifth is a surprise, at least to me. Looking at the chart, we're in decent shape for the macro and debt dynamic categories. It's the external vulnerability and political risk factors that let us down.

We rank the second worst when it comes to our current account balance and net international investment position. High foreign investment in primary sectors like mining is a key aspect here.

Australia is also let down by its short election cycles, which result in poor ratings for political risks.

Of other countries, Japan's 13th ranking may seem counterintuitive given its notoriously huge gross government debt to GDP ratio of 251%. That debt isn't seen as a large risk because of a high domestic savings rate and domestic ownership of the bond market. Also, Japan's interest costs as a percentage of GDP are also low, making it less vulnerable to higher bond yields. Finally, Schroders thinks Japan's external risks are low given its current account surplus and the country having the highest net international investment position in the G20.

For those interested, here is the data that Schroders used for its sovereign debt risk rankings.

Sovereign debt risk – the input data

	Macro inputs				Macro	Debt dynamic			External vulnerability/liquidity			Political & other risks		
	Rolling 12m ahead GDP Growth (%)	Rolling 12m ahead inflation (%)	Rolling 12m nominal GDP Growth (%)	WAM matched gov. bond yield	Rolling 12m nominal GDP Growth (%) minus 10y government bond yield	Debt/GDP (%)	Interest burden share GDP (%)	Primary budget forecast 2025 (% GDP)	Current account balance, 4Q average (%)	Net international Investment Position (% GDP)	REER (Z-score)	Months to next election	Months incumbent in power	Old-age dependency ratio 2030
Argentina	4.5%	23.4%	29%	12%	17%	85	-1.6	1.8	1.0	12%	-0.7	28	18	20
Australia	2.0%	2.6%	5%	4%	1%	50	-1.1	-1.4	-1.9	-25%	0.2	35	36	31
Brazil	1.9%	5.0%	7%	14%	-7%	87	-6.3	-0.6	-2.8	-41%	-1.0	16	29	20
Canada	1.3%	2.2%	4%	3%	0%	111	-0.2	-1.3	-0.5	59%	-0.9	52	1	36
China	4.4%	0.7%	5%	2%	4%	88	-1.0	-7.3	2.9	16%	0.6	#N/A	#N/A	26
France	0.8%	1.4%	2%	3%	-1%	113	-1.8	-3.4	0.2	-24%	-0.8	22	96	40
Germany	0.4%	2.2%	3%	3%	0%	64	-0.9	-2.1	5.7	76%	-0.8	44	3	44
India	6.4%	4.7%	11%	6%	5%	81	-5.1	-1.6	-0.8	-9%	1.0	47	132	12
Indonesia	5.0%	2.3%	7%	5%	3%	40	-2.2	-0.5	-0.4	-18%	-0.1	44	15	13
Italy	0.7%	1.8%	3%	3%	-1%	135	-3.7	0.6	1.1	12%	-0.8	30	32	46
Japan	1.1%	2.5%	4%	3%	1%	237	-0.4	-2.4	4.9	85%	-1.7	40	7	53
Mexico	0.9%	3.7%	5%	9%	-5%	58	-5.9	1.6	-0.3	-36%	-0.4	60	11	15
Russia	1.6%	6.4%	8%	15%	-7%	20	-0.7	0.1	3.0	41%	0.1	57	304	30
Saudi Arabia	3.8%	2.1%	6%	0%	6%	30	-0.1	-4.5	0.0	69%	1.2	#N/A	#N/A	5
South Africa	1.7%	4.0%	6%	11%	-5%	76	-5.3	-0.9	-0.6	29%	-1.0	47	12	12
South Korea	1.7%	1.9%	4%	3%	1%	52	0.1	-0.4	5.3	50%	-1.1	60	0	38
Turkey	3.0%	29.7%	34%	35%	-2%	26	-2.1	-1.7	-0.7	-25%	-0.9	35	129	18
UK	1.0%	3.8%	5%	5%	0%	101	-2.0	-1.9	-2.7	-11%	-0.2	50	10	33
US	2.0%	2.8%	5%	4%	1%	121	-3.7	-2.6	-3.9	-81%	2.3	41	6	32

Source: LSEG Datastream, IMF WEO, Schroders, 3 June 2025.

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Debates about improving productivity are heating up as the Labor Government waits for the results of five separate inquiries on the issue. In my article this week, I suggest that franking credits should be part of the debate into reforming our languishing economy.

James Gruber

Also in this week's edition...

There has been a lot of comment and confusion in *Firstlinks* about how the new $3 million super tax will be calculated. **The Association of Superannuation Funds of Australia** (ASFA) has put together a useful guide with seven examples of how the tax will affect different individuals.

Meanwhile, this week's whitepaper from **Heffron** has an explainer on the new tax for those with more than $3 million in super.

Will some of the world's biggest tech disruptors soon become the disrupted? **Trent Masters** says the rise of artificial intelligence could pose the greatest threat that Apple and Google have ever faced, and it opens a plausible path for their dominance to be challenged.

Defined benefit pensions were designed to offer security in retirement. But **Peter Swan** says that new tax policies and arbitrary limits now erode their value - especially for Australians who contributed their own savings to these plans.

Australia's farmland price boom has stalled. **Nerida Conisbee** investigates what's happened and why the sector may be entering a new and more nuanced phase.

Retail property has held up reasonably well given pressures on consumer spending. There's one niche, neighbourhood shopping centres, that has done especially well. **Cromwell's Colin Mackay** details why this niche offers sound prospects for both income and capital gain.

It's no secret that IPOs in Australia have dried up, the upcoming Virgin float notwithstanding. ASIC has announced measures to encourage more listings, though **Mark Humphery-Jenner** believes they don't go far enough.

Curated by James Gruber and Leisa Bell

Are franking credits hurting Australia's economy?

James Gruber

Franking credits are an emotive topic. Many people love them and pensioners often rely on them to supplement their retirement income. Arguably, they contributed to thwarting Bill Shorten's bid to become Prime Minister in 2019.

Yet, at a broader level, there needs to be a serious discussion about whether franking credits are hurting business investment and the economy.

Investment and per capita GDP have languished over the past decade and the Labor Government has made it a priority to find out why. It's ordered the Productivity Commission to conduct no less than five separate inquiries into the issue and is also hosting a productivity roundtable with economists in August.

Here, I'll outline why franking credits should be part of the debate about our stalling economy.

To be clear, this article isn't about whether franking credits, especially refunds, are fair or not. Instead, this is about the second, third, and fourth order effects they may be having on businesses, markets, and the economy.

What are franking credits?

There's a lot of confusion about what franking credits are and how they were created, so let's briefly clear this up.

Franking credits are tax paid by companies that are attributed to shareholders.

Before 1987, a company made a profit, paid tax, and paid dividends to shareholders, who then paid tax again.

In 1987, Treasurer Paul Keating created the dividend imputation scheme to do away with the government's double taxation.

The Howard Government expanded the dividend imputation scheme in 2001 so taxpayers with excess imputation credits could get refunds from the ATO.

In the 2019 election campaign, Labor leader Bill Shorten proposed to abolish the refund system to 'save' $60 billion over the subsequent decade. The issue contributed to him losing the unlosable election.

How do franking credits work?

A franking credit – also known as an imputation credit - is a tax credit that can be attached to dividends paid to shareholders. Franking credits are designed to offset the income tax already paid by the company, and the intention is for the shareholder to pay their own individual rate of tax on the profits instead. The aim is to prevent double taxation or paying tax twice on the same income.

Here are two examples of how it works in practice:

> *Tim owns shares in CBA. The company pays him a fully franked dividend of $700. His dividend statement indicates there is a franking credit of $300. This represents the tax that CBA has already paid. It means the dividend, before company tax was deducted, would have been $1,000 ($700 + $300).*
>
> *At tax time, Tim must declare the income of $1,000. If his marginal rate is 20%, he would have paid $200 in tax on the dividend. Because CBA has already paid $300 in tax, Tim will get a refund of the difference, totalling $100 ($300 - $200).*
>
> *If Tim was in a higher tax bracket, he may not have been entitled to a tax refund.*

And:

> *Genoveve holds shares in CSL. The company paid her a dividend of $750 and her statement showed a franking credit of $750, amounting to total income of $1,500.*
>
> *Genoveve pays no tax. At tax time, she can claim back the $750 tax paid by CSL. In other words, she gets a tax refund of $750.*

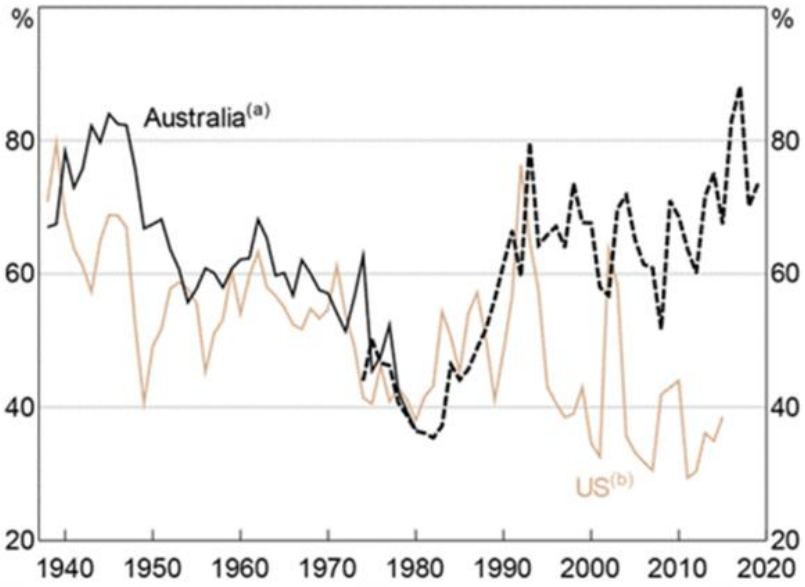
First-order effect: Higher dividend payout ratios

Government policies influence the behaviour and actions of individuals and companies, and the introduction of the dividend imputation system was no different.

Individual shareholders quickly came to revere franking credits. They demanded more dividends with franking credits attached. And companies obliged by paying out more of their earnings as dividends. The impact was immediate and dramatic.

Dividend payout ratios for ASX All Ordinaries companies went from mid-40% to 80% within a decade and have stayed high ever since.

Dividend payout ratio



Source: RBA

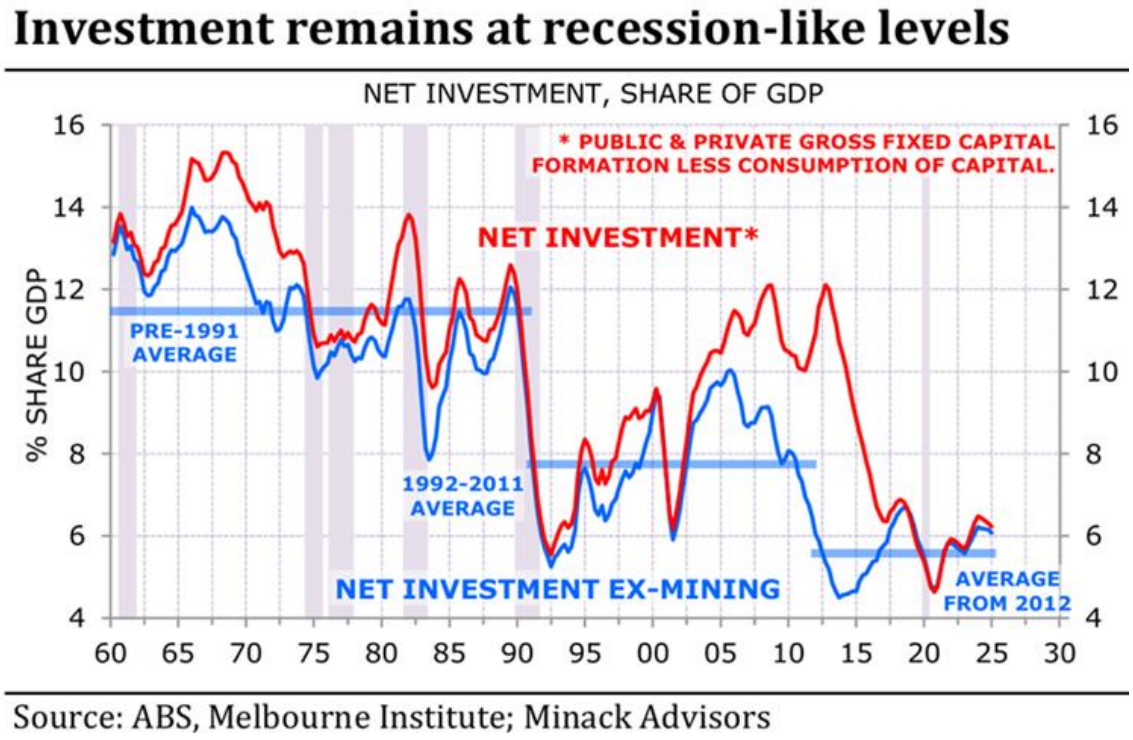
Second-order effect: lower business investment

Higher dividend payout ratios mean companies retain less of their free cashflow for reinvestment into their businesses.

Say a company earns $20 million in a year, and pays 70% of profit as dividends, it results in 30% or $6.8 million being potentially reinvested back into the company.

If the dividend payout ratio was 50%, $10 million would be available for reinvestment, $3.2 million more than if the ratio was 70%.

There's little doubt that companies acquiescing to shareholder demands for higher dividend payouts has led to lower business reinvestment than there otherwise would have been. And that this has contributed, at least in part, to the major fall in business investment in Australia.



Yes, business investment has only really collapsed over the past 15 years. Before that, it was still reasonably healthy.

Keep in mind, though, that the circumstances back then were different. In the 1990s and 2000s, Australia benefited from the de-regulation policies of Hawke and Keating. There was also the rise of China and the dramatic impact that had on mining demand, which filtered through to other parts of the economy.

Consequently, I don't think it's a stretch to say that franking credits have led to reduced listed company investment. And given the size of the listed companies, this has resulted in a broader slowdown in business investment over the past four decades.

Third-order effect: potentially lower ASX market returns

Prominent commentators like Roger Montgomery blame Australia's dividend fetish for the ASX's lacklustre performance since the GFC.

Here is Montgomery's logic:

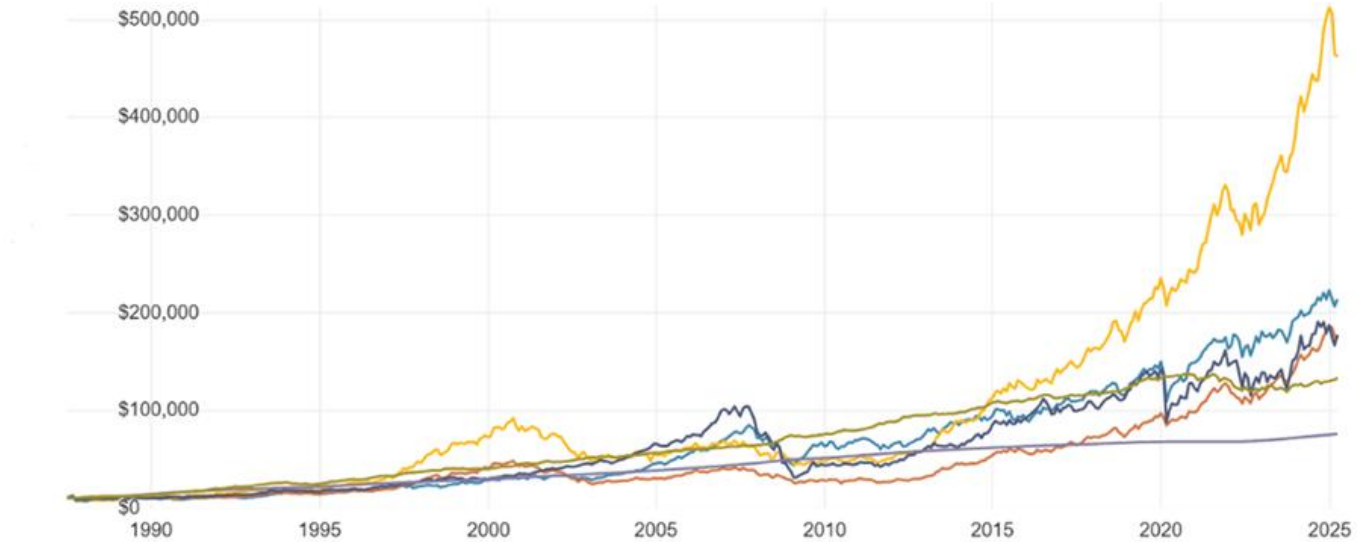
> *"Australian companies tend to pay out the franked dividends to make their super fund and retiree shareholders happier. Of course, shareholders would be better off if a company earning a high rate of return on equity kept the dividends and reinvested them. Even after discounted capital gains tax and franking credits are considered, the investor who insists their company retain profits at 20 per cent rates of return on equity will be far better off than if they take the dividend."*

He has a point. If a company has a return on equity (ROE) of 20%, and it retains 100% of the profit, then shareholder returns over the long term are likely to be close to 20% per annum. Fantastic.

The issue is that not all companies have ROEs that high. The ASX 300 has an average ROE of 12%. That means many companies have ROEs sub-10% and below their cost of capital, and when that happens, it's arguably better for these businesses to pay out more dividends rather than less ie. their returns are too poor to warrant retaining much in the way of earnings.

Another possible argument in favour of higher dividend payouts is that dividends enforce discipline on companies. Australian companies have a long history of blowing large wads of cash on silly acquisitions. Witness James Hardie's attempted takeover of late. In this respect, it's understandable that shareholders may prefer dividends over reinvestment.

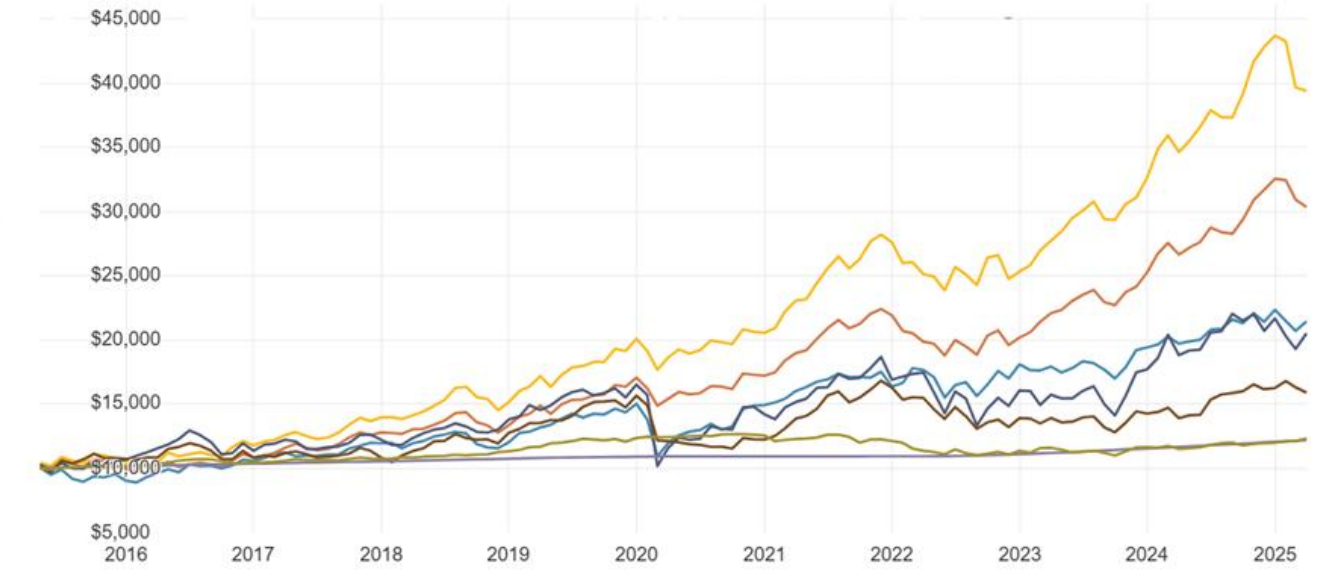
Getting back to Montgomery's notion that the dividend fetish has dragged on market returns, the evidence isn't so clear cut. Since franking credits were introduced in 1987, the ASX 300 has returned 8.4%, close to its longer run average, and well above international shares.



Asset classes	Value at 30 Apr 2025	Return since 1 Jul 1987
Australian Shares	$214,197	8.4% p.a.
International Shares	$173,078	7.8% p.a.
US Shares	$462,190	10.7% p.a.
Australian Property	$177,484	7.9% p.a.
Australian Bonds	$133,638	7.1% p.a.
International Bonds	$147,204	7.4% p.a.
Cash	$76,036	5.5% p.a.

Portfolios	Value at 30 Apr 2025	Return since 1 Jul 1987

The past decade has been a different story, though it's mainly been because of the stellar performance of the US, which now accounts for 64% of world equity indices.



Asset classes	Value at 30 Apr 2025	Return since 1 May 2015
Australian Shares	$21,452	7.9% p.a.
International Shares	$30,355	11.7% p.a.
US Shares	$39,391	14.7% p.a.
Australian Property	$20,523	7.5% p.a.
International Property	$15,905	4.8% p.a.
Australian Bonds	$12,336	2.1% p.a.
International Bonds	$11,858	1.7% p.a.
Cash	$12,199	2.0% p.a.

Portfolios	Value at 30 Apr 2025	Return since 1 May 2015

Though I have sympathy for Montgomery's argument, I think the evidence that higher dividends have reduced ASX returns is still inconclusive.

Fourth-order effect: lower productivity?

Have franking credits impacted productivity and the economy?

Despite what our economists believe, productivity is a difficult thing to measure. Put simply, productivity is how efficiently work is done. It depends on both the efficiency of workers and the quality of materials used by workers.

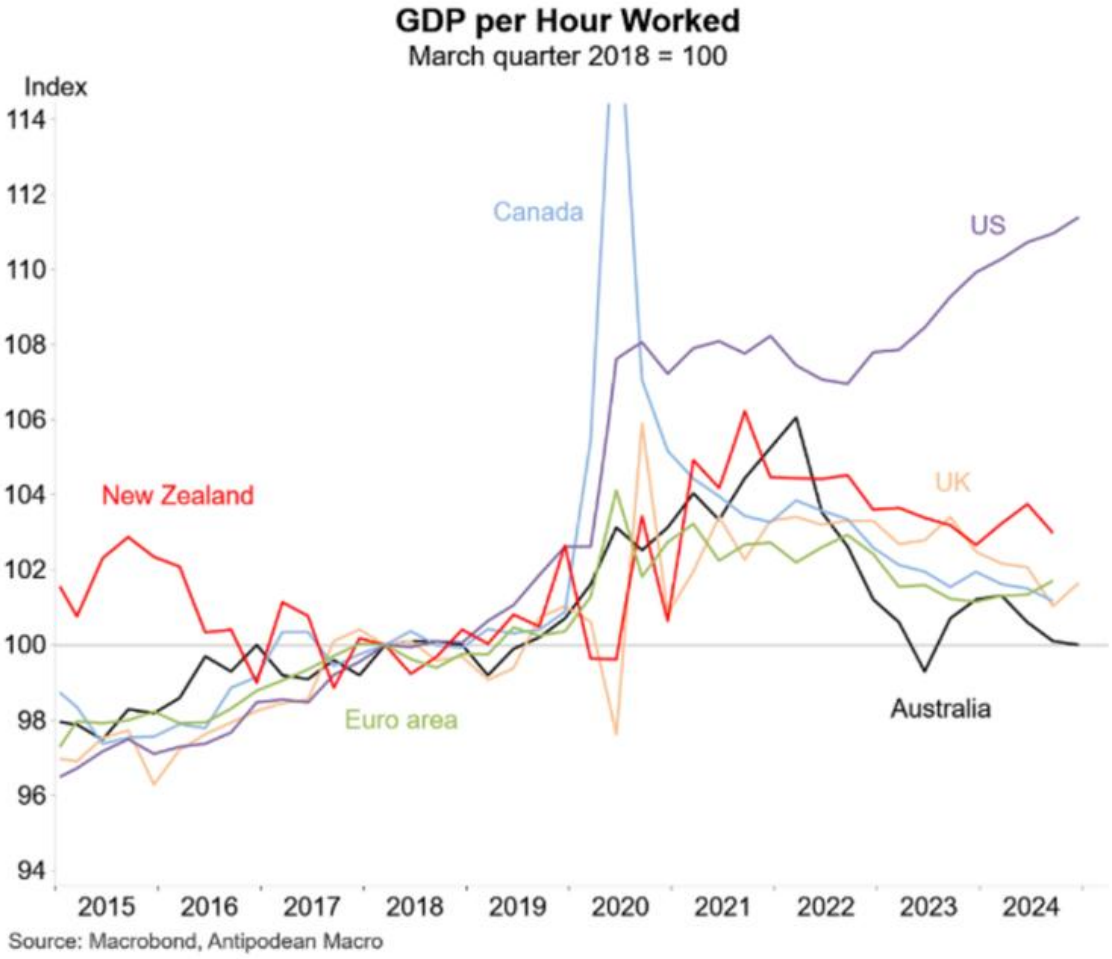
For instance, if better quality technology is used, it tends to improve productivity. Yet, if management of workers is poor, then better technology may not help a company's productivity. In fact, better management with lower quality technology may be able to do more.

So, productivity relies on investment in better machinery, technology and tools, as well as quality management overseeing the work.

Governments also play a role in productivity. For example, they can provide modern roads for efficient transport. They can also provide open and transparent governance, as opposed to a corrupt regime, which can hold back productivity.

What do franking credits have to do with productivity? Well, if they result in lower business investment as I attest, then it does play a role in lower productivity potential.

But let's overstate things: there are a lot of other factors that feed into productivity too.



What else influences productivity?

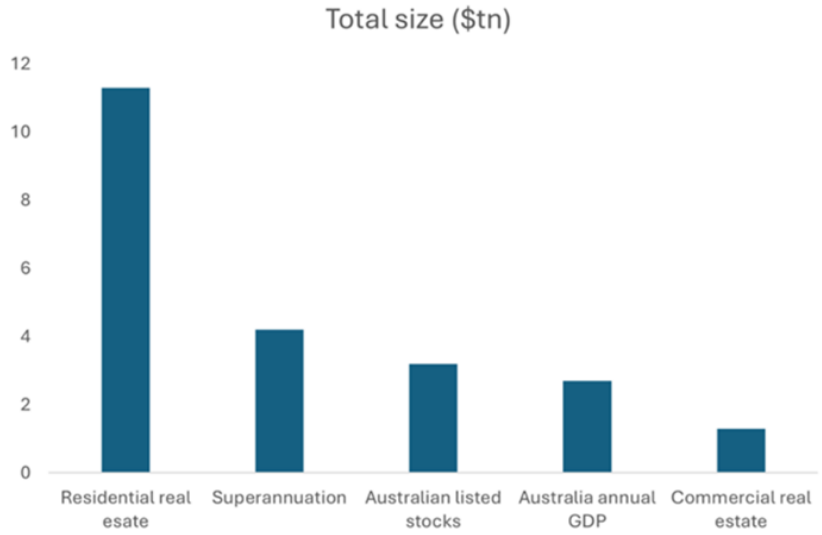
Competition, or the lack thereof, gets talked about a lot, and rightfully so. Australia is full of duopolies and oligopolies, from banks to supermarkets to electricity distributors to telecoms and supermarkets. These arrangements, backed by government regulation, reduce competition, and thereby lower investment, innovation and productivity.

CBA is the most expensive bank in the world by a distance and therefore the market believes it's among the best banking franchises. Why then does Australia feel the need to retain its Big Four policy and prevent more competition in the sector?

While there might have been an argument once for this policy, surely the banks are big enough to handle themselves by now. And opening banking up to more competition is unlikely to lead to financial instability given the lead that the current banks have over any other rivals.

A less talked about factor in the productivity debate is over-investment in unproductive areas. I think Australia may be a world leader is this respect.

I show the following chart often because it encapsulates this over-investment in certain areas.



Sources: CoreLogic, APRA, RBA

The size of the housing market – one of the least productive sectors – is four times that of annual GDP and dwarfs any other sector.

Is it any surprise that we have a productivity issue when so much money is directed, or ill-directed, towards residential property?

I'm not sure we can improve productivity and economic growth much without addressing housing.

There are a host of other factors which play a role in productivity, such as immigration, technology, entrepreneurship, and the list goes on.

Suffice to say that franking credits are part of the debate, though far from all of it.

Alternatives to dividend imputation

What kind of reforms do I propose for franking credits? I don't have any set ones because any changes would have knock-on effects that would have to be dealt with through other reform.

It should be noted that there are lots of other models out there when it comes to taxing dividends as we're one of the few countries – New Zealand and Malta are others – that have a dividend imputation system.

Canada grosses up dividend income and then offers federal and state tax credits to prevent double taxation. In many European countries like the UK, dividends are taxed as personal income, though at reduced rates. The US has double taxation though capital gains are taxed at a concessional rate. It discourages dividend payments and hence why companies prefer to buy back shares in America. In Hong Kong, India, Singapore and Brazil, dividends are not taxed as personal income.

In sum, I think franking credits are part of the productivity puzzle and should at least be studied along with other areas at may be holding our economy back.

The need to get economic growth moving again is urgent and everything should be on the table.

James Gruber is Editor of Firstlinks.

7 examples of how the new super tax will be calculated

ASFA

The Federal Government has proposed reducing the concession paid on earnings in superannuation accounts holding more than $3 million dollars. The worked examples below show how the tax is calculated for a range of different superannuation account holders.

The examples below are for illustration purposes only and based on current information about the proposed tax as at 5 June 2025. The table below summarises the figures in the examples.

Example	Starting balance	Finishing balance	Taxable earnings under Div 296 after adjustment for contributions and withdrawals and share of balance over $3 million	Div 296 tax payable
Jill	$3,000,000	$3,100,000	$3,230	$485
John	$3,200,000	$3,400,000	$20,580	$3,087
Joan	$3,700,000	$4,100,000	$93,905	$14,085
Harry	$5,000,000	$5,500,000	$227,250	$34,088
Fred	$3,800,000	$4,100,000	$131,467	$19,720
Pedro	$5,985,450	$6,070,560	$169,498	$25,425
Patricia	$6,076,075	$6,288,737	$241,873	$36,281

Joan, a retiree with account-based pensions

In the 2025–26 income year Joan received benefit payments of $250,000 combined from her two pension accounts and made a $300,000 downsizer contribution. On 30 June 2025 Joan's Total Superannuation Balance (TSB) was $3.7 million and $4.1 million on 30 June 2026.

Joan's adjusted TSB at the end of the year is calculated to be $4.05 million by adding her total withdrawals of $250,000 and deducting her total contributions of $300,000 from her 2025–26 TSB of $4.1 million. Her superannuation earnings for the year are $350,000 (the difference between $4.05 million and $3.7 million).

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $4.1 million and then dividing it by $4.1 million, resulting in a percentage of earnings attributable to the balance over $3 million of 26.83%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $350,000 by 26.83%, which is $93,905. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $14,085.75. This is a relatively small proportion – approximately 4% – of the overall superannuation earnings of $350,000.

Jill, not currently working, aged 55

On 30 June 2025 Jill's Total Superannuation Balance (TSB) was $3.0 million and $3.1 million on 30 June 2026.

Her superannuation earnings for the year are $100,000 (the difference between $3.1 million and $3.0 million).

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $3.1 million and then dividing it by $3.1 million, resulting in a percentage of earnings attributable to the balance over $3 million of 3.23%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $100,000 by 3.236%, which is $3,230. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $485.

John, an employee who has not retired

In the 2025–26 income year John had total employer contributions totalling $25,000 after deduction of the 15% contribution tax. On 30 June 2025 John's Total Superannuation Balance (TSB) was $3.2 million and $3.4 million on 30 June 2026.

John's adjusted TSB at the end of the year is calculated to be $3.375 million by deducting his total contributions of $25,000 from his 30 June 2026 TSB of $3.4 million. His superannuation earnings for the year are $175,000 (the difference between $3.375 million and $3.2 million).

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $3.4 million and then dividing it by $3.4 million, resulting in a percentage of earnings attributable to the balance over $3 million of 11.76%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $175,000 by 11.76%, which is $20,580. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $3,087. This is a relatively small proportion – less than 2% – of the overall superannuation earnings of $175,000.

Harry, self-employed and not retired

On 30 June 2025 Harry's Total Superannuation Balance (TSB) was $5 million and $5.5 million on 30 June 2026.

Harry made no contributions and had no withdrawals from his super, so the superannuation earnings for the purpose of the tax are $500,000, the difference between the two figures.

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $5.5 million and then dividing it by $5.5 million, resulting in a percentage of earnings attributable to the balance over $3 million of 45.45%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $500,000 by 45.45%, which is $227,250. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $34,088.

Fred the retired farmer

Fred has retired from farming. His children continue the farming business, paying rent to the Self-Managed Super Fund (SMSF) which holds the property as an investment asset.

Fred's account in the SMSF has an investment portfolio represented by the $3 million value of the farm, together with shares and bank deposits. His total superannuation balance as at 30 June 2025 is $3.8 million. The fund receives rent in 2025–26 at a yield of 4% on the opening value of the land, which equates to $120,000. The SMSF is required to charge a commercial rent for the farming land. Rent is a set amount and does not vary with the profitability (up or down) of the farming business.

Interest and dividends amount to $60,000 a year. Fred draws down at the minimum required rate for his age (70), so his benefit payment is $190,000 in 2025–26. Even in the absence of any Division 296 tax the fund needs to have access to cash to pay the minimum required drawdown.

At 30 June 2026 the value of his interest in the farm has increased by 10% to $3.3 million. The total value of his interest in the SMSF is $4.1 million.

Fred's adjusted TSB at the end of the year is calculated to be $4.29 million by adding his total withdrawals of $190,000. His superannuation earnings for the year are $490,000 (the difference between $4.29 million and $3.8 million).

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $4.1 million and then dividing it by $4.1 million, resulting in a percentage of earnings attributable to the balance over $3 million of 26.83%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $490,000 by 26.83%, which is $131,467. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $19,720. This is approximately 4% of the overall superannuation earnings of $490,000 and around 10% of the otherwise tax-free payment he received from superannuation.

Pedro, retired male MP

Pedro retired from Parliament in May 2025 after many years of service, including as a Minister and Shadow Minister. Due to his date of entry to Parliament he qualifies for a defined benefit pension which he started to receive from May 2025. He has informed the fund trustee that he has a spouse. He is aged 55 as at 30 June 2025.

In the 2025–26 income year Pedro received benefit payments of $250,000.

The trustee of the fund has used the Family Law valuation method to determine a Total Superannuation Balance (TSB) of $5,985,450 on 30 June 2025 and a closing balance of $6,070,560 as at 30 June 2026. The closing balance reflects a lower valuation factor due to the member being one year older but there is also an increase in the benefit paid, which for the purpose of this illustration is indexed by growth in average earnings of 3.5%.

Pedro's adjusted TSB at the end of the year is calculated to be $6,320,560 by adding his total withdrawals of $250,000. His calculated superannuation earnings for the year are $335,110 (the difference between $6,320,560 and $5,985,450).

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $6,070,560 and then dividing it by $6,070,560, resulting in a percentage of earnings attributable to the balance over $3 million of 50.58%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $335,110 by 50.58%, which is $169,498. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $25,425 from $335,110 in earnings.

Patricia, retired female MP

Patricia also retired from Parliament in May 2025 after many years of service, including as a Minister, Shadow Minister and Committee Chair. Due to her date of entry to Parliament she qualifies for a defined benefit pension which she started to receive from May 2025. She has informed the fund trustee that she has a same-sex spouse. She is aged 55 at 30 June 2025.In the 2025–26 income year Patricia received benefit payments of $250,000.

The trustee of the fund has used the Family Law valuation method to determine a Total Superannuation Balance (TSB) of $6,076,075 on 30 June 2025 and a closing balance of $6,288,737 as at 30 June 2026. The closing balance reflects both a lower valuation factor due to the member being one year older and also an increase in the benefit paid (to $258,750), which for the purpose of this illustration is indexed by growth in average earnings of 3.5%.

The Family Law valuations use gender-based factors, reflecting longer life expectancy for women. A higher valuation also applies when there is a spouse, because of the reversionary pension paid on the death of the primary recipient. The valuation factors assume a spouse is of the opposite gender. It is also not clear whether the factors apply to a person based on their gender at birth or the gender they currently identify with.

Patricia's adjusted TSB at the end of the year is calculated to be $6,538,737 by adding her total withdrawals of $250,000 to the closing balance. Her calculated superannuation earnings for the year are $462,562 (the difference between $6,538,737 and $6,076,075).

The percentage of taxable earnings over $3 million is calculated by subtracting $3 million from $6,288,737 and then dividing it by $6,288,737, resulting in a percentage of earnings attributable to the balance over $3 million of 52.29%.

The Division 296 tax amount is calculated by first multiplying the superannuation earnings of $462,562 by 52.29%, which is $241,873. That amount is then multiplied by the 15% tax rate, leading to a Division 296 tax amount of $36,281 – around 14% of the pension received.

The Division 296 tax payable by Patricia is about 45% more than the tax payable by Pedro, even though they receive the same pension payment. This is due to the use of gender-based valuation factors. The calculated investment earnings are higher and a greater amount of the account balance is over $3 million. In submissions on the valuation methods ASFA has advocated for the same valuation factors to apply to males and females for both the primary and reversionary beneficiaries.

ASFA represents the APRA regulated superannuation industry with over 100 organisations as members from corporate, industry, retail and public sector funds, and service providers. We develop policy positions through collaboration with our diverse membership base and use our deep technical expertise and research capabilities to assist in advancing outcomes for Australians.

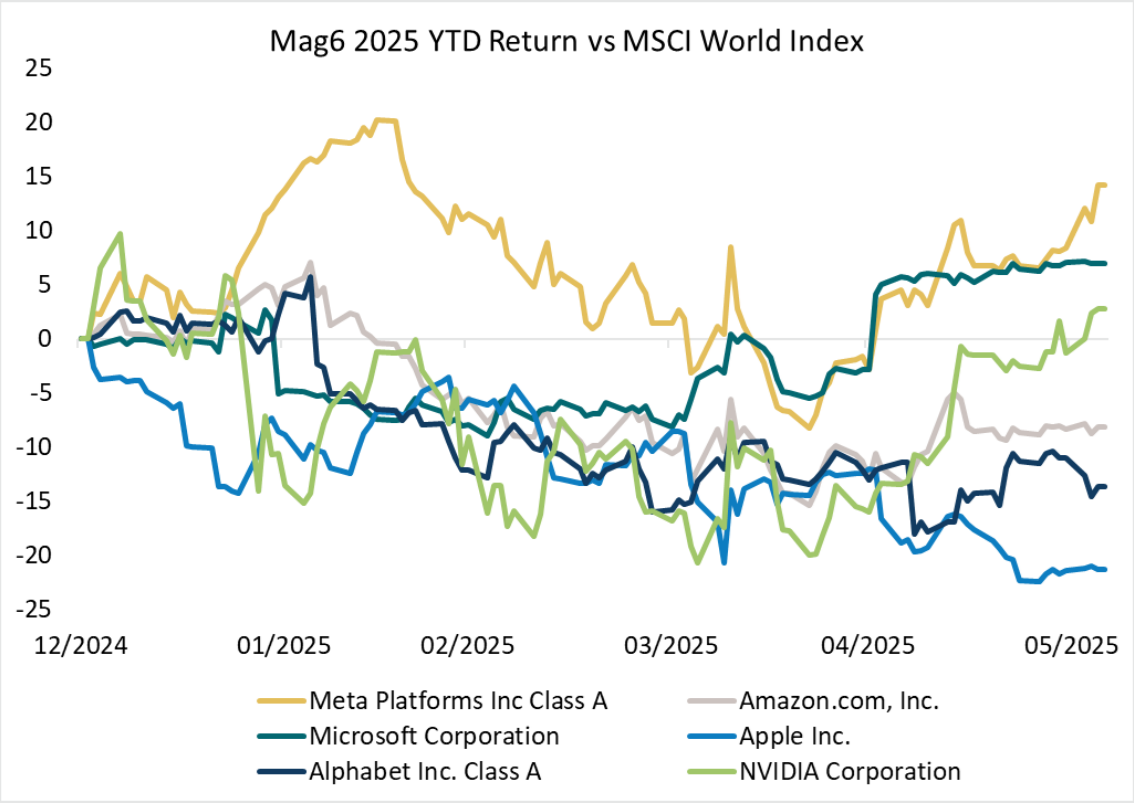
Have Apple and Google reached the beginning of the end?

Trent Masters

It's hard to imagine a world where Apple and Google (Alphabet) aren't dominant. These two tech giants have been at the centre of our digital lives for nearly two decades - Apple through its control of the smartphone ecosystem, and Google through its command of online search. But history reminds us that no company, no matter how dominant, is completely immune to disruption.

The rise of artificial intelligence (AI) could pose the greatest threat these businesses have ever faced, and opens a plausible path for this dominance to be challenged.

Divergence within the Mag6 – Apple and Alphabet underperforming YTD



Source: Factset, 5 June 2025

Google's grip on search is under threat

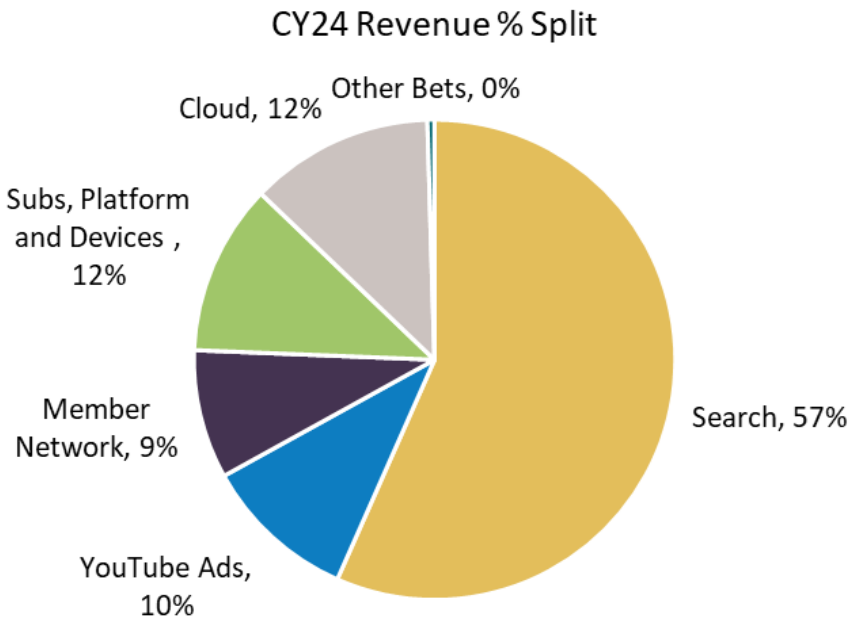
Google has long enjoyed an unshakable position in internet search, capturing more than 90% of global market share. But this near monopoly is no longer as impregnable as it once was. The emergence of large language models (LLMs) like OpenAI's ChatGPT and newer players like Perplexity introduces a very different way to access information - one that doesn't rely on the traditional '10 blue links' model of search.

These AI systems offer more direct, conversational answers. They aggregate information across sources and present it in a more human and contextual way. For many types of queries, particularly research, how-tos, and summaries, they can be faster and more useful than Google. And these new LLM's are beginning to take their conversational interface into commercial search, the very core of Google's business. If users increasingly turn to LLMs for commercial queries, ad revenue will begin to migrate with this shift in engagement.

This is important as Search advertising revenue is circa 57% of Google total revenue, and given the high margin attached to it, this would translate into > 80% of Google profitability. While Youtube, Cloud and Waymo are quality and growing businesses, the key to the future value of Google remains inextricably tied to Search and this is currently under threat.

Google is investing heavily in AI through its Gemini platform, but the challenge it faces is not just technological - it's structural. Shifting its business to meet the new paradigm of AI summaries could cannibalise its existing ad revenues. In short, Google has to disrupt itself while fending off nimbler rivals that don't carry the same baggage - the ultimate "innovators dilemma". To date these moves have been tentative, leaving the door ajar for competitive displacement.

'Search' accounts for the majority of Alphabet's revenue



Source: Alphabet CY24 Results

Apple's ecosystem fortress is showing cracks

Apple's dominance has long rested on two powerful pillars: its tightly integrated hardware led by the iPhone (which still accounts for more than 50% of revenue), and its faster growing, high-margin services business. Together, they form one of the most valuable consumer ecosystems ever built. But both sides of this ecosystem are now facing meaningful threats from technological disruption, compounded by regulatory pressure.

On the technology front, Apple looks to be slipping behind in the race to define the next user interface. As AI becomes central to how we interact with devices - through voice agents and intelligent assistants - Apple's core interface in Siri is lagging badly. While rivals like Open AI, Meta and Perplexity are rapidly advancing conversational AI, Apple's Siri updates are continually delayed, with the next major upgrade now not reportedly arriving until 2027. If new device platforms emerge that are built around AI-first interaction, Apple's dominance in hardware could be challenged. We are already seeing a potential alternate device state emerge in glasses, with Meta in development with Essilor Luxottica and Google announcing a deal with Warby Parker. The acquisition by Open AI of Apple alumni Jony Ive's AI hardware startup "io" is another strand in the intensifying AI device competitive landscape.

At the same time, Apple's services business is under legal scrutiny. Regulators in the U.S. are seeking to block its multibillion-dollar search deal with Google; a move that could curtail a major source of annual revenue and earnings. Court documents have put this payment at around $25bn per annum or 6% of revenue. Meanwhile, pressure is mounting globally to force Apple to open its App Store to alternative payment systems and third-party downloads, weakening its ability to charge developers a 30% commission (often called the "Apple tax"). Coupled together we have approx. $55bn of high margin Apple Services revenue under threat from a tightening regulatory landscape.

Together, these risks suggest that Apple's once-unshakeable ecosystem is increasingly vulnerable. Just as Apple rose to power during the mobile revolution, the shift toward AI at a time of greater regulatory interventions could open the door for new competitors to disrupt both its hardware and services businesses.

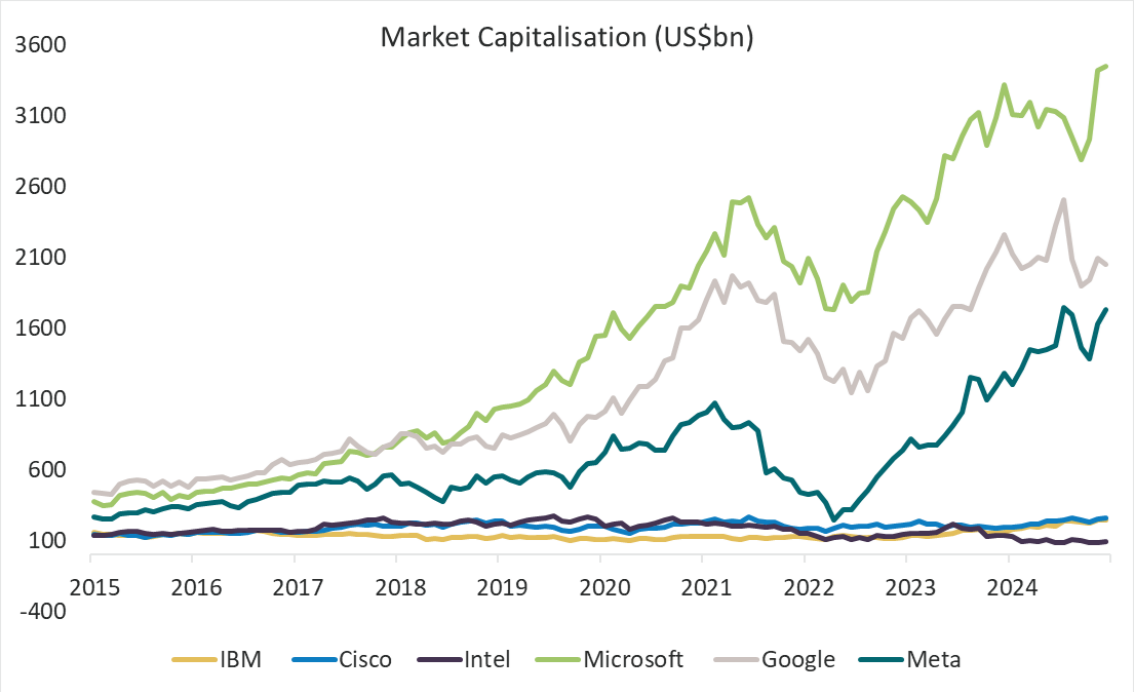
Lessons from history

While it is difficult to imagine a world where Google and Apple are not dominant, the technology sector is littered with examples of once-dominant firms that failed to adapt to technology platform shifts:

- **IBM** was the world's most valuable company in 1980 but lost its lead as computing moved from mainframes to PCs and then to the cloud.
- **Cisco** and **Intel** were titans of the early internet era but struggled as the centre of innovation shifted to software and mobile.
- **Nokia** and **BlackBerry** were synonymous with mobile phones until Apple's iPhone and Google's Android completely upended consumer demand.

The birth of the internet gave rise to today's giants. The birth of AI may, in turn, create the conditions for new leaders to emerge - or for today's leaders to stumble.

The Internet gave rise to a new era of technology leaders



Source: Bloomberg, 5 June 2025

What this means for investors

As an investor it's tempting to stick with the familiar and extrapolate what we currently see. Apple and Google have delivered years of strong returns and are still generating exorbitant levels of free cash. But dominance in tech is rarely permanent. Disruption often starts with tiny cracks and by the time it is more obvious, the market has already repriced the winners and losers.

Now this doesn't mean it is definitely 'over' for these two giants. They have faced substantial risks before and managed to morph their business to adapt to the prevailing conditions. And there are competing, more positive narratives that the breadth of Google services and depth of AI skills can see it emerge as an AI winner while Apple can position as the "on-ramp" for consumer AI engagement.

For the first time in a while, however, the wind seems to be more in these companies' faces, and while still uncertain, a path to a substantial weakening of the Apple and Google businesses is beginning to open-up. As such, a more cautious view on these companies is warranted, and it means staying highly attuned to shifts in user behaviour, the adoption of AI tools, and focusing on where the innovation is really happening.

The companies that succeed in the AI era may look very different from those that have succeeded in the internet era and the potential weakening of Apple and Google could create the space for an AI native trillion-dollar company to emerge.

Trent Masters is a Global Portfolio Manager at Aphinity Investment Management. This article is general information that does not consider the personal circumstances of any individual.

Did retirees lose out when they accepted defined benefit schemes?

Peter Swan

Many retired Australians are covered by defined benefit schemes funded by their superannuation savings. These schemes were supposed to be very beneficial to retirees as are the unfunded defined benefit schemes provided by all governments to groups such as politicians, public servants and the military. Were they?

First, a little background

Superannuation deductions from your wage or salary are compulsory; and these make a sizeable and growing share of your total employee receipts.

These superannuation contributions are taxed at what is described as a concessional rate of 15%. But as pointed out by economist Jonathan Pincus, they are not actually.

Pincus points out that Treasury's preferred benchmark is nominal comprehensive income, which lacks both effective protection against inflation and generates exceedingly high effective tax rates based on the consumption/cash-flow benefits of the superannuation scheme.

For long-term savings plans such as superannuation, the appropriate benchmark is the consumption yielded on retirement. This is essentially a consumption or expenditure benchmark. He finds that Australia's tax regime imposes unjustifiably heavy burdens on low-income earners, and effective rates of over 50% on middle- and upper-income earners. Thus, contrary to the view of Treasury, superannuation is not lightly taxed. Treasury claims a loss of nearly $50 billion in annual tax revenue.

When the Organisation for Economic Co-operation and Development (OECD) reported on the rate of tax subsidy provided by 41 countries' main private superannuation scheme on a lifetime basis, Australia came in with a tax subsidy rate of about 24%, which is at about the medium value. Hence, the so-called concessions included in Australia's superannuation scheme seem quite reasonable based on international standards.

Despite this, the Turnbull government introduced a lifetime transfer balance cap which greatly limits access to so called concessional contributions and plays a critical role in my story. In the belief that superannuants are not sufficiently taxed, in 2025 the Albanese Labor government proposes to introduce a new tax set at the rate of 30% on unrealised capital gains in superannuation accounts. Such a tax has already been applied in Norway with an unprecedented exodus of the country's ultra-wealthy. The tax attempted to raise only $146 million but $54 billion in wealth left the country with the departure of hundreds of wealthy people.

While this will be initially limited to supposed high-dollar value accounts (on the amount over $3 million), the base will not be indexed. Hence, eventually, most superannuants will be subject to it. The Grattan Institute disputes this, claiming that only the top 10% will be affected in 30 years. But this makes no sense. Inflation could be exceedingly high, or the government could lower the threshold substantially and potentially to zero. The Grattan Institute already recommends that the threshold be lowered by one-third.

There are untaxed alternatives to superannuation investment such as one's principal residence, as well as the presence of tax havens offering shelter to wealthy investors. If the government forces savers to take as much money as they can out of their superannuation accounts, there could be a net loss of revenue, as occurred in Norway. Moreover, if this happens, more will end up receiving the Age Pension which is exceedingly costly to taxpayers. It does not seem good policy to largely discourage our system of superannuation by falsely claiming that our compulsory superannuation system is excessively generous.

With this background, I now turn to defined benefit pensions.

Defined benefit schemes in Australia

Defined benefit pensions are what are called annuities. An annuity is a fixed amount, which is paid annually, hence the name 'annuity'.

A conventional annuity has a specified life, such as 20 years. But, for the one million or so Australians on a defined benefit indexed pension (DBIP) annuity, it has an uncertain life as it ends when you die. If you have a spouse who outlives you, then the annuity will generally continue until the death of the spouse at a diminished rate.

These defined benefit pensions are peculiar, and the rules are convoluted. Some schemes depend on the retiree's final salary, others on the lifetime contributions made.

Some schemes are unfunded. For example, for public servants and politicians their defined benefit plans are paid directly out of Consolidated Revenue. Hence, there are no contributions and no earnings.

There are arbitrary-seeming limits on how much tax-free annual income an individual can receive from any retirement scheme. This is known as the lifetime transfer balance cap. Each superannuation fund member will have their own personal transfer balance cap, which depends on the general balance cap at the time the pensioner enters the scheme.

For anyone joining from 2023, the cap is set at $1.9 million and for someone joining from July 1, 2025, it will be $2 million. Approximately 17% of superfund members have a balance that is at or exceeds the cap.

Your entering transfer balance cap itself is indexed for inflation, but, sadly, your personalised cap is not indexed if it was ever fully utilised, even temporarily. This means that only the unused portion of your cap can be indexed for inflation. This is arbitrarily discriminatory. It is designed to prevent any further access to tax-free benefits over your lifetime even when inflation has made you a great deal worse off.

This deemed special value of your annuity is directly related to your annual pension. The value is 16 times your annual entitlement (and conversely, your annual entitlement is the value divided by 16). Thus, if your DBIP cap is set at $1.9 million and your annuity amount (annual pension) is set at the current permitted maximum of $118,750, then this special value equals your cap of $1.9 million as 16 times $118,750 is $1.9 million.

According to the Australian Bureau of Statistics, the pensioner/spouse combination entered the scheme at the age of 65 in 2022 and the age at death is 83 with an expected retirement phase of 18 years. I allow for a rising life expectation such that the last surviving person in the combination is expected to die after 20 years in the scheme.

Government policy reduces the benefits by 33%

With a universal multiplication factor of 16 and a generous expected 20-year life, the implied real (in excess of the Consumer Price Index) return for the pensioner is only 2.2% per annum. The government, in conjunction with the funds, chose the factor of 16 to impose a severe cap on the value of funded defined benefit pensions.

Over the last 32 years superfunds have earned a nominal rate of return of 8% per annum and with an average CPI inflation rate of 2.6% per annum, the real return was 5.4% per annum which is far more than the 2.2% rate stemming from the factor of 16.

This understatement of fund returns lowers the multiplicative factor for funded schemes from 16 to 12 and means that pensions would need to be raised by a massive 33% to reflect the expected returns on the funds provided by the pensioner over his lifetime. That is, the government set return on funded defined benefit plans is exceedingly low.

Thus, a risk neutral investor would prefer an accumulation account to a funded defined benefit plan as the expected returns are 33% higher. Sufficiently risk adverse investors may prefer the certainty of funded defined benefit plans over more risky accumulation funds.

Within the $1.9 million cap, a 5.4% return increases the annual pension by over $39,000 for someone at the cap limit to $157,674.

Doubling the expected time in retirement to 38 years with expected death at age 103 would also be consistent with a 5.4% return.

Whether the multiplicative factor is 16 or the more justifiable 12, the deemed value of the pension remains constant over the expected 20 years of the pension life. This makes no sense other than to arbitrarily restrict access to super. The older and closer to death (termination) the smaller is the remaining value of the pension. One day prior to death, the deemed pension value is identical to when the person first entered the scheme.

Naturally, there are penalties for exceeding the cap. For example, if you have additional assets or contribute to an accumulation fund such that the value of your transfer balance exceeds the value of your personalised DBIP cap, then the excess balance is taxed at 15% for the first time you have an excess transfer balance and 30% the second.

Funds placed into an accumulation account are taxed at your marginal rate. This inability of the pensioner to replenish the value of his capped pension by taking on additional work could discourage socially beneficial participation in the labour market at a critical time in which the elderly are encouraged to continue to contribute by working longer.

Millions of prospective retirees commiserated, and super funds celebrated when funded defined benefit plans were withdrawn by universities and private employees as they were supposedly not commercially viable. But this is not necessarily true.

In conclusion, any retiree who at one time reaches his capped amount is no longer eligible for inflation indexation.

Moreover, funded defined benefit pensions terms set by the government can be severely discriminatory against recipients who have personally contributed to their fund and appear designed to subsidise superfunds and accumulation accounts at the expense of pensioned retirees.

Peter Swan AO is emeritus professor of finance at the UNSW Sydney Business School. This article was originally published by Austaxpolicy: Tax and Transfer Policy Blog, 6 June 2025, and is reproduced with permission.

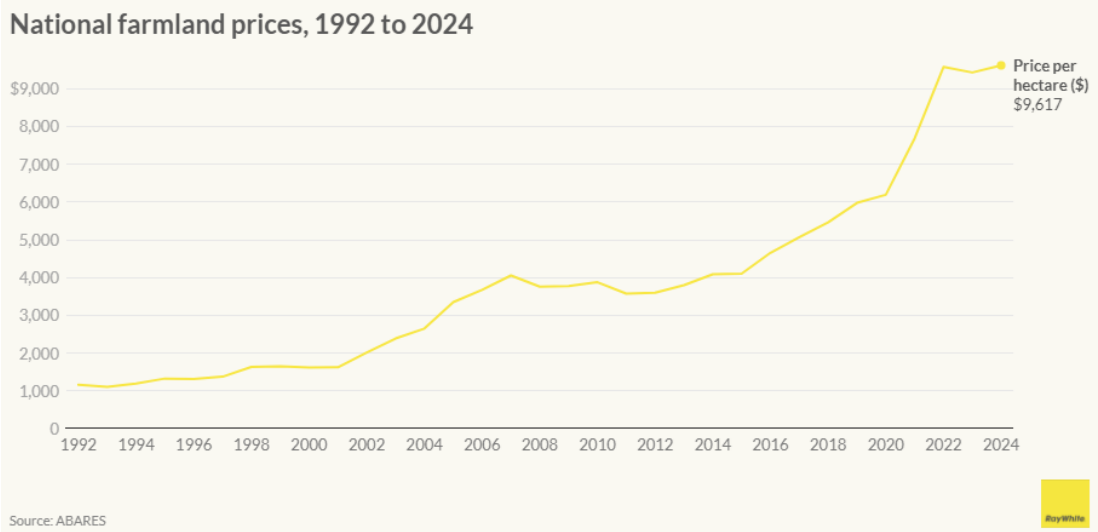
Why Australia's agricultural land boom has stalled

Nerida Conisbee

Australia's farmland price boom has hit the brakes. After explosive growth that saw national agricultural land values more than double since the pandemic began, prices have essentially plateaued at around $9,600 per hectare, marking the end of one of the most dramatic rural property cycles in Australian history.

The numbers tell a compelling story of a market that has fundamentally shifted. Where 2021 and 2022 delivered annual growth rates of around 25%, 2024 managed just 2% nationally. It's a dramatic

deceleration that signals rural property markets are entering a new phase characterised by regional divergence rather than uniform national growth.



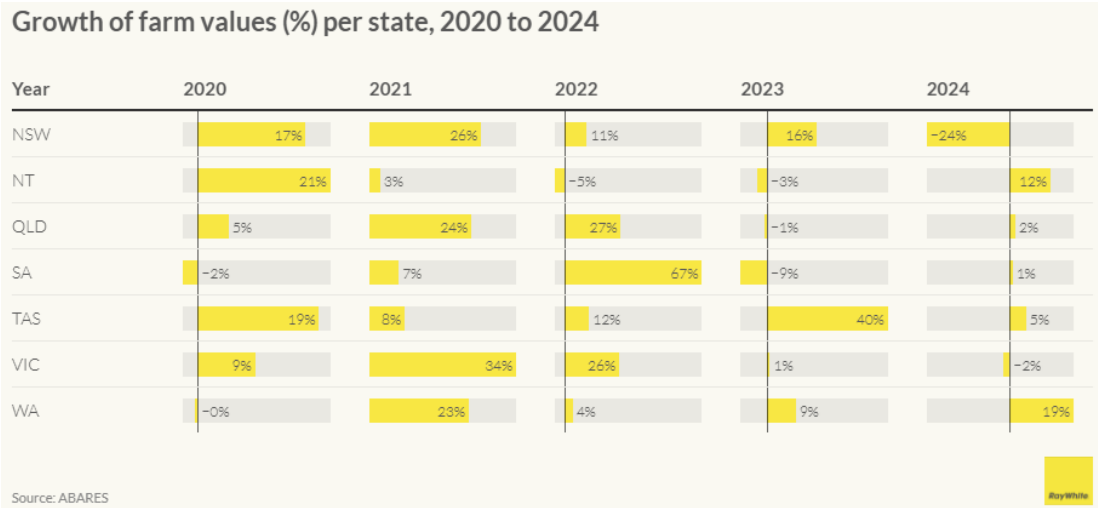
This plateau comes despite continued strong agricultural commodity prices and relatively favourable seasonal conditions across much of Australia. The traditional drivers of farmland demand haven't disappeared, but new dynamics are reshaping how the market operates.

Transaction volumes have collapsed to their lowest levels, with just 2,258 rural properties changing hands in 2024 compared to averages above 4,700 annually in the mid-2010s. This suggests low levels of distress - no one is being forced to sell. But also lower levels of buy demand.

The global economic uncertainty that has characterised 2024 and early 2025 appears to be influencing rural property decisions. Farmers and investors who might previously have transacted are holding off, creating an unusual combination of price stability and market paralysis.

States chart dramatically different paths

While national figures show flattening, state-level data reveals the Australian agricultural land market is fracturing along regional lines. Western Australia bucked the national trend with robust 18.7% growth in 2024, while New South Wales experienced a sharp 24.4% correction that wiped out much of its recent gains.

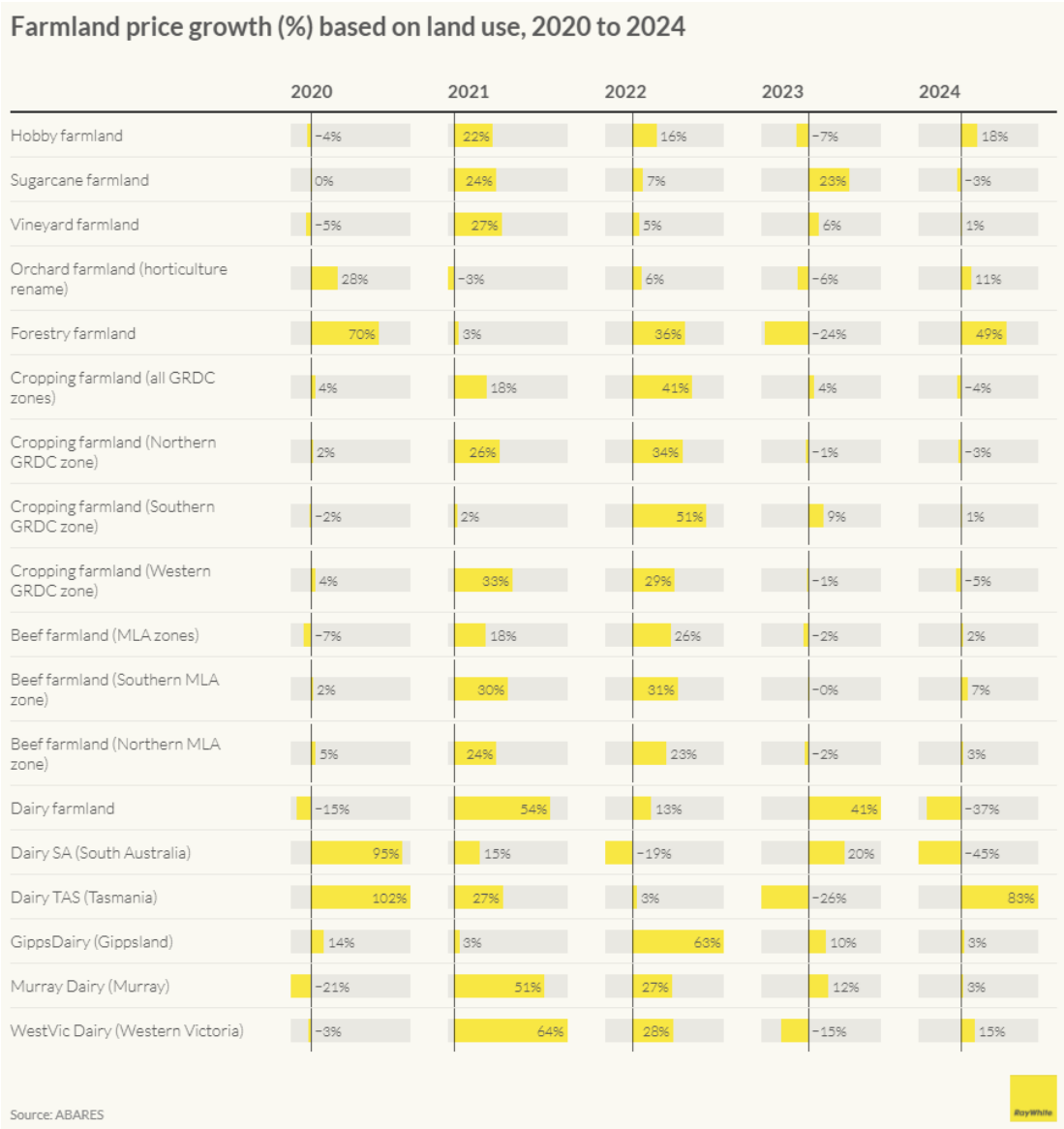


While house prices have stalled in Tasmania, the same cannot be said for agricultural land. Tasmania continues to command Australia's highest rural land prices at over $18,000 per hectare. The Northern Territory, by contrast, remains Australia's most affordable rural real estate at just over $5,000 per hectare, though even it managed 11.9% growth in 2024.

These divergent paths suggest local factors - from mining activity to lifestyle migration patterns - now matter more than broad national agricultural trends. Australian farmland prices are no longer moving in a unified manner, instead shifting according to local market conditions.

Land use tells the real story

Perhaps the most revealing insights come from examining different agricultural land uses, where 2024 delivered some genuinely surprising outcomes. Dairy farming, traditionally one of Australia's most stable rural sectors, experienced extreme volatility with growth rates ranging from plus 83% in Tasmania to minus 45% in South Australia. The decline in South Australia is being driven by drought conditions in this state. The result in Tasmania is more surprising as this state is also experiencing drought however it may reflect fewer transactions, and perhaps slightly better weather conditions.



Forestry emerged as 2024's standout performer with 48.6% growth, reflecting increasing investor interest in carbon farming. Meanwhile, traditional cropping land declined 3.8% nationally, suggesting the sector may be entering a more challenging phase after years of exceptional returns.

The hobby farming sector continues to command extraordinary premiums, with prices exceeding $229,000 per hectare – a reflection of ongoing lifestyle migration trends and the premium city residents will pay for rural amenity.

What happens next?

Australian agriculture is undergoing structural change. Carbon farming, for example, is creating new sources of land value. In addition, the uniform national growth story that characterised the pandemic period appears to have ended, replaced by a more complex landscape where local fundamentals drive outcomes. For now, it appears to be at an inflection point. Prices may have stopped rising rapidly, but the lack of transaction activity means fewer options for buyers. This holding pattern is likely to continue for a while longer however ongoing interest rate cuts are likely to create more opportunities for both buyers and sellers.

The timing of this shift will largely depend on how aggressively the Reserve Bank cuts rates and how quickly agricultural commodity prices respond to global economic conditions. Ongoing geopolitical tensions and supply disruptions globally continue to support agricultural commodity prices, which should underpin farmland values even as transaction volumes remain subdued. If rates fall meaningfully over the coming months, we could see transaction volumes recover well before prices resume their upward trajectory.

Nerida Conisbee is Chief Economist at Ray White.

The retail property niche offering income and growth

Colin Mackay

The retail property landscape has faced a number of challenges over the past five years, from e-commerce to pandemic lockdowns, squeezed household wallets, and weak consumer sentiment. But one centre type has stood tall through it all – Neighbourhoods. These convenience-oriented centres are the cornerstones of local communities and offer a compelling investment proposition underpinned by several advantageous characteristics.

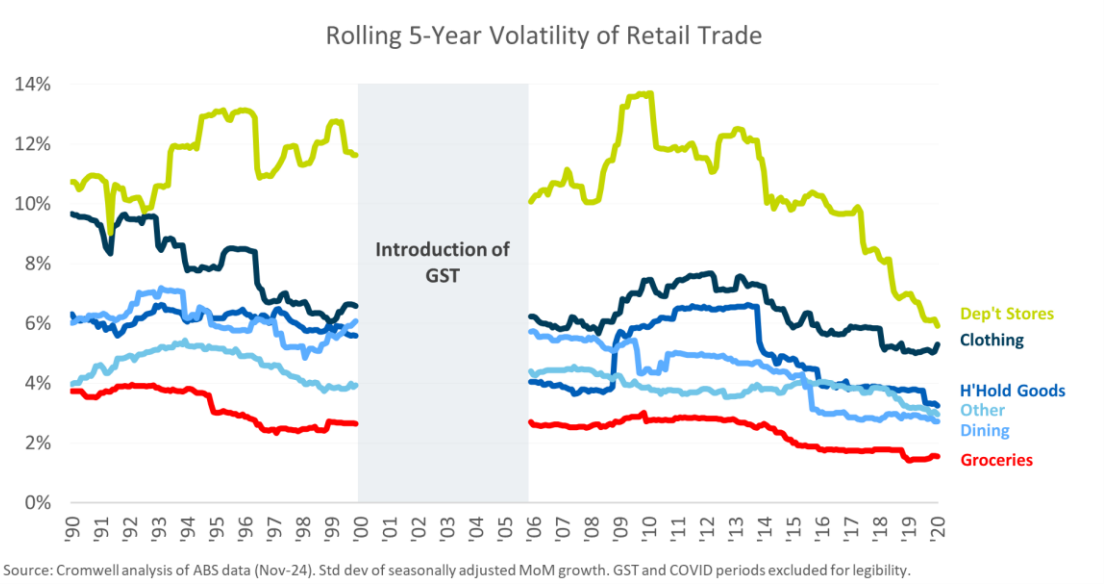
Income security

Neighbourhood shopping centres are supermarket-based and heavily weighted to blue chip tenants such as Woolworths, Coles and Aldi. These brands are strong, providing exceptional credit quality and security of income. Their leases are also long, typically 20 years with multiple options to extend, further reducing the variability of income received.

Demand stability

A selection of specialty tenants complements the grocery offer. These smaller shops often span essential categories such as food, services and healthcare, rather than non-essential items such as fashion. This

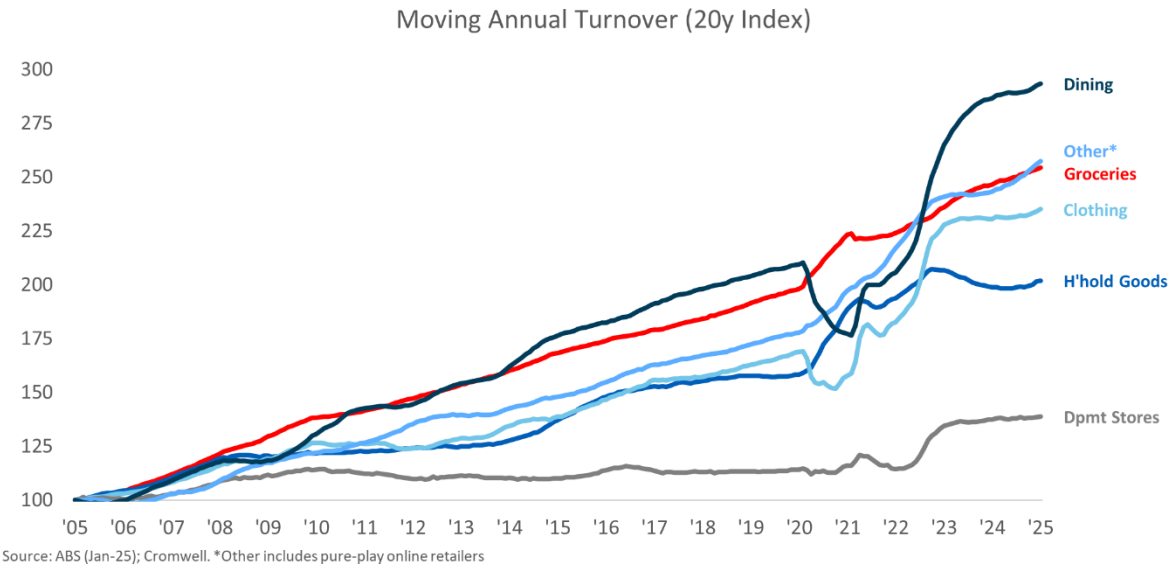
tenant mix means Neighbourhoods are largely focused on meeting basic, long-term human needs rather than fleeting style or brand preferences. As a result, these assets benefit from steady demand and foot traffic, regardless of the business cycle or economic conditions, evident in the lower volatility of grocery sales.



Source: Cromwell analysis of ABS data (Nov-24). Std dev of seasonally adjusted MoM growth. GST and COVID periods excluded for legibility.

Growth tailwinds

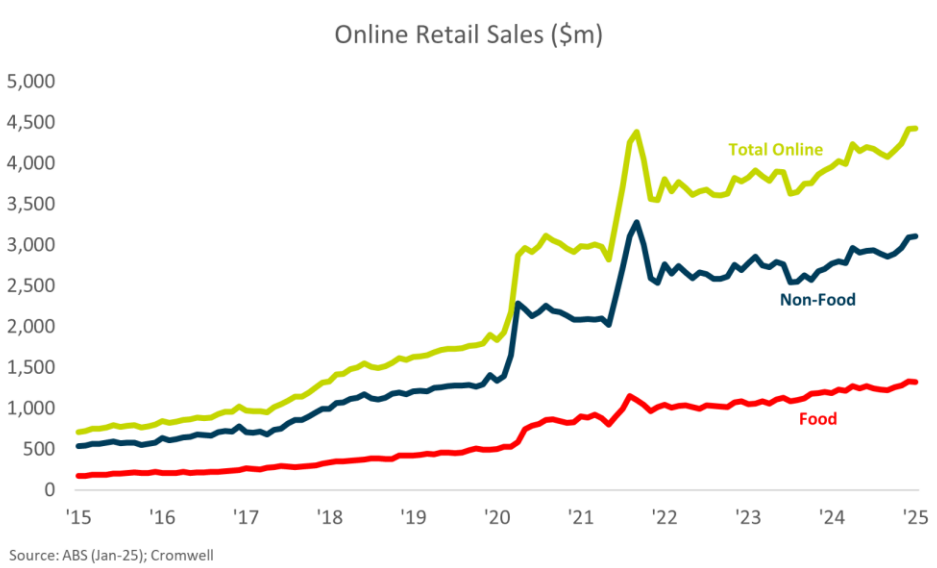
Positively, the lower volatility of grocery spending doesn't come at the expense of growth. The category has recorded growth of 4.9% p.a. over the last 20 years, behind only Dining and Other (which includes online-only retailers) [1]. One of the factors underpinning headline grocery trading performance is inflation. Since groceries are essential and demand is inelastic, price increases can be more readily passed on to consumers compared to non-essential items. Deflationary effects from technology advancement or cheaper offshore sourcing also apply to a lesser extent than in the case of categories such as electronics or clothing. Stronger headline sales growth supports sustainable rent increases, which escalate on a nominal basis.



Source: ABS (Jan-25); Cromwell. *Other includes pure-play online retailers

E-commerce resilience

Growth through physical stores, rather than online, is most relevant for the performance of shopping centres. Over the last ten years, for every extra dollar spent on food (like groceries and dining), 16 cents went to online purchases. Meanwhile, non-food items lost 43 cents to online sales [1]. In this regard, Neighbourhood centres have a favourable retail mix which is heavily weighted to food spending through supermarket and specialty grocery exposure. They also have a healthy weighting to categories which consumers must shop in-person, such as personal services (e.g. hairdressing). We also believe the shopping experience small local centres provide, underpinned by convenient carparking and wayfinding, further defends against loss of market share to e-commerce.

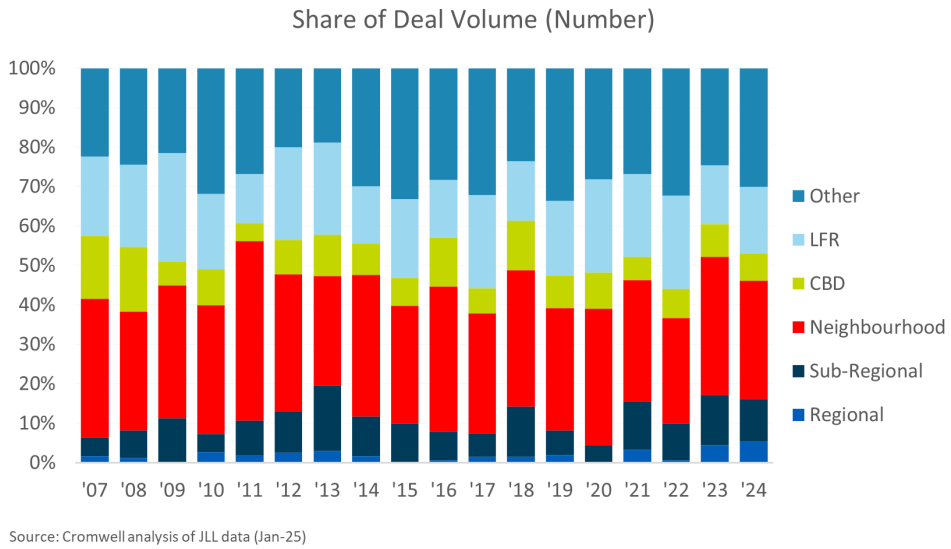


Bigger investment universe

Larger forms of retail investment, such as Regional shopping centres, can only be sustained in catchments with sizable populations (i.e. major metropolitan hubs). In contrast, Neighbourhood centres are found in cities and towns all across the country. This provides investors with a less constrained and more diverse investment universe which is around 30 times bigger (by number of assets). It allows exposure to a wider range of regions/catchments and their associated drivers of economic performance.

Investment liquidity

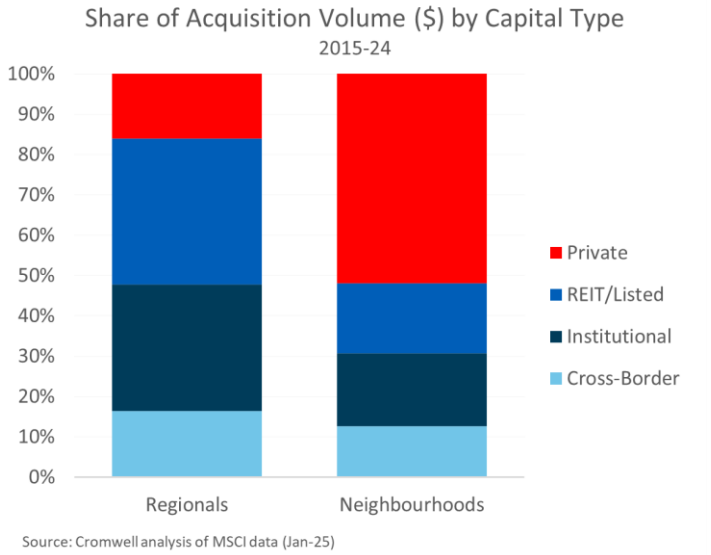
The Neighbourhood investment market is broader than other retail centre types, offering increased liquidity and supporting a competitive bidding process (and outcome) regardless of position within the economic or real estate cycle. Over the last decade, an average of 51



Neighbourhood centres transacted each year compared to 15 Sub-Regionals and four Regionals. Trading was most constrained in 2020, at the height of the pandemic. In that year, there was still 38 Neighbourhoods sold, while only five Sub-Regionals and no Regionals changed hands.

Fragmented sector

Ownership of Neighbourhoods is more fragmented than other retail centre types. While Regional shopping centres are typically owned by a small number of institutional investors, private investors are the dominant holders of Neighbourhoods. These private investors have different skills, goals, and priorities, which can affect how well the centres are maintained and managed. In our opinion, this presents opportunities for experienced managers to "add value" to assets through capital projects, leasing and operations, and increases the likelihood that an asset can be acquired and sold at favourable pricing.



Source: Cromwell analysis of MSCI data (Jan-25)

Bringing home the bacon

Retail conditions are expected to improve over 2025, with consumer sentiment becoming more optimistic and real disposable household incomes increasing as inflation moderates and rate cuts materialise. Stronger retail conditions are a positive for Neighbourhoods, but these shopping centres will also benefit from their unique characteristics and advantages. The combination of strong, long-term leases to blue-chip tenants, consistent bricks and mortar demand for essential goods and services, and resilience to changing economic and capital market conditions has positioned Neighbourhood centres as a robust and attractive asset class.

[1] Cromwell analysis of ABS data (Jan-25)

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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ASX plans to attract more IPOs don't go far enough

Mark Humphery-Jenner

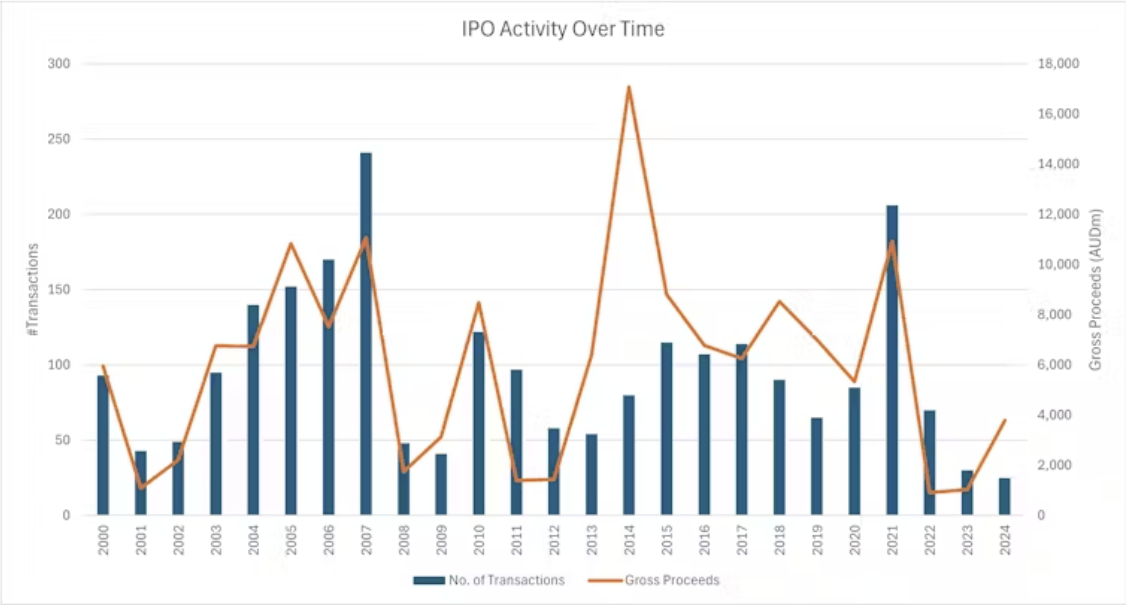
Whenever a high-profile company lists on the Australian stock market it attracts much excitement. Employees and founders enjoy some financial gains and investors get a chance to invest in a potentially exciting stock.

For these reasons, fast-food chain Guzman Y Gomez was one of the biggest financial events of 2024. It undertook an initial public offering which meant for the first time, its shares were available to the public and started being traded on the stock exchange.

However, such public offerings have become rare with many companies remaining private instead of listing on the market.

Indeed, the number of businesses in Australia listed on the stock exchange is declining. This has been described as the worst public offering drought "since the global financial crisis".

The number of initial public offerings since 2000



Initial public offering activity in Australia since 2000. Data from Factset

In response, on Monday, the Australian Securities and Investment Commission (ASIC) announced measures to encourage more listings by streamlining the initial public offering process.

How do companies list on the stock exchange?

Firms undertake an initial public offering by filing documents with ASIC. These includes a "prospectus", which details the information investors might need to evaluate whether to buy shares.

ASIC reviews the documentation and then decides if changes are necessary or whether to let the business list.

Typically, this requires the business to use an investment bank to manage the process and a law firm to prepare the documentation. The business will also engage an underwriter to evaluate the offering and ensure it raises enough capital. All these services cost money.

When they are trading, the business must comply with additional regulations imposed by ASIC and the Australian Securities Exchange. These include meeting corporate governance, continuous disclosure and other operating requirements.

Why should a business lists its shares?

There are many potential gains for a business and the public to list on the stock exchange.

Companies can encourage employees by paying them with shares in the business. This gives workers buy-in to the company they help to build. This is much easier when it is listed because employees can identify the value of that incentive and sell shares when they choose.

Being listed can also help raise capital. Having shares listed helps the business raise money to expand. In a direct sense, initial public offerings do this by enabling the firm to sell shares directly to the public rather than being restricted to the subset of investors who can invest in unlisted stocks.

In an indirect sense, being publicly listed forces businesses to comply with even more stringent disclosure rules. This can give lenders and investors more confidence in the firm.

Further, because the shares are now readily traded in the market, they can now be more easily used to acquire, or merge with, another company.

What does ASIC intend to do?

The commission believes one of the biggest barriers to listing on the market is the initial documentation and administrative requirements. They believe if they can slash red tape there will be more listings.

The goal is to help them get their documents in order from the beginning, to reduce the potential number of changes that may be needed. ASIC believes it will make the process cheaper and quicker, and enable firms to better time the initial public offerings for periods of strong demand.

The fast track process would only be open to businesses with a market capitalisation of at least A$100 million and firms that had no ASX escrow requirement.

An escrow is a financial and legal agreement designed to protect buyers and sellers in a transaction. An independent third party holds payment for a fee, until everyone fulfils their transaction responsibilities.

What else could ASIC do?

ASIC's plan to reduce red tape will help but there are other barriers to businesses listing on the sharemarket. These include:

- **share structures and control**: founders are often psychologically invested in their companies and prefer to retain control over the business they built after listing.
  This is part of the reason "dual-class" share structures exist in the United States. These give some shareholders supernormal voting rights, enabling them to retain control. Singapore and Hong Kong also offer dual class structures.
  Australia doesn't have a dual-class system, but enabling such structures could make the market more attractive

- **disclosure and expense**: the initial public offering process is expensive. ASIC's plan does partly address this, but only for larger businesses, which ironically have greater financial resources to pay the service providers.
- **governance requirements**: the ASX imposes corporate governance requirements on businesses that publicly list on the market. These requirements take a one-size-fits-all to factors such as who should be on the board of directors. These requirements appear to cost extra with an unclear financial gain. And the ASX's rules appear not to be evidence-backed.
- **escrows**: ASIC's fast track process is only available if the firm does not have to satisfy an escrow requirement. An escrow requirement typically applies when an early investor, or a founder, is involved. This is to stop such people from opportunistically selling shares at an inflated process, which then nosedives. It is not clear why ASIC excluded such businesses from fast track review. Smaller companies are some of the most likely to be subject to escrow. So they are the most likely to benefit from reducing the cost-barriers to listing.

ASIC has tried to reduce red tape for larger businesses, but the changes don't go far enough and more work is necessary to address the underlying factors that cause firms to stay private for longer.

Mark Humphery-Jenner, Associate Professor of Finance, UNSW Sydney. This article is republished from The Conversation under a Creative Commons license. Read the original article.