

Industry funds face attacks on unlisted valuations

Sally Patten and Duncan Hughes

Superannuation funds face another wave of damaging write-downs as the major funds prepare to revalue billions of dollars of unlisted assets such as infrastructure, property and private equity investments in their portfolios.

The annual process of placing up-to-date prices on unlisted assets could result in substantial cuts to carrying

FINANCIAL SERVICES

'Babcock & Brown is locked in talks with its bank syndicate, which has appointed a corporate doctor.'

— Full report, page 52

➔ Market disruption now borrowers' risk, say banks, page 53

➔ AFG posts \$18.3m profit, but warns on credit growth, page 54

values, reflecting tumbling markets and a weaker economic outlook.

Funds including MTAA, West-scheme, Cbus, Host-Plus and Aus-

tralianSuper have as much as half their portfolios held in unlisted investments, which are typically valued only once a year. The rest is invested in

Australian and overseas equities, bonds, listed property and cash, which have attributable market values.

Financial planning group Dixon Advisory told its 2700 clients last week that most default options or balanced funds within industry super funds are probably overvalued by between 3 and 15 per cent because of their exposure to unlisted assets and international shares.

"This gives individual investors who make a decision quickly a chance to leave these funds at the higher prices currently being assessed by the funds," said managing director Alan Dixon.

However, the \$250 billion industry funds sector, which has regularly attributed its outperformance to unlisted assets, is expected to hit back

Continued page 8

From page 1

at Dixon Advisory's claims this week with a joint response as debate heats up over the methods used to value those assets.

But Dixon Advisory is not alone in its criticisms. According to Warren Chant of research firm Chant West, the value of unlisted assets could fall by up to a fifth, adding to the 20 per cent that median retirement vehicles have lost in the year to October 31.

Some funds are also expected to bring forward valuations of assets they suspect are overpriced.

If assets are not priced properly, it can create problems for trustees — who must ensure that all members are treated equally — because investors who sold units early would achieve an artificially high price, to the detriment of those who remain in the fund.

The prudential regulator has also stepped up its monitoring of super funds, demanding that they justify year-end revaluations of unlisted assets in response to the slowing global economy and falling share prices.

The Australian Prudential Regulation Authority requires trustees to be able to document how they reach specific valuations.

One of the difficulties facing accountants is that the turmoil in financial markets has resulted in a dearth of sales of property and other assets, so they may have no reliable prices to use as a gauge.

This will force the valuers to rely more heavily on other valuation methods, which means making assumptions about funding and maintenance costs and revenue growth. The latter involves making predictions about occupancy rates in the case of buildings, or airport traffic, road and bridge usage rates.

"The old process that super funds and funds managers and custodians used won't necessarily work, mainly because in the past they would have gone to a single pricing source to get information for fair values," said Ernst & Young accounting advisory partner Vincent Sheehan. "But now that may be a stale price, so there is a lot more work that people have to do to make sure the numbers are right."

Making assumptions in the midst of a financial crisis is far from easy. The outlook for the global and Australian economy is changing rapidly while governments and central banks try to steer their economies away from recession.

"There might be a wide range of possibilities [about the direction of the economy]. You need a crystal ball to work out what the outcomes are going to be, so companies and super funds need to work out what they think is the best estimate [of growth and yields] and justify the process for coming up with the best estimate," said Mr Sheehan.

But one of the largest industry funds, Cbus, has already criticised the research by Dixon Advisory.

Investors who sold units early would receive an artificially high price.

"I was astonished by the recommendation," said David Atkin, the chief executive of Cbus, which manages \$13 billion for construction industry workers. "We are very conservative in our valuations and very confident of the process. The Australian Prudential Regulation Authority has been through our valuations in the past three months."

The chief executive of the Australian Institute of Superannuation Trustees, Fiona Reynolds, said:

"APRA provides very clear guidelines to super funds on the frequency and independence of valuations of assets that are not traded on a regular basis, such as unlisted property.

"Unlisted property and listed property assets are very different products. The markdown in listed property valuations reflects investor concerns over high gearing, poor governance and excessive fees paid to management. Given the current market volatility, unlisted assets play an important role in providing members with stable, long-term returns."

The last round of revaluations for calendar 2008 is to begin soon.

While institutions such as Macquarie Group have recently argued that the value of infrastructure assets such as toll roads and airports have held up well in the downturn, they have been forced to write down their real estate investments.

With the listed side of their portfolios having fallen so steeply, there are fears that some funds will be tempted to use overly optimistic assumptions about revenue growth when valuing their unquoted assets.

"You have an expectation that when the revaluations are done ... you are not going to find that every

unlisted asset has gone up," APRA deputy chairman Ross Jones told *The Australian Financial Review* earlier this year.

"When you look at the revaluations, you are asking [funds] for justification. They can't be random calls on the part of the trustee."

Accountants and asset consultants recommend that super funds bring forward revaluations of assets which could be sitting on their books at inflated prices.

"We are challenging clients to change their processes," Mr Sheehan said. "In the past they might have had a triennial valuation for a certain property portfolio and now we might be challenging that, depending on how big of a risk it is."

AustralianSuper chief investment officer Mark Delaney said he expected that infrastructure prices would hold up because assets sold recently achieved reasonable prices.

That said, Mr Delaney predicted prices of other types of assets, such as property, would fall owing to scarce debt financing. However, he said listed vehicles would fall further because the quoted market tended to overreact on the upside and downside.