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IPD Property Newsletter

Trends in commercial property investment

1 December 2011

This report has been commissioned by Quintessential Equities 022 Pty Ltd as an independent assessment and forecast of the current Melbourne industrial property market

Property Newsletter
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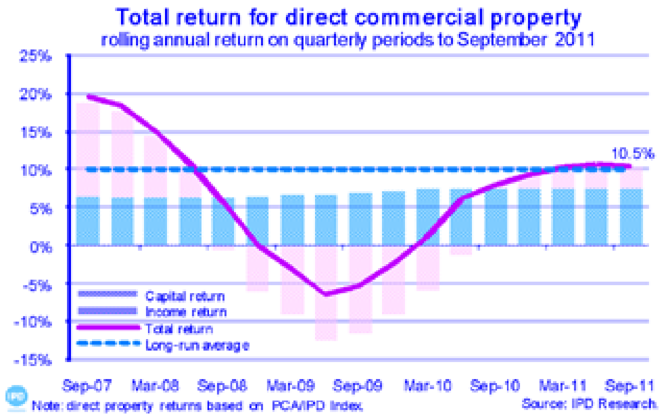
On the pulse of the property world

Commercial property market overview

The overall commercial property market recorded a solid total return of 10.5% for the year ending September 2011. This consisted of a 7.5% income return and a 2.9% capital return.

Figure 1 shows rolling annual total returns split by income and capital return. It clearly highlights that whilst the commercial property investment market is still exhibiting high annualised total returns, the return profile has moderated slightly over the last quarter. However, this still compares favourably with the average annual long run total return of 10.1%.

Figure 1



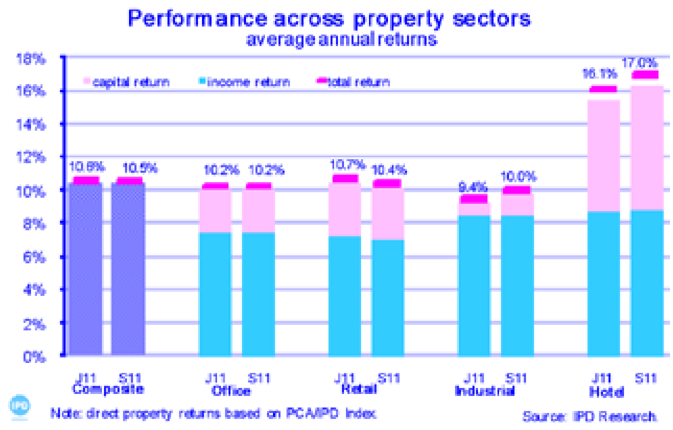
Over the next 12 months we expect investment returns to soften slightly but remain relatively stable. This is underpinned by softening macroeconomic conditions and ongoing turbulence in capital markets.

Performance across property sectors

A summary of the investment performance across the core property sectors is shown in Figure 2. Annualised total return to September 2011 for the office, retail, industrial and hotel sector indices stood at 10.2%, 10.4%, 10.0% and 17.0% respectively.

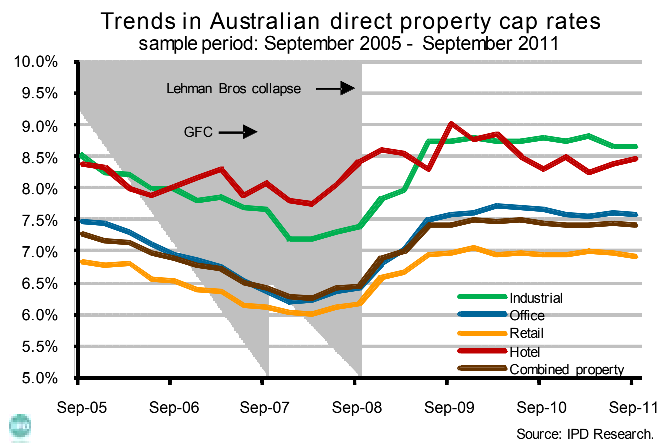
The return on office buildings remained stable while the retail sector experienced a slight softening. In contrast, the industrial performed strongly with annual returns rising by 60bps, reflected by a higher capital return. The office and industrial sector are expected to outperform the retail property sector over the next 12 months due to sluggish growth in retail sales.

Figure 2



With reference to pricing, Figure 3 shows movements in average cap rates since September 2005 across the four sectors. As at September 2011, the average cap rate stood at 7.4% and has remained relatively stable since September 2009 within a range of c10bps. Given the continued uncertainty surrounding global economies due to the European sovereign debt crisis, there is further downside risk to cap rates over the short term (i.e. cap rates are likely to soften). However, some cap rate firming is envisaged for good quality assets.

Figure 3



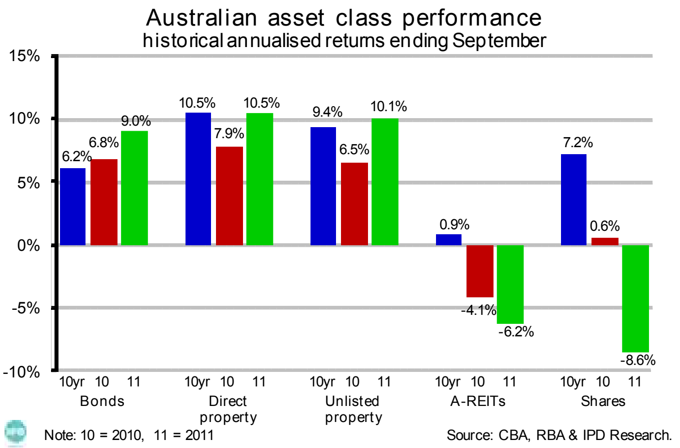
Performance across asset classes

Figure 4 highlights the short and long-term average return performance between direct property, unlisted property, A-REITs, shares and bonds.

Direct property has outperformed all competing asset classes over both the short and long term, with an annualised total return of 10.5% (in the year and ten years to September 2011). Direct and unlisted property returns have remained relatively consistent, while A-REITs and shares have displayed high volatility with total returns falling into negative territory in recent periods.

Against this backdrop, property looks to remain an attractive investment against competing asset classes; offering a competitive income yield against bonds, an inflation hedge, and relatively stable returns against shares. The return spread between direct property and unlisted property is generally attributed to gearing.

Figure 4

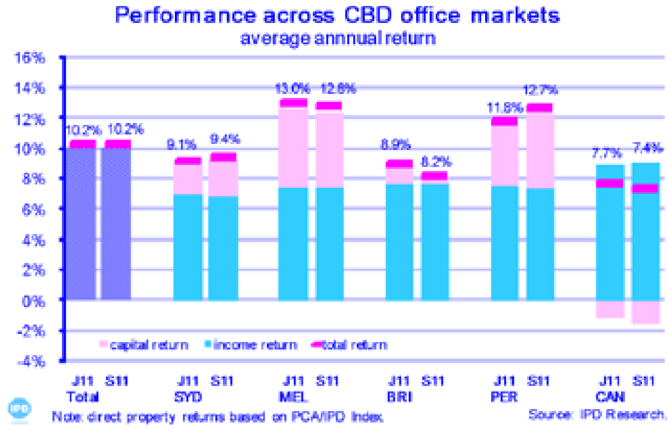


Office property sector performance and trends

Figure 5 shows annualised returns across major CBD office markets to September 2011. Notably, return performance across CBD markets is variable, partly reflecting different space market conditions.

Melbourne's outperformance was largely due to solid demand, underpinned by a diversified tenant profile across industries. The relatively moderate return profile for Sydney CBD reflects a general weakness in demand mainly concentrated in the Finance and Insurance sector. Perth's strong return reflects strong demand associated with a buoyant resource sector.

Figure 5



Industrial property sector performance and trends

Return performance for industrial property across states is shown in Figure 6. With the exception of South Australia, all other states have seen an uplift in returns. Both Victoria and Western Australia have been the top performing states with annual returns of 12.2% and 13.2% respectively.

After the GFC all industrial markets experienced a strong upswing, with returns continuing to rise, albeit at a far more moderate rate since the start of 2010. Going forwards over the short term, returns should continue to strengthen at a moderate pace primarily due to a strong income return with a mild capital return.

Figure 6