Investment MarketBeat

Q4 2015

Australia

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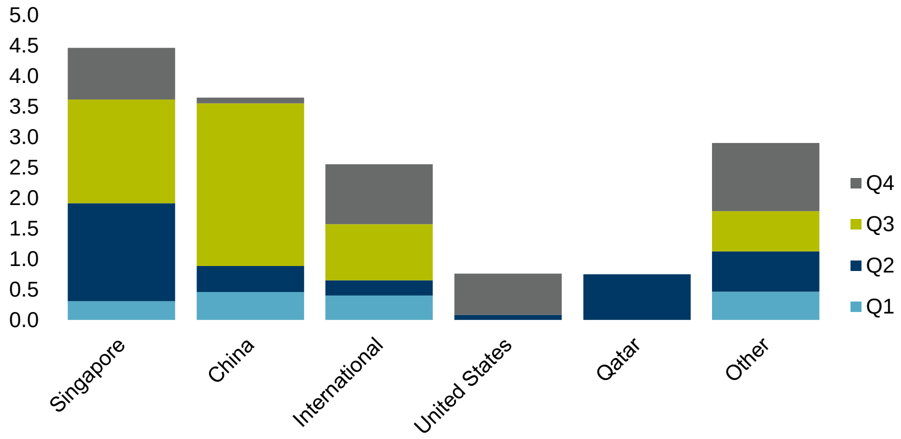
Contents

- Investment momentum has continued to build over the year, with Q4 being the strongest quarter recorded for calendar year 2015 at $9.4bn. At the year's end, total annual investment volume reached $29.9bn, falling 14% short of last year's post-GFC record of $34.8bn.
- The retail sector set a quarterly investment record with $3.0bn of assets transacting over Q4 2015. The final quarter figure followed steadily increasing activity through the year, resulting in an annual volume of $7.2bn – a 25% increase on 2014. Nevertheless, the office sector ended the year as the most transacted asset class, recording an annual volume of $14.9bn, accounting for almost 50% of the national volume.
- The flow of offshore capital into Australia not only continued, but intensified, in 2015. Following the $13.8bn invested by foreign entities into Australia in 2014, a further $15.4bn was invested in 2015. Singaporean-based investors ($4.5bn) continue to account for the majority of overseas capital in 2015, with Chinese investors ($3.7bn) in second place despite a lower number of transactions (Figure 1). International investors (those with a global platform) were significantly more active in 2015 committing $2.6bn – double their 2014 amount.
- In looking to 2016, many of the market characteristics evident at the start of this year remain on show. The main difference being that the market is further through the cycle. Nevertheless, it does not appear that the investment market will significantly slow in the near term and so we expect volumes to be sustained at least over H1 2016.
- Anticipated US Federal Reserve hikes will likely place upward pressure on Government bond yields, but this is not expected to flow onto the property sector in the near term. Rather there remains scope for further yield compression in selected markets and sectors as abundant domestic and offshore capital is yet to be deployed. In general core assets, or those with a strong value-add play, will remain in favour and generate the most competition.

Figure 1

Foreign investment by source of capital, 2015 (AUDbn)



Source: Cushman & Wakefield Research

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Investment volume

Strong final quarter pushes volumes to $30bn

Investment momentum continued to build as investors once again used end of year as a deadline in which to close deals. Indeed Q4 2015 was the strongest quarter recorded for the calendar year at $9.4bn (Figure 2). This was an 12% increase on Q3 2015, in which $8.4bn was invested in Australian commercial real estate. It also represents the second strongest fourth quarter since 2008, only being edged out by last year's result of $10.1bn.

At the year's end, total annual investment volume reached $29.9bn, falling 14% short of last year's post-GFC record of $34.8bn. One of the reasons for this being the New Year "hangover" in the investment market recorded in Q1, when $3.9bn was recorded. While this was on-par with the longer run Q1 average, it fell almost 20% short of Q1 2014. Ostensibly, this was due to lack of product on the market as well as purchasers and vendors reassessing market pricing given the yield compression seen in H2 2014.

Furthermore, although investment volume in 2015 was underpinned by two significant portfolio transactions – Investa Office ($2.45bn) and GIC/Australand Industrial ($1.1bn) – together they fell short of the $6.3bn seen in 2014 resulting from the sale of the CPA and Australand portfolios.

Remarkably, average deal size in 2015 did not change from that seen in 2014, with both at $60m over the full year (Figure 3), though greater quarter-on-quarter (q-o-q) variability was seen in 2015. Rather the lower volume in 2015 was the result of a 14% decline in the number of deals recorded.

The office sector recorded a slight q-o-q decline in volume, down from $4.8bn in Q3 2015 to $4.5bn in Q4 (Figure 4). Nevertheless, it ended the year as the most transacted asset class, recording $14.9bn in investment over the year and accounting for 50% of the national volume. The largest transaction occurred late in the quarter, with Lendlease selling a further 25% stake in International Tower 1 at Barangaroo for $350m to an Asia-Pacific-based institutional investor. This leaves Lendlease with a 12.5% stake in the tower following transactions to QIA (37.5%) and APPF (25%) previously.

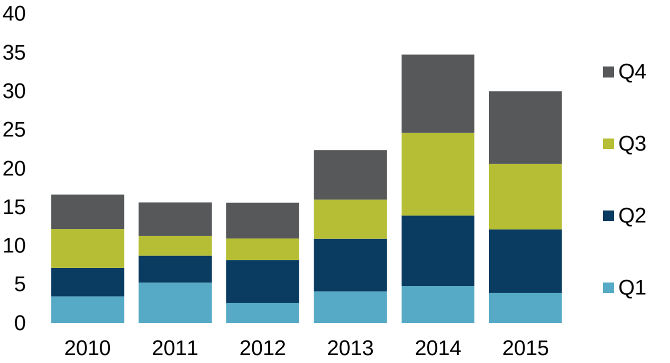
Investment in the retail sector set a quarterly record with $3.0bn of assets transacting over Q4 2015. The final quarter figure followed steadily increasing activity through the year, resulting in an annual volume of $7.2bn – a 25% increase on 2014. Whilst a lot of deal activity was continuing to occur for neighbourhood centres, predominantly by unlisted funds this quarter, this was also supplemented with several large-scale purchases. Blackstone acquired Rundle Plaza Mall in Adelaide CBD for $400m and ISPT acquired 50% of World Square in Sydney CBD for over $280m at an estimated initial yield of 4.5%.

Investment in industrial assets has been somewhat muted in 2015, with the exception of the GIC/Australand portfolio being acquired by Ascendas. A total of $706m was invested in Q4 to bring the annual total to $3.1bn, considerably less than 2014 in which $4.9bn transacted.

Finally, investors continued to pursue opportunities in "other" asset classes to secure higher returns. Together they added $4.7bn to the total national volume over the year. Hotels accounted for the lion's share at $2.8bn, with overseas investors accounting for 50% of the volume. More significantly, overseas investors committed $1.7bn of the $2.2bn (77%) invested in hotel assets of over $50m.

Figure 2

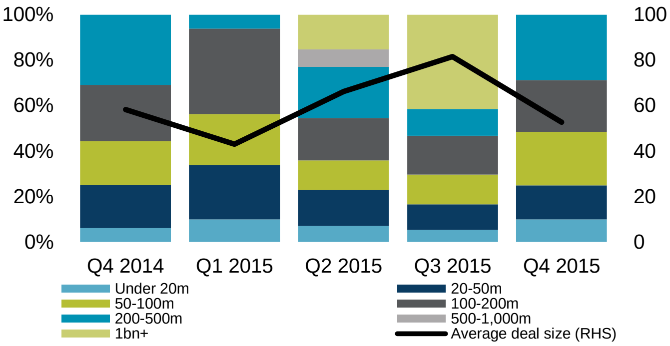
Total real estate investment purchasing activity (AUDbn)



Source: Cushman & Wakefield Research

Figure 3

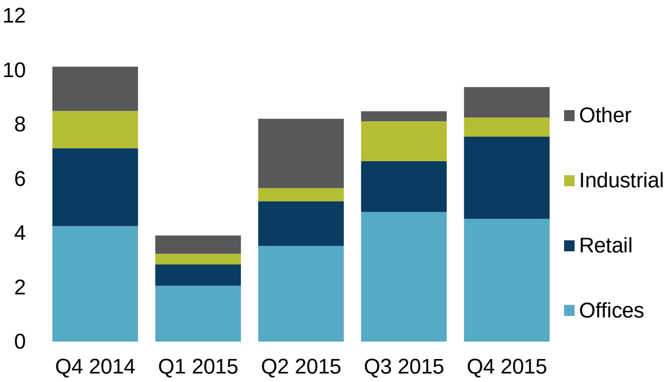
Total purchasing activity by lot size (AUDm)



Source: Cushman & Wakefield Research

Figure 4

Total purchasing activity by sector (AUDbn)



Source: Cushman & Wakefield Research

Investor Type

Sovereign Wealth Funds and Institutions most active net purchasers in 2015

On a net purchasing basis, 2015 showed a variety of often contrasting trends. Sovereign Wealth Fund GIC were selling out of Australia while at the same time CIC were heavily investing. Equally several domestic government bodies, including Urban Growth and ICWA were divesting of assets while New South Wales Government undertook the first of several resumptions to accommodate the Sydney metro line. The upshot being that Government bodies, predominantly led by SWFs due to larger transaction sizes, ended the year as the largest net purchasers (Figure 5).

Institutions, comprising pension and insurance funds, also continued their net purchasing into 2015, ending the year at almost $640m in the black. While this was down on 2014, the main difference was that activity was dominated by domestic funds in 2015, compared to offshore funds in the previous year. Over the past few years, domestic funds have increasingly demonstrated the ability to compete for high quality assets, highlighted by ISPT's purchase of World Square and Challenger Life's earlier purchase of 215 Adelaide Street in Brisbane (Table 1).

In contrast, listed vehicles returned to divesting assets after being net purchasers in 2014. However, this is skewed by two significant divestments. Lendlease sold 82.5% of International Tower 1, worth approximately $1.75bn, and Brookfield Multiplex, and its associated entities, divested over $1.1bn across five assets in 2015.

Foreign investment activity

Internationals dominate the quarter, but Singaporean investors ahead for the year

The flow of offshore capital into Australia not only continued, but intensified, in 2015. Following the $13.8bn invested by foreign entities into Australia in 2014, a further $15.4bn was invested in 2015 accounting for 40% and 51% of the total volume respectively. Throughout 2015, overseas investors accounted for at least 40% of the investment volume, peaking at $6.0bn and 70% in Q3, when CIC and Ascendas both made portfolio acquisitions (Figure 6). In Q4 2015, the respective figures were $4.0bn and 42%.

Singaporean-based investors accounted for the majority of overseas capital into Australia at $4.5bn in 2015 (Figure 7). While Chinese investors have increased their volume by 28% year-on-year to $3.7bn in 2015, this is largely as a result of the major CIC purchase. Without this purchase, volume would have been down by 60%. Last year's figures were bolstered by a string of high profile residential conversion purchases, which have been more limited this year. We expect them to have a sharper focus on commercial properties in 2016.

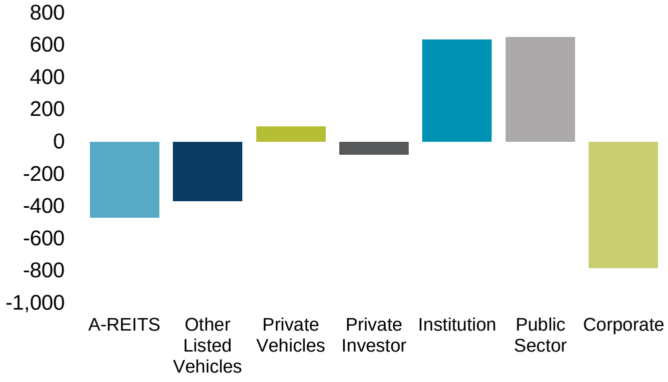
In contrast, International investors (those with a global platform) were significantly more active in 2015 than in 2014, committing $2.6bn compared to $1.3bn. Blackstone led way with seven purchases of high quality, core office and retail assets with a total deal volume of $1.6bn; the vast majority in H2 2015. LaSalle Investment Management also made multiple purchases worth a combined $556m.

Overall, foreign investors focussed on the largest and most liquid markets in 2015 – New South Wales and Victoria office markets. These are also the markets showing the strongest signs of recovery. Of the $4.9bn invested in these two office markets, 75% was directed towards CBD towers (Map 1).

Disaggregating by source of capital, reveals that Singaporean investors also strongly favoured the hotel sector and while the largest acquisitions were in Sydney, they purchased all over the country. As highlighted earlier, internationals also favoured retail assets, mainly in New South Wales and Queensland, expecting a stronger sectoral recovery going forwards.

Figure 5

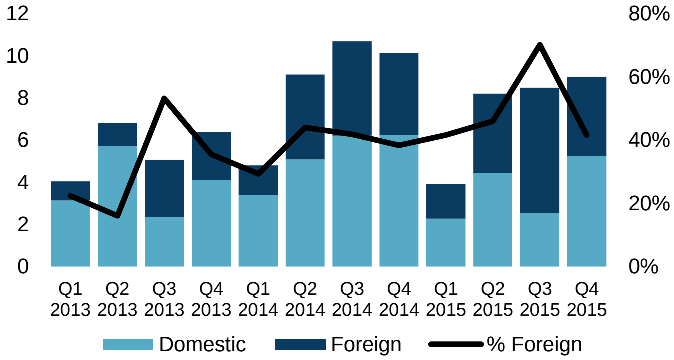
Net purchasing activity by investor type, 2015



Source: Cushman & Wakefield Research

Figure 6

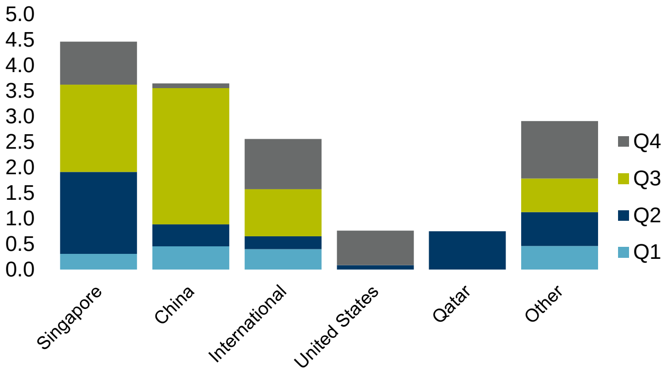
Domestic vs. foreign purchasing activity (AUDbn)



Source: Cushman & Wakefield Research

Figure 7

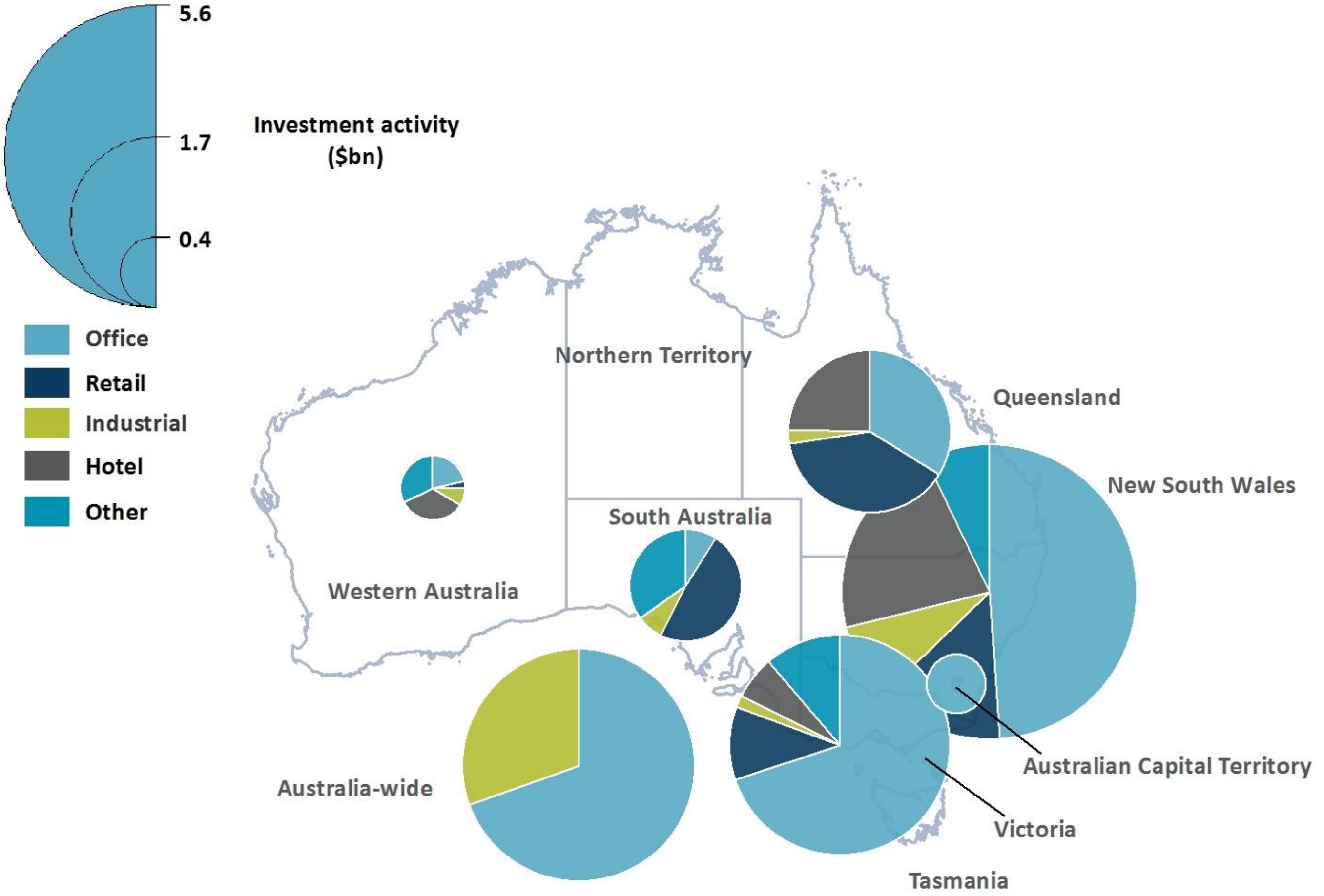
Foreign investment by source of capital, 2015 (AUDbn)



Source: Cushman and Wakefield Research

Map 1

Foreign investment by sector and state/territory, 2015



Source: Cushman and Wakefield Research

Table 1

Significant investment transactions, Q4 2015

PROPERTY	TOWN/CITY	PURCHASER	VENDOR	SECTOR	PRICE
South Cross East Tower (50%)	Melbourne	Blackstone	Brookfield PPF / Brookfield Asset Mngmt	Office	$457m
Rundle Place Mall	Adelaide	Blackstone	Pacific Development	Retail	$400m
World Square (50%)	Sydney	ISPT	Brookfield Property Partners	Retail	$280m
T&G Building	Melbourne	Pembroke Real Estate	SachsenFonds / Liberman Family	Office	$275m
The Shops at Ellenbrook	Ellenbrook	Vicinity	Insurance Commission of W.A.	Retail	$232m
Louisa Lawson Building	Greenway	FG Asset Management	Amalgamated Property Group	Office	$225m
South Cross West Tower (25%)	Melbourne	Blackstone	Brookfield PPF	Office	$218m
Dandenong Plaza	Dandenong	Armada Funds Mangmt	GPT	Retail	$197m

Source: Cushman and Wakefield Research

Investment by location

New South Wales CBD preferred

The strong and consistent story throughout the year has been the preference of both domestic and foreign investors for assets located in New South Wales. In Q4, $3.6bn was invested in the State, to bring the annual total to $11.4bn – almost 40% of the national total (Figure 8).

Excluding the CIC transaction, $4.3bn was directed towards Sydney CBD office towers, compared to $1.9bn in Melbourne and $800m in Brisbane. Not only is there a deep asset pool located in Sydney, but its economy is performing strongly on the back of a steadily improving global economic outlook. As such it is leading the national recovery in the office sector.

The somewhat surprising result for the year was in Queensland. In annualised terms, the State finished behind Victoria at $5.1bn and $6.3bn respectively. However, it outstripped its larger rival with regard to retail investment, which at $1.9bn, compared to $1.7bn in Victoria, comprised 37% of its annual volume. While this in part reflects the more limited opportunities in the Brisbane office sector, given the currently weak fundamentals, it also shows investors' long-term confidence in the State.

Outlook

Further yield compression expected, despite US Federal Reserve rate hikes

For the most part, the past year has progressed largely as forecast. Overall, volumes were lower in 2015 than in 2014, which was a significant post-GFC peak. Abundant capital from domestic and overseas sources continued to circle the market, driving heavy competition for quality assets. While this was forecast to lead to yield compression, the amount of compression seen over the year, especially in the office market, was higher than originally expected.

For the Sydney and Melbourne CBD prime office markets, yields compressed by 80-100bps over the year. In contrast compression has been much more muted in Brisbane and non-existent in Perth, reflecting the much lower volume of investment and weaker fundamentals. Finally, we expected a renewed focus on retail assets, which also came to fruition with its highest annual investment volume in the post-GFC era.

In looking to 2016, many of the market characteristics evident last year remain on show. The main difference being that the market is further through the cycle and closer to "midnight". Nevertheless, it does not appear that the investment market will significantly slow in the near term. Given the amount and quality of stock expected to be brought to market early in the year, volumes should be sustained at least over H1 2016.

Although the US Federal Reserve has started to lift interest rates, analysis by Cushman and Wakefield has shown that they have little impact on US property yields, which are more closely calibrated to GDP growth. At the national level, while there will be some upward pressure on Australian Government bond yields, indeed they showed an initial rise leading up to the December Federal Reserve decision, local interest rates are expected to be on hold for much of 2016.

Given that spreads between bond yields and property yields are still above historic trends, we do not see any immediate upwards pressure on property yields. Indeed they could head lower in some markets such as Sydney and Melbourne offices. However, there is risk of earlier decompression in the Perth office market given its weaker fundamentals. In general core assets, or those with a strong value-add play, will remain in favour.

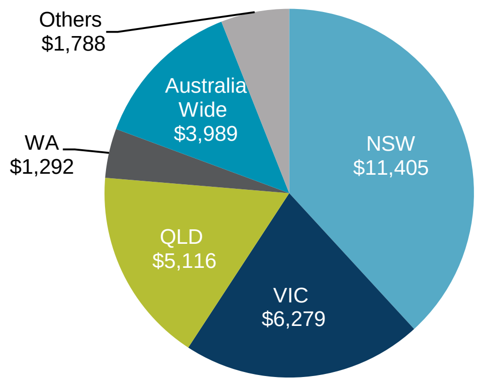
Foreign investment in the retail sector is expected to gain pace, as overseas investors diversify from the office market into other sectors. As such, domestic investors are likely to experience greater competition for assets.

A weakening Australian dollar is likely to assist the beleaguered manufacturing sector in Australia. An improvement in fundamentals could tempt more investors into this sector, though the majority of focus is expected to remain on higher quality logistics and warehousing assets situated in prime locations.

Finally, portfolio transactions across all sectors are expected to continue to command a price premium as they allow purchasers to build scale quickly. As such, significant portfolio transactions will remain hotly contested by domestic and offshore entities alike and therefore do drive further repricing.

Figure 8

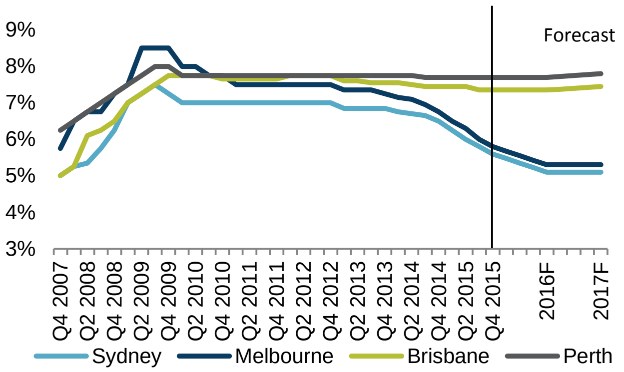
Investment activity by State/Territory (AUDm), 2015



Source: Cushman and Wakefield Research

Figure 9

Australian prime office yields



Source: Cushman & Wakefield Research

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