17/9/2017

Welcome to this weeks Property News.

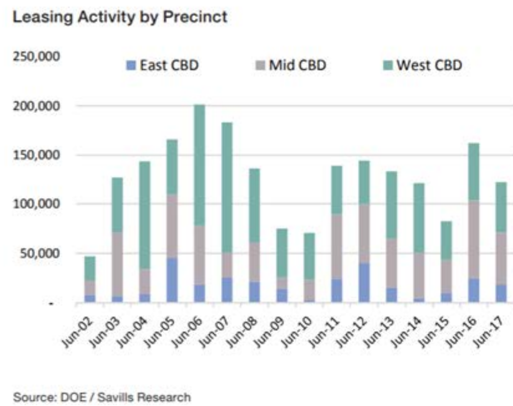
Counter Cyclical Take on Perth

The downturn in the resources sector had a significant impact on the Perth commercial market with vacancy escalating from near 0% in 2007 to 25% in 2016. Incentives and rents have only just begun to stabilise and vacancy rates are showing the first signs of recovery. For landlords holding property through this period, it has been a grin-and-bear-it few years. Some landlords don't have the luxury of time and a few assets have recently traded. Major institutions still avoid Perth due to the volitality of the market, so is the timing right for a counter cyclical move for the brave?

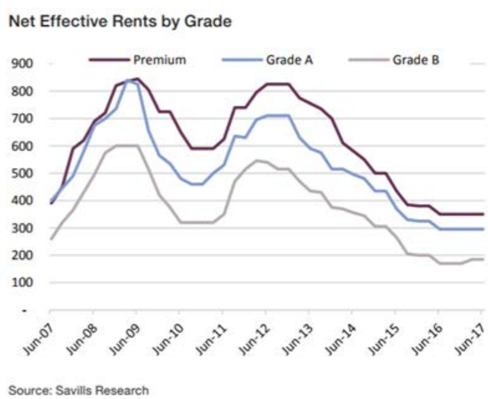
One of the most telling signs of recovery in the market is the shift from negative absorption to positive. The Perth CBD office market recorded the highest net absorption figure of all Australian CBD markets in the six months to June 2017 and this is a direct result of positive tenant demand as opposed to supply-led pre-commitments. Other CBD markets have had strong demand but also with increasing supply.

According to Savills, there is currently some 373,000 square metres of vacant space in Perth and that over the past 12 months approximately 122,034 square metres of leasing activity occurred in the Perth CBD. Although this is down on the 12 months prior, it is on par with the five year annual average of 124,241 square metres. At this rate (assuming no new supply) there are about 3 years of average leasing activity required to absorb the current vacancy.

There remains only one major office building under construction in the CBD – Capital Square. The 55,000 square metre building, will be the new headquarters for Woodside Petroleum who will relocate from 240 St Georges Terrace, leaving behind backfill space of approximately 46,000 square metres.



Another indication of the recovery of the market is the stablised level of Net Effective Rents which dropped from a peak of $800/sqm to circa $350/sqm. Incentive levels are very high at around 48% and as vacancy rates decline, incentives will drop and net effective rents will begin to rise.



Two recent sales in the market, point to the classic counter cyclical move. These sales were at Westralia Square 141 St George's Terrace acquired by GDI and 109 St George's Terrace acquired by Far East Organisation.


109 St George's Terrace


141 St George's Terrace

GDI's purchase was the last of the assets disposed of by the Western Australia Insurance Commission and was transacted at $216.25M representing $6,626/sqm of NLA. Despite a market vacancy of 20%, this asset has only 7% vacancy due to its quality offering. The passing income for the asset is high (avg $751/sqm) as the current leases were struck during the peak of the boom. GDI negotiated a price which produced a passing yield of 11.3% however with a 2.5 year WALE, the higher income won't last long. To make this investment work, GDI will need to secure new leases at or above $500/sqm and resell the building for a cap rate sharper than 7.5%. This is a classic counter cyclical move for GDI who will attract strong retail capital inflows attracted to a high initial yield. The test will be whether GDI can execute the strategy - I think there is a good chance of both, however for a total return of 8%-9% pa, I think alternative sectors are more favourable at present (ie debt deals).

The acquisition by Singapore's Far East Organisation is another example of a counter cyclical play. This assets was a disposal by Charter Hall's Prime Office Fund who sold out for $71.7M and will leave with Far East with an 80% vacant building, after Westpac moves to Brookfield Place later this year. The acquisition price represents $5,167/sqm and was acquired at an equated yield of 7.25%. Charter Hall acquired the 1970's B-grade office building almost 10 years ago for what was then described as a bargain $65 million. A solid leasing covenant such as Westpac would have appeared to be a good proposition for Charter Hall, however it does heighten the risk of a large vacancy at lease expiry. The building sits within a prime location and is likely to become a suitable redevelopment site in years to come. Until then, Far East have a big job attracting tenants back to the 13,891sqm building.

There are significant risks to these strategies and as tempting as a counter cyclical move may appear, there isn't enough of a return at present to reward the risks of a value add exposure in Perth. The bones of a good value add deal would be an asset in a good location for circa $5,200/psm with 20% vacancy (or less) and a passing yield north of 8% pa.

CMA aims to assist real estate investment managers and clients to add value to their investment decisions with relevant market based advice. We value your relationship and hope that we can be of assistance to you. If you require any strategic advice, market insights, transaction report or individual REIT assessments, please feel to contact us.

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Property Transactions

This week we recorded 11 major deals for a total value of $372M.

The largest deal this week was the confirmation of the settlement by Hong Kong based Fund Manager, Euro Properties Group of the Channel 9 Willoughby studios site for $147M. Read more about the DA issues for the site along with details of 10 other major deals.

24 Artamon Rd, Willoughby

Continue reading....

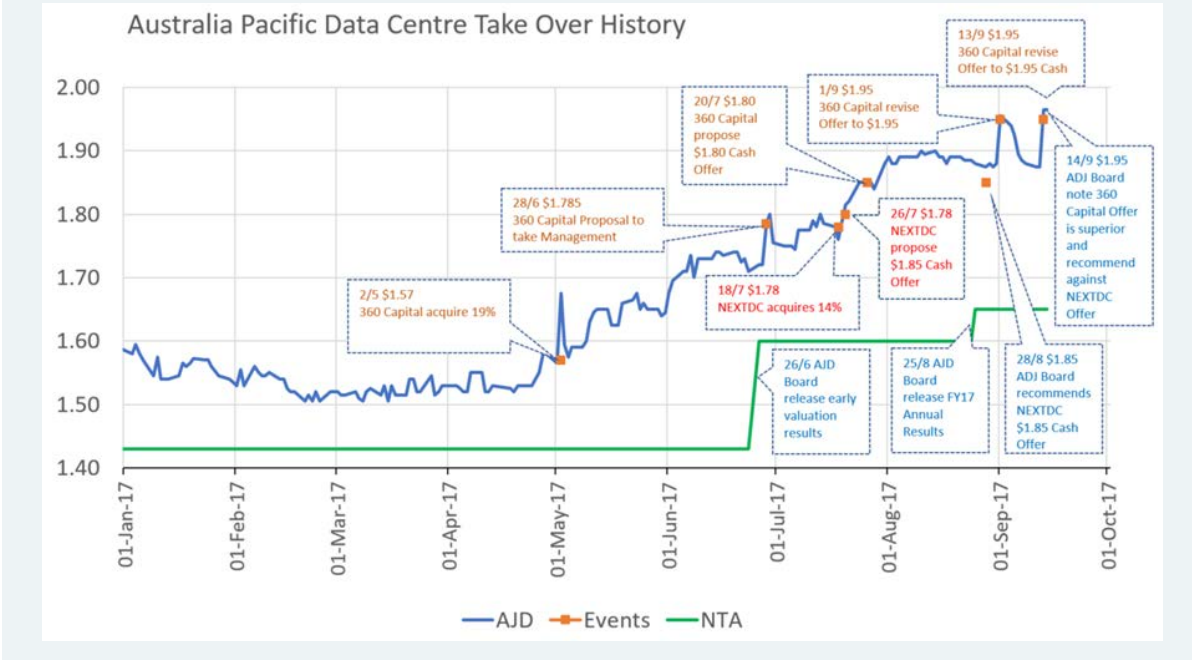
Support finally for 360 Capital Offer

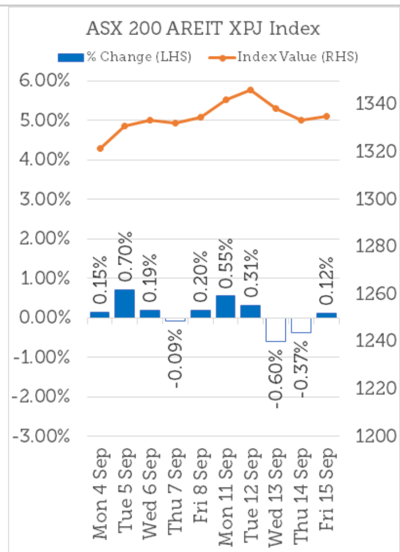
The war for control of the Australia Pacific Data Centres trust continued last week with 360 Capital amending the terms of its recent offer to obtain the support of the AJD Board. The Board had previously scuttled 360's earlier offer of $1.30 in cash up front and another 65¢ through a capital distribution from the AJD trust (to be funded from higher borrowings in the trust). The AJD Board said that the earlier offer was too conditional and so 360 Capital have this week converted the offer to a full cash proposal of $1.95 cpu.

The AJD Board have now indicated that it favours the 360 Capital proposal ahead of the rival $1.87-a-share offer from NextDC, which had previously been endorsed by the board. Meanwhile, NextDC have continued to buy up the stock and now hold 29% of the units, while 360 Capital hold 19.9%. NextDC have capacity and the desire to better the 360 bid or just continue to acquire units to block the 360 move, so it will be interesting to see how this continues to play out.

Morgan Stanley stepped in this week to acquire a 5% interest in the REIT. We suspect Morgan Stanley are aligned with 360 Capital now that the proposal has the support of the Board.

The chart below shows the progress of the take over and the relative share price movement. The unit price for the fund has now increased 24% since 360 Capital's acquisition in early May 2017.





Fund News

The ASX 200 AREIT index had a flat week with mixed results. Strong gains were made by Lend Lease (up 5.6%), Goodman (up 2.3%) and Abacus (up 2.2%) but these were offset by poor results from Westfield (down -1.5%), Dexus (down -0.8%), Mirvac (down -0.9%) and Stockland (down -0.7%).

More Gloom for Retail Sector

The news this week that Myer's profit was down 80% was not surprising given the anecdotal feedback from consumers dismayed by the lack of customer service at it's stores. Myer blames their results on an excessive focus on concession sites within their stores with average sales growth of just 0.1 per cent for the year. Their result was somewhat better when compared to David Jones' 0.7 per cent decline. Overall, the gradual decline in traditional retailing is evident and store closures are inevitable. In 2017, Myer closed 3 stores (Wollongong, Brookside and Orange) and this week announced a further 3 to close (Adelaide, Belconnen and Hornsby).

Blackstone Takes Control of Astro Japan

Astro Japan Property Trust unit holders have voted overwhelmingly to sell the trust and its $1.1 billion portfolio of Japanese retail, office and residential properties to US private equity giant Blackstone for $430 million. The sale price was a 2.4 per cent premium to their most recent valuations and a 13 per cent premium to their August trading price. (read more)

Other News

- Mirvac received an upgraded credit rating last week from Moody's recognising the groups strategic direction and capital management approach. The rating lifted from Baa1 to A3. (read more)
- Lend Lease presented an update of their business at the CLSA Investor Forum in Hong Kong (read more)

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