

# Benchmarking Building Returns in Perth

IPD Australia and New Zealand  
Friday 29 October 2010

On the pulse of  
the property world



# Outline



- 1 IPD Index Overview
- 2 Macroeconomy
- 3 Property markets
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- ① IPD Index Overview
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## A. Investment level

- returns – total returns & discount rates
- pricing – cap rates
- risk – volatility

## B. Asset level

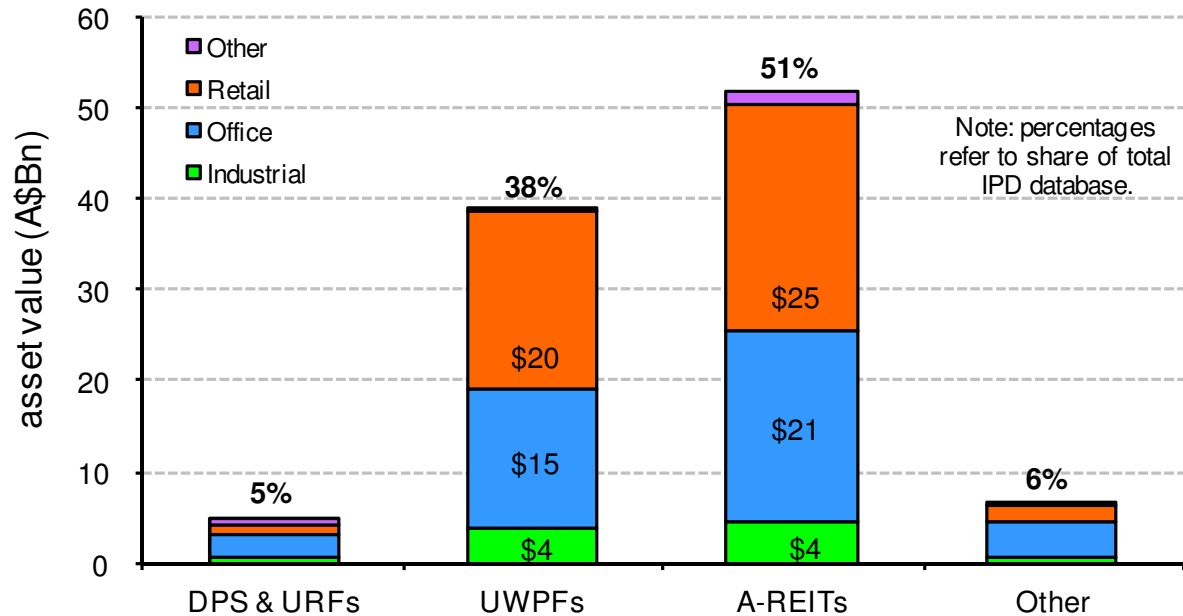
- income - rentals
- asset value – capital value
- excess space – vacancy rate
- expenditure – opex & capex

Metrics form part  
of PCA/IPD Index  
data base.

# IPD property database - exposure concentrated in UWPF and REIT property structures



**Size of IPD database by property segment**  
estimated at A\$101bn as at June 2010



Note: "Other" denotes other corporations and government.

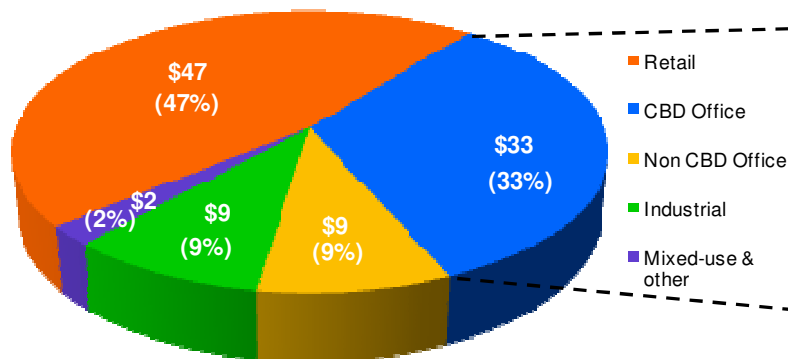
Source: IPD Research.

- The IPD database has a market coverage of about c45%.
- The greatest coverage is in unlisted wholesale property funds (UWPF) and A-REITs.
- Office property is distributed across each vehicle structure.

# Composition of Index - by property sector and CBD office market

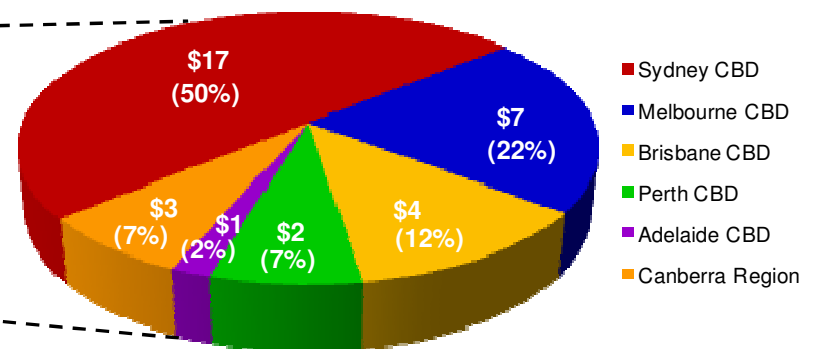


**Database composition by property sector**  
A\$101.4Bn as at June 2010



Source: IPD Research.

**CBD office property market by value**  
A\$33.4Bn as at June 2010



Source: IPD Research.

- Australian CBD office markets represent 32% or A\$33 Billion of the PCA/IPD index.
- Largest CBD markets by value are Sydney CBD (A\$17 Billion) & Melbourne CBD (A\$7Billion).

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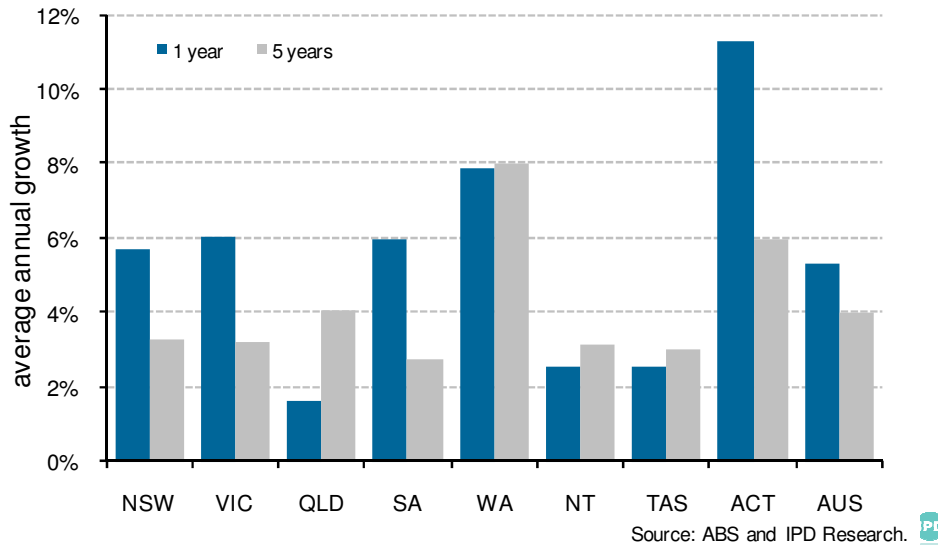


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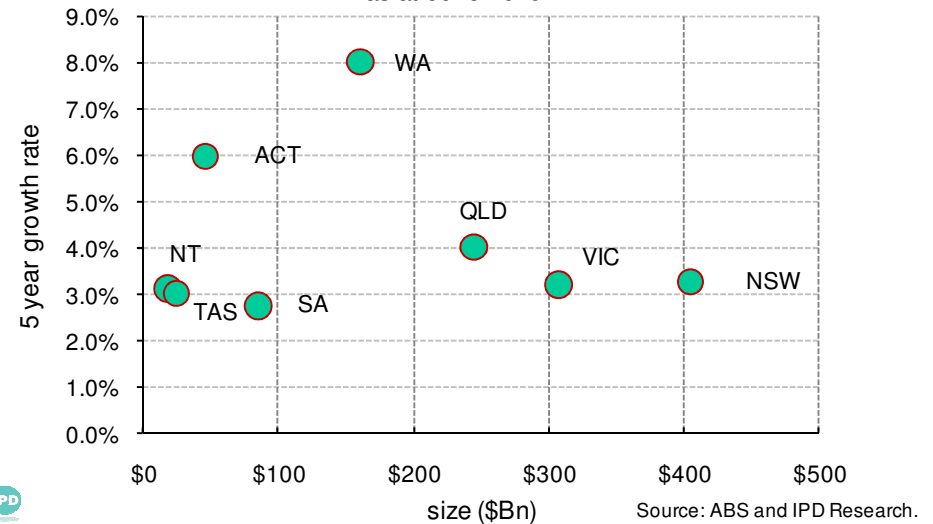
# Economic growth versus size - smaller states generally growing faster



State final demand across states



State final demand: growth versus size  
as at June 2010

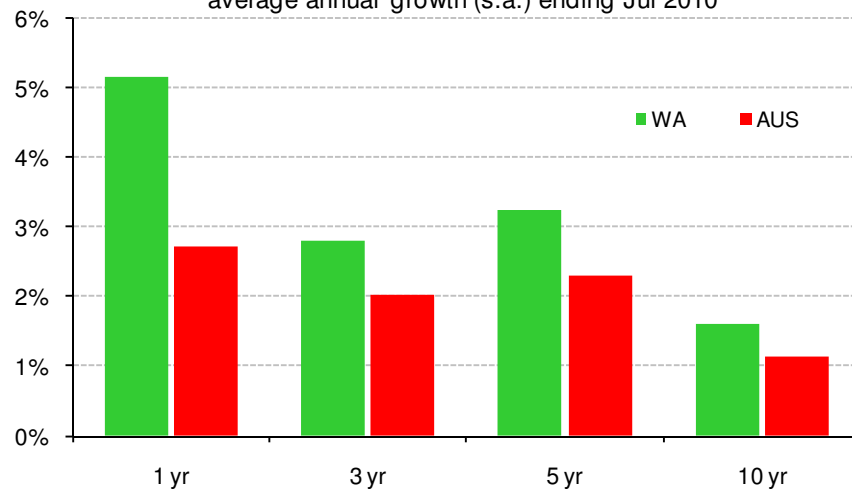


- WA outperformed each state/territory over the last five years and continues to outperform the national average
- WA like many of the smaller states is experiencing above the national annual growth rate.

# Employment growth - WA has displayed a relatively stronger labour market against AUS

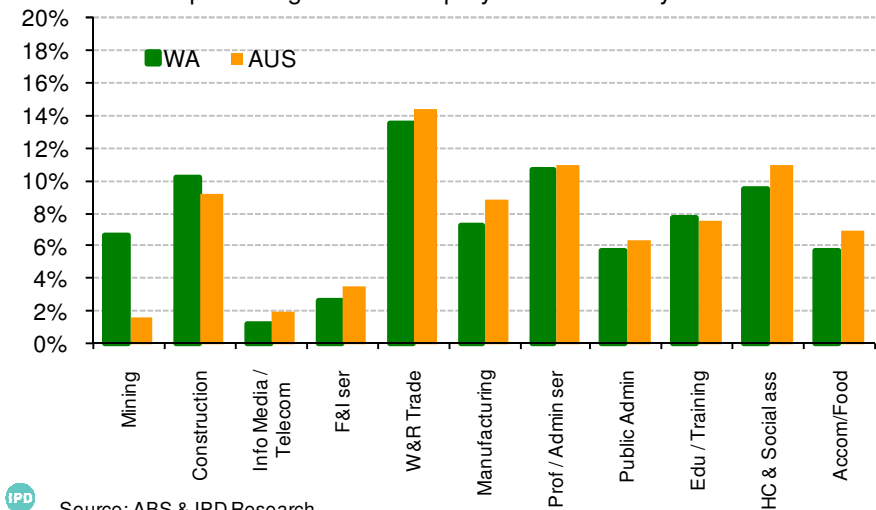


**Employment growth: WA versus AUS**  
average annual growth (s.a.) ending Jul 2010



Source: ABS & IPD Research.

**Employment by selected industries**  
percentage of total employment as at May 2010



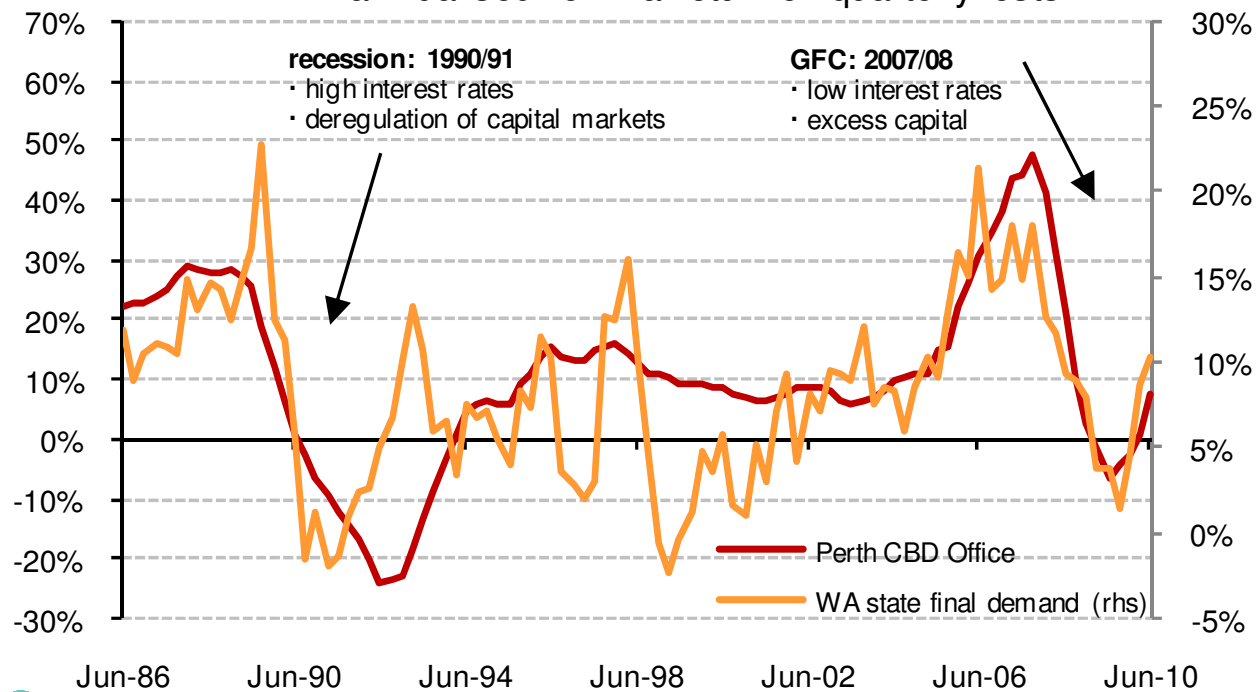
Source: ABS & IPD Research.

- **WA's strong employment profile linked to its high exposure to the mining/resource and construction industries.**
- **40% of Perth CBD office space linked to mining/resource sector**
- **Strong employment growth should translate to**

# Link between WA economy and CBD office property market



**Perth CBD office and the WA economy**  
annualised nominal return on quarterly rests



Note: property returns based on PCA/IPD Index.

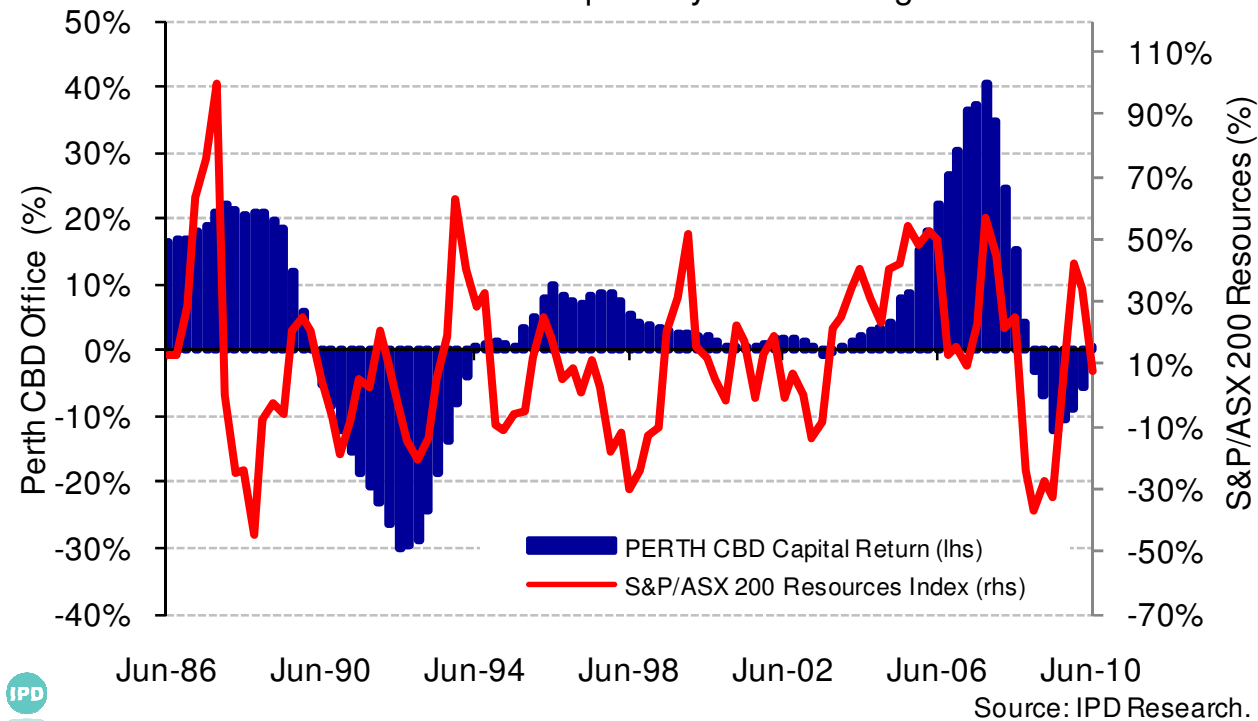
Source: ABS & IPD Research.

- Strong positive correlation between macroeconomic activity and Perth CBD office market returns.

# Resource prices & performance - not a strong relationship



**Perth office v S&P/ASX 200 resources index**  
annual observations on quarterly rests ending Jun 2010



- Price movements in resources shares don't directly translate in Perth CBD office performance.

# Outline

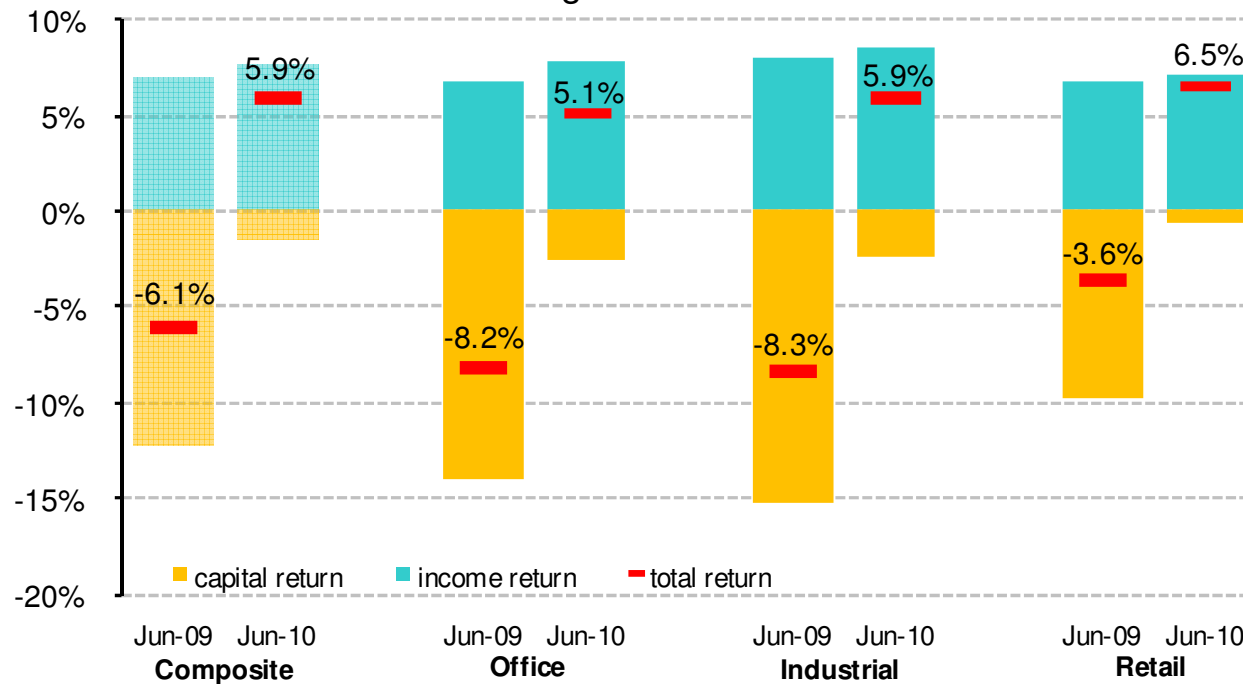


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# Property returns across sectors - retail sector leads but office & industrial display greatest improvement



**Performance across core property sectors**  
historical average nominal annual return



Note: direct property returns based on PCA/IPD Index.

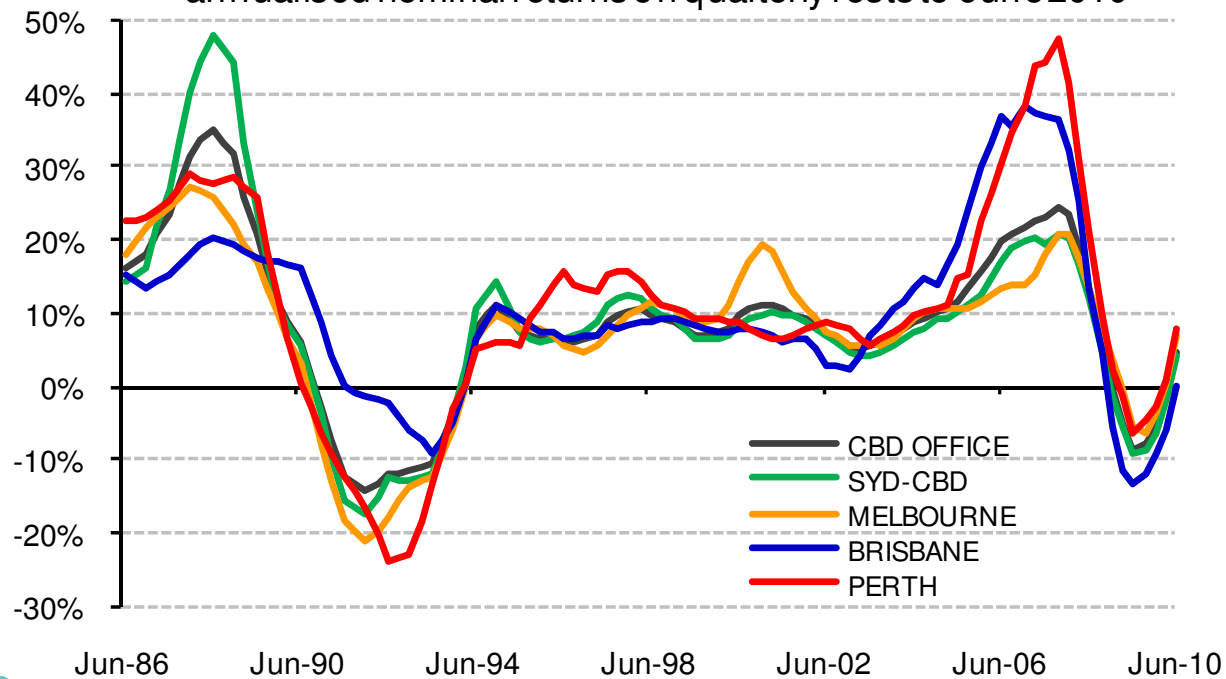
Source: IPD Research.

- The Australian retail sector has outperformed in 2009 and 2010.
- The Australian office and industrial sectors however have shown the largest turnaround in returns.

# CBD office investment cycle - two pronounced swings



**Direct property total returns for CBD office**  
annualised nominal returns on quarterly rests to June 2010



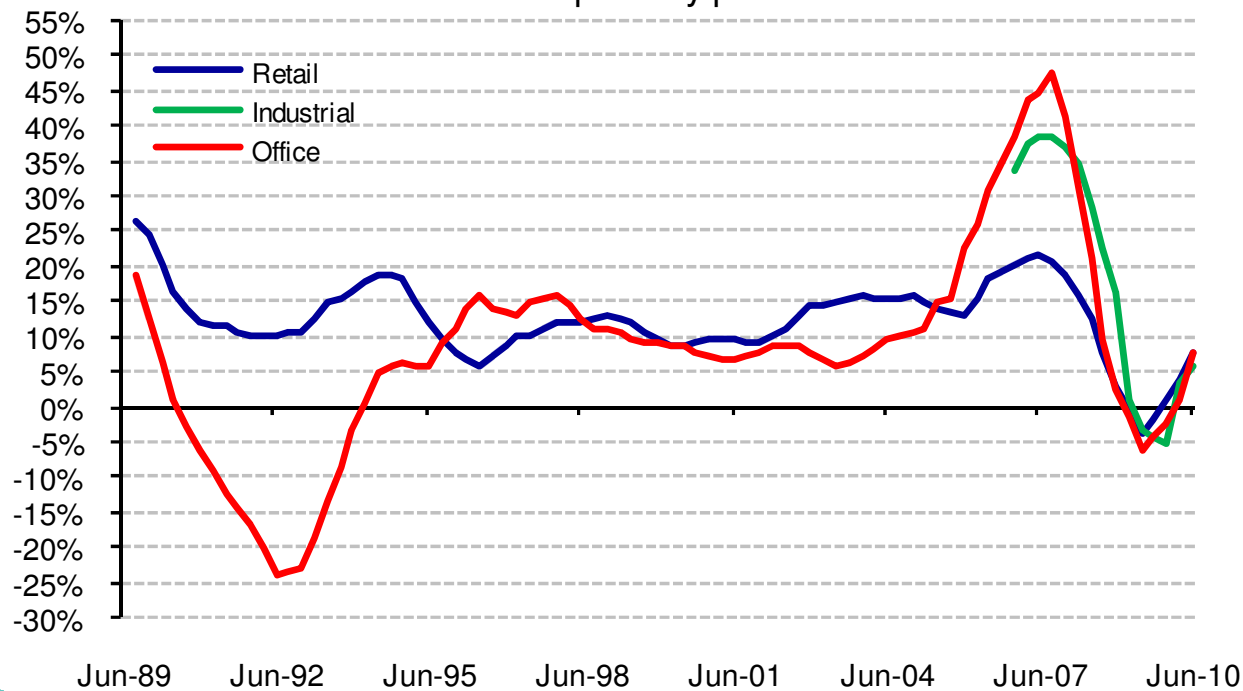
Source: IPD Research.

- CBD office returns have converged in the past two years.
- Perth CBD outperformed in upswing and outperformed in downturn – the exact opposite to the last cycle.
- Perth CBD has outperformed all other markets over rolling 3, 5, 10, 15 and 25 years

# WA property sector cycle - changing cycle patterns across sectors



**WA property sector total return**  
annualised return on quarterly periods to June 2010



Note: direct property returns based on PCA/IPD Index.

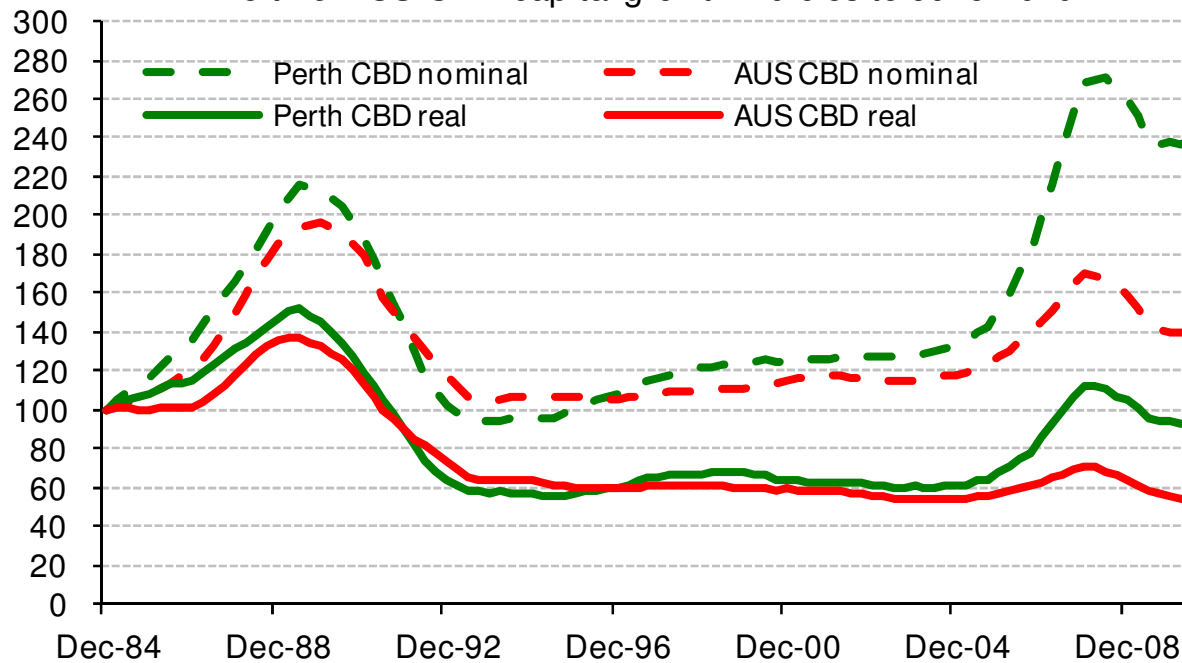
Source: IPD Research.

- In WA, the returns of the three core sectors have converged.
- WA retail property has experienced synchronised downturn with office sector unlike the last cycle.

# CBD office capital growth cycle - Australia versus Perth



**Real versus nominal capital growth**  
Perth & AUS CBD capital growth indices to June 2010



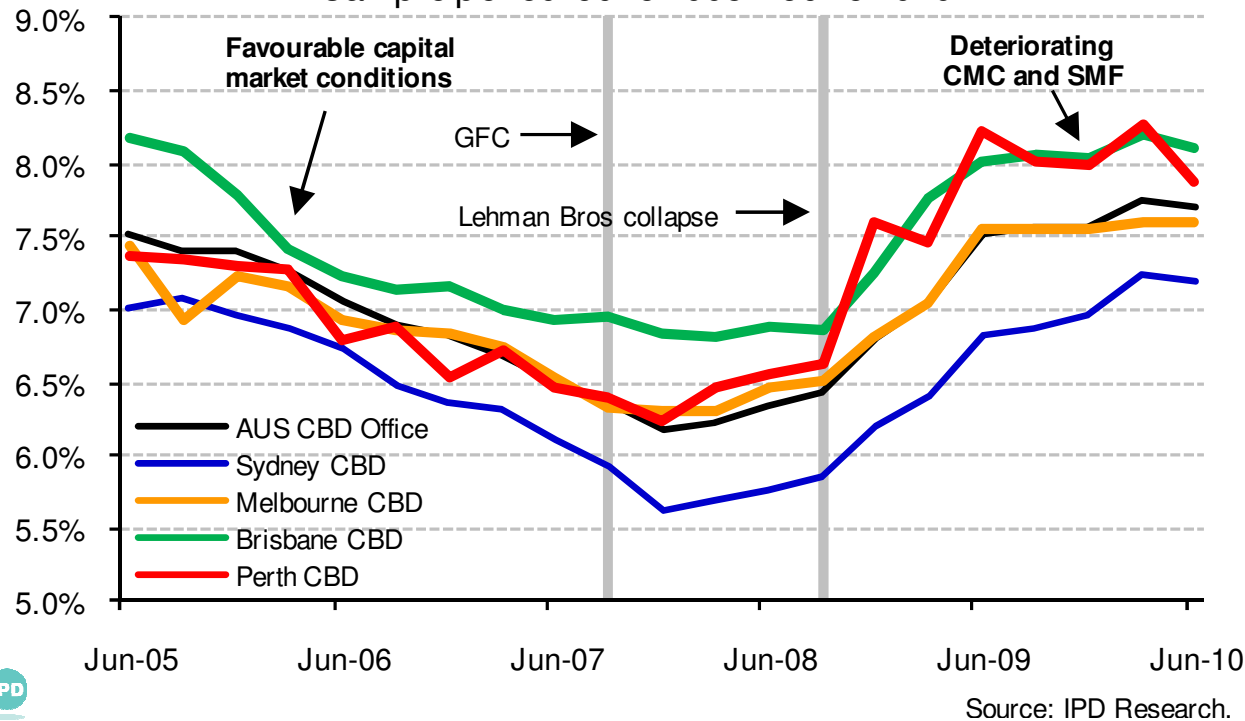
Source: IPD Research.

- It appears both the Australian and Perth CBD markets experienced a pronounced upswing in this cycle.
- Adjusting for inflation (i.e. real returns) this cycle did not exceed the previous cycle peak.

# Movements in CBD office cap rates - nearing peak of softening cycle



**AUS weighted CBD Office cap rates**  
sample period: June 2005 - June 2010

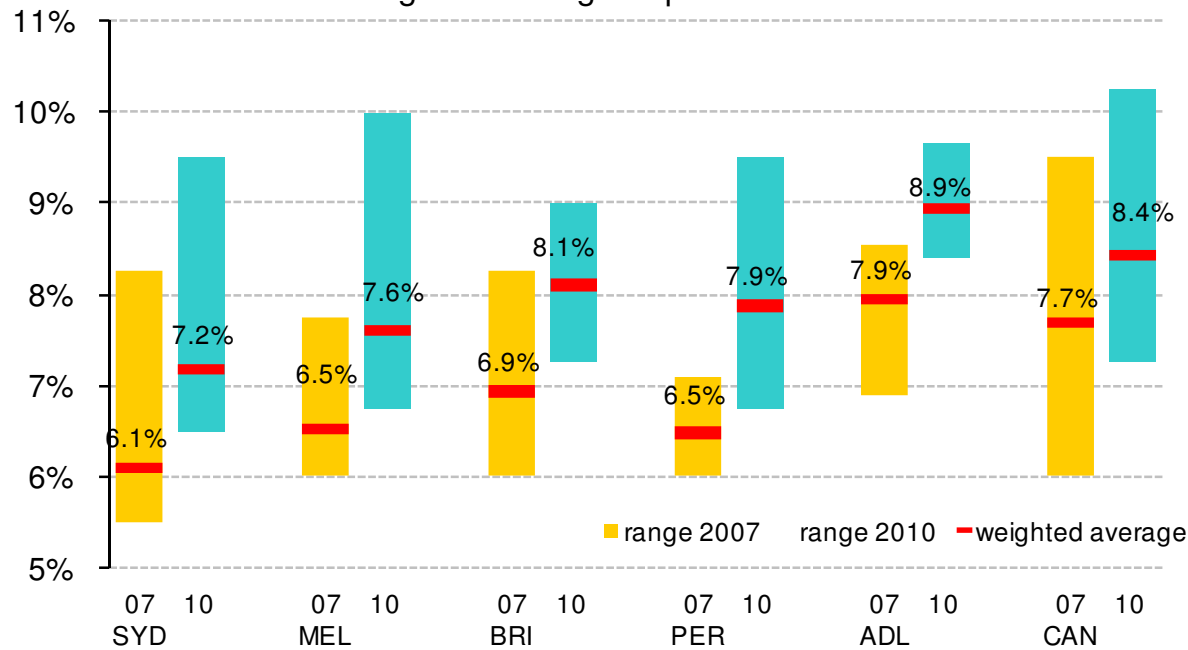


- Perth CBD cap rates have responded quicker compared to other CBD markets.

# Spread in CBD office cap rates - a dynamic assessment over the last two years



**Spread in cap rates across CBD office markets**  
weighted average cap rates as at June



Note: direct property returns based on PCA/IPD Index.

Source: IPD Research.

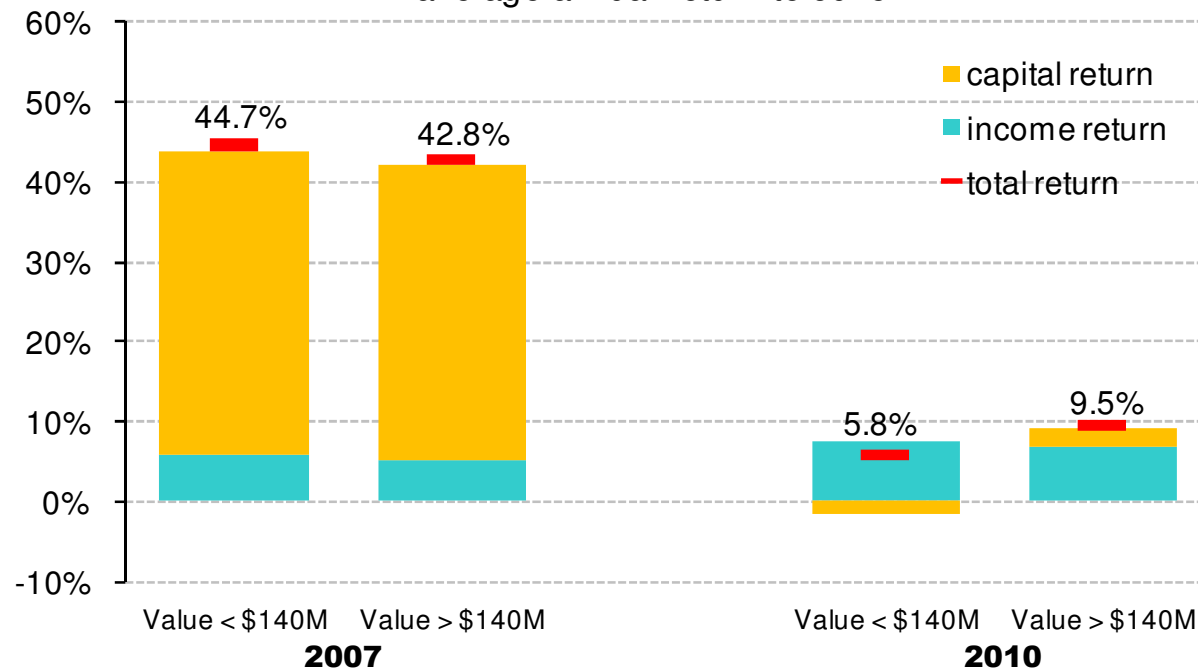
- Spread in cap rates across all markets is now wider than 2007 – a signal that the prime vs secondary pricing differential is returning to the market
- At the peak of the market there was a tight band in Perth CBD cap rates.
- The spread of Perth cap rates is now wider and more in line with other CBD markets

# Return performance segmented by asset size and quality

## - a flight to quality



**Perth CBD assets segmented by value**  
average annual return to June



Note: direct property returns based on PCA/IPD Index.

Source: IPD Research.

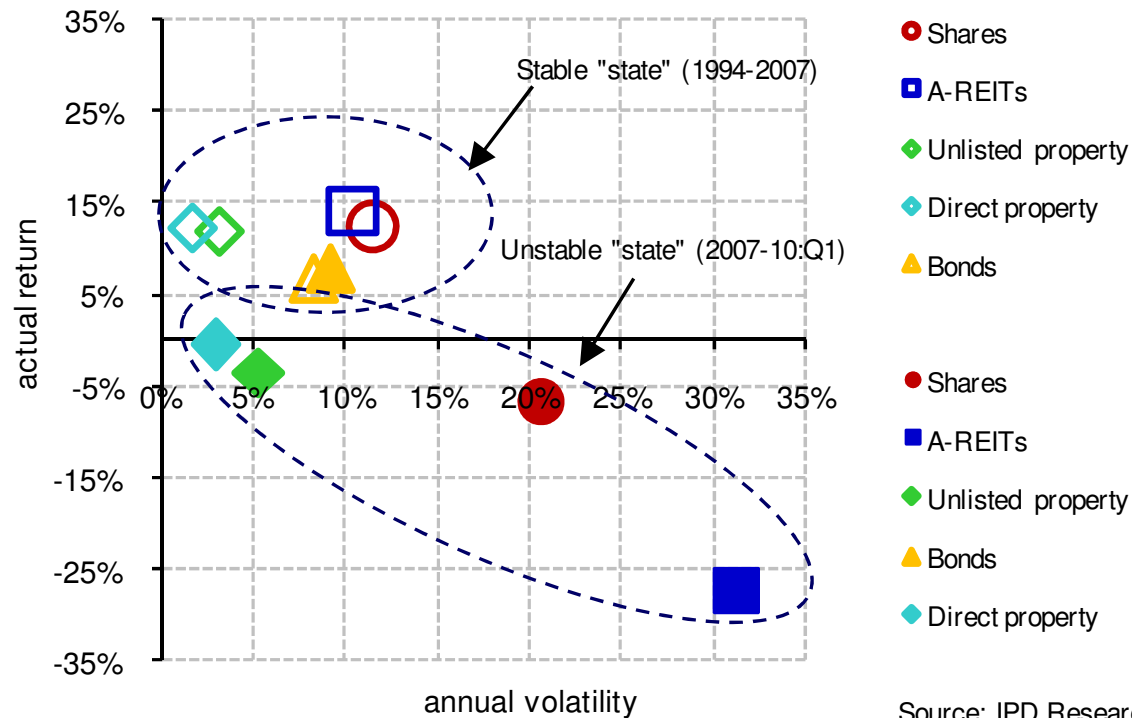
- At the peak of the market smaller assets slightly outperformed larger (prime) assets in line with a convergence of prime and secondary pricing – the classic mis-pricing of risk in a boom cycle.
- In the past year, larger assets have outperformed – a flight to quality assets!

# Asset class dynamics

- current market dynamics highlight that markets are in transition phase



**Risk-reward trade-off for various investments**  
annualised observations



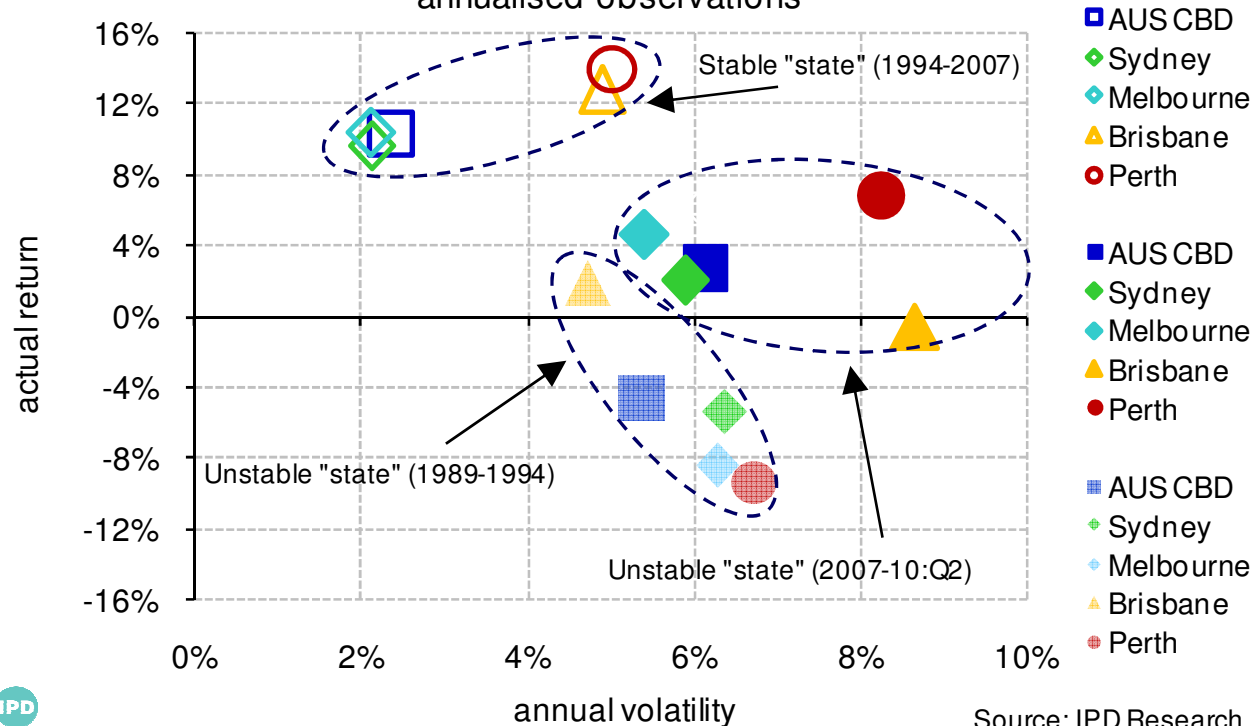
- There was a wide dislocation in asset class performance during the GFC.

# CBD office market dynamics

## - risk-reward trade-off has changed



**Risk-reward trade-off for CBD office markets**  
annualised observations

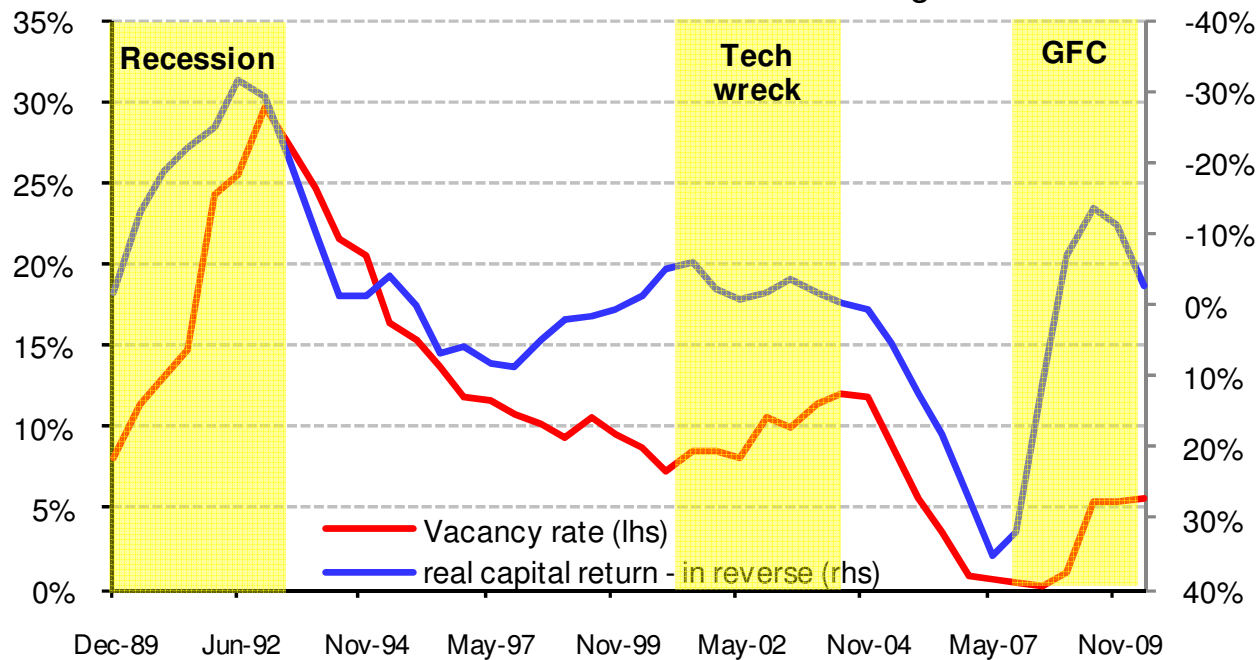


- Between 1989-1994 Perth's performance similar to Sydney and Melbourne.
- Between 1994-2007 Perth's performance similar to Brisbane.
- Between 2007-2010 Perth performed differently to Sydney, Melbourne and Brisbane.

# Space markets and performance - closely tied



**Perth CBD vacancy v real capital return**  
annualised values on bi-annual rests ending June 2010



Note: return series is inversed. So, when the series rises, returns are falling and vice-versa.

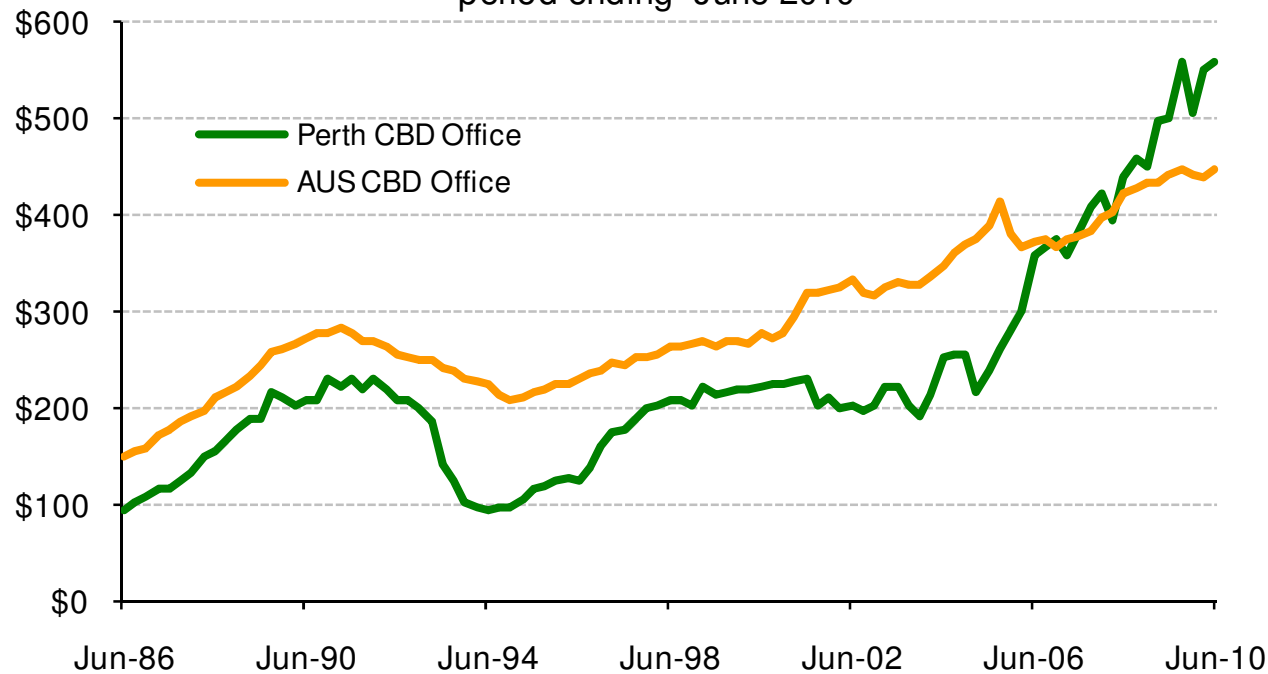
Source: PCA (OMR) and IPD Research.

- Performance in space markets is reflected in investment performance.
- Will be interesting to see whether as more supply hits the Perth CBD market and vacancy rate remains high – will the growth in positive capital returns moderate or will the next few years buck the historical trend

# Perth CBD office income growth - positive growth in rental income revenue



**Trends in net income for AUS and Perth CBD**  
period ending June 2010



Note: net income expressed as \$/sqm.

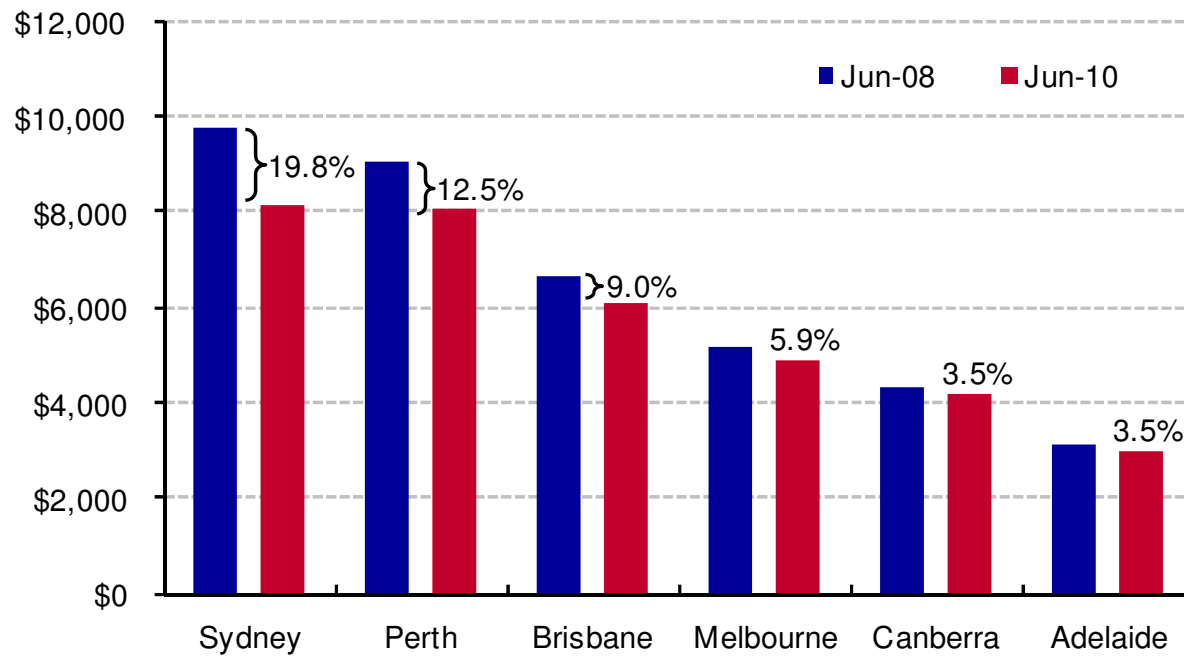
Source: IPD Research.

- Perth CBD's net income per sq.m. has been below that of national average
- Since late 2008, Perth CBD is now higher than the national average

# Comparative market prices - Perth commercial & residential expensive?



**Capital value per sqm for CBD office markets**  
value as at June 2008 & June 2010



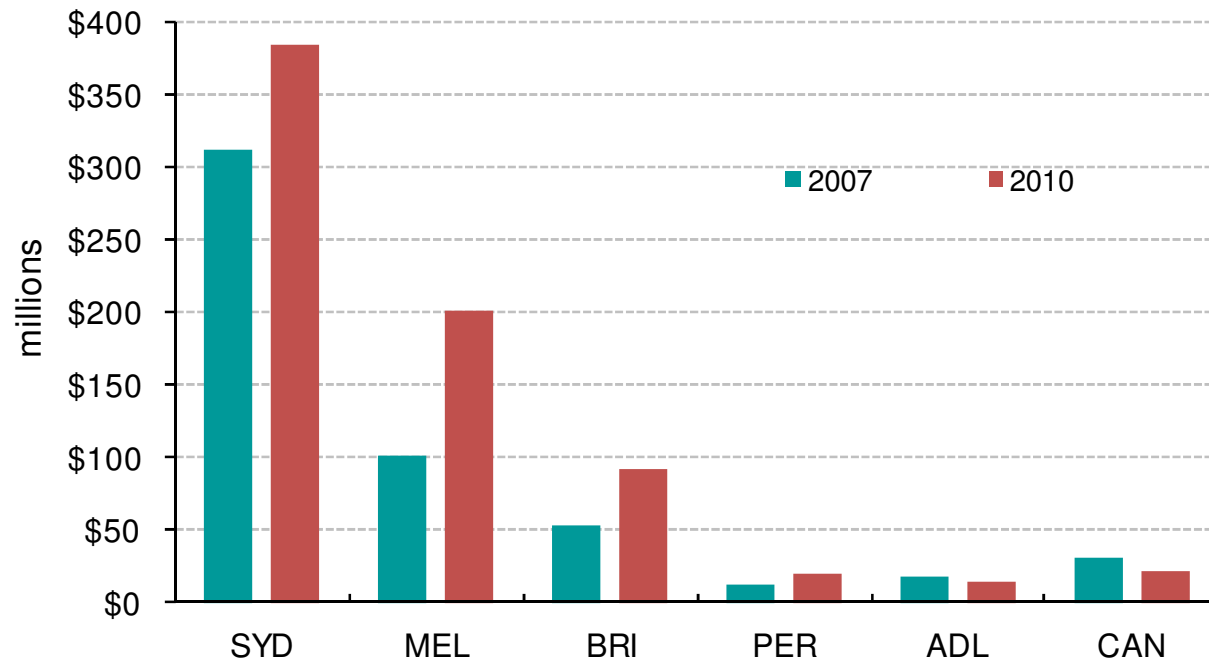
Source: IPD Research.

- Perth CBD market is the second most expensive market on \$ per square metre.

# Cap-ex across CBD office markets - increasing across most markets



**Capital expenditure for CBD markets**  
annual development & non-development capex to June



Source: IPD Research.

- Across all major CBD office markets except for Adelaide and Canberra, cap-ex is now higher than at the peak of the market.
- Perth CBD only spent 0.2% of total market value compared to 2.2% and 2.7% in Sydney CBD and Melbourne CBD respectively in 2009/2010 – a function of the older stock in the Sydney and Melbourne markets.

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# Summary remarks



- WA economy is robust and should continue to outperform the national economy
- The Perth CBD office market:
  - is maturing due to its increase size and depth
  - has different space market drivers and therefore a distinctive investment profile
  - is expected to display outperformance against the national CBD office market over the short-medium term
  - will therefore be a good diversifier in a CBD office portfolio.

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