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News release

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Sydney and Melbourne office rents and values to double

Recovery from GFC and leasing conditions driving upswing

Strong returns are forecast for Sydney and Melbourne CBD office investments as the markets stage a recovery from the GFC and go on to strengthen further, according to leading industry analyst and economic forecaster, BIS Shrapnel.

BIS Shrapnel's latest commercial property reports, *Sydney Commercial Property Prospects, 2010 – 2020* and *Melbourne Commercial Property Prospects, 2010 – 2020*, lay out a positive scenario for both markets over the next five to seven years.

There are two key factors at play according to Maria Lee, BIS Shrapnel Senior Project Manager and author of the Melbourne report.

"Firstly, both markets overreacted to the GFC-induced economic downturn," says Lee. "The overreaction occurred in both the leasing and investment markets and making up this lost ground alone will result in solid gains in rents and prices. On top of that, the fundamental demand/supply balance is improving in both markets, which will lead to lower vacancy rates and further gains in rents and values."

Lee Walker, BIS Shrapnel Project Manager and author of the Sydney report, points out that prime leasing incentives in Sydney were quickly ramped up to an average 2.8 years' rent-free equivalent as landlords panicked in the wake of the GFC.

"Prime gross effective rents fell by almost one-quarter during the GFC," says Walker. "Incentives are well above levels normally representative of a market with an eight per cent vacancy rate."

In Melbourne the story is similar, though somewhat more complicated.

"In the Melbourne market, the initial panic occurred from 2001 to 2004, when landlords feared substantial oversupply due to the quantum of floorspace under construction at the time," says Lee.

"Net effective rents slumped by 30 per cent, and as vacancy rates subsequently tightened to 3.3 per cent, rents didn't even manage to regain 2001 levels in real terms before the GFC-induced economic downturn caused rents to fall again – this time by 12 per cent. Hence, Melbourne's rents have taken two hits."

Investment markets have also overreacted in both Sydney and Melbourne, with prime grade investment yields blowing out by 160 and 155 basis points respectively. Whereas in industrial and retail markets, investment yields firmed too far before the GFC, this was not the case in the office sector. BIS Shrapnel says the scene is now set for yields to firm.

Evidence already points to the Sydney and Melbourne office markets stabilising. While vacancy rates in Sydney may not peak until later this year, leasing incentives in both markets appear to be on their way down and yields have plateaued.

But the recovery from the GFC is only half the story, says BIS Shrapnel. The other key factor propelling rents and values higher over the medium-term will be stronger leasing conditions and buoyant investment markets as vacancy rates fall.

“The recovering economy provides part of the explanation, but the major contributing factor is a lack of new supply once the last remaining projects, which were commenced pre-GFC, are completed,” says Lee.

“The silver lining of the credit crisis is that it caused an abrupt slump in building commencements. With property values now below replacement cost, financial feasibilities for development don’t work. Add to that the cost and difficulty of obtaining finance, and we are unlikely to see substantial development for some years to come.”

Meanwhile, BIS Shrapnel states that falling vacancy rates will see the balance of power in leasing markets swing back to landlords, who will be able to cut back leasing incentives. Effective rents are forecast to more or less double to a peak in 2015 in Melbourne and 2017 in Sydney.

Walker says that rapidly rising rents through the middle of the decade will re-ignite investors’ expectations of capital gain and drive yields back down to, or below, 2007 levels.

“The combination of rising rents and firming yields will lead to a more than doubling in capital values,” concludes Lee.

About BIS Shrapnel

BIS Shrapnel is Australia's leading provider of industry research, analysis and forecasting services. BIS Shrapnel helps clients better understand the markets in which they operate, through reliable and detailed market data, analysis of developments and drivers and thoroughly researched forecasts.

BIS Shrapnel compiles accurate, clearly explained and detailed information on industry sectors, markets and industries in which their clients operate. BIS Shrapnel provides market size and segmentation data, market shares, consumer attitudes and supplier reputation information, and regularly conducts both business-to-business and consumer research.

Over the company's 46-year history, BIS Shrapnel has built up a strong level of expertise and unique methodologies for forecasting. The company has been forecasting office markets since 1988 and publishes reports on the major capital city CBD office markets as well as Sydney and Melbourne suburban markets. Industrial and retail property market reports are also produced on an annual basis.

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