

Australian Property Markets News & Views

A review of last weeks property transactions and AREIT activities.

22nd September 2017

Record Price in North Sydney
No MIT for Build to Rent Sector

25/9/2017

Welcome to this weeks Property News.

This week we review a record price paid for a commercial building in North Sydney, changes to the MIT arrangements for the build to rent proposals and the implications for investment in the face of rising interest rates. We also cover off on the weeks key property transactions and REIT news.

Investing in the face of Rising Interest Rates

This week the RBA governor Philip Lowe presented another upbeat review of the Australian economy and warned investors to consider the impacts of rising interest rates. Low said that a key risk was that many investors who took on too much risk in the hunt for yield are left exposed if global rates rise faster than expected in response to a sudden increase in inflation. Philip Low recommended watching surprise increases in inflation which could create a difficult adjustment in financial markets if interest rates are raised in response.

With bond yields pointing to 60bps rise over a 5 year period, an increase in interest rates is inevitable. Economists are factoring in the first tightening of rates in 2018. In anticipation of higher interest rates, many REITs and investment managers are continuing to reduce the amount of debt they hold or are seeking opportunities to replace existing debt with new facilities with longer tenures and lower costs.

The consequences of increased interest rates is not just to higher borrowing costs but also the prospect of a softening of investment yields and a potential decline in values as the

market adjusts to the typical 2.0% - 3.0% spread to bond yields. Any adjustment in yields may take time to be evident and may be cushioned by the weight of capital seeking investments in Australia and the strength and breadth of the economic growth.

To fully offset a decline in value from a 50bps cap rate softening to 7.0%, rents would need to increase by 7.7%. The required rental adjustments to offset a potential decline in value from a 50bps softening are shown in the table below and as you would expect increase for the sharper cap rates.

50Bps Cap Rate Move	Value Decline	Required Rent Rise
8.0% to 8.5%	-5.9%	6.3%
7.5% to 8.0%	-6.3%	6.7%
7.0% to 7.5%	-6.7%	7.1%
6.5% to 7.0%	-7.1%	7.7%
6.0% to 6.5%	-7.7%	8.3%

So with the prospect of interest rates moving 50-60bps higher over the next 5 years (as the bond yield curve suggests), investors seeking to cushion themselves from the prospect of softer cap rates should move to markets & investments with the highest prospects of rental growth. These are markets with low or declining vacancy, declining incentives, constraints to supply and benefits from new infrastructure.

Sydney & Melbourne office markets have already had a significant period of rental growth with more to come in 2017/18. Parramatta will also see strong rental growth with vacancy rates currently at 4.8% and incentives at only 15%.

Rental growth in industrial markets is typically very low, however capacity constraints along with improved infrastructure and a new airport precinct in Sydney's west, the prospect of rental growth in the western precincts is good. Inner suburbs of Sydney & Melbourne may also provide compelling opportunities where supply is heavily constrained.

Retail markets are unlikely to experience significant rental growth even if economic activity improves. Competition from new on line entrants will continue to impact retailers' ability to pay higher rents.

For higher return & value add investors selecting sites for development or refurbishment in to these hotter markets should be considered in preference to other areas.

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 10 major deals for a total value of \$518M.

The largest deal was the sale of 1 Pacific Highway North Sydney for \$114M. The sale by AMP Capital to an unnamed Asian investor represents a rate per meter of \$14,983/sqm which is the highest rate for a property in North Sydney.

Also this week CBUS announced the acquisition of the Mercure Melbourne Treasury Gardens Hotel in Spring Street for \$70M.



1 Pacific Highway, North Sydney

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Property Transaction Database

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Federal Government Change MIT Rules

The proposal to develop a new Build to Rent sector in Australia which is being pursued by Mirvac and others hit a snag this week with the announcement that the MIT rules will exclude investments in residential housing (other than affordable housing) ([see announcement](#)). This change provides legislative clarification of the long-standing

convention that the primary purpose of the MIT concessional tax treatment is to apply to passive investment income. A Build to Rent investment is considered to be both for capital gain (ie development profit, albeit deferred) and for rental income and therefore doesn't qualify.

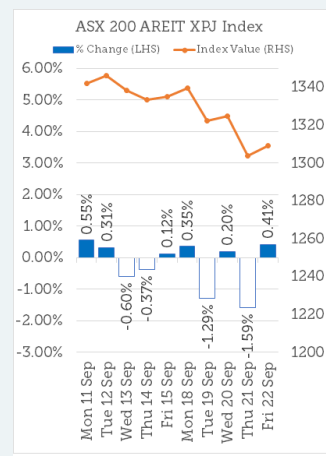
The MIT status can still be used for an Affordable Housing Scheme which by definition requires substantial discounts to market to qualify and must be run for a not for profit Community Housing Provider. Unfortunately, investment returns for Affordable Housing are unlikely to generate substantial interest from offshore capital markets to take full advantage of the MIT arrangements.

The consequences of this are that the Build to Rent projects will likely be taxed at higher rates and only attractive to domestic investors who may be able to utilise franking credits.

Fund News

The ASX 200 AREIT index was down 1.9% with all major REITS down as most stocks go Ex Dividend. Scentre (down 2.7%), Goodman (down 3.5%) Westfield (down 2.3%) and GPT down (3.2%).

Gains were made by Lend Lease (up 1.2%) and Dexus (up 1.0%).



Focus on Debt Re-Financing

Mirvac, Goodman and GPT undertook a round of debt re-financing deals this week sourcing cheaper capital from the US to replace existing facilities.

Mirvac announced a US\$400M Notes Issue with a term of 9.5 years at a fixed coupon of 3.63%. As at June 17 Mirvac's average debt maturity was 6.2 yrs and its average cost of debt was 4.8%. This latest issuance will further improve these metrics and Mirvac will use the proceeds to retire existing debt facilities including \$200M of bonds expiry in FY18.

Goodman announced the issuance of two tranches of US Notes; a US\$525M with a 10.5 year term at 3.7% and US\$325M with a 20 year term at 4.5%. The notes issue will allow Goodman to repurchase US\$1,000M Notes and GBPS129M Notes.

GPT announced a private placement of US\$325M of debt in two tranches; US\$160M for a 12 year term and \$165M for a 15 year term on an average margin of 1.89% over BBSW.

Cromwell Drops European Trust

Brisbane-based fund manager **Cromwell** Property Group has pulled its proposed \$1.5 billion float of a portfolio of European properties on the Singapore exchange, after an institutional bookbuild fell short this week. Whilst Cromwell had originally hoped to co-invest just 13% in the trust, they were forced to consider reducing the bookbuild and double their stake to 26%, however even this was not enough to gain sufficient support to the proposal.

The proposal was also thwarted by Moody's placing Cromwell on review for a downgrade on the basis that it was funding investments with short term finance including its stake in the European REIT and its 10% stake in IOF.

The proposed float involved an 81-asset portfolio that Cromwell manages in Europe on behalf of investors. The portfolio holds a mix of office, logistics and retail real estate split between Poland, the Netherlands and Italy, with smaller exposures in Germany, Denmark and France.

Cromwell will re-assess the options for its investors.

Other News

- The offer by NextDC to take over **Australia Pacific Data Centres** lapsed this week, the battle will continue with NextDC gaining a 29% interest and seeking two positions on the Board of ADJ. ([read more](#))
- Paul Lederer increased his stake in **Centuria** Industrial REIT to 9.39% after acquiring a further 5.3% this week ([read more](#))
- **Folkestone** announced it had entered a 5th JV with ID Land to deliver 64 Townhouses in Hadfield, VIC. ([read more](#))
- **Stockland** issued an update on its Sustainability Strategy pointing to its energy efficiency and solar projects, a Stockland estates livability index, and its commitment to improving green star ratings in its residential and retail centres. ([read more](#))

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