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Uncharted Waters: 2020 Real Estate Outlook

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Current state of play

- Liquidity and valuations will be the key issue for real estate in the COVID19 induced economic downturn period
- Similarly to the 9-11 downturn we are anticipating a short, sharp downturn followed by a speedy recovery
- Capital formations rapidly reorganising around long WALE and opportunistic deals
- In the lead up to COVID global liquidity was strong with almost $USD 1 Trillion in investment sales and $USD 350bn in dry powder
- REIT discounting appealing to core and opportunistic buyers – currently no pressure for fire sales like GFC
- Early signs of two buyer groups emerging – those that have to buy with cash on hand and opportunistic/PE buyers looking for bargains.
- Office outlook solid with low vacancy, and supply in some markets being postponed
- Retail outlook under pressure short term negative impacts on performance related to shut downs.
- Logistics servicing food delivery & online retail to remain attractive with long term growth upside
- Returns across all real estate asset classes likely to come under pressure near to medium term, before rebounding strongly
- Still early in cycle but a post COVID rally likely to be sharp, supported by cheap debt, high levels of government stimulus

Source: AMP Capital Real Estate Research

Impact of COVID19 by asset class

Implications	Short-term	Longer-term
Asset class	✓ Balance sheets are stronger than the GFC: lower gearing, diversification of debt sources, solid liquidity.	✓ Risk-free yields remain low.
	✓ Majority of income is contracted rent.	
	✗✓ Reduced transaction volumes may inhibit alpha generation, but can reduce volatility in values.	
	✗ Developments facing supply chain delays.	
Retail	✗ Decline in footfall will impact sales and pressure retailer profitability.	✗ Faster e-commerce penetration and growth
	✗ Reduced cashflow as a result of government shutdowns will impact centre productivity	
	✗ Inventory issues for retailers due to supply chain.	
	✗ Reduction in tenant demand / lease signings given uncertainty.	
Office	✓ Most professional services firms able to remain operational to some extent, and large-firm bankruptcies unlikely.	✗ Work-from-home adoption may increase.
	✗✓ Developments facing supply chain delays, a potential negative for development profits but a positive for stock supply risk.	
	✗ Pressure on vacancy and incentives, particularly for lower grade assets.	
Industrial	✓ Significant demand for food manufacturing / cold store / household essentials / medical manufacturing.	✗ Poorly capitalised speculative developers may come under stress.
	✗ Slowdown in domestic economy and movement of goods will impact demand.	
	✗ Speculative developments come under pressure as occupier demand slows.	

Source: AMPCI RE Research

Short term (3-6 month) liquidity & valuation implications

Liquidity	Valuations
• Banks supportive not contemplating foreclosures	• Too soon to tell, market data still patchy on rental abatements
• Funds lowly geared today vs GFC 28% vs 45% in 2007	• Capital support for Australian core still strong supporting valuations until clearer picture emerges
• Two distinct investor camps emerging – core investors that have to allocate & Opportunistic HNW/Private Equity buyers	• Supply on hold for office and speculative logistics assets
• Market liquidity at record levels in lead up to COVID crisis - $USD1 trillion in global sales in 2019 & $USD 350bn dry powder in the queue	• Lower growth outlook for income in the next 12 months to be factored into valuations
• Flight to quality by lenders & investors favouring core strategies	• Banks not pressuring valuers for a view
• Secondary market risk harder to price given shorter income profile – most investors favouring long WALE	• No ‘fire sales’ bought to market as yet

Source: AMPCI RE Research

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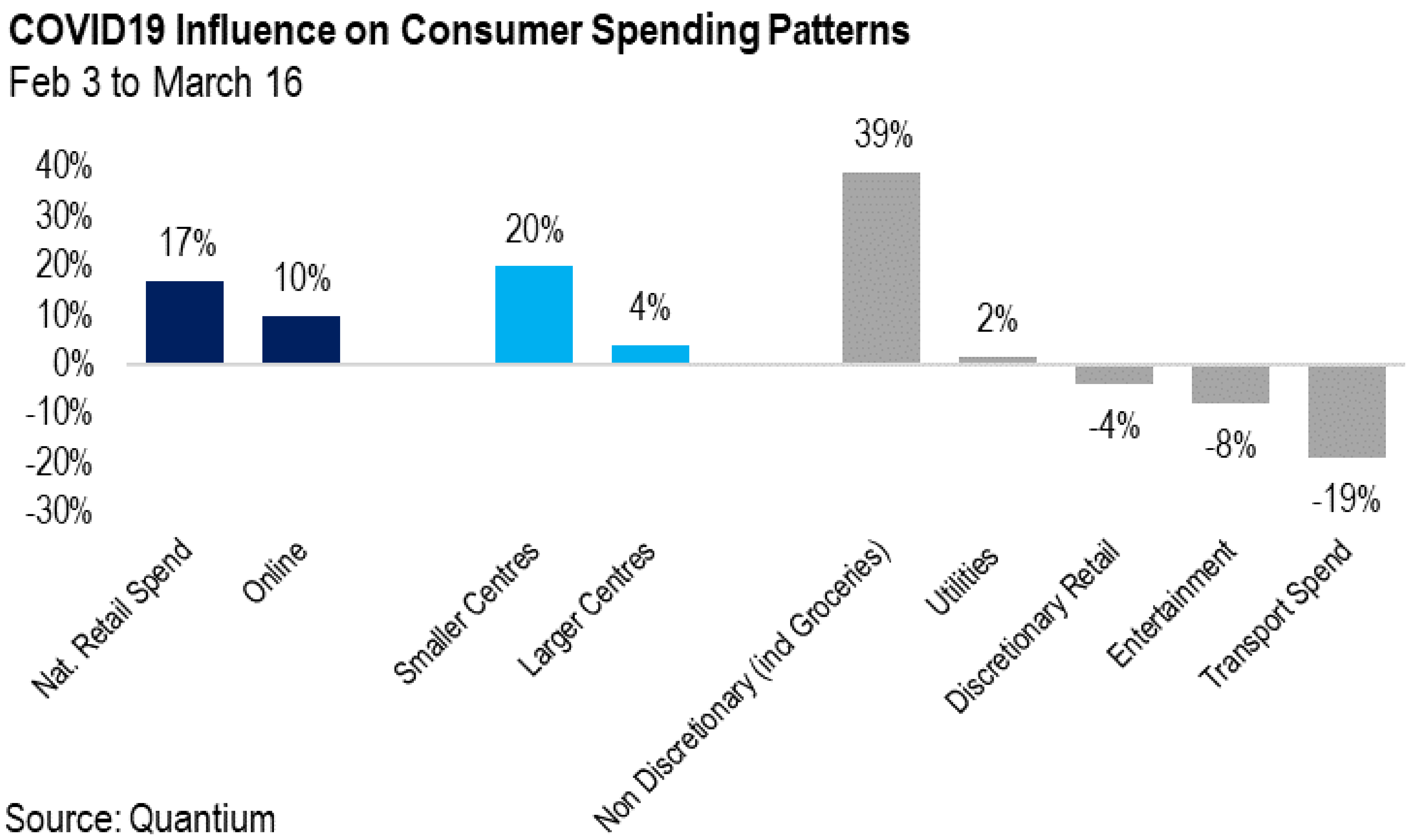
How are consumers responding to COVID19 & what does it mean for category risks?

Category Risks

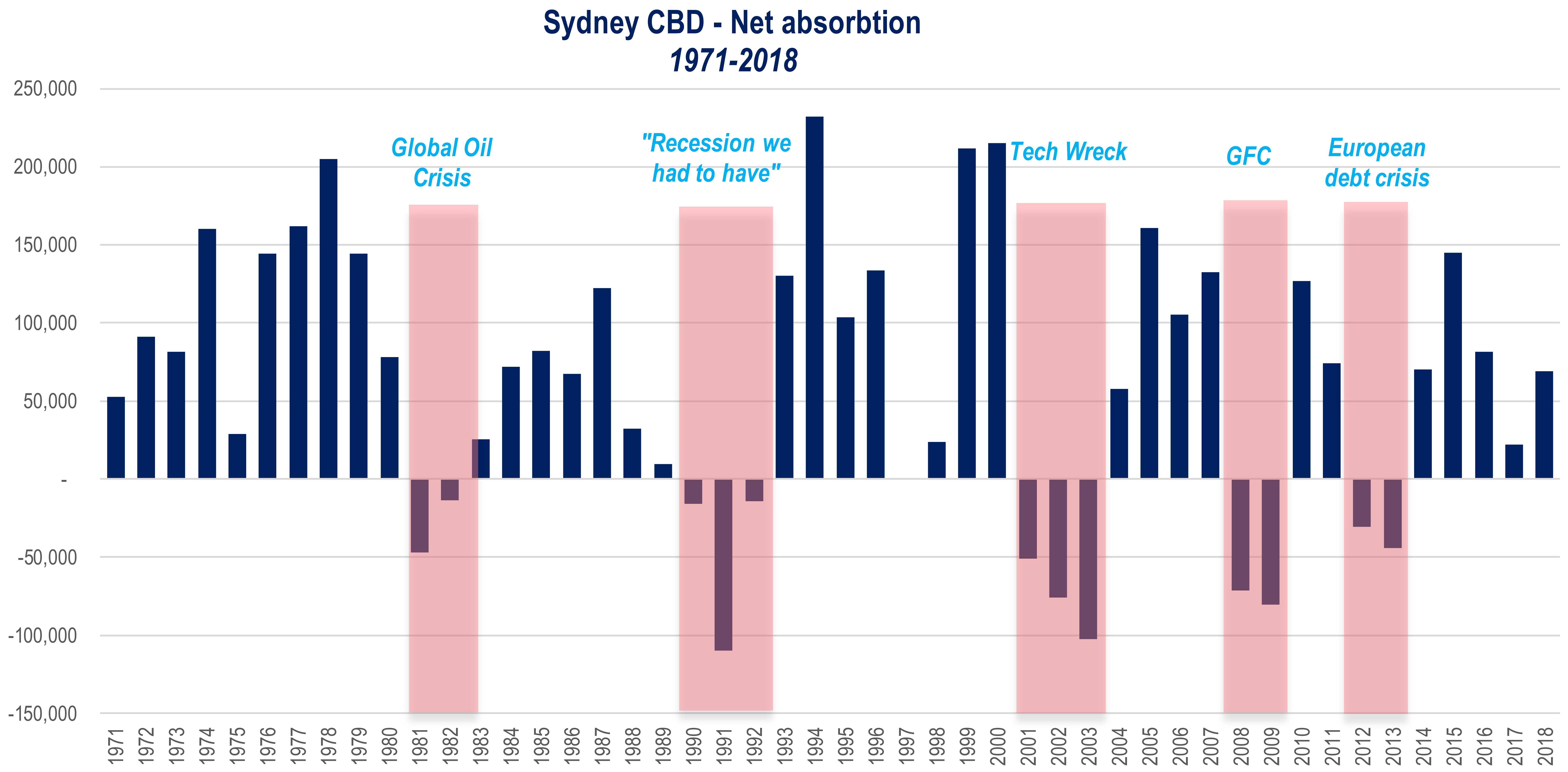
Category	Risk
Medical Services	Low
Supermarkets	Low
Pharmacy	Low
Food Retail	Med
Food Catering	Med
Apparel	High
DS/DDS	High
Entertainment (Cinemas & Arcades	High
Travel	High

COVID & Consumer Spending Behavior



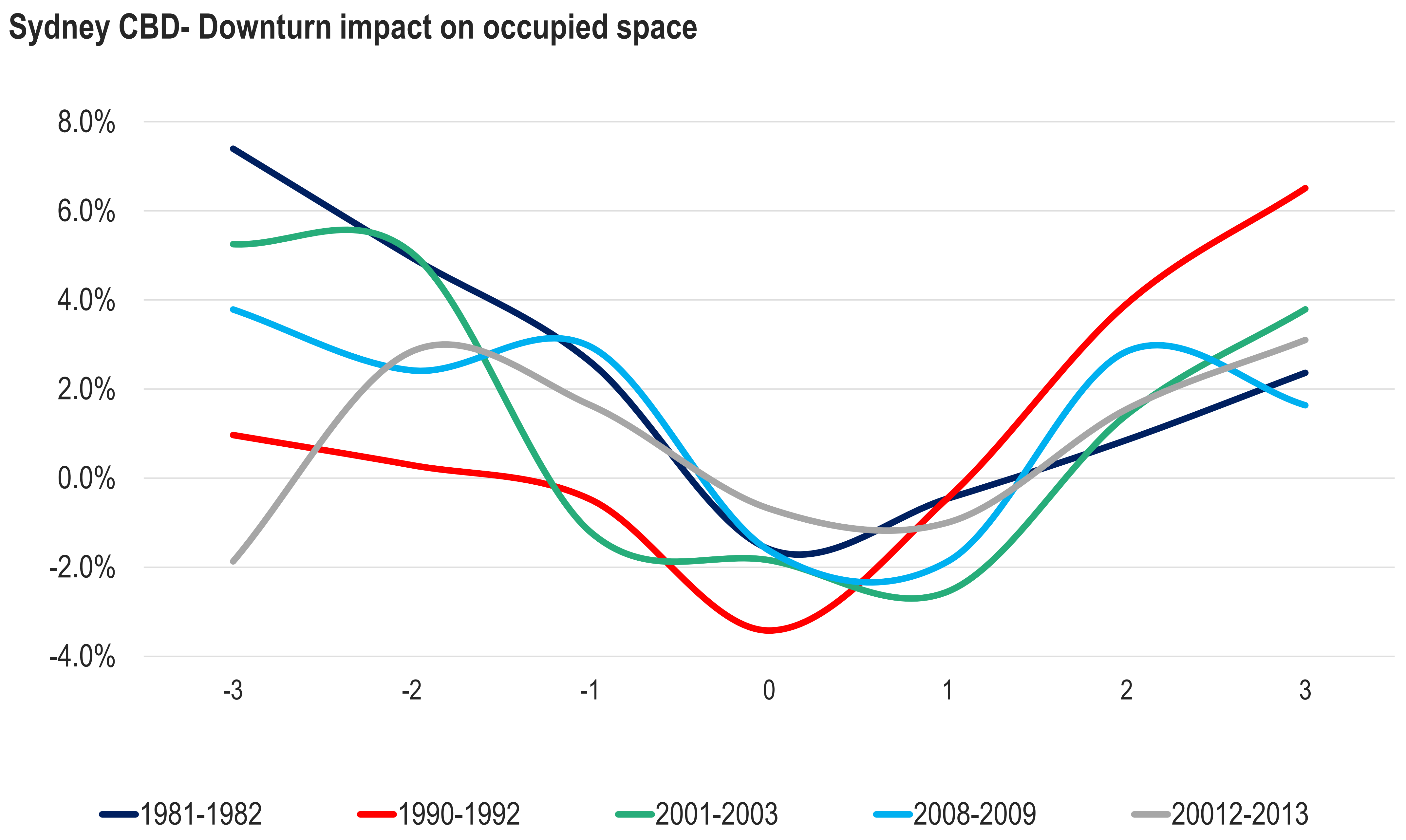
Source: Quantium

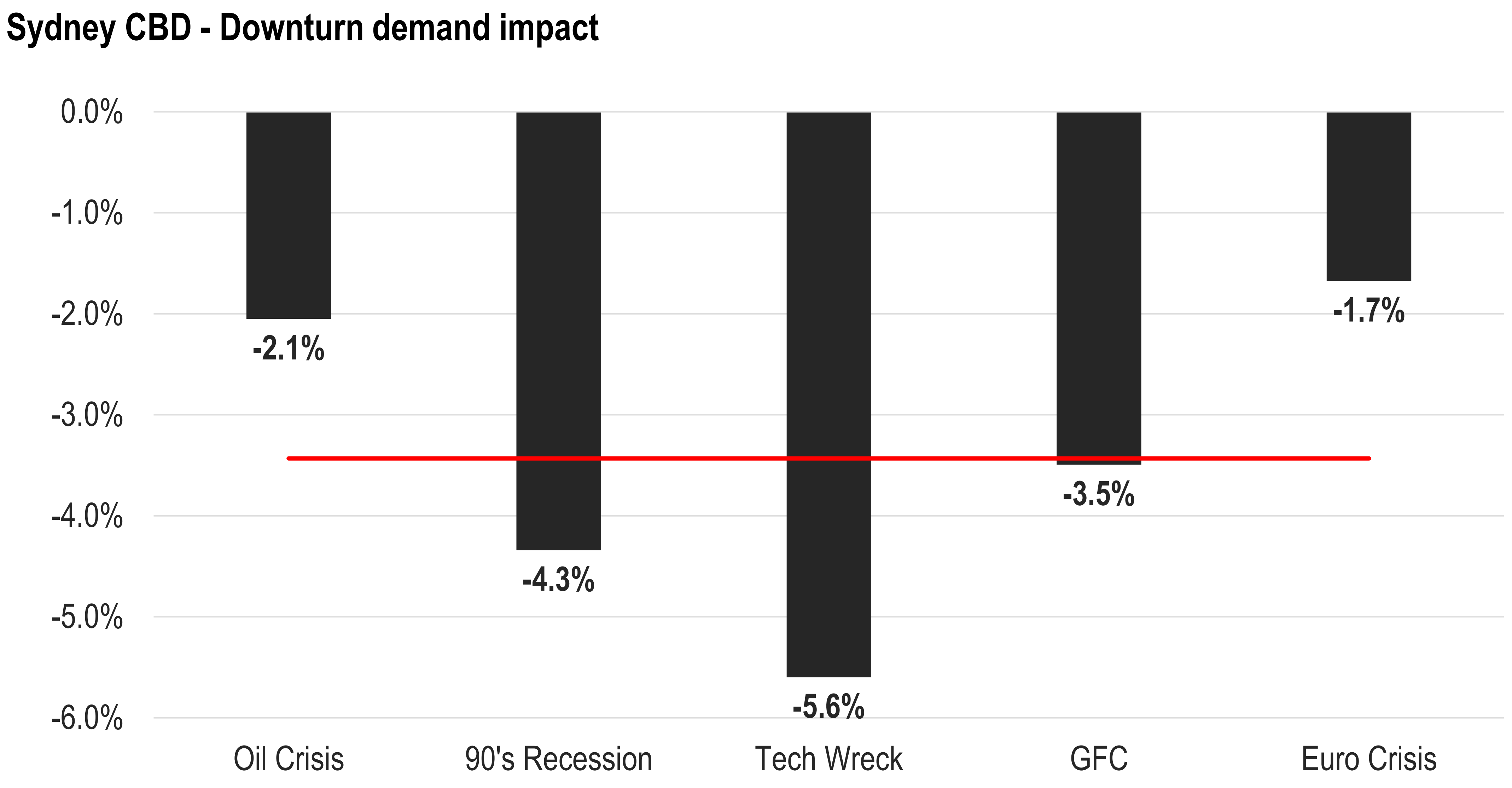
Downturns in the Office Markets: Different causes but similar outcomes

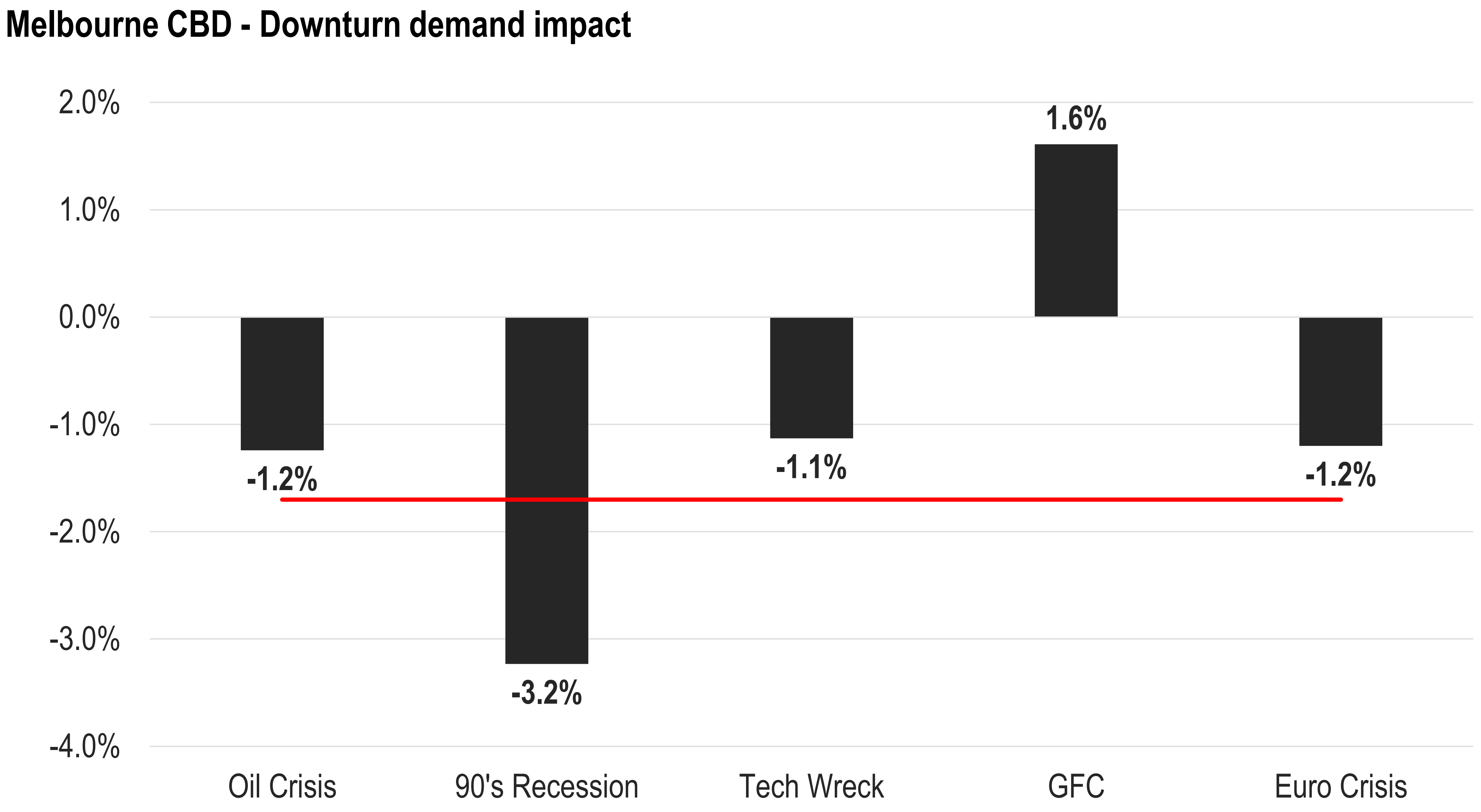


> Over the past 40 years, the Sydney CBD has experienced just 5 market corrections (Oil Crisis, 90's Recession, Tech Wreck, GFC & European Debt Crisis). While the causes were always different the outcomes were fairly similar.

The impact on office demand…short, but punchy

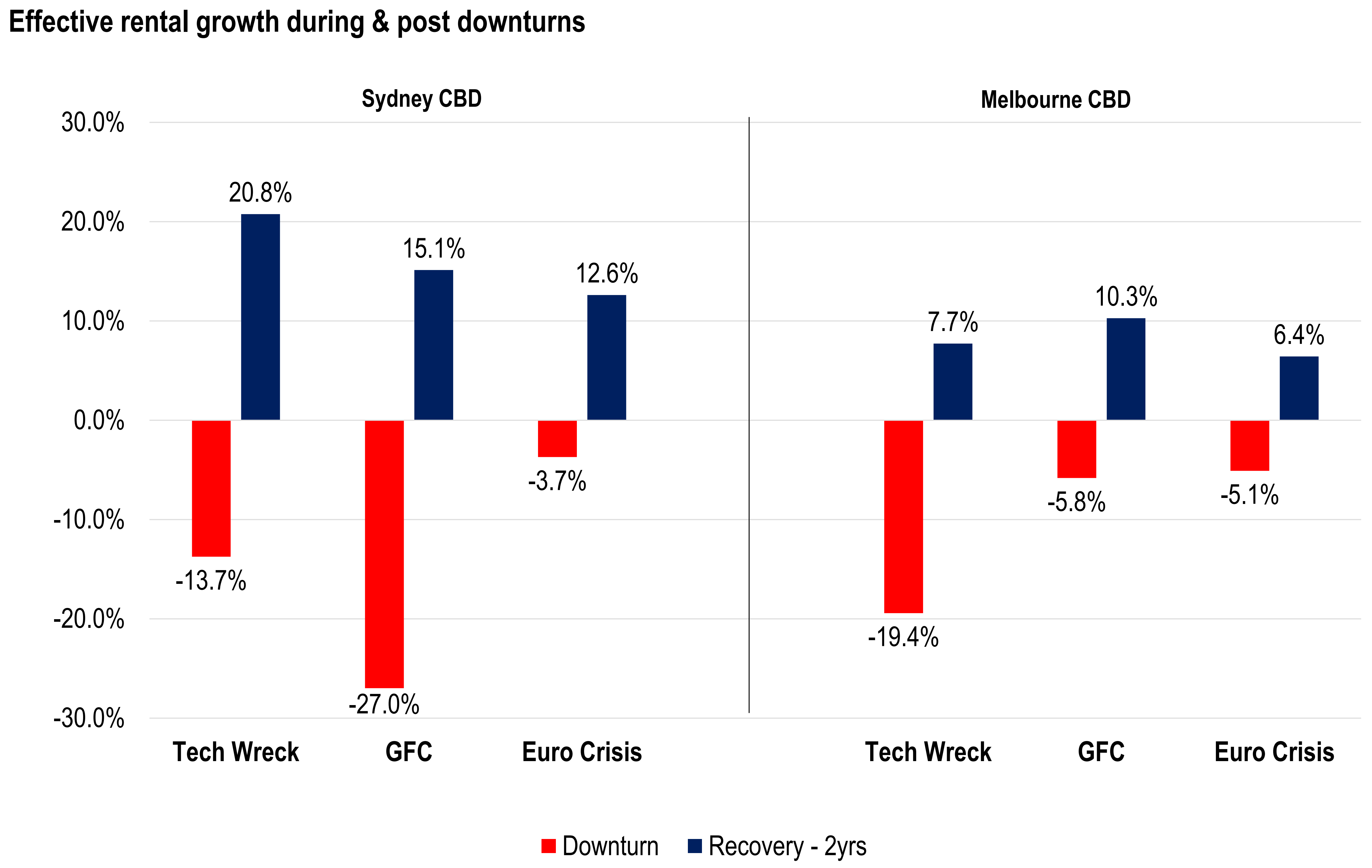


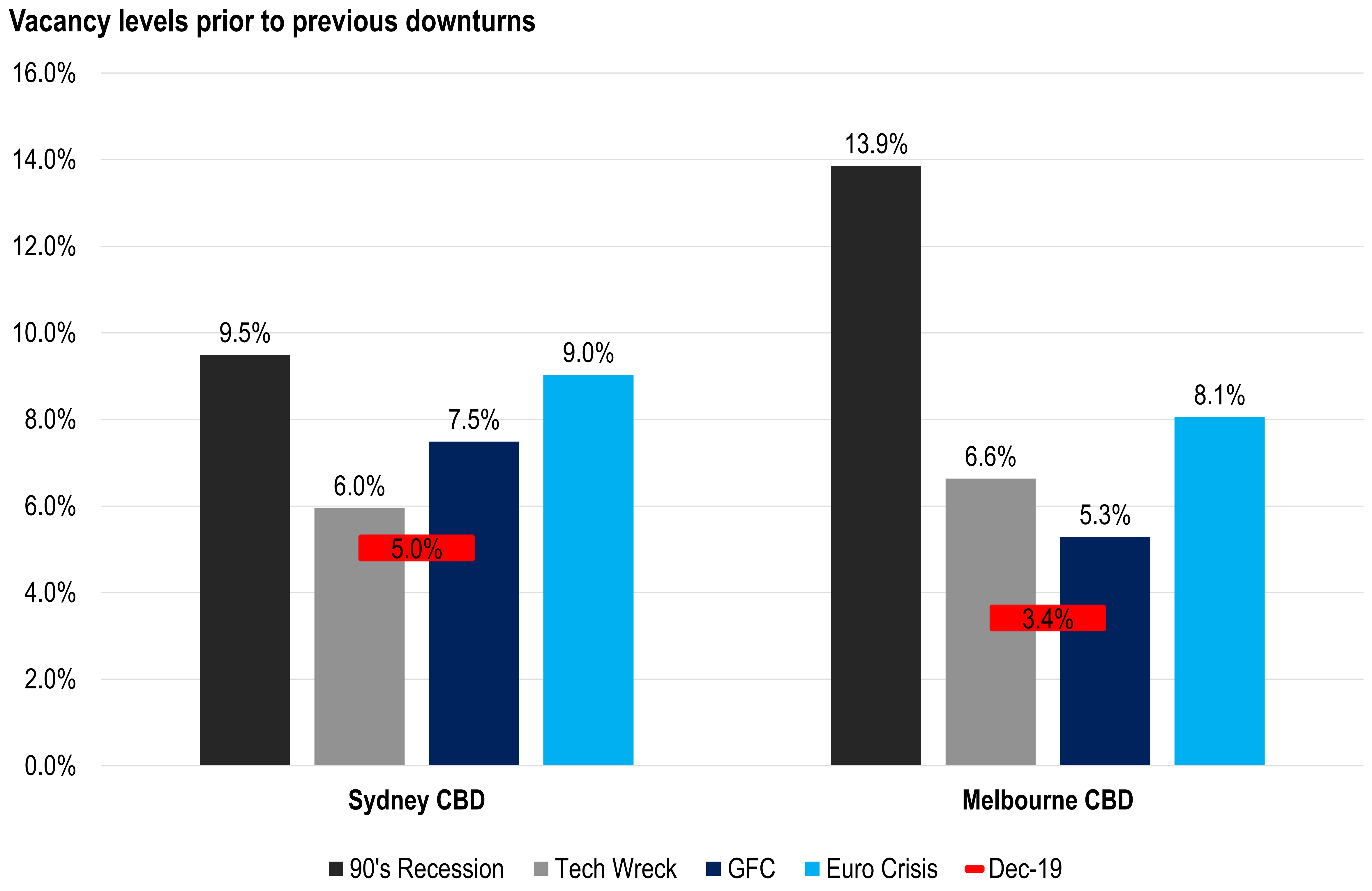




- Market corrections tend to be relatively short with a duration of 2-3 years and 12-18 months in Sydney and Melbourne, respectively.
- On average the past market corrections have reduced occupied space by about 3.4% in Sydney and just 1.7% in Melbourne.
- **In all cases market corrections were followed by a strong rebound in office demand.** On average the Sydney CBD & Melbourne CBD recorded an increase in occupied space of 5.6% and 5.5% in the two years following a downturn.

Office markets to feel the impact on rents…but better positioned this time

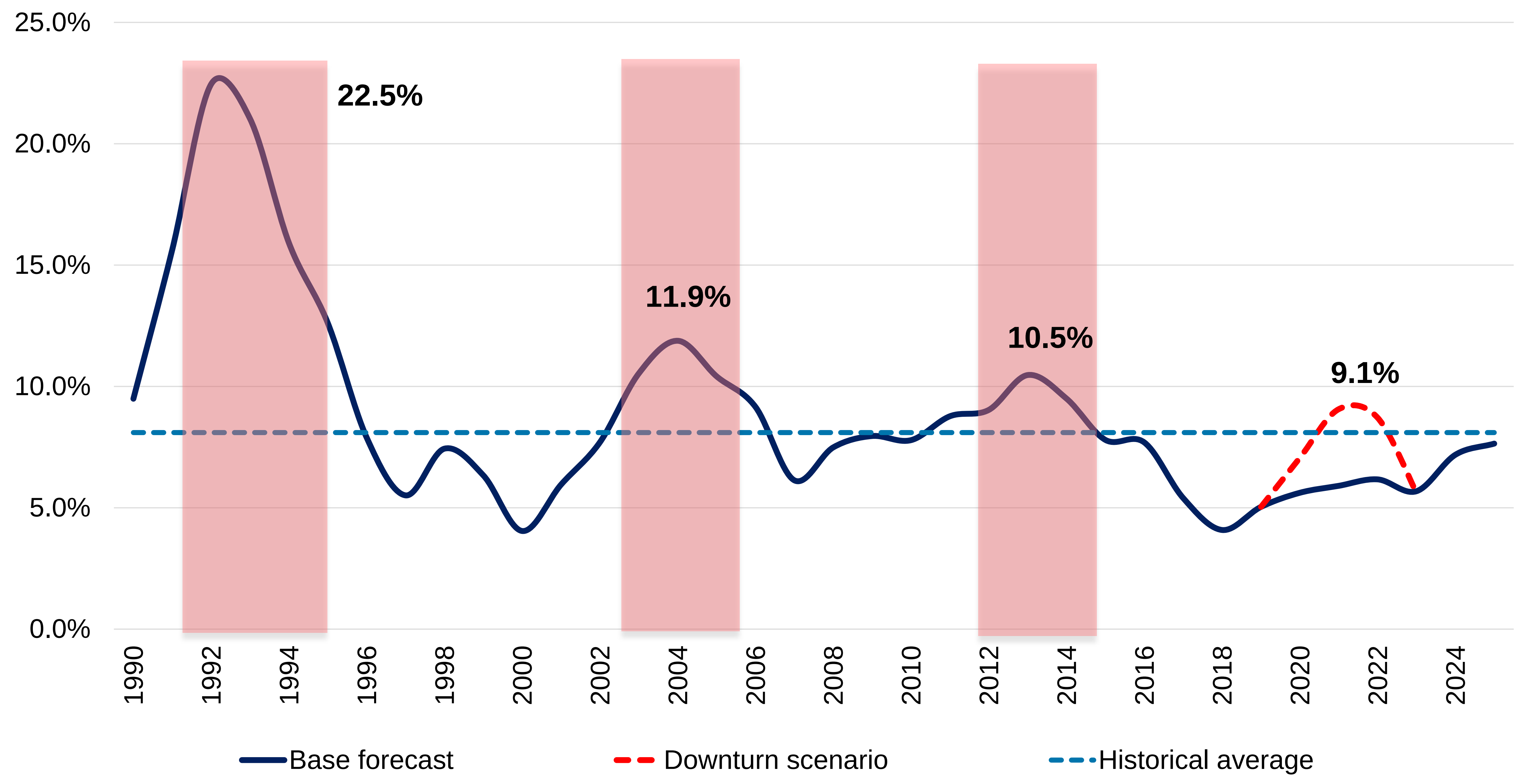




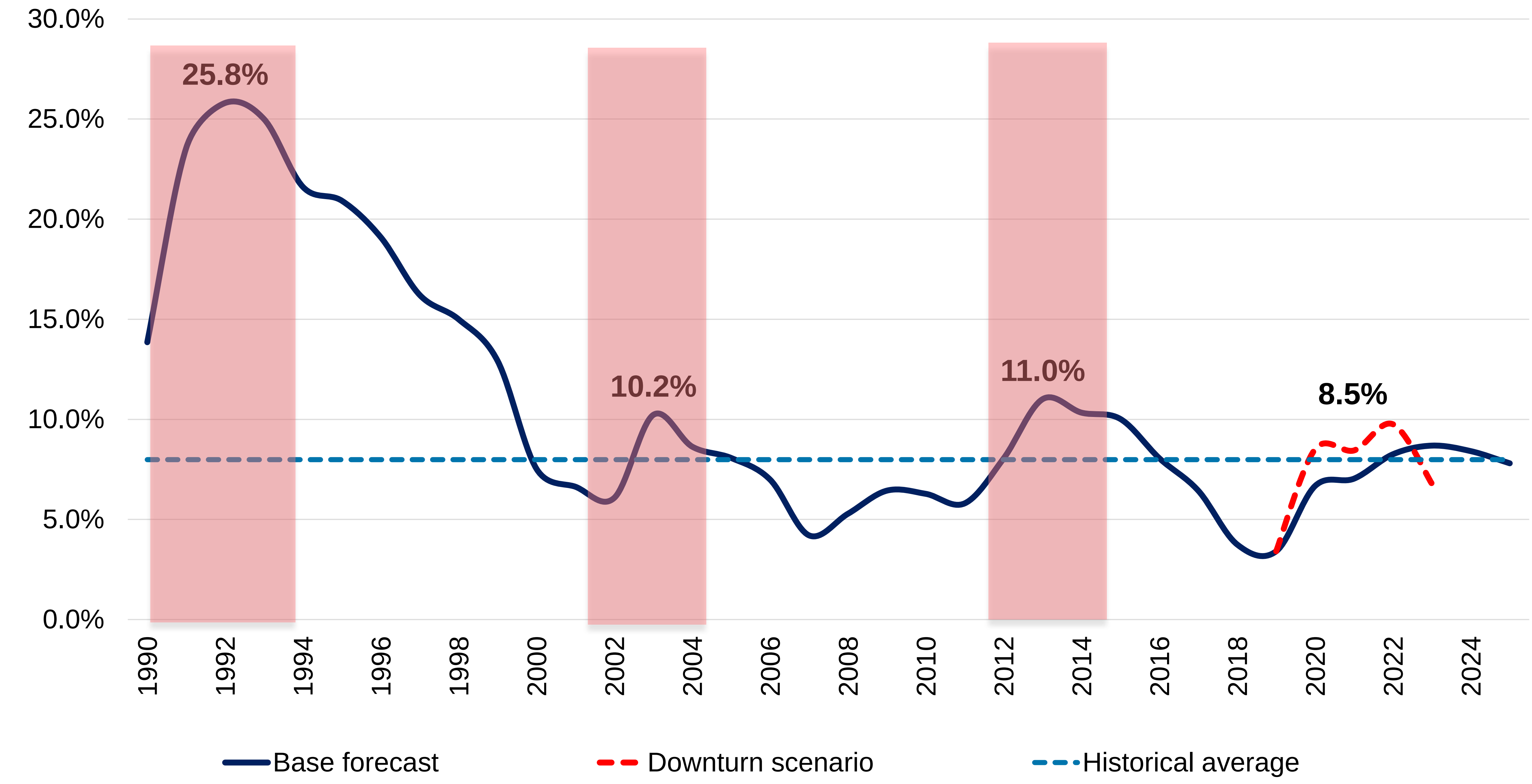
- Market rents have reacted quite differently during previous downturns. While the impact of the Tech Wreck and the GFC was quite significant the impact of the Euro Debt Crisis (and the GFC in Melbourne) was less profound.
- In comparison to previous downturns the Sydney and the Melbourne CBD are relatively well positioned with vacancy levels sitting at historical low of 5.0% and 3.4% respectively.

Office downturn vacancy scenario

Sydney CBD - Vacancy downturn scenario



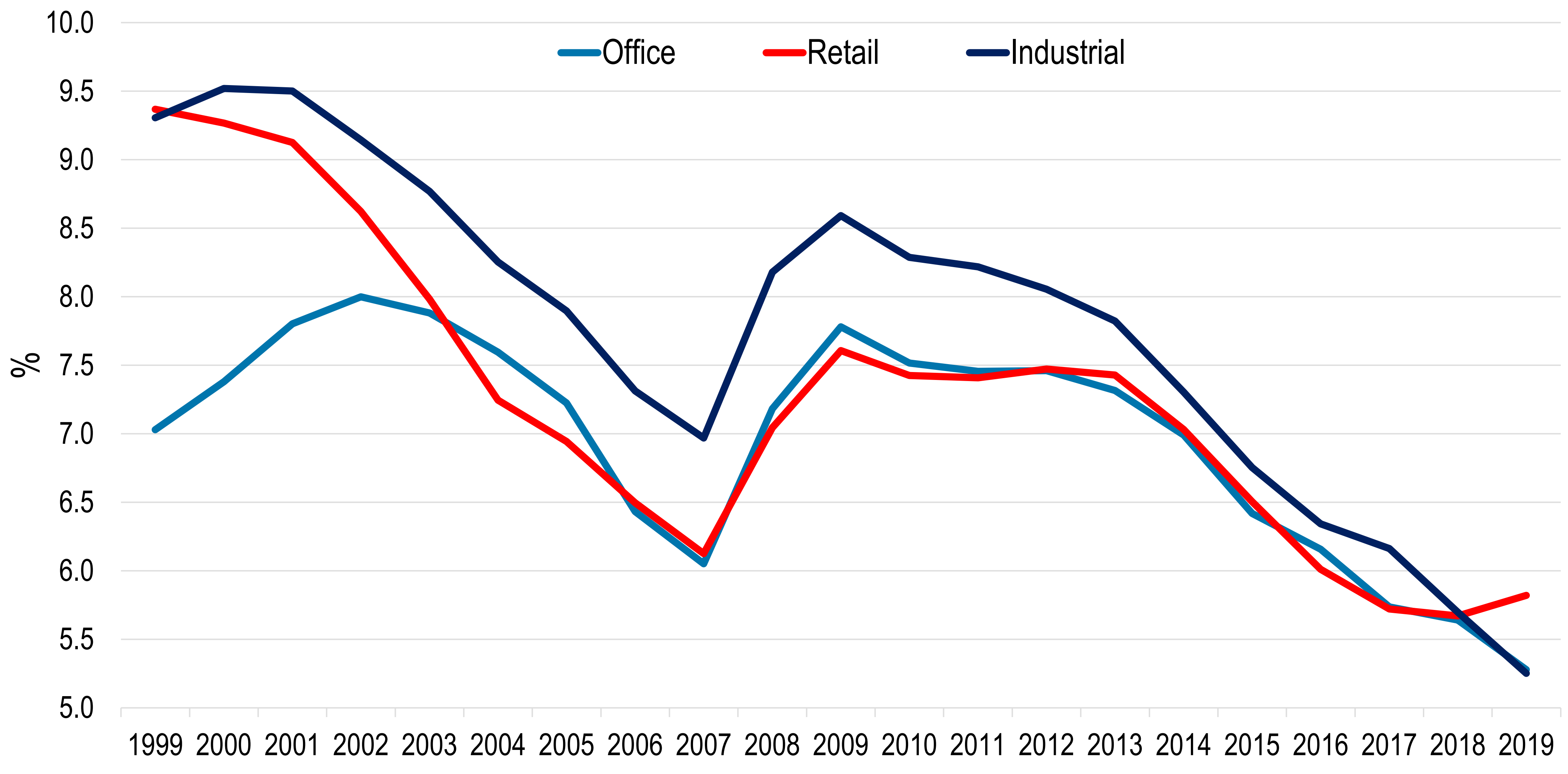
Melbourne CBD - Vacancy downturn scenario



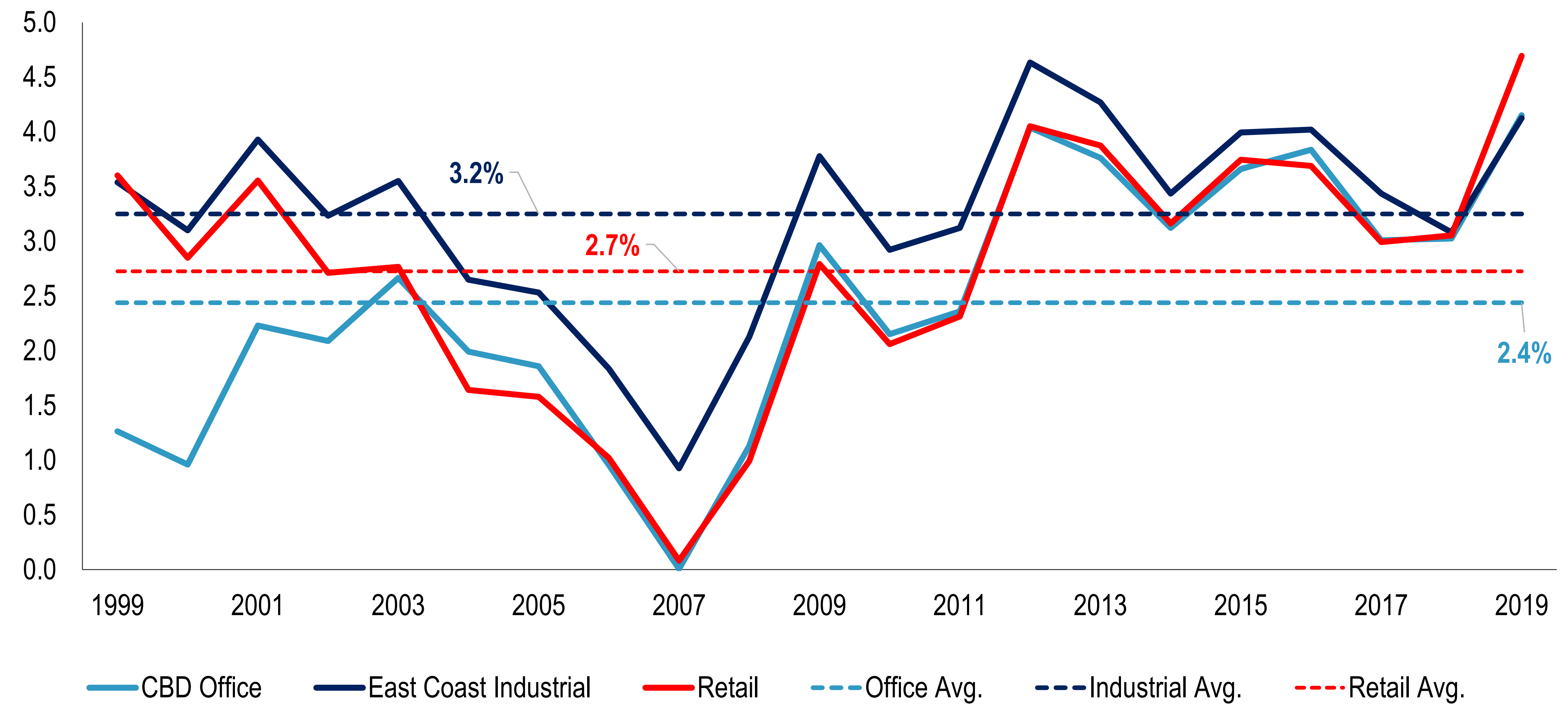
> In comparison to previous downturns, the major office markets are relatively well positioned with vacancy levels remaining at historical lows of 5.0% in Sydney and just 3.7% in Melbourne. While Melbourne is facing significant supply in 2020, ~90% of that supply is pre-committed with existing tenant commitments to drive ~120,000sqm of net absorption after adjusting for backfill space.

Transaction activity to slow but balance sheets in better shape

Commercial Real Estate Yields



Real estate yield spreads to 10y bonds



Source: RBA; JLL; AMP Capital

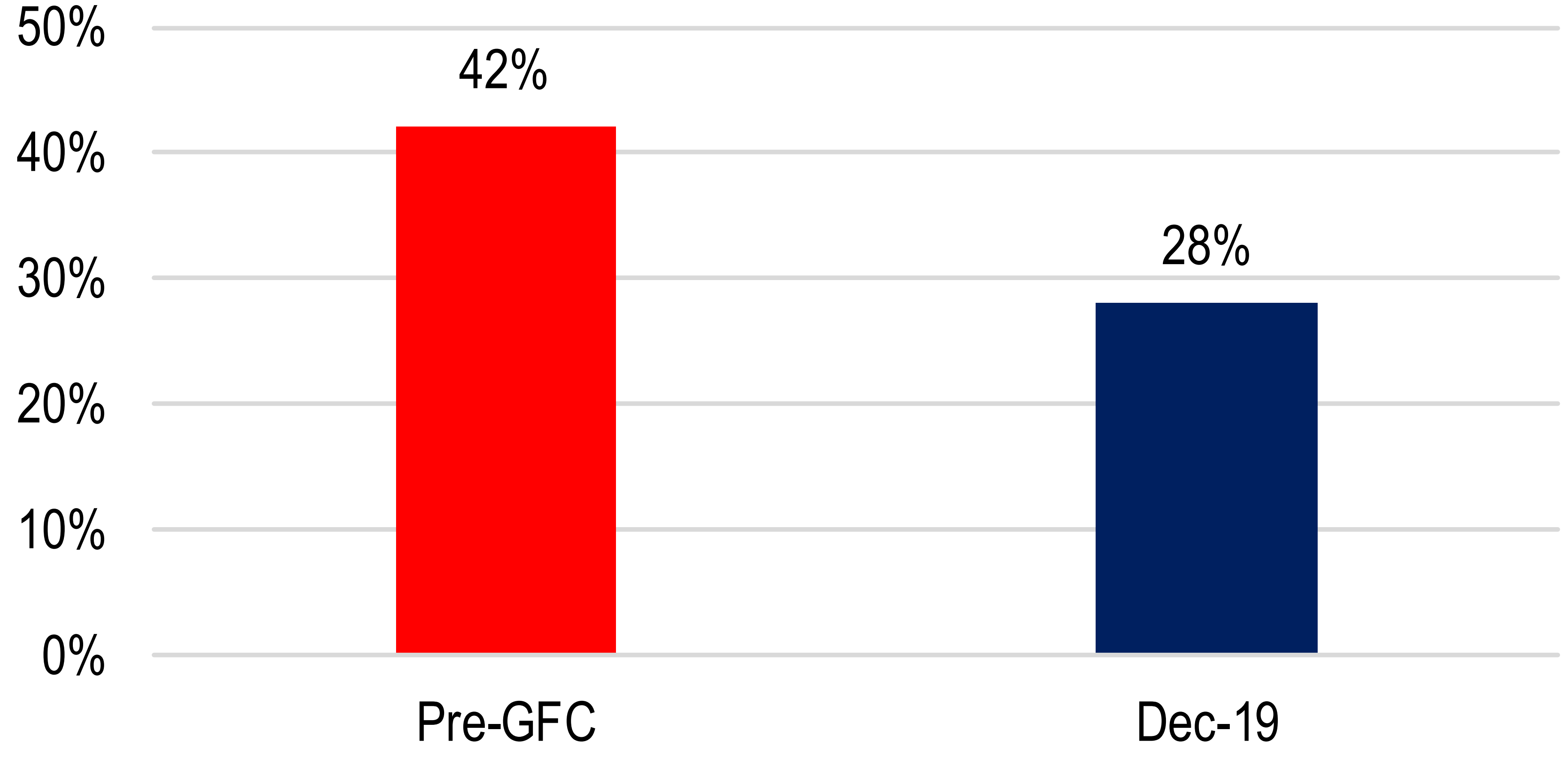
> **Transaction activity to slow significantly** with investors expected to delay investment decisions.

> **Gearing levels are at a 15 year low.** A-REITs have been relatively prudent in regards to capital management post the GFC. Income-based credit metrics (net debt / EBITDA, interest coverage) are also below thresholds ascribed by credit rating agencies.

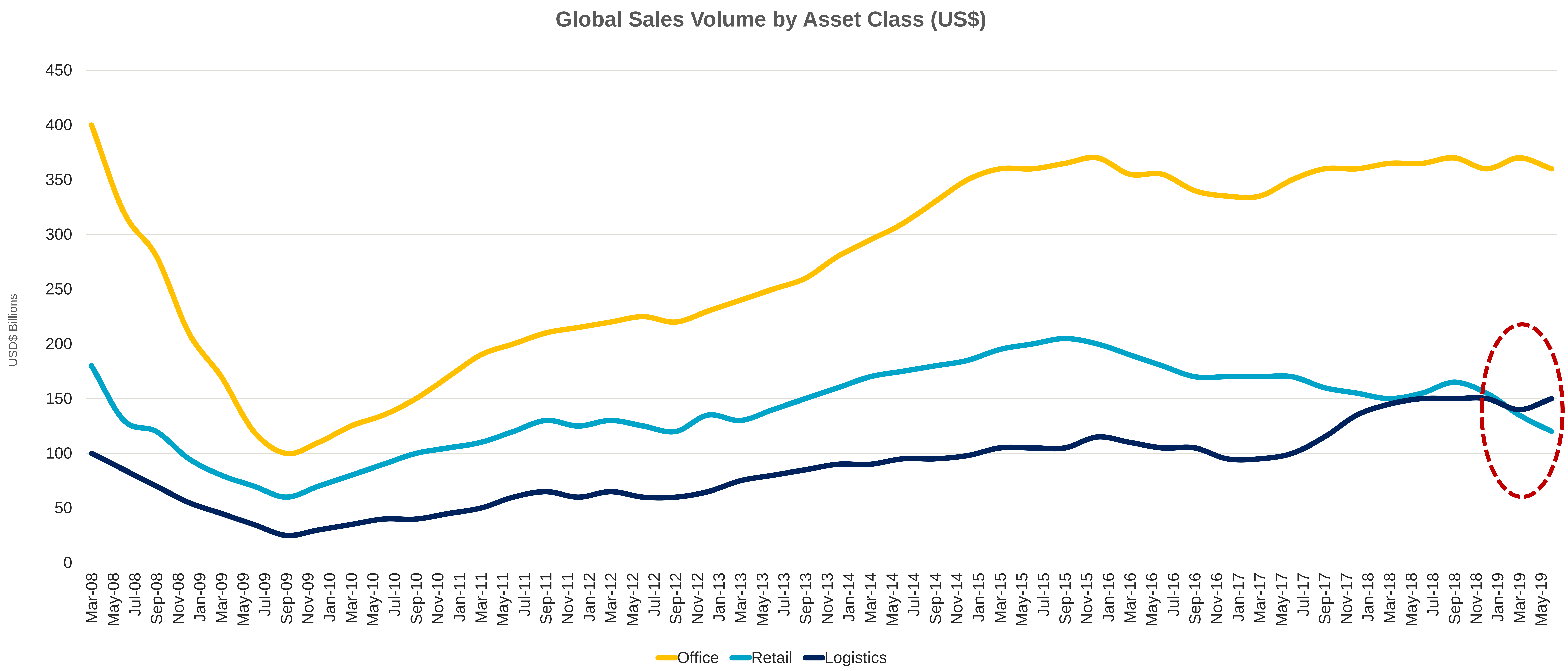
> **Liquidity a low risk at this point.** Weighted average debt maturities are 4.6 years across the sector, with a limited amount of facilities expiring over the next 12 months (~3.8% sector average) and the next 3 years (~30%).

A-REIT Gearing Levels

(Net debt/Tang. assets)



Structural shifts driving investor preferences set to intensify



Source: JLL, Real Capital Analytics

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