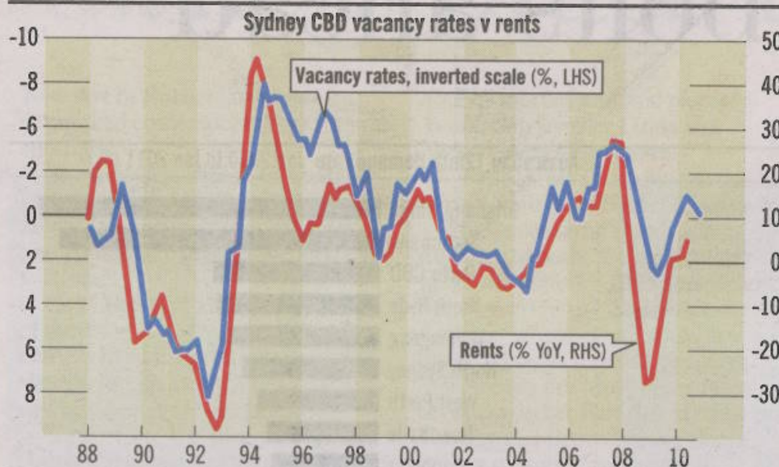
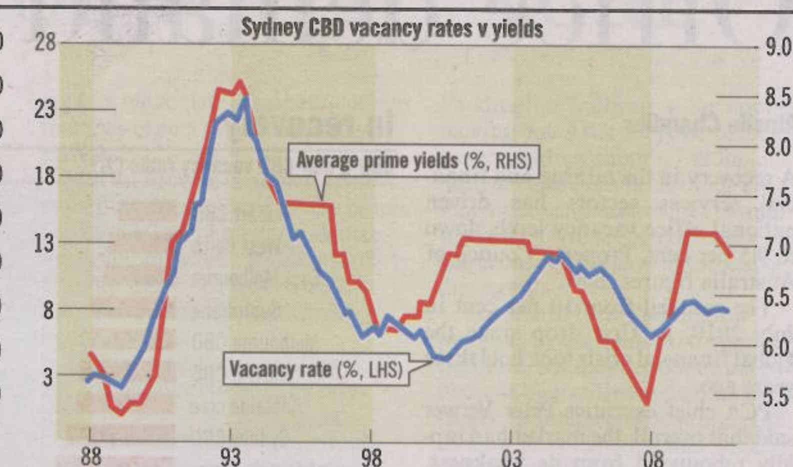
REITs get ahead of the rental game

Property observed

Robert Harley

Leading the way





SOURCE: MACQUARIE CAPITAL ADVISORS, JONES LANG LASALLE

The Australian real estate investment trusts specialising in office towers had a run last month. They bettered the other REITs and even outperformed equities. One, the hard-hit Commonwealth Property Office Fund, topped the pack last week with a 7 per cent jump. It's a classic case of capital moving well ahead of the actual improvement in performance.

With the exception of some first-mover landlords in Melbourne, no one is yet pushing up the rents or cutting incentives.

Nor is anyone tipping income growth in the towers this year, certainly nothing more than the consumer price index-linked increases on existing agreements – less if vacant space needs to be filled or existing leases, at rents now above market, come up for renegotiation.

No office REIT is likely to pay out more this year than last, and one, Charter Hall Office REIT, will pay out less. But the real estate strategist from Macquarie Capital Advisers, Rod Cornish, has seen the future in past cycles.

The turn in vacancy rates in the latest Property Council numbers points to bigger things. As the graphs show, a fall in vacancy rates is a key indicator of future rises in value and rents.

"In previous cycles, prime office yields have generally tended to either track or shift ahead of changes to the vacancy rate," he says. The reason: "Yields reflect investors' expectations for future rents."

The Cornish analysis also shows that rents move with vacancy.

"In previous cycles effective rents – face rents plus incentives – have also typically tracked or started to shift just ahead of changes to the vacancy rate," he says.

Of course every cycle is different. This time around the towers did not empty as much, or for as long, as in past downturns. Business shed hours rather than staff.

So far, this recovery appears weaker than those that followed the crashes of 1990 and the tech wreck.

Steve Urwin, a principal of tenant advisers MPS Property, does not see any need to hurry. In Brisbane, he says, the improvement in the vacancy rate is temporary and rents are still falling; in Melbourne the rental growth is limited by the ease of building new towers; and in Sydney there is still a "stream" of A-grade space freed up as tenants move. "If the Sydney landlords were confident, they would not be offering 30 per cent incentives but you can get them from anyone," he says.

One landlord, Anvil Capital director Adam Learmonth, acknowledges that rental growth is 12 months away in most cities.

Cornish forecasts that rental growth – "pretty solid numbers assuming the financial markets behave as equity analysts expect" – will not start in Sydney until 2012.

He also says Brisbane will lag.

Campbell Hanan, group executive of Investa Property Group and its $6 billion office portfolio, is cautiously optimistic.

If the recovery continues at the current pace, he says, Melbourne is headed for a vacancy rate of 2 per cent and Sydney for 5 per cent. Both would mean substantial rent rises.

"Look forward 12 months and everyone will be optimistic," he says.

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