COLLIERS RADAR

WEEKLY REAL ESTATE UPDATE

What we have learnt this week - 9th April 2020

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On the 7th April, The National Cabinet announced the Industry Code of Conduct for commercial tenancies. The Code of Conduct provides a degree of clarity for those tenants who are eligible for the 'Jobkeeper' program and who generate annual revenue less than $50 million, and in turn their landlords. The principle of proportionality is applied, whereby the impact to the revenue of the impacted tenant will be reflected in rental relief. However, the code is also intended to apply 'in spirit' to all existing leasing arrangements.

Capital Markets

- The first major CBD office deal transacted since the onset of the Covid-19 pandemic in Australia. This was the sale of St Martin's 50% share of Rialto to Dexus/GIC for $644m – with GIC taking a 90% interest in the joint venture, and Dexus the remaining 10%. This is a rare trophy asset transaction, and completed after many months of due diligence. While a full sales analysis has yet to be completed, the price reflects limited movement in value compared to pre-Covid levels. The strong long term fundamentals of Australian CBDs, 'trophy' nature of the asset, as well as currency benefits derived from a weak AUD, all contributed to preserving value through this economic shock

Impacts to Other Asia Markets

- Following the lessons of SARS in 2003, we assumed activity in APAC real estate capital markets would rebound from the impact of COVID-19 from late Q2 or early H2 2020. However, the global spread of COVID-19 implies this rebound will be pushed back three to six months.
- Economic growth forecasts for 2020 have fallen fast since early March. However, historical examples suggest growth may recover rapidly in late 2020 and 2021. Quicker economic recovery should help drive a pick-up in property deal volumes.
- Among top investment markets in APAC, the COVID-19 outbreak has peaked in China, which is slowly returning to normal. Conversely, disruption has risen since early March in Australia, Singapore, and most recently Japan.

Office

- There appears to be varying impacts to the flexspace market. Co-working is experiencing very low vacancy, and there is significant uncertainty around the demand for this type of product even once Covid-19 recedes. There is evidence, however that the serviced office type product is seeing reasonable demand. This is from smaller groups of coming out of co-working, who want their own private space to meet social distancing guidelines, as well as from employees working from home who require some private workspace for parts of their day. Some serviced office providers have quickly pivoted their business model to cater for this new demand category.
- We have recorded a significant decline in tenant inspection activity from the first week of March, through to the final week. Compared to the week beginning 16th March, there was an 87% decrease in inspections through to the week beginning 30th March. The trend is unsurprising, as uncertainty took a grip of the Australian market over this time, and social distancing and lockdown measures put in place have made physical inspections difficult.
- Mid to large size occupiers are likely to take the opportunity over the next few months to re-evaluate their space usage. Consolidation programmes are likely to be placed on hold by some firms, to mitigate concentration risk. There is also the prospect of on-shoring of some core activities (eg. Call centres) which is likely to occur in more cost effective markets.

Industrial

- Despite the near-term uncertainty, lease deals are still being struck, particularly from defensive occupiers including food and beverage retailers, e-commerce groups, transport and logistics providers and cold storage occupiers. Most recently, this included Fernhurst committing to a 7,070 sqm purpose-built cold storage facility at the Drystone Industrial Estate within Truganina

- Demand for online retail goods continues to surge, with some retailers recording a threefold increase in revenue growth across their online platform. Online retailer Catch.com.au has reported sales of household goods on their site increased by 290% in the first two weeks of March. Household, pantry, health and baby products have been the most popular items in demand from online consumers. As a result, online retailers have ramped up their supply chain operations and focussed on maintaining stock levels. With consumers turning to online shopping as a result of COVID-19, early estimates suggest that e-commerce could potentially account for 20% of all retail sales in Australia by the end of 2022
- In response to high demand levels for essential items and services, the Victorian Government have approved new planning rules that exempt essential businesses from existing noise restrictions. This will allow for 24-hour dispatch and delivery options and will enable supermarkets, hospitals, pharmacies and other essential businesses to meet current demand levels and applies to warehouses and factories across the state

Retail Capital Markets

- The release of the Code of Conduct gives a framework for tenants and landlords to negotiate their way through this period, with retail expected to be the largest sector hit
- There has been one major transaction this week with Regent Arcade in Adelaide selling for circa $50 million. This was purchased by a Chinese buyer from a local private investor
- SCA have announced a capital raising for $300 million to allow for further acquisitions with the focus on neighbourhood centres
- More retailers are looking at in-car collection options with Westfield speeding up roll out of Westfield Direct and Adelaide Central market trialling an in-car collection service

Healthcare & Retirement Living

- The impacts on healthcare are varied depending on the asset class. At the lowest level of acuity, childcare is seeing a mixed response between lower occupancy as a result of people being at home to the Government stimulus package designed to provide relief. Land Lease communities and retirement villages are being viewed as a bit of a safe haven by consumers. That said, whilst enquiry is up, it is likely that conversion will take longer due to the restrictions placed on the residential housing market. Residential aged care is potentially at risk as an outbreak of COVID-19 within the sector would see a sharp decline in occupancy. This would lead to an even sharper decline in both earnings and capital putting many at risk. That said, residential aged care operators are well placed at dealing with outbreaks and the facility designs both directly and indirectly promote social isolation. Ironically, these facilities may in fact be the safest places for our elderly population. Hospitals are a mixed bag. Although treatment volumes are up, they are across services that cost a lot to administer but don't attract a lot of revenue – margin squeeze therefore occurs. On top of that, if you're in the private sector, the ban on elective surgeries coupled with general delaying of procedures means a decline in revenues also. However, operators across all of these asset classes are/have retooled their businesses to ensure margin recovery.
- Notwithstanding, the above are temporary as the systems adjust quickly to deal with COVID-19. Ultimately the sector is underpinned by necessarily required services and therefore is the best place asset class from a return to normal standpoint. It is also counter cyclical.
- Accordingly, investors and institutions have increased their focus on the sector in the last month and are actively looking to diversify into healthcare asset – be it going concern or greenfield – as it provides earnings and risk diversification for their portfolios.
- This has been empirically evidenced in the high levels of interest across two healthcare opportunities currently underway - Australia's largest NDIS portfolio and a specialised medical asset anchored by a the third largest pathology operator.
- Activity it likely to increase in the sector, especially as operations find a new normal relatively more quickly than other asset classes and capital seeks quality underpinned by long term sustainable cashflows.

Residential

- Despite the rapid change in sentiment throughout March, Australia's housing markets benefit from strong fundamentals and foundations, those of which contributed to growth across all capital cities during Q1 with Sydney (3.9%) and Melbourne (2.9%) leading the charge (CoreLogic). Whilst the number of listings begin to accumulate and contribute to a likely decrease in values during the forthcoming quarter, these fundamentals are expected to aid the post COVID-19 recovery.
- The rental market has experienced a significant decline in tenant pools with the pause in migration, reduced number of international students and significant levels of the younger cohort delaying moves or moving back into the family home. The impact of the virus on short-term rentals has resulted in a surge in rental listings across the nation with many Airbnb operators placing their property back on the long-term rental market. This is expected to place downwards pressure on rents.
- Despite the uncertainty, we are still seeing an appetite from developers looking for new opportunities in preparation for the recovery, highlighted by Golden Age's $23 Million acquisition in Glen Waverley, Victoria and the sale of the Brunswick Market, also in Victoria, to an interstate group for $17 Million

Hotels

- The current situation is unlike anything we have seen before and whilst previous cycles can provide insights to how markets might respond to global demand shocks, market conditions in 2020 are unprecedented.
  - » Over the past six weeks, room night demand has contracted with impacts felt initially across inbound, notably groups from China and then Asia before extending to conference, corporate, leisure and crew. The closing of borders – both state and international – is having a material impact on hotel demand.
  - » Forward bookings have largely been cancelled and whilst some hotels may be repurposed to provide medical or isolation care during the crisis.
  - » With social distancing measures and closed intrastate borders expected to remain in place for up to six months, considerably lower levels of travel are anticipated through 2020. Restrictions on large gatherings are expected to extend slightly longer, impacting conference & meeting hotels.
  - » Global international travel restrictions are expected to extend for a longer period, owing to timing of outbreak in home country, global recession and government response. This is the big unknown.
  - » We are tracking hotels closures, noting that nearly 30 hotels have shut in Melbourne CBD and over 20 hotels closed in Sydney
  - » Labour cost structures have been re-shaped through the governments Jobkeeper programs, helping to mitigate the impact on cashflow

Agribusiness

- Over the past few weeks, farmers providing direct delivery to the public have experienced an increase in demand as Australians avoid shopping in supermarkets.
- On Saturday 4th of April, the Federal Government announced the change for visa requirements for foreign workers, allowing tourists employed in agriculture, food processing and health to be exempt from the six-month work limitation. As a result, backpackers continue to travel to farming areas in search of working opportunities. However, they now face two weeks of quarantine prior to commencing work. These measures have been implemented by farmers to ensure continuity of operations and to avoid a COVID-19 outbreak.

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