Global Commercial Office Space

Post Covid Disaster Continues

Robert Hecek LAFPI, CPV, LREA, MAICD, WAVO-WRV
Executive President – WAVO
Chair – APIV Ltd.

Moody's Predicts $250 Billion U.S. Office Property Value Loss By 2026

- The persistent Work–From-Home trend will see U.S. office vacancies reach 24% by 2026, creating big challenges for landlords and decimating $250 billion in property value. A significant jump from the current rate of 19.8%.

- This Shift in workplace preferences could slash commercial property values by as much as $250 billion. A decrease of this magnitude would completely alter the landscape of U.S. commercial office use.

- Hybrid work environments are now dominating U.S. workforce preferences and full-time in office work environments are falling out of favour, as shown in Flex Index's Q2 2024 report.

- 37% of U.S. companies have adopted a structured hybrid model, which is a significant increase from 20% in the previous year. This outpaces the 31% of companies that require full-time in-office work and the 32% of companies that are fully flexible.

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- Office vacancy rates reaching 24%, combined with frequent lease turnovers, are projected to diminish landlords' incomes by $8-10 billion

- “Research conducted using the Survey of Working Attitudes and Arrangements suggests that nearly 20% of full working days will be done from home post 2021, compared to 5% pre pandemic” according to Moody’s report.

- Moody’s forecast align with the broader employee demands for flexible work arrangements which are fundamentally challenging traditional office demand and employer retention strategies.

- The decline in demand for office spaces has led to increased borrowing costs for property owners and lenders, further adding to the financial strain in the U.S. commercial real estate market.

- The impact of remote work on commercial real estate is significant and far reaching. The decline in revenue and increased borrowing costs are expected to further exacerbate the situation leading to a significant property value destruction.

- As remote work becomes mainstay, companies, investors and policymakers must navigate the economic implications beyond the empty cubicles and conference rooms.

Pressure on Global Office Values

- 91% of CEOs are backing hybrid working, a decision which is expected to impact office market valuations and lead to further repricing of assets, which are already trading at a discount to book value.

- The Global International Workplace Group which surveyed more than 500 CEOs, 75% of respondents said adopting hybrid working has led to an improvement in productivity, with 76% saying it has resulted in improved staff retention.

- 74% said asking employees to be in the office full time was not a business priority.

- 65% believe they would lose talent if they insisted on their employees being present in the office five days a week.

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Bumpy ride continues for office sector in Australia - GPT suffers

- GPT (Trust Group Funds Management) has swung to a $240 million full-year-loss following a whack to the value of office portfolio while it is looking to offload its half-share in Austrak Business Park in Melbourne with expectations at around $300 million.

- 2023 Devaluations wiped off $819 million, or 5.1% off its total portfolio value. The office portfolio saw 9.2% or $555.8 million wiped off, while the logistics portfolio saw a 1.9% decrease, or 84.7 million, and its retail assets lost $178.7 million or 3.1%.

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Singapore Land and UOL team up for Sydney Office

- A joint venture between Singapore-listed companies UOL Group and Singapore Land Group(SingLand) has confirmed its acquisition of Brookfield’s half-stake in Sydney office tower 388 George Street at $460 million.
- The deal has long-mooted in property circles and comes in **on a yield of around 6.2%,** reflecting the softening in office values in recent years.
- 388 George Street is an A-grade 30-storey commercial building with two storey basement parking and five –storey retail and commercial podium building that includes luxury retail giant **Cartier’s flagship Australia store.** Office tenants QBE, Aware Super and co-working operator the Commons. Cartier and the Commons joined on the back of a $200 million refurbishment of the tower in 2020.
- This transaction is a result of sustained period of falling values in the Global Office Sector.

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Sentinel revs up mispriced assets strategy with 9.34pc yield acquisition

- Sentinel Property Group has taken advantage of repricing in the office market by purchasing a Brisbane building for $72 million-on a yield of 9.34% and significantly below replacement cost.
- Sentinal has acquired RACQ House from the motoring club RACQ, which occupies the building and put it on the market for the first time in 10 years.
- The acquisition price is well below the estimated replacement cost of
  $152 million.

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Melbourne Office Values set to Fall

- MSCI data shows Melbourne office peak to trough values have fallen 21% in this cycle which is more than 14% decline recorded during CFC. Current data would suggest values need to decline by another 18% for liquidity to return to the market.

- Property Council of Australia office market Report shows Melbourne now has almost 1 million sqm of vacant office space.

- The latest results of the MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index show the past 12mths to June 24, the overall index fell 13.8% predominantly driven by the office specialist funds, which saw values fall by 18.5% The total return for the index was 10.4% the worst annual result since 2009.

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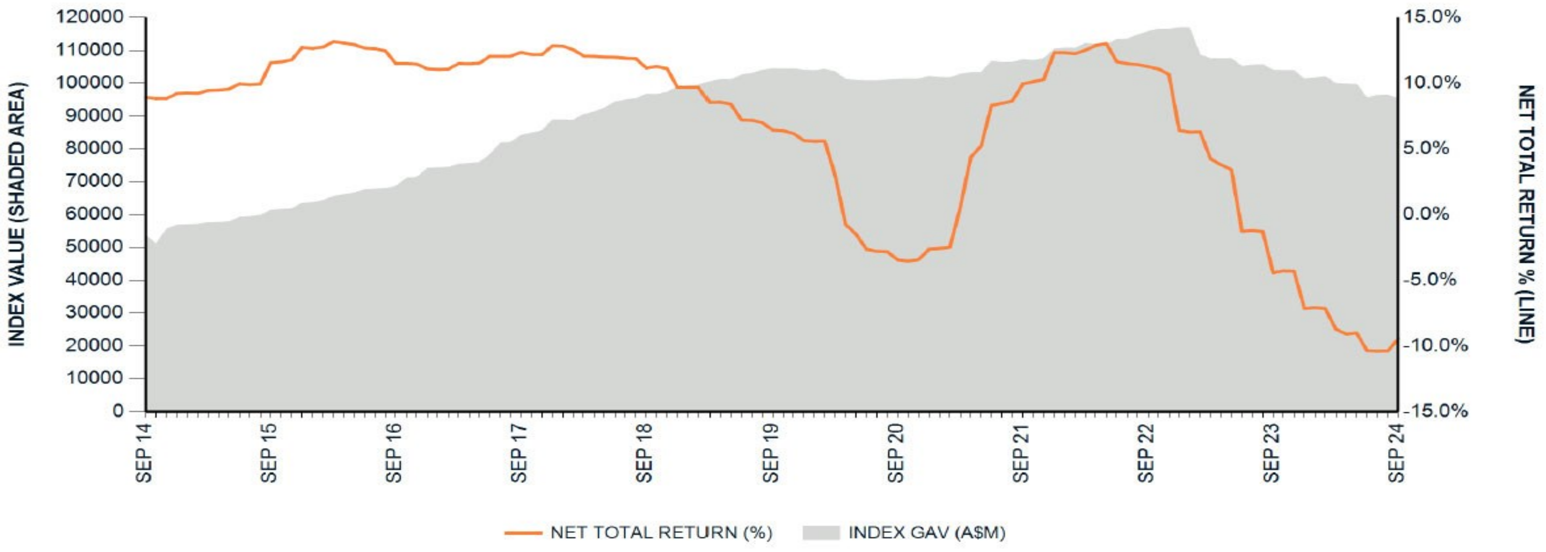
MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index - AUD

Results for the month to 30 September 2024

The MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index measures Net Total Return (Post Fee NAV) to Core Unlisted Wholesale funds within the Australian investment market.



Index Performance

	Total Return Index to Sep 2024 Jun 2007 = 100	Income Return Yr (%)	Capital Growth Yr (%)	TOTAL RETURN % 1 Mth	3 Mth	FYTD	1 Yr	ANNUALIZED 3 Yr	5 Yr
All Funds	249.1	4.1	-13.0	-1.0	-0.6	-0.6	-9.5	-1.3	0.4
Office Funds	265.5	3.9	-18.9	-2.4	-2.0	-2.0	-15.7	-5.1	-0.4
Retail Funds	218.6	5.3	-6.0	0.9	1.6	1.6	-1.1	2.2	-1.6
Industrial Funds	361.5	3.6	-9.0	0.3	0.6	0.6	-5.7	6.1	10.4
Diversified Funds	255.5	3.8	-11.8	-1.3	-0.8	-0.8	-8.4	-1.3	0.9

Office Hangover likely to linger longer - KMPG

- “Tenant demand for retail and office spaces across the country remains week, with a turnaround unlikely for some time” KPMG chief economist Brendan Rynne said.

- “The likelihood is, it will be some time before the recent peak in real asset values will be achieved again. For many recent investors, they are now facing the headache after the party. Made harder where these investors are crystallising losses through continual marking-to-market valuations” as outlined in the report.

- Office building sales froze in the wake of the widespread adoption of flexible and remote working during the pandemic, which is still creating uncertainty over office space requirements. Liquidity is only just returning the market, and major assets, such as Mirvac’s 40 Miller St North Sydney and 367 Collins Street in Melbourne, have sold at 20% discounts to peak book values.

Canberra office vacancies climb to highest level on record..

- According to Knight Frank's latest Canberra Office Market report (Sep 2024), the Canberra office market vacancy was up from 8.3% to 9.5% over the first half of 2024.
- Over the half, 37,030 sqm of space was injected into the office market, bringing total stock up to its highest level on record at 2,397,006 sqm. With around 115,000 sqm new development stock forecast for delivery over the coming two years.
- Like other markets around Australia, we have seen strong demand for A-grade office space due to the flight to quality trend and in Canberra we have seen sustained level of demand for prime space from government tenants in particular.

Seller's loss – Investors Gain (Australia)

- Global Investment Manager, DWS loss is Clarences gain. Investors make counter cyclical play. Global real estate investment manager DWS is the latest Vendor to sell an office asset at a major discount, exchanging its **120 Edward St tower for $24 million <u>less</u>** than they paid in 2017.

- Dexus mulls $100m office sales. 636 St Kilda Road is larger asset (by value) if the two assets being sold by Dexus. It was valued at $59 million as at June 30 2024, on cap rate of 8%. But latest valuation is significantly below the peak book value of $121.8 million as at December 2019.

- Charter Hall selling 200 Queens Street to the Barristers' Chambers for $190 million and Mirvac's sale of 367 Collins St for $345 million – 20% below peak values.

- Swiss fund AFIAA sold 628 Bourke Street for $115.8 Million to Bayley Stuart. The sale result will be disappointing for the Swiss fund as the sale price is below the $185 million it paid M&G Real Estate seven years ago and AFIAA spent a further $35 million refurbishing the building.

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Weak office values will weigh on REITS performance in Asia Pacific

- “Rental income growth for rated companies in the next 12mths will soften from levels we had projected for 2023”. Moody’s Ratings said in its new report, *Risks to credit quality to increase in 2024 amid high interest rates and office weakness.*

- Average rental income growth for rated companies’ office portfolios will be “muted” in 2024, according to Moody’s Ratings, with the weakest performance in Hong Kong while growth will be “very modest” in Australia and Japan.

- Market Vacancy levels have increased above historical averages, and we expect further increases in the next 12months as more supply comes online.

- Office rental income in Hong Kong will fall be between 5% and 10% in 2024 amid a supply glut and weak corporate expansion demand, the report said while in China, the office segment will continue to weaken, driven by a high vacancy rate and lower rents dampened further by the economic slowdown.

- Singapore office rental income will be flat in 2024 amid weaker demand and new supply while in Japan, modest growth in office rents in 2024 reflects stable supply and demand dynamics.

- “The flight to quality continues to favour well-located and good quality office assets owned by rated real estate companies. Vacancy rates in the market are still higher than pre-pandemic levels, but lower than those in other APAC gateway cities, such as Sydney, Melbourne and Hong Kong. The Comparatively high office attendance rate after the pandemic will also likely support Japan’s office market.”

- Australia's largest owner of office buildings, Dexus swung to a first half loss as another $687 million was wiped of the value of its portfolio as changing workplace habits continued to bring uncertainty to the sector. That followed a $1.184 billion devaluation in the previous half. Asset value losses were seen across the commercial real estate sector in 2023 as rising interest rates have affected yields and the office sector grapples with structural headwinds such as working from home.

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Alternative Use of Office Buildings - Australia

- One of those development strategies that is strongly being considered in cities around the world is repurposing vacant buildings into housing spaces.
- Apart from conversion of office buildings to apartments space, new technology and data demand has brought new interest into office buildings – **Liquid Cooling Data Centres**.
- AGILE institutional investor Centuria Capital Group is looking to the future of the surging data centre sector, acquiring a 50% in provider ResetData in another early-mover play- this time with a focus on liquid immersion cooling technology.
- LIC allows for a smaller footprint that the traditional data centres that are often developed on larger-scale green and brownfield sites. LIC means 100 sqm of “white space” within a office floorplate could potentially house up to 1.5 megawatts of capacity – in comparison, a traditional 1.5-megawatt data centre would require approximately 1000 sqm of white space.
- McBain said demand for data storage is increasing over 30% per annum, and supply is less than 6% per annum. “People are going to be looking all over the country for potential places to have your data storage. The saving is to go liquid-cooled-around 40%-45% in terms of energy. For people who really require their data closer for latency, that is really bringing the cloud to your office building.”
- Listed on ASX Exchange CCG – Australasian Funds Management Group has assets of $21 Billion.

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Data Centre on track to double *(use of surplus office buildings)*

- THE Australian investable universe for data centres is set to almost double to $40 billion over the coming four years, driven by hyperscalers and the hasty adoption of generative AI.
- According to CBRE's Australia's Data Centres 2024 report, by 2028 the investable universe for the sector will grow from the current $23 billion to $40 billion.
- "Demand for data centres in Australia is increasing exponentially, key drivers for this are greater data generation and storage needs, growing adoption of cloud computing services, and advancements in technology, particularly the adoption of AI," said Sass Jalili, head of data centre research at CBRE.
- Several global data centre operators have a presence in Australia, and their built-out capacity (megawatts), has been growing over the past decade. Both large and small players have expanded their server networks and upgraded data storage service facilities to meet rising demand for the industry's services.
- "Occupiers are now competing aggressively to increase their data centre footprint to accommodate future business needs. Australia specifically is set to see a large gap between capacity and demand in the medium term, which will lead to significant rental growth and make the sector even more appealing the data centre investors" said Darcy Frawley, Pacific data centre capital markets director at CBRE.

Doubt over plan to convert CBD offices space into residential housing

- A MUCH-HYPED plan to convert Melbourne CBD offices into residential apartments to unlock up to 12,000 homes isn’t feasible for some buildings.
- The Victorian government set a target to build 80,000 homes across the state each year over the next decade when unveiling its long-awaited housing statement in September 2023. It also vowed to work with the Property Councils of Australia and the city of Melbourne to look at opportunities to convert almost 80 under-used commercial office buildings into about 10,000 to 12,000 apartments and mixed-use properties.
- Almost a year on-Sep 2024, Housing Minister Harriet Shing conceded that retrofitting some buildings was just not possible. “We know it would cost billions of dollars to upgrade and retrofit those tower sites” she said
- The jury remains out on surplus office space across the globe.

Thank you.

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