MSCI **Q2 2023**

Capital Trends

Australia

$7.0b Transaction volume

-61% YOY volume change

Australia's commercial property market continued its significant slowdown with transaction volume totalling just $7.0b in the second quarter of the year. This represents the worst second quarter performance since 2011.

Transaction activity for the first half of 2023 amounted to just $14.2b, a 62% decrease compared to the same period last year, and perhaps more worryingly, a 23% decline relative to 2020. The last time the market saw a year-over-year decline of such magnitude was in the first half of 2008 during the Global Financial Crisis (GFC).

In the age of market extremes brought about by the pandemic, annual changes have often been somewhat misleading, necessitating a deeper examination. However, no matter how the numbers are sliced, it is evident that 2023 has so far been very slow. When compared to the average volumes of the past five years, transaction activity for the first half of 2023 was 49% below the trend, with the number of deals also down close to 50% versus the prior average.

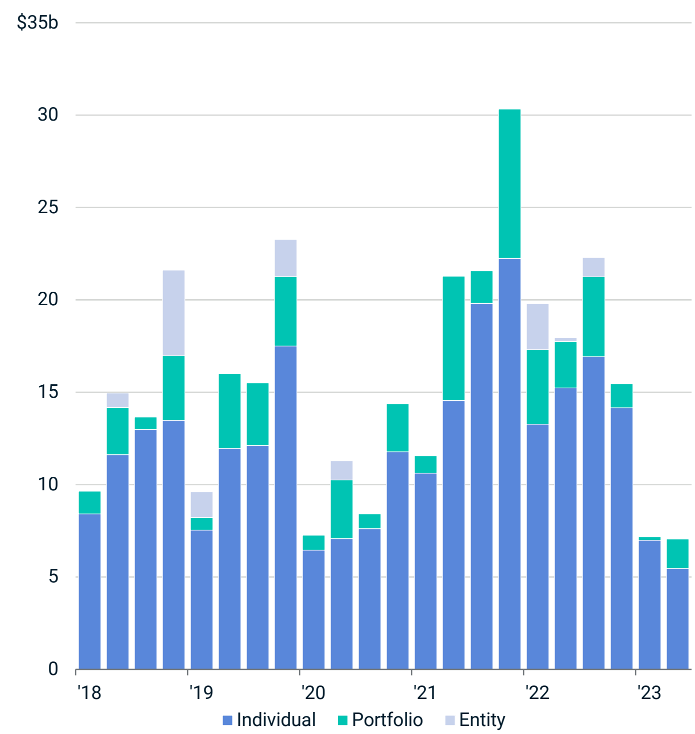
Nevertheless, there is a glimmer of positivity when considering the value of assets that have been exchanged but are yet to be closed. Currently, over $4.3b worth of assets are in the pipeline and expected to close later this year, barring unforeseen challenges. Market reports suggest that deals are taking longer to finalise than in previous years, potentially due to difficulties in obtaining financing because of increased costs of capital.

The Reserve Bank of Australia (RBA) has continued to raise the official cash rate, which now stands at 4.1%. Although the RBA has paused its rate hikes on a couple of occasions during this cycle, the rate has still increased by 400 basis points since May 2022. The resulting higher cost of capital for investors has most likely put downward pressure on the offering prices of potential bidders. If these bids do not align with the expectations of sellers, fewer assets are likely to be transacted. (See more on this pricing discrepancy on page 6.)

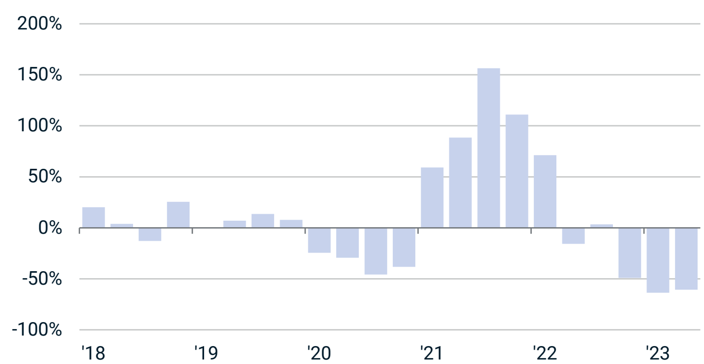
Limited transactional evidence has been cited as the reason that underlying property values did not reflect any significant changes in Q4 2022 and Q1 2023, despite the negative market sentiment as well as the broader economic stagnation. However, the second quarter results of the MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index indicate that values have finally started to adjust, with the index returning -2.8% for the quarter. (See more on page 5.)

Join Benjamin Martin-Henry at briefings in Brisbane, Melbourne and Sydney during August as he discusses the latest market trends. Register here for these events.

Quarterly Transaction Volume



Year-On-Year Change



Transactions by Deal Type

	Q2 2023 Volume		H1 2023 Volume	
	$b	YOY	$b	YOY
Individual	5.5	-64%	12.5	-56%
Portfolio	1.6	-37%	1.8	-73%
Entity	0.0	0%	0.0	0%
Total	7.0	-61%	14.2	-62%

All volume cited in Australian dollars. Aggregate volume includes major income-producing property types; development sites excluded unless otherwise stated.

Recent Trends

In the second quarter of the year, diverging patterns have started to emerge amongst the core sectors. The industrial sector had a subdued start to 2023 following its strong performance and popularity in recent years. In the second quarter, transaction volume amounted to just over $2.4b, marking a year-over-year decline of 62%.

Despite the drop, industrial has remained the most desirable property sector for investors, with just under $4.7b of assets acquired so far in 2023, representing 33% of total acquisition volumes. One of the largest deals of the second quarter involved a joint venture between Sydney-based Wentworth Capital and market stalwart BlackRock acquiring GPT Group's Rosehill Business Park and Citiport Business Park for $256m.

Following closely behind the industrial sector is the retail sector, which recorded transactions totalling $1.8b in Q2 2023, bringing the total for 2023 so far to $3.4b. The retail sector has faced challenges as consumer shopping patterns shifted towards online platforms, resulting in increased demand for distribution warehouses and decreased demand for brick-and-mortar retail assets. However, this shift in demand and the resulting increase in retail yields have created opportunities for investors to acquire retail assets at reduced prices.

The office market, facing well-documented struggles, has lagged the other core sectors. Investor demand for office assets has been limited, particularly at the valuations seen in the past 12 months. In Q2 2023, less than a billion dollars' worth of office assets were traded ($983m), marking the lowest quarterly result since Q1 2009. The proposed acquisitions of 44 Market Street and 60 Margaret Street in Sydney have yet to be finalised. Moreover, the reported prices for these transactions represent substantial discounts compared to previous book values, in a worrying sign for what has traditionally been Australia's largest commercial property sector.

In a sign of history repeating itself, private investors are once again dominating the market during a period of market uncertainty. In 2023 to date, private investors have acquired assets worth over $7.2b. Although this reflects a substantial decline compared to the same period in 2022, private buyers have been marginally more active than their listed counterparts. Domestic and cross-border institutional investors have been largely absent.

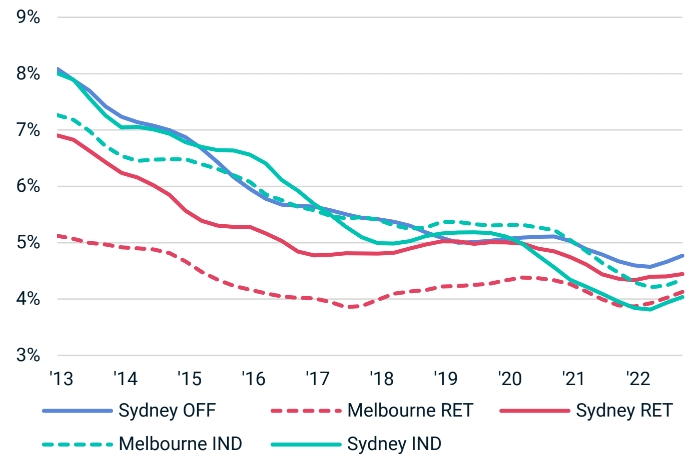
In terms of market share, private investors accounted for 51% of total transaction volumes, higher than their share in H1 2022. This increase in overall market share is even more significant when considering longer-term averages, highlighting the more resilient behaviour of these investors during challenging periods. (An article on private buyers was first published on *RCA Insights*. Read more.)

Transactions by Property Type

	Q2 2023 Volume		H1 2023 Volume	
	$b	YOY	$b	YOY
Office	1.0	-83%	3.0	-73%
Industrial	2.4	-62%	4.7	-63%
Retail	1.8	-57%	3.4	-68%
All Commercial	5.2	-68%	11.1	-68%
Hotel	0.4	-16%	1.5	16%
Apartment	1.4	50%	1.4	39%
Seniors Housing & Care	0.1	-36%	0.2	-72%
Income Properties	7.0	-61%	14.2	-62%
Dev Site	1.7	-50%	2.3	-61%
Grand Total	8.7	-59%	16.6	-62%

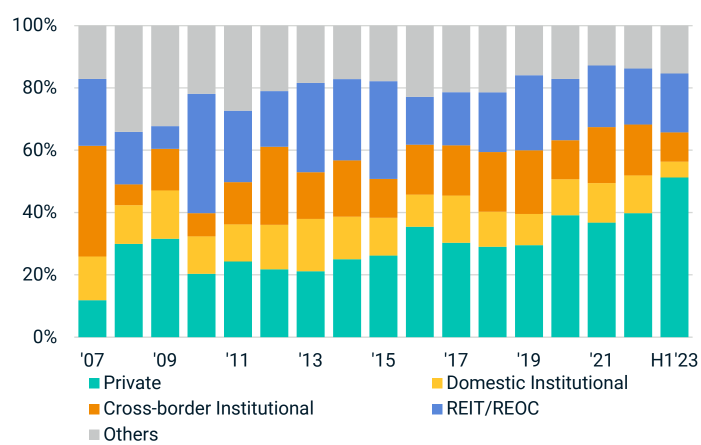
The apartment/build-to-rent sector comprises multifamily rental properties and includes student housing.

Selected Transaction Yields



RCA Hedonic Series

Buyer Composition



By volume of deals.

Capital Flows

Overseas investors increased their activity in Australia the second quarter following a quiet start to the year. They deployed more than $2.8b, representing around 39% of overall acquisitions in Q2 2023. While this marks a significant jump from the $500m spent in Q1 2023, year-to-date activity is, at $3.3b, still 68% lower than the first half of 2022.

The rise in cross-border acquisitions in the second quarter was primarily driven by investors from the APAC region. Their $2.1b in investment accounted for 75% of the total. This is a substantial increase from the previous quarter's $328m. Although investors from outside the APAC region only made up 25% of the total cross-border investment, they significantly increased their acquisition levels, to just under $700m from $182m in the first quarter.

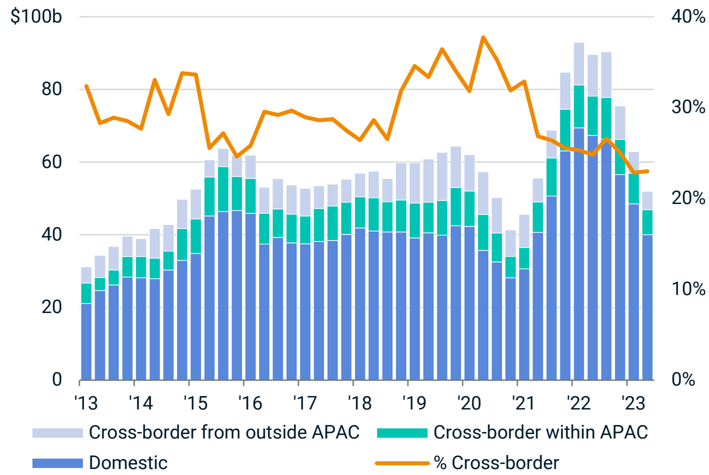
Despite the latest increase in activity by overseas buyers, their share of acquisitions in 2023 remains below long-term averages. Overseas buyers accounted for only 23% of acquisitions in the first half of the year, compared to a 10-year average of 29%. Moreover, this share has been decreasing each year since it reached 34% in 2019. But why is this the case? Two potential reasons could explain the retreat: the sector composition of cross-border investment and relative changes in value compared to overseas markets.

It is fair to say that Australian property values have not adjusted nearly as quickly as comparable global markets. Taking the office sector as an example, between 2019 and 2022, Australian values increased by 4.5%. In contrast, the U.K. and the U.S. saw declines of 16.3% and 11.4%, respectively, according to their local MSCI property index results over the same period.

Another significant factor contributing to the decrease in overseas investment is changing sector preference. Traditionally, the office sector has been the top choice for offshore investors when allocating capital in Australia, accounting for 49% of all overseas acquisitions between 2018 and 2022. However, in 2023, the office sector's share of acquisitions has plummeted to just 15%. This shift can be attributed to the challenges faced by office markets globally, causing investors to be hesitant in acquiring even quality assets without substantial discounts.

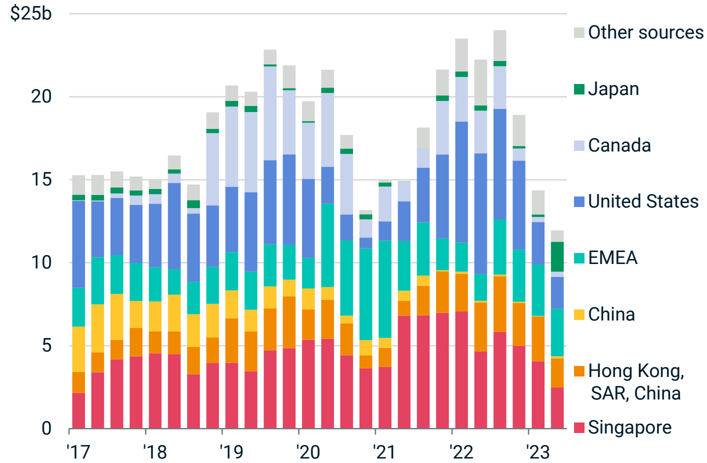
Against this background of diminished investment in offices, investors have redirected their capital. Reflecting the current trends, the living sectors — particularly the build-to-rent sector (BTR) — have experienced the most substantial influx of investment. Japan's Mitsubishi Estate invested in a portfolio of both operational and under-development BTR assets owned by Mirvac Group. Mitsubishi, along with the Clean Energy Finance Corporation, acquired a partial stake in the portfolio. This transaction has propelled Japan to become the leading source of overseas capital for Australia in H1 2023, reflecting a wider global trend of increased Japanese spending.

Australia Investment by Source of Capital



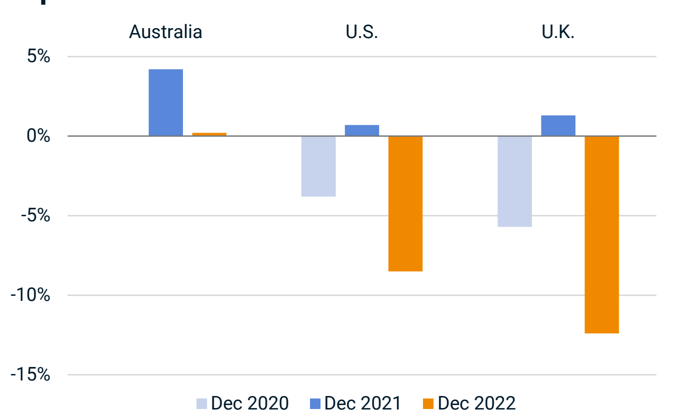
Rolling four-quarter transaction volume.

Australia Cross-Border Investment by Capital Origin



Rolling four-quarter transaction volume.

Capital Growth for Office Sectors



The Property Council of Australia/MSCI Australia Annual Property Index (Unfrozen) Published Quarterly, MSCI UK Annual Property Index, MSCI U.S. Annual Property Index (Unfrozen).

Top Market Segments and Alternatives

At the start of the year, the Sydney market dominated the top five ranks for most active market segments, but it has since retreated, allowing Melbourne, Australia's second city, to take advantage. Melbourne now boasts four markets in the top 10, up from the start of 2023 when it had only one market in the top ranks. While a Sydney market still holds the top spot, it's not the perennial number one, the office market, but rather the industrial sector.

During the first half of the year, the Sydney industrial market recorded just under $2.2b worth of transactions, which, though lower than last year's volume, is still remarkably strong compared to some other segments of the market. One of the standout deals in the second quarter of the year was the acquisition of 49-61 Stephen Road by ESR and GIC for $143m in a sale-and-leaseback agreement from Gemany's allnex.

Melbourne's retail market secured the second spot with just under $1.2b of transactions. Private investors have shown considerable interest in the retail space, particularly in the Melbourne market. The largest deal of the quarter was IP Generation's acquisition of Craigieburn Central for $300m from Lendlease.

Making a rare entry into the top five is the Melbourne apartment market which rose in the rankings thanks to Mitsubishi Estate's investment in BTR assets (see page 3). With the growing popularity of the living sectors, it wouldn't be surprising to see more apartment markets featuring near the top of the rankings in the coming years.

Another market that made its way into the top five is the Melbourne industrial market, primarily due to the acquisition of a quintessential Australian asset — the Vegemite Factory — in Charter Hall Group's $114m deal.

Most Active Markets H1 2023

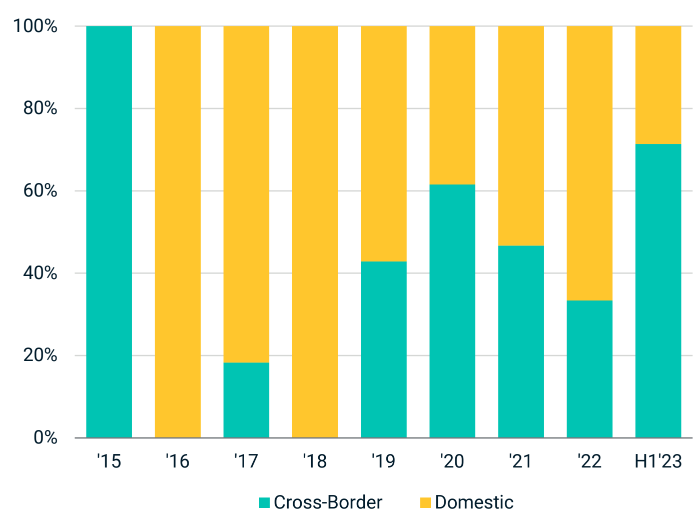
2021	2022	H1'23	Metro Segment	Sales Volume ($m)	YOY Change
3	2	1	Sydney Industrial	2,175	-41%
8	7	2	Melbourne Retail	1,186	-35%
22	20	3	Melbourne Apartment	941	202%
2	3	4	Melbourne Industrial	888	-74%
1	1	5	Sydney Office	864	-82%
16	9	6	Sydney Hotel	795	117%
4	5	7	Sydney Retail	691	-79%
5	4	8	Melbourne Office	643	-73%
7	6	9	Brisbane Office	434	-78%
6	8	10	Brisbane Industrial	399	-76%

Build-to-Rent Momentum Gains

The recent announcement by the federal government regarding build-to-rent assets in managed investment trusts — reducing the withholding tax rate for overseas investors from July 1, 2024 — has been met with positively in the industry. Subsequently, there have been several new BTR developments announced, and while these were very likely already in the works, the tax changes do indicate the potential for increased interest in the sector.

Cross-border investors have accounted for 48% of units that have either been completed or are currently under construction in Australia since 2015. Global groups such as Greystar of the U.S. are experienced multifamily investors across multiple markets and have embarked on several projects locally. Australia's private residential rental market is characterized by low national vacancy rates hovering around 1%, surging rents and persistent undersupply — qualities which could underpin the demand for BTR units.

Capital Composition of Build-to-Rent Starts



Pricing and Performance

The uncertain economic outlook coupled with the pressures of rising inflation and interest rates continued to take their toll on Australian core wholesale property funds as they recorded a negative total return in Q2 2023, according to the MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index.

The overall quarterly total return for the index was -2.8% for Q2 2023. The office funds were the main culprits, recording a 5.2% fall in capital growth. Annual performance for the overall index slipped into negative territory as the index posted a total return of -1.3% in the second quarter, compared to the 4.2% in the first and a far cry from the 11.6% recorded 12 months ago. The annual results comprised an income return of 4.0% and capital growth of -5.1%.

After months of speculation about when the market would see significant falls in value for the office sector, the negative turn finally arrived. The one-month capital growth for June came in at -5.2%, driving the worst 12-month total return since early 2010.

Office funds recorded an annual total return of -4.4%, comprising capital growth of -7.9% and an income return of 3.7%. This is the first significant write-down in values for the sector and was widely expected as global markets have already seen substantial adjustments in the office space. Offices account for almost 40% of the index, bearing a major influence on overall returns.

Retail funds recorded capital growth of -3.4% for the quarter, making them the second worst performing sector. While retail funds performed better than office, annual capital growth of -4.0% was a reversal of the 3.9% recorded 12 months ago. The retail market is undergoing cyclical struggles. Rising interest rates and persistently high inflation are reducing consumer disposable incomes, which in turn is leading to less patronage of brick-and-mortar retail assets, particularly non-discretionary types.

As widely expected, the industrial funds were the standout performers, but with an annual total return of 6.0% they are well off the 20.4% total return of a year ago. A slowdown in the pace of growth for the industrial sector was almost inevitable given its extraordinary performance of recent years.

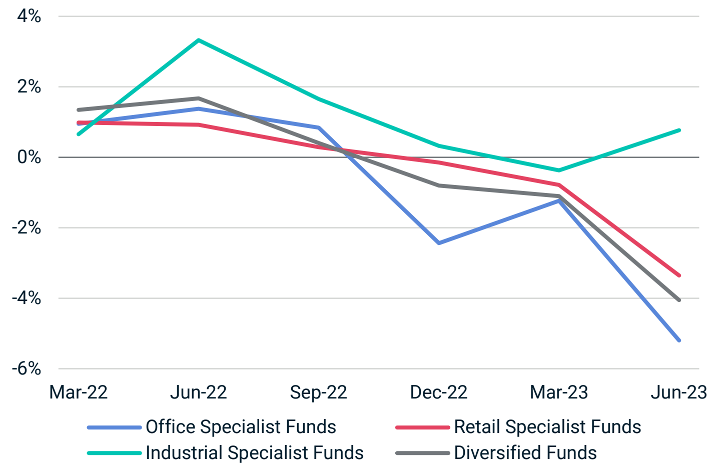
The significance of online retailing for the industrial sector is such that a decline in consumer discretionary spending will have ripple effects. However, despite this negative factor, second quarter performance improved compared to the first, suggesting that the industrial sector may have already reached its low point.

This bottoming-out trend is also evident in the listed sector. Industrial real estate investment trusts (REITs) experienced a share price decline of over 30% in 2022. In 2023, however, prices have risen by 14%, potentially indicating that the market believes the worst is behind us.

Nevertheless, it is important to be cautious in interpreting these signals due to the divergent performance in listed and unlisted property. Indeed, the contrasting paths of the listed and unlisted asset classes in general have prompted calls from both the Australian Prudential Regulation Authority and the Financial Regulator Assessment Authority for increased scrutiny on valuations of unlisted assets.

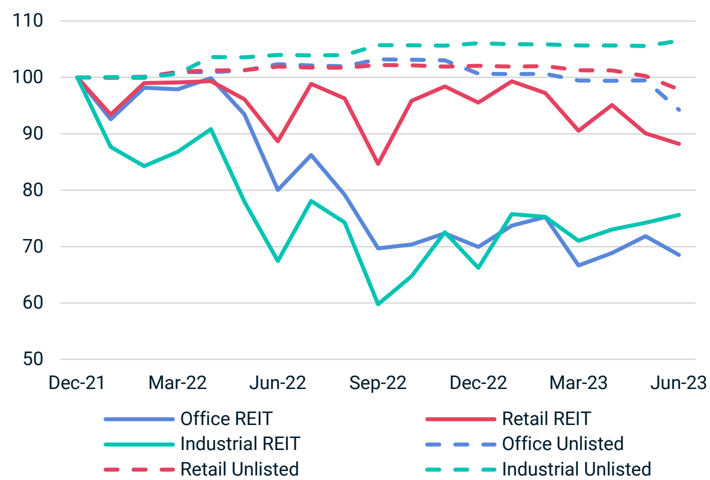
In 2022, the office REIT series recorded a price decline of 30%, while unlisted office assets in the core wholesale index remained relatively stable. Similarly, industrial REITs posted a 34% decrease in share prices, whereas unlisted industrial assets in the index saw capital growth of 6%. This discrepancy is not unprecedented, as during the GFC, REIT share prices plummeted by 67%, while underlying property values experienced peak-to-trough declines of approximately 15%.

Quarterly Capital Growth, Property Funds



MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index, June 2023 results

Listed vs Unlisted Property Performance



MSCI Australia IMI indexes for industrial, retail, office REITs (price series). MSCI/Mercer Australia Core Wholesale Monthly Property Fund Index, June 2023 results.

Australia in a Global Context

In today's interconnected world, property markets cannot be viewed in isolation. They are influenced by global economic trends, investment flows and geopolitical developments. Considering the global context is crucial, as different market paces create opportunities for global investors, making it essential to examine Australia's results from a broader perspective.

In 2023, transaction volumes in the Asia Pacific region have remained relatively robust compared to the Americas and Europe, Middle East and Africa (EMEA). While the Americas and EMEA experienced significant declines of around 60% in H1 2023, the Asia Pacific region recorded a milder 43% YOY decline. (APAC transaction activity results are preliminary.)

The U.S. has seen the sharpest slowdown in transaction activity in 2023, with a 61% YOY decrease and a 36% drop below the five-year average. Transaction activity in the living sectors — predominantly comprising multifamily assets — plummeted 67% YOY, following back-to-back record years in 2021 and 2022. Deal volume in these two years was more than double the previous four years combined.

In a pattern that’s being repeated across the globe, offices were the weakest of the major sectors in the U.K. so far in 2023. Despite being one of the first markets to see significant write-downs in valuations, investors have still seemed cautious about U.K. offices.

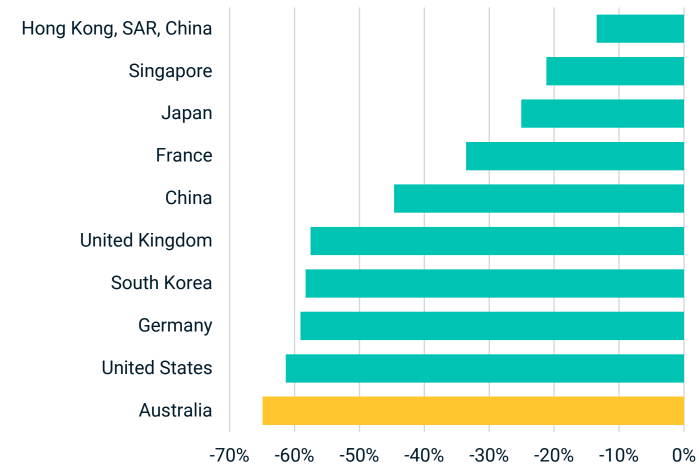
In contrast, investors have shown more confidence in deploying capital to the Asia Pacific region. For instance, Japan experienced a modest 25% decline in the first half of the year. Japan’s industrial sector even recorded an increase in deal volume relative to 2022, making it one of the few market segments globally to see growth.

Singapore was the exception among major global markets, being the only one to surpass five-year averages for deal volume. Singapore has experienced consistent growth in the recent past: four out of the last five years have been the strongest first halves on record. Although volume was down 21% YOY for Singapore, compared to five-year averages the activity was 16% higher.

The relatively robust performance of Singapore's property market can be attributed, in part, to the consistently narrow gap between buyer and seller expectations over the past few years, as indicated by the MSCI Price Expectations Gap.

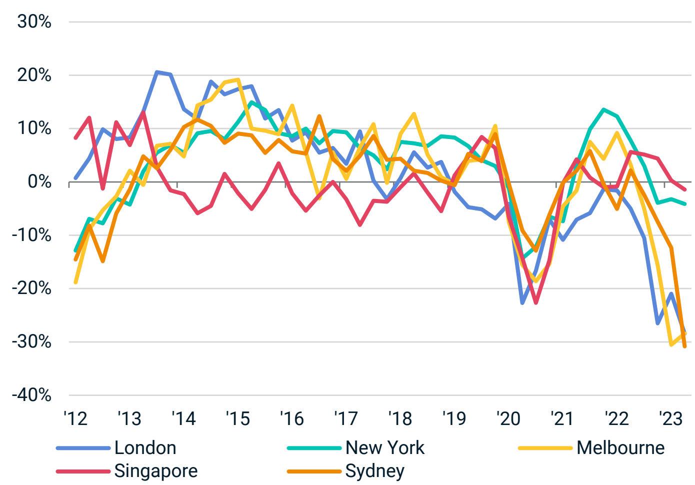
According to the model — which estimates the amount sellers would need to shift their price expectations to bring transaction activity back to “normal” — the gap between buyers and sellers in the Singapore office market is just -1.4%. The result means that the implied additional price movement needed to restore liquidity is just 0.7%, i.e., both parties need to meet in the middle. Over the last two and a half years, this modeled price adjustment has never exceeded 2.8%, which goes some way to explain why the Singapore office market has remained relatively more liquid than many others.

YOY Change in Transaction Volume H1 2023



Results for APAC markets are preliminary. All major property types excluding development sites. Closed deals US$10m and greater.

Price Expectations Gap for Office Markets



MSCI Price Expectations Gap

The contrast between Singapore's office markets and Australia’s major markets is stark. In the Sydney office market, the gap in price expectations stands at 30.8%, indicating that sellers would need to lower their prices by 15.4% to restore long-term liquidity. This gap has doubled since Q1 2023. In Melbourne, the price expectations gap stood at 28.4% at midyear.

The gaps in pricing positions in Australia's largest sectors and markets contribute to its status as one of the worst performing global markets. Restoring long-term liquidity levels appears distant until valuations adjust and price expectations converge.

To learn more about the MSCI Price Expectations Gap, contact us.

Top Players and Deals H1 2023

Top Buyers and Sellers

Buyers by Market

New South Wales
Tattarang
Milligan Group
Clean Energy Fin Corp
Mitsubishi Estate
Goodman Group

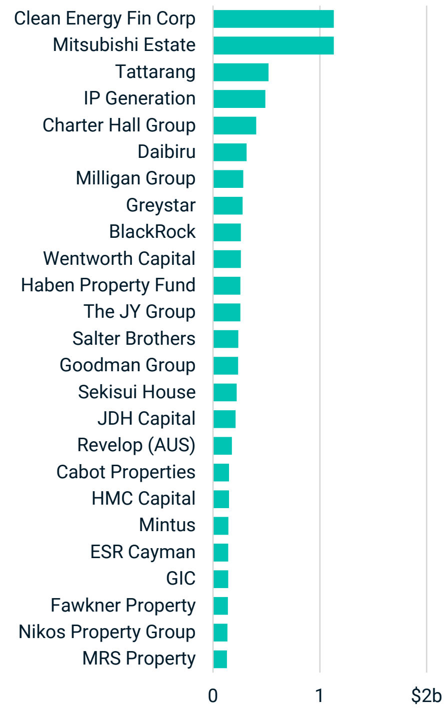
Western Australia
IP Generation
HomeCo Daily Needs REIT
Acure
Hesperia
Western Australia Gov

Victoria
Clean Energy Fin Corp
Mitsubishi Estate
Daibiru
IP Generation
Greystar

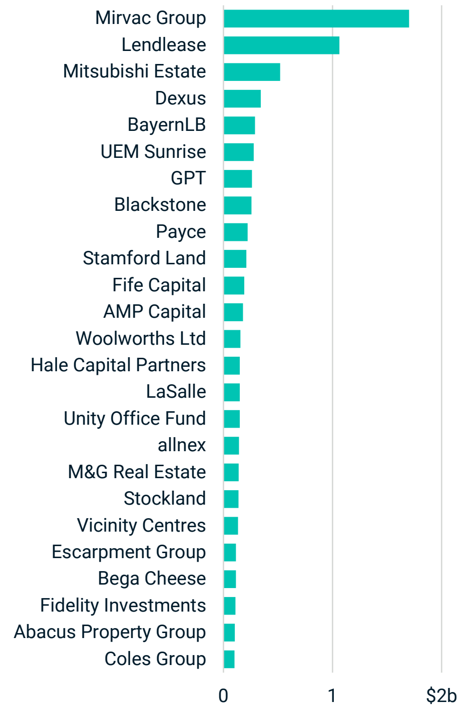
South Australia
MRS Property
Realside
Catholic Church Edwmt Soc
Renewal SA
Lifestyle Pk Coober Pedy

Queensland
Clean Energy Fin Corp
Mitsubishi Estate
Fawkner Property
Hancock Prospecting
Savills IM

Buyers



Sellers



Ranked by investment volume.

Methodology: Rankings are based on the pro-rated share of the total property or portfolio value. In the case of joint ventures, full credit is assigned to each investor.

Top Single Asset Property Sales

	Property	Location	Size	Type	Volume($m)Δ	$/unit	Buyer	Seller
1	Waldorf Astoria Hotel	Sydney	220 units	HTL	520.0 **	2,363,636	Tattarang	Lendlease JV Mitsubishi Estate
2	7 Spencer Street	Melbourne	45,000 sqm	OFF	315.0 * **	14,000	Daibiru	Mirvac Group
3	Craigieburn Central	Melbourne	64,159 sqm	RET	300.0	4,676	IP Generation	Lendlease
4	ATO HQ (Leasehold)	Canberra	43,000 sqm	OFF	290.0	6,744	Charter Hall Group	BayernLB
5	21-53 Hoddle Street	Melbourne	400 units	APT	277.3 **	693,325	Greystar	UEM Sunrise
6	Forest Hill Chase Shopping Cntr	Melbourne	63,581 sqm	RET	256.5	4,034	Haben Property Fund JV The JY Group	Blackstone
7	38-42 Wharf Road	Sydney	30,344 sqm	IND	221.4	7,296	Sekisui House	Payce
8	Sir Stamford at Circular Quay	Sydney	105 units	HTL	210.5	2,004,762	JDH Capital	Stamford Land
9	Rockingham Shopping Centre	Rockingham	62,216 sqm	RET	180.0 *	5,786	IP Generation	AMP Capital
10	Stanhope Village	Sydney	18,051 sqm	RET	158.0	8,753	Revelop (AUS)	Mirvac Group
11	Currency House	Sydney	- sqm	OFF	155.3	-	Milligan Group	Multiple individual sellers
12	Menai Marketplace	Sydney	16,485 sqm	RET	150.0	9,099	HMC Capital	Lendlease
13	Portal - 42-52 Raymond Avenue	Sydney	19,757 sqm	IND	- **	-	Cabot Properties	LaSalle JV Hale Capital Partners
14	49-61 Stephen Road	Sydney	- sqm	IND	143.0	-	ESR Cayman JV GIC	allnex
15	Stockland Gladstone	Gladstone	20,252 sqm	RET	139.0	6,864	Fawkner Property	Stockland

Δ When prices are not known, estimated prices are used in the ranking but are not shown. Volume is adjusted pro-rata for partial interests although $/unit reflects 100% valuation.
* Partial interest ** Forward sale Excludes development site sales.
The number of buyers or sellers shown on a deal is truncated to two. For full deal and player information go to the MSCI Real Capital Analytics website.

Benjamin Martin-Henry
Head of Real Assets Research, Pacific

David Green-Morgan
Global Head of Real Assets Research

Benjamin Chow
Head of Real Assets Research, Asia

Lynette Ng
Senior Associate, Real Assets Research

Methodology

Data based on office, retail, industrial, hotel, apartment, seniors housing and development site properties and portfolios A$1m and greater unless otherwise stated. Data as of July 21, 2023 unless otherwise stated.

About Capital Trends

Capital Trends reports analyze and interpret trends in the global real estate market. US Capital Trends is a monthly edition comprising an overview of the U.S. market and separate reports on the five main property types. Asia Pacific, Australia, Europe and Global Capital Trends are published quarterly. UK Capital Trends, launched in 2023, is published monthly.

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