



Analysis

Property values to fall further, but fall at lower rate than in 1990s

- Despite the paucity of sales to provide evidence, it is estimated that on average commercial property values have fallen by between 10% and 20% since late 2007.
- The driving factor has been rising yields, which for offices and prime industrial are back to, or above, 10 year averages. However, retail yields remain below this average.
- Values need to fall a further 15% to meet historic inflation adjusted post recession values, but better market fundamentals than in the early 1990s suggest such a fall may be too high.

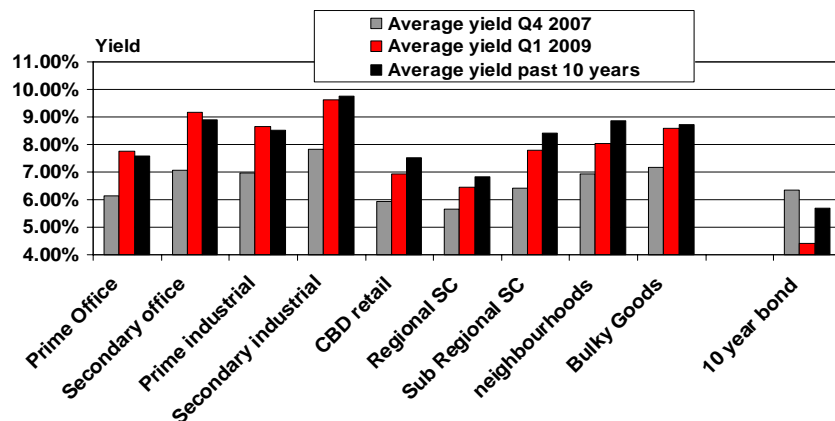
There are a number of questions on many investors minds at present. Two key ones are 'How far has the market fallen?' and 'How much further has it to go?' In this paper we attempt to offer analysis that may help answer these questions.

A paucity of sales evidence makes accurate assessment of price/value movement difficult. However, using data from CBRE research we have taken a view as to how far values had fallen in various markets from the peak of 2007 to Q1 2009. The range was estimated at falls in value of between 7% and 28% for offices, 11% and 33% for industrial and 12% to 18% in retail properties, the extent depending on the different sub-sectors. These estimates have largely been based on yield movement, which have lifted on average by between 100 and 250 basis points since the peak of December 2007. Certainly the rise in yields has started to grab the attention of some of the more seasoned private investors, many of whom considered the market of 2006/7 to be over priced and the yields too low. However, while yields may now appear attractive, the concern has shifted to the economic downturn and the extent to which the recession will hit property income. This leads us to consider that commercial property yields and values, which have already fallen further than we were anticipating 12-15 months ago, have further to move in 2009.

Values are estimated to have fallen 10-20% since end 2007, driven by rising yields

Yields have eased significantly, but further to go?

Diagram 1: National average yields



Source: CBRE/RBA
Analysis Westpac Property

Yields have eased to above 10 year averages in some sectors.

As mentioned, the yield movement has been far greater than expected a year ago, but as a result yields in many sectors are back to their 10 year average. If we are to believe the 10 year average is an acceptable yield, diagram 1 suggests office and prime industrial property yields should experience limited pressure for further easing, as they are at or above their 10 year average. Retail yields and secondary industrial yields are still below this average and could move higher. In assessing how much further values would fall should yields revert to 10 year averages, the answer is not much for office and prime industrial properties. Secondary industrial values would need to fall a further 2%, while retail property values would need to fall between 2% for bulky goods shopping centres and 9% for neighbourhood shopping centres, to reach the target yield. However, these value declines are based purely on yield shifts and ignore the impact of potential income loss in the expected recession.

Comparisons to last property crash

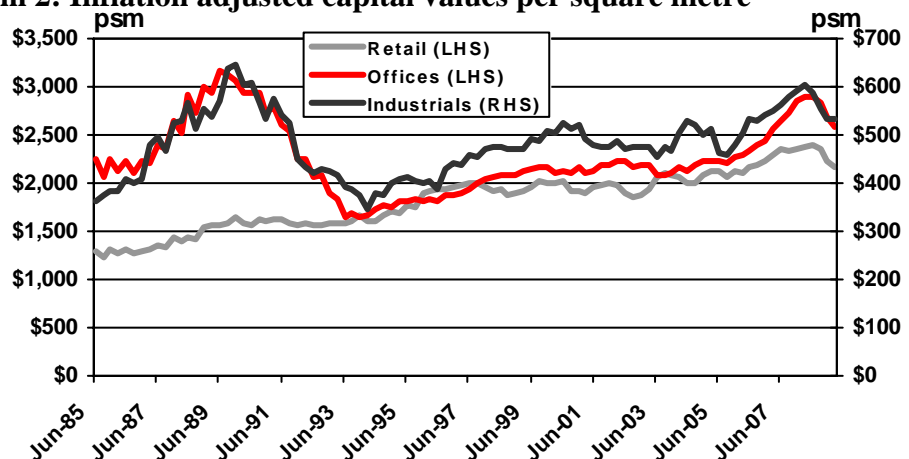
Another method of considering how far values have to fall is by looking at past downturns. The March 2009 Investment Property Databank (IPD) investment index allows us to compare the rise in values of the most recent cycle with the boom of the 1980s and the crash of the 1990s. Given inflation was higher in the lead up to the 1980s boom, we have analysed and compared the cycles after stripping out inflation. The results suggest that the recent boom in values wasn't as high as in the late 1980s, as indicated in table 1 below.

Table 1: Real growth rates – commercial property booms compared

Growth period	Office	Industrial	Retail
1986-1989	37%	58%	27%
2005-2008	31%	28%	16%

Source: IPD performance indicator March 2009/ABS/Westpac Property analysis

Diagram 2: Inflation adjusted capital values per square metre



Source: IPD performance indicator March 2009/ABS/Westpac Property Markets

In the early 1990s values for offices fell by an average of 48%, while industrial values fell 46%, once adjusted for inflation. Real retail values fell by 3% over the same period, in essence keeping pace with inflation. In the current market, if inflation adjusted values were to fall to post recession value lows of early 1994, the 2007 peak to trough decline would suggest falls of 34% for retail, 42% for offices and 43% for industrial. Adding back

As values didn't rise as much in this boom as in the 1980s boom, the crash need not be as deep to reach past lows

**But further falls
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inflation this suggests peak to trough falls of around 25% to 35% for the current cycle. Our assessment of CBRE data earlier in this paper suggested that values have fallen by 10-20%, in nominal terms, across all sectors. Therefore further falls of around 15% would take values back to the lows following the last crash. Of course considerations of a milder recession and a comparatively lower level of supply, particularly in offices, suggest that the falls may not be as high as history indicates.

In **conclusion**, market values have fallen an estimated 10-20% since the peak of December 2007. While yields for offices and industrial are around a 10 year average, further falls are likely across all sectors as the country moves into recession and income levels are challenged by company failure. If past post recession inflation adjusted values are reached, further declines of up to 15% may be experienced, taking peak to trough declines to between 25% and 35% for this cycle. However, healthier market fundamentals than in the early 1990s suggest that previous lows may not need to be reached to start attracting investors.

Westpac Property Markets
Frank Allen
June 25th 2009
Email: Fallen@westpac.com.au

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