Property development and investment in Australia are currently undergoing profound change. In fact, the scale and pace of alterations now taking place in investor attitudes and developer thinking, and the great expansion of opportunities flowing from an unprecedented liberalisation in the Australian government’s and monetary authorities’ views of overseas investment, mean that Australian property development and investment is experiencing its second-most revolutionary transformation in almost 200 years. (The most dramatic property transaction Australia has ever witnessed was also the result of overseas involvement. It took place on that day 200 years ago when Captain Arthur Phillip by a single act, and without any money changing hands, converted the entire continent into the property of the Crown!) Many hitherto-unknown opportunities for profit are being thrown up amid the changing circumstances. They are being avidly seized, and they will continue to be capitalised upon as they occur. However where there is opportunity for exceptional gain there is always the risk of loss. The rash, the ignorant and the inexperienced are always at greatest risk in precisely those conditions of uncertainty that provide experienced players and cool heads with their best profit opportunities. Several underlying conditions have changed. Two recent alterations to the ground rules may prove to have a critical impact on the continuing health of the Australian property development industry. I refer to the reduction in depreciation on buildings from 4 per cent to 2.5 per cent per annum, and to the ruling that developer’s profit must be declared for tax at an earlier stage of a project than I — and certainly many other property professionals — consider prudent. However, these are in a sense technical factors. They are adverse, no-one can deny that, but they will not cause a fundamental change of direction in a flourishing industry. What are the important long-term influences? Why are they coming into play? In essence, they stem from fundamental reappraisals Australia by international markets, and of international markets by Australian investors. The result is a two-way movement of funds and expertise that is having a strongly stimulatory impact on the Australian property investment industry. Until recently, the Australian property investment market was an insular, self-contained system, relatively cut off from influences outside Australia. Government policy prohibited or inhibited the entry of funds from foreign investors for use in property develop-

by PETER WILLS

The sharemarket crash has caused little change in the optimism of the property development industry, and none in the sentiments in this address delivered on that fateful day, October 19, 1987.

Peter Wills is chairman and managing director of CRI Limited. His views on the investment outlook were delivered to a conference in Sydney on financing property development and investment. Although, his address, of which edited extracts are published here, was prepared in October 1987, Mr Wills has told JASSA that his forecasts for the industry are unaltered despite the market shake-out of that month.
The previously cosy and uncompetitive peace of the Australian investment property market is now being shattered by the clamour of strong international investors looking for a piece of the action.

As a quick comparison, a survey several months ago found that a “typical” rent for prime office space in Sydney was $460 per square metre per year. In New York similar space cost $720; in London $1,120 and in Tokyo $3,000!

The yield to the investor in Sydney was 6 per cent, in New York 8 per cent and in London 4.75 per cent. I haven’t been able to ascertain a yield for Tokyo but it would be paper-thin.

In passing: I noted recently an estimated that the grounds of Emperor Hirohito’s palace in Tokyo, if valued at the average price per square metre for central Tokyo property generally, would be worth more than the entire State of California!

Please keep that New York figure in mind. It means we won’t be seeing much investment in the short term at least from the US, and it may help provide some perspective on what is happening in Australia.

Internationalisation of investment markets. Driven by the exponential growth of computer-controlled electronic information systems, a global attitude has developed toward investment. Investment funds have leapfrogged to virtually all countries in which private investment is permitted, finding their way into any area offering apparent comparative advantage. Thus the previously cosy and uncompetitive peace of the Australian investment property market is now being shattered by the clamour of strong international investors looking for a piece of the action.

New Zealand investors are now moving into Australia in force. Yields for prime property in Auckland CBD are estimated to be around 5 per cent, so property in Sydney’s CBD, with yields ranging upwards from around 5.75 per cent, looks good value to New Zealand purchasers. (I must emphasise that in both cities high-quality properties are scarce and seldom traded. Since benchmark sales are few and far between, these yields are arrived at by “guesstimation,” based on sales of good quality CBD properties and the opinions of professionals).

Apart from snapping up what they see as comparative bargains, New Zealand investors in Australian property take the view that the relaxation of restrictions on the influx of foreign money into Australia will push up values overall. Very sensibly, they are getting in on the ground floor.

The influences that are having the critical impact on Australian property values are not New Zealanders but Japanese and, to a lesser but nevertheless important degree, South Asian Chinese.

To Japanese interests, faced with fixed interest securities in Japan yielding below 2 per cent and the Tokyo Stock Exchange showing a gross aggregate dividend yield of 0.5 per cent, the yields currently being generated by Australian prime property are highly attractive, especially given the strong upside potential in underlying values.

The very favourable parity rate yen investors enjoy when buying Australian-dollar-denominated assets is a further incentive. Australia offers, in addition, relatively free availability of property investment opportunities — opportunities simply not available in densely-populated and highly-priced Japanese metropolitan areas. It is therefore little surprise that Japanese investors are pursuing long-term investment strategies in Australia.

We have already witnessed a very sizable influx of Japanese investment funds. Recently it was reported that Japanese interests have invested in excess of $8,000 million in various Australian property projects. Undoubtedly much more will be added to this sum.

I need only cite a few recent major Japanese acquisitions to make that point.
EIE Development Co Limited bought both the Sydney Regent Hotel for $145 million and CRI's own major Sydney hotel development, the Regent on Campbell's Cove. A 25 per cent stake in the Jupiters Casino on the Gold Coast is another such deal. A third major Japanese acquisition was the purchase of the Burswood Island casino and tourism resort complex in Perth for $110 million.

Nor are Japanese investors buying only into established properties. Mr Iwasaki has described his extremely ambitious Yeppoon tourism resort in Queensland as "a hundred-year project." Mr Yokoyama's Daikyo Kanko has committed $400 million to date to investments in Australian property and is concentrating heavily on tourism.

Australia's tourism potential is its third major source of attraction to Japanese and Asian property investors. The Commonwealth Department of Sport, Recreation and Tourism has projected one million Japanese tourist arrivals a year in Australia by the end of the century.

The Barrier Reef is only seven flying hours from Tokyo. It is one of the "spectacular" tourism destinations Japanese tourists demand when they travel and which Australia is fortunately able to offer. Other Australian destinations regarded by Japanese tourists as "spectacular" include the Sydney Opera House and Ayers Rock.

Australian golf courses, easily accessible and unbelievably affordable by comparison with facilities in Japan, are also a strong attraction to Japanese visitors.

What does this mean for Australian investors?

It is unlikely that many local investors will be able to secure a direct stake in Japanese-inspired projects (or indeed in investment projects initiated by any other overseas-based entrepreneur or investment group).

However, the competition for prime development opportunities will inevitably drive up Australian property values across the board. Step 1 in getting a share of those rising values is therefore to invest in Australian property in potentially high-growth areas. Most property trusts can expect to reap some of the benefits. Even the mediocre performers are likely to float up on the tide. And new investment opportunities will eventuate as forms of ownership novel in Australia are brought to the market. At present the "unitisation" of single properties and the floating of single-property joint-stock companies are well along the development pipeline.

Where is the best area of Australia in which to invest in property? I have mentioned briefly the city's attraction to tourists, both international and local. (Apart from a million international tourists in 1986, about five million Australians not resident in Sydney visited the city).

However Sydney also enjoys another advantage in its global location. In an era in which 24-hour trading of financial securities and commodities is firmly established, Sydney is well placed relative to the major markets of Asia, America and Europe. Office hours in Sydney broadly overlap with the business day in Asian centres — Sydney is in the same time zone as Tokyo — while filling the gap between the office days of America and Europe.

It seems probable that Sydney will experience significantly increased development pressure because of demand arising from the location of finance corporations who see Sydney as the ideal location for their type of business in the Asia-Pacific region.

If those expectations are realised, the implications for development are interesting. Financial corporations are almost exclusively users of premium office space.

Accordingly, we are seeing greater impetus towards the amalgamation of large sites, possibly through the demolition of relatively "modern" buildings in order to make possible
projects offering state-of-the-art technology, such as integrated computer wiring and optical fibre networks throughout, and to gain the benefit of the higher plot ratios achievable on larger sites.

Obviously Melbourne, which is home to many large corporations and has a long tradition as a centre of the finance industry, will attract its share of this business. However property growth indicators for Melbourne are all marginally less encouraging. Yields are lower, despite the fact that underlying asset values are too; the vacancy ratio is higher; and growth trends are flatter.

It seems undeniable that Sydney is being propelled towards the status of Australia’s “international” city. Nevertheless Melbourne is, outside Sydney, the only Australian city centre at present offering attractive investment prospects. Brisbane is widely considered to be currently oversupplied with office space and other capital cities are of interest principally to local investors.

Insistence on high quality is likely to be a major characteristic of Australia’s property development future.

The country’s highest rental level for office space is at present $610 per square metre per year being asked for Grosvenor Place in Sydney. However that level is likely to be substantially exceeded by the proposed development on the site recently sold by CSR. Projected rentals when that project has been completed in 1990 are reported to be between $750 and $800 per square metre per year — a little bullish, possibly, but definitely indicating strong upward movement.

As always, location is a major factor in determining project development. A trend towards development on the periphery of the CBD is gathering momentum in both Sydney and Melbourne. Examples in Sydney include the Carringbush Tower and the proposed Sky Tower development on the present Waltons Bond site. In Melbourne, Kumagai Gumi is developing the $700 million Victoria Central project. It is not yet clear that these peripheral locations have been fully accepted by the market. In fact there has been some evidence of resistance to them by tenants, but that appears — in the light of the success in leasing the Carringbush Tower — to be crumbling.

However in the short term the main area of competition will continue to be the traditional CBD and, as good sites become fewer and more difficult to develop within the CBD, values in that area will be pushed up faster and higher than those in other areas.

The separation of the property development function and the finance function is likely to become more distinct as competitive pressures compel ever-increasing degrees of specialisation.

For example, developers, confronted by the opportunity to progress simultaneously several projects with values in the hundreds of millions of dollars, may lack the resources to participate financially in all of them. Investors would accordingly gain opportunities to “take out” the developer on major deals through syndication, as is already occurring in some current projects.

Investor participation may take several forms, from direct investment through to an underwriting involvement during construction, on the basis that long-term finance will be arranged on completion. Returns on this form of investment can be very attractive.

The widely-anticipated reduction in property yields will require investors to adjust both their expectations and their techniques. Yields however can be supplemented by investors adopting entrepreneurial positions. Project underwriting fees and take-out syndication profits could help to offset reductions in property investors’ cashflow resulting from reduced yields. Composition of property portfolios will henceforth demand substantial care in order to produce for investors and fund managers the correct return with an acceptable risk factor.

Turning to Australian investment opportunities in other countries, it is apparent that substantial Australian-sourced investment funds are now being directed to other countries, especially the United States.

This is no new phenomenon — Lend Lease and Hooker have been active in the US for many years — but as deregulation has taken hold and controls on investment overseas have been relaxed, the propensity for Australian investors to seek opportunities in other markets has gained strength. Most Australians now have some overseas investment, whether they know it or not, through their insurance policies and superannuation funds.

In summary:

Australia’s property outlook is being revolutionised by the influence of current and anticipated overseas investment. That investment will radically alter both the shape of the market and the expectations of the players.

At the same time, Australian investors are looking increasingly abroad for portfolio balance and a wider spread of risk.

Yields are likely to fall as asset values increase.

Geographically, Sydney is the immediate hot spot, followed by the tourist-related activities at the Gold Coast and Cairns.

Melbourne and Brisbane are good medium-term prospects.

Premium office space and tourism are the sectors most likely to draw overseas investment. The investment influx will boost property values overall.

Successful development will involve CBD sites, amalgamations and very costly projects. It will demand skill and sophistication.

Investors can achieve great success in this climate — but the risks too can be substantial for the unwary.