REAL ESTATE INSTITUTE OF AUSTRALIA

REIA

State of the Industry:

Australian Commercial Real Estate

December 2022

Re-Leased

ACKNOWLEDGEMENT OF COUNTRY

The Real Estate Institute of Australia (REIA) respectfully acknowledges the Traditional Owners of Country throughout Australia and recognises their continuing connection to land, water, and community. We pay our respect to them, their culture and their leaders, past, present and emerging.

DISCLAIMER

REIA is a federation of state and territory Real Estate Institutes. Formed in 1924, it represents the real estate industry in Australia at national and international levels.

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ISSN: 1447 6606

Registered by Australia Post. Publication No. PP 299436/00045

PRESIDENT'S FOREWORD

Dear valued stakeholders,

It is my pleasure to present REIA's first ever State of the Industry: Australian Commercial Real Estate Report.

Commercial real estate, encompassing industrial and retail, is facing a critical juncture in its transition from the COVID-19 pandemic to the new global environment of high inflation and interest rates for businesses, investors, and tenants to navigate.

When REIA developed our 2025 vision and strategy to Advance Australia's Prosperity, one of our key findings from consultation with industry was the need to elevate the voice of the commercial real estate practitioner.

This $1.1 trillion dollar sector told us they are hungry for insights, information, in person engagement and more tailored tools in the toolbox to position their business for success.

And so, the REIA Commercial Agency Engagement Program (Project CRE) was born.

Project CRE aims to: Listen to Australian commercial real estate practitioners, formulate a program of works for REIA and our member Institutes out to 2025 and most importantly ensure now and into the future real estate agents remain a critical component of commercial transactions.

We were delighted to form an alliance with Re-Leased to help make this possible and thank them for coming on board as our trusted technology partner for Project CRE.

This State of the Industry Report provides a robust benchmark for commercial practitioners; and identifies the areas where we need better data and evidence which REIA will implement in 2023.

It identifies five key structural considerations moving forward for the operating environment of the commercial practitioner: Regional migration, sustainability, monetary policy and construction costs, supply and automation and technology.

It also examines the top ten opportunities the current environment offers.

Our commitment to better serving you, through our network of Institutes and Affiliates, is unequivocal.

So, whether you are a commercial practitioner, a decision maker within three levels of government or another allied stakeholder, I encourage to reach out to the REIA team and become involved in Project CRE.

We look forward to working with you all in 2023 and seeing what is yet to come.

Yours faithfully,

Hayden Groves
President
Real Estate Institute of Australia

SPONSOR'S FOREWORD

It is a great honour and privilege to partner with the Real Estate Institute of Australia on their commercial programme of work.

Our two organisations are aligned in a common desire to drive growth through advocacy, training, and enhanced support for a traditionally underserved industry in Australia. Re-Leased are passionate advocates for the commercial real estate sector and we are proud to be the inaugural sponsors of REIA's first State of the Industry report.

Australia's commercial real estate market is estimated to be approximately trillion dollars and is an important contributor to the way Australians live and work. This report could not come at a more pivotal time for the industry as we emerge from the pandemic into an uncertain macro-economic landscape.

Throughout the pandemic Re-Leased provided local market reports and commentary based on our own proprietary data to support the commercial real estate ecosystem in Australia. The aim of this was to help commercial real estate stakeholders benchmark their own performance against an always-evolving market and have constructive and informed conversations with tenants and landlords alike.

This report is a significant milestone for the industry and will be great resource to the wider commercial real estate community.

Tom Wallace
Chief Executive Officer
Re-Leased

THE OPERATING ENVIRONMENT

Demographic outlook

Post-Covid demographic patterns reflect critical trends of:

Interstate migration
expected to normalise and return to pre-COVID patterns

235,000 people
are expected to migrate to Australia from overseas over 2023 - 2024

New South Wales
to be the leading destination of choice for international migration

Queensland
to continue be the leading destination of choice for interstate migration

Economic outlook

Economic conditions remain a mixed bag with key highlights for the 2023 outlook being:

+2.5%:
Australia's forecast GDP growth by the OECD

+56%:
Predicted rise in Australian energy costs

A strong labour
market with a peak of 480,000 advertised job vacancies over 2022

Business and consumer confidence at equilibrium or at record lows

These key demographic and economic trends will impact on investors, occupiers, and practitioners in unique ways and are unpacked throughout this report.

OPPURTUNITIES FOR INVESTORS AND OCCUPIERS

1. POPULATION CHANGES

Opportunities

- Regions offer comparative growth opportunities for both rents and yields
- Industrial property offered with full automation solutions for occupiers

2. SUSTAINABILITY

Opportunities

- Energy efficiency innovations that reduce costs and increase demand
- Future proofing buildings

3. MONETARY POLICY AND CONSTRUCTION COSTS

Opportunities

- Energy efficient buildings to offer desired value to occupiers
- Demand for office space to strengthen as economy recovers

4. A SUPPLY CRUNCH?

Opportunities

- Supply driving rental growth
- Identifying future development sites and opportunities

5. AUTOMATION AND TECHNOLOGY

Opportunities

- In house automation solutions for occupiers
- In house automation offering to provide additional value to investors

Contents

INTRODUCTION

The Australian commercial property sector is a constantly evolving one, although it is fair to say the pace of evolution was dramatically sped up at the onset of Covid-19.

Like all industries, the commercial property sector had to deal with numerous challenges, the likes of which participants in the industry hadn't dealt with before.

This included providing government mandated rent relief to tenants, closing shopping centres and office buildings to occupiers while still maintaining basic functionality of the buildings, and trying to maintain supply of goods and services to customers and clients through other channels, namely warehouses and technology.

The aftereffects of Covid-19 are still being felt in the industry.

Managers of CBD office buildings are still reporting far less workers moving through them than pre-Covid, and the movement of people around the country has profoundly changed demand conditions.

Industrial property markets are recording record low vacancy rates, as businesses build up inventory to cope with constrained global supply chains.

However, the global economic outlook is becoming increasingly gloomy, and 2023 will prove another challenging period, albeit for different reasons.

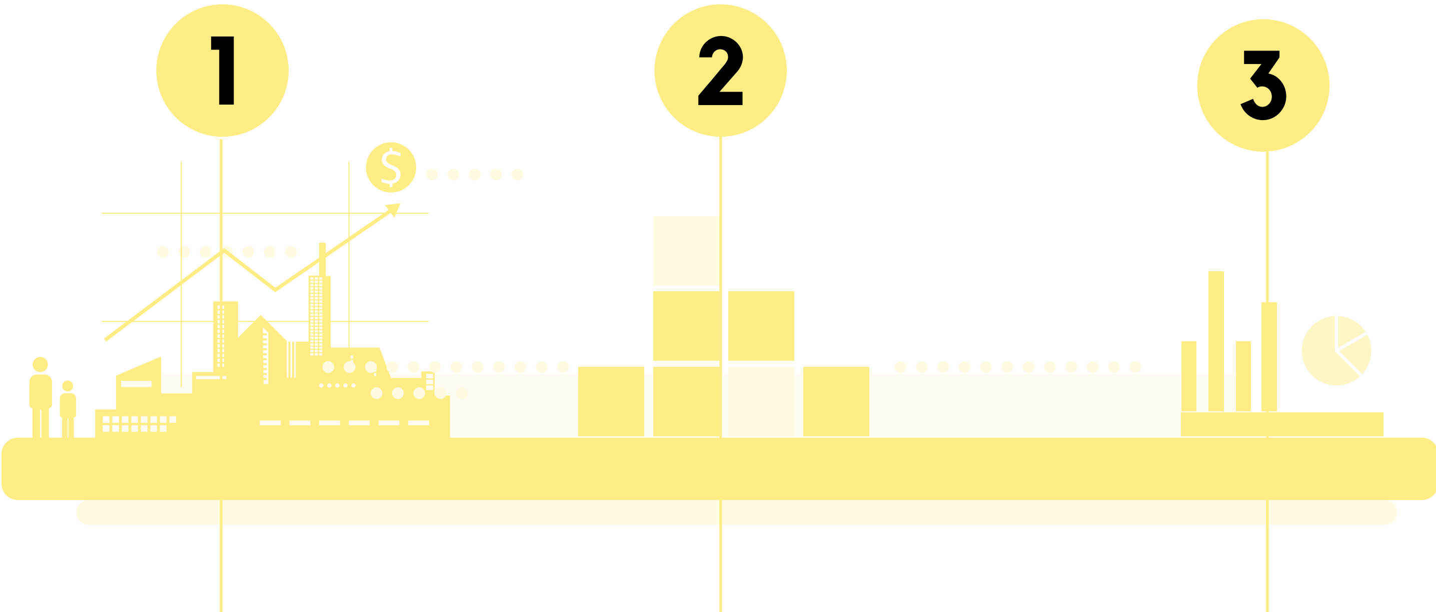
The commercial property sector will continue to provide enormous opportunity and good returns for investors, however, understanding just how the sector is changing and what the implications are will be key to successful investment.

The REIA State of the Industry Report is the first of its kind and is intended to be an annual publication.

It outlines some of the major changes impacting the industry, including movements in people, climate change, automation, and resilience preparation, and what the opportunities and challenges are for commercial property owners.

As an inaugural report, it also highlights the key data and evidence gaps, and sets out a forward program of works to collect this information.

REIA's State of the Industry Report is structured in three parts:



PART 1:
Demographic and Economic Outlook

PART 2:
Structural Challenges and Opportunities

PART 3:
Future REIA Data and Reporting

Part One:

Demographic and Economic Outlook for 2023

DEMOGRAPHIC OUTLOOK

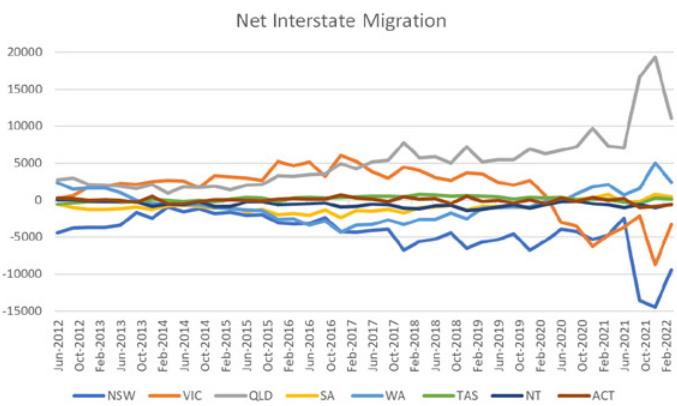
Interstate migration

Understanding interstate migration patterns has always been critical to understanding how demand for commercial property will ebb and flow around Australia.

Throughout the pandemic, Queensland saw a huge number of people migrate to the state, with almost 85,000 interstate migrants moving to the Sunshine state since March 2020.

Over the same time period, just over 58,000 from NSW and almost 36,000 migrants have left Victoria for other states.

While weather and lifestyle have always been major motivators for people moving to Queensland, the state also offers good regional lifestyle opportunities, particularly around the Sunshine and Gold Coasts, which have been very attractive to people since the onset of the Covid-19 pandemic.



Source: ABS

Interstate migration patterns are starting to normalise, with fewer people now leaving Victoria and New South Wales than early on in the pandemic, and fewer people moving to Queensland. Still the numbers are still vastly different to pre-Covid levels, and this is having immediate consequences on rental prices in particular.

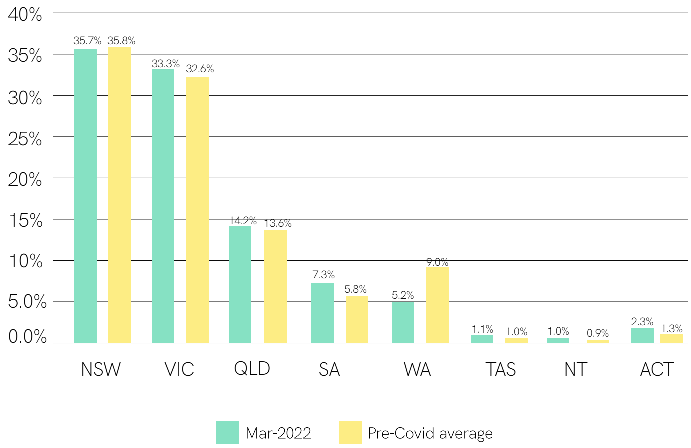
OVERSEAS MIGRATION

Overseas migration patterns, however, tell a very different story.

The March 2022 quarter saw the largest ever number (on net terms) of overseas migrants enter the country, at 96,107. The March quarter historically records the highest number of migrant entries each year, due to the academic year starting, and the previous largest number of migrants was March 2008 quarter, when 93,462 migrants entered the country.

Overseas migrants are also following broadly the same migration patterns as they did post Covid, with the vast majority settling in New South Wales and Victoria. A small uplift has been recorded in SA, where 7.3% of migrants settled in compared to an average of 5.8% pre-Covid. WA is also seeing a smaller share than pre-Covid overseas migrant settlements.

Proportion of quarterly net overseas migration



Source: ABS

The reason for the difference is that interstate migrants tend to relocate for lifestyle reasons, and overseas migrants for economic reasons. Hence they will move to bigger cities where there are not only plentiful jobs but a wide variety of them. They will also move to locations where they have existing family or cultural community connections, and where housing is relatively plentiful.

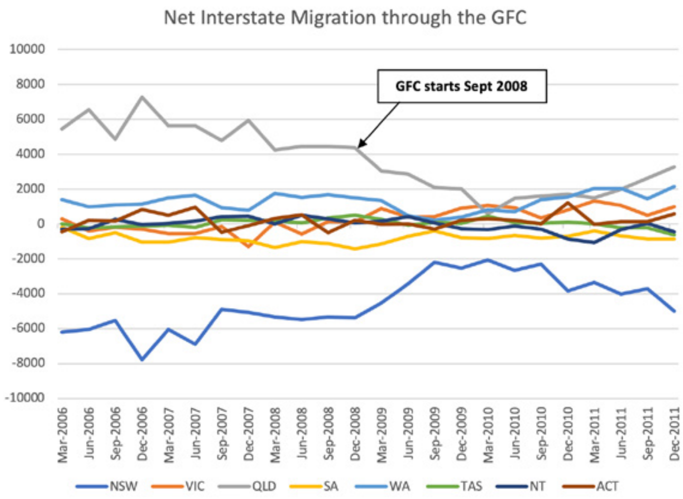
THE OUTLOOK FOR MIGRATION PATTERNS

On present trends, it looks like Queensland will remain a major beneficiary of interstate migrants and continue to attract roughly 14% of all overseas migrants.

However, the economic environment does play a major role in how people move about. In the immediate aftermath of the GFC, overseas migration plummeted, which impacted all states, however, interstate migration also decreased dramatically.

The reason is people tend to move for lifestyle reasons when economic conditions are good, they have money in the bank and/or jobs are plentiful around the country. When economic conditions change, which they are highly likely to in 2023, then people tend to stay put as an interstate move is a risky decision.

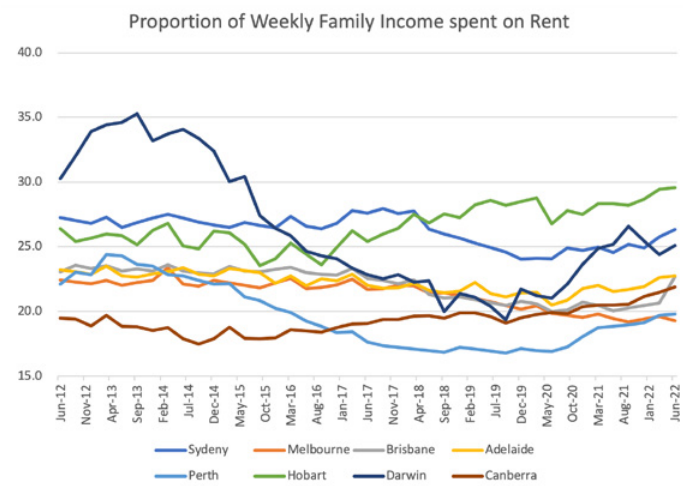
As we move through 2023 and 2024, the number of migrants moving interstate, and particularly to Queensland, to change as the economy fluctuates.



Source: ABS

Another key factor will be the cost of housing. Many new interstate migrants start out as tenants, and the cost of renting in capital cities outside of Sydney and Melbourne has recently skyrocketed. September 2022 inflation data shows that rents in the 6 capital cities outside of Sydney and Melbourne rose by 5.6% y-o-y, the highest ever increase. At the same time, rents in Sydney and Melbourne grew by 1.6% and 1.2% respectively.

When factoring in income, nearly all capital cities are showing increases in the proportion of income needed to pay rent, except for Melbourne, where the trend of reducing rents as a proportion of income continues. This is likely because Melbourne has built a lot of high-density dwellings to accommodate students and housing in greenfield developments to house overseas migrants. This will be another key driver that will keep overseas migrants moving to Melbourne in particular.

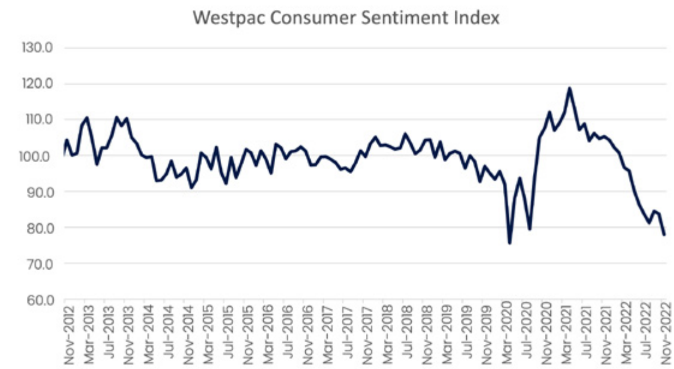


Source: REIA

ECONOMIC OUTLOOK

The outlook for the Australian businesses is for much more challenging conditions in 2023.

Monetary policy tightening by the Reserve Bank of Australia (RBA) is just starting to have real world effects on the economy, with consumer confidence plunging to near record low levels, and business confidence now sitting below equilibrium (at time of writing).



Source: Westpac Consumer Sentiment Index, Nov 2022

For some time now, Australian businesses have been operating at record high capacity utilisation, which has contributed to higher inflation as businesses have felt confident increasing prices as demand has been so strong. It is clear now that businesses expect demand to slow in 2023, as confidence falls and forward orders decline.

Of major importance to commercial property demand is Job Vacancies. Job Vacancies in Australia soared to record levels as lockdowns eased and borders remained shut. Recent survey data, however, has shown that the number of vacant jobs available has started to plateau, suggesting that jobs are both being filled at a faster rate, and jobs are being created at a slower rate.

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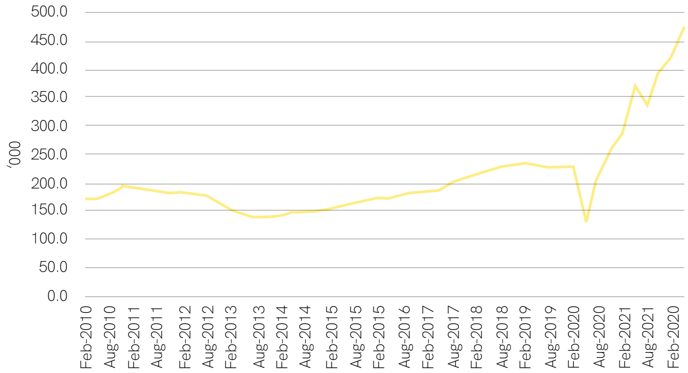
Australian Job Vacancies



Source: ABS. Job Vacancies August 2022 seasonally adjusted

Overall, the outlook is for slower growth in 2023 and 2024, and for higher unemployment – although unemployment will remain at historically low levels. While this will present a challenge for businesses and owners of commercial properties, the reality is that the world needs slower growth to bring down inflation in 2023 and 2024.

Selected economic forecasts - October Federal Budget 2022/23

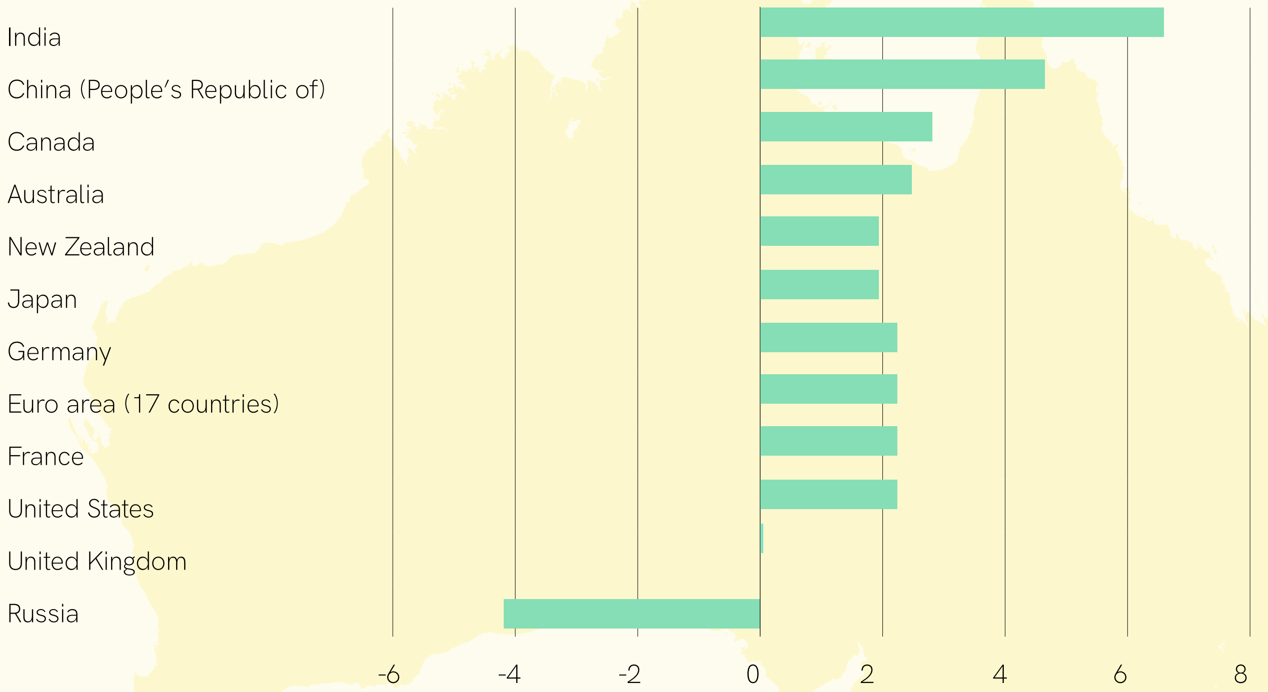
	Outcomes	Forecasts	
	2021-22	2022-23	2023-24
Real GDP	3.9	3.25	1.5
Household Consumption	4.1	6.5	1.25
Dwelling Investment	2.8	-2	-1
Consumer Price Index	6.1	5.75	3.5
Wage Price Index	2.6	3.75	3.75
Unemployment Rate	3.8	3.75	4.5
Net Overseas Migration	150,000	235,000	235,000

Source: Treasury

In context, the Australian economy is forecast to perform better than many global economies, with the OECD forecasting GDP growth to be near 2.5% in Australia over 2023.

For the commercial property market, this is likely to provide encouragement for global capital to either remain in Australia or to enter the Australian property market.

Forecast GDP, 2023



Source: OECD

Part Two:

Structural Challenges and Opportunities

REGIONAL POPULATION MOVEMENTS

The pandemic altered many of our normal patterns of behaviour, none more so than where we preferred to live.

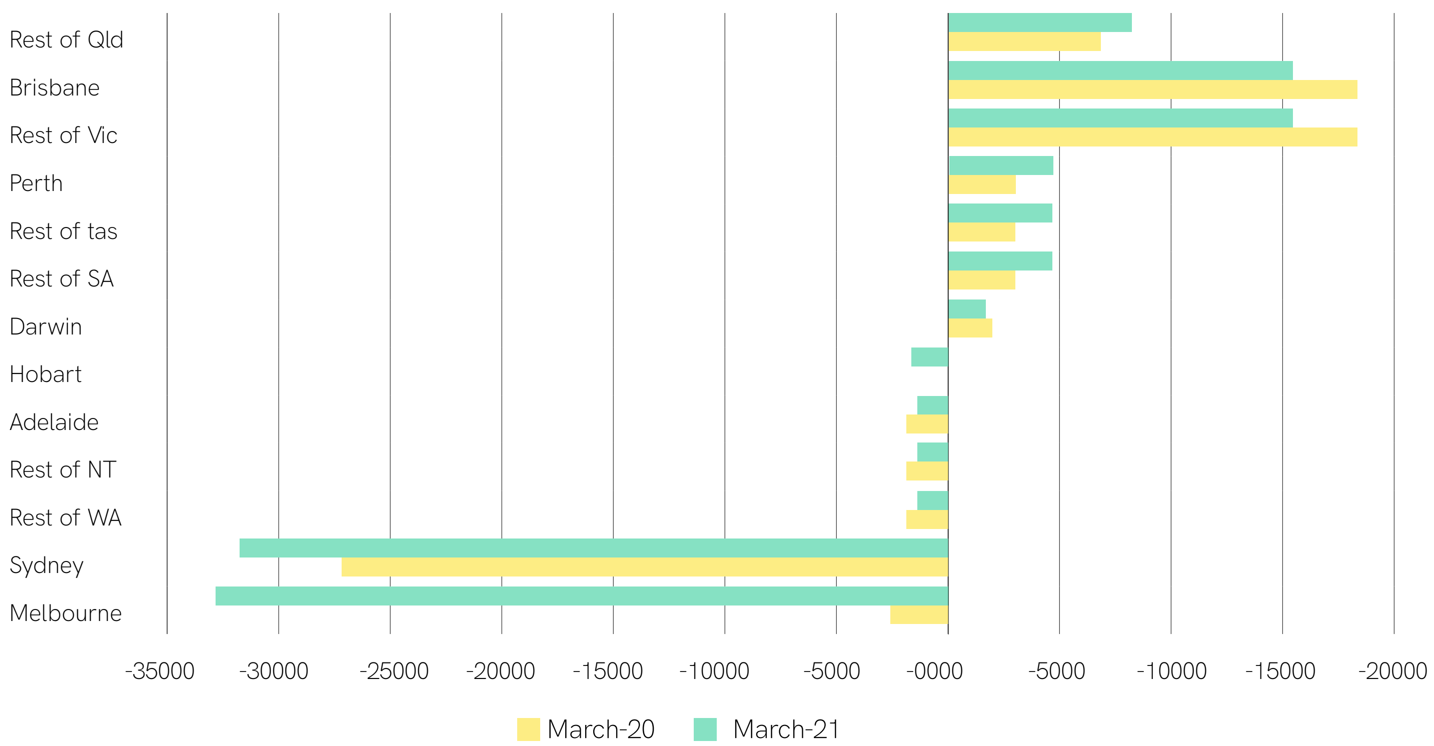
Suddenly, small, inner urban apartments, particularly those that were shared with housemates, were out of favour. Australians quickly grew to appreciate larger homes with room to move, study and work. Being close to a CBD or city centre was no longer essential, as many of us were forced to stay and work at home.

These changing preferences, coupled with some extreme differences in frequency and length of lockdowns across the country, dramatically altered internal migration patterns during the pandemic.

Regional Queensland was the biggest beneficiary, where almost 16,500 thousand people moved to in the year to March 2021, up from 9,354 a year prior.

Conversely, Melbourne saw a massive number of people leave the city - just over 32,000 people left in the year to March 2021, up from 2,637 a year prior. Other areas that saw large increases in internal migrants were regional New South Wales, regional Victoria and Perth.

Regional Interal Migration estimates, year to



Source: ABS

While it remains to be seen if these regional migrants intend on making their move permanent, small business data tells us that Regional Queensland is a hive of activity now.

[1] the ABS did not publish data for March 2022 as too many people updated their medicare details as a result of the Covid mass vaccination program, and they couldn't be certain that the number of address changes were recent or a past move. Internal migration moves are ascertained via medicare address changes

Queensland has by far the largest proportion of small businesses in regional areas of their state, partly due to the size and popularity of the Sunshine and Gold Coasts but would also be reflective of just how many people have moved here and started small businesses.

This means that for commercial property owners, regional Queensland is going to remain very important and provide a lot of opportunity for growth. The type of commercial property demanded by these businesses will differ to CBD requirements. While there will be a slight increase in demand for offices and retail in regional areas as populations grow, industrial property demand will see the biggest growth, as regional populations are far more spread out, making logistics, warehousing, and storage ever important to servicing these populations.

White collar workers in regional areas will be more likely to work from home and potentially travel in to the closest CBD or large regional town for in person work, meaning there will still be relatively limited demand for offices in regional areas.

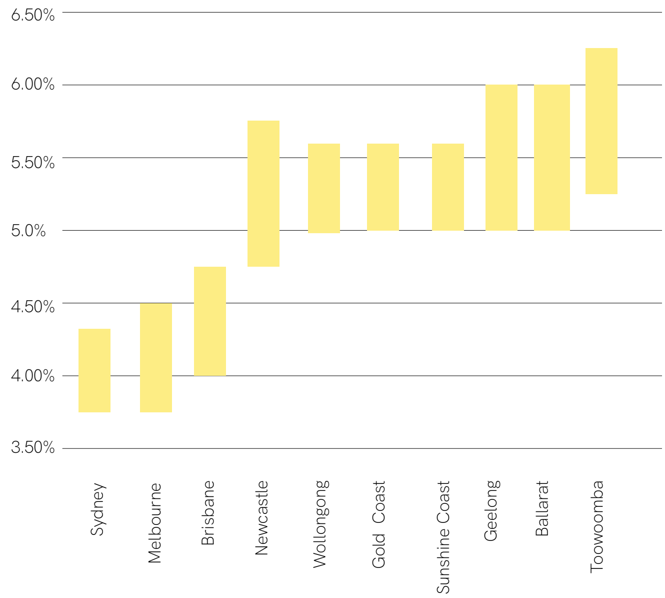
Proportion of small business in capital cities vs regional areas , 30 June 2021

Source: ASBFEO

For commercial property investors, there is certainly opportunity to capitalise on these changing population trends and small business activity in regional areas, notwithstanding the current interest rate environment.

Yields on offer for prime industrial property are far more generous in regional locations versus their CBD counterparts, and tenant demand for them should stay strong as long as the population is there that needs to be serviced.

Prime Industrial Yield Range



Source: Colliers Regional Industrial Spotlight 2022

Opportunities

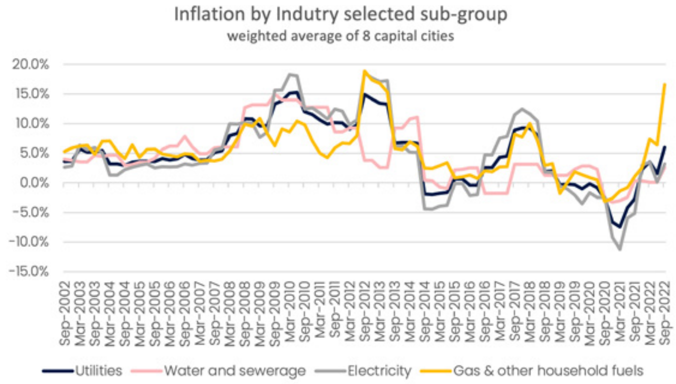
- Many regional areas in Australia are primed for growth in demand for commercial property, after years' of investors focussing on capital city opportunities
- Areas that are experiencing rapid population and business growth, but where limited supply is being added, could have both good rental growth and attractive yields versus their Capital City counterparts
- Industrial property stands out as a clear opportunity for investment, particularly those that can provide automation solutions for their tenants, who in regional areas are likely to be small businesses

ENVIRONMENTAL SUSTAINABILITY IMPACTS ON COMMERCIAL PROPERTY

Over the last 10 to 15 years, the commercial property market has been heavily invested in ensuring sustainability of assets is continually reported on, in part to incentivise owners to upgrade their facilities. In 2003, the Green Building Council of Australia introduced the Green Star rating system and has since then certified fitouts, buildings and homes throughout Australia. The National Built Environment Rating System (NABERS) was originally launched as the Australian Building Greenhouse Rating (ABGR) System and is used to measure a building's energy efficiency. With the fairly sudden rise in energy costs, as well as climate change induced floods and fires along the east coast of Australia, the drive for energy efficiency in Australia is now coming firmly from the occupier side.

The preference for energy efficient buildings by major corporates has been known for some time. A recent survey of over 550 Asia Pacific office occupiers and investors by JLL Asia Pacific revealed that 70% of occupiers are willing to pay a premium to lease sustainability-certified buildings, and 72% of investors believe that green certifications drive higher occupancy, rents, tenant retention and overall asset value . And while technology plays a key role in helping the world move towards a carbon neutral future, widespread digitisation in itself contributes to carbon pollution via the rapid and necessary increase in data centres around the world. The good news is that data centre operators are keenly aware of this, and a survey of data centre operators in Asia Pacific revealed that becoming more sustainable and socially responsible is the topmost priority for data centres in the next two years. While only 28% of survey respondents interviewed had visibility of their energy utilisation to drive transformational business value, 85% agreed that sustainability adoption will significantly impact operations and business decision making .

While corporate social responsibility is an important driver of change, there is no greater motivator for immediate and fast change like financial motivators. While brutal for residential and commercial consumers, the rising cost of energy will fast track the move of tenants towards and owners towards environmentally sustainable initiatives. September quarter inflation recorded y-o-y rises in all categories of major household utilities, including an extraordinary 16.6% rise in the cost of Gas and other household fuels. Treasurer Jim Chalmers outlined in his October Budget 2021-22 update that households will be hit by energy bill increases of up to 56% in the coming two years. These cost rises will flow on to commercial users as well.



Source: ABS 6401.0 Consumer Price Index

What this means for commercial property owners is that tenants will be laser focused on cost savings in their real estate going forward. When entering lease negotiations, face rents are a tenant's 'known quantity'. The starting rent and increases are agreed to at the start of a lease. Outgoings costs, however, change annually based on the annual budget prepared by the building manager, and this is where tenants will feel the squeeze over the next few years. Already we are seeing a flight to quality buildings – both in terms of built form and management quality – as tenants understand that energy use of their building will impact them more and more throughout the life of their lease.

Although rising energy costs is very much a topic of conversation in Australia right now, the relative efficiency of buildings has been front of mind for many in the commercial property industry right now. Take Sydney CBD office outgoings as an example. In December 2010, outgoings in B Grade buildings were 20% cheaper than those of Prime grade buildings. Ten years' later, and the outgoings in B Grade buildings were only 2.7% cheaper.

While the reason for this is a combination of many factors, one of them is the relative efficiency of running modern buildings with more up to date energy efficiency and technology. The difference in outgoings is also even more pronounced when you consider the additional base building benefits prime grade buildings offer versus most B grade buildings, such as end of trip facilities, better lifting capacity etc.

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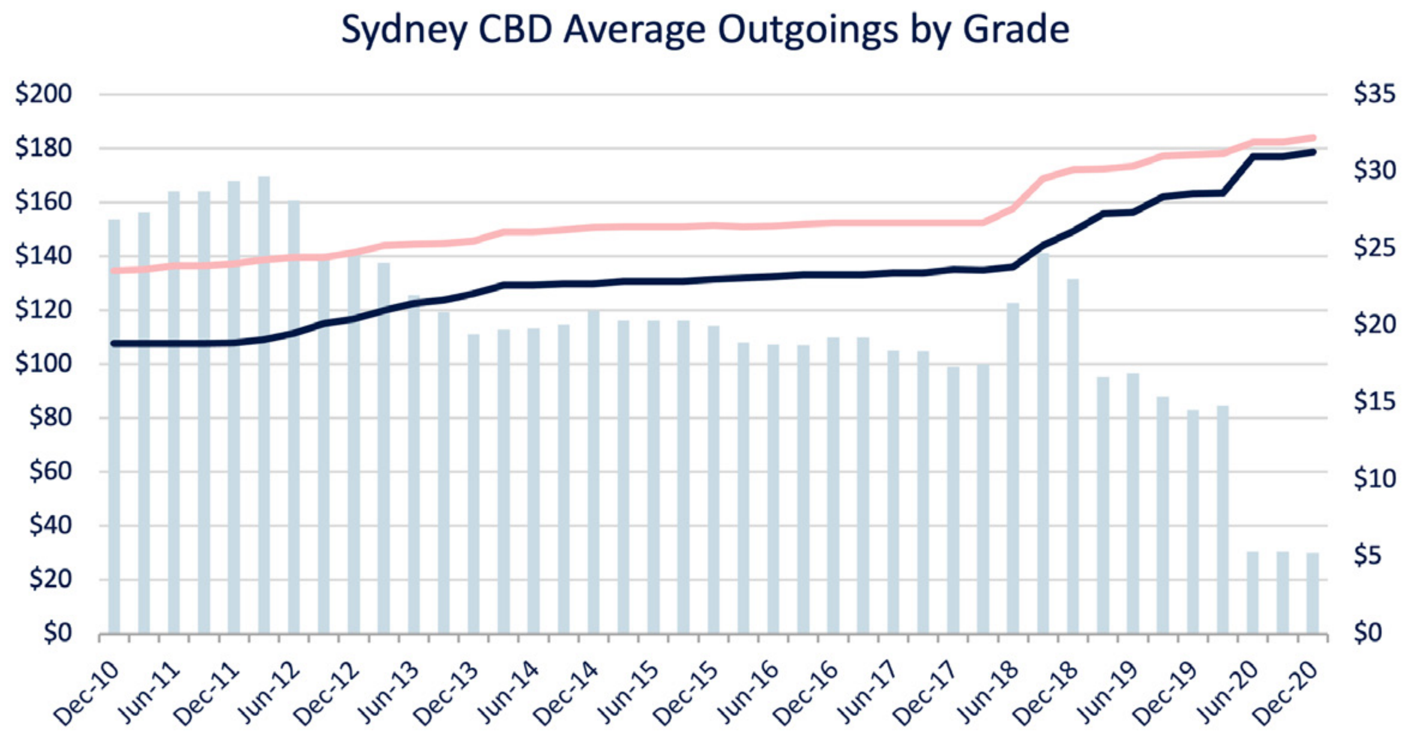
[3] JLL Asia Pacific Research, ESG ambitions: Shaping the future of data centres

[2] JLL Asia Pacific Research, Sustainable Real Estate: Translating Ambition into action



Source: Colliers

Opportunities

- **Investing in initiatives to reduce energy consumption in commercial buildings will not only reduce costs, but increase demand**
- **Future proofing buildings against almost certain rises in energy costs is critical, particularly as Australia transitions to clean energy and the outlook is for higher prices until we reach of critical mass of renewable energy**

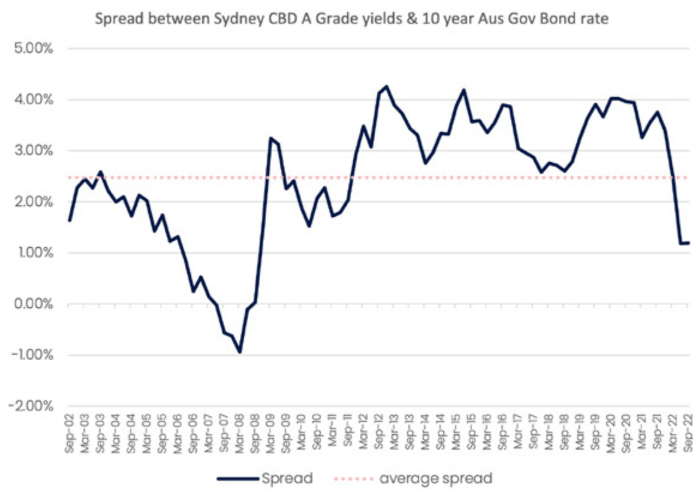
TIGHTENING MONETARY POLICY AND COMMERCIAL PROPERTY IMPACTS

The commercial property industry was one of the most seriously impacted by the events of the Global Financial Crisis (GFC), as credit dried up dramatically and heavily geared borrowers were exposed very quickly. Australian REITs at the time were highly leveraged, after floods of money came in both the form of equity and direct investment into commercial property. Against the ASX 200, A-REITs have performed worse through both most recent economic shocks to hit the listed sector – the GFC and Covid.

	ASX 100 A-REIT	ASX 200
GFC	-56%	-43%
Covid	-21%	0%

Source: Google Finance, ASX

Interestingly, the ASX 200 has recovered all of the losses sustained since early February 2020 (though still off its peak) while the A-REIT sector is valued just over 20% lower than the same time. One of the reasons that investors have taken a harsher view on the sector is that the risk premium on commercial property has plummeted as 10 year bond yields have increased. The risk premium is the spread between commercial property yields and the 10 year bond rate, and over the last 20 years has averaged between 2.0% (for super prime assets) and 10% (for secondary assets in non-core markets). To take an example, Sydney A Grade office yields have a 20 year spread average of around 2.5%. The current spread is around 1.2%. Investor nervousness stems from this spread being well below the long term average and many investors believe yields will have to rise to get risk premiums back to more sustainable levels.



Source: RBA, Yieldbroker, Colliers, Clio Research

[4] GFC measure from Nov 10 2007 to Nov 15 2008, Covid measure Feb 8 2020 to Nov 9 2022

There are clear differences in market conditions between today's Australian commercial property market and the pre-GFC period. First of all, gearing levels are far more conservative, particularly amongst the listed sector. Investor depth is much deeper now as well, with many offshore sovereign wealth funds invested in Australian commercial property. These funds tend to be long term holders of assets, and have plentiful liquidity to ride out periods of monetary policy tightening.

And on the occupier side, while there are clear structural changes to come to terms with, particularly in the office sector, by and large occupancy is holding up well. The retail sector was hit the hardest during the GFC, as recessions started to pinch around the world. However, since that time, many major shopping centre and retail owners have adapted to changes in consumer behaviour, and re-imagined their centres with more services types uses. In some ways, the retail sector was ahead of it's time, implementing ways to get shoppers in to centres as they battled the onset of online shopping. The office sector is going through the same structural shift, and already owners of prime and secondary grade buildings that invested in upgrades to add tenant amenity are benefitting from this change, and this will help to hold their value overall. As discussed in the previous section, those buildings with below average energy usage and costs will also hold their value better than others.

The industrial sector is well and truly in undersupply in Australia, and despite increases in the bond rate, industrial values are holding up as the sector finally starts to record good increases in face rents. Historically rent growth in the industrial market (outside of Sydney at least) has been very weak, as supply mostly kept up with demand. Since Covid-19, demand has well outstripped supply, again helping to preserve value.

Opportunities

- **While the risk premium on commercial property is now very tight, the sector should return to supply/demand rebalance relatively quickly, as supply slows over the next few years and demand strengthens as we move in to recovery mode**
- **Occupancy has been battered in the office sector, although it is likely to be more of a structural change, rather than a permanent shift down in demand. Energy efficient buildings with great base building offerings and tenant amenity still offer good long term value**

IS THE COMMERCIAL PROPERTY SECTOR PRIMED FOR A SUPPLY CRUNCH?

The extremely strong take up of the Australian Government's HomeBuilder scheme during the pandemic has been one of many factors to contribute to soaring construction costs in Australia. At the time, the Department of Treasury expected there would be 27,000 HomeBuilder grants approved, at a cost of about $678 million. However analysis by KPMG found that by June 2022, 110,214 grants had been approved at a cost of $2.3 billion.

This extraordinary cost has had and will continue to have implications for both the residential and the commercial property markets. First, the program had the effect of pulling forward years of residential building demand in to 2020 and 2021. This will result in lower than normal demand over 2023 and 2024 – notwithstanding other demand side factors such as interest rate increases. Secondly, the sudden surge in demand for builders, tradespeople and materials had a real impact on the cost of these. The supply side was also heavily impacted by logistics issues associated with the pandemic, the war in Ukraine and bad weather along the east coast of Australia.

The result, according to leading Quantity Surveying firm Slattery, has been significant cost escalations around the country. Over the year to October 2022, costs rose by between 6 and 10% in Sydney and Melbourne, by 10 to 12% in Brisbane and Perth and an extraordinary 12%+ in Hobart. While these cost escalations are starting to ease, Slattery still expects reasonable cost escalations in 2023, 2024 and beyond.

Construction cost escalations, y-o-y % change – current and forecast

	Year to Oct 22	Remainder of 2022	2023	2024 and Beyond
Sydney	6 to 8	0 to 1	4 to 6	3 to 5
Melbourne	8 to 10	0 to 1	4 to 6	3 to 4
Brisbane	10 to 12	0 to 1	3 to 6	3 to 4
Perth	10 to 12	2.5 to 3.5	7 to 8	3 to 4
Adelaide	5 to 7	0 to 1	5 to 7	3 to 4
Hobart	12 +	1 to 2	9	6 to 8

Source: Slattery, National Market Update, Pressure Points in an Uncertain Market, October 2022

Both the residential and commercial property sectors are very sensitive to building cost increases, and the impact to supply is usually felt 1 to 2 years in the future for residential, and 2 to 3 years for the commercial sector. Sound Project Feasibilities are the basis on which all property developments start, and if construction costs are too high and/or end buyers/tenants can't be found in time, project works stall.

The Australian Construction Industry Forum (ACIF) has recently released forecasts showing that supply completions across both residential and commercial will be far more muted over the next 5 years, when compared to the last 5. Of most concern is the slowdown of residential housing to be completed over the next few years. While it is true that housing values are currently falling due to interest rate rises, on a supply and demand basis, we still have a shortage of housing in Australia. This is evidenced by the extremely low residential vacancy rates across the country.

Coupled with overseas migration quickly getting back to pre-pandemic levels, we look set to have a real problem with housing Australians in the future. This has broad implications for the economy, as people paying too much for housing or being unable to live near where they work creates bottlenecks and reduces productivity across the country.

Commercial construction is set to slow down too. The industrial market has very little vacancy at the moment, and growth in the value of work done is set to slow dramatically over the next 2 years, and go backwards in 2025. And while vacancy rates in office are currently high around the country, we expect that vacancy will begin reducing dramatically in 2024 as new completions slow down or halt completely, and an economic recovery by that stage drives white collar employment growth.

Construction work, year on year % change

							FORECAST			
FYE	2018	2019	2020	2021	2022	*2023*	*2024*	*2025*	*2026*	*2027*
No. of completions										
New House	0.3	7.2	-13.5	-0.4	11.1	-0.2	-9.4	1.9	5.1	6
New Other Residential	-5.5	-6.1	-6.7	-13.3	-22.3	-2.2	-1.3	1.8	10	8.2
Value of Work Done										
Accommodation	32.7	-6.6	7.8	-11.6	-21.4	-8.5	6.5	-1.3	-4.4	9.7
Health & Aged Care	-6.3	-8.3	16.2	-10.3	-1.7	0.4	15.2	7	-1.2	4
Industrial	-2.4	14.9	18.6	-8	19.4	3	1.3	-14.8	5.9	2.5
Offices	40.1	5.9	13.2	-11.9	-2	6.5	-4.9	0.5	4.3	2.8
Retail & Wholesale Trade	-5.3	-4.9	-4.2	-7.8	-4.1	0.2	-7.7	0.5	6.8	5.7

Source: ACIF, Australian Construction Market Report, November 2022

Overall, lower supply means higher prices for occupiers. This is good news for investors in the commercial sector, who can expect continued good rental growth in the industrial sector, and for an uplift in rental returns in the office sector from 2024.

Opportunities

- **The property industry will be severely impacted for years' to come by extreme rises in construction pricing. This will result in undersupply in many locations, and there is opportunity for rental growth in existing supply**
- **Identifying sites now for future development and/ or consolidation could offer very lucrative future opportunities in an undersupplied market**

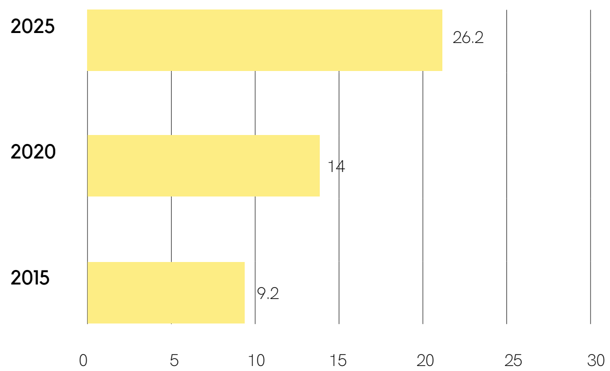
AUTOMATION AND TECHNOLOGY

One of the key long term changes as a result of the pandemic and the resultant worker shortage will be a renewed drive of businesses towards automation. Automation provides a 'hedge' against unforeseen shocks that impact human behaviour and migration, such as we felt with the pandemic. For predominately office based businesses, those which already had good remote working technology in place fared better than those that had to suddenly find ways to conduct online meetings - not to mention train their staff.

For the retail and industrial sector, a sudden and massive swing to online shopping put large retailers and wholesalers who had invested in automation in warehousing at a distinct advantage. A recent report by JLL estimates that the global automation market will increase from a value of $9.2 billion in 2015 to $26.2 billion (all USD) by 2025.

Size of global warehouse automation market

$USD billion



Source: JLL, LogisticsIQ William Blair, Statista estimates; ID 1094202

Solutions to automate warehousing have been around for some time, however, the Return on Investment has not always been appealing in Australia, given the high cost of setting up the technology versus the older, manual operation.

However, recent short-term changes to workforce availability, coupled with the long term outlook, means that logistics firms and major retailers and wholesalers will be left with little choice but to invest.

For owners of property, particularly industrial property, now is the time to start thinking about ways to help tenants automate their operations. This is particularly important for small to medium sized tenants, who may not have the capital to invest in expensive automation. An emerging trend, as highlighted by JLL, is Robots as a Service (RaaS) where developers and investors provide automation to their tenants as a lease option. Owners of warehouses who go down this path can benefit through greater tenant retention, higher rents and better future proofing of their asset, which should result in their property being valued with a more generous capitalisation rate than a standard shell warehouse. Owners of multiple warehouses can also capture the benefits of economies of scale that their smaller tenants may not have access to, helping to reduce the cost of implementing automation by spreading it across multiple facilities.

Opportunities

- **There is a clear opportunity for industrial property owners to offer in-house automation solutions for tenants who do not have the size or scale to invest in on their own**
- **For owners, the benefit is increased demand, higher rent tenant loyalty as well as the ability to roll out successful projects and benefit from economies of scale**

Part Three:

Future REIA Data and Reporting

As part of Project CRE consultation, practitioners frequently reported the lack of available and accessible real time data available to the Australian commercial real estate industry both at a markets and sector level.

Now that we have identified emerging trends and opportunities (in conjunction with industry during our Roundtables), future REIA State of the Industry reports will be rolled out on a more frequent basis. Importantly, we aim to build a data series to enable more quantitative and measurable reporting on key themes of sustainability, supply and automation.

A potential data series will focus on the below areas:

Sustainability

- Uptake by sector
- Uptake by location
- Future investment intentions
- % use of green leases

Supply

- Undersupply/oversupply using a scale method
- By location
- By sector

Automation

- Uptake by sector
- Uptake by location
- Future investment intentions

Business

- Key business trends and insights

The REIA kindly asks for the participation and assistance in collecting this data throughout 2023 and beyond. We look forward to sharing more details with you early in the New Year.

CONCLUSION

We look forward to providing continued industry insights and data as part of our REIA Commercial Agency Engagement Program (Project CRE).

The commercial property sector is undergoing significant structural changes, where the challenges of implementation need to be balanced with the opportunities this presents.

The Australian market is one of the most innovative in the world, and we are here to help the industry work its way through these opportunities and continue to showcase to the world the latest in commercial property capability.

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Want to know more about REIA's Commercial Agency Engagement Program? Visit us today:

https://reia.com.au/project-cre/