

DIRECT COMMERCIAL PROPERTY IS BACK IN THE BLACK – BUT HAVE ALL SECTORS CONTRIBUTED TO THIS RESULT?

Dr Frank Wolf, Managing Director Abacus Property Group and Abacus Funds Management Limited

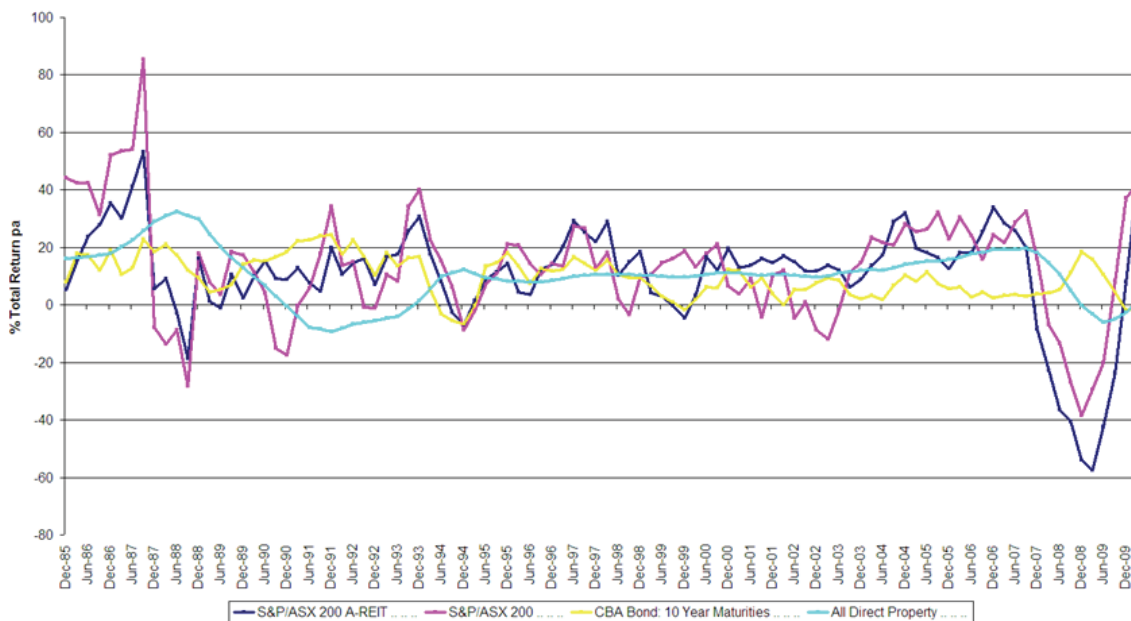
This research paper analyses the commercial property market and investigates the various factors contributing to long-term, medium-term and short-term trends. Like the Australian equities market, which has many sub-sectors that can be analysed, so too does direct property. These include office/retail/industrial; A grade/B grade; and, pricing points (effectively large cap/small cap). This paper investigates each of the commercial property sub-sectors, highlighting the differences and similarities of each during good and bad times and argues that outperformance is best served by an active, value adding approach which can extract greater value than market movements alone.

COMPARATIVE PERFORMANCE OVER THE LAST 24 YEARS

The direct commercial property market has not been immune to return volatility, as shown in Figure 1 below which highlights direct commercial property returns relative to other asset classes.

Figure 1: Asset class comparison – quarterly rolling one year returns

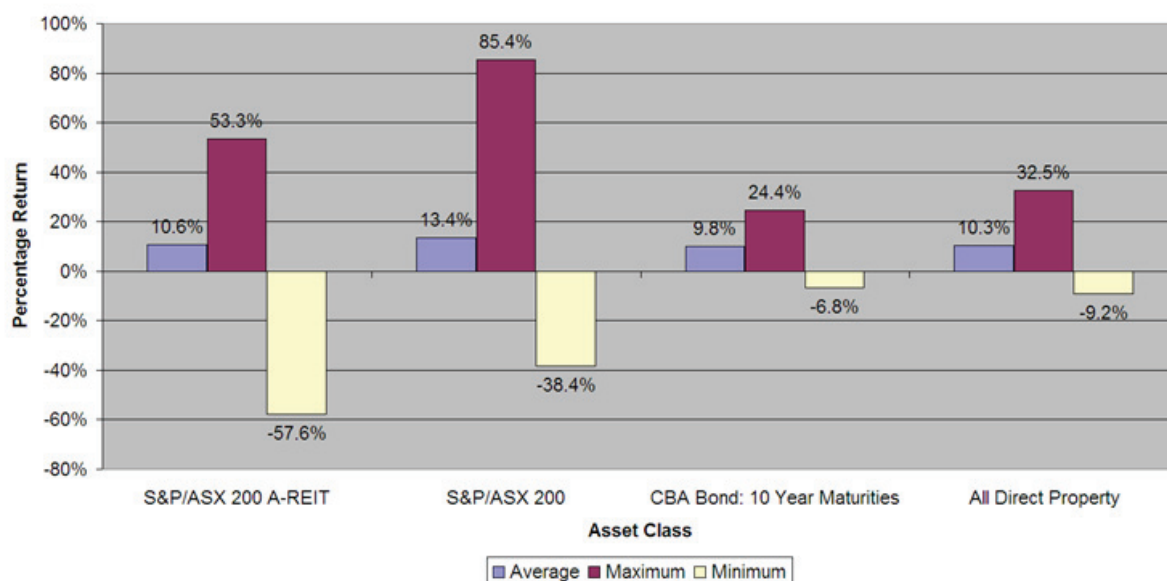
(December 1985 - March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010). All Direct Property is compiled from valuation and management records, collected from investors and property managers by IPD.

The dispersion of returns over the period (Figure 2) was greatest for Australian equities, ranging from 85.4% to -38.4%. Not surprisingly, the least dispersion was from Australian bonds, which ranged from 24.4% to -6.8%. Direct commercial property had only a slightly higher dispersion of returns.

Figure 2: Return dispersion – quarterly annual average, maximum and minimum one-year returns (December 1985 - March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

Although the dispersion of returns for each asset class differed quite significantly, the average returns for each asset class over the were within less than 4% of each other, ranging from 9.8% for Australian bonds to 13.4% for Australian equities. And, as Figure 3 below shows, direct commercial property was lowly correlated with other asset classes, so could contribute to lowering the overall risk of a diversified portfolio.

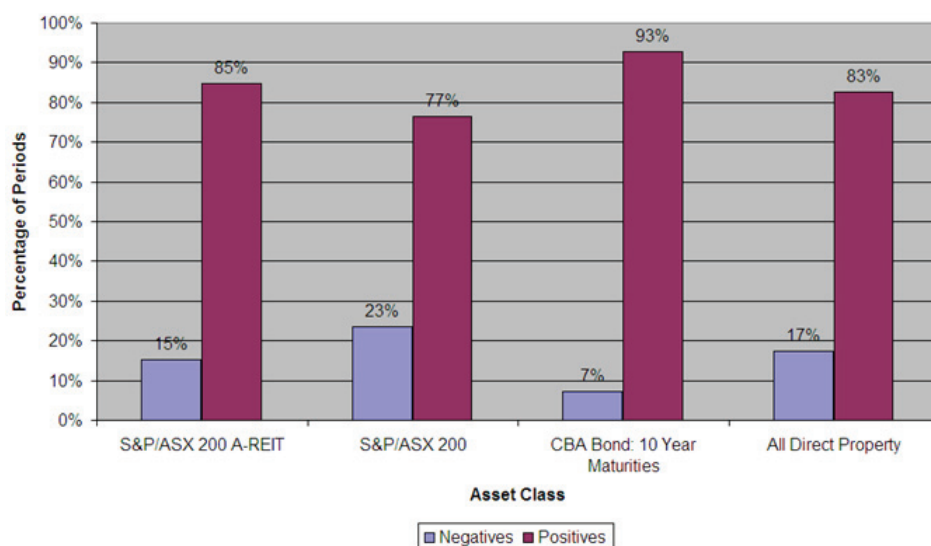
Figure 3: Standard deviation and correlation of asset classes (10 years to 30 March 2010)

	Std Dev	All Direct Property	CBA Bond: 10 yr Maturities	S&P/ASX 200	S&P/ASX 200 A-REIT
All Direct Property	4.90	1.00			
CBA Bond: 10 Yr Maturities	4.04	-0.26	1.00		
S&P/ASX 200	17.98	0.49	-0.64	1.00	
S&P/ASX 200 A-REIT	22.27	0.62	-0.48	0.79	1.00

Source: Investment Property Databank Australian Property Investors Digest (March 2010)

A further facet of risk is that of experiencing negative returns. Historically, Australian equities experienced the highest percentage of negative rolling one-year returns. As Figure 4 below shows, the percentage of negative periods are similar for both A-REITs and Direct Property. Despite this, as Figure 1 above shows, there have only been two periods over the last 24 years that Direct Property had negative returns, and the percentage of rolling one-year returns that were negative all occurred in those two periods.

Figure 4: Occurrence of negative returns – quarterly rolling one-year periods
(December 1985 - March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

The Global Financial Crisis and uncertain market conditions had a negative impact on commercial property valuations. However, the long-term volatility of direct commercial property remains low and the average one-year return over the past 24 years for direct commercial property is still comparable to that delivered of A-REITs.

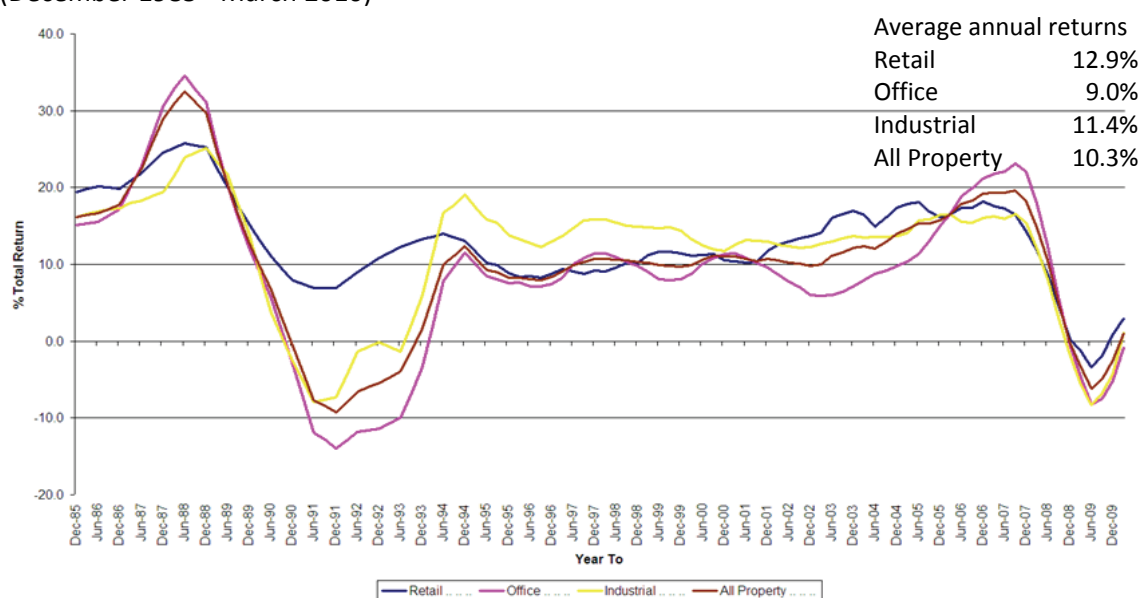
Summary

- The volatility of direct commercial property returns over the last 24 years was significantly lower than Australian shares and A-REITs;
- Average returns from direct commercial property were almost identical to A-REITs over the same period; and,
- Direct commercial property was lowly correlated to other asset classes, and could therefore have provided diversification benefits by lowering overall portfolio risk.

DIRECT COMMERCIAL PROPERTY TRENDS

All Direct Property as described above is predominantly made up of three commercial property sectors – office, retail and industrial. As each subsector of the Australia sharemarket varies in performance, so too does the performance of each commercial property sector vary somewhat. Figure 5 below shows the returns of each of the main direct property sectors over the last 24 years.

Figure 5: Property subsectors - Quarterly rolling one-year total returns
(December 1985 - March 2010)

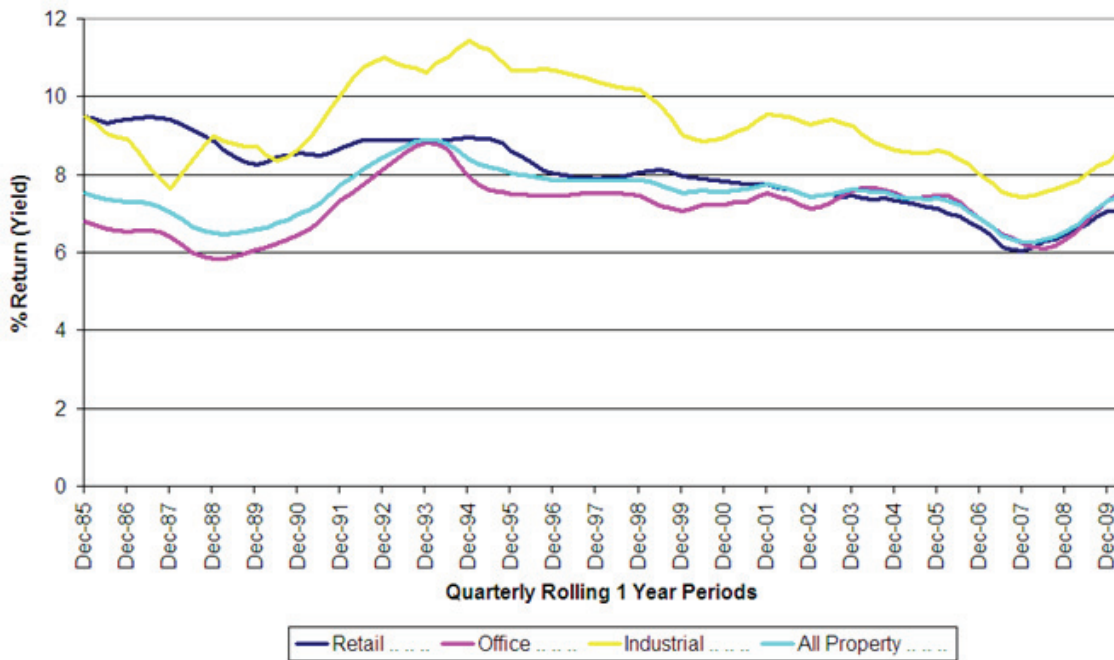


Source: Investment Property Databank Australian Property Investors Digest (March 2010).

While each sector had similar performance trends Figure 5 shows that the Retail sector had only one period of negative total returns, compared to two for the other sectors. Figure 5 also shows that over the 24 years, each sector had periods of relative under- and outperformance, confirming that diversification within the direct property sector is as relevant as within other asset classes.

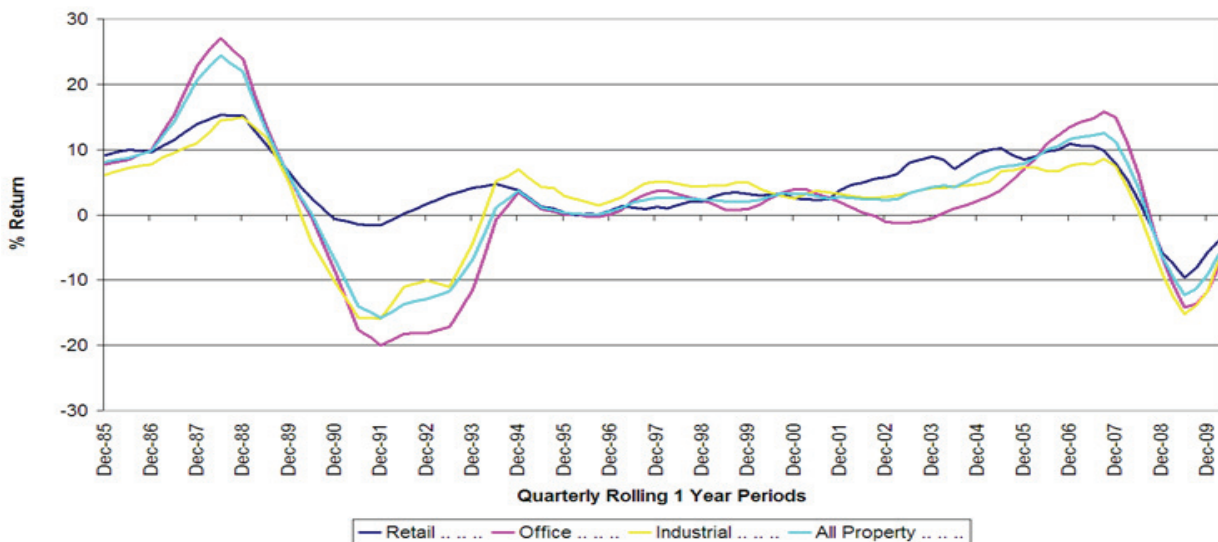
Figure 6 below shows the income returns (yield) from each sector. Retail's yield has trended downwards over the past 24 years. Since December 1990, Industrial has consistently produced higher yields than the other sectors. While yields rose 300 basis points during the early 1990s downturn, they rose just 150 basis points during the most recent downturn. The GFC led to a re-pricing of risk meaning the required return for a commercial property investment rose, resulting in increased yields and thus lower capital values. The risk re-pricing was based on expectations of a significant downturn in the real economy and an increase in the unemployment rate. There is a strong correlation between these factors and property market returns (the correlation of nominal GDP growth and property returns is 0.81 with a 0.74 correlation between employment growth and real property returns, according to IPD). Forecast GDP growth in December 2008 was expected to be negative while the forecast peak unemployment rate was 7.5% (Access Economics, June 2009). It actually peaked at 5.8% in June 2009 and over the next 12 months reduced to 5.2% (ABS). This latest downturn was neither as severe nor as long as that of the 1990s (Figure 7).

Figure 6: Property subsectors - quarterly rolling one-year income returns (yield)
(December 1985 - March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

Figure 7: Property subsectors - Quarterly rolling one-year capital returns
(December 1985 - March 2010)

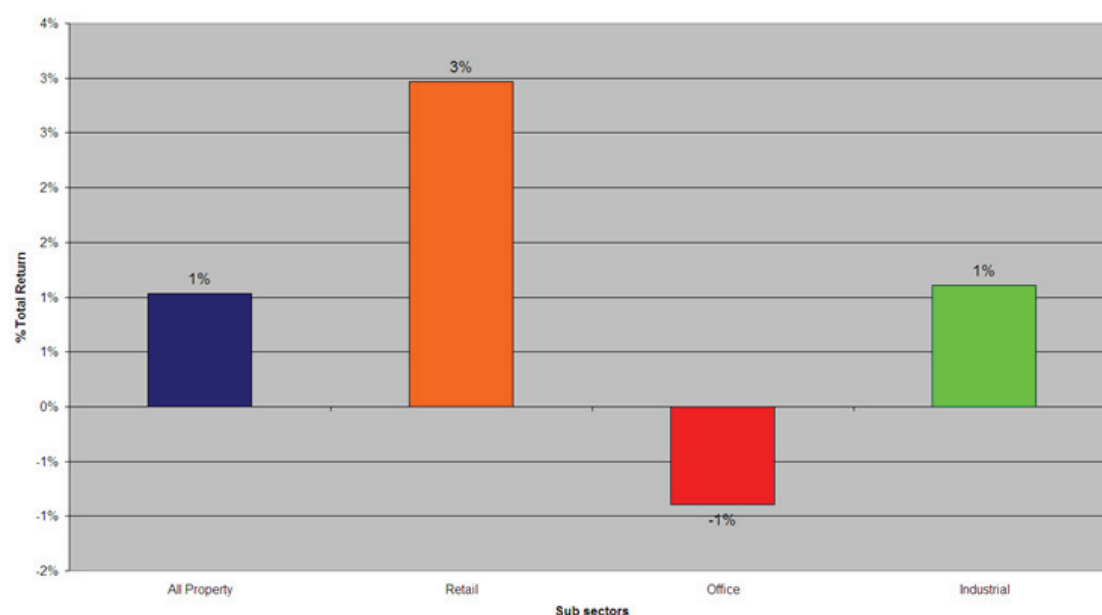


Source: Investment Property Databank Australian Property Investors Digest (March 2010)

Improving economic conditions also resulted in an improvement in direct commercial property returns. The one-year return to 30 March 2010 was back in positive territory (1% according to

Investment Property Databank). However, the contribution by each main sector to this positive performance varied as can be seen in Figure 8. The standout performer over the year to 30 June 2010 was the Retail sector, with Office lagging.

Figure 8: Property subsectors – contribution to All Property returns
(One year to 31 March 2010)

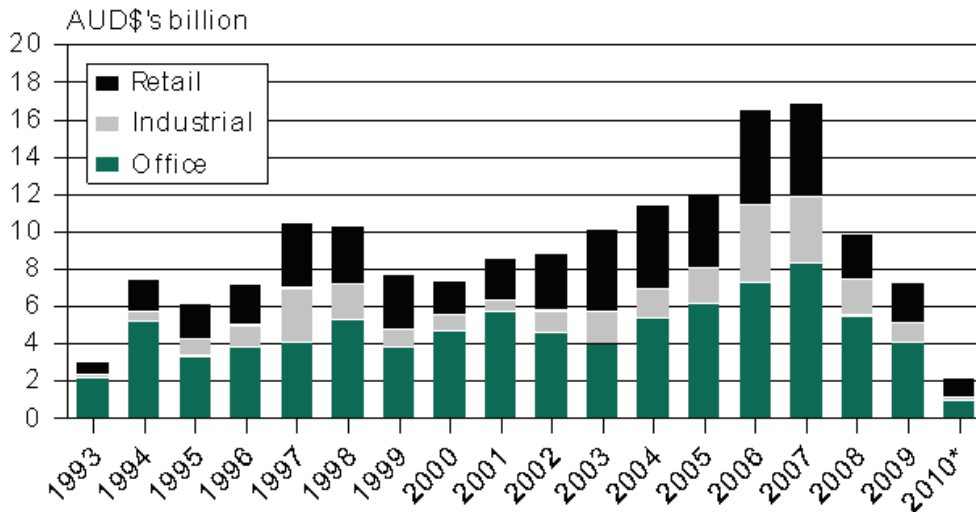


Source: Investment Property Databank Australian Property Investors Digest (March 2010)

For the period during 2001 to 2008, the average value of transactions in the commercial property market was \$26.2 million, however, the average value of transactions occurring in 2008 was \$24.8 million, falling short of the historic average (CB Richard Ellis). Commercial property sales activity was 17% lower in 2009 than 2008 (Figure 9 below). In 2009, sales reached \$7.8 billion for the full calendar year, compared to \$9.5 billion in 2008.

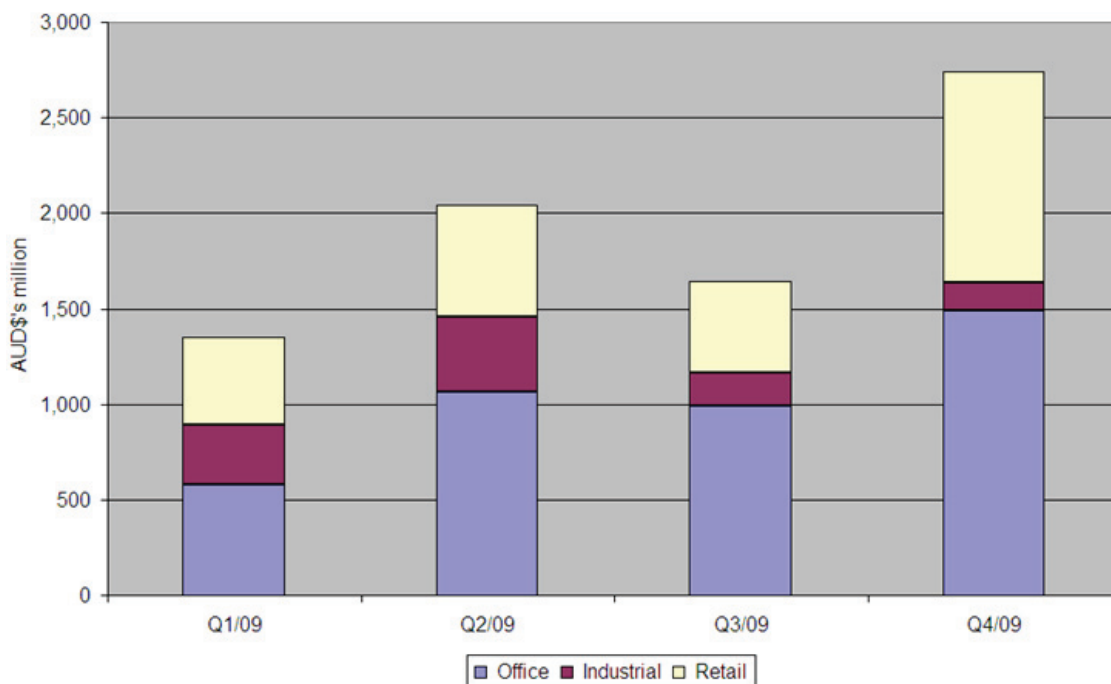
However, by the fourth quarter of 2009, there were signs of trading activity picking up as institutions, both domestic and international, started purchasing again (Figure 10 below). Quarterly turnover in 2009 showed increasing sales activity throughout the year. In Q4 2009, over \$2.5 billion of commercial real estate traded, including the largest office and retail property transactions for two years (CB Richard Ellis).

Figure 9: Australian commercial property – transaction value
(Calendar years 1993 to 2009. 2010 to 30 June)



Source: CB Richard Ellis (July 2010). Includes sales over \$5.0 million. * Up to June 2010

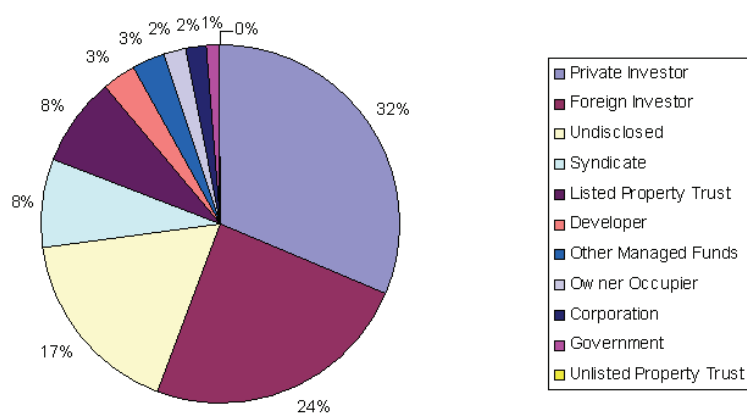
Figure 10: Australian commercial property – quarterly sales
(Calendar 2009)



Source: CB Richard Ellis

While institutions, especially A-REITs, were focussed on addressing balance sheet imbalances for most of 2009, private investors were active, purchasing approximately 32% of all properties traded (by volume) as shown in Figure 11 below. Syndicates backed by private equity represented a further 8% of all trade, taking private interest to almost 40% of all traded commercial real estate in 2009, a record amount for this category of purchaser (CB Richard Ellis).

Figure 11: Purchaser groups - percentage of all commercial property transactions (Calendar 2009)



Source: CB Richard Ellis

Foreign investors were the other stand-out purchaser group in 2009, representing 24% of all turnover. This is more than twice that in 2008 when they represented just 11% of turnover, and almost five times the long-term average share of acquisitions made by foreign investors. Calendar 2009 was attractive to foreign investors with the cost of debt low, the Australian exchange rate conducive to hedging (for most of the year) and pricing at its low point of the cycle. With these conditions now very different, it will likely be more difficult for foreign investors to stock up viable transactions in 2010 and purchases may drop (CB Richard Ellis).

A notable exclusion to property sales during 2009 was Unlisted Property Trusts. In 2008, this purchaser group accounted for 14% of all trades (CB Richard Ellis). A-REITs accounted for just 8% of all transactions in 2009; they typically account for at least 25% per annum. Activity by this purchaser group is now rising and will probably lead to the share of sales in all other purchaser categories falling in 2010 (CB Richard Ellis).

Summary

- Diversification within property sectors can lower overall portfolio risk;
- The Retail sector outperformed in the year to 30 March 2010, due to greater capital growth. Income returns (yields) for the Retail sector have been trending downwards over last 24 years.
- The Industrial sector has consistently produced highest income yields since December 1990;
- Both the number and value of property transactions fell during the recent downturn. The average property transaction value for 2008 was less than \$25 million;
- Private investors were the largest purchasers of property during the downturn;

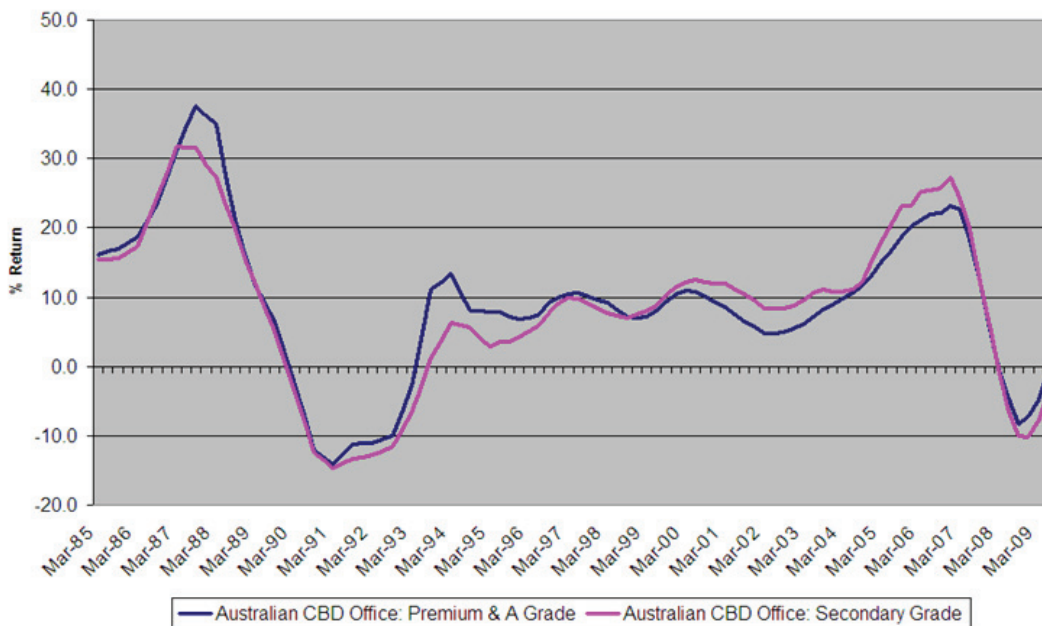
- There was evidence of increased property trading by fourth quarter of 2009; and,
- Direct commercial property market is in the early stages of an upward swing.

THE AUSTRALIAN OFFICE PROPERTY SECTOR

Premium & A Grade vs Secondary Grade office property

The Australian Office property sector can be divided into five grades of property, being Premium, A Grade, B Grade, C Grade and D Grade. These can be combined into two categories: Premium & A Grade and Secondary Grade, the total returns of which are shown in Figure 12.

Figure 12: Australian office property – quarterly rolling one-year total returns
(December 1985 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

While both categories have followed a similar trend, at various points over the past 24 years, both have achieved relative outperformance. The Secondary Grade category has outperformed for the vast majority of the time since 1999, with the Premium & A Grade category achieving the bulk of its outperformance prior to 1999. The Secondary Grade category suffered marginally greater losses in the negative years, with the minimum return of -15% compared to a minimum return of -14% for the Premium & A Grade category. The percentage of time that each category produced negative returns over the period was also very similar as shown in Figure 13 below.

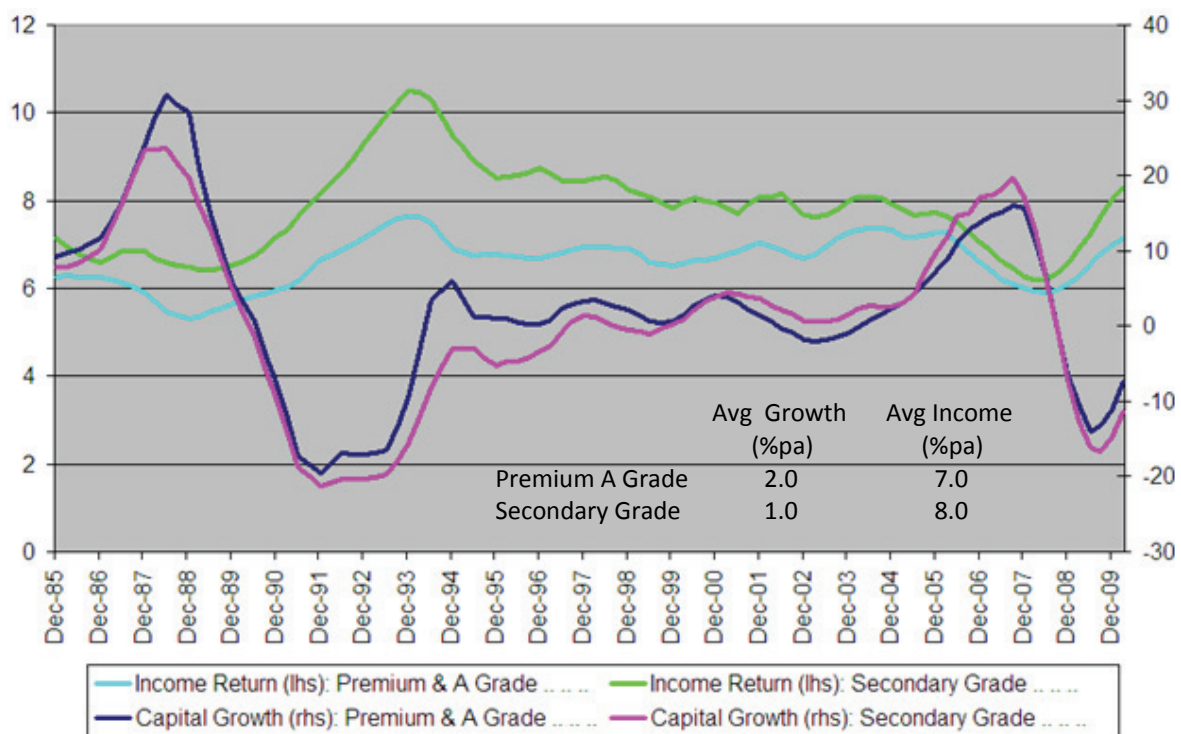
Figure 13: Australian office property - quarterly rolling one-year total returns
(December 1985 – March 2010)

	Average Returns % pa	Negative returns % of all observations	Positive returns % of all observations
Premium & A Grade	9	19	81
Secondary Grade	9	20	80

Source: Investment Property Databank Australian Property Investors Digest (March 2010)

Both categories had an average total return of 9% per annum over the 24 year period. However, the greater contributor for the Secondary Grade category was income return (yield) as shown in Figure 14. The income return achieved by the Premium & A Grade category has been consistently less than over the last 24 years. If the primary objective for investing in commercial property is to achieve a high yield, the Secondary Grade category appears more likely to achieve this than an investment in the Premium & A Grade category.

Figure 14: Australian office property – quarterly rolling one-year income & capital returns
(December 1985 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

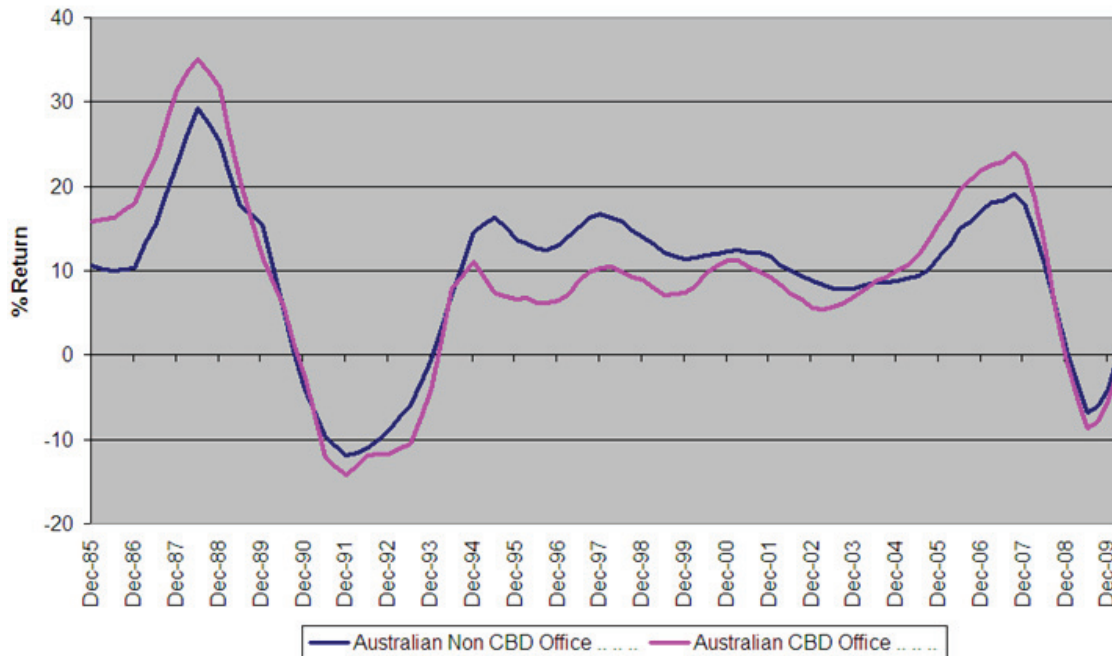
Capital growth over the period followed a similar trend to total returns. As noted previously, the Secondary Grade category outperformed for the vast majority of the time since 1999, with the Premium & A Grade category achieving the bulk of its outperformance prior to 1999.

CBD vs non-CBD office property

A further analysis of the Australian Office property sector can be undertaken based on location; whether the property is located in a CBD or outside of a CBD region.

Figure 15 shows that from 1990 to 2003, the Australian CBD Office category underperformed the non-CBD category, despite the CBD sector outperforming in the few years leading up to the peak. This occurred for both downturn periods over the last 24 years. As a consequence, the CBD category suffered greater losses in the negative years, with a minimum return of -14% compared to -12% for the non-CBD category.

Figure 15: Australian office property (CBD & non-CBD) – quarterly rolling one-year total returns (December 1985 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

The percentage of time (based on quarterly observations) that each category had negative returns over the period was also within 2% of each other as shown in Figure 16 below.

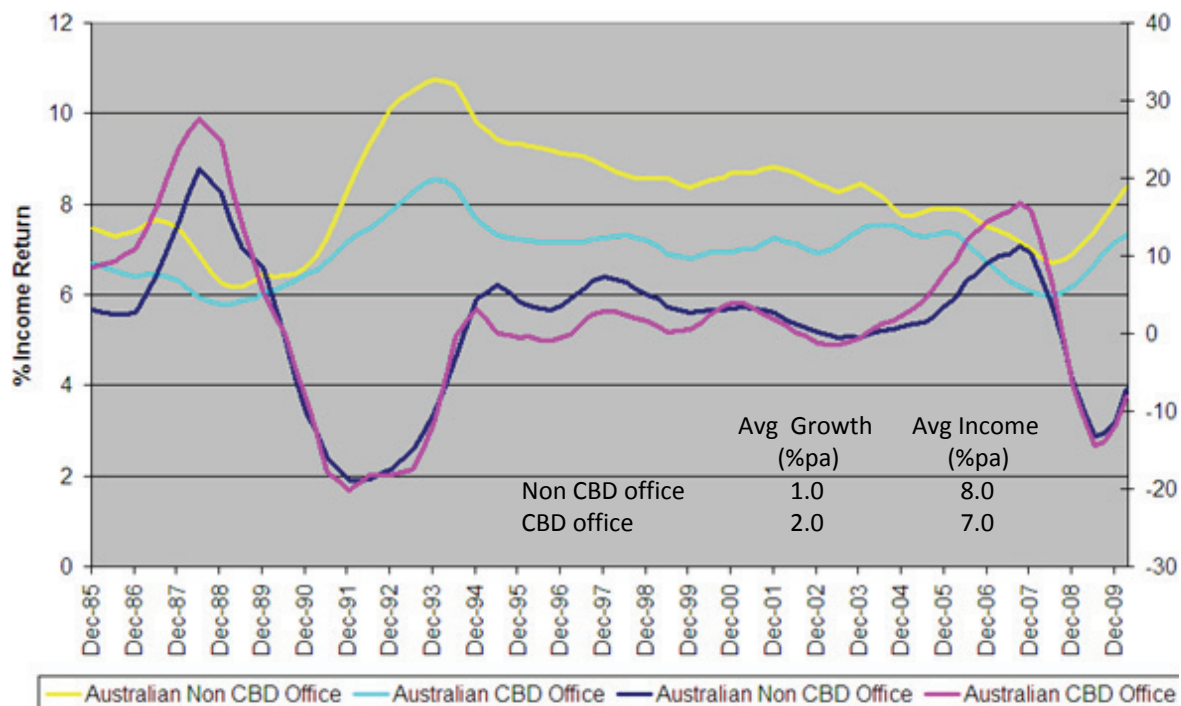
Figure 16: Australian CBD and non-CBD office property – quarterly rolling one-year total returns (December 1985 - March 2010)

	Average returns %pa	Negative returns % of all observations	Positive returns % of all observations
Non CBD Office	9	17	83
CBD Office	9	19	81

Source: Investment Property Databank Australian Property Investors Digest (March 2010)

The average total return for both categories over the 24 years was also 9% per annum. However, the greater contributor to this for both regions was the income yield, contributing an average 8.2% for the non-CBD category and 7% for the CBD category. The income return achieved by the non-CBD category has been consistently higher than those from the CBD category over the last 24 years. If the primary objective for investing in commercial property was to achieve a high yield, the non-CBD category has been more likely to achieve this.

Figure 17: Australian office property (regions) - quarterly rolling one-year income & capital returns (December 1985 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

Both categories had periods of relative greater or lesser capital growth over the last 24 years. As previously stated, the CBD category tended to show higher capital growth in the few years leading up

to both peak periods. Possibly surprisingly, the actual average capital growth over the 24 year period for the non-CBD category was just 1.2% and for the CBD category was just 1.9% (Investment Property Databank). Solid capital growth in the office sector and indeed all direct commercial property is achievable of course, but is possibly more dependent on the timing of the purchase and sale, the price paid and the strategic management applied to the property. Evidence of this approach can be seen later in this paper.

Summary

- Both the Premium & A Grade category and the Secondary Grade category achieved a similar average annual return of approximately 9% over the last 24 years, as did CBD and non-CBD categories;
- All categories experienced positive returns between 80% and 83% of the time, based on quarterly rolling one-year return observations;
- The Secondary Grade category consistently achieved a higher income return (yield) over the period compared to the Premium & A Grade category.
- The non-CBD category also consistently achieved a higher income return (yield) over the period compared to the CBD category;
- Overall, the Office sector achieved less than 2% per annum capital growth on average since December 1985, with each category varying between approximately 1% and 2% per annum.

THE AUSTRALIAN RETAIL PROPERTY SECTOR

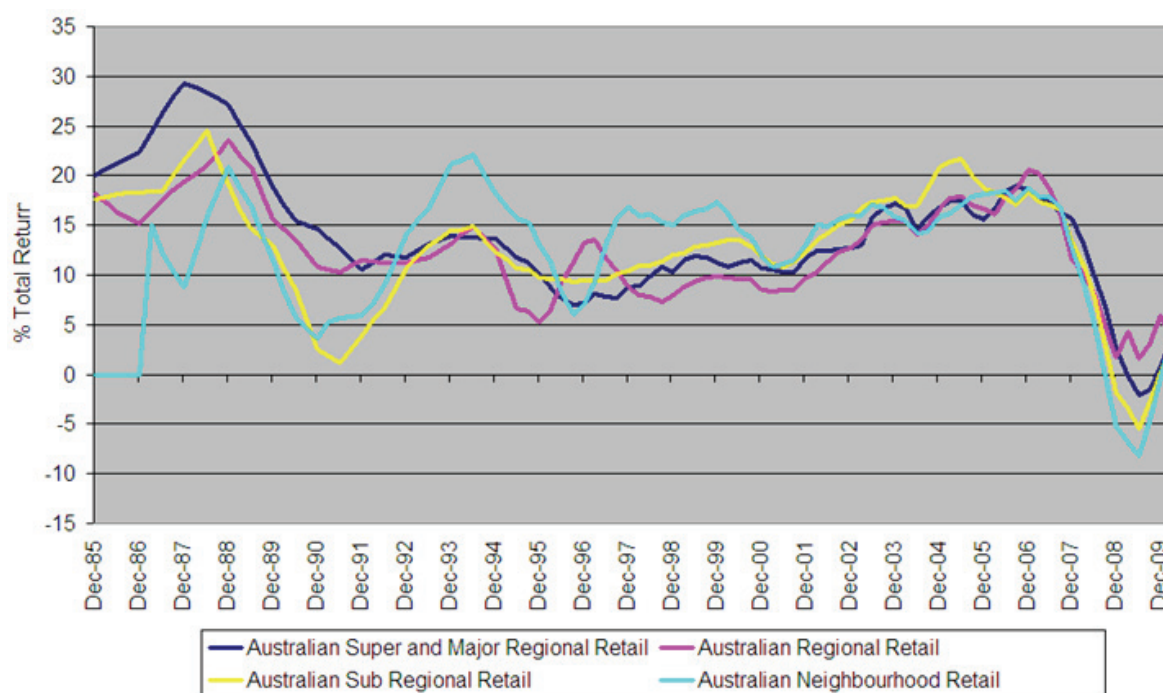
The Australian Retail property sector can be broken down by size (gross lettable area):

- **Super Regional Retail** – a major shopping centre typically incorporating two full-line department stores, one or more full-line discount department stores, two supermarkets and around 250 speciality shops. Total gross lettable retail area exceeds 85,000 square metres.
- **Major Regional Retail** – a major shopping centre typically incorporating at least one full-line department store, one or more full-line discount department stores, one or more supermarkets and around 150 speciality shops. Total gross lettable retail area generally ranges between 50,000 and 85,000 square metres.
- **Regional Retail** – a shopping centre typically incorporating one full-line department store, one full-line discount department store, one or more supermarkets and 100 or more speciality shops. Total gross lettable retail area typically ranges between 30,000 and 50,000 square metres.
- **Sub-Regional Retail** – a medium-sized shopping centre typically incorporating at least one full-line discount department store, a major supermarket and around 40 or more speciality shops. Total gross lettable retail area will typically range between 10,000 and 30,000 square metres.

- **Neighbourhood Retail** – a local shopping centre comprising a supermarket and up to around 35 specialty shops. Total gross lettable retail area will typically be less than 10,000 square metres.

The total performance of the five Retail property categories is shown in Figure 18. As with the Office sector, the various Retail categories have had periods of mixed relative performance over the last 24 years. Unlike other commercial property sectors, Retail has only had one period of negative returns while the Regional Retail category did not enter into negative territory at all, and has maintained positive rolling one-year returns 100% of the time over the entire period.

Figure 18: Australian retail property - quarterly rolling one-year total returns
(December 1985 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

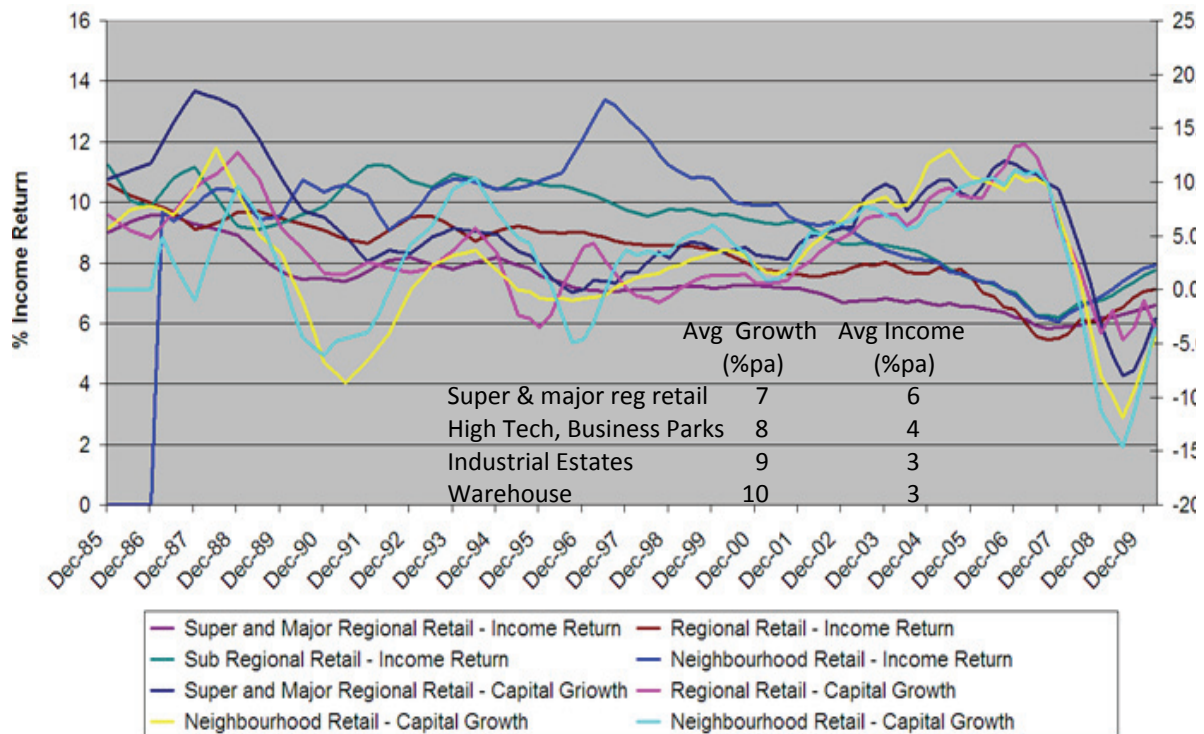
Figure 19: Australian retail property – quarterly rolling one-year total returns
(December 1985 – March 2010)

	Average returns %pa	Negative returns % of all observations	Positive returns % of all observations
Super & Major Regional Retail	14	3	97
Regional Retail	13	0	100
Sub Regional Retail	13	4	96
Neighbourhood Retail	13	6	89

Source: Investment Property Databank Australian Property Investors Digest (March 2010)

The average total return of the retail property types was almost the same over the period, with Super and Major Regional Retail outperforming slightly. The average total return of 13% per annum is markedly higher than the Office Sector (9% pa). The contribution of capital growth was more meaningful (from 3% to 6%) in the Retail categories compared to the Office sector. However, the greater contributor was still the income yield with the average income return over the period ranging from 7% to 10%. Once again, if the primary objective for investing in commercial property was to achieve a high yield, Neighbourhood Retail properties were more likely to achieve this.

Figure 20: Australian retail property – quarterly rolling one-year income & capital returns
(December 1985 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

All retail categories had periods of relative greater or lesser capital growth over the last 24 years. However, the Super and Major Regional Retail sector produced the largest average capital growth of 6% per annum while producing the lowest income return (yield) of 7%. Conversely, Neighbourhood Retail produced the largest income return of 10%, with a lower capital growth of 3%.

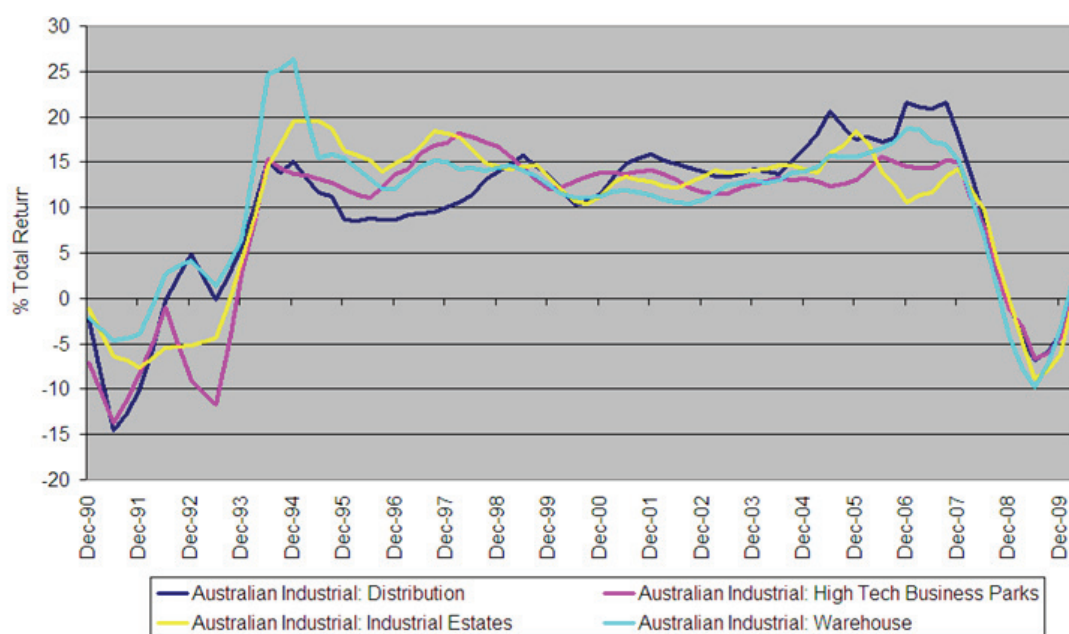
Summary

- The Australian Retail property had more positive returns over the last 24 years than any other sector, with an average total return of 13% per annum;
- The Super and Major Regional Retail categories achieved the highest average total return (14% pa) and the highest average capital growth (6% pa) over the last 24 years;
- The Regional Retail sector achieved positive returns 100% of the time; and,
- The Neighbourhood Retail category achieved the highest average income yield (10% pa).

THE AUSTRALIAN INDUSTRIAL PROPERTY SECTOR

All Australian Industrial property categories had periods of mixed performance over the last 24 years. During the early 1990s downturn, the High Tech Business Parks category experienced a double dip negative period, while the Industrial Warehouse category outperformed. In the lead up to the last downturn, the Industrial Distribution category outperformed. Since December 1990, minimum quarterly rolling one-year returns ranged from -9% for Industrial Estates to -15% for Distribution (Investment Property Databank).

Figure 21: Australian industrial property – quarterly rolling one-year total returns
(December 1990 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

The periods of negative returns as a percentage of all periods observed ranged between 14% for the Warehouse category to 22% for both the High Tech Business Park and Industrial Estates categories.

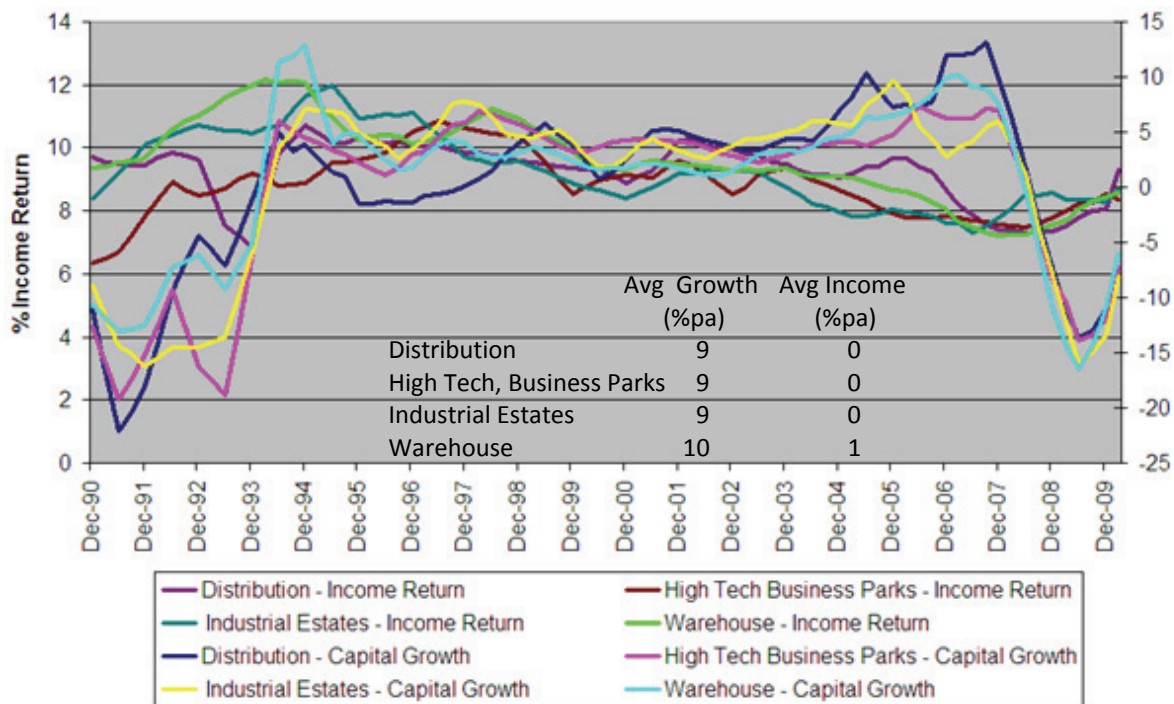
Figure 22: Australian industry property - quarterly rolling one-year total returns
(December 1990 - March 2010)

	Average returns %pa	Negative returns % of all observations	Positive returns % of all observations
Distribution	10	17	83
High Tech Business Parks	9	22	78
Industrial Estates	10	22	78
Warehouse	10	14	86

Source: Investment Property Databank Australian Property Investors Digest (March 2010)

The average total returns of all industry property categories were within 1% per annum of each other, with the High Tech Business Park category marginally underperforming. The contribution of income versus capital growth was significant. Since December 1990, all industrial property categories except Industrial Warehouse experienced an average capital growth return of close to zero on a quarterly rolling one-year basis. The Industrial Warehouse category managed an average 1% capital growth over the same period. However, capital growth achieved by the total Direct Commercial Property market since December 1985 has averaged less than 2% per annum. The average income return was almost identical for each industrial property category, with the Warehouse category slightly outperforming with an average 10% per annum yield, 1% ahead of its peers. Figure 23 shows the compression of capital growth across all Industrial categories during the recent downturn.

Figure 23: Australian industrial property – quarterly rolling one-year income & capital returns (December 1990 – March 2010)



Source: Investment Property Databank Australian Property Investors Digest (March 2010)

Summary

- All Industrial property categories produced similar average annual returns over the last 20 years of approximately 10% per annum, with less than 1% per annum capital growth.
- The Distribution and Warehouse categories achieved the highest percentage of positive returns.
- All Industrial property categories produced higher income returns than the other categories within the Direct Commercial Property market.

EXTRACTING VALUE FROM DIRECT COMMERCIAL PROPERTY

Given that each direct commercial property sector has in essence produced the same total return over the last two decades, the question becomes ‘how best to outperform the market?’. Below a number of case studies are presented comparing the relevant sector average returns to a value-adding active approach to property. A value-adding active approach incorporates a number of facets, including purchasing property at the right price, developing and implementing a strategic property improvement program, and selling the property at the right time for the right price. This process compares to a more traditional buy and hold growth strategy.

Case Study 1

This was an older style office building. The strategy for the property was to obtain development approval for apartments, which the building was better suited to at that point in time. No actual development was undertaken however the property was on sold with development approval, thereby allowing the new purchaser to undertake the future development potential.

- Property: 431 Glebe Street, Glebe
- Sector: Office, Non CBD, Secondary Grade
- Purchase Date: 30 June 2000
- Sale Date: 30 June 2006
- Purchase Price: \$10,839,020
- Sale Price: \$14,800,000

The total return achieved was approximately 1.5% per annum higher than its peer sectors over the same period, while maintaining similar income yields (Figure 24).

Figure 24: Case Study 1 property vs secondary grade and non CBD office – rolling one-year returns (June 2000 – 30 June 2006)

	Average return Secondary Grade	Average return Non CBD	431 Glebe St Glebe NSW
Total return (%pa)	12.1	10.0	13.5
Income return (%pa)	7.8	8.3	8.2
Capital growth (%pa)	4.0	1.6	5.3

Source: IPD Australian Property Investors Digest (March 2010), Abacus Property Group

Case Study 2

This B Grade property was viewed as poorly managed and leased. The strategy was to significantly improve the management of the property and renegotiate the leases to improve the rental income and ultimately capital value.

- Property: 671 Gympie Road, Chermside, Qld
- Sector: Office, Non CBD, Secondary Grade
- Purchase Date: 17 December 2004
- Sale Date: 17 March 2009
- Purchase Price: \$4,742,693
- Sale Price: \$6,200,000

The total return achieved by this property was significantly higher than the average return from the non-CBD category over the same period, outperforming by approximately 3% (Figure 25). However, it slightly underperformed the average return of the Secondary Grade category. Nevertheless, it achieved a better income return than both of its peer categories.

Figure 25: Case Study 2 property vs secondary grade and CBD office – rolling one year returns
(December 2005 to June 2007)

	Average return Secondary Grade	Average return Non CBD	671 Gympie Rd Chermside QLD
Total return (%pa)	16.3	11.8	14.7
Income return (%pa)	7.0	7.4	8.2
Capital growth (%pa)	8.7	4.1	6.5

Source: IPD Australian Property Investors Digest (March 2010), Abacus Property Group

Case Study 3

The existing space was under-rented when compared to its potential. The strategy for this property was therefore to increase the rent achieved by renegotiating the leases, thereby achieving both an increase in rental income and an increase in capital valuation.

- Property: 500 Princess Highway, Noble Park, VIC
- Sector: Industrial Warehouse
- Purchase Date: 27 November 2003
- Sale Date: 11 October 2007
- Purchase Price: \$19,216,428.43
- Sale Price: \$27,950,000

The total return achieved from this property (Figure 26) was greater than its peer category by more than 2% per annum, achieved through both increased income returns and capital growth.

Figure 26: Case Study 3 property vs industrial estate – rolling one-year returns
(December 2004 to September 2007)

	Average return Industrial Estate	500 Princess Hwy Noble Park, VIC
Total return (%pa)	16.4	18.7
Income return (%pa)	8.4	8.9
Capital growth (%pa)	7.5	9.8

Source: IPD Australian Property Investors Digest (March 2010), Abacus Property Group

Case Study 4

This property was an industrial site with significant vacant land attached. The strategy was to potentially subdivide this land with an expectation of increasing the capital return. Ultimately, an adjoining landowner negotiated the purchase of the property to accommodate its growth strategy offering a price that provided a solid return on investment to the existing vendor.

- Property: 23-43 Tattersall Road, Kings Park, Bathurst NSW
- Sector: Industrial Estate
- Purchase Date: 16 February 2004
- Sale Date: 18 September 2006
- Purchase Price: \$15,304,057
- Gearing Level: 65%
- Sale Price: \$19,600,000

The total return achieved by this property was 4% higher than its peer category over a similar period, with both higher income return and capital growth returns (Figure 27).

Figure 27: Case Study 4 property vs industrial estate – rolling one-year returns
(March 2005 to September 2006)

	Average return Industrial Estate	23-43 Tattersall Rd Kings Park NSW
Total return (%pa)	15.5	19.6
Income return (%pa)	7.9	9.2
Capital growth (%pa)	1.7	10.4

Source: IPD Australian Property Investors Digest (March 2010), Abacus Property Group

CONCLUSION

This paper highlights a number of facts about the returns from Australian direct commercial property since December 1985.

- The volatility of direct commercial property was significantly lower than Australian equities and A-REITs, but produced an average total return over the period very similar to A-REITs.
- Direct commercial property is lowly correlated to other asset classes, providing diversification benefits by lowering overall portfolio risk. However, the three different sectors within the direct commercial property market – office, retail, industrial – produced different results at different points in time, not only total returns, but also from income returns and capital growth returns. Therefore, diversification across and within the direct commercial property sectors will also lower overall risk.
- During periods of downturn, the number of property sale transactions and the average value per sale reduced. This can impact on liquidity, particularly in the large value property segment, given that nearly 40% of transactions (by value) that occurred in 2008 were from private investors, with an average transactional value of less than \$25 million.
- Further analysis of each of the different categories within each sector shows that the average total returns have been very similar over the long term. For example, all of the office categories recorded an average total return of around 9% per annum, all of the retail categories gave an average total return around 13% per annum, and all of the industrial categories had an average total return of around 10% per annum. It should be noted, however, that the contribution to the total return that income versus capital growth made differed slightly within each sector.
- The vast majority of the commercial property market returns has been achieved via income not capital growth with the later averaging less than 2% per annum over the last 24 years. Retail is the only sector that has achieved a higher capital growth (nearly 5% on average). Based on history, different sectors would be selected if the primary objective was income yield versus capital growth. For example, an investment in the Industrial Warehousing category produced the highest income yield over the long term. Similarly, the Super and Major Regional Retail category produced the highest capital growth.
- The case studies provided illustrate that outperformance including solid capital growth can be achieved through an active, value-added approach to property investing compared to an average buy and hold strategy.

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