- *31% of sales tracked in March were settled/unconditional by EOFY*
- *Brisbane had 46% of sales completed; higher than Sydney or Melbourne*
- *Industrial has remained the most resilient sector*

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COVID-19 impacts remain divergent

Capital Market Insight, August 2020

TURNOVER REMAINS LOWER BUT DEALS ARE PROGRESSING

This report examines the capital market response in the current environment and provides an in-depth analysis of a basket of sales transactions tracked by Knight Frank

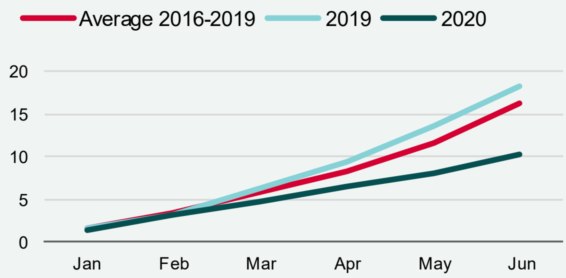
H1 TURNOVER 43% DOWN

The continued limitation on domestic and international travel, plus the ongoing knocks to confidence as a result of the COVID-19, has continued to dampen activity in capital markets.

The level of capital market transactions has continued to be impacted by the physical and confidence limitations arising from the COVID-19 pandemic. This is despite the fundamental cost of funds and weight of money remaining supportive of investment into Australian real estate.

Turnover across the office, industrial and retail markets during H1 2020 totalled $10.37 billion, 43% below the $18.26 billion recorded over the same period in 2019. With 2019 considered a stand-out year in terms of transactions, particularly in the office market, the average 2016-2019 is also provided for comparison with H1 2020 36% below this benchmark.

Cumulative Capital Market Turnover
$ billion



Source: Knight Frank Research, RCA

INDUSTRIAL MOST RESILIENT

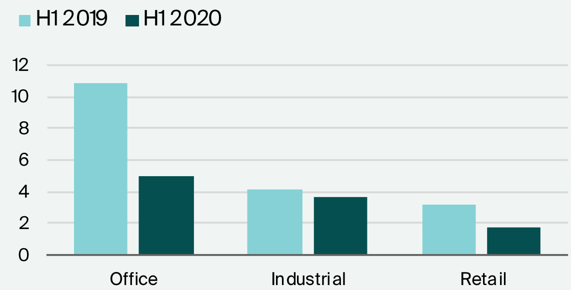
As anticipated, the essential nature of industrial, dominated by warehouse & distribution of non-discretionary items, has seen investment into this sector remain the most resilient during 2020.

Splitting the turnover out by sector shows that the in-favour industrial sector, boosted by some high profile portfolio sales (ie Arnotts, Aldi, Sigma), had turnover in H1 2020 of $3.71 billion, only 10% less than the equivalent 2019 figure.

Retail, already subject to fluctuating investor demand during 2019, has seen turnover fall a further 45% in 2020 to date with $1.74 billion in transactions.

The office market has been the hardest hit across Australia as a whole, down by 55% in H1 2020. This is despite the key markets of Sydney and Melbourne still seeing marquee sales taking place (Rialto, 100 Market St).

H1 Capital Market Turnover Comparison
$ billion by sector



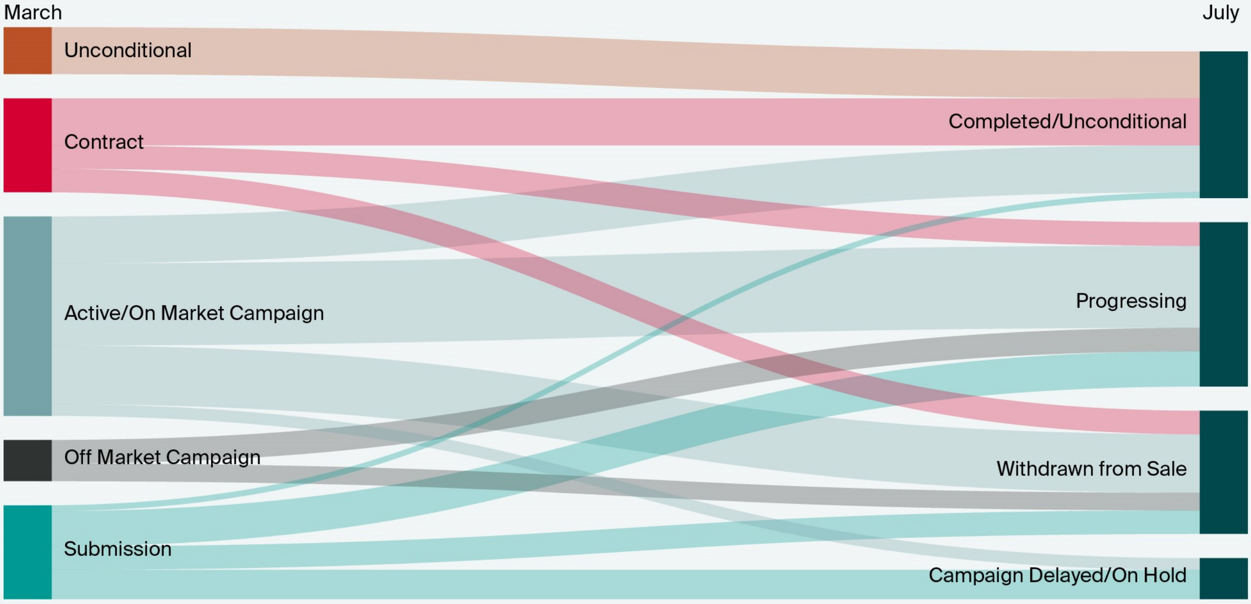
Source: Knight Frank Research, RCA

ANALYSIS OF KNIGHT FRANK DEALS MARCH TO JULY

To assess the real world impacts of COVID-19 impacts on capital markets, Knight Frank analysed 81 deals in progress in March to track their outcomes through the end of financial year across the major Eastern Seaboard markets.

Post Covid Deal Progression

Status of Knight Frank Basket of Deals



Source: Knight Frank Research

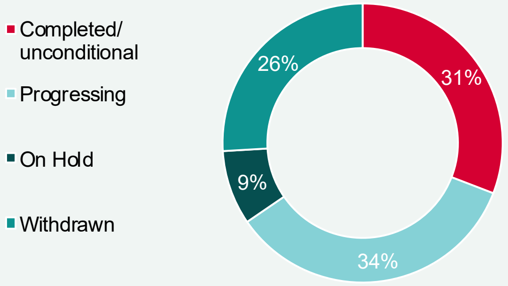
Analysis of the Knight Frank basket of transactions shows that 31% of deals underway in March have now settled or are subject to an unconditional contract. While there was some leakage from deals within due diligence periods, no unconditional contract fell over during the period studied.

Practical travel limitations and knocks to confidence have seen transactions take longer than they normally would, with 34% of deals tracked still progressing. This category includes properties currently under contract (11%), on-market campaigns (10%), off-market campaigns (11%) and submissions (2%).

While not all of the deals in progression will necessarily come to fruition, it has been encouraging to see transactions continue to progress through the COVID-19 impacted period. There was a notable re-building of confidence and activity across Australian markets during May and June. Unfortunately this has been somewhat stifled by the second wave which emerged in Victoria in early July and has continued to dampen market activity and confidence through to the time of writing.

Just under 10% of deals studied were on hold, seeking greater clarity around economic conditions, confidence, tenant profiles and any rental abatement discussions before proceeding. While more than a quarter of assets on the market in March have now been withdrawn, there have been new campaigns commenced with 15 new asset disposals underway in July which have emerged since March.

March active deals - status as at July 2020



Source: Knight Frank Research

DEAL STATUS BY SECTOR

In line with turnover levels, the data on the ground from Knight Frank deals shows that industrial has seen the greatest completion rate.

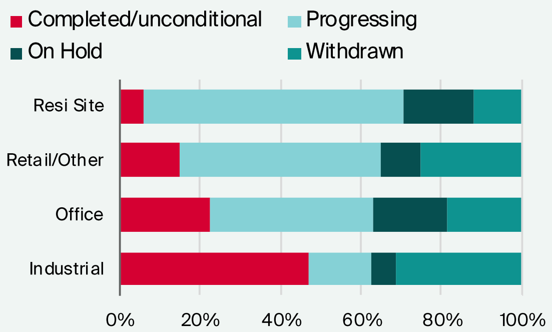
As shown below the industrial market has had the most linear reaction to the COVID-19 restrictions, recording both the highest completion rate (47%), and the highest withdrawal rate (31%) for deals analysed by Knight Frank. Ongoing brokerage deals have been impacted by the confidence knock of the Victorian second wave. However, the high institutional demand for industrial assets has and will see further opportunities bought to market as well as portfolio sales like the DALT/Dexus Property Group transactions.

The office market has a high proportion of deals remaining in the progressing stage (41%) as transactions are taking longer to occur. This is partially due to the ongoing uncertainty around tenants seeking rental abatement, occupancy and rental levels in both the short and longer term as the potential structural WFH changes flow through the market.

Additionally, with a strong offshore investor base, the physical limitations of inspecting and undertaking due diligence has continued to slow transactions. This has also contributed to office having the largest proportion of deals on hold at 19%, with vendors waiting for a more appropriate time to commence marketing their asset. As office market investors continue to refine strategies to pursue cross border investment the deal flow will gradually increase.

Status by Property Sector

Deal Status July 2020



Source: Knight Frank Research

BRISBANE ACTIVITY HIGHEST

To date Brisbane has been fortunate to have less time under restrictive lockdowns than Melbourne or Sydney which has buoyed activity.

The status of deals by location appears to mirror the levels of lockdown and direct impact from the COVID-19 virus. Brisbane has seen the highest level of completions followed by Sydney and then Melbourne.

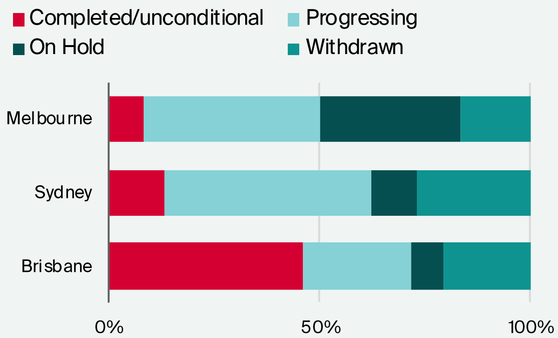
The level of completions in the Brisbane market sits at 46%, with only 21% reported as being withdrawn from the market. . It should be noted that more than 90% of the completed deals in Brisbane have had a value of $25 million or less. At this price range private buyers have proven to be more nimble. With Queensland recently reintroducing a hard border with NSW and Victoria, larger sales will be more difficult. A significant recent sale in Brisbane was a 50% interest in a major Coles cold store to DWS for $152.5 million, representing a 12% uplift to the value DWS paid for the other half of the asset in June 2019.

In Sydney just under half of the deals remain in progress as vendors are confident that buyers remain engaged for their assets, but that the process will take longer given the complexities of selling in this environment. Sydney also has the highest percentage of properties withdrawn from sale at 27% with owners choosing to retain assets that have performed well for them, rather than sell into an uncertain market.

Melbourne's struggles with infection numbers are reflected in the high number of assets remaining in progress (42%) with an extended programme, or on-hold for more favourable timing (33%) when the way forward is more clear.

Status by location

Deal Status July 2020



Source: Knight Frank Research

SMALLER DEALS DOMINANT

As expected, smaller deals, more likely with local purchasers and vendors, were far easier to conclude during Q2 2020.

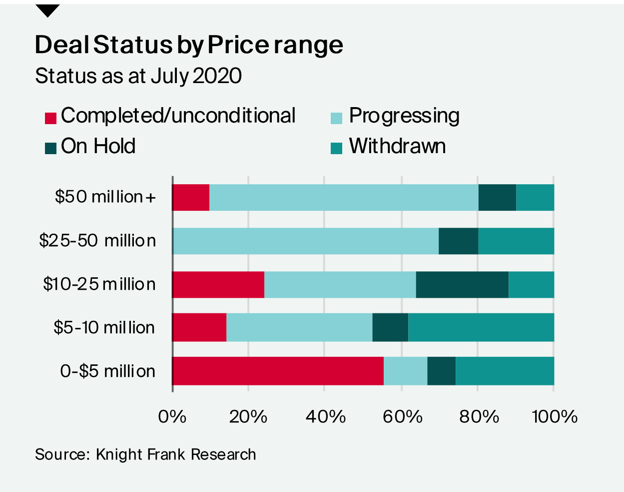
Sales of under $5 million had a 56% completion rate for deals underway in March. This aligned with expectations as smaller transactions are more likely to involve local parties, private investors and owner occupiers all of which have been more nimble in the recently challenging environment.

It has been more difficult to achieve completion on larger deals with between 9% and 24% of deals reaching unconditional status or settled for the $5 million to $50 million price brackets.

For institutional grade assets of $50 million+ there remains strong buyer interest, currently concentrated in core assets with limited short term tenant risk. More than three-quarters of assets $50 million+ in the sample analysed remain in progress.

'The impacts of COVID-19 have been divergent across the economy with some job types and industries virtually unaffected while others have been heavily impacted.

The property market has been the same with core defensive assets maintaining values while exposed secondary assets are falling out of favour."



YIELDS LARGELY STABLE

Yield ranges are broadening with uncertainty a key factor in pricing. The thirst for truely core assets has seen firmness at the lower yield band.

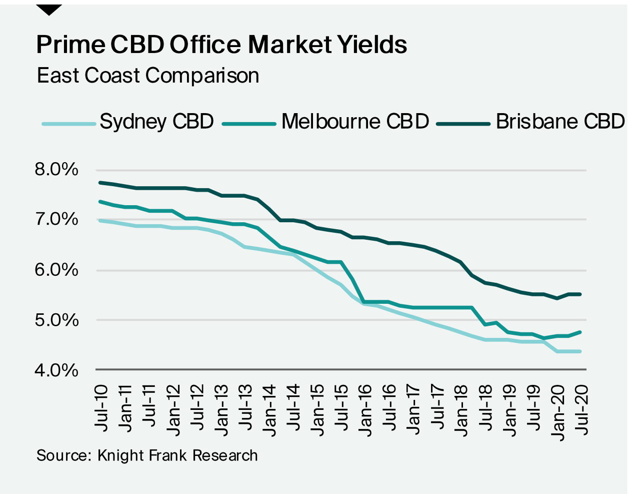
Prime office yields have been largely stable in recent months, although transactional evidence to has been relatively thin and values are still subject to more uncertainty than recently. When appraising assets, investors are factoring in falling effective rents in the near term, higher allowances for downtime and lower growth expectations over the long term. Coupled with renewed heightened risk aversion, this will put pressure on pricing in coming months for exposed assets. This is tempered by the offsetting influence of substantial interest rate reductions, which will act as a more powerful counterbalance than existed during the GFC.

The impact will vary greatly by location and tenant profile, with overall yields likely to rise on average in the near term, but assets with no immediate exposure will largely hold firm.

There is a renewed thirst for core prime property across any sector. Higher quality and longer leased assets with secure covenants that enable investors to look through the current period of uncertainty will continue to see tight yields.

In contrast, markets more impacted by the economic downturn, or secondary assets with tenant exposure (lease term or industry type) are facing longer selling periods with greater evidence likely to reveal some uplift in yields.

Across all markets we expect greater divergence in outcomes and a broadening yield range as the pricing of risk accelerates.



DATA DIGEST

The **Knight Frank Basket of sales and analysis of deal progression** is based on a sample of 81 sales being undertaken by Knight Frank across the East Coast during March and again in July 2020. Each sale's status was classified as "Submission to client, Off Market Appointment, On Market Appointment, Active Campaign, Offers Being Assessed, Contract, Unconditional, Settled, Campaign Delayed/On Hold or Withdrawn from Sale" in both March and July. If a sale moved forwards in the process (ie submission to off market appointment, or offers being assessed to Contract) then that sale was categorised as "Progressing". If a sale was still at the same stage (ie contract as at March and still under contract as at July), and the associated comments indicated that there were no negative issues emerging then that was "No change".

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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