RESEARCH

CAPITAL MARKETS INSIGHT: LARGE DEALS DRIVE ACTIVITY

LARGE TRANSACTIONS DRIVE OFFICE INVESTMENT VOLUMES IN 2019

Large deals have driven office property investment volumes in 2019 to date, while activity involving smaller deal sizes has been relatively weak. Sydney has also accounted for a relatively high share of large deal volume over the year to date. These trends reflect a desire among large institutional investors to continue to allocate capital to office property as interest rates fall despite the softer economic outlook and moderating rental growth in Sydney.

Highlights

Larger transactions have played a greater role than normal in driving office property investment activity in 2019.

This reflects institutional investors' ongoing desire to allocate capital to the Sydney and Melbourne office markets despite the softening growth outlook.

Capital growth for office property assets has moderated from elevated levels, but lower interest rates are likely to drive further yield compression, prolonging the property price cycle.

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Large deals dominate 2019 investment activity

Office property investment volumes have totaled $14.3 billion to end Q3, compared with $12.7 billion for the same period last year. While investment this year is likely to end up being around the record level seen in 2018, large deals have played a greater role in driving activity in 2019. Investment volume for deals greater than or equal to $200 million has totaled $8.4 billion in 2019 to date, significantly above the $4.8 billion and $6.1 billion recorded for the same period in 2018 and 2017 respectively.

Deals greater than or equal to $200 million have accounted for a historically high share (59%) of investment volume in 2019 to date, compared with an average share of 35% since 2010.

By contrast, investment activity for deals less than $200 million has been more subdued, with transaction volume totaling $5.9 billion over the nine months to September compared with $7.9 billion for the same period in 2018 and $9.2 billion in 2017. Reduced liquidity for smaller deal sizes in 2019 is notable as investment volume for smaller deals tends to be relatively stable from year to year compared to larger deal sizes.

Large deals continue to be concentrated in Sydney

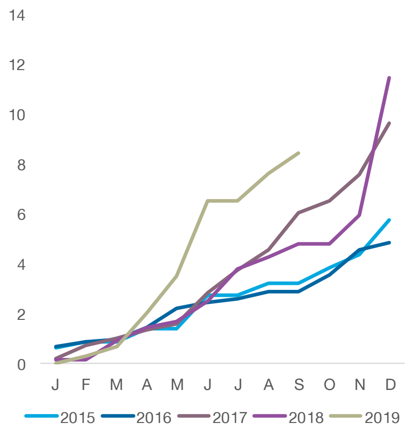
Geographically, the run-up in large deal activity has been most pronounced in Sydney. Investment volume for $200 million+ deals has totaled $5.5 billion over the nine months to September, significantly above the levels recorded in recent years. Outside of Sydney, the increase in investment activity for larger deals has not been as marked but still solid in 2019, with transaction volume currently running slightly ahead of the record levels seen in 2017.

Sydney has accounted for 66% of total investment volume for $200m+ deals in Australia in 2019 to date, the third highest

FIGURE 1

Investment Volume Deals ≥$200m

$b, cumulative monthly total

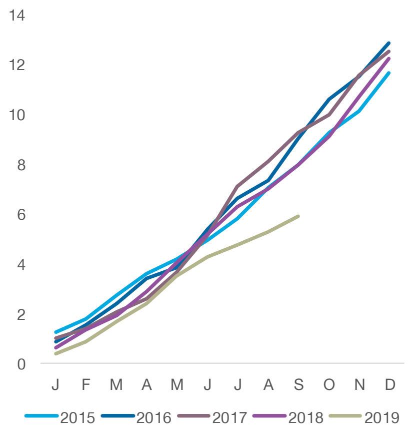


Source: RCA, Knight Frank Research

FIGURE 2

Investment Volume Deals <$200m

$b, cumulative monthly total



Source: RCA, Knight Frank Research

share this decade after 2012 (79%) and 2018 (67%). This compares to an average share of 54% since 2010.

A number of notable large deals in 2019 have boosted investment activity in Sydney including:

- Blackstone's acquisition of the Scentre Portfolio ($1.5 billion);
- GIC's purchase of a 25% stake in Lendlease International Towers Sydney Trust (c.$1 billion);
- Charter Hall's acquisition of a 50% stake in Chifley Tower ($900 million) and 201 Elizabeth Street ($630 million);
- Dexus' purchase of a 50% stake in the MLC Centre ($800 million);
- GPT's acquisition of a 25% stake in Darling Park Towers 1 and 2 ($531 million);
- Arrow and Starwood's acquisition of Zenith Towers ($438 million);
- Investa's purchase of a 50% stake in 135 King Street ($340 million).

Despite Sydney's high share of activity, several large deals in other cities have made a significant contribution to total volume. For example, in Melbourne, Dexus acquired the 80 Collins Street development for $947 million (office component) and Charter Hall acquired 242 Exhibition Street for $830 million.

Lower interest rates driving greater institutional appetite

The greater concentration of investment activity in larger deals is likely to reflect a contrasting reaction to current market conditions on the part of large institutional and smaller private investors.

The shift to lower interest rates over the past year has increased the attractiveness of commercial property assets and prompted institutional investors to re-assess the potential for further yield compression, whereas a year ago many were of the view that yield compression had largely run its course.

Larger institutional investors have also been well-placed to take advantage of the lower funding costs that have come as a result of the shifting rates environment, and this has boosted their appetite to deploy capital.

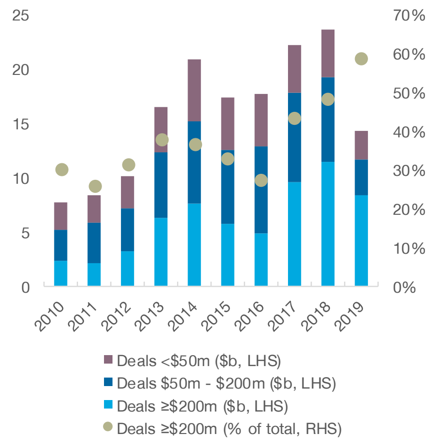
On the other hand, slowing growth and greater uncertainty around the economic outlook has impacted sentiment to a greater degree among private and smaller investors, resulting in reduced liquidity for smaller and mid-sized deals. A tightening of credit availability in the aftermath of the banking Royal Commission, notwithstanding lower interest rates, may also be constraining the ability of smaller investors to borrow, adversely affecting investment activity.

However, looking ahead to 2020, if the economy recovers as anticipated, sustained capital growth and improving confidence are likely to spur a return to higher levels of liquidity in smaller size brackets.

FIGURE 5

Investment by Deal Size

Total volume ($b)

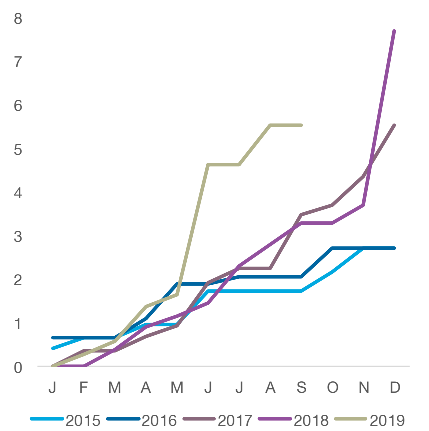


Source: RCA, Knight Frank Research

FIGURE 3

Deals ≥$200m Sydney

Total volume ($b, cumulative monthly total)

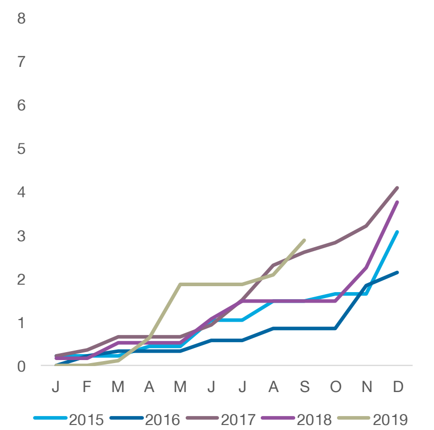


Source: RCA, Knight Frank Research

FIGURE 4

Deals ≥$200m Australia ex Sydney

Total volume ($b, cumulative monthly total)

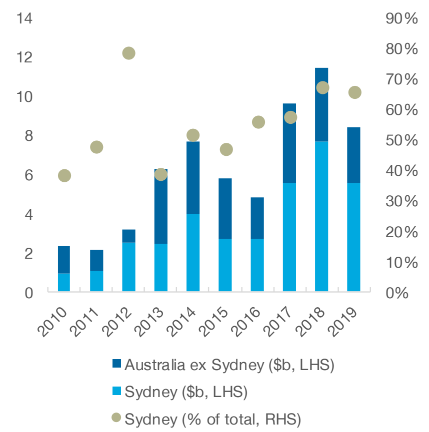


Source: RCA, Knight Frank Research

FIGURE 6

Deals ≥$200m by Region

Total volume ($b)



Source: RCA, Knight Frank Research

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