2020

OUTLOOK REPORT

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FOCAL POINTS

Welcome to our report on the outlook for the Australian property market in 2020. The report provides an assessment of the global and local economic trends that will shape market performance in 2020, and a series of predictions as to how we see the office and industrial markets evolving.

In many ways, we are in uncharted territory, with the global economy and property market cycle entering its 11th year since the last downturn – a record expansion by some measures. Despite an extended cycle, we are yet to see the re-emergence of inflationary pressures and higher interest rates; in fact, rates are at record lows and there is a strong chance they will head even lower in 2020. Meanwhile, evolving occupier needs are putting ever more pressure on real estate to respond.

This move into uncharted waters sets the scene for 2020, with a contrasting outlook for occupier and investment markets. Leasing market conditions will be impacted by subdued economic growth, but the sharp downward shift in interest rates will drive the investment market to new highs, prolonging the property price cycle.

TOP PREDICTIONS FOR 2020:

1 Economic growth set to improve in 2020 but remain slow

Growth in the Australian economy should pick up in 2020 as lower interest rates and the recovery in the housing market boost consumer spending but will remain slow by historical standards. Ongoing solid employment growth will support demand for office space, but the global outlook will weigh on confidence and absorption to some extent.

2 Interest rates to fall further

The RBA will cut interest rates further amid persistent slack in the labour market and the associated weak wage growth, and ongoing low inflation. We expect the RBA will cut the cash rate two more times to 0.25% and, if further fiscal stimulus is not forthcoming, launch quantitative easing.

3 Office property yields will tighten

Lower interest rates will boost demand for commercial property assets as investors continue to seek relatively high yielding assets with a fixed income stream. We estimate, for example that Sydney prime CBD office property yields will decline by 50 basis points over the next two years to 4.1%.

4 Capital growth to pick up after slowing in 2019

After slowing this year from elevated levels, capital growth should pick up a little in 2020 and 2021, underpinned by further yield compression. Consequently, total returns will remain in double digit territory for the sixth consecutive year. For office property, capital growth is expected to pick up to 5.8% in 2020 and 6.4% in 2021 from an estimated 5.4% this year.

5 Lower interest rates will boost investment activity

Lower interest rates will drive demand for commercial property assets as investors reassess the potential for further yield compression. Strong demand from institutional investors for prime office property assets has been evident in 2019 and this should continue next year. We also expect the improving economic outlook and sustained capital growth to encourage smaller private investors to be more active in 2020. Offshore investors should also continue to make a strong contribution to investment activity, attracted by relatively high yields in Australia compared to many cities in the Asia Pacific region, reduced hedging costs, and a lower exchange rate.

6 Capital raisings and yield compression to drive more development starts

The boost to capital values from further yield compression will spur new development starts in 2020. A spate of capital raisings in recent months points to strong investor appetite for increasing exposure to office and industrial property and ongoing confidence in market fundamentals.

7 Office vacancy in Melbourne set to increase, particularly in the Docklands & Western core

The large wave of new office supply coming to the Melbourne CBD in 2020 and 2021 will see the vacancy rate rise from historically low levels and rental growth moderate. The increase in supply will be concentrated in Docklands, the Western Core and the Eastern Core will outperform.

8 Rents to grow at a more even pace across office markets

Brisbane, Perth and Adelaide are set to benefit from stronger effective rental growth as the improving economic outlook continues to foster stronger net absorption and lower vacancy. At the same time, rental growth in Sydney and Melbourne is set moderate after an extended period of above average growth.

9 Strong capital inflows into the industrial sector

The surge in capital raisings by REITs will drive strong capital inflows into industrial property in 2020 as they seek to increase exposure to the sector. Demand for prime industrial product will remain robust reflecting rising e-commerce and record infrastructure spending on new road and rail projects, as well as occupier demand to improve supply-chain efficiencies.

10 After dealing with cladding issues, property owners to focus on education and increasing building density

In the near future, some commercial property owners will face significant unplanned capital spending as they replace combustible cladding. Over the longer-term, owners will focus more on education facilities to augment employee skills and increasing building density as demand for flexible workspaces rises.

GLOBAL OUTLOOK UNDER THE MICROSCOPE

> **"The current slowdown in global growth is expected to be temporary and the outlook is not forecast to deteriorate sharply from here."**

GROWTH HAS SLOWED BUT THE GLOBAL ECONOMY IS EXPECTED TO IMPROVE IN 2020

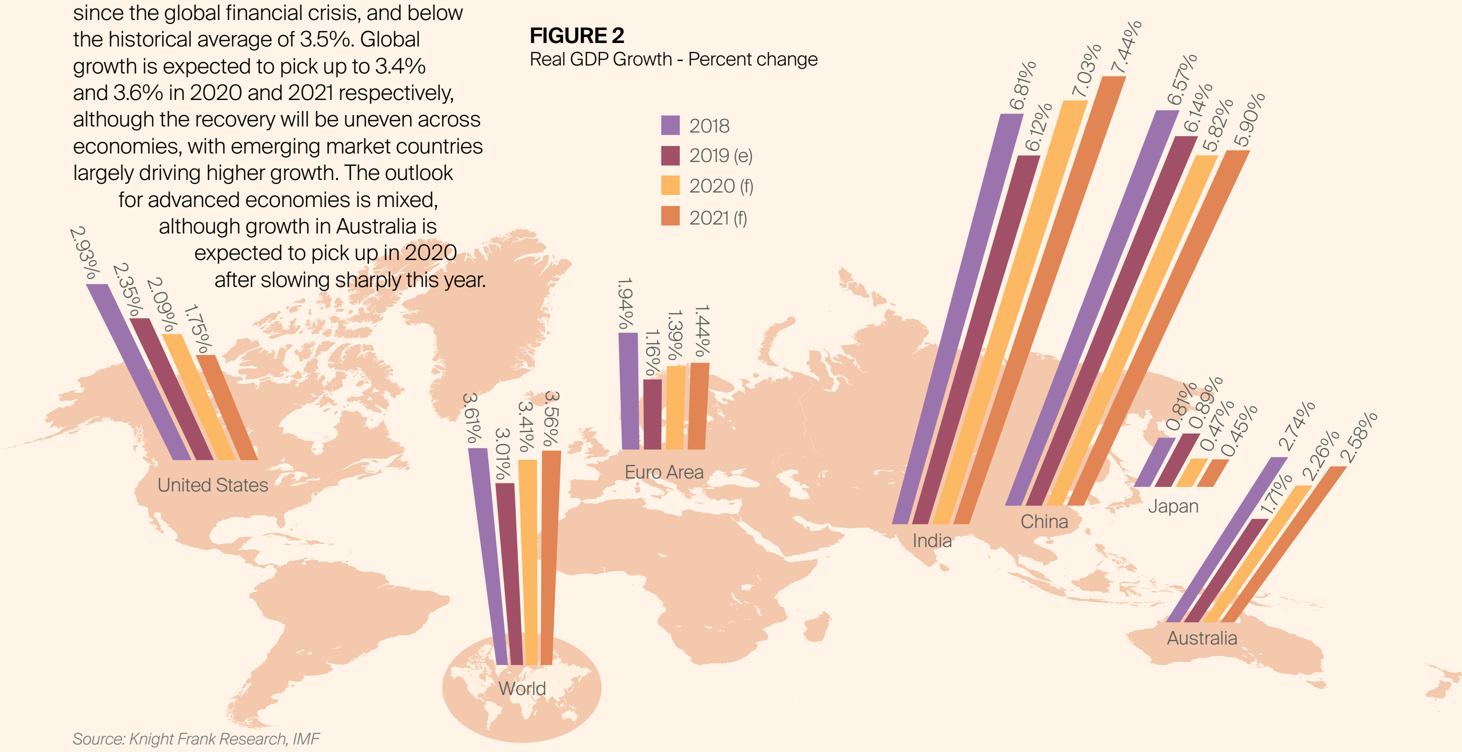
Global growth continues to soften, driven by a sharp slowdown in manufacturing activity and global trade. Ongoing trade tensions between the United States and China have weighed on investment and increased uncertainty around the outlook for the global economy. While also slowing, activity in the larger services sector remains resilient, supporting buoyant labour market conditions, solid wage growth and consumer spending in many advanced economies. In response to the global slowdown and increased downside risks, many central banks have further eased monetary policy.

The current slowdown in global growth is expected to be temporary and the outlook is not forecast to deteriorate sharply from here. The IMF predicts that the global economy will grow by 3% in 2019, the slowest pace since the global financial crisis, and below the historical average of 3.5%. Global growth is expected to pick up to 3.4% and 3.6% in 2020 and 2021 respectively, although the recovery will be uneven across economies, with emerging market countries largely driving higher growth. The outlook for advanced economies is mixed, although growth in Australia is expected to pick up in 2020 after slowing sharply this year.

FIGURE 1
Global Trade Volumes and Industrial Production - 3 month moving average, percent change year on year

Source: Knight Frank Research, CPB Netherlands Bureau for Economic Policy Analysis

FIGURE 2
Real GDP Growth - Percent change



Source: Knight Frank Research, IMF

While growth is expected to stabilise and begin to pick up next year, the risks around the outlook have increased. The slowdown in growth could become more widespread if prolonged weakness in manufacturing activity spills over to the services sector, adversely affecting employment growth and consumer spending. Policy uncertainty and geopolitical risks such as the potential for further escalation in US-China trade tensions, a no-deal Brexit, and disruptions to oil supply in the Middle East could also lead to weaker than expected growth. On the other hand, further monetary policy stimulus and easier financial conditions could boost growth more than currently anticipated.

PARTIAL TRADE DEAL LIKELY BUT A COMPREHENSIVE US-CHINA SETTLEMENT WILL REMAIN ELUSIVE

The United States and China have reached a tentative agreement on a limited trade deal. While a partial trade deal is likely to be signed, disputes over trade and technology transfers are likely to continue as China's rise challenges the political, economic and military power of the United States in the Asia Pacific region and around the world. A prolonged trade war could have adverse effects on business confidence and investment and have a significant impact on global supply chains, particularly weighing on growth in the Asia Pacific region.

China is Australia's largest trading partner accounting for 37% of Australia's total exports. While Australia's exposure to China is significant, Australia is not a big part of global supply chains, particularly for technology products. This limits the downside risk for Australia should trade tensions escalate. Furthermore, China's fiscal stimulus to combat the impact of the trade dispute and a slowing economy is being directed mainly at steel intensive infrastructure projects, which is boosting Chinese demand for Australian resource exports.

NATIONAL OUTLOOK UNDER THE MICROSCOPE

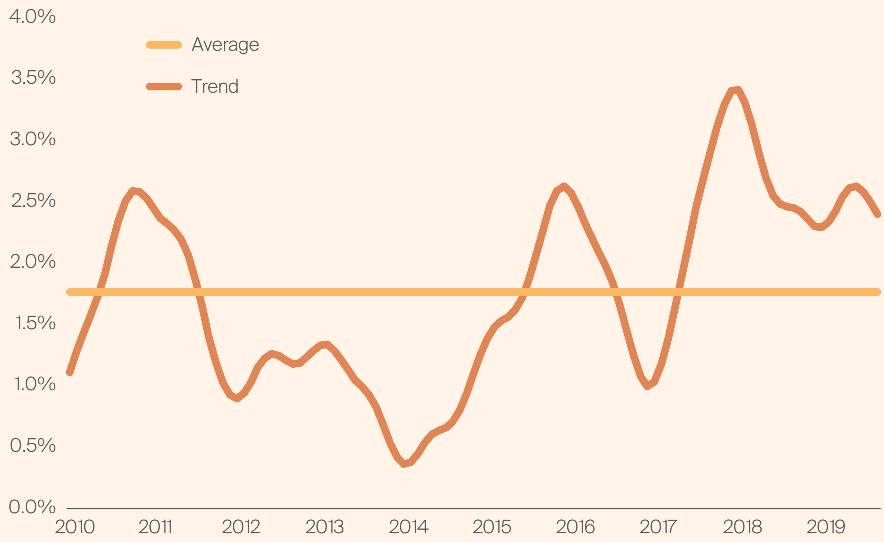
> **"Growth will become more balanced between the states as the downturn in residential construction weighs on activity in NSW and Victoria, while export growth drives stronger activity in Queensland and Western Australia."**

OUTLOOK FOR AUSTRALIA SET TO IMPROVE BUT RESIDENTIAL CONSTRUCTION WILL WEIGH ON GROWTH

Growth in the Australian economy has slowed sharply over the past year, although quarterly GDP growth picked up the first half of the year compared to the second half of 2018. Slow income growth has weighed on consumer spending, while housing investment has declined sharply following the large run-up during the housing boom. By contrast, government spending has made a strong contribution to growth and the depreciation of the Australian dollar has supported demand for exports.

While employment growth remains well above average contributing to demand for office space, strong population growth and higher labour force participation are increasing labour supply and restraining wage growth.

FIGURE 3
Employment Growth - Percent change year on year



Source: Knight Frank Research, ABS

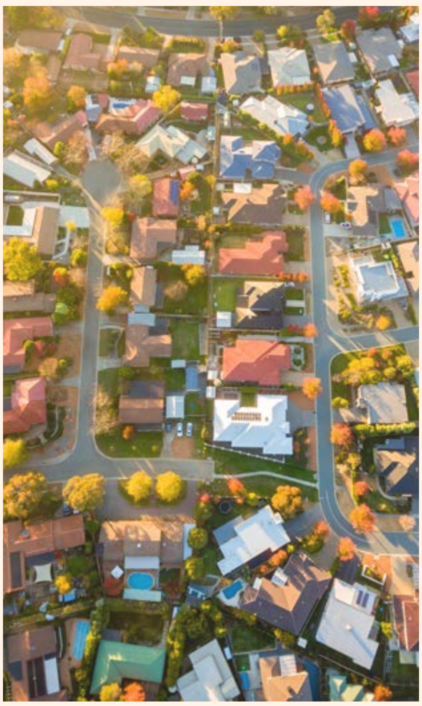
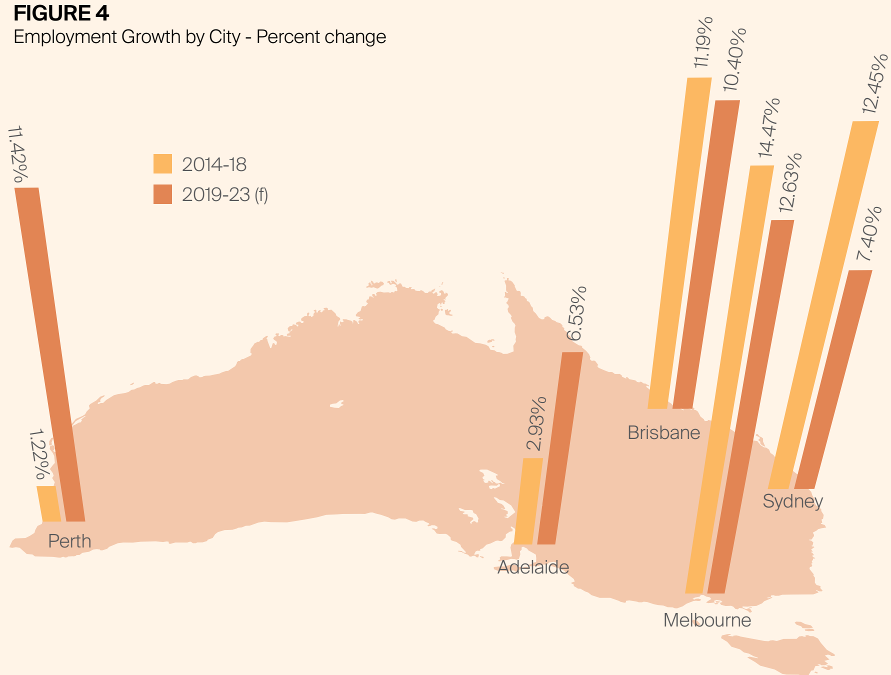


FIGURE 4
Employment Growth by City - Percent change

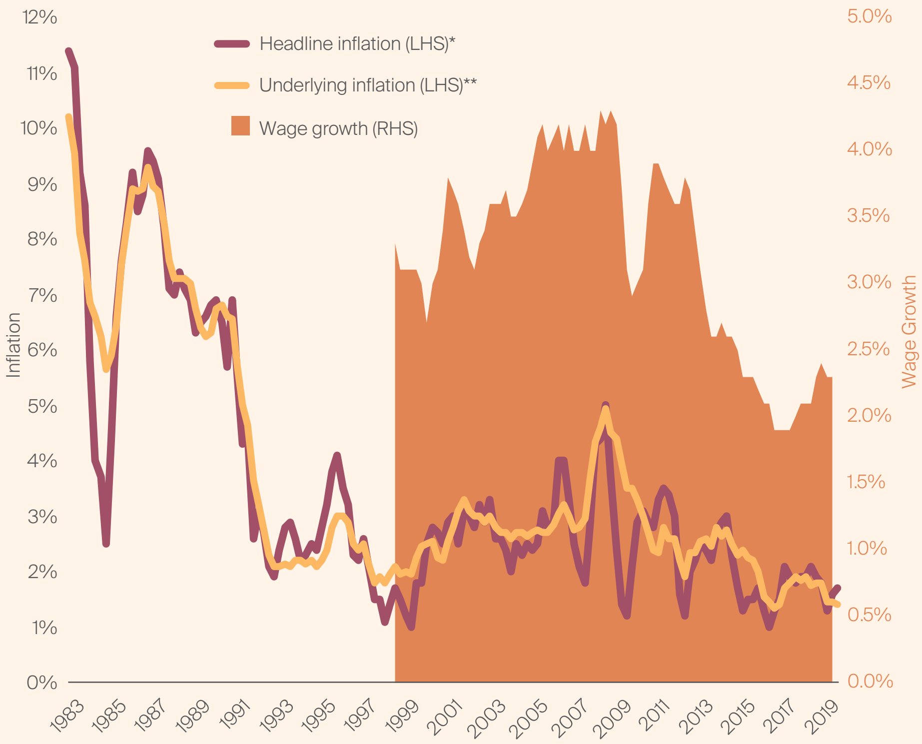


Source: Knight Frank Research, Oxford Economics

THE RBA TO CUT INTEREST RATES FURTHER AND LIKELY TO LAUNCH QUANTITATIVE EASING

Despite the brighter outlook going into 2020, the RBA has cut interest rates by a cumulative 75 basis points to 0.75% since June citing the ongoing spare capacity in the labour market, low inflation, and greater uncertainty around the global outlook. The RBA has emphasised the limited effectiveness of monetary policy in stimulating growth given the already low level of interest rates, high level of household debt and called for fiscal policy to play a greater role in boosting activity. The Federal Government appears to be reluctant to implement further stimulus measures viewing the return to surplus as the key political objective. Given the limited progress in reducing labour market slack and persistently weak growth in wages and inflation, the RBA is set to cut interest rates to near zero, and if further fiscal stimulus is not forthcoming, will likely launch quantitative easing.

FIGURE 5
Inflation and Wage Growth - Percent change year on year



Source: Knight Frank Research, ABS
** Excludes the impact of tax changes*
*** Average of the trimmed mean and weighted median measures of underlying inflation*

MARKET IMPLICATIONS

1 While the outlook is set to improve, growth will remain low by historic standards and many global risks weigh on confidence. In this environment, firms will be more cautious, and absorption will remain subdued.

2 Occupier market performance in Australia will converge to some extent as economic and employment growth becomes more balanced between the states.

3 Monetary easing will provide substantial stimulus, boosting activity in capital markets and driving values higher.

CAPITAL MARKETS FORESIGHT

> **“Lower interest rates and the prospect of further yield compression will continue to support commercial property investment, as investors search for yield in a low interest rate environment.”**

COMMERCIAL PROPERTY YIELDS WILL TIGHTEN FURTHER

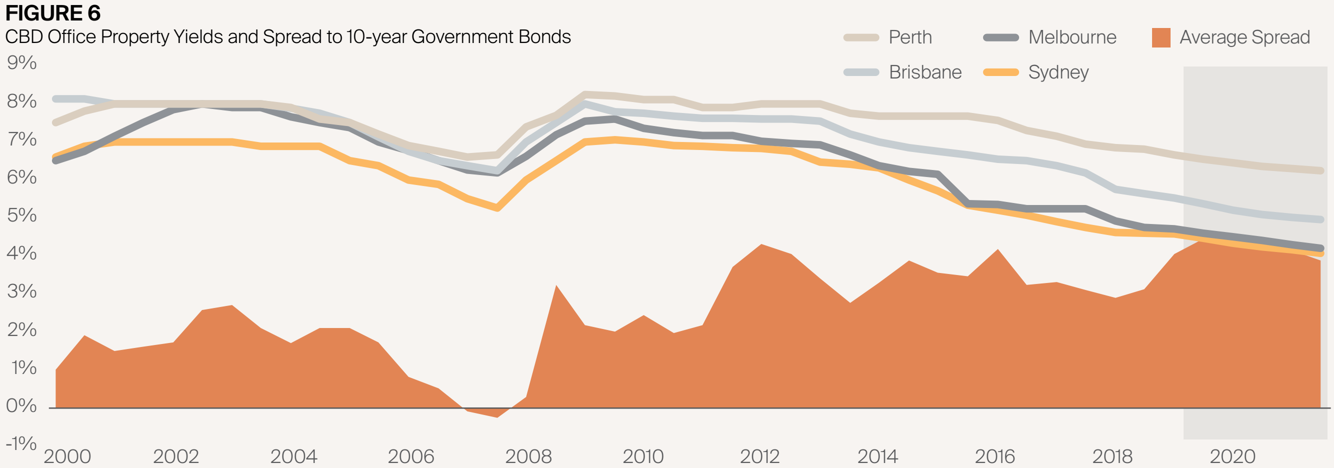
The sharp shift to lower interest rates this year will increase the attractiveness of commercial property assets and drive further compression in commercial property yields, resulting in a longer property price cycle. Compared to 12 months ago, this represents a significant change in the outlook when many had thought, including us, that the current cycle of broad-based yield compression was coming to an end.

Lower interest rates have increased the relative value of commercial property assets. While yields are at record low levels, the average spread between prime CBD office property yields and 10-year government bonds increased to 426 basis points in the September quarter, its highest level since 2012. The spread to government bonds will likely remain above its historical average because of structural factors such as shorter average lease periods, however, we expect property yields will tighten further from here. For example, we estimate that Sydney prime CBD office property yields will decline by 50 basis points over the next two years to 4.1%.

RETURNS SLOW FROM 2018 BUT ASSET PERFORMANCE WILL REMAIN STRONG

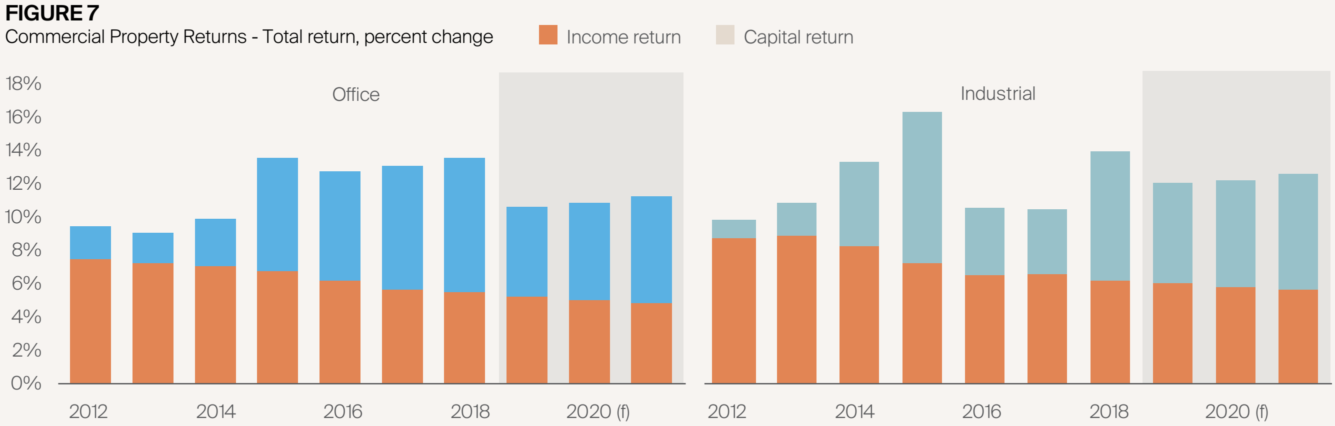
As we predicted at the start of the year, capital growth for office and industrial assets has slowed in 2019 but remains high, and total returns have been in the double digits for five consecutive years. While we had expected capital growth to slow further in 2020, the sharp downward shift in interest rates will drive additional yield compression and lend support to capital growth. For office property, capital growth is expected to slow from 8% in

FIGURE 6
CBD Office Property Yields and Spread to 10-year Government Bonds

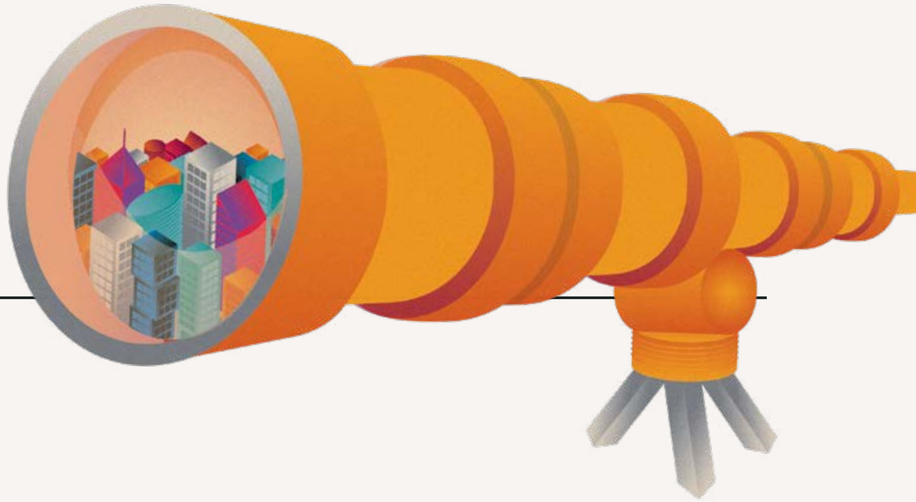


Source: Knight Frank Research, RBA

FIGURE 7
Commercial Property Returns - Total return, percent change



Source: Knight Frank Research, MSCI



2018 to 5.4% this year, driven by a slowdown in the Sydney CBD. Capital growth is expected to pick up a little to 5.8% and 6.4% in 2020 and 2021 respectively. Industrial property should perform relatively well driven by strong demand for warehousing space partly reflecting the rapid growth of e-commerce and logistics. Capital growth is expected to slow from 7.7% last year to 6% in 2019, before picking up to 6.4% in 2020 and 7% in 2021.

LOWER INTEREST RATES WILL UNDERPIN STRONG INVESTMENT ACTIVITY

Office property investment volumes have remained strong in 2019 after reaching a record high level in 2018, while challenging conditions have weighed on retail sector investment. Looking ahead, lower interest rates and the prospect of further yield compression will continue to support commercial property investment, as investors search for yield in a low interest rate environment.

Large institutional investors have been particularly responsive to the shift to lower interest rates, driving a historically high concentration of investment activity in relatively large deals. Deals greater than or equal to $200 million have accounted for 59% of investment volume in 2019 compared with an average of 35% since 2010, boosted by activity from institutional investors such as Blackstone, Charter Hall, Dexus, GIC, GPT and Investa. We expect ongoing strong demand from institutional investors as they reassess the potential for further yield compression.

By contrast, 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. Looking ahead to 2020, assuming the economy recovers as anticipated, we expect sustained capital growth and improving confidence to spur a return to stronger activity among smaller private investors and higher levels of liquidity in the smaller size brackets which will boost overall investment activity.

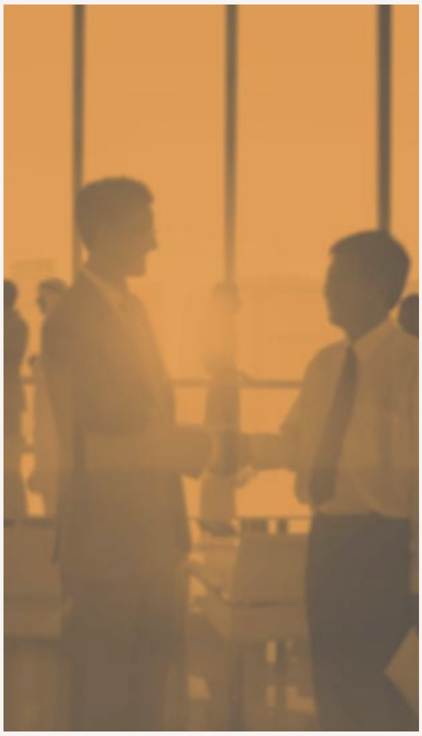
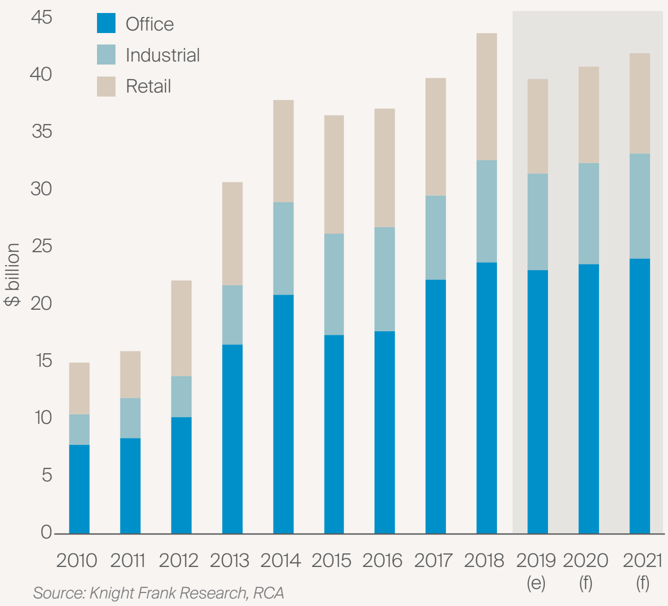
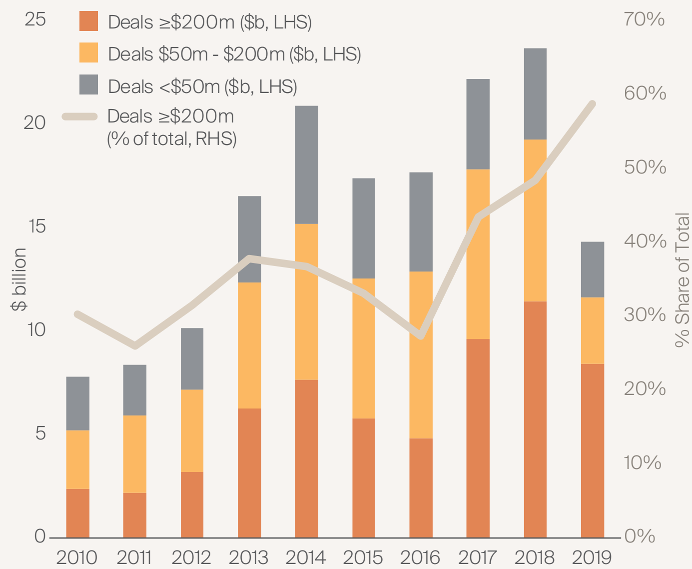


FIGURE 8
Investment Volume



Source: Knight Frank Research, RCA

FIGURE 9
Office Investment Volume by Deal Size



Source: Knight Frank Research, RCA

> **The recent run of capital raisings points to strong prospective demand from institutional investors to allocate to office and industrial property assets.**

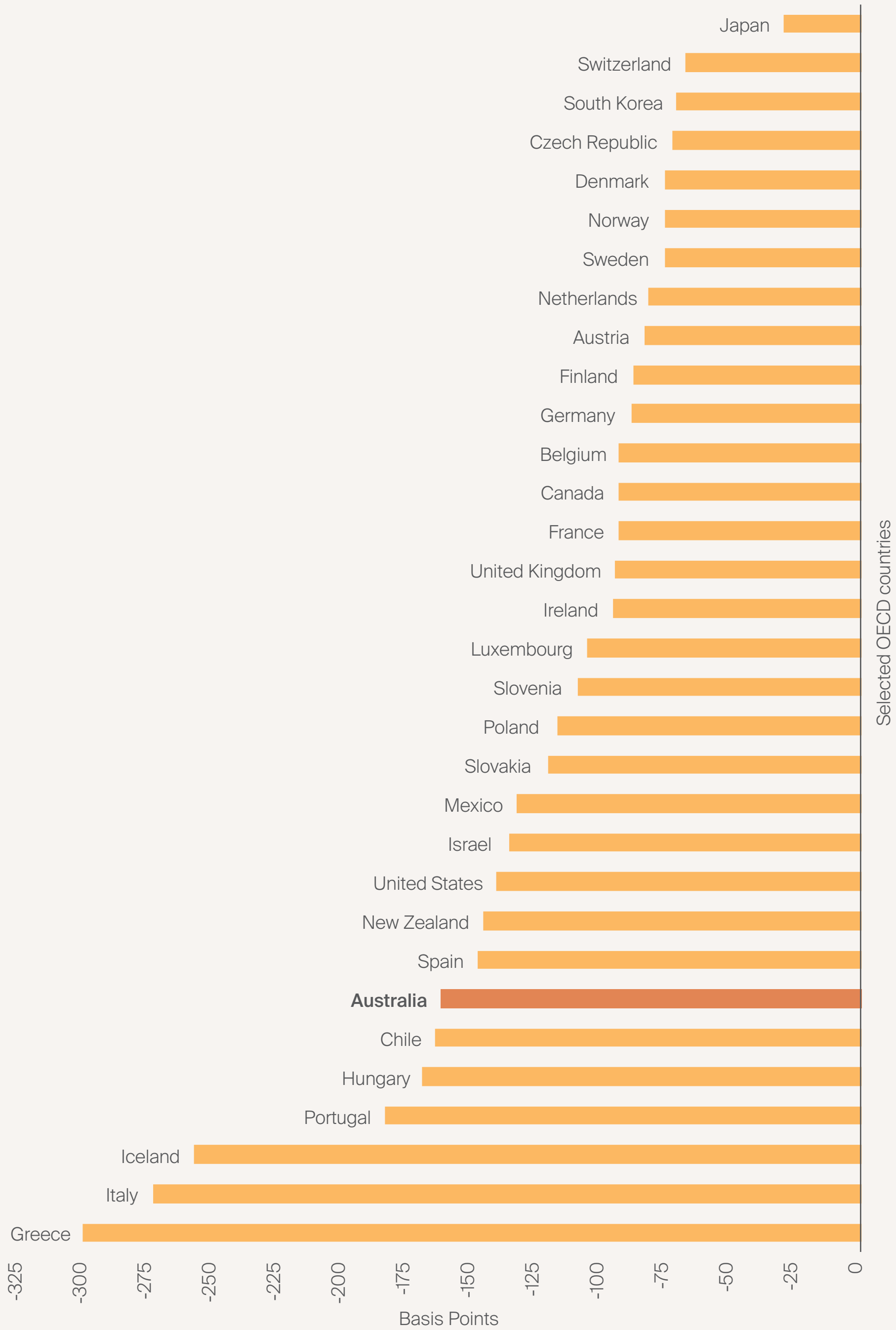
LOWER HEDGING COSTS AND EXCHANGE RATE TO DRIVE CROSS-BORDER INVESTMENT

The lower interest rate environment has made Australia a more attractive destination for offshore investors. While interest rates have fallen around the world, the decline in interest rates in Australia over the past 12 months has been relatively large compared to most OECD countries. Offshore investors looking to invest in Australia will benefit from lower hedging costs as interest rates in Australia, which have historically been higher than in the domicile of major cross border investors such as the United States and Canada, are now lower. The relatively large shift in interest rates in Australia and greater uncertainty around the global outlook, has led the Australian dollar to depreciate against the US dollar and other major currencies in 2019, increasing the attractiveness of investment in Australia. These factors are likely to foster ongoing strong demand from offshore investors for commercial property assets in Australia, which have relatively attractive yields compared to alternative domestic investments for most foreign investors.

STRONG CAPITAL RAISINGS POINT TO CONFIDENCE IN THE RETURN OUTLOOK FOR COMMERCIAL PROPERTY

The sharp decline in interest rates has prompted a spate of capital raisings this year among listed REITs and to a lesser extent unlisted funds. Equity issuance among real estate companies is running at the highest level in a decade. The strong interest from investors reflects confidence in the return outlook for office and industrial property and more defensive positioning in a slowing economy. The recent run of capital raisings points to strong prospective demand from institutional investors to allocate to office and industrial property assets.

FIGURE 10
Change in 10-year Government Bond Yields over the past 12 months



Source: Knight Frank Research, Macrobond

TABLE 1

SELECTED RECENT CAPITAL RAISINGS

Date Announced	Entity	Capital Raised	Primary Use of Capital
2 May 2019	Dexus	$900 million	Acquisition of 75% stake in 80 Collins Street, Melbourne.
19 June 2019	GPT	$800 million	Acquisition of 25% stake in Darling Park Towers 1 and 2, Sydney.
29 May 2019	Mirvac	$750 million	Repay debt and fund development pipeline across office, industrial, mixed-use and residential sectors.
16 October 2019	Charter Hall*	$725 million	Industrial property acquisitions.
3 October 2019	Investa**	$500 million	Replenish fund balance sheet and fund office property acquisition and development.
26 June 2019	Cromwell	$375 million	Core office investments in Australia, and office and retail investments in Europe.
16 August 2019	Charter Hall***	$261 million	Acquisition of one office property and 24.5% stake in 37 telecommunication exchange properties.
5 June 2019	Charter Hall***	$200 million	Acquisition of two office properties and 50% stake in one industrial property.
27 June 2019	Growthpoint	$150 million	Various office and industrial sector acquisitions and development projects.
28 May 2019	Investec****	$102 million	Repay debt and reduce fund gearing.
18 September 2019	Centuria	$100 million	Acquisition of two A-grade office assets in Sydney and Perth.
26 September 2019	Investec****	$84 million	Acquisition of three industral properties in Perth, Adelaide and Darwin.

** Charter Hall Prime Industrial Fund*
*** Investa Commercial Property Fund*
**** Charter Hall Long WALE REIT*
***** Investec Australia Property Fund*
Source: Knight Frank Research, ASX

OFFICE MARKETS OBSERVATION

> "The pipeline is set to receive a boost in 2020 as yield compression and recent capital risings act to spur more development starts."

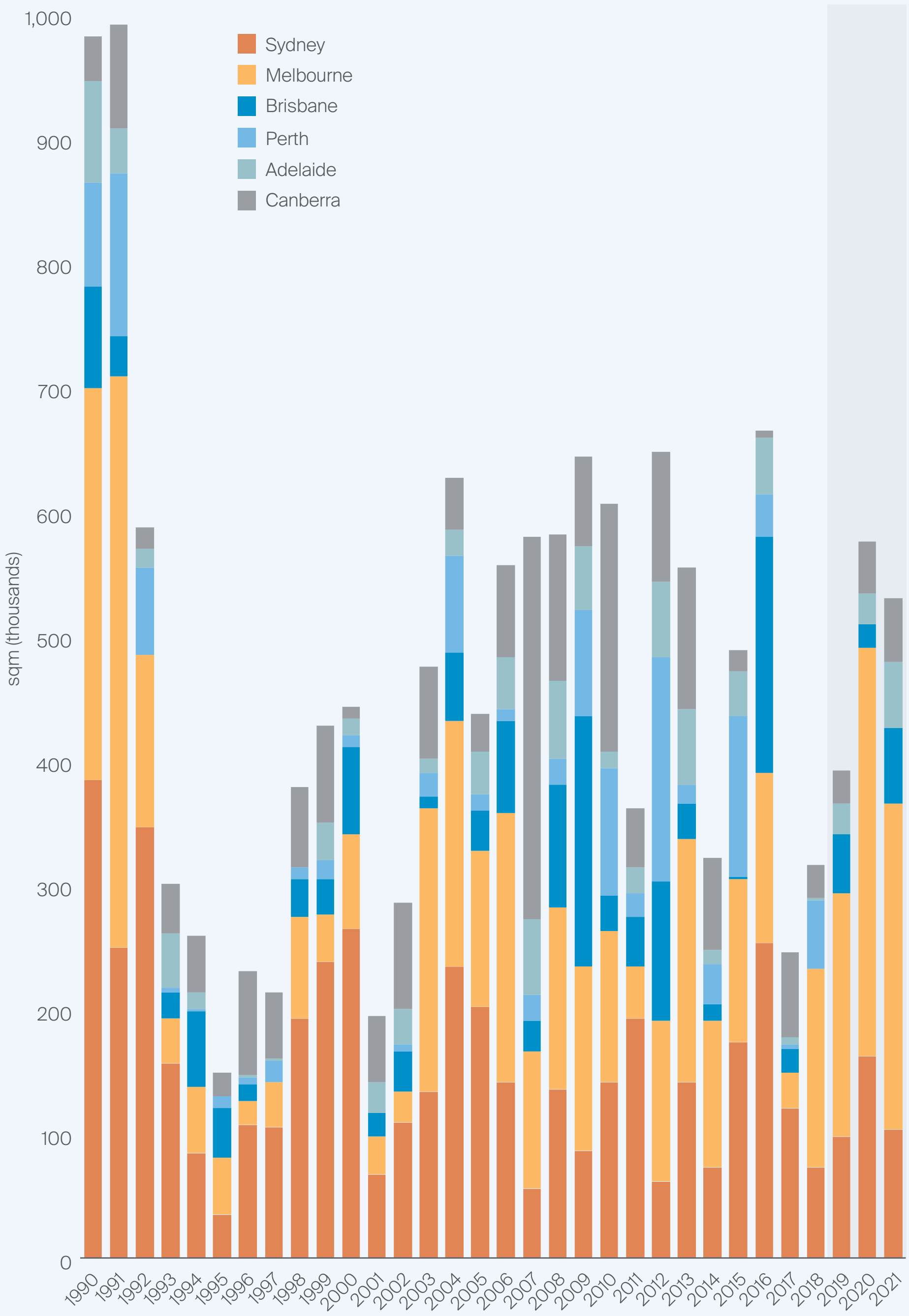
CAPITAL RAISINGS AND YIELD COMPRESSION WILL ACT TO BOOST DEVELOPMENT STARTS

Outside of Melbourne, the development pipeline has been thin for some time, with the level of completions nationally well below average over the past three years. In Sydney this has perhaps reflected caution following the completion of the International Towers, while in Brisbane, Adelaide and Perth it has reflected high vacancy and subdued sentiment in the leasing market.

However, the pipeline is set to receive a boost in 2020 as yield compression and recent capital risings act to spur more development starts. Yield compression, and increased confidence that yields will remain low given a prolonged low interest rate environment, will act to boost the value of completed assets, making development more attractive. Likewise, recent capital raising speak to the appetite and confidence of major institutions looking to increase their exposure to the office sector, and development will play an important role in this.

With Sydney heavily undersupplied, and other cities now seeing stronger confidence owing to declining overall vacancy and a lack of prime product, the market will welcome a measured expansion of the pipeline.

FIGURE 11
Development Completions



Source: Knight Frank Research, PCA

MELBOURNE VACANCY SET TO RISE, PARTICULARLY IN DOCKLANDS AND WESTERN CORE

Melbourne office market conditions have been very tight for the past two years, with the market benefiting from a sustained run of high net absorption that has driven the vacancy rate to a low of 3.3%. The supply dynamic is set to change in 2020, however, with around 590,000 sqm due to be delivered in 2020 and 2021, the largest increase in supply since the early 1990s. The increase in supply will be concentrated in Docklands and the Western Core precincts.

While strong tenant demand is expected to continue, and the new schemes are substantially pre-committed, the sheer quantum of new development set to be completed over the next few years is expected to push the prime CBD office vacancy rate from 3.3% currently to a peak of 7.7% in 2021. Higher vacancy is expected to lead to rental growth easing from its current rapid pace. Face rents are likely to continue growing, albeit at a slower pace, with much of the adjustment coming through higher incentives.

Given higher supply, investors and developers will need to be cognisant of increased risks around the outlook, and closely monitor trends in backfill vacancy as well as new development completions.

OUTLOOK FOR CONTINUED RENTAL GROWTH AT A MORE EVEN PACE ACROSS ALL MARKETS

Sydney and Melbourne have dominated office market performance over the past five years, substantially out-stripping Brisbane, Adelaide and Perth in terms of rental growth, capital growth and total returns. This sharp contrast in performance is starting to change, and we expect a more even pattern of growth going forward, particularly for prime buildings.

Brisbane, Perth and Adelaide have each benefited from a sustained run of positive absorption which has lowered vacancy and exposed a shortage of prime stock after several years with limited supply additions. Related to this, strong employment growth and an improved economic outlook for Queensland, Western Australia and South Australia has buoyed sentiment.

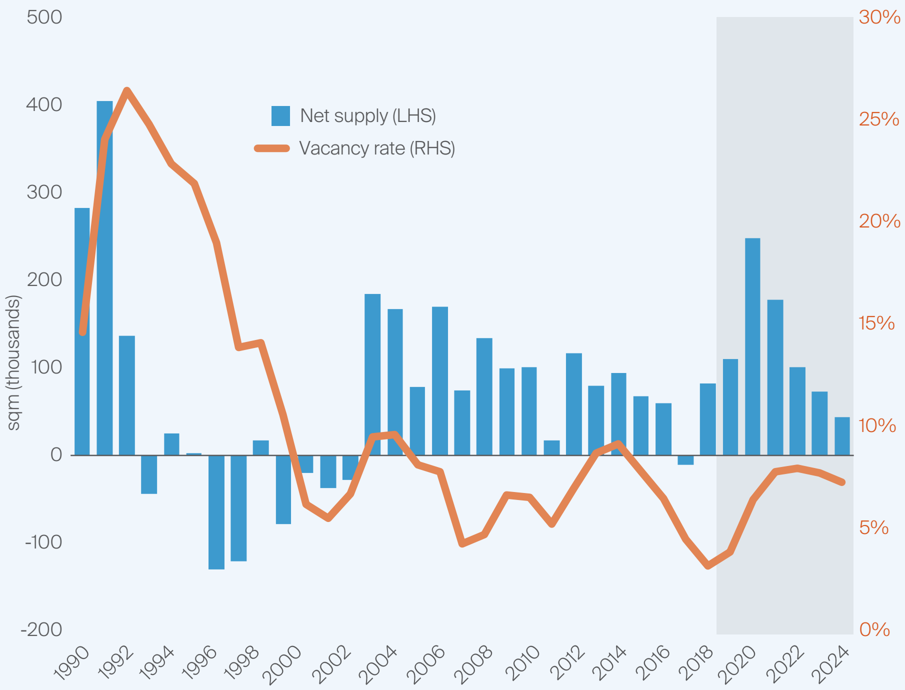
As a result of lower vacancy and a lack of choice for occupiers seeking larger spaces, these cities have each seen improved rental performance. Face rents are now rising, and stronger sentiment is also leading to a narrowing of incentives that looks set to continue in 2020.

TABLE 2

NET FACE RENT GROWTH

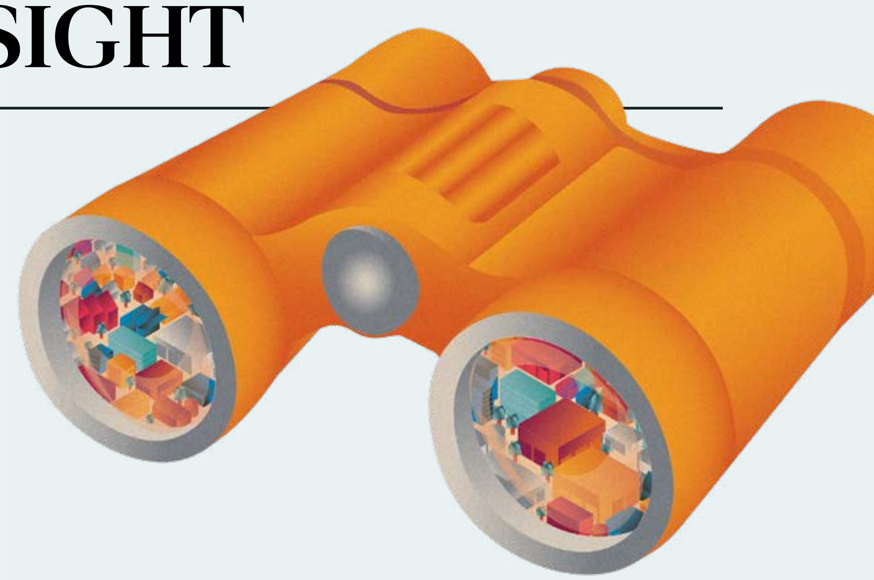
City	2015 - 2019	2020 - 2024 (f)
Sydney	46%	25%
Melbourne	43%	22%
Brisbane	11%	16%
Perth	-10%	15%
Adelaide	9%	14%

FIGURE 12
Melbourne CBD Net Supply and Vacancy Rate



Source: Knight Frank Research, PCA

INDUSTRIAL MARKETS INSIGHT



CONTINUED OPTIMISM WILL DRIVE MARKET EXPANSION IN SYDNEY AND MELBOURNE

The strength of the industrial and logistics sector has been a key theme in recent years, led by e-commerce demand and the ongoing evolution of the supply-chain to fulfil that demand.

Core markets on the eastern seaboard are expected to remain tightly held, with continued supply constraints in the traditional markets creating expansionary demand for new industrial product beyond the existing core areas. This is especially true for Melbourne's West and South East and Sydney's South West and Outer West precincts, where the volume of new development in the pipeline is running above its average.

RISING ALLOCATIONS TO INDUSTRIAL WILL BOOST THE DEVELOPMENT PIPELINE

Both offshore and domestic REITs have been candid about their desire to increase asset allocations to the sector, particularly through the development of logistics and industrial assets on the eastern seaboard over the next three to five years. Capital raisings by some of the institutions in recent times have been oversubscribed, pointing to widespread market support for this strategy and the appetite of domestic and offshore investors for deploying capital into the logistics sector.

Earlier this year, Mirvac raised $750 million to support accretive industrial, along with office and mixed-use projects, and to pay down debt. While the $645 million of new capital raised by Dexus this year has enabled the group to launch new funds and activate industrial development projects. More recently, the Charter Hall Prime Industrial Fund closed a $725 million equity raising that was oversubscribed by both domestic and offshore investors.

“Core markets on the eastern seaboard are expected to remain tightly held, with continued supply constraints in the traditional markets creating expansionary demand for new industrial product beyond the existing core areas.”

FIGURE 13
East Coast Industrial Supply - New construction by location

Source: Knight Frank Research

REITS ACTIVELY EXPANDING LAND BANKS

Many of these institutions are currently reporting occupancy rates in the high 90% range, with above-average take-up levels and a reduction in vacancy rates underpinned by strong demand for industrial space, evolving supply-chain efficiencies and record infrastructure spending. Recent speculative schemes have achieved significant success, with the vast majority fully let within a few months of completion.

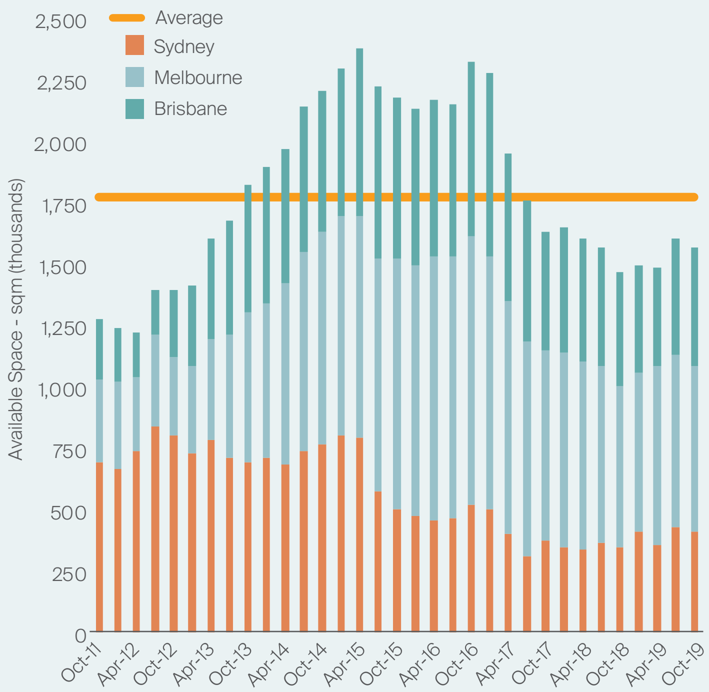
Following GPT's capital raising earlier this year, the group now has the capacity to develop more than 500,000 sqm of prime logistics facilities predominantly in the core markets of Sydney and Melbourne. Mirvac has increased its future industrial development pipeline in Sydney to $1.2 billion after securing sites in Western Sydney, including Kemps Creek, Badgerys Creek and Auburn. While ESR Australia has expanded its industrial development pipeline to $1.8 billion after exchanging contracts on sites in Sydney, Melbourne and Brisbane. The substantial potential pipeline by REITs in Australia suggests a high-level of confidence in the macro fundamentals surrounding the sector, particularly e-commerce and population growth, in driving future demand.

NEW CAPITAL PARTNERSHIPS ON THE HORIZON

In addition to new investors and new equity raising, the industrial sector will potentially see an increase in new capital partnerships over the next year. This is likely to coincide with a rise in domestic and offshore institutional funds and trusts stepping up their exposure to industrial through their development pipeline.

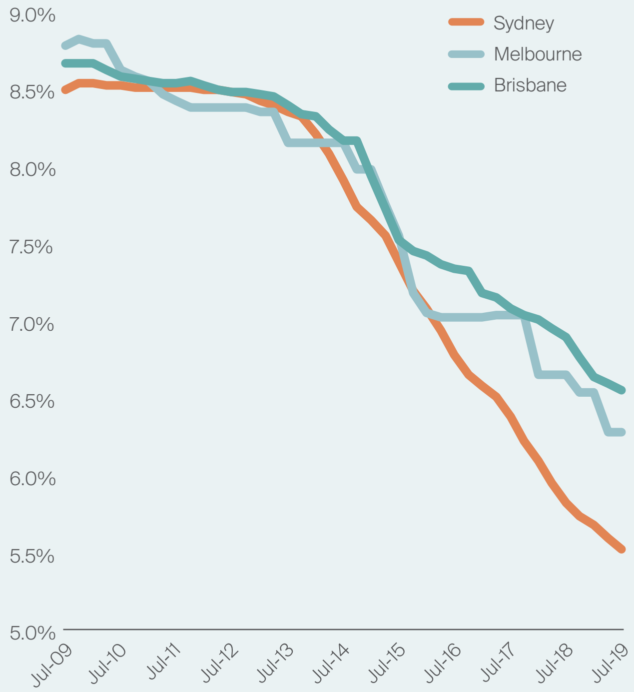
As well as increasing exposure to the sector for new entrants, capital partnerships enable smaller REITs seeking to gain market share to improve their purchasing power through economies of scale by partnering with an established group as they look to cash in on future demand for logistics and warehousing space and the outlook for capital growth.

FIGURE 14
East Coast Industrial Vacancy



Source: Knight Frank Research

FIGURE 15
East Coast Industrial Average Prime Yield



Source: Knight Frank Research

STRONG TAKE-UP TO BE SUSTAINED AS DEMAND STARTS TO OUTSTRIP SUPPLY

A boost to development activity bodes well for improving the availability of product in constrained markets in the short-term, potentially helping to close the gap in demand from logistics occupiers trying to fulfil mandates for 3PL contract space on the back of growing cross-border e-commerce. In Sydney, the transport and logistics sector accounted for 57% share of take-up on new speculative supply between 2017 and 2019, compared to 37% more broadly across the market, suggesting that these occupiers are undergoing rapid expansion.

Total east coast vacancy remains well-below its long-term average, driven largely by demand from 3PL providers, online retailers and distributors. In Melbourne, absorption rates as at September 2019 are 23% higher than the same period last year, with many of the speculative projects earmarked for completion in 2019 already being leased.

YIELD COMPRESSION CYCLE HAS FURTHER TO RUN

Yield spread to bonds remains attractive relative to other global markets and the strong performance of industrial real estate backed by record infrastructure spending, rising e-commerce, and increasing demand for companies to implement supply-chain efficiencies suggests the sector is well positioned for further growth over the coming years. Notwithstanding that yields are already at record lows, these forces point to the potential for further yield compression on prime product in the near term.

A PEEK AT PRODUCT INNOVATION

> **“The shift towards higher density workplaces reflects a desire to make property assets more efficient as well as increasing demand for flexible workspaces.”**

MENTAL WELL-BEING AND EDUCATION TO PLAY A KEY ROLE IN NEXT GENERATION DEVELOPMENTS

Occupiers continue to expect buildings that deliver amenity and a positive workplace experience for their staff. This is no longer just about physical wellness though, and we believe that over the next few years we will see a transition with more and more focus on mental well-being and the integration of educational facilities in office environments to enrich the occupier experience.

Businesses want to attract and retain the best talent, and part of this is providing training and development for staff to boost engagement. And as technology disrupts business, changing the nature of different roles and the composition of the workplace, employers will need to address the mismatch between their changing needs and their employee’s current skills. Forward thinking owners that support incubation and retention of talent through their assets and precincts offer a very attractive proposition for an occupier.

Offices and third space will increasingly become thought hubs as process is replaced with automation. For instance, Facebook has created an innovation hub in their space in Sydney, while the partnership between WeWork and 2U points to the synergy between co-working environments and education. And the integration is not only within specific buildings, it is also impacting the design and mix of uses for larger scale precincts. For example, Innovation Quarter by Charter Hall promises to be a multidisciplinary research space that allows collaboration between business, health and research, and there are many other examples globally where we see the integration of universities and research facilities within modern precinct developments.

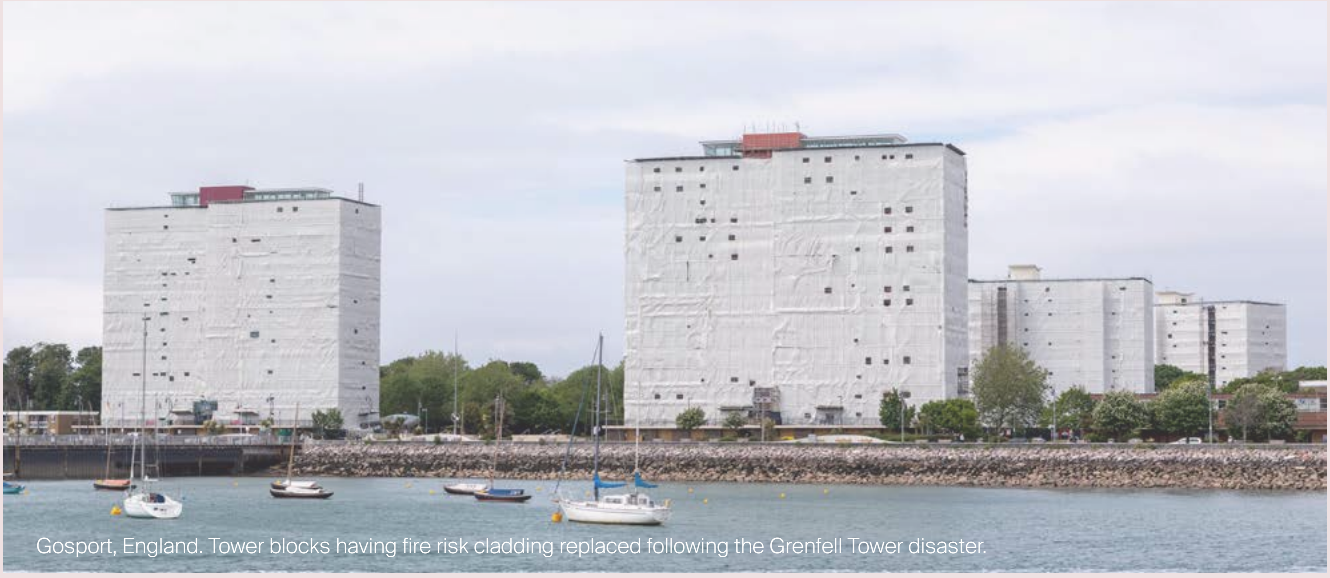
FOCUS ON INCREASING BUILDING DENSITY

Property owners are focusing on increasing building density in existing workplaces as well as for new developments to be more in line with shifting occupier preferences and global specification trends. Assets are being asked to work harder. Tenants are being better advised and multi-national businesses in particular will be seeking a common specification across their portfolio including the ability to occupy at high density. As a result, owners are quietly taking stock of their existing assets to understand what is needed to reposition them to higher density ratios, and for new developments we expect the market to gradually shift to a tighter standard with more schemes to be developed at 1:8 in future.

The move towards higher density workplaces partly reflects a desire to make property assets more efficient. However, the rise of co-working spaces and activity-based working is also influencing tenant preferences and increasing the demand for higher density workspaces.

CLADDING REPLACEMENT IS HAVING A LARGE CAPEX IMPACT

The Grenfell Tower fire in London in 2017 highlighted the dangers of combustible cladding used in many high-rise residential and commercial buildings and prompted some Australian states to impose bans on certain types of cladding. For example, in 2018 the New South Wales Government banned cladding made from aluminium composite panels (ACPs) with a core comprised of more than 30% polyethylene by mass for use in any external cladding, external wall, external insulation, facade or rendered finish in buildings. The ramifications of the ban are significant for commercial property owners, with many office properties now requiring replacement cladding. Replacing ACPs involves a large capital expenditure outlay for little additional return from that investment. While the financial impact of replacing ACPs is reducing the resources available to make amenity-enhancing investments in buildings, some property owners are using the replacement of combustible cladding as an opportunity to improve building features.



Gosport, England. Tower blocks having fire risk cladding replaced following the Grenfell Tower disaster.

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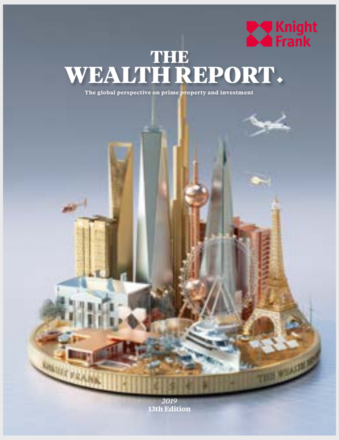

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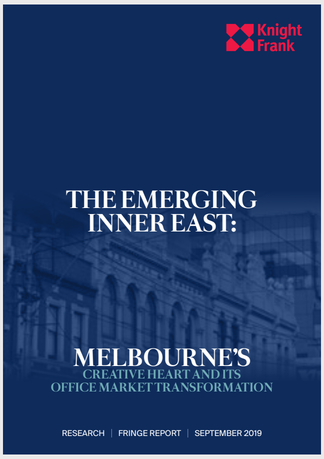

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