2022

OUTLOOK REPORT

RESEARCH INSIGHT

ROTATING TO RECOVERY AND RESILIENCE

Read the 2022 Outlook Report digital publication online now.

knightfrank.com.au/2022outlook

Written by Knight Frank Australia's Research and Consulting Team including:

Ben Burston
Partner, Chief Economist

Michelle Ciesielski
Partner, Head of Residential Research

Jennelle Wilson
Partner, Research & Consulting

Chris Naughtin
Director, Research & Consulting

Katy Dean
Director, Head of Industrial Research, Research & Consulting

Contributing Authors:

Suzanna Murray
Director, Occupier Services, New South Wales

Sean Lucas
Director, Client Solutions & Flexible Real Estate Lead

Design, Illustration and Production:

Daniel Terry
Associate Director, Creative Services Specialist
KFACreative.com.au

Marketing and Communications:

Tammy Clinch
Associate Director, Corporate Brand Marketing

Contents

Introduction

***By* Ben Burston**
Knight Frank Australia.

After two years of persistent disruption to lives and livelihoods, 2022 begins with the expectation that the worst of the pandemic has passed and prospects for a return to growth. A wide range of indicators now point to economic recovery, with employment returning to growth, businesses aggressively seeking to hire, wages starting to rise and confidence rapidly growing across the economy as consumers prepare to unleash a post-lockdown spending spree.

This shift to expansion mode will help drive property markets over the next 12 months and cyclical recovery will ensue in markets most impacted by the demand-side uncertainties. But while the red lights on the dashboard are quickly switching to green, enough has already changed over the course of the pandemic to know that we are in for a period of accelerated change, motivated by the rapidly evolving needs and wants of the businesses and consumers that underpin property demand.

This is nowhere clearer than in industrial and logistics markets, where supply chain disruption at a time of rising consumer demand globally has highlighted the fragility of just-in-time distribution strategies. This is causing a reassessment of required inventory levels and a scaling up of distribution capacity and hence long-term space needs.

Meanwhile, office occupiers are adapting to the challenges and opportunities of hybrid working while beginning an assessment of long-term needs. Early fears of widespread downsizing are looking misplaced, but the form and function of offices will adapt in response to myriad pressures including the increasingly prominent Environmental Social Governance (ESG) agenda.

In residential markets, buyers are also responding to the sustainable living agenda and are tilting to homes and apartments that offer energy efficiency and wellness attributes, while the ending of restrictions is also triggering renewed interest in city living.

Each of these behavioural shifts has important implications for property performance and the market is adapting rapidly as investors seek to boost exposure to new opportunities while ensuring resilience to the challenges that some of them entail. Just as the economic downturn saw divergent market outcomes, so too will the recovery phase. Against this backdrop, our 2022 Outlook Report seeks to identify the sectors aligned with behavioural change, some of the locations best positioned to capture growth and the asset characteristics that will best respond to customer demands.

Top 10 predictions for 2022

1 Strong economic recovery in 2022 driven by pent-up consumer demand

Pent up consumer demand will drive a renewed V-shaped economic recovery, with spending on services expected to grow particularly strongly. Household savings have been substantially boosted by government income support and weaker services spending during lockdowns, while consumer confidence has been much less adversely impacted by the Delta outbreak compared to the onset of the pandemic in early 2020. Stronger labour market conditions will also contribute to consumer demand with very high job vacancies pointing to a quick recovery in the labour market as the economy reopens, and this will feed through to rising business sentiment and create a favourable backdrop for property.

2 Negative real interest rates will keep property yields low

Growth in headline inflation has increased significantly over the past year, driven by pent-up demand, supply chain bottlenecks, and higher commodity and energy prices. Higher inflation has led to an increase in inflation expectations, albeit from very low levels, and prompted many financial market participants to ponder whether central banks will be forced to remove very accommodative monetary policy more quickly than previously anticipated. While this has fed through to rising nominal bond yields, real interest rates have continued to fall and are well below zero. A negative real interest rate environment only serves to increase the appeal of real assets and we expect negative real yields to further increase demand for property from a wide range of capital sources.

3 Pent up demand will drive office leasing market recovery

With persistent lockdowns and huge uncertainty during 2020 and 2021, many businesses bought time by deferring major decisions on their office space, instead taking short term lease extensions and in most cases opting to remain in their current space until they have greater clarity on future space needs. Looking ahead, with prospects for a robust economic recovery and rising employment, the scene is set for the release of pent-up demand which will help boost absorption rates and drive market recovery in 2022. This recovery will take place notwithstanding an ongoing debate on workplace dynamics, and while there is no evidence of widespread downsizing these pressures will mean that absorption is unlikely to rebound quite as strongly as it has in previous recoveries in the early 90s and post GFC period.

4 Unrelenting demand for service, experience and amenity will reshape office markets

While the office remains central to the workplace experience, the so-called SEA change – Service, Experience and Amenity – will be firmly in focus for businesses when making decisions on their space needs going forward. This inexorably points to the need to many tenants to upgrade their office space, and as such we expect premium and upper A grade space to be at the forefront of the resurgence in demand with more generic space less likely to be perceived as the compelling office of the future. With vacancy rates likely to remain elevated for some time, lower quality secondary assets will need to be upgraded or risk accelerated obsolescence.

5 Focus on supply chain resilience will continue to drive industrial demand

While growth in e-commerce continues to be the stalwart behind the demand for industrial and logistics real estate, the pandemic has exposed widespread supply chain vulnerability and these pressures will continue to drive demand in 2022. Many companies simultaneously wish to expand their warehouse facilities to enable higher inventory levels and cater to rising consumer demand and there has been a scramble for space. Demand for modern stock is well and truly outpacing supply and this will see the market remain tight.

6 Industrial rents (finally) shifting into growth mode

With so much positive momentum in industrial markets it is easy to forget that rental performance has been distinctly underwhelming in recent years. However, after a long wait, the dynamic is now shifting with multiple drivers combining to put upward pressure on rents. Strong and sustained demand has pushed down vacancy of existing stock, widespread shortages of zoned and serviced land are pushing up land values, while supply constraints and higher costs are impacting new developments. These signals all point toward solid rental growth in 2022 and 2023. This will be led by Sydney and Melbourne, but Brisbane, Perth and Adelaide are not far behind and will also see a strong uplift.

7 Rising residential buyer demand for sustainable living

For many prestige residential buyers, reducing their environmental footprint is a growing aspiration. When asked about a future residential purchase, three-quarters of Australians say the energy efficiency of a home is important (48%) or very important (26%) to them. In addition, health and wellbeing are also key considerations, with proximity to green space, air quality and a good outlook with a view of the ocean, mountain range or skyline the key factors in determining locational choice. The rise in importance of sustainable living presents a significant opportunity for developers to evolve and differentiate their offer and this will increasingly shape building design.

8 Paucity of prestige apartments as cities mount a comeback

The 'race for space' has grabbed headlines globally but cities look to be mounting a comeback, with demand on the rise for city apartments and vacancy rates in rental markets now falling. Against this backdrop, concerns over looming under-supply are mounting. The total number of apartments in low-rise, mid-rise, and high-rise projects averaged 26,040 a year, across Australia's major cities since 2015. This is expected to fall by 39% over the next three years, driven by declines in Sydney, Melbourne and Brisbane, pointing to a strong outlook for price growth in the prestige apartment market.

9 Investors rotating into build-to-rent and other specialist sectors through build-to-core strategies

Investors are continuing to shift their investment allocations towards operational real estate sectors such as data centres, medical facilities, build-to-rent, seniors housing, and student accommodation. The share of these alternative sectors has accelerated markedly since the onset on the pandemic, representing 35% of investment volume globally in 2021, up by nine percentage points compared to the average over the five years to 2019. With limited established stock, the rotation is largely occurring through build-to-core strategies, led by build-to-rent. Multiple large-scale developments are now under way and plans continue to take shape for a sustained pipeline of activity across the country, with Melbourne emerging as the focal point for new activity.

10 The green premium will become more evident as investors adopt net zero portfolio targets

Hedonic price modelling of office investment sales over the past decade reveals that Sydney and Melbourne office buildings with a NABERS Energy rating of up to 4.5 stars benefit from an 8% premium on sales price compared to unrated buildings, while those with very high ratings of 5, 5.5 or 6 stars enjoy an 18% premium. Importantly, the analysis allows for the fact that several other factors influence price and is an estimate of the specific impact of the NABERS rating. Going forward, the importance of energy efficiency and its impact on building values can only be expected to increase as more and more tenants and investors adopt specific environmental targets for their own real estate activities.

Economy and forecasts:

Rotating to Recovery

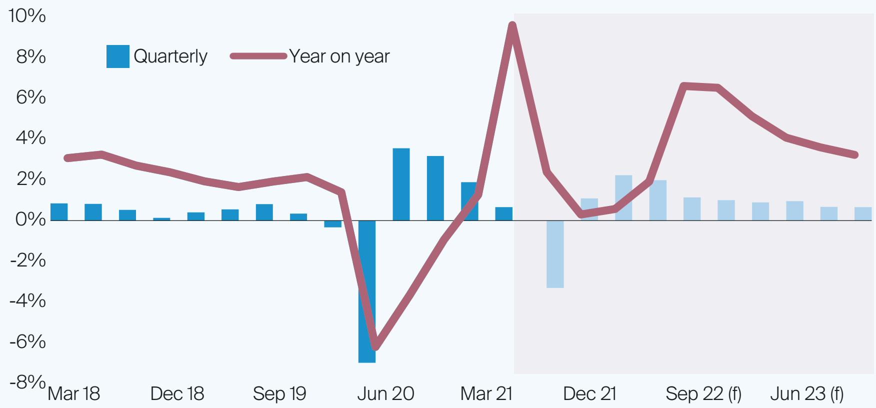
By Ben Burston and Chris Naughtin
Knight Frank Australia.

Strong economic recovery in 2022 driven by pent-up consumer demand

The Australian economy will rebound strongly next year following the lifting of restrictions on economic activity in NSW, Victoria, and the ACT, and the reopening of Australia's domestic and international borders as vaccination rates reach very high levels. Following a large contraction in Q3, output has begun to rebound in Q4 and we expect momentum to strengthen sharply in the first half of 2022. Oxford Economics expects GDP to grow by 4.3% in the first half of next year and by 3.9% for the whole of 2022 in annual average terms over the year to December 2022.

Pent up consumer demand will drive the recovery, with services consumption expected to grow particularly strongly. Household savings have been boosted by government income support and remains high at 9.7% of disposable income, well above the 4.8% average over the past 25 years. Consumer confidence has been much less adversely impacted by the Delta outbreak compared to the onset of the pandemic in early 2020. Stronger labour market conditions will also contribute to consumer demand. Higher job vacancies point to a quick recovery in the labour market as the economy reopens, with job ads rising by 10.2% in October to be 51.3% above pre-pandemic levels, with particularly strong gains in lockdown-impacted states and industries.

Australia GDP growth



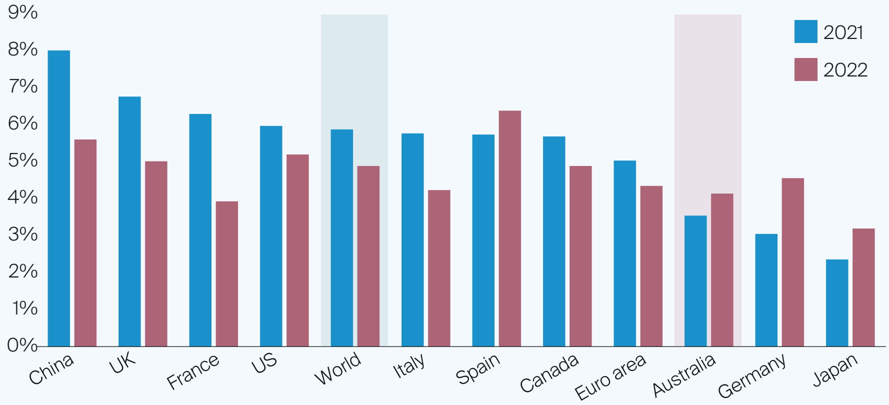
Source: Knight Frank Research, Macrobond, Oxford Economics

Rapid global growth will extend into 2022

The pace of economic growth has started to slow in major economies following the sharp V-shaped recovery earlier this year. The US and China look to have achieved peak growth in Q2 2021, while the Euro area and Japan are likely have reached their respective peaks in Q3 and Q4. Despite slowing, global growth will remain above trend next year supported by an ongoing acceleration in services spending, which in many economies remains well below pre-pandemic levels. The IMF's October World Economic Outlook predicts that the global economy will continue to grow strongly, with GDP rising by 4.9% in 2022 following 5.9% growth in 2021.

IMF GDP growth forecasts

Percent (%) change



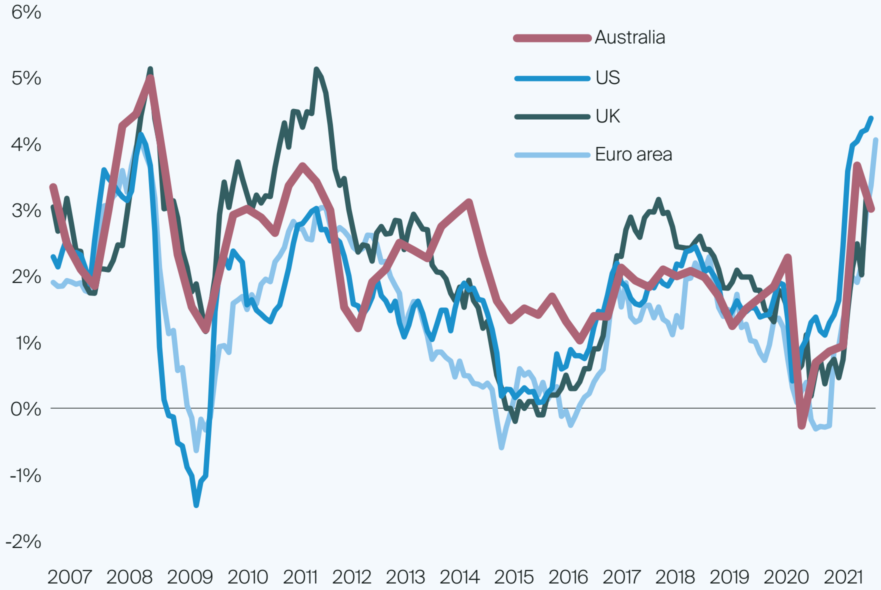
Source: Knight Frank Research, IMF

Inflation outlook: Cost pressures rising but long-term structural disinflationary forces remain intact

Growth in headline inflation has increased significantly over the past year, driven by pent-up demand, supply chain bottlenecks, and higher commodity and energy prices. Higher inflation has led to an increase in inflation expectations, albeit from very low levels, and prompted many financial market participants to ponder whether central banks will be forced to remove very accommodative monetary policy more quickly than previously anticipated.

Headline CPI in Australia rose by 3.0% over the year to September, while in the US, the Federal Reserve's preferred measure of inflation increased by 4.1% over the same period, with even stronger growth in the CPI equivalent, although growth in underlying inflation remains much more subdued.

Headline inflation
Percent (%) change year on year

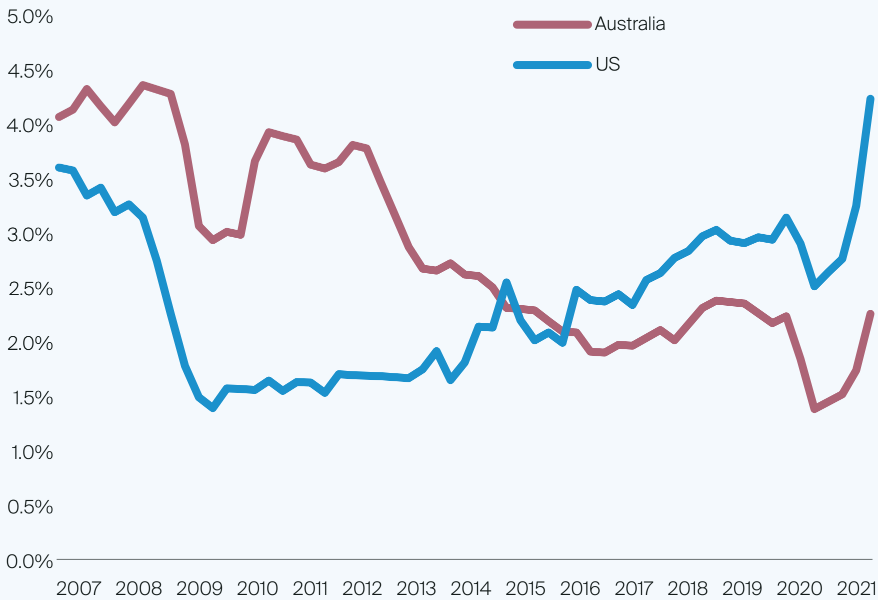


Source: Knight Frank Research, Macrobond

Wage growth remains subdued in Australia, limiting the risk of a sustained period of high inflation

A key factor in driving demand inflation is wage growth. While labour markets in many advanced economies have experienced a strong rebound, employment remains below pre-pandemic levels. Consequently, while overall wage growth has strengthened significantly from pandemic lows, it remains at sustainable levels. Indeed, wage growth remains particularly low in Australia (as it was in years before the onset of the pandemic), growing by 2.2% over the year to September, compared with 4.2% in the US. While wage growth has picked up, it remains below average and the reopening of Australia's international border will eventually increase the nation's labour supply and again exert downward pressure on wage growth.

Wage growth
Percent (%) change year on year



Source: Knight Frank Research, Macrobond

Rise in inflation largely driven by supply-chain disruption rather than demand factors

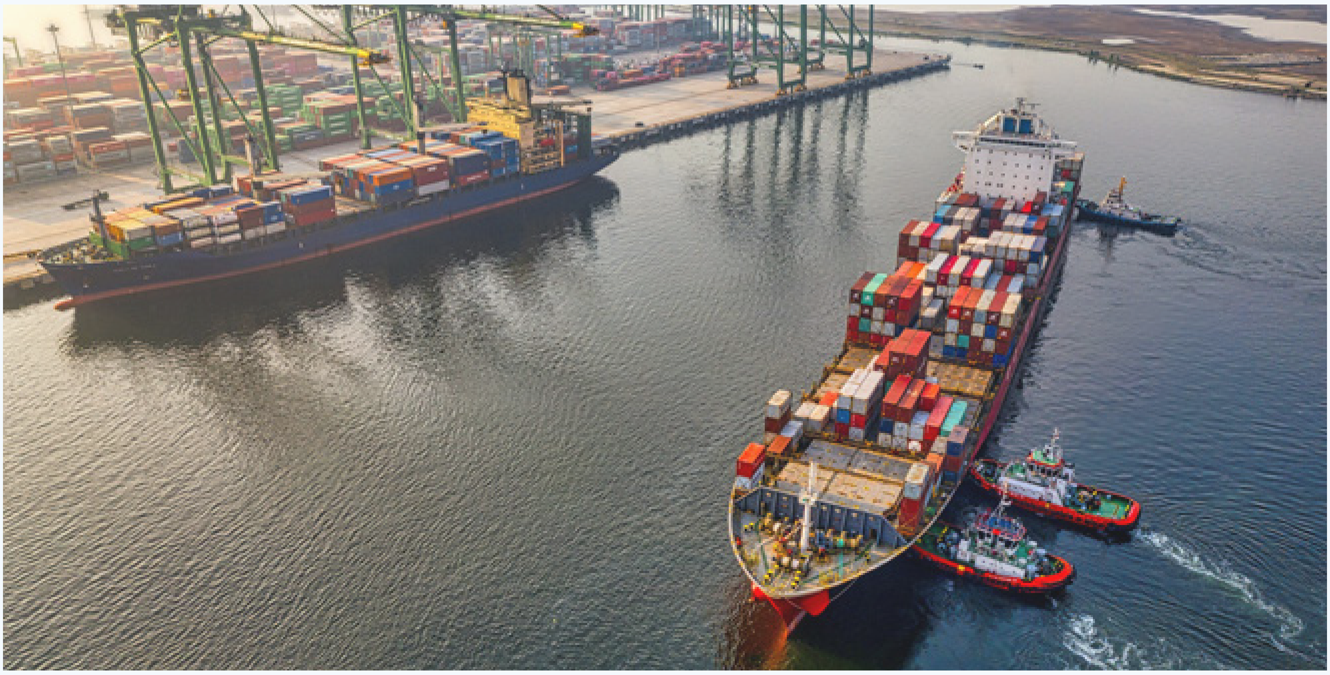
A significant proportion of the increase in inflation is transitory, resulting from large base effects – comparison with prices from the previous year that were abnormally low, for example, oil prices – and rising prices in heavily pandemic impacted industries (such aviation and hospitality) as they resume operations.

Higher cost inflation is also a key factor driving up prices such as COVID-related supply chain disruptions, which is driving prices for many inputs in production upwards, and rising energy and commodity prices (such as oil, electricity, gas, and thermal coal), as well as shipping prices. While cost inflation will ease eventually, major central bank heads have recently said inflation could be more persistent than they had previously anticipated. However, in setting monetary policy, central banks are principally concerned with persistent demand-driven inflation, given monetary policy's ability to influence aggregate demand, and will be less responsive to cost inflation unless it begins to drive inflation expectations materially higher.

Cost inflation

Commodity	Percent (%) change year on year
Brent crude oil	107%
Coal (Australia)	306%
Natural gas (US)	144%
Natural gas (Europe)	535%
LNG (Japan)	100%
Aluminium	62%
Copper	46%
Lead	32%
Tin	108%
Nickel	27%
Zinc	38%
Baltic Dry Shipping Index	127%

Source: Knight Frank Research, The World Bank



Bond yield outlook: Rates rising but yields will remain low during the recovery phase

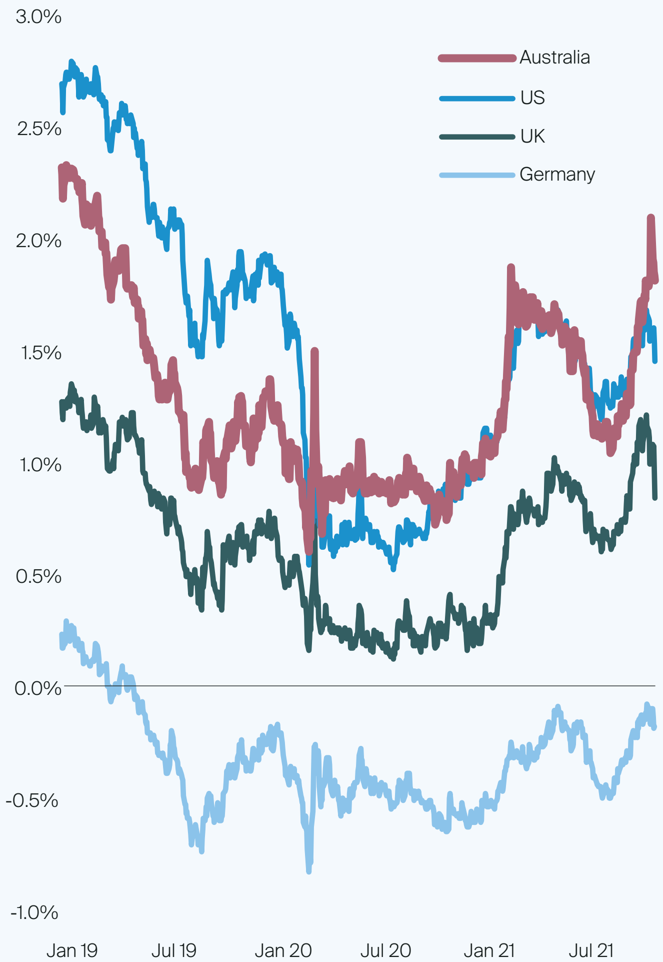
Reflecting the ongoing recovery in economic activity and higher inflation expectations, government bond yields have risen from pandemic lows. US 10-year Treasury yields rose from around 0.5% in mid-2020 to spike at 1.7% in March this year, before falling back to around 1.2% mid-this year as the Delta variant interrupted the recovery, and a similar trend was evident in Australian government bond yields. Reflecting the higher vaccination rates in advanced economies supporting expectations of ongoing above trend growth and higher inflation, bond yields have begun to rise again to around 1.8% as central banks begin to taper asset purchases and market participants anticipate policy rate increases.

While we expect bond yields to remain at relatively low levels, there is the potential for a further rise in bond yields and a temporary spike as seen in early 2021, particularly as central banks begin tapering asset purchases. However, interest rate increases are a separate and distinct policy tool from asset purchases. The RBA has indicated it will be a long time before they begin raising rates and currently the central bank expects to remain on hold until 2024. The US Federal Reserve expects to begin raising interest rates earlier, with half of Federal Open Market Committee members expecting at least one rate rise next year, while a majority of FOMC members expect the federal funds rate will be at least 50bps higher than current levels by the end of 2023.

Despite taking the first steps to tighten policy, central banks will maintain a very accommodative monetary policy by historical standards, which will keep bond yields anchored at relatively low levels. One reason for this is that higher interest rates would be counterproductive as is it would dampen demand but do nothing to address the cost inflation pressures that are the predominant driver of higher inflation.

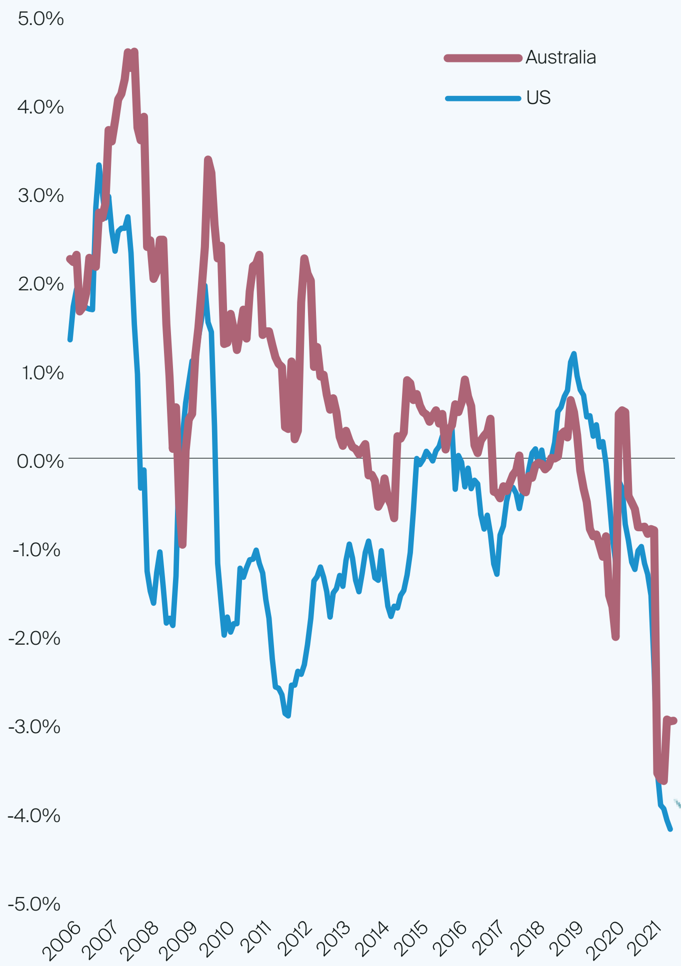
Despite the rise in nominal bond yields, real yields continue to fall and are well below zero. Real yields on 1-year US Treasuries fell to -4.3% in September, the lowest level since the mid-1970s when inflation rates were in the double-digits, while the Australian equivalent is -3.0%, also the lowest level since the 1970s. This environment increases the appeal of real assets such as property and we expect negative real yields to generate stronger demand for property assets.

10-year government bond yields
Percent (%)



Source: Knight Frank Research, Macrobond

Real bond yields
Percent (%), 1-year government bond yield less annual headline infation



Source: Knight Frank Research, Macrobond

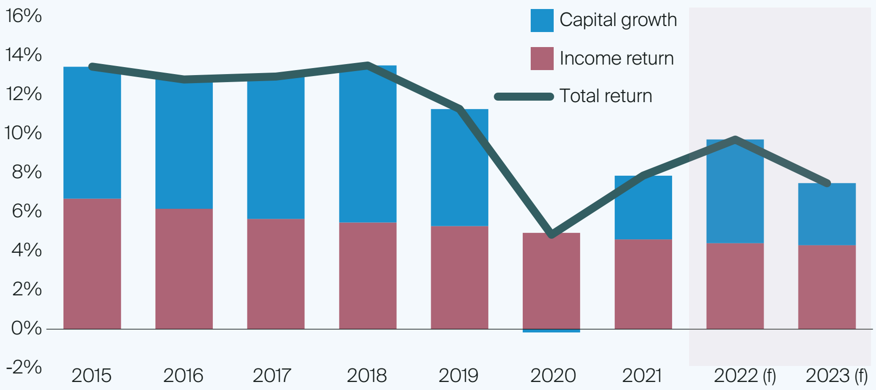
Total returns: Offices to pick up in 2022, as industrial slows

Commercial property asset performance has begun to rebound from the downturn seen in 2020, with the impact of low interest rates and yield compression generally outweighing the higher income risks for some sectors and assets arising from the pandemic. Capital growth for a broad range of Australian commercial property assets tracked by MSCI rose by 3.3% in the first nine months of 2021 compared with -4.4% in 2020. The turnaround has been driven by exceptionally strong capital growth for industrial assets over the period (+12.8%), while office capital values are rebounding from their slight fall in 2020 (+2.4%) and retail asset values have remained steady after large falls in 2020.

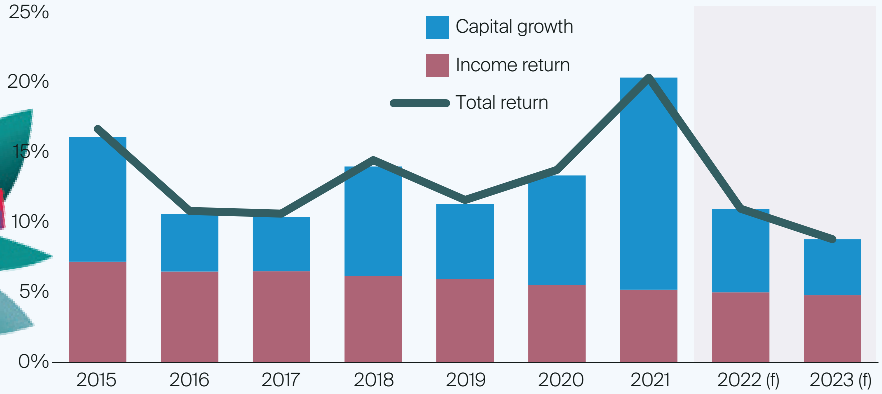
For the office sector, we expect average capital growth to strengthen to 3.3% in calendar year 2021, and 5.3% in 2022, with total returns rising to 7.9% and 9.7% respectively. Stronger capital growth will be underpinned by ongoing yield compression. However, while occupier market conditions are expected to improve, the long-term impact of the pandemic on the leasing market remains uncertain and the performance of individual office assets may vary in the medium term based on tenant risk. We expect average capital growth to slow to 3.2% in 2023 reflecting a slowdown in yield compression and the rising risk of higher interest rates globally, with total returns slowing to 7.5%.

Average capital growth for industrial property is expected to slow from the elevated levels the sector is currently experiencing but remain strong, underpinned by sustained demand for logistics assets. Capital growth has accelerated sharply this year and is expected to average 15.2% over the year, up from 7.8% in 2020, and total returns will surpass 20%. Capital growth at this pace is unsustainable, and growth in capital values is expected to slow to 6.0% and 4.0% in 2022 and 2023 respectively, notwithstanding the strong structural tailwinds benefitting the logistics sector. As the prolonged cycle of yield compression abates, particularly in Sydney and Melbourne, rental growth is expected to take over as a more important driver of returns.

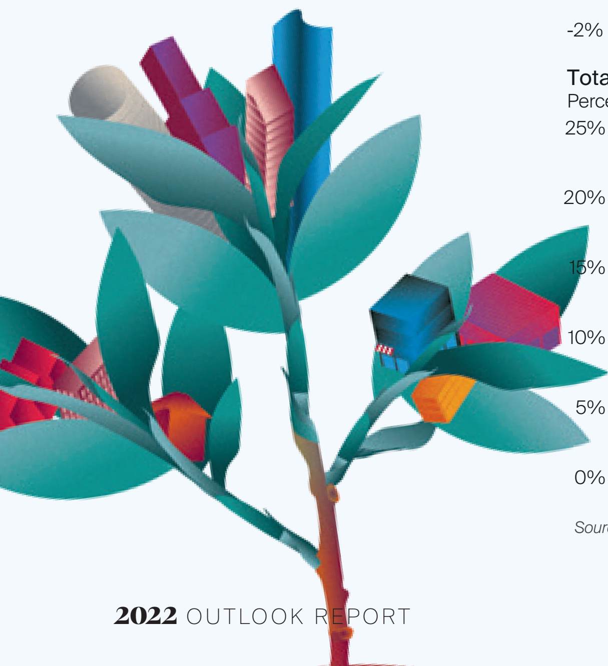
Total return for office property
Percent (%) change year on year



Total return for industrial property
Percent (%) change year on year



Source: Knight Frank Research, MSCI



Negative real interest rates will keep property yields low in spite of higher nominal yields

Amid a surge in bond yields, it is only natural to consider the implications for property. Nominal yields have seen a rapid rise, reflecting concerns over higher inflation and the potential for this to result in central banks bringing forward the timing of rate rises.

While this is unlikely to run much further in the absence of a sustained pick-up in wage growth, it will clearly impact swap rates and hence raise borrowing costs for property investment.

While in one sense this will put upward pressure on property yields, the impact of higher inflation on real interest rates also needs to be considered. Real interest rates have fallen precipitously – with headline CPI inflation currently at 3.0% and short-term nominal rates close to zero, the current short term real interest rate sits at around -3.0%.

Property is a real asset class, and hence the real bond yield is a better like-for-like comparator to property yields than the nominal yield. In normal times – with inflation hovering around, or somewhat below, its target level – the movement in nominal yields is an excellent proxy for movements in the real yield, but at times like this, real and nominal yields are moving in opposite directions and both need to be carefully considered.

While higher nominal yields will push up borrowing costs for leveraged buyers, negative real yields will result in more equity capital being attracted to property as investors seek alternatives to holding cash and other fixed income investments with a negative real return.

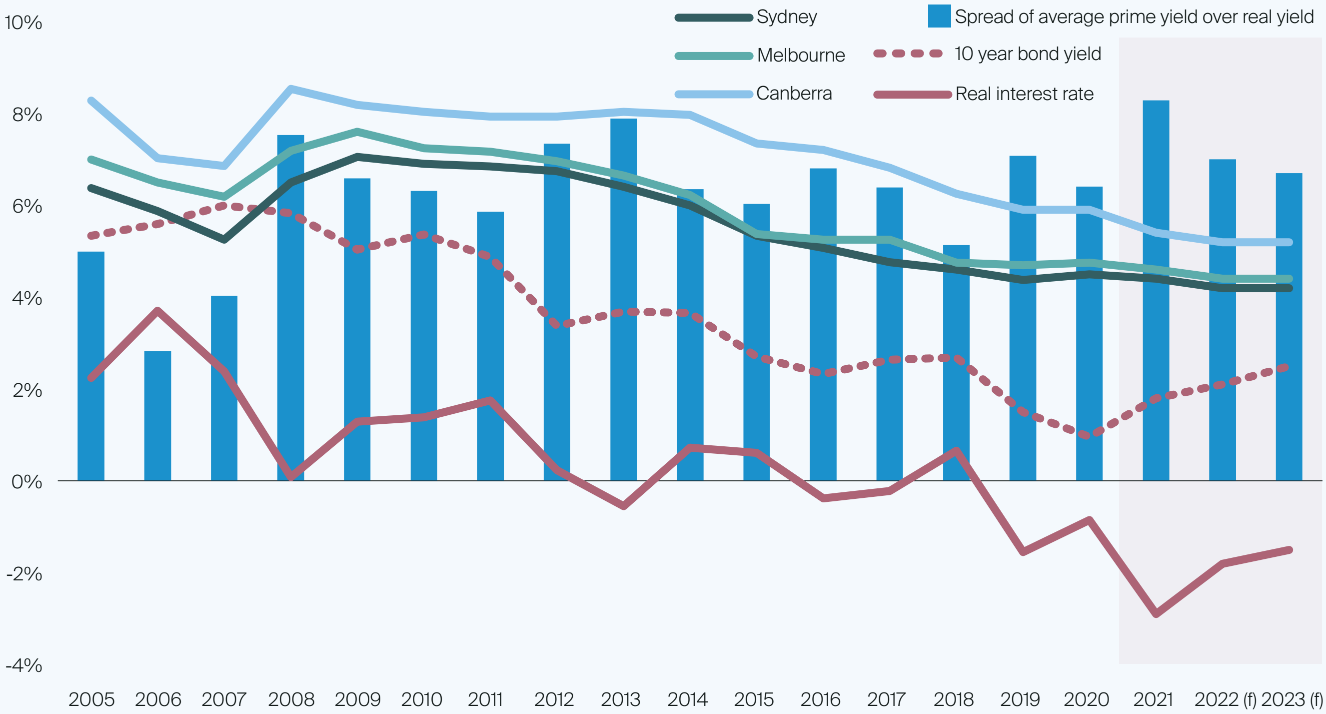
Property assets that are able to quickly adjust rental income to a higher inflation environment will be well placed, and this explains part of the drive for specialist property assets such as build-to-rent, childcare centres and healthcare.

For office markets, the market is unlikely to respond aggressively in either direction to what is still generally perceived to be a temporary spike in inflation. Following the pattern of 2021, well-located office assets offering strong income are expected to see modest yield compression, with potential for faster capital growth in higher yielding markets outside of Sydney and Melbourne such as Canberra.

> ***Rather than getting paid less than inflation, why not buy stuff – any stuff – that will equal inflation or better? We see a lot of investments that we expect to do significantly better than inflation.***
>
> *Ray Dalio, Bridgewater Associates*

Prime office yield outlook

Percent (%)



Source: Knight Frank Research, Oxford Economics, Macrobond

Industrial yields will show convergence across cities toward global norm of 3-4%

Structural change in the occupier market has translated in a fundamental re-rating of the industrial sector by investors and it is increasingly viewed as essential community infrastructure, offering stable long-term and low-risk income and a growing demand base.

In addition, as our cities have grown, the value, scarcity and growth potential of the underlying land is becoming a more important factor in establishing the value of specific assets as investors scramble to bolster their holdings.

Reflecting these shifts, pricing has adjusted markedly, not only in Australia but globally. Prime industrial yields in the major gateway markets now generally trade in a lower, tighter band of 3-4%. At this level, industrial yields have edged below office yields in many global markets including Australia and pricing is increasingly in line with stabilised assets in operational real estate sectors such as healthcare and build-to rent, having historically traded at a significant discount.

With global yields showing convergence, we expect this to be mirrored at a national level with further convergence across the major cities. After dramatic yield compression, Sydney and Melbourne yields are now in line with global pricing trends. Current market momentum indicates that further compression may occur, but there is arguably more potential for growth in markets such as Perth and Adelaide where yields remain well above those on the Eastern seaboard.

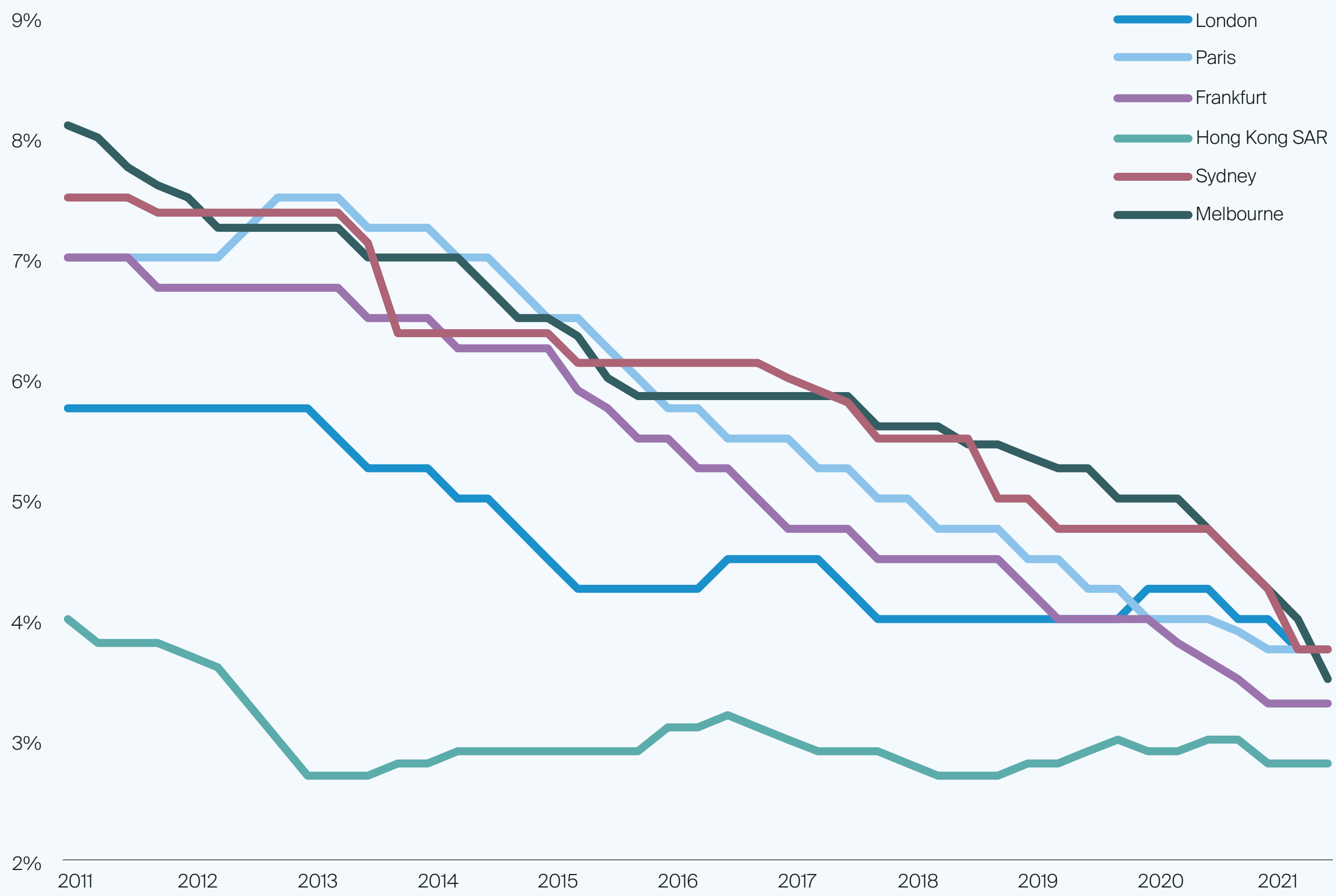
With tight land supply and a positive occupier market outlook across the board, pricing is more likely to reflect asset fundamentals and lease length so pricing differences based on historic perceptions of city-specific factors will become less relevant.

Industrial yield trajectory in 2022

Sydney down 25bps	▼	3.5%
Melbourne to hold	▶	3.5%
Brisbane down 25bps	▼	4.0%
Perth down 50bps	▼	4.25%
Adelaide down 50bps	▼	4.25%

Source: Knight Frank Research

Global prime industrial yields
Percent (%)



Source: Knight Frank Research

Pent up demand will drive office leasing market recovery

With persistent lockdowns and huge uncertainty during 2020 and 2021, many businesses bought time by deferring major decisions on their office space, instead taking short term lease extensions and in most cases opting to remain in their current space until they have greater clarity on future. space needs.

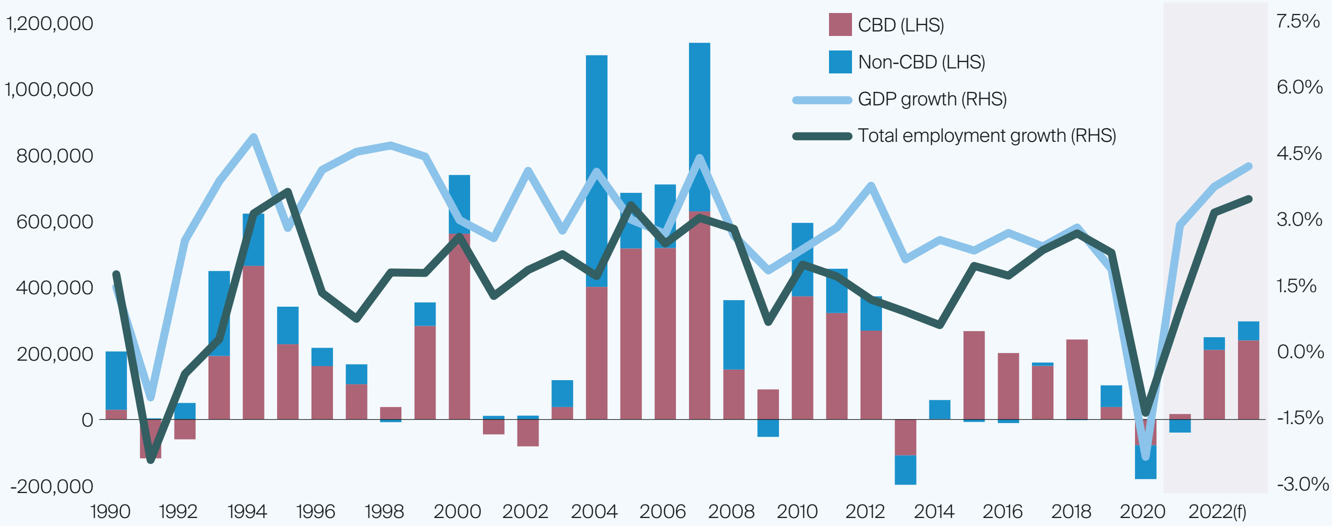
As a consequence, occupier demand has been subdued and some corporates have gone further and opted to shed excess space, resulting in a contraction in net office demand. This has primarily impacted Sydney and Melbourne, where vacancy rates have risen sharply, but all markets have experienced this weaker sentiment to some degree.

Looking ahead, with prospects for a robust economic recovery and rising employment, the scene is set for the release of pent-up demand which will help boost absorption rates and drive market recovery in 2022.

This recovery will take place notwithstanding an ongoing debate on workplace dynamics, as explored in the workplace chapter of this report. The corporate response will vary widely, and there is no evidence of widespread downsizing. Furthermore, the fact that density ratios have tightened substantially over the past decade means that for most businesses there is limited excess space to cut.

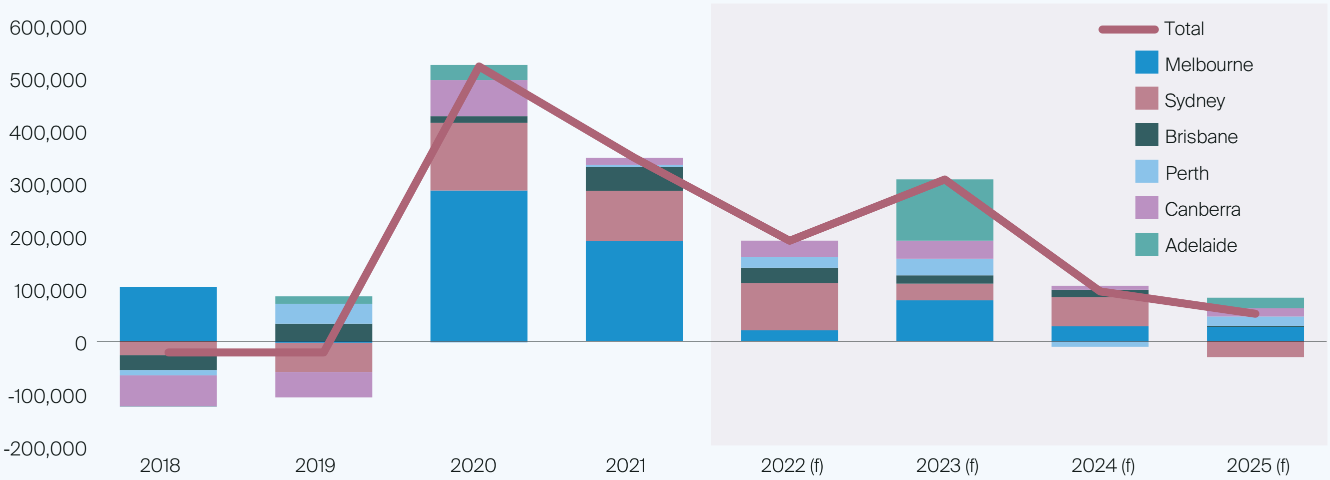
However, these pressures will mean that absorption is unlikely to rebound quite as strongly as it has in previous recoveries in the early 90s and post GFC period, and we expect demand to instead rebound back to levels of demand similar to that experienced in 2015-18.

Office net absorption and economic growth
LHS - sqm, RHS - Percent (%)



Source: Knight Frank Research, PCA, Oxford Economics

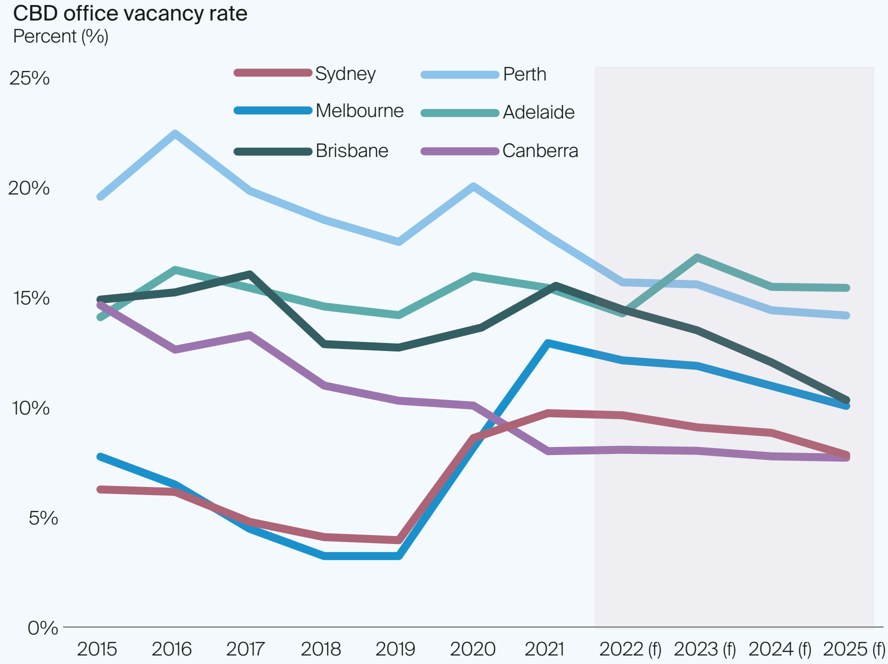
Office net supply - major CBDs
sqm



Source: Knight Frank Research, PCA

Stronger rental growth underpinned by tightening vacancy over the next few years

After rising sharply since the onset of the pandemic, vacancy rates in most major capital city markets are expected to decline over the next few years reflecting strengthening demand for office space coming out of the pandemic. Vacancy rates across the major capital city markets are expected to fall by between 1.9% to 5.2% between 2022 and 2025, with Brisbane and Perth recording the largest declines.



Source: Knight Frank Research, PCA

Incentives will begin to fall in 2022 driving stronger effective rental growth

Following large falls in effective rents in 2020 and smaller declines this year, average incentives look to have peaked in most major capital city markets. Declining incentives will fuel stronger effective rental growth over the next few years. Perth, Sydney, Melbourne, and Brisbane are all expected to see significant increases in effective rents between 2022 and 2025. Perth is expected to see the strongest rise at 5.4% in average annual terms over the period reflecting the current elevated incentives, followed by Sydney with 4.8% and Melbourne at 4.0%.

Net effective rental growth

	Average annual growth, 2020-2021	Average annual growth, 2022-2025
Perth	-8.4%	5.4%
Sydney	-10.5%	4.8%
Melbourne	-8.2%	4.0%
Brisbane	-7.6%	3.7%
Canberra	1.0%	3.3%
Adelaide	1.0%	2.0%

Source: Knight Frank Research

Investment:

Rotating to resilience

By Ben Burston and Chris Naughtin
Knight Frank Australia.

Resilience of property performance will drive higher portfolio allocations to real estate

At the outset of the pandemic, uncertainty gripped the property markets across all sectors: would the 'late cycle' environment so often referred to in 2019 give way to a downturn bearing resemblance to the GFC? Would retrenchment in the labour market erode consumer and business confidence and result in a protracted period of economic under-performance and a slow-grind recovery akin to the early 1990s?

These were reasonable questions, but as we noted at the time the circumstances of the pandemic were very different, and the structure of the global capital market has changed dramatically over the past decade.

Fears of a major downturn have proven to be misplaced and property has once again demonstrated its resilience and critical role in providing stable income and ballast to multi-asset portfolios.

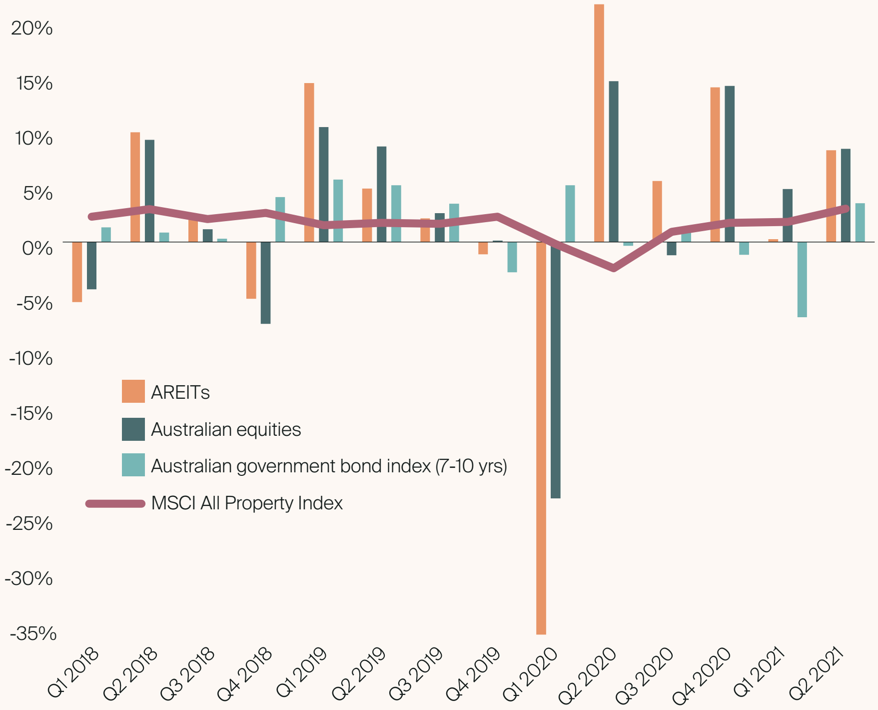
Across the Australian commercial market, returns dipped into negative territory in Q1 and Q2 2020, but the combined -2.6% fall according to the MSCI All Property Index stood in stark contrast to the wild ride endured by equity markets, with steep falls in Q1 followed by a strong recovery.

The pandemic adds weight to the argument that property has become less volatile over successive economic cycles. Peak returns at the top of each successive cycle have been lower, and the downturns have been shallower. The dramatic highs and lows of the late 1980s and early 1990s and the GFC period have given way to a more stable environment.

There are a number of reasons for this, most obviously the low interest rate environment which has been supportive for property over the past decade and which provided an anchor for valuations during the pandemic. This has attracted large flows of equity capital to property seeking secure long-term income returns no longer available in bond markets, and in turn this has given property a deeper and broader base of investors less likely to retreat from the sector during economic downturns.

These long-standing forces are mutually reinforcing and have been exacerbated by the pandemic. The gradual upward trend in property allocations – up from an estimated 9% of global institutional portfolios in 2013 to 11% in 2021 – looks set to continue in 2022 and beyond and Australia is firmly in the sights as a key target destination.

Quarterly return by asset class
quarter on quarter total investment return



Source: Knight Frank Research, MSCI

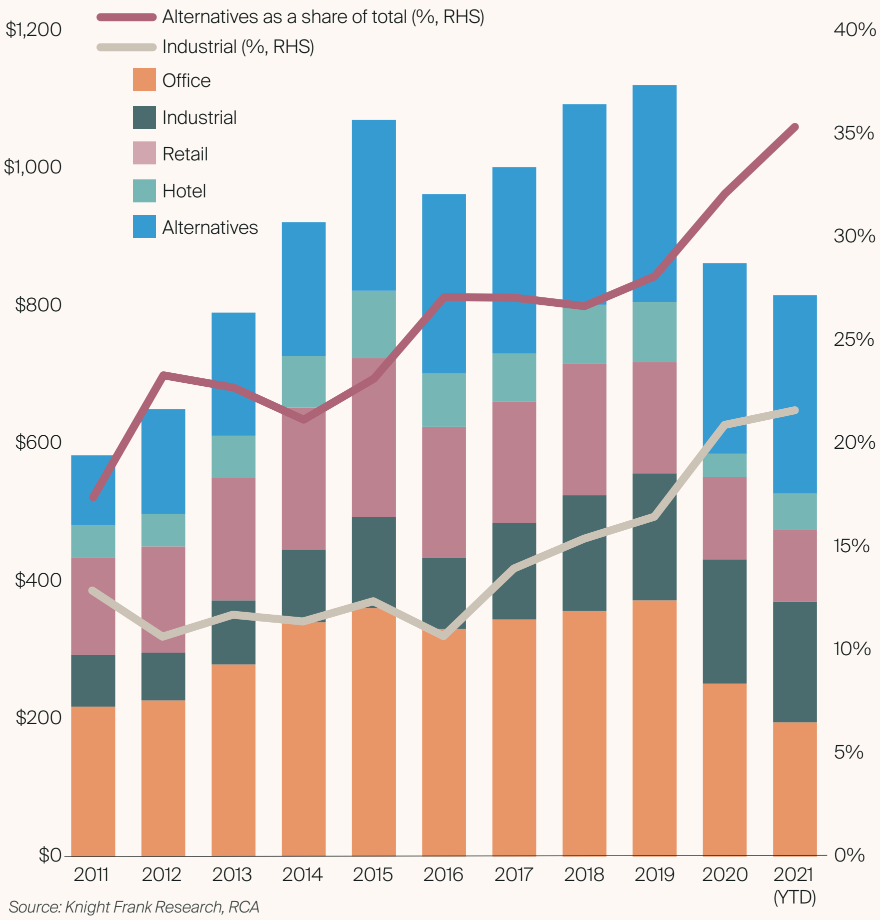
Shift into specialist sectors and long income assets will continue

While the low/risk return profile of property makes it an attractive sector to allocate capital, investors are continuing to shift their investment allocations within the sector. Investment in alternatives assets such as data centres, medical facilities, build-to-rent, seniors housing, and student accommodation, has accelerated markedly since the onset of the pandemic. Globally, investment in alternatives assets has totalled US$288.1 billion in 2021 to date, accounting for 35% of global investment volume, up three percentage points from 2020, and nine percentage compared to the average over the five years to 2019.

The rotation into alternative and specialist sectors has been partly motivated by a desire for greater diversification among investors, particularly as occupier market conditions become more uncertain in some sectors. Investment in office assets in particular remains well down on pre-pandemic levels globally, in part reflecting uncertainty around the strength occupier demand as companies navigate the return to the office and more flexible working arrangements. While office assets remain attractive investments for many, investors have placed a higher premium longer and more stable income streams. The strong demand for long and reliable income assets is particularly evident in higher investment in the alternatives sector as well as for industrial and logistics assets. We expect the desire for income stability to continue to drive the rotation into alternatives assets.

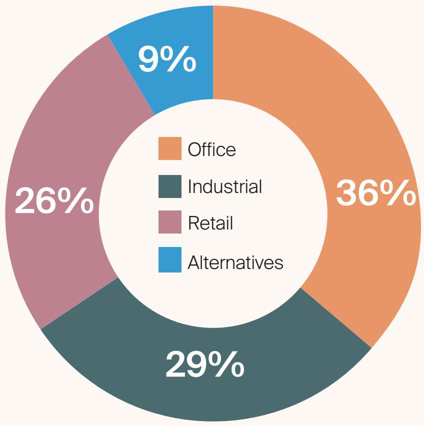
In Australia, the shift in asset allocation is particularly evident among domestic REITs. Over the year to Q3 2021, office assets accounted for 36% of REITs' total commercial property acquisitions compared to 70% of REITs' total disposals. By contrast, industrial assets accounted for 29% of acquisitions but just 12% of disposals, while retail assets made up 26% of acquisitions and 18% of disposals. REITs were also significant net acquirers of alternative assets despite the relatively small size of the market in some segments, such as build-to-rent, and limited investment opportunities.

Global commercial property investment volume
US$ billion (LHS), Percent (%) (RHS)

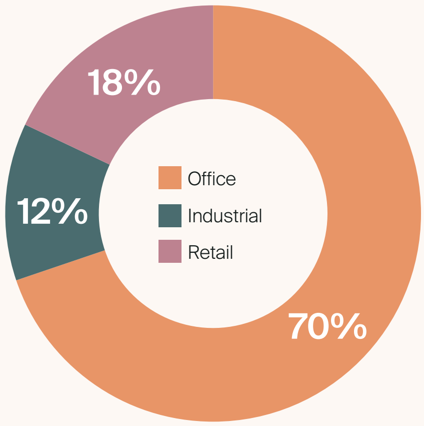


Source: Knight Frank Research, RCA

Domestic REIT acquisitions by sector
Share of total, year to Q3 2021



Domestic REIT disposals by sector
Share of total, year to Q3 2021



Source: Knight Frank Research, RCA

Build-to-rent pipeline will continue to expand as funds seek diversification and build-to-core strategies

After a lengthy wait, an Australian Build-to-Rent (BTR) sector is finally emerging. Multiple large-scale developments are now under way and plans continue to take shape for a sustained pipeline of activity across the country, with Melbourne emerging as the focal point for new development.

While the demand side drivers have been supportive for some time, numerous barriers have stood in the path of BTR. However, shifting dynamics as a result of the pandemic have combined to make BTR more attractive and triggered widespread investor interest.

Firstly, the pandemic has prompted property investors to seek greater diversification. The traditional dominance of office and retail assets is waning, with investors seeking increased exposure to industrial and specialist sectors linked to demographic trends.

Secondly, the pipeline of traditional apartment development has slowed substantially from the highs of recent years, which could lead to under-supply when borders reopen and international migration resumes. Apartment approvals have dropped substantially across the Eastern seaboard from the peak levels of 2015-17, thereby creating greater opportunity for BTR to help fill the void.

Lastly, land tax discounts in NSW and Victoria have been enacted to help spur the growth of the sector, which state governments view as having an important role to play in providing more housing options as well as boosting the pipeline of new construction on a sustained basis going forward.

The combined impact has been to prompt a wave of new schemes as developers react to the changed environment and in some cases pivot away from plans for hotel or conventional build-to-sell developments. Melbourne is now emerging as the epicentre of activity, with robust demand and lower site values than in Sydney leading a wide range of investors to form development plans and new capital partnerships.

Numerous challenges remain, with tax and planning frameworks still grappling with how and to what extent they should adapt to accommodate the growth of BTR, and even with growing momentum it will take many years for the sector to mature. But the current momentum is undeniable and BTR looks set to emerge as an important part of the new supply picture in years to come.

Allocating into acceleration

E-commerce	▶	Industrial (logistics)
More renters	▶	Build-to-rent Self storage
Aging population	▶	Retirement living
Health spend	▶	Life sciences Medical centres
Cloud computing	▶	Data centres
Female workforce participation	▶	Childcare centres
Domestic tourism	▶	Pubs
ESG focus	▶	Carbon neutral buildings Renewables infrastructure

Source: Knight Frank Research

Offshore investors will continue to play an active role in investment markets as assets shift to buyers with lower target returns

While domestic investor activity has picked up noticeably in recent months, offshore investors continue to play a key role in driving commercial property investment in Australia. Offshore investors have accounted for an above-average 43% of commercial property investment volume in 2021 to date, and 68% of investment for deals greater than $250 million.

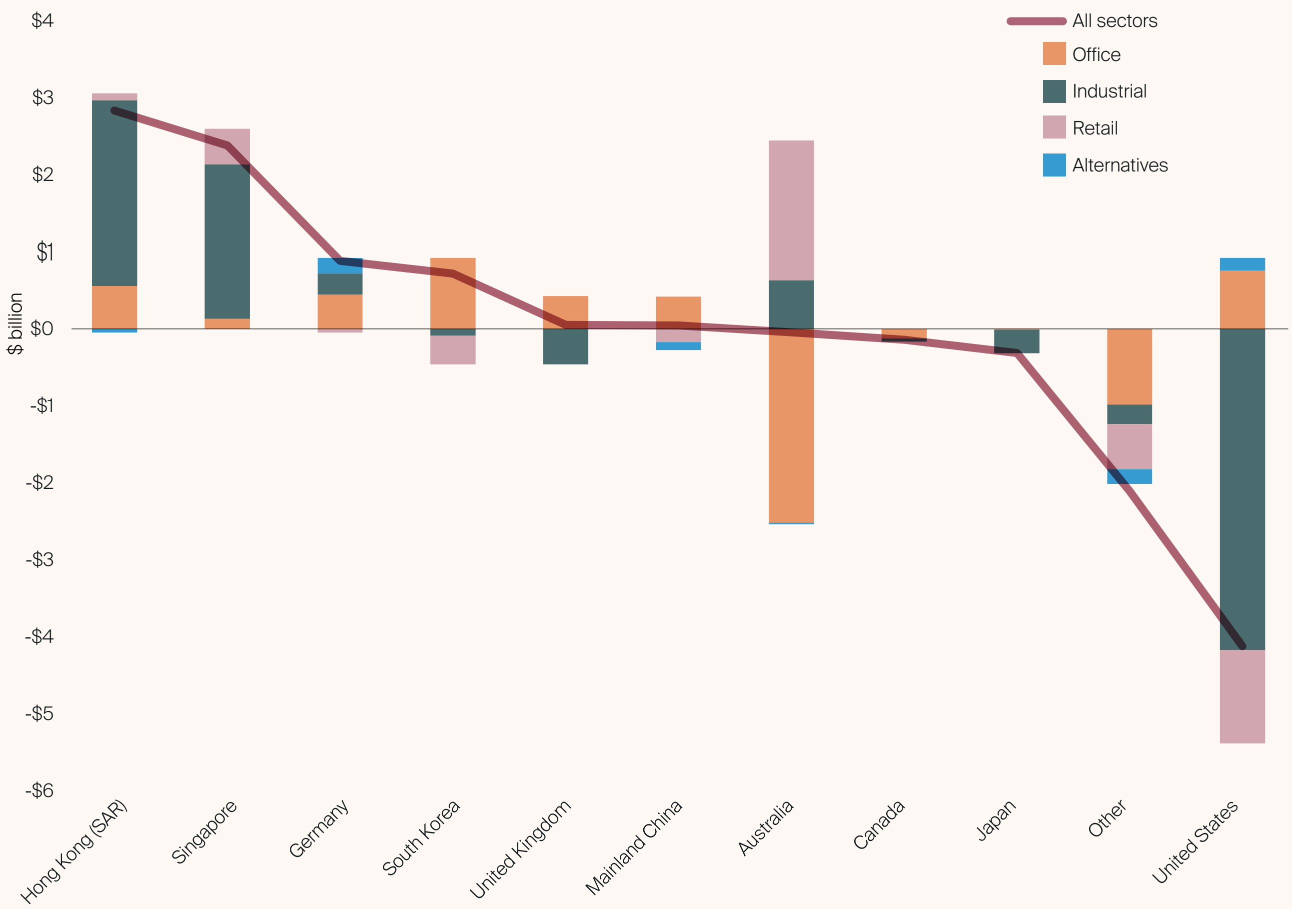
Singaporean and Hong Kong investors have been the main drivers of offshore investment activity, particularly the acquisition of Milestone logistics portfolio by GIC and ESR from Blackstone. While there is perennial interest in Australian property assets from Singapore and Hong Kong, investment activity has also picked up among European investors, particularly from the UK and Germany. By contrast, US investors have been net sellers although this mainly reflects the Milestone deal. Australian investors have been marginal net sellers, with a sizable net disposal of office assets mostly offset by net acquisitions of industrial and retail assets.

A key reason underpinning sustained offshore investment activity is that offshore investors generally have lower target returns. Most advanced economies adopted near-zero interest rate policies more quickly than Australia and so major global funds have a had longer to adjust to lower returns compared to domestic investors.

Another factor supporting offshore investment is the significant narrowing of the interest rate differential between Australia and major advanced economies over the past few years as the RBA further eased monetary policy. The interest rate differential is one of the main factors determining currency hedging costs, and the lower interest rate differential has reduced hedging costs for offshore investors looking to deploy capital in Australia.

For these reasons we expect offshore investors will continue to play a highly active role in Australian commercial property markets. Along with sustained investment from countries like Singapore and Hong Kong, the recent increase in activity among European investors is adding an additional source of capital to the market that will bolster market depth and liquidity.

Net acquisitions of Australian assets by country
Year to Q3 2021, $bn



Source: Knight Frank Research, RCA

The green premium will become more evident as investors adopt net zero portfolio targets

The increasing importance of ESG considerations within real estate has been widely publicised, but it is less well understood that sustainability credentials are already having a significant impact on building values.

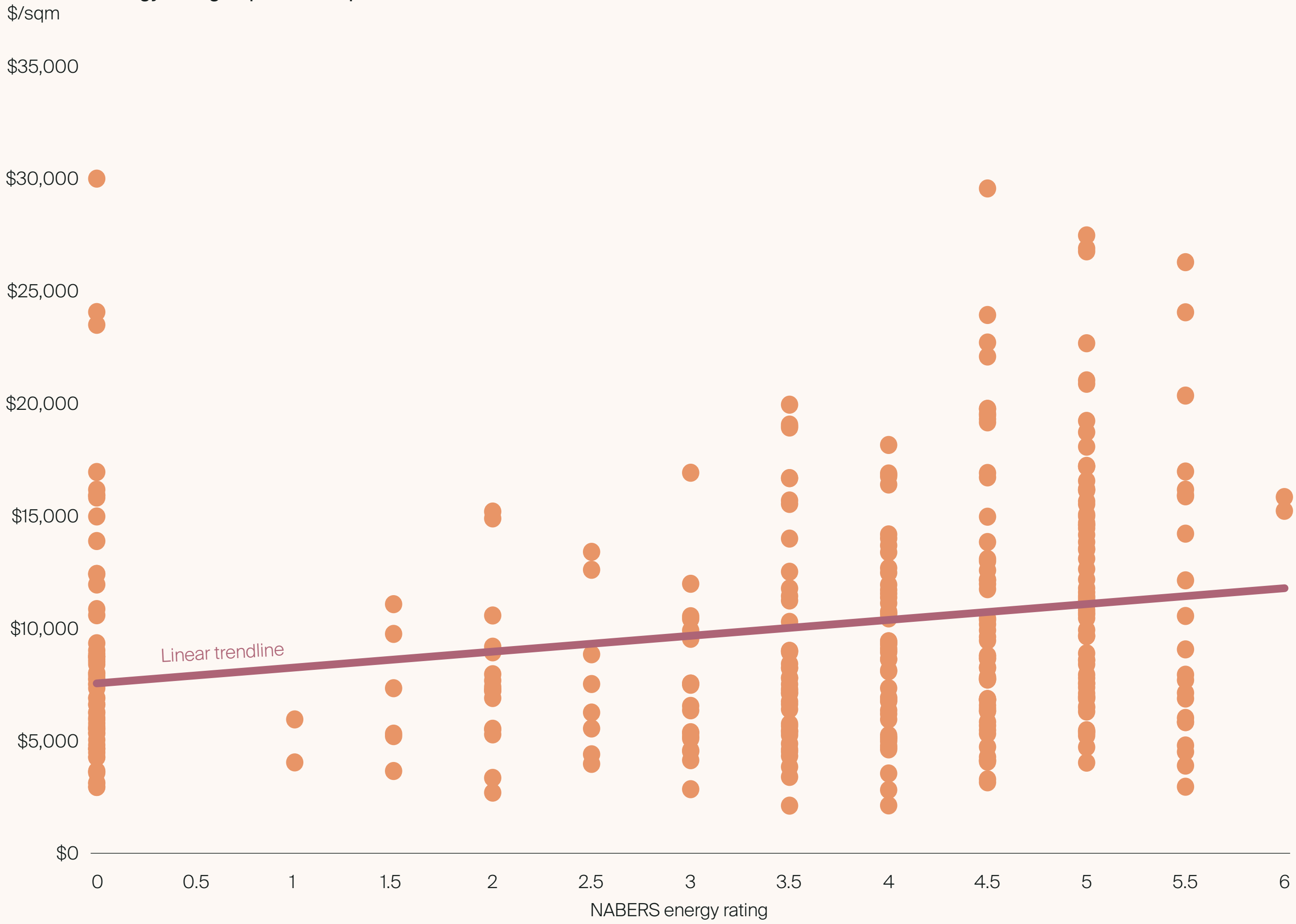
As presented in the 2021 Active Capital Report, Knight Frank have used hedonic price modelling to identify the contribution to sales price attributable to building's green rating. The results found that Sydney and Melbourne office buildings with a NABERS Energy rating of up to 4.5 stars benefit from an 8% premium on sales price compared to unrated buildings, while those with very high ratings of 5, 5.5 or 6 stars enjoy an 18% premium.

Importantly, the analysis allows for the fact that several other factors influence price – such as location, building height and grade – so is an estimate of the specific impact of the NABERS rating after taking these other considerations into account.

Modelling on London offices also suggests a significant price premium based on sustainability credentials, so the analysis depicts a global trend consistent with the rise of ESG. Tenants are increasingly gravitating toward stock that offers a high degree of energy efficiency and this is impacting rental performance and allowances for downtime in buildings with vacant space. At the same, investors are taking a forward-looking approach when assessing building value and view strong sustainability credentials as key to minimising risk.

Going forward, the importance of energy efficiency and its impact on building values can only be expected to increase as more and more tenants and investors adopt specific environmental targets for their own real estate activities. Under-performing assets will come under greater pressure from a reduced pool of potential tenants and buyers and this is likely to increase the differential in values between high and low performing assets in years to come.

NABERS energy rating impact on capital value



Source: Knight Frank Research

Domestic institutions rotating out of older office assets and into development in emerging precincts

Artists Impression: Quay Quarter Tower, Sydney.

While a strong recovery in demand is likely during 2022, the office market will still see a period of adjustment in response to demand-side changes wrought by the pandemic. Real estate will retain its strategic importance for business, but the need to provide a compelling workplace experience has become more pressing, resulting in a heightened focus on the quality and breadth of amenity provision, as discussed in the Workplace section of this report.

As a consequence, the market will see continued change to the form, function, quality and quantity of space demanded. This will naturally favour premium and A grade stock, and tenants can be expected to take advantage of the greater range of choice and more favourable terms on offer by trading up to higher graded assets.

The presents risks to the performance of secondary assets – or worse, of accelerated obsolescence – and they are likely to lag the market recovery. Furthermore, older assets with lower NABERS ratings may be vulnerable as institutions adopt stringent ESG criteria and seek to offload non-compliant assets.

Reflecting these forces, 2022 is likely to see domestic institutions trading out of older stabilised assets and focussing instead on new developments. With yields close to historic lows in most markets, build-to-core strategies offer the opportunity to achieve higher returns while mitigating against these risks by prioritising the higher-grade stock that tenants will gravitate towards.

Over time this will help to drive the transition in the office market, providing a welcome boost to the economic recovery and shaping new precincts off the back of infrastructure changes and expansion into the emerging fringes.

New Super benchmarks may deter funds from large-scale development

The Federal Government's Your Future, Your Super reforms came into effect on 1 July 2021 and are intended to improve the efficiency, transparency and accountability of the superannuation system.

The reforms require APRA to conduct an annual performance test for MySuper products, to assess the investment performance of each product over an eight-year time horizon. If a fund fails the test it will be required to report this to its unitholders and persistently underperforming products will be prevented from taking on new members.

One aspect of the debate around the reforms concerns the extent to which they will encourage 'index hugging' and passive investment strategies, as funds guard against the risk of more active strategies leading to underperformance relative to performance benchmarks.

For real estate, the reforms will potentially deter some funds from deploying capital into large scale development projects, since these expose them to specific project risks that could negatively impact their performance relative to the benchmarks. Funds such as CBUS have noted that a push to passive investing could make it more difficult for them 'to be active and direct providers of capital into the economy'.

Super funds have been vital sources of capital for the property industry and have taken a key role in development, but the reforms may lead them to adopt a more passive approach to real estate investment.

Industrial:

Responding to supply chain disruption

By Katy Dean
Knight Frank Australia.

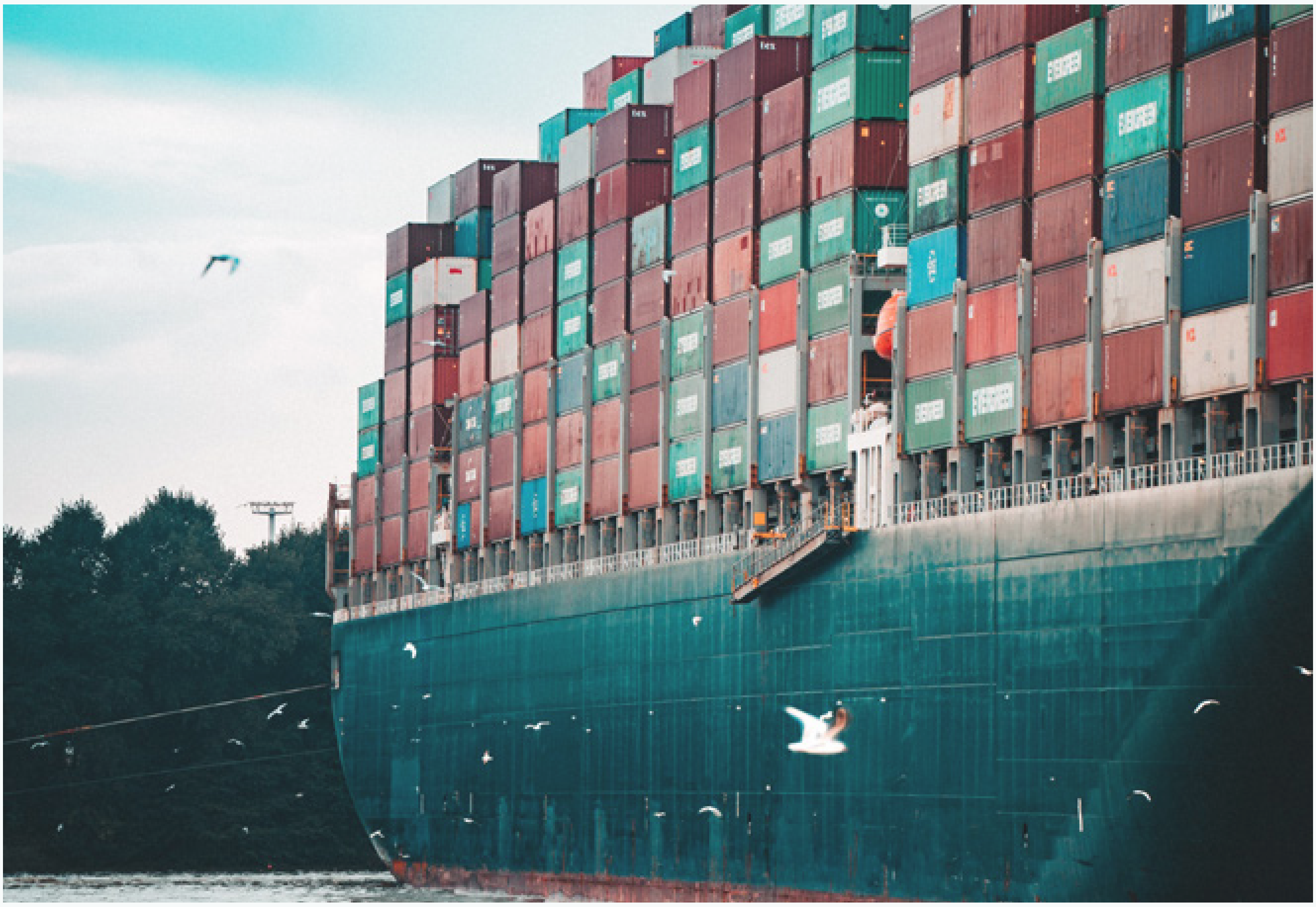
Focus on supply chain resilience will continue to drive demand

While growth in e-commerce continues to be the stalwart behind the demand for industrial and logistics real estate, the pandemic has exposed widespread supply chain vulnerability. These pressures will drive demand and also influence the supply side in 2022 and beyond.

According to a special survey by the ABS before the recent lockdowns, three in 10 Australian businesses said they were having trouble getting parts or products they need. Of the 30% that reported supply chain disruptions, more than a third (37%) were affected to a great extent, suffering major delays or were unable to get certain items, with the respondents saying this was significantly impacting revenue.

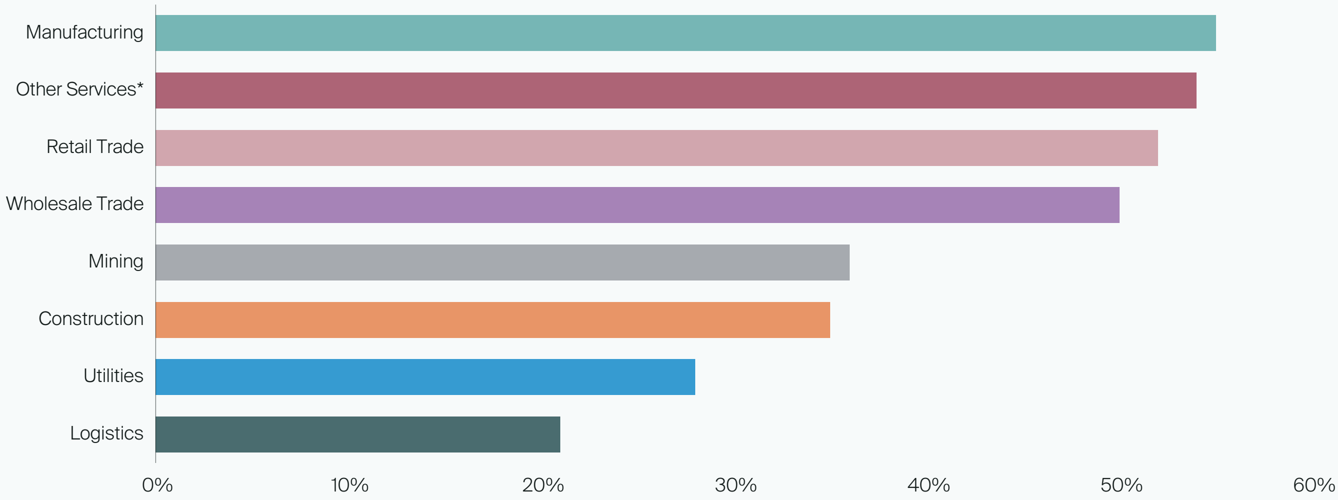
Manufacturing has been the hardest hit of the sectors, with 55% of respondents reporting supply chain disruptions. Retail and wholesale trade sectors were at 52% and 50% respectively and logistics businesses at 21%. Of the firms that reported disruption, the problems are most acute for the logistics sector, particularly the availability of sea freight services, with 73% of those logistics businesses experiencing disruption 'to a great extent', followed by 60% of wholesalers.

Globally, commodity and energy prices are on the rise, while shipping line constraints and port congestion due to the pandemic have seen transportation costs spiral upward since mid-2020. This is putting huge pressure on retailers and manufacturers that urgently require container space for imports at a time when demand is very high from consumers set to unleash a further spending spree as lockdowns end.



Reports of Supply Chain Disruption

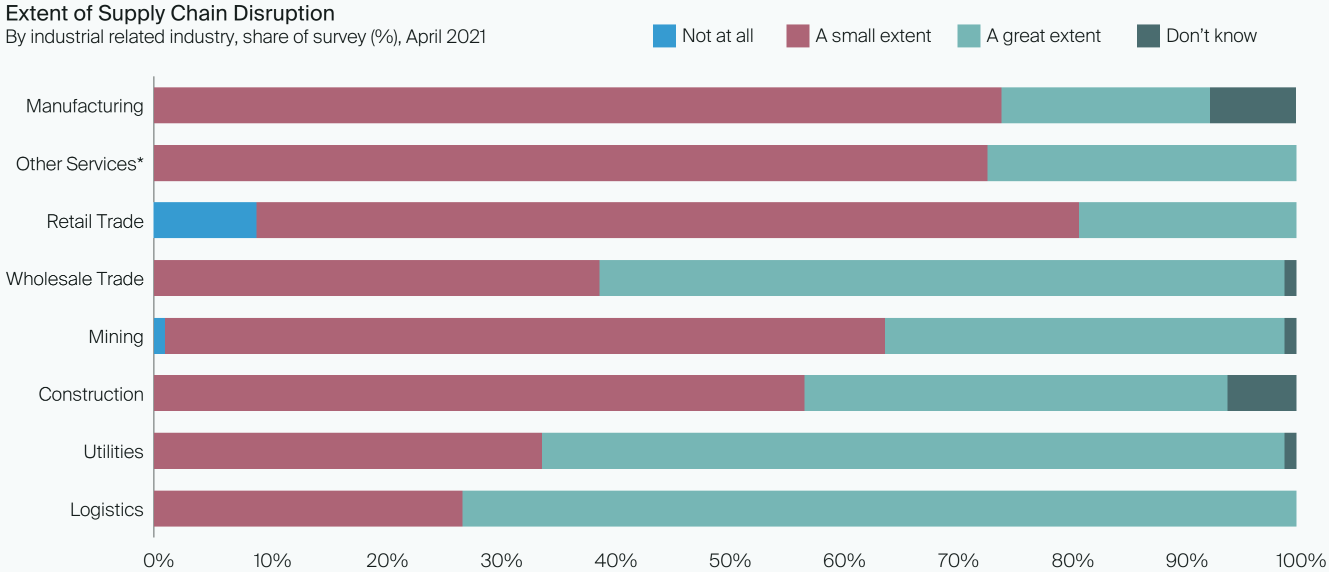
By industrial related industry, share of survey (%), April 2021



*Source: Knight Frank Research, ABS *includes repairs and maintenance*

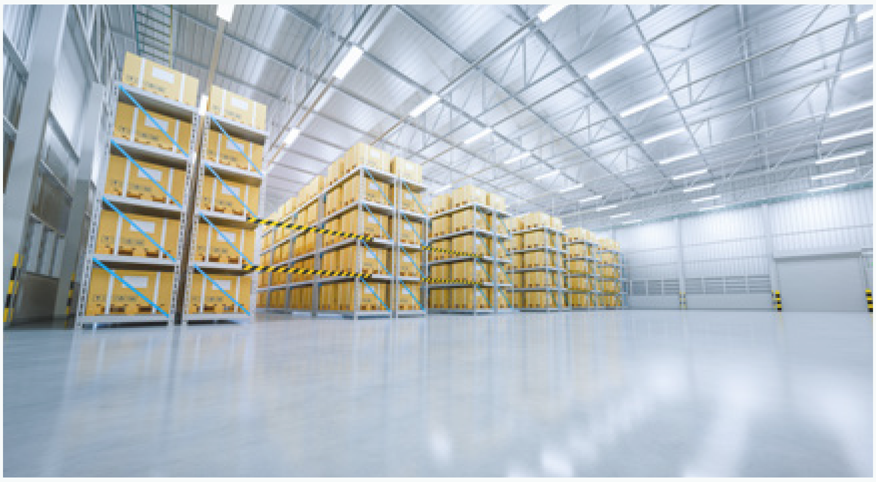
Extent of Supply Chain Disruption

By industrial related industry, share of survey (%), April 2021

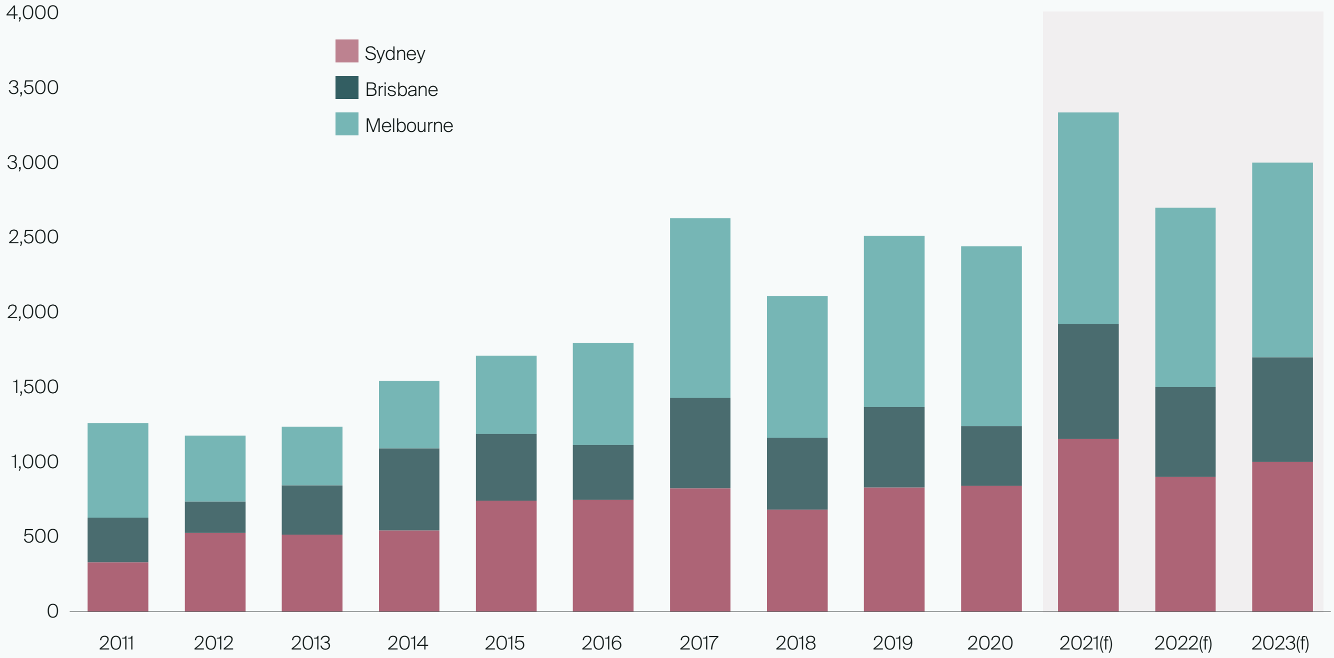


*Source: Knight Frank Research, ABS *includes repairs and maintenance*

Many companies wish to expand their warehouse facilities to manage this surge capacity and there has been a scramble for space. As a result, leasing take-up volumes are currently running 31% above their long-run averages on the east coast, while pre-leasing activity for new buildings grew by 11% in the 12 months to October 2021. Demand for modern stock is well and truly outpacing supply and will see the market remain tight during 2022. This will have an impact on take-up levels in 2022, which are forecast to be slightly below the peak levels of 2021, with the lack of stock putting some pressure on deal flow until 2023 when some of the pressures should have eased.



Eastern Seaboard Industrial Take-Up
By City, '000 sqm, (>5,000sqm)*

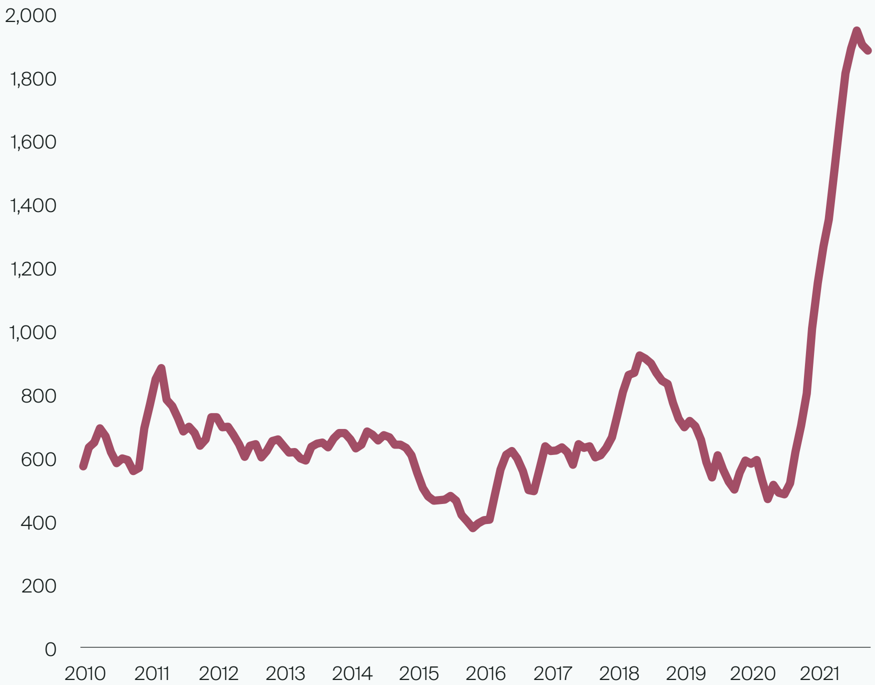


Source: Knight Frank Research **Take-up of vacant space, includes pre-commitments*

Pressures also impacting the supply side

Meanwhile, cost pressures are also impacting the supply side of the equation. Steel has seen dramatic price increases since the end of 2020. The benchmark price for hot-rolled steel hit another record high recently, climbing to US$1,900 per ton. This is up from the US$580 that it traded at in February 2020, representing a staggering 228% increase. This price growth trajectory, alongside increases in cost for other building materials including timber, metals and electrical goods, is escalating industrial building construction costs and causing project delays. These forces will add upward pressure on rents in the near term as owners look to absorb these inflationary pressures.

US Midwest domestic hot-rolled coil steel futures price
US$/metric ton



Source: Knight Frank Research, Investing.com US futures price monthly price

How is supply chain disruption impacting business decisions?

Suzanna Murray,
Director, Occupier Services
Knight Frank Australia.

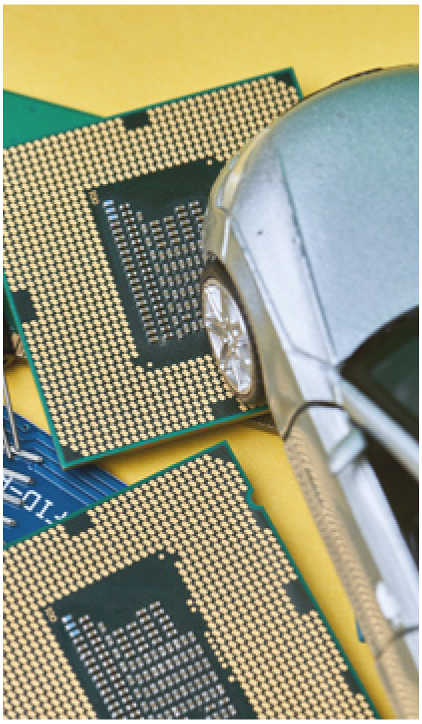
The past 18 months have been transformational in the way we as a society view the supply chain. A decade ago, conversations about the movement of goods rarely breached the walls of a board meeting or into the day-to-day conversation of the public. The influences of COVID-19 have brought to light the importance of understanding how global supply chain works and how it influences each of us on a daily basis. Here are the top five ways that supply chain has impacted us, and how it's impacting the property choices that occupiers are making:

1 Panic buying

Retailers stock their shelves on an assumption of what is purchased on an average basis at each stage of the year. This assumption plays critically into the just-in-time storage model. Australians have been named as among the worst culprits of Panic Buying since the pandemic began with over 17% of us taking part, according to a survey by Deakin University, QUT and the University of Melbourne. Further compounding the unreliability of the just-in-time storage model, requirements of industrial tenants have grown to be able to store goods required by the public.

2 Just-in-time storage

Previously retailers and industrial clients purchased and held goods at storage levels that only allowed them to manage through each cycle. The knowledge that goods could be imported on a reliable basis meant that few people stopped to think "What if the supply chain isn't reliable?" However, pandemic-induced disruption to manufacturing and distribution, particularly out of China, was the tipping point for widespread delay in goods reaching our shores. Compounded by the effects of port side union disputes and further consolidation of the shipping lines, this has pushed the reliability and turnaround time for the supply chain. In response, we are now seeing retailers and warehouse tenants move to storage models that will allow goods to be held for multiple retail cycles, providing more certainty for businesses and consumers.



3 Proximity to consumers

Consumers want to know that when they purchase their goods online, they will be delivered to them quickly and intact. This has placed greater pressure on industrial tenants who service e-commerce to be closer to the end consumer than ever before, as retailers compete amongst themselves to be the most effective e-commerce provider. This increased pressure from consumers has led to a shift in distribution strategies. Local big box retailers and grocers have transformed their stores into distribution hubs where orders can be collected alongside in person shopping. Some retailers such as Big W and Kmart shut their doors to the public to become only distribution locations at the heart of lockdowns in Australia.

4 Higher land values

Increased warehousing requirements as users transform away from the just-in-time storage model, alongside the need for proximity to consumers, has boosted demand and placed pressure on supply in the industrial market. The level of existing supply has dwindled, and pre-leasing commitments on the east coast are up 11% year-on-year, as occupiers are now turning to development to meet their space needs. This is having a knock-on impact on the market for land itself, as more and more developers seek to secure development land to meet demand.

5 Uncertainty about the future

With supply chain impacts likely to persist during 2022 and uncertainty around the potential for future variants of the virus to cause further problems, occupiers are not armed with enough information to make strategic property choices for the future with great confidence. While changes in the behaviour of consumers who use e-commerce are expected to persist after the pandemic has eased, reliability of the supply chain will remain an unknown until it is proven practice. The question of whether businesses can revert to just-in-time storage models won't be answered in the near future, and this uncertainty is pushing occupiers to prepare for the worst but hope for the best.

Industrial rents (finally) shifting into growth mode

With so much positive momentum in industrial markets it is easy to forget that rental performance has been distinctly underwhelming in recent years, with few markets seeing any meaningful uplift over the past decade. In fact, it is really only the inner fringes of Sydney and Melbourne that have seen solid growth, with other precincts across all cities largely flat-lining.

While the perception of industrial has changed markedly, this lack of growth has been in keeping with the traditional perception of industrial as a sector less likely to experience rental growth due to a lack of supply constraints and short lead times for new developments.

However, after a long wait, the traditional dynamic is now shifting with multiple drivers combining to put upward pressure on rents. Strong and sustained demand has pushed down vacancy of existing stock across the board and there are also signs that developers are struggling to keep up with the need for new stock. Widespread shortages of zoned and serviced land are pushing up land values, while supply constraints and higher costs are impacting new developments.

At the same time, the pandemic has highlighted the rise of e-commerce and the need to be closer to the end-user. This will continue to intensify moving forward. While the conversion of under-utilised space, such as retail to logistics, will fulfil some of the pent-up demand in urban areas, it is unlikely to increase overall supply enough to meet short-term demand, particularly from large users in 2022.

These signals all point toward solid rental growth in 2022 and 2023. This will be led by Sydney and Melbourne but Brisbane, Perth and Adelaide are not far behind and will also see a strong uplift.

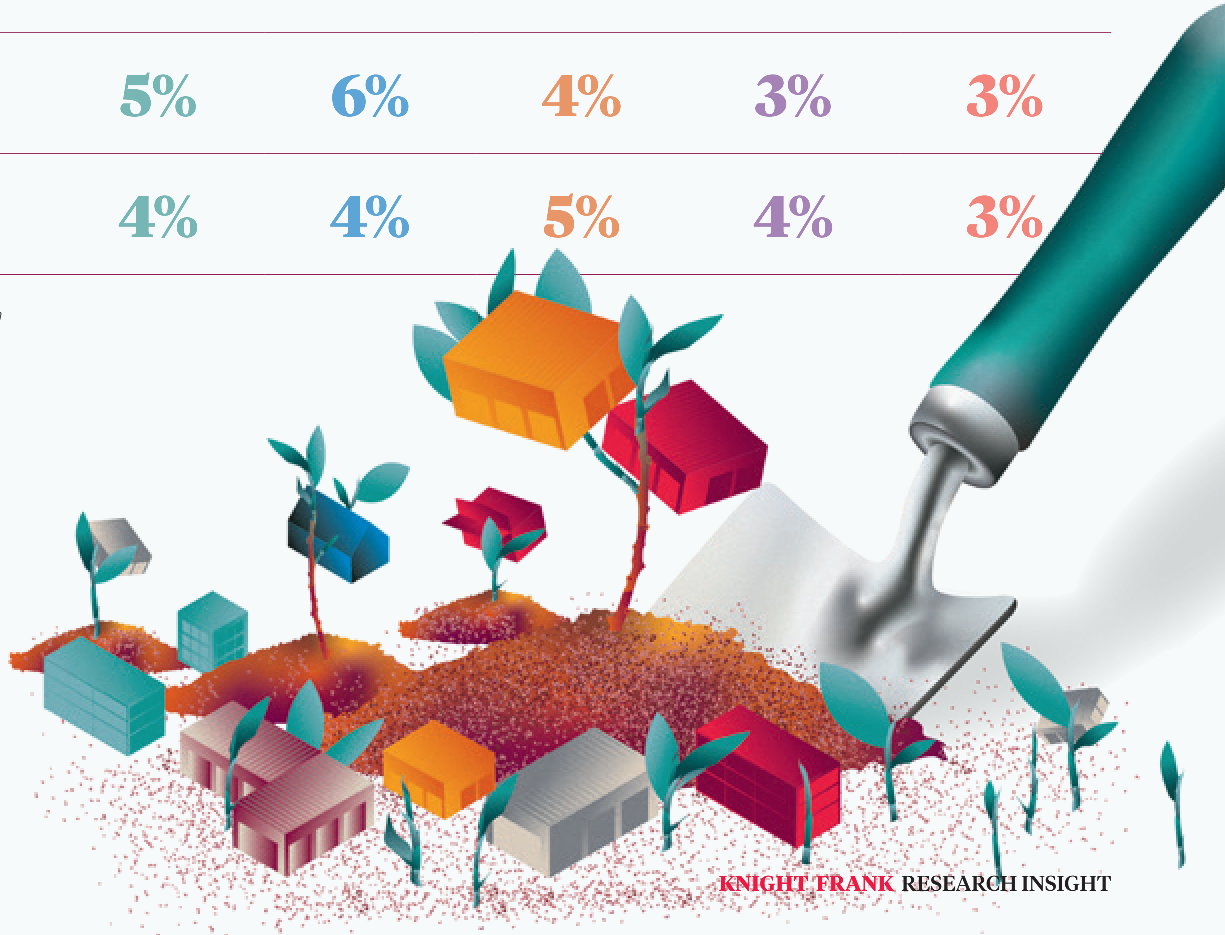
Well located secondary property will also see rental growth, particularly in Melbourne and Sydney, where the value of older style facilities in areas with close proximity to transport networks or end-users is growing rapidly.

The growth outlook is being driven by headline rental growth, with the early phases of this cycle only emerging in the second half of 2021. In most markets incentives have started to reduce as the structural trends behind the demand continue to mount.

Prime industrial face rent forecasts
By City, Growth rate percentage (%) based on blended market prime rent average

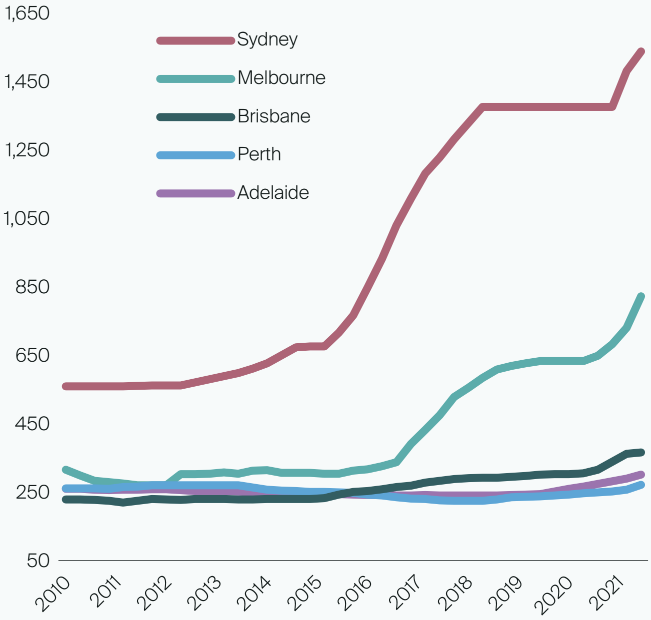
	Sydney	Melbourne	Brisbane	Perth	Adelaide
2021	5%	5%	2%	3%	3%
2022	5%	6%	4%	3%	3%
2023	4%	4%	5%	4%	3%

Source: Knight Frank Research



Land shortage will persist, pointing to the need for planning policies to adapt to the greater demand for industrial real estate

Average Land Values
By City, Blended Markets Average $/sqm for medium lots



Source: Knight Frank Research

Sydney Undeveloped & Serviced Land Stocks
By Precinct, ha, 2010-2020

Source: Knight Frank Research, NSW DPIE
**Other =sum of undeveloped and serviced land <5ha in precincts*

Beyond the market for existing space, the strength of occupier demand is intensifying the competition for serviceable and zoned industrial land, with some industrial markets expected to face a critical shortage in 2022.

Some areas in Melbourne's South East, North and West, alongside Sydney's Outer and South West and Brisbane's South and South West, are facing shortages now and land values are increasing at a rapid rate. This reflects supply constraints amid the e-commerce demand tailwind, plus the knock-on effect from yield compression is driving up values of completed product. Land values in Melbourne are expected to show at least a 30% growth rate (in aggregate) for the year, with growth rates of at least double that possible for medium sized lots in the North and West. In Brisbane, medium lot prices are expected to grow by up to 20% y/y, while Sydney will record at least 12%, with some individual areas in the South West and Outer West likely to close in on 20%. There has also been a 7% uplift in land values in Perth East and South and Adelaide's blended rate for medium lots has risen by around 9%, with select examples of much higher growth in land values in some estates.

Based on the average consumption rate, all supply in Melbourne's South East began to diminish mid to late 2020, signifying the inflection point for escalating land rates in the area. Industrial land in the West is also rapidly declining, with available zoned and serviced land supplies likely to be exhausted by 2025.

In Sydney, while there is a large amount of land coming through the Mamre Road and Bringelly Road precincts, zoned and serviced land in the Outer West and South West region is also in short supply. Based on the average consumption rate, these supplies will start facing limitations from 2023.

Industrial land in inner city locations in all markets is also scarce, with near to no availability of zoned and serviced land in the near-term. This is expected to increase the pressure to build multi-level warehousing. However, the planning framework needs to be flexible and while this type of development is widely accepted across Asia, it has scarcely been seen in Australia to date.

In Melbourne's North, South East and Western precincts, where industrial land availability is decreasing, there has been an increase in developers buying up secondary sites with superior access to transport and logistics networks with the intention to redevelop later. In some cases, the reuse of these existing sites, which provide immediate access to serviced and zoned land, substantially outweighs the cost of acquiring a vacant lot without these amenities despite factoring in redevelopment or remediation costs.

Alongside land shortages, the current supply-chain disruptions and rising costs associated with development are contributing to the rising barriers to supply in some markets. Expansion of e-fulfillment will continue to result in competition for not just infill locations but also transport-oriented outer locations, leading to a continuation of the growth trajectory for land and rental values in 2022. Some of these pressures will start to correct themselves when future land is released and the turbulence in the supply-chain eases, but that's not likely to occur for at least another 12 to 18 months.

It's not all e-commerce: manufacturing demand set to grow

The increasing fragility of global supply chains during the last 18 months has impacted short-term manufacturing demand for industrial real estate but activity in the sector is expected to pick up again with the outlook for 2022 one of recovery amid pent-up demand.

The disruption to global supply chains has been challenging for manufacturing. Longer delivery times on imports and higher transportation costs due to less airfreight capacity, plus shipping container shortages and bottlenecks caused by the ramp-up in commodities demand have all presented significant hurdles.

However, the silver lining is that interest in onshoring is intensifying due to these tensions, particularly from manufacturers using vulnerable imports. Local manufacturing demand has re-emerged and recent employment figures from the ABS show that 61,000 manufacturing jobs have been created since February 2021, despite the protracted lockdown in Victoria and NSW. Manufacturing job numbers are now above pre-pandemic levels, driven by jobs growth on the eastern seaboard. The shift demonstrates the resilience of the sector amid the current global economic conditions and subsequent supply chain turbulence.

The Government is also investing $1.5 billion to help local manufacturers scale-up, improve competitiveness and build more resilient supply chains. The production of resources and critical minerals, such as lithium for batteries, and advanced manufacturing for recycling and clean energy, will be key targets in the short-term.

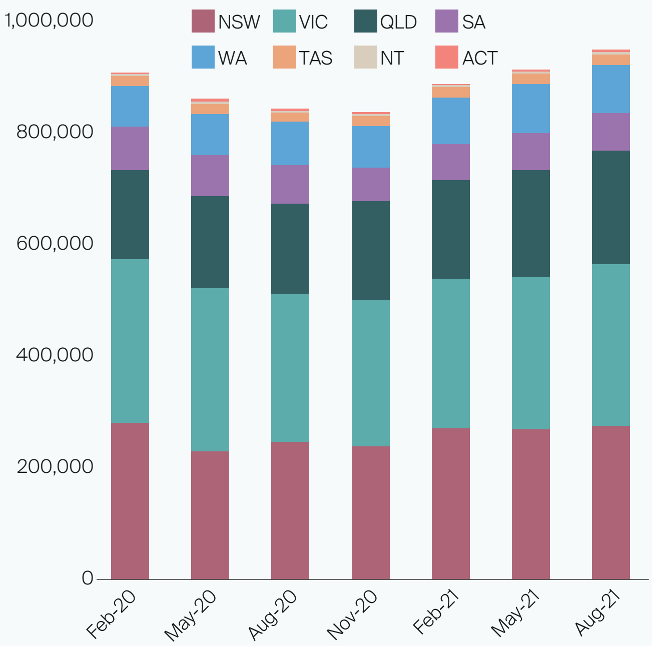
Growth in food and beverage and paper/packaging manufacturing for rapidly expanding e-commerce shipments will generate an increase in the demand for industrial facilities in all major cities in 2022. Some of this demand has already started to surface as retailers respond to the direct pandemic demand. Coles and Woolworths e-commerce sales grew between 52% and 74.7% on FY20, and that is on top of an increase in their bricks and mortar store sales.

There is also a symbiotic relationship between infrastructure investment and manufacturing demand, and this is important given the Government has a historic $110 billion investment budget for a pipeline of mega infrastructure projects over the next decade.

With a faster rate of e-commerce usage expected, greater investment in re-tooling existing supply chains will be required, increasing the impetus for local manufacturers to be a source of growth. While this will likely be in established locations in the short-term, such as Sydney's Outer and South West, Melbourne's North, West and City Fringe around the Port of Melbourne, Brisbane's western corridor, Adelaide's Outer South, Inner and Outer North, and Perth's East and South, the availability of the required workforce and land for warehouse space will determine how well-prepared areas are to compete with other locations to fulfil this demand.

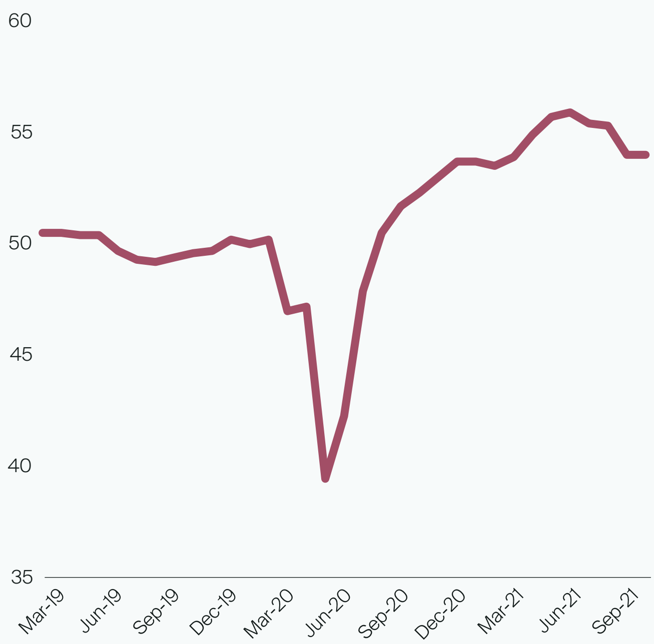
This demand could give rise to regional manufacturing hubs where there is a greater abundance of available land including Sydney's Western areas, Kemps Creek, Moorebank Defence Lands at Liverpool and Penrith, Melbourne's Officer – Pakenham and Port of Hastings, Brisbane's Outer South West and Yatala Enterprise Area, Perth's Kwinana, Neerabup and Perth Airport and Adelaide's Outer North.

Manufacturing Jobs
Employed total by State & Territory



Source: Knight Frank Research, ABS

Global manufacturing PMI
Index



Source: Knight Frank Research, Macrobond

Locations on the watchlist

Melbourne – Western corridor:

There are a number of locations that are set to absorb the growth in the demand, leading to an increase in size of the market beyond its existing boundaries. Arguably the South East precinct is close to capacity, with the rapid rise in land rates recently. Demand has spread beyond its traditional areas, such as Keysborough and Moorabbin, with Pakenham emerging as a new industrial area to keep an eye on. In the West, Truganina is mostly built out, with demand constraints pushing occupiers to Tarneit and Ravenhall. But with both now running out of land, developers are actively looking at Melton. With the Victorian government planning to build two new intermodal freight precincts at Truganina and Beveridge in Melbourne's outer north to service the state's growing freight and logistics sector, the western corridor around Truganina to Melton and north to Mickleham and Beveridge will also be worth watching.

Perth – Hazelmere:

There has been increased interest from developers, actively seeking land banks and redevelopment sites in Perth. The market faces a low level of available high-quality product to meet demand and the recent increase in enquiry for pre-lease space is providing developers the confidence to pursue opportunities within target markets. Hazelmere in the East remains worthy of watching, given it is still only built out to about half its capacity. It also has a number of opportunities for development on larger 10ha+ sites and is located close to Perth Airport. Given the tightly held nature of these areas, infill sites in Osborne Park, Kewdale and Welshpool will also be on the radar for redevelopment opportunities in 2022.

Sydney – Mamre Road precinct:

The NSW government approved the rezoning of the Mamre Road precinct in Sydney's Outer West in 2020, fast-tracking developments as part of the economic recovery plan post-COVID. The 850 hectare precinct is one of 10 key employment land hubs identified as part of the new Western Sydney airport at Badgerys Creek. Numerous institutional groups have been actively acquiring and consolidating land parcels within the precinct over the last few years to develop. With certainty in the development following the rezoning decision, it is expected that this will now feed through to the development of new product that was previously facing a barrier in regard to zoning. As a result of this, expect to see Erskine Park, Eastern Creek and Huntingwood on the radar, with secondary sites likely targets for repositioning to capture the overflow of unfulfilled demand.

Brisbane – North:

In Brisbane, land transactions have increased but the amount of zoned and serviced land is diminishing. There has been greater purchasing of brownfield sites in central locations, plus secondary assets are being priced with an eye for medium term redevelop -ment. Areas to watch in 2022 include areas north of the river such as Pinkenba, Banyo and Geebung through to Brendale with greater institutional purchasing in the North. Expansion zones in the South include Crestmead, Yatala, Redbank and Bundamba.

Adelaide – Outer North:

In Adelaide, the Outer North continues to expand, with around 95% of identified future employment land located in the region, although still subject to rezoning. The recent completion of the Northern Connector, which is directly accessible from the Northern Expressway, is a key attraction so land sales in Elizabeth South (home of the former GMH site), Edinburgh North, Direk and Roseworthy should be closely monitored. Additionally, the Inner West and Inner South, with key access to trade gateways, will always do well so should remain on the watchlist.

Workplaces:

Transitioning from resilience to reassessment

By Jennelle Wilson
Knight Frank Australia.

The great reassessment has only just begun

A year ago, looking into the promise that was 2021 and leaving 2020 behind, there was a sense that in a year everything could be resolved, or at least that we would be more progressed on the road to a new normal. We would have more certainty over how workplaces would be changing, with new paradigms of workplace expectation and behaviour embedded even if the physical office space changes were still to come.

However, amid persistent lockdowns a clear run at opening office space to pre-covid densities of occupation never quite eventuated and many of the big questions remain unanswered as we stand on the cusp of 2022. The past year has taught us that the adaptation of the workplace and in turn of offices will play out over a much longer period, and there will be widespread diversity of response. Many employers, employees and occupiers are still waiting to return to the former ways of operating, but how often has society or commerce been improved by ignoring the lessons learnt and innovations made during periods of upheaval and disruption? Instead, we should celebrate the flexibility and resilience of the technology and workforce that has continued to operate under challenging and frequently changing circumstances. Corporate occupiers will now move to a period of re-assessment, aiming to capture the best of both worlds as they frame their future real estate strategies.

Employees want more than a transactional relationship

Data from the US is showing that more than 19 million US workers have resigned from their jobs since April 2021, 20-year highs, resulting in major business disruption. While not certain to flow through to Australia there are indications that there is a growing level of reassessment across the workforce already visible in the Australian market. A survey from Australian HR platform Employment Hero indicated 40% of respondents said they were going to look for a new job within the next six months, while a PwC survey of Australian workers indicated 38% were looking to leave their employer in the next year.

Top factors why employees left last job

1	Not valued by organisation
2	Not valued by manager
3	Sense of belonging
4	Work-life balance
5	Inadequate compensation

A recent McKinsey study which covered almost 5,000 respondents across Australia, Canada, Singapore, UK and US showed similar results with 40% of respondents were at least somewhat likely to leave their current job in the next 3-6 months. Dispelling any thoughts that this may be contained to burnt-out front line workers, this survey showed that white-collar workers had a slightly higher intention to leave at 41%.

The same survey showed that 36% of employees who had resigned from their jobs in the past six months had done so without a new job in hand, indicating that dissatisfaction with their current job or life situation, rather than a tempting new offer, was the major factor. Of those currently contemplating resignation, 64% said they would do so without a new job lined up. The top three factors for resigning were that employees didn't feel valued by their organisations (54%), or their managers (52%) or because there was no sense of belonging at work (51%). None of these were transactional factors that tend to be the go-to for many traditional employers such as remuneration, additional leave and negotiated work-life balance. These reasons for leaving indicated an emotional disconnect between the employee and the organisation. Was this due to the physically remote location of the workers over the past 2 years, poor culture pre-COVID or the way the companies dealt with managing a remote workforce?

The past two years have proven that employees can be productive when untethered from the need to be in a central office location five days per week. But are they happier overall? Undoubtedly the freedom to determine the 'where and when' of working, unfettered by the lost time of commuting or being watched by bosses or colleagues will not easily be abandoned by the workforce. Indeed, a growing generational shift seeking greater net freedom ahead of net wealth has been building across Millennial workers for some time.

The self-reflection brought on by the pandemic is resulting in growing demand from employees to have greater control over their 'how', 'who', and 'why' in employment. Having a say on who they work with, the projects they engage with and a greater sense of purpose are all high on the agenda for knowledge workers. Employees are seeking social and personal connections with co-workers and managers and also want to feel a sense of common purpose. The office must remain a central gathering point and personal touchdown zone for employees but in the workplace of the future it cannot be the only tool to create a cohesive sense of purpose.

Likelihood that employees will leave their current job in next 3–6 months
Percent (%) of respondents

40% of employees stated that they are at least somewhat ***likely to leave their current job*** in the next 3–6 months

Source: McKinsey Group

Hybrid work is just the beginning of a more thorough reassessment of workplace needs

Far from being complete the workplace experiment is not over once lockdowns and social distancing requirements ease. Instead, the workplace shift is considered to only just be working through second phase of a three-phase timeline that sits within an overall climate of transition. Australian cities have been in Phase 1 or Phase 2 conditions for most of 2021 with density and social distancing restrictions in place if not lockdown restrictions.

Across the gamut of workplace options – from 100% office (already a dinosaur in 2020), to office first through to remote first and fully remote there is a company testing a strategy to see if it fits their situation. Undoubtedly there is far more experimentation and analysis to be done than initially expected and nothing should be considered as set in stone as yet. Hybrid working will need to be tested over time and in a situation free of home schooling and restrictions, where workers are truly able to choose their space.

A mid-2021 survey by The Age/SMH of the 50 top Australian businesses showed that 42 had adopted formal long-term hybrid policies with only seven of these dictating a minimum number of in-office days.

While hybrid work existed and was gaining in popularity before the pandemic and remains the most logical mid-line path as we emerge from the pandemic, it will not answer the workplace challenges emerging from changed employee priorities and is only part of the journey and not the destination. The paradox remains that workers have very different reasons for favouring home/secondary space over the office and vice versa. The removal of a long or stressful journeys has undoubtedly improved lifestyle for the "commuters". Meanwhile, there is evidence that working from home has been more stressful for the "segmentors" who prefer to separate the different spheres of life than for the "integrators" who are happy to blur the lines. Good segmentation policies would allow people to commit to predictable time off that shields them from work intrusions into their lives.

Phase 1
Lockdown enforced working from home

Phase 2
Re-occupancy but with restrictions

Phase 3
Restructuring business and reimagining the workplace

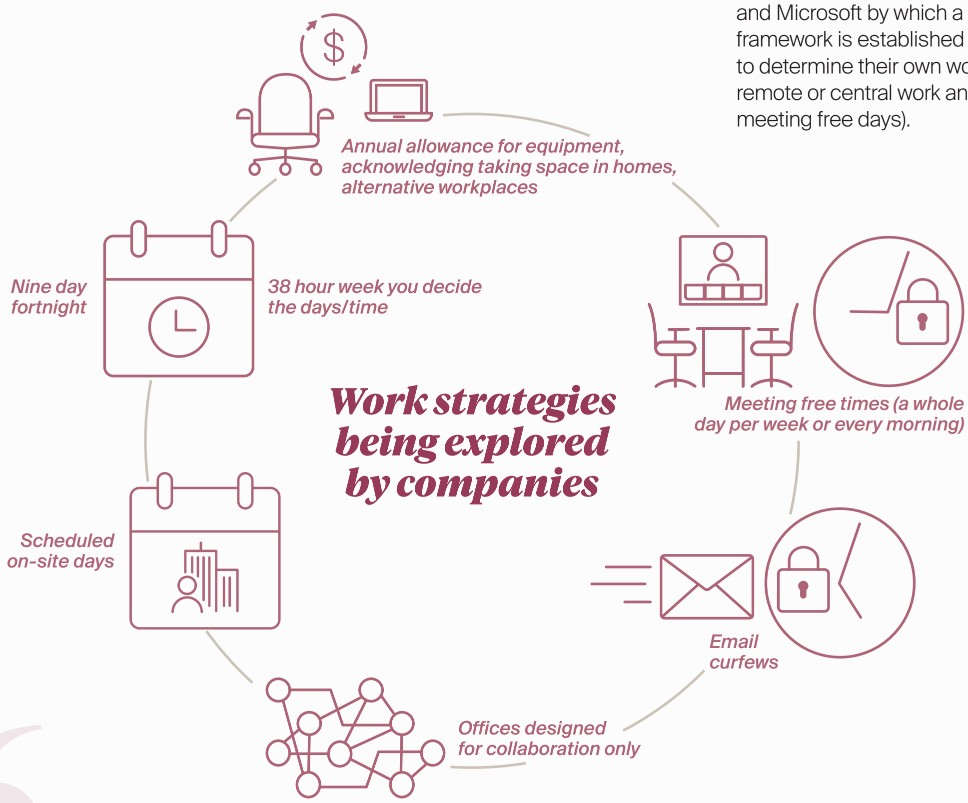
> ***We're going to be in a stage of experimenting, learning, and adjusting for a while as we emerge from this pandemic.***
>
> *Andy Jassy, CEO Amazon*

Experimentation, evaluation, evolution

The social aspects of a workplace are harder to maintain when employees work different days. Research from George Washington University has found the chance of two people bumping into each other in the office falls significantly from 55% when they both work one day remote to just 12% when they work three days away from the office. Frequency is important as it has been shown that to create communities amongst co-workers it is the frequency and time spent with a shared purpose which creates the strongest ties.

On the flip side it has been seen that frequency of interaction does nothing to promote productivity and creativity in a team setting, instead it is the quality and intensity of the interaction which produces results. Providing interruption free time to explore a problem and having all members focussed on the task is more important that how often the meetings take place, assuming there is a level of trust already present.

Phase 3 is not expected to be a revolution but more of an evolution with companies coming from a place of understanding of how their tests have worked in an unrestricted world and having examined the diversity of needs across their workforce. This evolution phase will likely take the next 3-5 years to play out. Already a company-wide mantra is seen as too restrictive with different teams within businesses having greatly differing views and requirements to get the best workplace experience. The likely alternative model is one recently adopted by Amazon and Microsoft by which a workplace framework is established allowing for teams to determine their own working models of remote or central work and rules of play (ie meeting free days).



With our employees working on average two days a week [from home] pre-COVID, we didn't need all of the office space we had. I think, at the moment, we're reserving judgment and waiting to see how this plays out.

Alex Badenoch,
Telstra Transformation, Communications and People, Group Executive

The office will be getting a major facelift driven by unrelenting demand for Service, Experience & Amenity

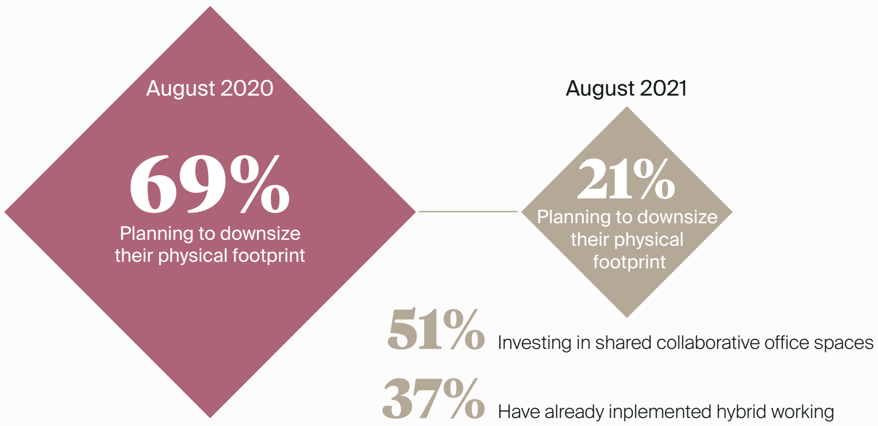
Soon after the work from home experiment was shown to be able to sustain a good level of productivity, the doomsayers emerged with headlines such as the death of the office. But early predictions of wholesale downscaling of office space have not come to fruition across most markets. As illustrated in the KPMG Global CEO survey, in 2020 69% of CEOs had already or were planning to downsize their physical footprint. The most recent survey in August 2021 now shows that only 21% either have, or plan to, downsize their office space. Equally the co-working sector has seen a strong bounce-back with quality and location key to seeing boosted occupancy levels whenever restrictions permit.

But while the office remains central to the workplace experience, the so-called SEA change – Service, Experience and Amenity will be firmly in focus for businesses when making decisions on their space needs going forward.

The most ephemeral of these elements is 'experience' and it is essentially how the office environment makes the person feel. Many elements are minor or even subliminal but add up to form a general impression of a place or working environment.

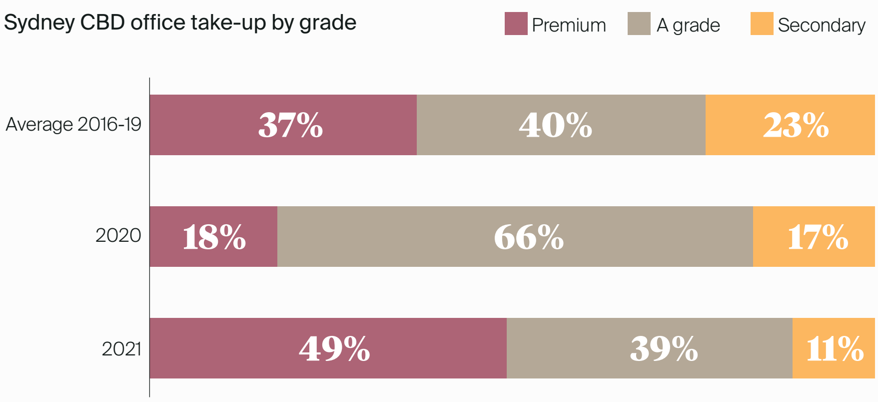
Experience can be influenced by either positive factors (natural light, good design, personalised service) or the absence of a negative issue (no queue, working wifi, comfortable temperature). Design features such as humanising space, allowing for openable windows and access to outdoor areas for entertainment and decompression zones will be strongly sought as the backbone of new office designs.

The Phoney war on space?



Source: KPMG Global CEO Survey

Sydney CBD office take-up by grade



Source: Knight Frank Research

Occupiers desire beautiful but uncomplicated workplaces with simple and stable IT, a clear purpose for each area within the space and not a plethora of rules and regulations. Recently this has continued to support the demand for speculatively fitted out space which provide plug and play options for companies without the lead time to develop. This has also supported the absorption of quality sub-lease space where the fitout is generic enough to suit the majority of tenants.

A significant reduction in friction points can come through advanced building automation or building wide apps which allow for building access, carparking, real time monitoring and connection to retail tenants within a single smart device.

This inexorably points to the need to many tenants to upgrade their office space. In the short term many will maintain a preference for plug and play space, but longer term there will be a shift back towards bespoke office space designed to fit the needs of the individual company. Advances in movable and modular office fitouts will also mean that a company can easily alter their tenancy without a full refit – a time, flexibility and ESG benefit.

Premium and upper A grade will have a resurgence in demand by being best able to create the level of service, amenity and experience required in the compelling office of the future. To date this is most obvious in the Sydney market where there has been a strong uptick in the take-up of premium space as a share of overall office take-up since the start of the pandemic.

An office that attracts and energises staff is seen as necessary, perhaps smaller in size but better used, the additional rental is seen as a worthy investment, potentially changing the cost rationalisation of office space which has been prevalent in large corporates in the past few years.

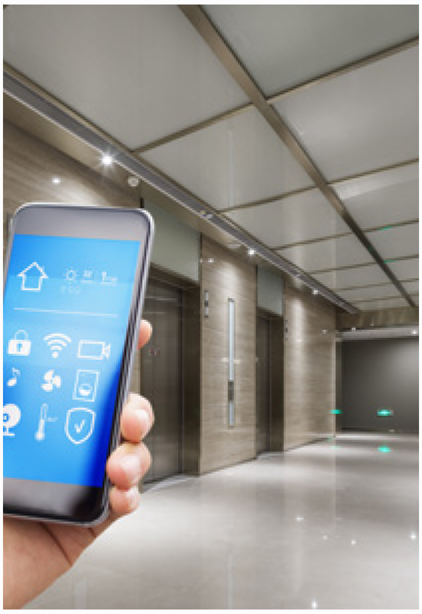
Space that catalyses human talents and has a management overlay to seamlessly fulfill the wants, needs, and desires of workers will thrive. Perfect workspaces will be those that enable people to be happy, healthy and productive.

Using data to improve occupier experience

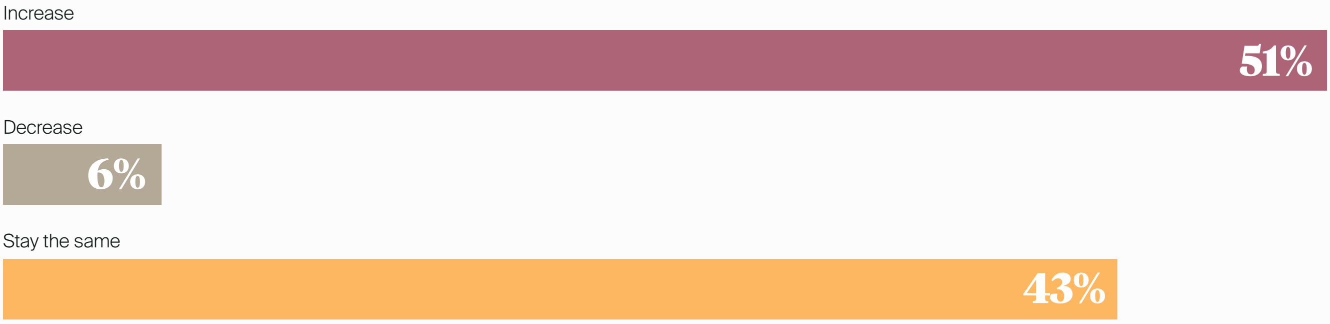
As digital disruption has provided the tools to enable a mobile workforce it has also enabled far greater reach and depth of data collected across the built environment. Again, enhanced by the upheavals of the pandemic the collection, analysis and real time use of this data has become more important. From measuring air quality in real time and reporting to tenants to ensuring continuous OH&S compliance, through to analysing busy times in the lobby and planning ways to make a wait more pleasant, data can enhance experience in many ways.

While pulse surveys will give a company some direction on how often workers want to be at a desk, the reality is that only smart data collection can provide the tools to fully reconcile the actual days used, busy times and types of activities taking place in different locations. With building specific apps set to become almost ubiquitous in the short term the de-identified meta data created will provide a rich source of occupier activity. The potential to then overlay this with internal occupier IT reporting will take the analysis of how and where people work to the next level.

In due course, such technologies could act as the data backbone behind workplace management decisions and if used correctly would boost employee engagement, providing a frictionless experience for the end-users, while simultaneously allowing companies to gain valuable business intelligence, employee satisfaction and space utilisation insights.



Use of data to make real estate and workplace decisions



Source: Knight Frank Research, Y(our) Space

We are seeing more and more companies realising their Real Estate strategies that were essentially theories come to reality. Companies are now adjusting to the new world of working and can visualise what works and what doesn't. Technology and data are now playing the most vital role as it gives insight and guidance as to how much flex and how much space companies really need.

Danny Chan, AVP Switch Australia

Flexibility essential to navigating the fluid landscape

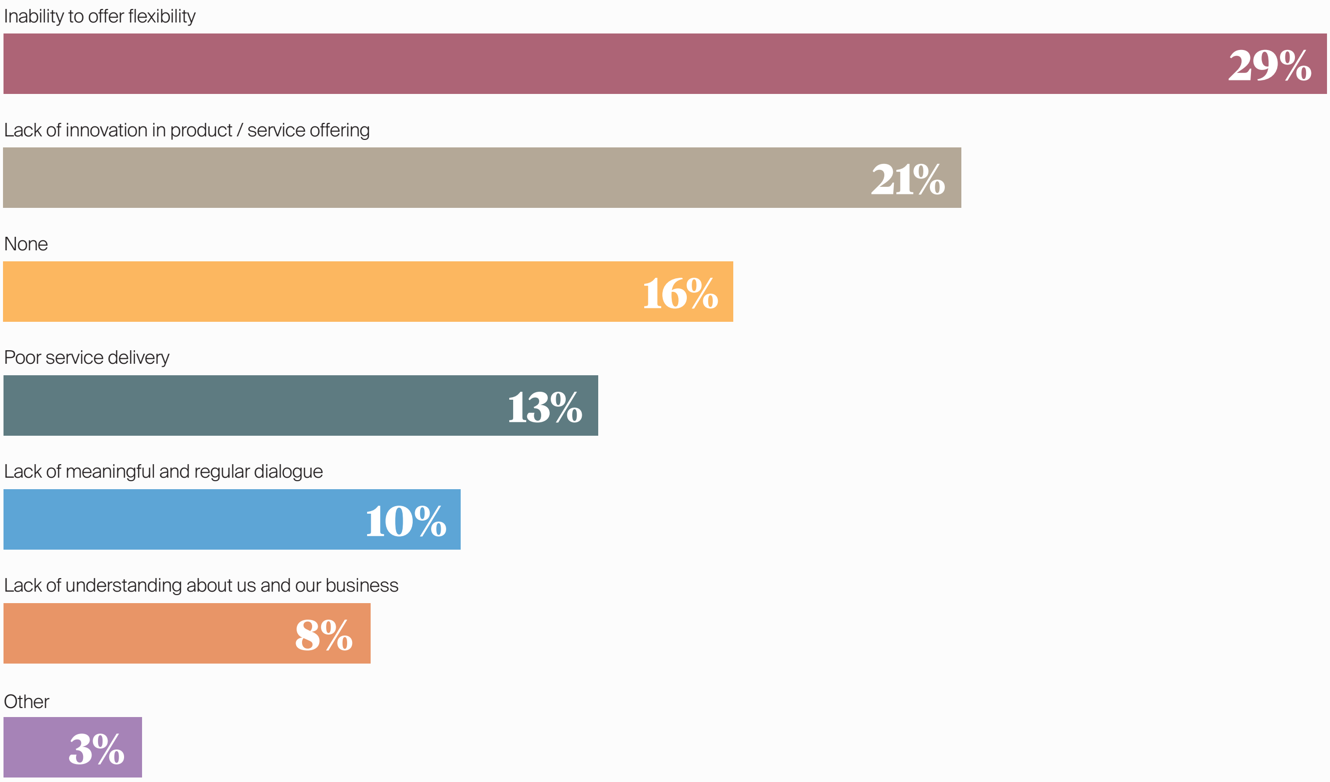
Flexibility has emerged as a key component of successfully navigating the bold changes the world has encountered since early 2020. This has been expressed through the need for employers and employees to embrace unprecedented flexibility in the way that work was achieved once lockdowns were in place. Additionally, the desire from occupiers to seek greater flexibility in their lease agreements and the amount and type of space occupied, already trending towards a more swift adaption to changing needs pre-covid, is being super-charged by the uncertainty and sense of experimentation currently driving corporate decisions.

The Y(our) Space survey of early 2021 indicated that the number one frustration of occupiers was the inability of their landlord/s to offer flexibility. As leasing deal volumes dropped it is true that many landlords responded with flexibility of rolling expiry dates and extensions or being more than usually open to renegotiation of total space taken in exchange for an extended term.

While these responses were targeted at short term decisions it is clear that tenants will require greater flexibility as a matter of course in the longer term, 34% of tenants surveyed by Knight Frank indicated they expected average lease terms to decline (Y(our) Space). This is expected to include greater adoption of expansion and contraction clauses in leases, break clauses and the breaking of tenancies in to core and secondary space. A lease agreement will consist of "core space" with a longer lease term and then a proportion of additional floors considered more flexible with different lease terms and/or break clauses to allow for easier downsizing. While these terms, along with first rights of refusal for expansion space or staged required offerings of additional floors, have long been included in large tenant pre-commitments, this will increasingly be seen in commitments to existing space and across a wider gamut of tenant sizes.

The ultimate flexibility comes from flex space providers and as outlined in Sean Lucas' article, this sector is poised to flourish.

Q: What is your greatest frustration as a customer in global real estate markets (only one allowed)?



Source: Knight Frank Research, Y(our) Space

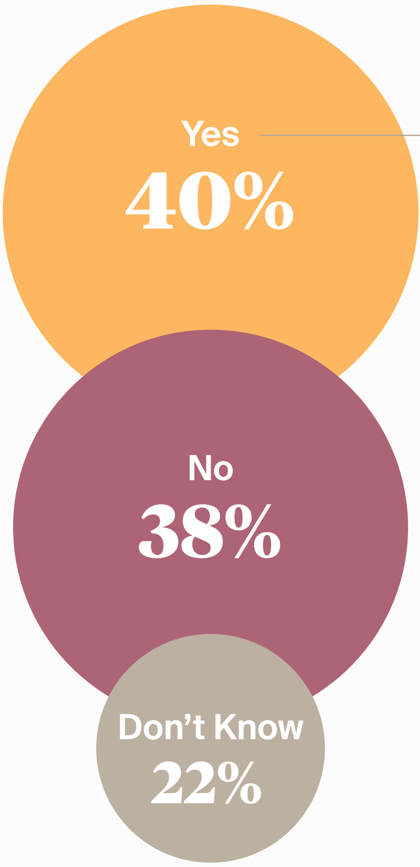
ESG considerations vital for both occupiers and investors

The intensity of focus on climate change and the need to commit to a carbon neutral world has increased markedly over the past two years, with the recent COP26 conference galvanising more countries to commit to a target which will limit future global warming to 1.5 degrees. While the world's largest carbon emitter, China, has pledged to carbon neutrality by 2060 and third largest emitter, India, has a target of 2070 some 137 countries have now committed to a 2050 or earlier timeframe. This makes ESG considerations a necessary part of mainstream business.

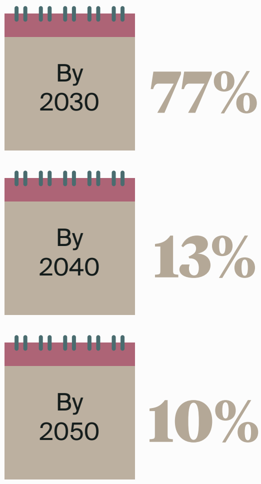
Initially led by tenants and adopted by owners in new assets and refurbishment plans, the focus of environmentally sustainable ratings was to attract and maintain occupancy levels and maximise income returns. Knight Frank's recent survey of global occupiers found that 40% of businesses have a formal net zero emissions target and of those 90% have the target for 2030 or 2040, ahead of the majority of countries.

More recently the necessity for documented sustainable ratings has expanded to include the desire to provide a pool of assets to satisfy the appetite of investors seeking to place funds only where ESG factors are a central focus. Moody's found that global inflows into ESG investments grew by 140%+ between 2019 and 2020, a breakout year from the 14% annual average inflow growth. As the weight of money into these funds have increased and the pool of assets deeper the returns are also more closely mirroring mainstream fund returns.

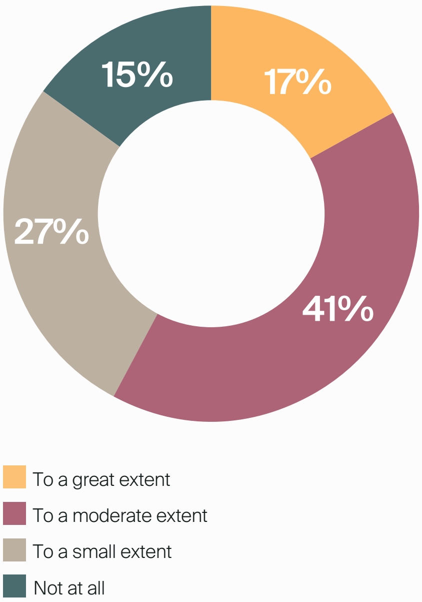
Q: Does your business have a stated net zero carbon emissions target?



Q: If yes, when is the target date?



Q: To what extent do you believe your organisations commitment to becoming net zero carbon will change your real estate choices?



Source: Knight Frank Research, Y(our) Space

Secondary market will be divided by whether an asset can be refurbished and repurposed or not

As outlined above the flight to quality and requirements for highly rated environmental performance will only continue to grow. More than ever secondary assets will need to innovate or risk accelerated obsolescence.

There is expected to be more secondary assets divested by funds which have ESG hurdles to meet. Paradoxically there is also good investor demand for value-add investment to renew secondary assets where they can be adapted and re-tooled to remain relevant. Secondary assets in the right location, with the right size and shape of floorplate and underlying structural and design ability to be retrofitted with cutting edge air handling and building management systems will be well sought. In fact many of these may not reach the open market – instead traded within a stable of funds from the core to the value-add focussed investment vehicles.

Once completed a renewed or refurbished building which also has strong Green credentials is an asset in demand from ESG funds. The recent renewal of the Midtown Centre in Brisbane is an example with the re-purposing of two outdated 1980's high-rise buildings by joining them together and adding seven levels on top, created some of the largest floorplates in the Brisbane CBD, but also achieved significant sustainability targets. By retaining the bulk of the old structure this has been deemed to be 231% environmentally friendlier than a demolish and rebuild option, representing a 37% reduction in carbon creation than a new build would represent. This represents 11,000 tonnes worth of carbon dioxide savings which translates to the building being carbon neutral when fully occupied and operating for 4 years. Retrofitting with leading technologies on water and air quality has also allowed the building to achieve a Gold WELL classification.

Before:

Two outdated secondary asset to be re-purposed into one building

After:

Midtown Centre: 1,800 - 2,000 sqm, 5 Star NABERS energy rating, carbon neutral, Gold WELL class office tower.

Flexible space leveraging on the shifting shape of demand

By Sean Lucas,
Director Client Solutions & Flexible Real Estate,
Knight Frank Australia.

The past 18-months, if nothing else, have been challenging. Social isolation, border closures, the pressures of home schooling, increased workloads, burn-out and a general and persistent sense of uncertainty have all run as common threads of the same ugly sweater. Yet through this challenging period, previously unconsidered or overlooked norms have been closely revaluated and priorities reassessed.

The trend away from office centricity was already occurring and set to gradually increase but has been significantly accelerated. The pandemic created a distinct shift in how office-based workers viewed the workplace, and beyond the initial shock, most organisations adapted quickly and efficiently to enable the vast majority of their staff to work exclusively from home in March of 2020.

The flexible office sector was one of the industries most disrupted by the pandemic. Flex operators found themselves severely impacted, with occupancy levels falling precipitously due to the nature of their short-term agreements, resulting in deteriorating revenue and profitability.

However, like airline share prices, flex spaces may have taken the lift down but at the very least are on a reasonably fast escalator on the way back up. We are observing a robust recovery across leading local and global operators with occupancy levels anecdotally at or above pre-COVID levels in Perth, Adelaide and Darwin and accelerating rapidly in Sydney and Melbourne, particularly across suburban locations.

Pre pandemic, the rise in demand for the flexible workspace sector offering was already advancing due to digital disruption. This stalled during the pandemic and in particular, for the core CBD's around the world as the uncertainty of commuting and close contact remained high, however, the city fringe and suburban network demand remained strong. We are now at an inflection point with demand in both central and suburban locations increasing and expected to rise to new levels and in particular with large corporates as they manage employee demand v's expectations when considering what the new world of work will look like, not only in the next 12 months but the next few years and beyond. If nothing else, the last two years have shown us that planning for disruption is a must and building in some form of flexibility to workplace strategy is not a consideration anymore, it is a must going forward.

Damien Sheehan, Country Head IWG

Demand emerging from new sources

Small and medium sized businesses, some of which let their direct leases expire during the uncertainties of the lockdowns are increasingly looking to the flexible workspace market for a low CAPEX, turn-key solution to allow their staff to return to a central location.

Similarly, many large organisations such as GSK, Novartis and Amgen have found that the binary choice of WFH or head office is often insufficient. These companies are turning to service providers to support flexibility with network membership solutions or smaller private suites to provide third space touchdown options to their staff. Thus, blended deals across direct and flex space will become even more mainstream with the importance of an in-building or in-portfolio flex offering to continue to grow.

Flex clients demanding a broader offering

The demand for more flexible solutions, increasingly in key suburban and regional centres, has seen new facilities open in Joondalup (Liberty), Surry Hills (The Commons), Newcastle and Brookvale (WOTSO). To provide a wider range of accommodation options Hub Australia and WOTSO have recently made their reciprocal membership arrangements permanent to give members a far broader coverage of CBD and non-CBD spaces. This may herald additional joint ventures or reciprocal arrangements as culturally aligned flex operators seek to provide the greatest possible range of offerings.

Demand for space from flex office providers is currently strong, but quite specific, with a desire to go premium or suburban/regional, or potentially both, with commitments recently in premium space for Work Club (200 George St Sydney CBD), Hub Australia (Church Street, Richmond), IWG via their Spaces brand (1 Dennison St, Nth Sydney and Parramatta Square) and Workplace365 (60 Station St, Parramatta) The structure of many of these deals have also seen a significant paradigm shift, as while direct leases are still occasionally being undertaken, increasingly partnership or management agreement structures are favoured, which may include services to the building beyond just the flex space occupied and allows both the landlord and operator to share in the upside of a successful location. At the same time operators are pivoting out of secondary or sub-performing space where the location or fit out has not kept pace with evolving user requirements.

Flex space will assist the workplace evolution

At their core, the best flex space and coworking locations provide great service, foster community, and create a place for a diverse range of individuals and groups to meet, connect and ideate. The "servicification" and "hotelification" of the office is now well underway and forward thinking tenants and landlords alike, are seizing on this period to re-think and explore the role of the workplace as a strategic lever to attract, retain and empower their employees.

Throughout the post-pandemic return-to-office as organisations test, analyse, and revise hybrid and work from anywhere models, assumptions will be tested, and work patterns will continue to evolve. By the very nature of autonomous work, there can be no one size fits all solution and flexspace will offer an increasingly broad suite of options to help organisations and individual employees alike adapt and flourish.

Residential trends:

Robust residential

By Michelle Ciesielski
Knight Frank Australia.

Five key trends residential developers should have on their radar

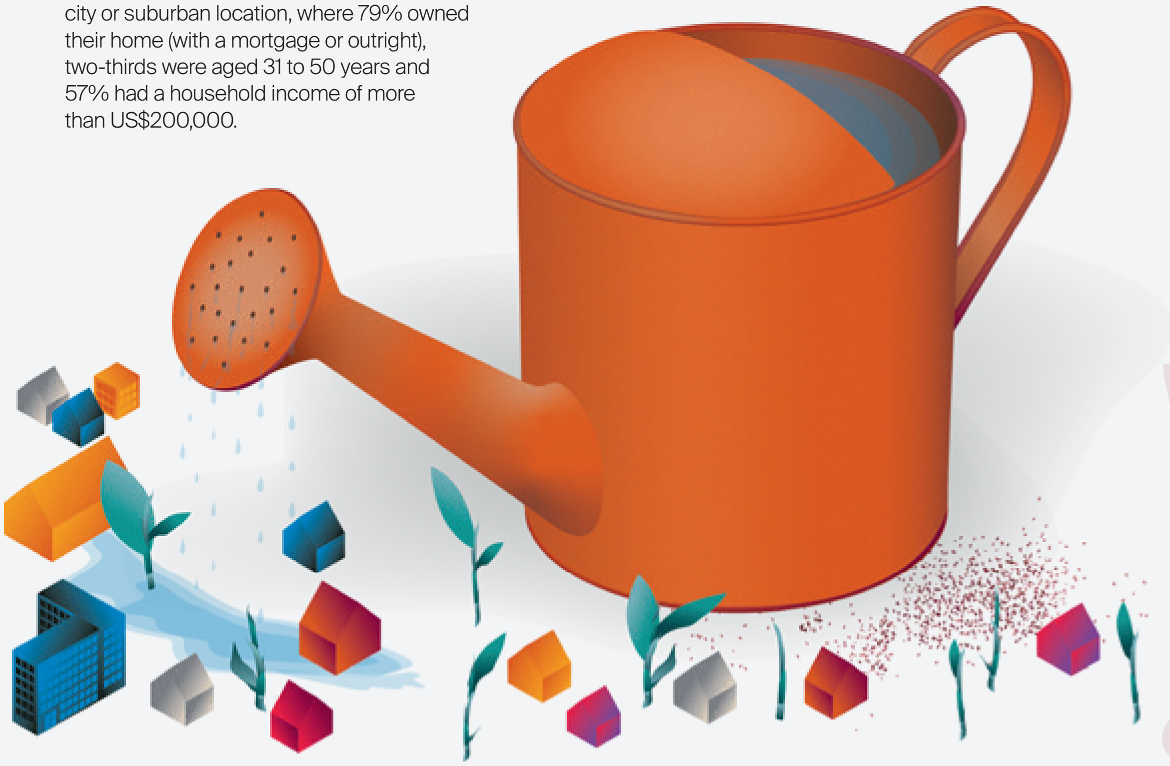
Every challenge presented since the start of the pandemic, has seen an opportunity being created across the Australian residential market. Extraordinarily, many buyers have considerably larger budgets than before this time, with more seeking greener living and with travel back on the agenda, more service provisions for wealthier buyers. However, the supply side is not keeping pace and buyer angst is likely to linger as the number of new apartments being built in prime regions over the coming years continues to diminish with increasing competition from Australian's living at home and abroad.

For the second consecutive year Knight Frank set out to understand residential property buyers' intentions and motivations resulting from the pandemic, within the Global Buyers Survey, and this year we are delighted to take a deeper dive and publish the Australian respondents' results. Alongside the breadth of our primary research captured across the Australian residential market throughout the year, we have been able to establish five key trends residential developers should have on their radar.

Global Buyer Survey 2021

Represents the views of over 900 Knight Frank clients across 49 countries and territories. The survey was conducted between 10 June and 22 July 2021.

Of the Australian respondents, 95% lived in a city or suburban location, where 79% owned their home (with a mortgage or outright), two-thirds were aged 31 to 50 years and 57% had a household income of more than US$200,000.



One:
Magnified spending power

One in three Australian clients surveyed (33%) in the Global Buyer Survey say their spending power has increased since the start of the pandemic. This was above the global average of 24%, and reflected data from Moodys mid-year, which reported over US$5.4 trillion has been amassed globally due to enforced lockdowns.

Around 19% of Australian respondents say their spending power has declined (26% globally), and 58% felt their budgets had remained the same. Compared to other regions globally, Australasians have seen the biggest rise in their budgets, while African respondents the biggest decline.

More than three-quarters of Australian survey respondents expect the value of their current home to increase in the next year (83%) – significantly higher than the two-thirds of global respondents – with most expecting a rise of between 1% and 9% over the 12-month period.

Only 5% of respondents expect the value of their home to decline over the same period, compared to the 14% global average. This contrasts to 2020 when 56% of respondents expected prices to soften.

This positivity reflects the strength of current market momentum. Over the 12 months to June 2021, the Australian mainstream residential market has experienced values rising by 16% while the prime luxury market grew by 6%. Over the same period the Australian stock market regained momentum with a rebound of 25% following a downturn in the early stages of the pandemic.

Other luxury assets also appreciated with the Knight Frank Luxury Investment Index growing by 3% in value in this time. Wine was the best performing with 13%, as watches grew by 5%, followed by cars at 4%.

History tells us that a large portion of created wealth is redirected back into the property market, so this stimulus is likely to have a lasting effect in the coming year.

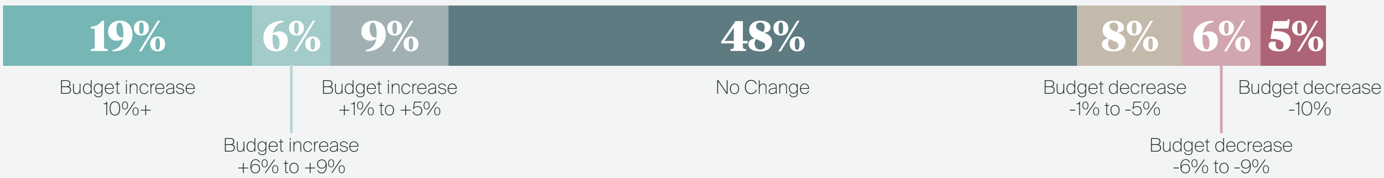
Wealth creation over the past year
Year ending June 2021, percent (%) annual growth

Aust. mainstream residential	16%
Aust. prime residential	6%
Aust. stock market	25%
Wine	13%
Watches	5%
Cars	4%

Source: Knight Frank Research

Q: How has your budget changed since the start of the pandemic?

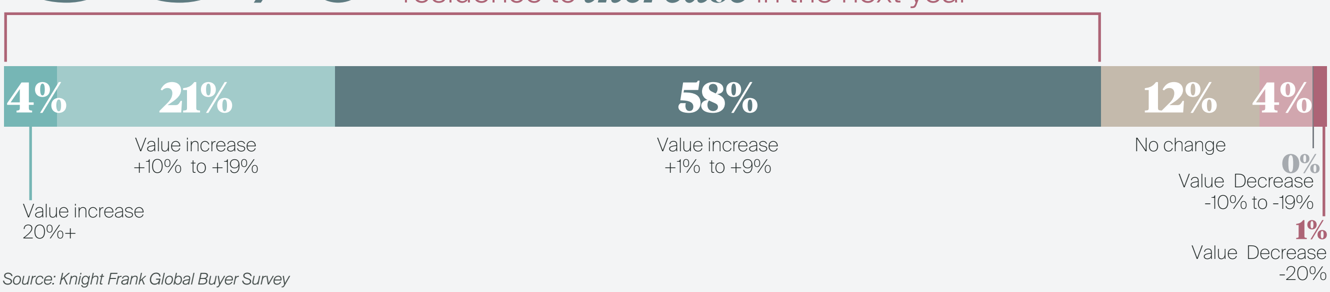
48% of Australian respondents say their ***budget is unchanged*** since the start of the pandemic



Source: Knight Frank Global Buyer Survey (Figures may not add up to 100% due to rounding)

Q: In your view how do you think the value of your primary residence will change in the next 12 months?

83% of Australians surveyed ***expect the value*** of their primary residence to ***increase*** in the next year



Source: Knight Frank Global Buyer Survey

Two:
Greener sustainable living

The Global Buyer Survey also revealed that health and wellbeing are uppermost in Australian buyers' minds. In terms of the location, proximity to green space (63%), good air quality (56%) and a good outlook with a view of the ocean, mountain range or skyline (51%) were the factors respondents considered most important when choosing where to live once restrictions end.

Consciously reducing our ecological footprint is a growing aspiration for many. As buyers have become increasingly wealthier over the last year, there has never been a better time for developers to integrate sustainable living initiatives into new homes across the country.

When asked about a future residential purchase, three-quarters of Australians say the energy efficiency of a home is important (48%) or very important (26%) to them.

The rise in importance of sustainable living present a significant opportunity for developers to evolve and differentiate their offer, but it may be overshadowed in the near term given the escalating cost of building materials delayed within the global supply chain and an ongoing shortage of skilled labour.

When asked what would motivate Australian buyers to buy an energy efficient home, the responses were mixed. One in five respondents say they would be more likely to buy an energy efficient home if future environmental regulations had a direct impact on its value.

Around 22% would prefer a greener home and would be willing to pay a premium for it, whilst the same consider the green finance element, and the prospect of cheaper mortgages, a motivating factor. One-third of respondents said the energy efficiency of a home would not influence their purchase decision. Of the 'other' respondents, ongoing costs in the form of lower energy bills were cited as a motivating factor.

Investors and corporates have arguably picked up the baton first, driven by heightened public awareness and increasing demands from shareholders to respond to ESG concerns pro-actively. For residential buyers, the bottom line is what matters. Cheaper, greener mortgages, or regulation-induced price inflation for the most energy efficient homes will be what tips the balance for the end user.

Globally, recent climate events, a spate of net zero carbon pledges from governments following the UN's climate change conference, COP26 in Glasgow, Scotland, shine a light on the significant role housing and the real estate industry as a whole has to play. More regulation and greater competition could be good news for Australian buyers keen to embrace greener, sustainable living.

Q: Thinking about a future purchase, is the energy efficiency of a home important to you?

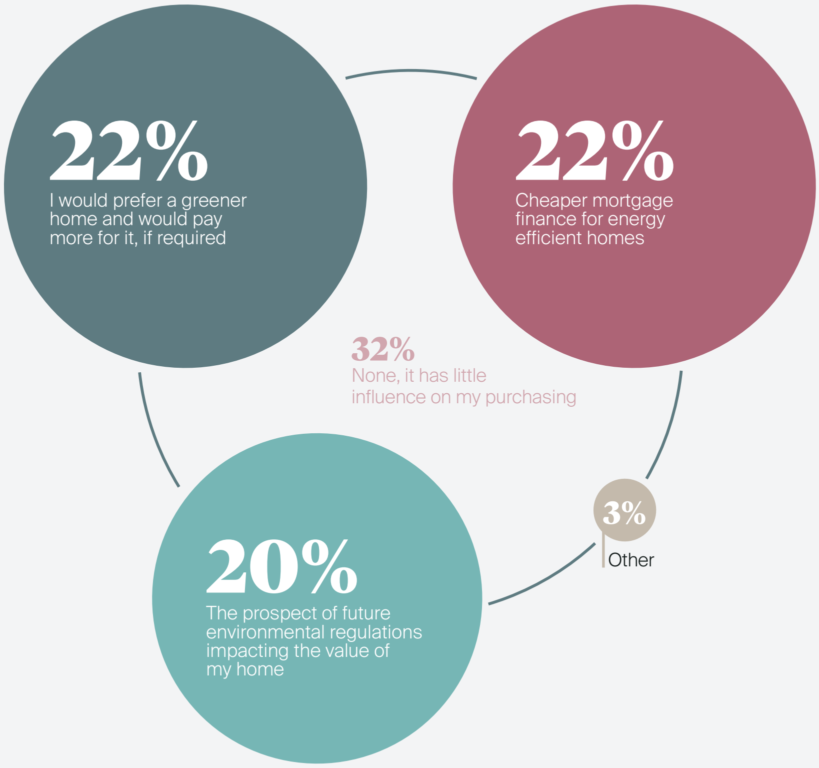
74%

of Australians surveyed say the ***energy efficiency*** of a ***future home is important*** or very important to them

Important = 48%
Very important = 26%

Source: Knight Frank Global Buyer Survey

Factors leading to Australian's buying more energy efficient homes in the future
% of respondents (Multiple responses permitted)



Source: Knight Frank Global Buyer Survey (Figures may not add up to 100% due to rounding)

Three: Paucity of luxury apartments as cities mount a comeback

The 'race for space' has grabbed headlines globally but cities look to be mounting a comeback. In Australia, of those respondents that are more inclined to move in the next 12 months, 42% are looking at a city location and 15% are moving for downsizing, or retiring, reasons.

Although more Australians have been confined to home since early 2020, one in five surveyed believed they were more likely to adopt apartment living post pandemic. Newly built, or off-the-plan high-rise prime apartments, have seen strong price growth of 36% since June 2015, outperforming both the Australian stock market (34%) and the established prime apartment market (31%) across the major cities in June 2021.

The Rightsizing 2022 report also found an upward momentum in prime established apartment sales volume continues. History has shown this tends to lead to further price growth, bolstering the outlook for the prime luxury apartment market over the coming year.

The first quarter of 2021 saw all five major Australian cities record positive annual growth in sales volume, only the third time this had occurred over the past ten years. We then saw for the first time, a second consecutive quarter of growth and this time collectively all cities recorded a strengthening upward trajectory.

Against this backdrop, concerns are looming of under-supply in our cities. The total number of apartments in low-rise, mid-rise, and high-rise projects averaged 26,040 a year, across Australia's major cities since 2015. This is expected to fall by 39% over the next three years when considering those projects currently under construction, being marketed and are possible to be built within this timeframe, and the contraction is led by Australia's largest three cities – Sydney, Melbourne and Brisbane.

Bucking the trend are Perth and the Gold Coast. Both cities welcome their modestly elevated number of new apartments in the pipeline following a chronic level of undersupply and additionally for the Gold Coast, a rising population drawn to the relative value and balmy lifestyle.

“

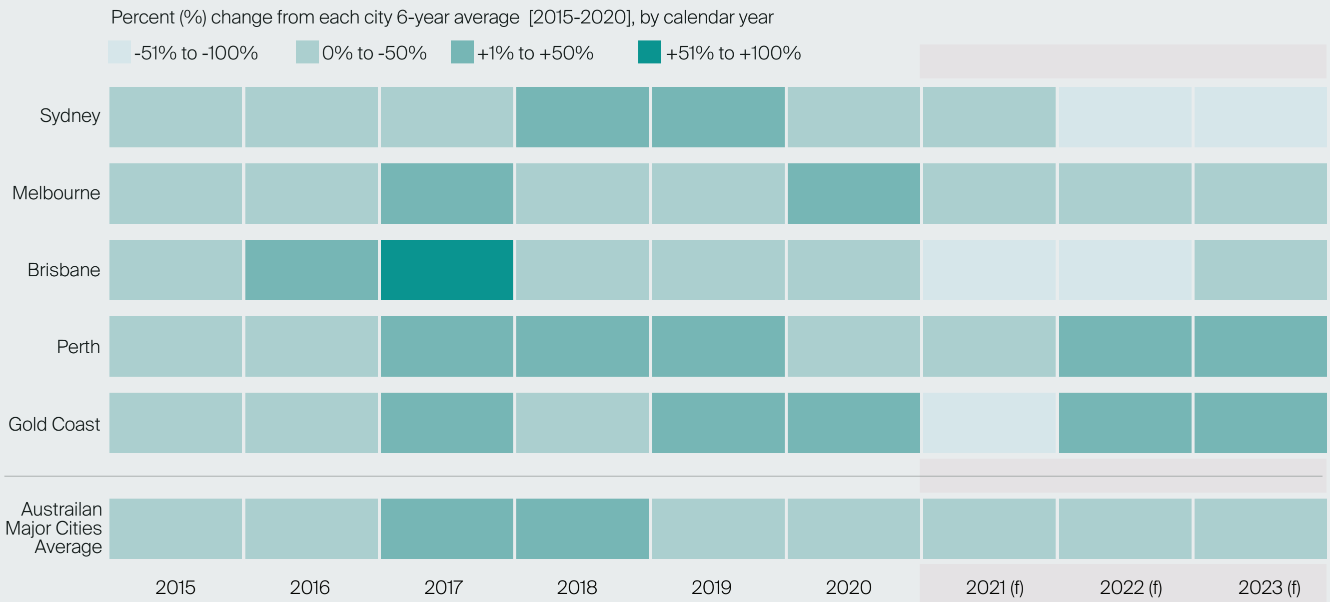
Prime (luxury) residential property is the most desirable and most expensive property in a given location, generally defined as the top 5% of each market, by value. Prime residential sales hold a $3m threshold in Sydney and Melbourne and $2m in Brisbane, Perth and the Gold Coast.

Price performance over the past year
Year ending June 2021, Percent (%) annual growth

Australian new apartments	**36%**
Australian stock market	**34%**
Australian established apartments	**31%**

Source: Knight Frank Research

Pipeline delivery of apartments in low-rise, mid-rise and high-rise projects across prime regions in major cities



Source: Knight Frank Research

Four:
Concierge and branded residences becoming increasingly appealing

Despite living through multiple lockdowns throughout a global pandemic, the concept of living in a luxury apartment in the sky, with house-like proportions, is still an aspiration for many across Australia as reported in the Knight Frank Rightsizing 2022 report.

Some may have felt the need to pause or delay their purchase over lockdown, to await confirmation of changing work patterns or to simply reassess their lifestyle, but they haven't been deterred as for many, the intention is still there to 'make the move' to a low maintenance way of living. Others are keen to get their passport out to travel to their second homes located around the world and are attracted to the ease of lock-up-and-leave when residing in a secured apartment residence.

The pandemic has induced the possibility of a co-primary home, where the second (holiday) home is now being treated as much equal to a primary home, as the main residence. As business activity picks up in the city centres, an apartment bolthole in the city is increasingly becoming an option for those who have become accustomed to spending more time in their coastal or country homes.

As the number of Australian ultra-wealthy individuals are expected to grow by at least 20% by 2025 according to The Wealth Report, so will the demand for luxury apartments with high levels of serviceability and little maintenance.

Within the Global Buyer Survey, we had the opportunity to deep dive and test the Australian buyer appetite for the branded residence product given the lifestyle the hotel-led development delivers. We found that 44% of Australian respondents would be willing to pay a premium to purchase a property in a branded residence development, ahead of the 39% global average.

Branded residences are also considered a safe investment to lock-up-and-leave with many hosting a 24-hour concierge and butler service – both attractive features now that regular travel is back on the agenda. As the branded residence segment is undergoing rapid growth and evolution, these factors play a big part in shaping the future of new developments.

Not only will this strengthen the selling of the development as a place of primary residence, but it will also improve the potential to increase in value and act as high-yielding investments for the long term. When considering rightsizers, developers throughout Australia will need to investigate more ways to differentiate the services and amenities they provide, and a branded residence can deliver this opportunity.

> ***Branded residence:***
> ***A hotel-led development with integrated or linked residences, benefitting from the hotel brand, its management and luxury services.***

Q: Would you be willing to pay a premium to purchase a property in a branded residence development?

44%

of Australian respondents said ***yes***

Source: Knight Frank Global Buyer Survey

One Barangaroo Penthouse Entry

One Barangaroo Porte Cochere

Five:
Expats influential source of property demand

Although only 5% of the Global Buyer Survey respondents define themselves as expatriates, this segment of the global workforce has been an influential source of property demand since the start of the pandemic.

The survey results confirm that the United States, Singapore, Hong Kong SAR, the United Kingdom and the Philippines were the key locations our expatriate respondents were based in prior to the pandemic.

For those that returned home, a desire to be closer to family (36%) was the biggest motivating factor, followed by an improved quality of life (24%) and a change in employment circumstances (16%).

Several acted quickly to avoid lengthy lockdowns in their host country or territory, whilst others have been prevented from returning home so instead relocated to an intermediary location they deemed safer. For those based in emerging markets there were concerns around quality healthcare and their ability to access the vaccine.

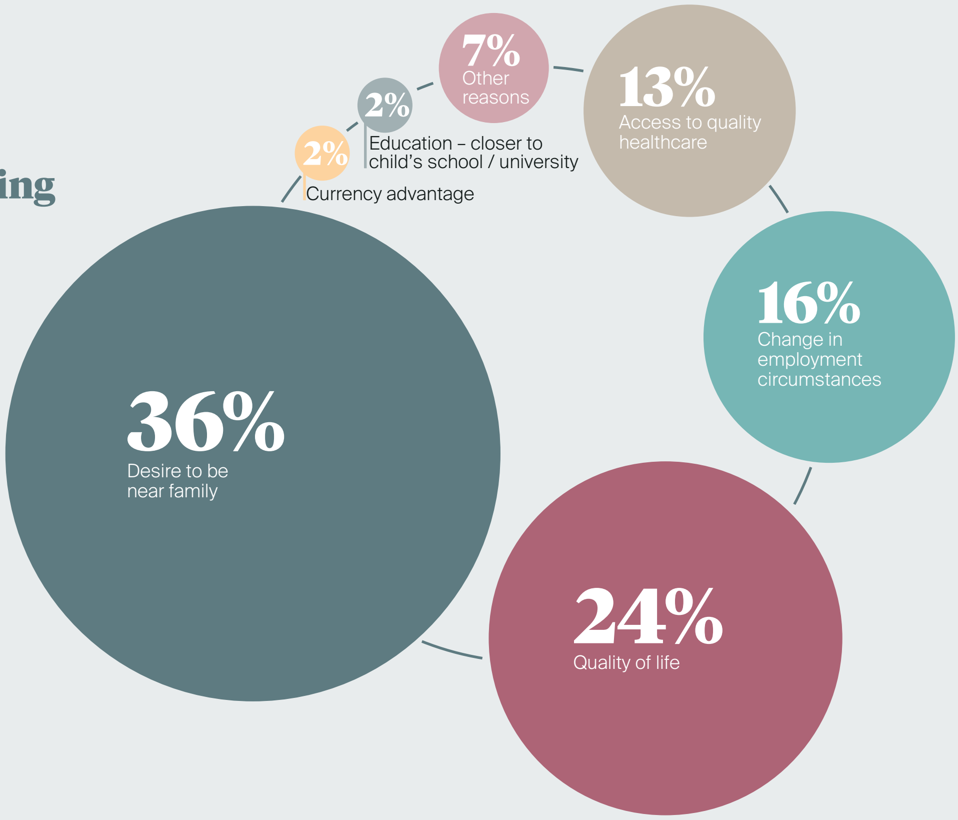
The uptick in demand identified in prime residential sales was supported by the survey results. Some 39% of expatriate respondents have bought a property since returning home. Around 20% purchased a primary residence, 7% a second home and for 11% it will be a co-primary home which they may retire to in the long term. For 43% of the respondents, they already had a home to return to and 18% opted to rent.

Perhaps most surprising is the propensity of the expatriates surveyed to work abroad again once the crisis is over. This may be borne out of a desire to travel, experience new cultures or potential tax benefits. Some 68% said they plan to work abroad again with 23% unsure and only 9% deciding to stay put.

Q: What was your motivation for returning home?
% of respondents (Select one anwser only)

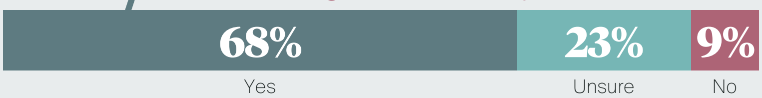
Proximity to family was a key driver for expatriates in deciding to return home.

Source: Knight Frank Global Buyer Survey



Q: Do you plan to work abroad/overseas again once the pandemic crisis is over?

Over 2/3 of expatriate respondents said ***yes***, they ***plan to work abroad/overseas*** again once the pandemic crisis is over



Source: Knight Frank Global Buyer Survey

Q: On returning home, have you purchased a property?

39% of expatriate respondents have ***purchased a property*** when returning home

**(a second home that may become a primary residence long-term)*

Source: Knight Frank Global Buyer Survey (Figures may not add up to 100% due to rounding)

Residential outlook

Mainsteam residential outlook

% annual growth

	2020	2021	2022 (f)
Australia	5%	18%	8%
Sydney	4%	22%	7%
Melbourne	3%	17%	8%
Brisbane	5%	19%	8%
Gold Coast	7%	22%	11%
Perth	7%	13%	7%
Adelaide	7%	14%	6%
Hobart	10%	23%	7%
Canberra	6%	22%	8%
Darwin	2%	17%	8%

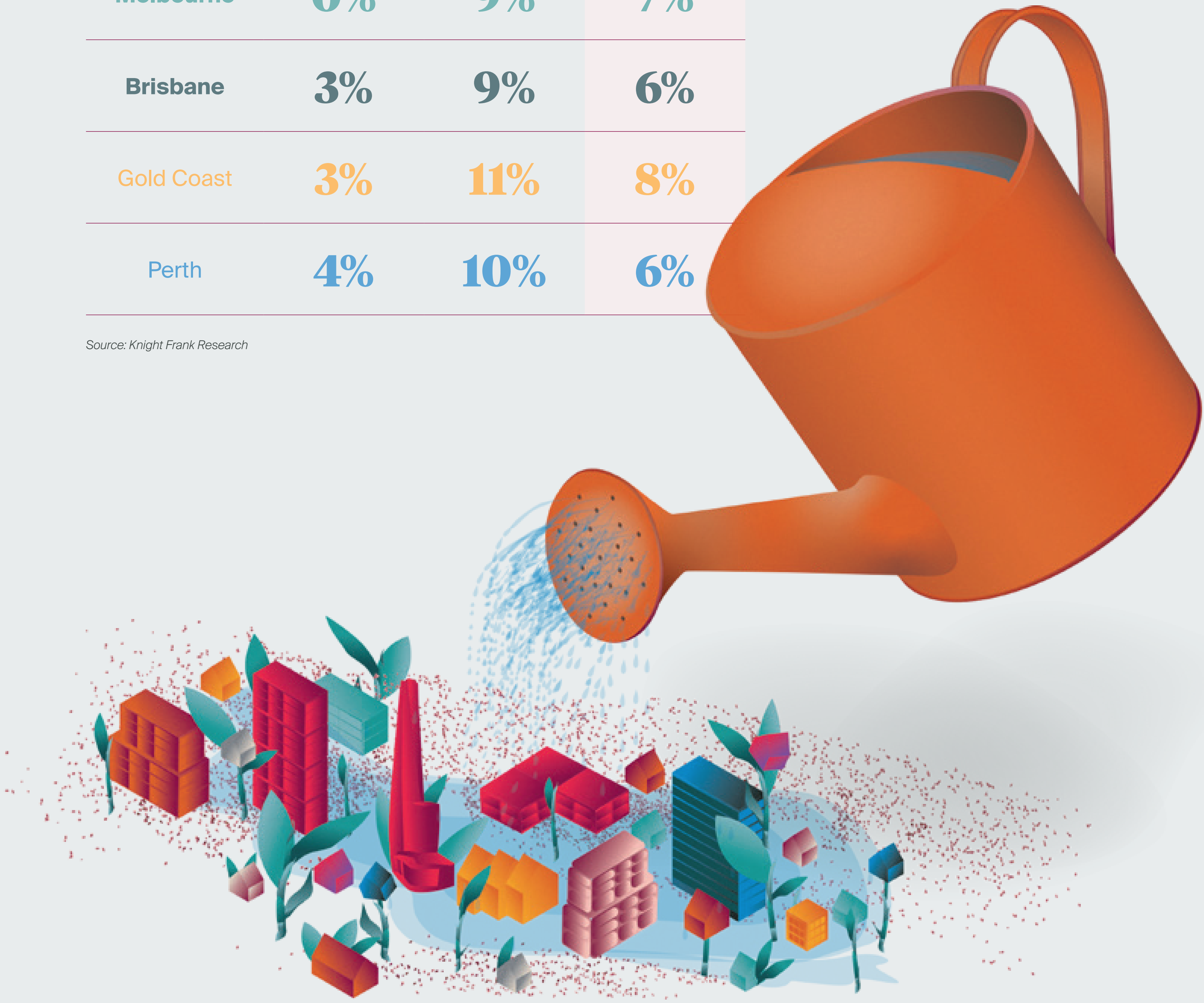
Source: Knight Frank Research

Prime residential outlook

% annual growth

	2020	2021	2022 (f)
Australia	2%	11%	8%
Sydney	1%	12%	9%
Melbourne	0%	9%	7%
Brisbane	3%	9%	6%
Gold Coast	3%	11%	8%
Perth	4%	10%	6%

Source: Knight Frank Research

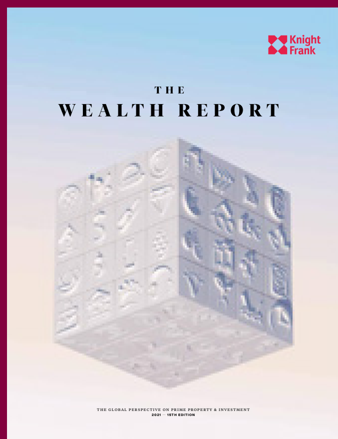


Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

Other recent market-leading research publications

ACTIVE CAPITAL
October 2021

(Y)OUR SPACE
April 2021



THE WEALTH REPORT
15th Edition 2021

URBAN LOGISTICS
July 2021

GLOBAL BUYER SURVEY 2021
August 2021

Knight Frank Research Reports are available at **knightfrank.com.au/research**

CAPITAL MARKETS

Paul Roberts
Partner, Head of New South Wales
and National Head of Capital Markets
+61 411 363 544
Paul.Roberts@au.knightfrank.com

INSTITUTIONAL SALES

Ben Schubert
Partner, Head of Institutional Sales, Australia
+61 403 195 424
Ben.Schubert@au.knightfrank.com

INDUSTRIAL

Darren Benson
Partner, National Head of Industrial Logistics
+61 403 722 104
Darren.Benson@au.knightfrank.com

LEASING

Andrea Roberts
Partner, National Head of Leasing
+61 410 628 024
Andrea.Roberts@au.knightfrank.com

OCCUPIER SERVICES

Office
Theo Smyrniotis
Partner, Head of Occupier Services, WA
+61 417 580 936
Theo.Smyrniotis@au.knightfrank.com

Industrial
James O'Neill
Partner, Occupier Services
+61 401 701 158
James.Oneill@au.knightfrank.com

ASSET MANAGEMENT SERVICES

Lisa Atkins
Partner, National Head of Asset Management Services
Lisa.Atkins@au.knightfrank.com

PROJECT MANAGEMENT

Andrea Brown
Partner, National Head of Project Management
+61 410 806 370
Andrea.Brown@au.knightfrank.com

BUILDING CONSULTANCY

Chris Barker
Partner, Head of Building Consultancy
+61 404 203 579
Chris.Barker@au.knightfrank.com

WORKPLACE

Claire Moran
Partner, Head of Workplace
+61 404 892 742
Claire.Moran@au.knightfrank.com

VALUATION & ADVISORY

Al Carpenter
Partner, National Head of Valuations & Advisory
+61 438 178 182
Al.Carpenter@au.knightfrank.com

PRIVATE OFFICE

Kymbal Dunne
Partner, Joint National Head of Private Office
+61 419 992 068
Kymbal.Dunne@au.knightfrank.com

Sarah Harding
Partner, Joint National Head of Private Office
+61 400 222 242
Sarah.Harding@au.knightfrank.com

RESIDENTIAL

Shayne Harris
Partner, Head of Residential, Australia
+61 2 9036 6713
Shayne.Harris@au.knightfrank.com

RESEARCH & CONSULTANCY

Ben Burston
Partner, Chief Economist
+61 452 661 682
Ben.Burston@au.knightfrank.com

Knight Frank

knightfrank.com.au/2022outlook

Knight Frank