Three unresolved problems in commercial real estate

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Coming to me as it did after almost a decade's absence from the academic profession, I accepted this invitation only with trepidation. While the profession has been extending the frontiers of economics, I have been operating deep within its margin…

• Alfred Kahn – Applications of Economics in an Imperfect World:
  • American Economic Association
Three unresolved problems

1) Incentives
2) Cycles
3) Bubbles

Source: JLL Research
Australian office markets: bargain basement?

Prime office yields, 2002 to 2014

Source: JLL Research
Office incentives, vacancy rates and rents
Global office markets – 2Q 2015

Incentives vs vacancy rates

Face and effective rents

# % of lease term

Source: JLL Research
“…we have to compare forecasts across Asia and also globally.

Australia market practice is somewhat unique, as yields are quoted on a pre-incentive basis, whereas for the rest of the markets in Asia yields are on a net effective basis.

Do you have the time series for net effective yields for Australia … otherwise, I’ll just take the

Net Effective Rent/ Capital Value

to derive the effective yield? “
Incentives – permanently higher?
Sydney CBD incentives 1987 to 2015 (quarterly data)

![Graph showing the relationship between vacancy and rent free months from 1987 to 2015. The R² value for the linear fit from 1987 to 2008 is 0.9212.](image-url)

Source: JLL Research
The incentive conundrum

1) Why are incentives so high in Australia?
2) Why do we have incentives at all?
3) Why do lease structures differ between global markets?
4) Post 2007 has the vacancy/incentive trade-off permanently changed?
5) What is the impact of incentives on investment returns?
6) What does a level global playing field look like?

Source: JLL Research
# AP office yields: a level playing field

<table>
<thead>
<tr>
<th>Office markets</th>
<th>Market yield 1Q 2015 (%)</th>
<th>Lease Term (Years)</th>
<th>Rent Escalation (%)pa</th>
<th>Long-term Inflation (%) p.a.</th>
<th>Incentives (Months’ rent free)</th>
<th>Adjusted yield (%)</th>
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<tbody>
<tr>
<td><strong>Australian CBD markets</strong></td>
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</table>

Source: JLL Research
Three unresolved problems

1) Incentives
2) Cycles
3) Bubbles

Source: JLL Research
The construction/withdrawal cycle
Sydney CBD completions & withdrawals 1980 to 2014

The withdrawal/completion ratio 1980-2014 (%)

<table>
<thead>
<tr>
<th>Region</th>
<th>Ratio</th>
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<td>Sydney</td>
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<tr>
<td>Canberra</td>
<td>31</td>
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</table>

Source: JLL Research
The office market construction/withdrawal cycle

1) The driver: strong or weak market – or both?
2) What is the “natural” CBD vacancy rate (still 6%-7%?)
3) Are “replacement cost” and “economic rent” useful concepts?
4) Do we need an option model of CBD land values?

Source: JLL Research
Three unresolved problems

1) Incentives
2) Withdrawals
3) Bubbles

Source: JLL Research
The “bubble” problem
http://www.weforum.org/reports

1) World Economic Forum project
2) Phase 2 – focus on case studies
3) Partnering with universities and global organisations
4) Target audience
5) Case studies as an education tool?
Thank you

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