



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

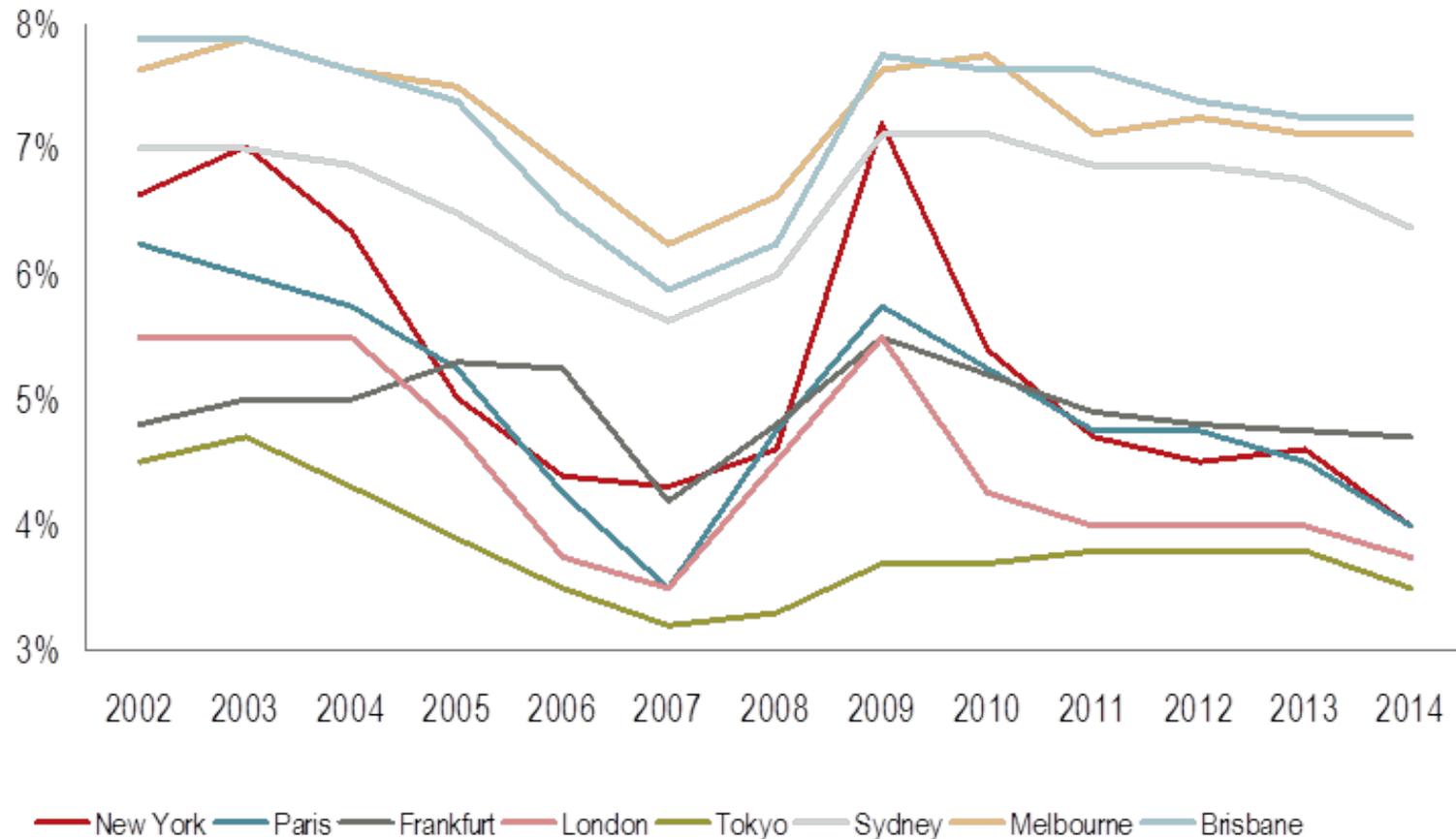
2) Cycles

3) Bubbles

Source: JLL Research

Australian office markets: bargain basement ?

Prime office yields, 2002 to 2014

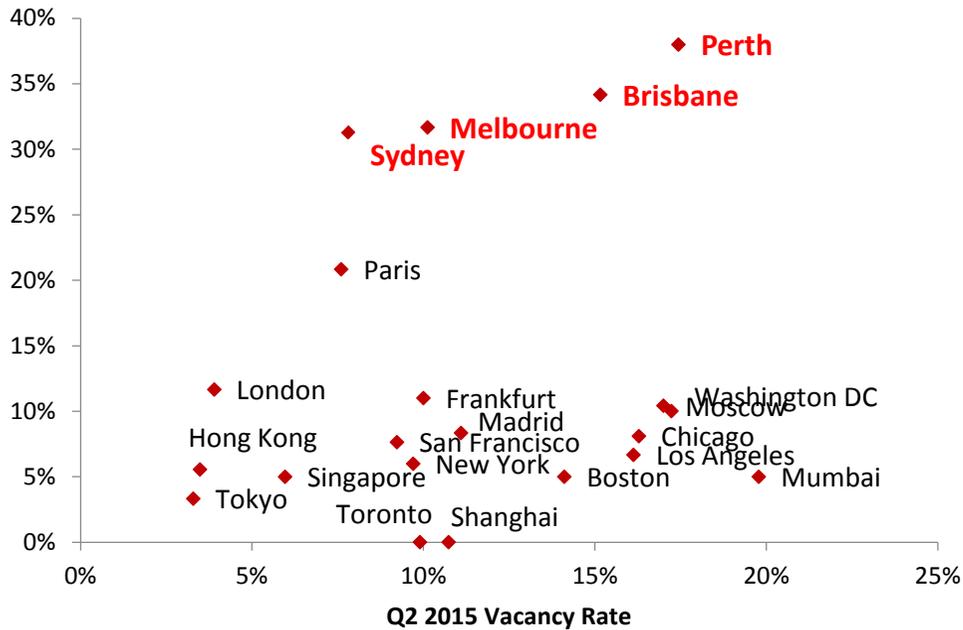


Source: JLL Research

Office incentives, vacancy rates and rents

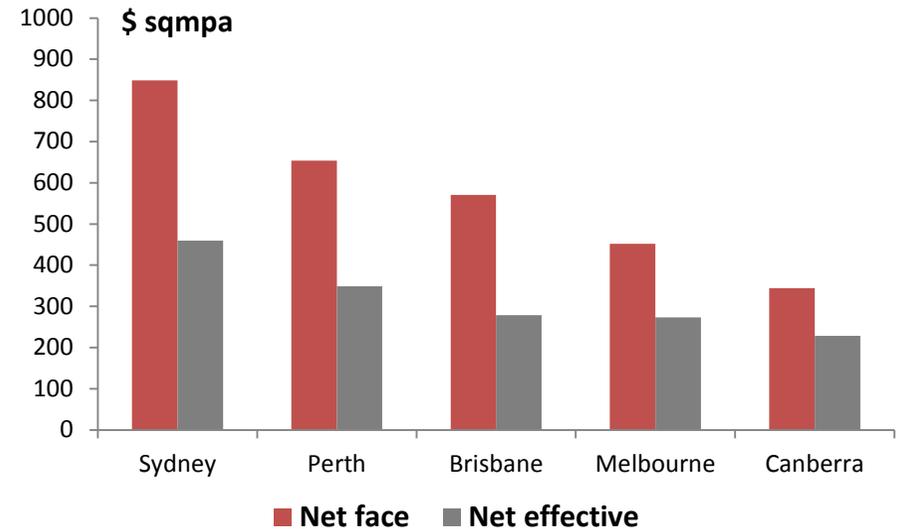
Global office markets – 2Q 2015

Incentives# vs vacancy rates



% of lease term

Face and effective rents



Source: JLL Research



Mind the gap...high yields can backfire

Turning 6.125% into 3.95%

"...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

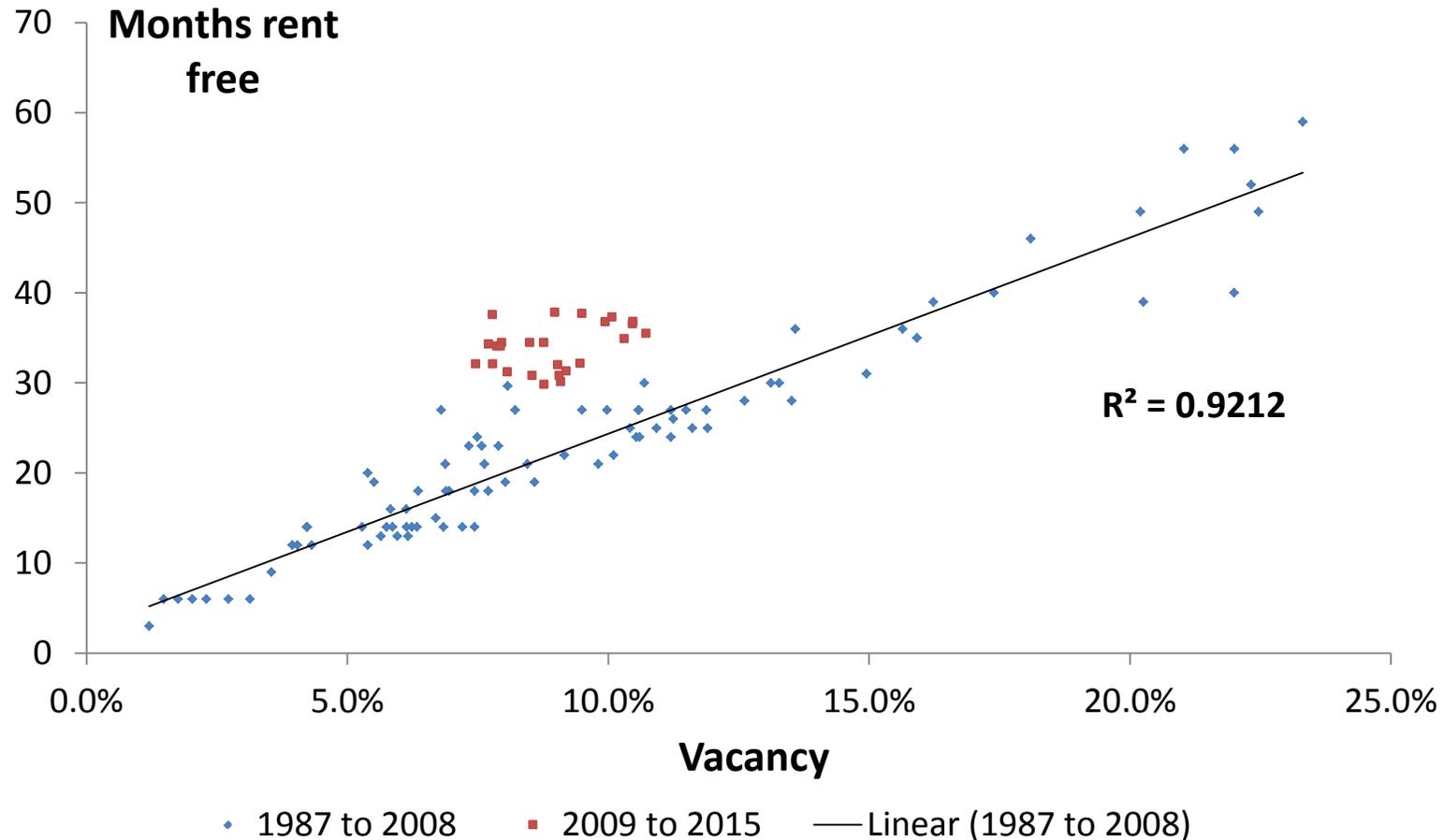
Net Effective Rent/ Capital Value

to derive the effective yield? "

•Global investor in Australia – 4 September 2015

Incentives – permanently higher?

Sydney CBD incentives 1987 to 2015 (quarterly data)



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



Office markets	Market yield 1Q 2015 %	Lease Term Years	Rent Escalation (%pa)		Long-term Inflation % p.a.	Incentives (Months' rent free)		Adjusted yield %
			Current lease	Future leases		Current lease	Future leases	
Australian CBD markets								
Sydney	6.13	10	4.0	3.5	2.5	38	24	5.37
Melbourne	6.63	10	3.8	3.3	2.5	38	24	5.53
Brisbane	7.25	10	3.8	3.5	2.5	40	22	6.14
Adelaide	7.75	10	3.3	3.0	2.5	33	24	6.25
Perth	7.50	10	3.3	3.0	2.5	42	24	5.82
Canberra	8.25	10	3.3	3.8	2.5	25	18	7.59
Singapore	4.20	3	0.0	0.0	2.0	0	0	4.30
Tokyo	3.38	3	0.0	0.0	0.0	2	2	3.29
Hong Kong	3.14	3	0.0	0.0	2.0	0	0	3.24
Shanghai	4.85	3	0.0	0.0	2.0	2	2	4.78



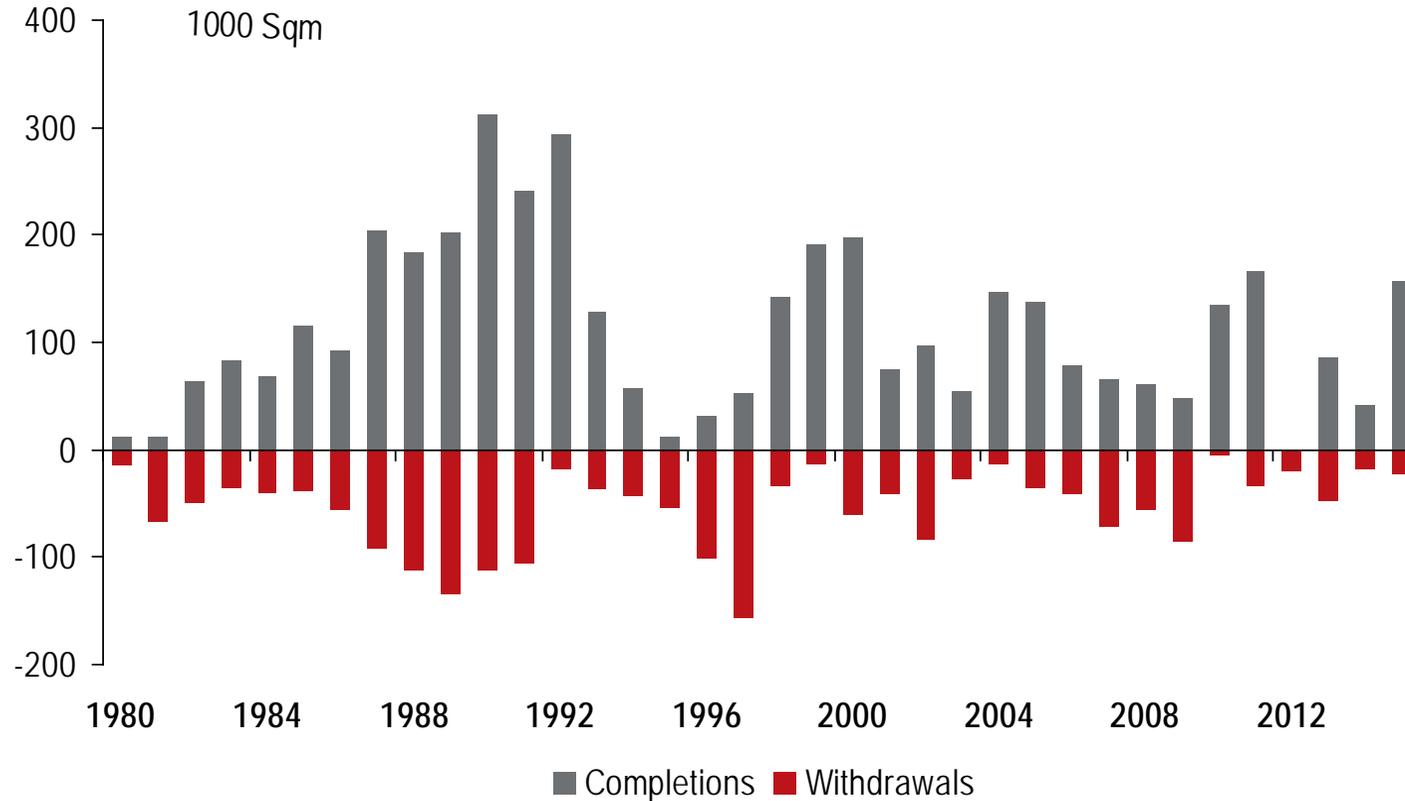
Three unresolved problems

- 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 (%)

Sydney	50
Melbourne	38
Brisbane	26
Adelaide	34
Perth	40
Canberra	31

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

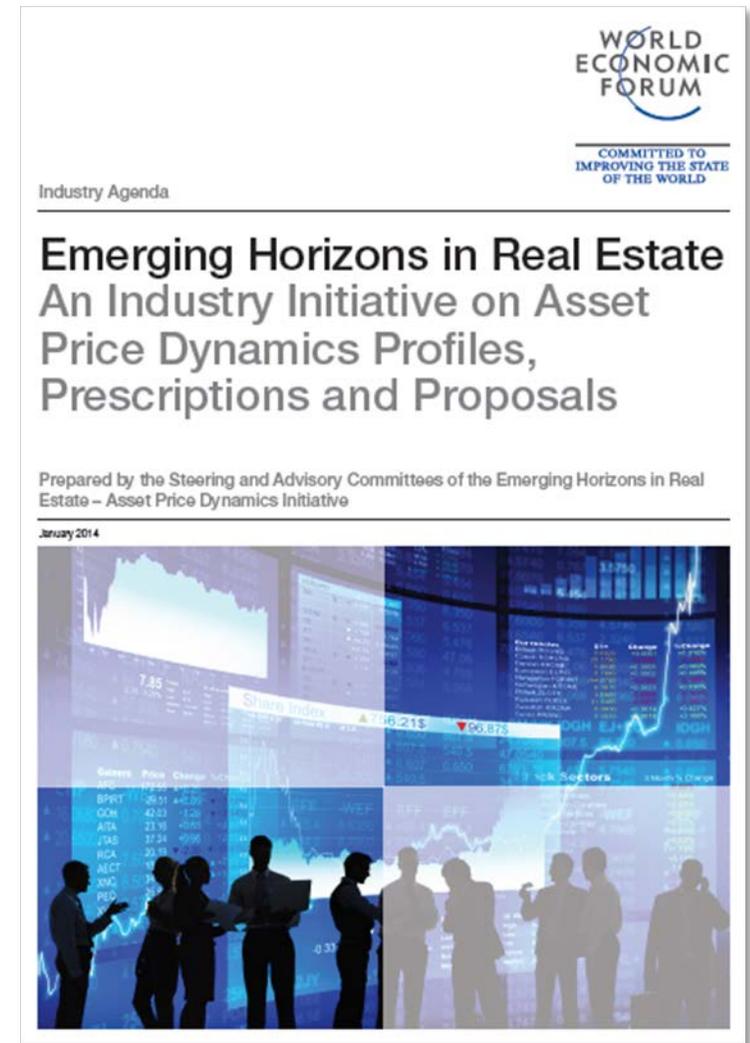
- 1) Incentives
- 2) Withdrawals
- 3) Bubbles

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?



Source: JLL Research



Thank you

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