

REVIEWING THE IMPACT OF THE 2008/2009 GLOBAL FINANCIAL CRISIS (GFC) ON INTERNATIONAL PROPERTY MARKETS AND PROPERTY PROFESSIONS

PROFESSOR CHRIS EVES

Queensland University of Technology

Email: chris.eves@qut.edu.au.

Abstract

The global financial crisis that impacted on all world economies in 2008 has had a continuing impact on all world economies throughout 2008 and 2009. This impact has not been confined to the finance industries but has had a direct and indirect impact on the property industry worldwide from both an ownership and investment perspective.

Property markets have experienced various levels of impact from this event, but universally the greatest impact has been on the traditional commercial and industrial property sectors from the investor perspective, with investment and superannuation funds reporting significant declines in the reported values of their investments.

Despite the very direct impact of these declining property markets, the GFC has also had a very significant indirect impact on the various property professions and how these professions are now operating in this declining property market. Of particular interest is the comparison of the property market forecasts in late 2007 to the actual results in 2008/2009.

Key words

Global Financial Crisis, property markets, property professions, commercial property, industrial property, residential property.

Introduction

The Global Financial Crisis (GFC) of 2008, that continued into 2009 (and still an issue for some countries and individuals leading into 2010) has had an impact across all financial and economic markets across the world. Although the impact was greatest in the developing countries that either relied heavily on foreign capital or were heavily geared (e.g. Iceland and the Baltic countries of Latvia, Estonia and Lithuania) the impact was also of concern across the developed countries. Of the developed countries, the hardest hit by the GFC were the United States, Japan (whose economy was already suffering prior to the GFC) and

the majority of developed Western Europe countries, especially those that relied on trade as their major economic driver (Beelaerts, 2007).

Individual investors were the major losers in the crisis due to the significant losses across the share markets, wiping out considerable company and individual wealth, particularly those investors who actually took out loans to take advantage of high gearing to grow wealth. Even cautious investors, including academics, saw their superannuation funds decline by up to 30 to 40% of their previous GFC balances (Unisuper, 2009).

The property sectors throughout the world were also subject to the fall out from the GFC. As many investors had geared heavily to maximise profits and capital growth in the equity markets, similar strategies were also prevalent in the property market. The reliance of the property development and property investment industries on retail and wholesale funds resulted in the commercial, industrial and in some cases the residential property sectors suffering significant declines in both activity and values.

Although the major real estate markets in most countries suffered a downturn during this period, this downturn was not consistent across countries or specific property sectors. The variation in relation to property market impact was offset to an extent by the various strategies put in place by governments to limit or reduce the impact of the GFC on the general economy and the regulation that was in place prior to the GFC, particularly in relation to the residential property markets.

Compounding the impact on the property market was the fact that this financial crisis had both a direct and indirect impact on companies and individuals. The fall in property values, as well as share prices, reduced the value of investment and pension/superannuation fund values by as much as 30% to 40%, with a direct impact on the ability of companies and individuals to provide additional funds for further investment in the property investment and development sectors.

Despite the overall negative impacts on the value, demand and supply of property, there have been some positive results following the crisis that will have some longer term benefits to the property sector. However, these positive benefits do not outweigh the negative impacts and have tended to only be of assistance to a small proportion of those involved in the property industry.

This presentation will review the property markets pre GFC at the end of 2007 and post GFC in late 2009 and provide a comparison of market expectations from the main real estate research firms in 2007 and actual results in 2008 and 2009. An overview of the impact of the GFC on selected direct property markets and how varied the impact has been on both commercial and residential property will also be addressed in the presentation.

GFC Winners and Losers

Before discussing the direct impact of the GFC on the property markets in developed countries, it is interesting to note which industries have benefited or suffered during this crisis. Recent reports by Ibis (2009) and Beelaerts (2009) have highlighted the various industries and sectors that have either benefited or been negatively affected by the GFC.

The Winners

Business Services

Business consulting services, particularly human resources management, liquidation and administration and legal advisors have benefited from the GFC as the demand for redundancy services, employment services and business restructuring services increased.

Agriculture

The agriculture sectors have been very resilient in respect to the impact of the GFC, particularly in relation to the staple commodities. Farm values have been relatively stable compared to other real estate markets.

Health

Health sectors have also shown growth and resilience during the GFC. As consumer

incomes fall, less is spent on healthy living and the incidence of sickness has increased so has the demand for health services. Issues of mental health and depression have also seen an increase during the GFC as people lost their employment or worried about losing employment.

Infrastructure

A major winner in the GFC has been any sector involved in infrastructure; especially those involved in the government bail-out plans (G8- Canada, France, Germany, Italy, Japan, Russia, UK and US). As these projects have been in the order of \$billions, any sector involved in these projects survived and recovered quickly. Major construction companies were big winners in the GFC, with these infrastructure projects taking up the reduced demand in the commercial property construction area.

Retail

In countries that provided direct financial stimulus packages to individuals (Australia, US), the retail sectors have been spared the major impact of the GFC

Australian Banks

Australian banks (including New Zealand subsidiaries) were also winners during the GFC and actually profited, which was not the case for the US banks. In addition to deposit guarantees from the Governments, these banks also benefited from a reduction in competition. During the period from late 2007 to 2009 the number of second tier lenders in Australia and New Zealand reduced dramatically. In New Zealand in 2007 there were 22 Finance companies operating in the commercial and residential property sectors. By 2009 this had reduced to five (5).

Australian and New Zealand banks have now become the dominant lenders in the

leasing market, where they did not have a significant exposure prior to the GFC.

Interest rates

A major tool used to boost economic spending and to support financial institutions during the GFC was the reduction in official cash rates. Any company or individual with debt has benefited from these reduced interest rates.

Resource Stocks

Although the equity markets throughout the world have been losers in the GFC, resource stocks have actually been winners, particularly during 2009, as the prospect of recovery is more likely.

The Losers

Tourism Sectors

Tourism has been a major casualty of the GFC. Little of the various retail stimulus packages found its way into the tourism sectors. Over the period of late 2007 to end of 2009, few airlines recorded profits and a number of once dominant airlines declared bankrupt (Alitalia, JAL). A major factor in the reduction in airline profits has not just been a reduction in leisure travel but also in businesses only allowing economy travel for staff.

Selected Equity markets

Two of the major losers in respect to their equity markets have been Europe and Japan. The Japanese Government did not introduce the sweeping stimulus packages that other countries introduced and this had a major impact on the share market that was already suffering prior to the GFC. The only stimulus package introduced in Japan was targeted to residential property including tax breaks on home mortgages, which increased residential property development.

The recovery of the European stock markets has not been as strong as the recovery of the US and Australian equity markets during 2009. This has been mainly due to negative sentiment as to whether the economy has actually improved.

Hedge Funds

Although hedge funds promoted the concept that profits can be made in declining as well as rising markets, during the GFC this has not proven to be the case, with very few hedge funds profiting in the recession.

Investors and self funded retirees

While reduced interest rates are beneficial to individuals and companies with debt, the reverse applies to individuals or companies that rely on interest generated from their investment assets. These groups have seen their incomes reduce substantially and many have had to realise capital assets to support themselves during this period of artificially low interest rates.

Property

One of the major losers during the GFC has been property. Across the globe commercial property markets (including retail) have seen significant declines in demand, new supply, income and values. Residential property has seen significant declines in value in the US, UK and New Zealand. The low value residential housing sectors in Australia were cushioned to some extent by the introduction of first home buyer grants, stamp duty waivers and interest rate reductions.

The indirect impact has been in relation to the employment areas of property. Property development companies were the first to make redundancies, followed by the property investment sector, sales and leasing and valuation firms. University graduates in 2008 and 2009 were also

losers in the GFC, as employment opportunities were limited compared to the period 2000-2007.

GFC and PROPERTY

The focus of this presentation will be a review of the market analysis and forecasts by the major real estate research sources, as at 4th quarter 2007 and compare these forecasts as to what actually occurred in the markets during the GFC. This review will be based on the comparison of the Prime office sectors in Brisbane, Auckland and Chicago. In addition a review of the investor sentiment surveys from late 2006 to late 2008 will be presented to show the difference in investor sentiment just prior and during the GFC.

Property Late 2007

In Australia, US and New Zealand, commercial, industrial and residential property had experienced a relatively long period of increasing demand and prices. From the period 2001 to 2007 the growth in the value of direct property was fuelled by readily available finance, less stringent lending criteria and an increasing supply of property based on a boom in speculative property development.

A review of the market commentary, as at 4th quarter 2007, provides an interesting retrospective view of how the property industry saw the outlook for property in 2008 and 2009. These market reports were prepared by the major real estate agents in the US, New Zealand and Australia and these reports also show that the research departments of these firms did not have any pre-warning of the impending GFC and its impact on the property market. Excerpts from these market research reports follow for the commercial CBD office markets in Chicago, Auckland and Brisbane. These predictions will then be compared to the actual market performance in 2008 and 2009.

Brisbane CBD Office

Predictions 4th Quarter 2007

The following are extracts and comments from various research firms and commentators for the Brisbane office market. The underlying theme from all sources was that the buoyant office market would continue into 2008 and 2009.

"the demand for office space is expected to continue at or better than the five year rate of 40,000m2 annually if there was sufficient supply" and "with vacancy rates at 1.2%, absorption will continue to be constrained and existing tenants looking to expand in the short term, will either have to stay put or look at the city fringe (Colliers International, 2007)".

Another major real estate firm also stated *"The strong tenant demand is anticipated to continue, with underlying economic conditions to remain positive for business expansion" and "Investment interest in Brisbane CBD is at an all time high, with investors seeking to gain a share of the reversionary income expected to flow through the majority of buildings within Brisbane over the next few years (Savills, 2007)".*

These optimistic predictions in late 2007 for the 2008 year were based on the very bullish market from 2005 through 2006. Data for Brisbane in late 2007 for office stock and vacancy is shown in Table 1.

The significant decrease in office stock in 2007, and the subsequent decrease in the vacancy rates for all but the Grade A space, did not provide any indication that the office market would not continue this trend in 2008. The optimistic forecasts by the Australian market researchers was based on the fact that as at the 4th quarter 2007 there was strong population growth, above average national private investment and strong interest generated from the availability of new and refurbished office space for lease and sale. Many forecasters highlighted the fact that property and Business Services, Utilities and Government were sectors that were very prominent in new leases throughout 2007.

Commercial office sales in Brisbane during 2007 were also at an all time high with sales of over \$1.572 billion for 19 transactions reported for the year, with these sales also recording lower yields than the previous 12 months. Table 2 shows some of the major office sales in Brisbane over 2007.

The highest reported sale for Brisbane in 2007 equated to \$14,682/m², again with yields lower than previous years. One leading forecaster stated *"With the recent increases to the cost of funds, the beginning of a global repricing of the risk and the crystallisation of the rental growth flowing into the market, there is now some stabilisation expected in the yield range".* However, this forecast went on to state *"given the growing expectation*

Table 1: Brisbane CBD Office Summary 2007

Grade	Stock	Vacancy	Vacancy % Jul -07	Vacancy % Jul -08
Premium	140,015	180	0.1	5.8
Grade A	590,244	9,862	1.7	0.2
Grade B	815,314	7,315	0.9	1.6
Grade C	157,873	1,480	0.9	8.8
Grade D	41,262	1,337	3.2	5.7
Total	1,744,698	20,174	1.2	2.3

Source: Property Council of Australia, 2007

Table 2: Brisbane CBD Office: Significant Sales Activity 2007

Date	Price (\$m)	Area (m2)	\$/Sqm	Yield (%)
Feb-07	\$76.6	15,216	\$5,034	6.66
Jun-07	\$110	13,422	\$8,195	6.23
Jun-07	\$45	8,327	\$5,404	6.20
Jun-07	\$40	6,361	\$6,288	3.70
Jun-07	\$16	2,670	\$5,768	6.00
Aug-07	\$48.5	6,566	\$7,387	N/A

that the market rents are now achieving a premium which will be eroded in three to four years time, the core market yields may increasingly reflect this perceived risk. In late 2007, this market analyst had predicted some correction in the market but not to the same extent that occurred in 2008”.

Some of the final comments in relation to the market expectations for the Brisbane market in 2008 were:

“The Brisbane CBD is entering a golden era of development that is unprecedented in its history. Over the next 5 years, Brisbane will see 500,000 m2 of modern energy efficient office space added to the existing stock” and “The Brisbane office market will be well poised to capitalise on improving local and international trading conditions by getting back to balanced supply and demand equation as soon as possible and then maintaining vacancy rates around 5% to 6%, which allows growth and movement in tenancies” (Savills, 2007)

The strength of Brisbane's white collar employment growth is putting more pressure on smaller tenants trying to secure CBD office space. The resources boom and Queensland's \$82 billion infrastructure program have created expansion opportunities across all relating sectors underpinning strong tenant demand. This strong leasing activity has positioned Brisbane's vacancy rate at an all time low of 0.45% at September 2007. The market is suffering from unsatisfied demand as

major tenancy requirements (>2,000m²) exceed 170,000m² (Colliers International, 2007).

A more cautious forecast was proposed by Knight Frank (2007), *“While the level of transactions for 2006/2007 was subdued, this is expected to change dramatically over the remainder of 2007 and into next year as the level of assets offered to the market has increased during the second half of this year. While the underlying investment demand remains extremely strong, purchasers are grappling with quantifying the sustainable rental levels when determining the amount of reversion to be expected from CBD assets.*

It is interesting to note that a less optimistic forecast was provided by Landmark White (2007) with their main forecast being *“Growth in effective rents to ease before a negative patch expected in 2010 and 2011 and prime and secondary yields forecast to soften 25 basis points by June 2008, with further softening in secondary properties expected in late 2009.*

The general market perception leading into 2008 was that the Australian office market was at an all time high and the confidence shown in previous years was set to continue into 2008 to 2009 but some commentators and researchers considered that there could be some decline in leasing and sales demand by 2010 or 2011. As late as December 2007, there were no research or outlook reports suggesting a decline in the direct commercial property markets.

Brisbane Office 2008-2009 reality

Although the Sydney and Melbourne office markets had seen a significant decline in sales and leasing activity in the first 2 quarters of 2008, the Brisbane market was still being supported by the Queensland resources boom. However as reported by Knight Frank (2008) the vacancy rate for Brisbane office space suffered its first increase in the second quarter 2008, with an increase of 0.5%, with a prediction that it would increase to 2.0% by the 4th quarter 2008.

Mid 2008 saw the peak in Brisbane office rental rates with the average prime gross rental rate increasing to \$835/m² (a 23% increase in the 12 months to June 2008; however the prediction was that this would fall to \$800/m² gross by the end of 2008 (Knight Frank, 2008).

Confidence in the Brisbane office market was softening and this was reflected in the market forecasts of mid 2008:

"In recent months, it has been noticeable that there is increased conservatism and longer decision making time frames by companies, although there still appears to be solid underlying demand from the tenant base. Sales activity has been sporadic and underpinned by private investors. Over the past six months yields have softened by 0.75 to 1.0% (Knight Frank (2008).

By the end of 2008, these predictions had been confirmed, with prime yields softening another 1.25% in the six months to December 2008 (Knight Frank, 2009).

Vacancy rates increased over the second half of 2008 from 2.0% to 4.2%, a significant 6 month increase. However, vacancy rates in the prime institutional grade property were still at pre GFC levels at 0.8%. The

forecast for vacancies in early 2009 for the 2009 year was an increase in the range of 8.5 to 10.0% due to the impact of the GFC, particularly due to the limited availability of credit. The Knight Frank forecast for 2010 is a vacancy rate of 12%.

By mid 2009 Colliers International reported a vacancy rate for Brisbane CBD at 10.5% and a 2010 forecast of between 13-15%, with 186,000 m² of space available. Of that, 34,850sq m was new supply, 104,036sqm was backfill in existing buildings, and the total sublease space on offer was 47,307sq m. The increase in vacancy rates across Brisbane CBD office also resulted in a decrease in the average prime gross rent from \$835 in mid 2008 to \$725 by December 2008. Rents in the B grade sector decreased over the second half of 2008 from a range of \$500-\$575/m² to \$450-\$500/m² (Colliers International, 2009).

Although the GFC did not stop sales investment activity in the Brisbane office market, it did change the dynamics of the sales investment market. In the 12 months from March 2007 to February 2008, there were 18 office building sales in Brisbane for a total value of AUD\$2.275 billion. However, for the 12 months from March 2008 to February 2009, there were 11 sales but with a total value of only AUD\$671 million. Figure 1 shows that this low sales volume was predominately due to the fact that the buyers in the market over this period were private buyers in the B, C, D, grade markets, rather than Institutional buyers in the Prime and A grade markets.

2009 saw a continuation in the decline of the Brisbane CBD office market. The main factors behind this continuing decline were the difficulty in investors obtaining finance, flagging business confidence and limited development activity due companies postponing commitments (Blundell, 2009).

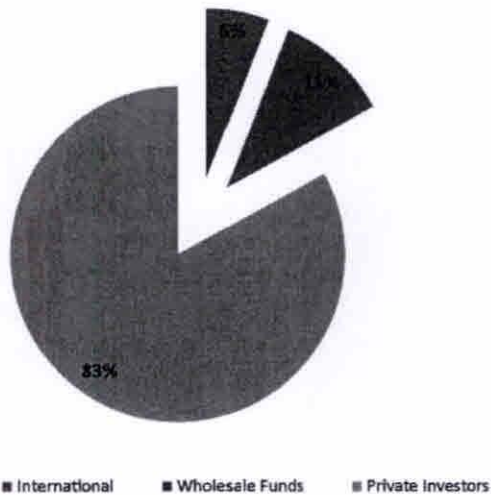


Figure 1: Brisbane Office Sales: Buyer Characteristics

The CBRE summary of the Brisbane CBD office market in 2009 was:

"Brisbane's office markets in 2009 have been characterised by a diminishing supply pipeline, negative net absorption, rising vacancy, falling rentals and softening yields. Investment demand has been subdued".

Although the fall in gross rentals declined further in 2009 from \$725/m² in December 2008 to \$662/m², the effective average prime rental was actually only \$516/m² due to rent incentives of 22%. The level of rent incentives in the B, C and D grade markets were in excess of 30% (Knight Frank, 2009a)

By the end of 2009, core prime office yields had softened to 8.00 to 9.19%, well below the 2007 levels of 6.2% to 6.5%.

Despite these significant falls in all areas of the Brisbane office market in 2008 and 2009, the increased optimism in the general Australian economy, the major real estate firms and market analysts still have a pessimistic forecast for 2010.

Based on the latest reports from Colliers International, Knight Frank, CBRE and Jones Lang LaSalle the following are the forecasts for the Brisbane CBD office market for 2010:

- Yield will continue to soften before stabilising in late 2010, remaining stable in 2011 and firming in 2012
- With falls of 30%+ in effective rents over 2009, a further 10% to 15% reduction is likely before a period of stabilisation.
- The increased sale activities in the second half of 2009 were promising signs for the capital market; however, a greater breadth of purchasers beyond private investors is required to consolidate the yields.
- While it appears that Australia has avoided a technical recession and the worst of the GFC may be behind us, there is unlikely to be any significant turnaround in Brisbane's office market performance until 2011 at the earliest.

Chicago Office Market

Chicago CBD Office

Predictions 2007

As early as 1st quarter 2007 some researchers were indicating that despite the relative slow market in Chicago in 2006, the outlook was till positive leading into 2008. According to New York Real Estate News (2007) "The regions slow economy and weak job growth has hindered Chicago office property leasing, but record office sales in 2006 and investor appetite for Chicago property is reason to build".

According to Newmark Knight Frank (2007) virtually all of the Chicago Office markets

enjoyed some improvement during 2006, with these markets expected to improve in 2007 due the moderate amount of inventory that will be added next year in a number of the better-performing markets. This sentiment was echoed by Bradford Allen, (2007) who stated that vacancy rates for the Chicago office market were at their lowest point since 2001, with the expectation of increasing rental rates and the 2nd quarter 2007 recording the highest rates of return since 1st quarter 2002

By late 2007 and the 1st quarter 2008, the forecasts for the Chicago Downtown office market were still reasonably buoyant, with some expectation of a softening market.

"The 1st quarter overall CBD vacancy rate measured 13.5%, a slight increase from 13.3% posted during the 4th quarter 2007. This marks only the second increase in CBD vacancy in the last 12 quarters, a sign that the market MAY be softening (Colliers Bennett & Kahnweiler Inc, 2008)"

By late October 2007, there was still a measure of optimism in the Chicago office market. According to Diesenhouse (2007), a survey of 600 real estate experts interviewed for an Emerging trends report stated that:

- Chicago was not a 24 hour city but an 18 hour city and a great place to invest.
- This aspect of the city will help it withstand the slowdown from the sizzling commercial property market of the past few years.
- 78% of respondents predicted that real estate would outperform US stocks and bonds over 2008.
- The downturn in commercial real estate will be less severe than the slump in residential property.

Chicago Office Market 2008-2009 Reality

By early 2008, the impact of the GFC was starting to be reflected in the forecasts for the US commercial office markets, including Chicago. However, these early 2008 forecasts were still reasonable optimistic.

"Despite the significant residential real estate downturn and meaningful reductions in net absorption, the commercial real estate fundamentals are expected to remain relatively stable based upon controlled delivery of new product and relatively low vacancy rates" and "Business confidence is expected to remain flat in the first half of 2008 as the sub-prime factor and broader capital markets displacement gradually play out. As a result, national office vacancy rates are expected to increase slightly in 2008 and a few markets are beginning to experience an increase in tenant inducements" (Wong, 2008).

However, the market reviews in 2009 and the market predictions for 2010 provide a more sombre outlook on Chicago office performance.

The following Table 3 is a summary of the CB Richard Ellis market expectations for 2009/2010.

The Chicago Downtown office market will have an increase in stock due to the completion of pre GFC construction projects.. The slight increase in the absorption rate in 2008 will be offset by a negative absorption of 159, 391m2 in 2009.

Table shows the significant increase in vacancy rates for office space from 12.8% in 2008 to 16.5% at the end of 2009, with a decline in the overall absorption rate from the end of 2008 to late 2009.

A breakdown of office vacancies in the Chicago CBD also shows that the Prime

Table 3: Chicago Downtown Office Market Accommodation Summary

Chicago CBD	2008	2009
Vacancy Rate	12.8%	16.5%
Absorption rate (m2)	28,248	-159,391
Inventory (m2)	11,912,870	12,252,360

office market at the end of 4th quarter 2009 had a vacancy rate of 17.1%, compared to 16.0% and 14.2% respectively for A and B grade office buildings.

Figure 2 shows the significant fall in the total value and number of sales that occurred in the Chicago CBD office market in 2008. Of more significance is the fact that during 2008 there was only a single sale of a Prime grade office building in the Chicago CBD.

The forecast for 2009 in the Chicago CBD office market was that all sectors of the market were cautious and that any buyers would expect a discount to replacement cost and most often these buyers would require vendor financing or buildings with income streams that covered any finance charges (positive gearing) (CBRE, 2009).

CBRE's (2009) final forecast for this market was "Given the current economic circumstances and widespread credit shortages, we expect 2009 sales activity

to be about on par with 2008 activity. However, we anticipate that sales activity in 2010 will approach volumes closer to historical averages".

From an income perspective the gross asking rent increased from \$344/m2 in 2007 to \$353/m2 in 2008. However, the expectation for Chicago gross asking rents in 2009 was a significant fall and a possible eight year rental recovery cycle (CBRE, 2009). According to Colliers (2009) rentals at the end of 2009 had fallen to \$306/m2, well below both the 2008 and 2007 levels.

Colliers forecast for 2010 is a continuing deterioration in the Chicago office market but not at the same rate as 2009. This decline will be in both the level of gross rents, as well as the sale price for buildings that are coming onto the market as cash strapped owners fail to seek refinancing (Colliers B&K, 2010).

Auckland CBD Office

Predictions 4th Quarter 2007

The New Zealand property market was also experiencing a period of substantial growth in the five years up to the end of 2007. This growth was across all sectors, with significant growth in the office and residential sectors (Eves, 2008; 2009). Unlike the Australian commercial property sectors, the New Zealand market experienced significant downturns in the mid 1990s and also in the late 1990s. However, there was significant activity in the commercial office market, particularly

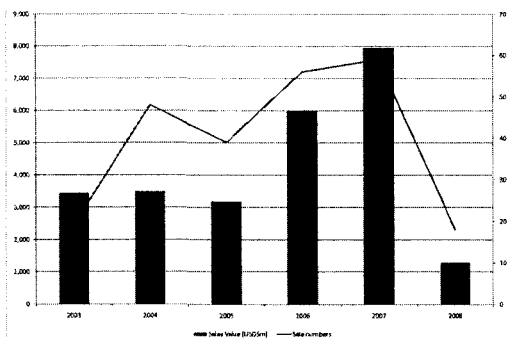


Figure 2: Chicago Downtown Office Sales Activity 2005 to 2008

Auckland, from 2001 to 2007 as Australian investment and superannuation funds were actively purchasing property in Auckland.

In mid 2007, the outlook for Auckland was very positive. There had been over 16 high value commercial office buildings sold in the Auckland CBD from October 2006 to May 2007 for a total sale price in excess of NZ\$500 million, with market yields ranging from 8.8% to 6.43%, record lows for this market sector (Colliers International, 2007; Bayleys, 2007)

As at June 2007 the Auckland CBD vacancy rate had reduced from 10.9% as at December 2006 to 9.5%. However, the Prime CBD vacancy rate was only 1.2% and A Grade 4.5% vacancy with virtually no incentives needed to attract tenants (BIS Shrapnel, 2008).

Limited supply coming onto the market was a major factor in the optimistic view of increasing rents, lower yields and limited tenant incentives (Colliers International, 2007). The average prime rent as at June 2007 in Auckland was \$302/m² p.a., with a forecast to rise to at least \$320/m² pa by December 2007.

The Bayleys and Colliers International forecast for the 2007 year was "Overall market indicators point towards a strong year for the Auckland CBD, with high levels of leasing enquiry and absorption resulting in a tightening market and growth in values.

By December 2007, the Auckland commercial office market was still performing strongly and market forecasts were still very favourable. By December 2007, the vacancy rate for all office accommodation in the Auckland CBD had decreased to 8.6%, a level not recorded since major real estate agency firms commenced research records in 1995.

According to Colliers International (2008) "On-going leasing enquiry shows no clear sign of easing" and "Overseas demand, particularly from European and Australian investment companies, was responsible for many of the major sales, with over \$300 million worth of investment coming from off-shore funds.

The mid 2007 forecast for average prime rents to increase to \$320/m² were exceeded with the average prime office rent reaching \$345/m² by December 2007, an annual increase of 9.4% in 2007 (Colliers International, 2008).

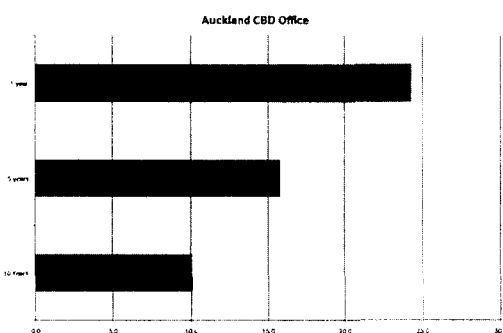


Figure 3: Auckland CBD Office Total Return (%): 2007, 2003-2007 and 1998-2007

Source: IPD

Figure 3 shows the significant investment gains for Auckland CBD office property in 2007. The annual total return for 2007 was 24.47%, compared to 10.1% for the last ten year average and at a time when yields were at record lows of 6.43% (PCNZ/IPD, 2007).

Auckland Office 2008-2009 reality

By the end of 2007, market players were still confident that the market fundamentals were still strong and the outlook for 2008 would follow the movement from the

previous 5 years, as evidenced by the following quote from Colliers international research, 2008:

"Despite negative sentiment surrounding global credit issues, economic uncertainty and the demise of a number of financial companies, Auckland's CBD office market continues to produce positive results". And "In the short-term, Bayleys Research anticipates that the Auckland CBD office market will continue to perform strongly and consolidate on the strong foundation that now sees it at its current healthy state.

By the end of 2008, the effects of the GFC had impacted on all sectors of the Auckland CBD market. Figure 4 shows that the level of investment sales had declined significantly in 2008, compared to the previous 5 years and in the main this was due to the absence of the Australian investment and superannuation companies from the market (CBRE, 2008).

Even by August 2008, market sentiment in Auckland had changed significantly due to the GFC. Market expectations were following the sentiment below:

- There is an increased supply of property on the market but not forced sales at giveaway prices
- domestic institutional demand will remain subdued
- the ability and imperative for Australian funds to invest in New Zealand will be reduced (CBRE, 2008).

These less optimistic views were driven by a decline in sales activity, reduced effective rental growth and a lack of investor confidence. Figure 5 shows that during 2008 the effective rental growth across the major property investment markets were all negative, with the Auckland CBD market showing negative growth of 17.1%.

Investment Activity

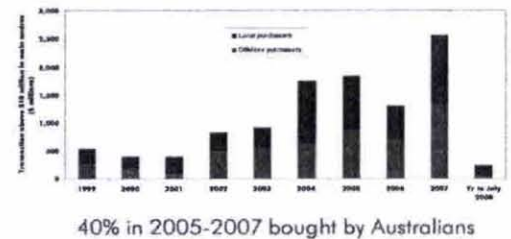


Figure 4: Auckland CBD Sales Activity: Buyer Profile

Source: Bayleys Research, 2008

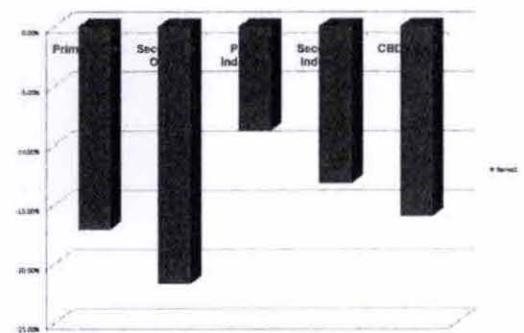


Figure 5: Auckland Property Sectors: Effective Rental growth: 2008

By the 3rd quarter 2008, the impact of the GFC was being felt in the Auckland property market. Continued negative rental growth across all sectors resulted in the reduction of total returns for the 2008 year. The following statement from PCNZ/IPD provides a telling summary of how the GFC was impacting on the office market.

"The Property Council/IPD New Zealand Property Index for the 12 months to end June 2008 shows the total return for New Zealand ungeared direct property investments was 13.5 per cent, a significant drop from the 24.1 per cent return achieved over the same period to June 2007. The main driving factor was the fall in the capital growth rate - from 14.6 per cent in June 2007 to 5.8 per cent in 2008. Income return drifted downwards at 7.2 per cent

compared to 8.3 per cent over the same period last year".

Although this appears to be a minor fall, it was across the institutional grade property that had very little change in vacancy rates and a lower fall in effective rental growth. While the impact on the prime CBD office market was significant, the impact on the secondary markets was considerably greater. In 2008 rent incentives in these lower grade markets had increased to over 15% and yields had softened to over 10% (Colliers, 2009).

The full impact of the GFC was felt during 2009. By the 4th quarter 2009, Auckland CBD prime office vacancies had increased from 4.1% in 2008 to 11.5%, with the secondary office space with average vacancy rates over 30% (Colliers International, 2010).

Prime office capital values declined by (-15%) during 2009, and this was accompanied with a reduction of (-8.4%) in prime rentals (Colliers International, 2010).

Forecasts for the Auckland office market in 2010 suggests that the decline in this market will continue, with the prospect of some improved investor confidence in the last quarter of 2010.

Investor Sentiment 2006 and 2008

The final section of this comparison of market sentiment both before and during the GFC compares the results of the Jones Lang LaSalle Survey of Investor Sentiment 2006 and 2008 (Australia).

This comparison shows the significant variation in the thoughts and attitudes of investors over this short time period of two years. This change in sentiment was due to the impact of the GFC on the Australian property and investment markets. Table 3 provides a comparison of the survey results. Respondents to the survey place

blame for the significant differences in their expectations for all sectors of the property markets in Australia on the direct impact of the GFC (Jones Lang LaSalle, 2006; 2008). The 2008 survey also stated that the low interest rate in 2008 was the main factor in the decision to hold property assets.

Residential Property

Although this paper has concentrated on the commercial property investment market, it is interesting to view the impact of the GFC on a residential property market. For this purpose the Christchurch New Zealand market has been analysed to show the changes in this market both just before the GFC and during the GFC to December 2009.

Figure 6 shows the average residential listings for 15 suburbs of Christchurch. This figure shows the significant decrease in house and unit listings as the GFC took hold across the residential markets.

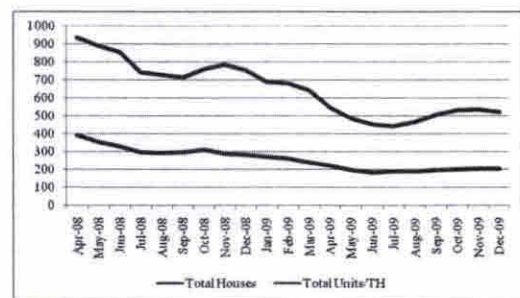


Figure 6: Christchurch Residential Property Listings 2008 - 2009

This decline for both houses and units continued through to July 2009, where there was a greater increase in the average number of house listings; however, there was not a corresponding increase in the number of units being offered for sale from July 2009 to December 2009. During the period, April 2008 to February 2009, the reduction in houses available for sale was also occurring at the same time as an

Table 3: Investor Sentiment Survey Comparison: 2006 and 2008

2006 (investors favour office property)	2008 (Investor sentiment for property negative)
Retail property is still judged to be around the peak of the current cycle (some survey respondents considered that the retail market had moved into the next phase of the cycle. Over 2006, the office sector was seen to have moved up to join the industrial sector at the "late upturn phase"	All three commercial property sectors are judged to be in the midst of the early downturn stage of the cycle. Respondents indicated that there is very little to split the sectors with the average of 1.4 being the lowest since the survey began in 1991.
Short term investor sentiment has eased but remained solid. In contrast investors are now more confident in the medium term (3 years) outlook than they were 12 months previously (2005)	Short term investor sentiment towards the commercial real estate markets has changed considerably since the last survey, with the net balance shifting from three years of fairly positive sentiment to extreme negativity in 2008
Investors remain confident about the office market in the short and medium term; slightly less positive about the industrial sector, but still more positive than 2005, but retail is expected to have lower returns in the short and long terms	Sentiment towards the commercial market in the medium term has fallen for the second consecutive year, with the office market in particular expected to remain highly volatile
Investors are confident about property in Sydney and Melbourne in the short term. Over the medium term, investors still like Sydney and Melbourne, but are more evenly split over Brisbane and Perth and consider lower returns will be achieved in Canberra and Adelaide.	Investor sentiment towards all cities is extremely negative, marking a major turnaround from last year, especially for Melbourne and Sydney
Overwhelmingly investors intend to keep purchasing real estate through all investment vehicles over both the short and medium term. Investors also intend to increase their overseas exposure to direct property	Investors overwhelmingly are intending to hold on to their commercial real estate over the next 12 months. The overall strategy of almost half the respondents is to keep hold of assets, while a third indicated that they were keen to sell down.
Investors suggest that required long term returns have fallen slightly across all sectors. Office and industrial property are expected to achieve returns above investor expectations and retail at investor expectations	The expected 10-year total return forecast by respondents remain unchanged for office and retail assets, but softened for industrial
Respondents indicated that sustainability was having a significant impact on investment decisions and that it would be a critical issue within five years. "Tenant expectations was identified as the most important sustainability issue	Sustainability remains high on the agenda for most investors with 52% (76% in 2006) of respondents citing that all other things being equal sustainability would sway their decision between alternative investments.

overall reduction in the actual number of residential property sales (refer to Figure 8).

Figure 7 breaks down the monthly listing based on the value of the properties in the markets. This figure shows the average monthly listing for low, middle and high value suburbs in Christchurch. Again this figure shows that the impact of the GFC was not consistent across all markets. Although the number of properties offered for sale declined over the GFC period, along with median house prices, there were more properties for sale in the middle to higher value suburbs than the lower value suburbs of Christchurch, despite the fact that there is greater stock of houses in

the lower value markets compared to the higher value residential property markets in Christchurch (Eves, 2009). Since July

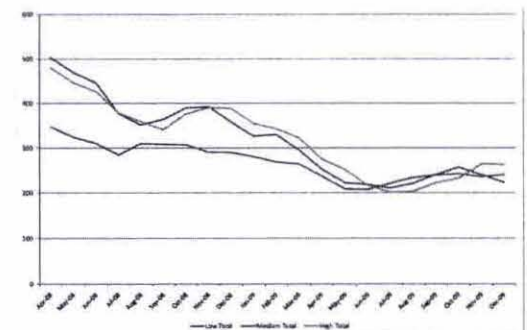


Figure 7: Christchurch Residential Property Listings: Socio-Economic Sectors.

2009, there has been an increase in the number of properties being placed on the market, and this has been particularly the case in the higher value suburbs.

Figure 8 compares the average monthly listings in 15 suburbs in Christchurch and the subsequent monthly sales in those same suburbs. It can be seen that during the initial stages of the GFC the decrease in listings was also corresponding with a decrease in the number of actual sales occurring across the market.

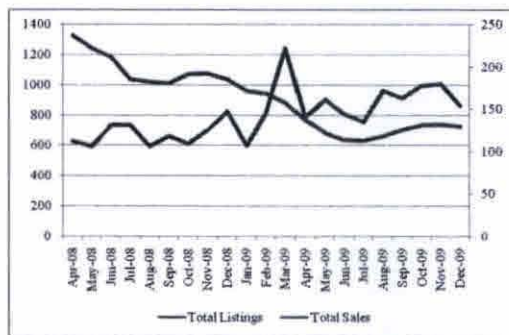


Figure 8: Christchurch Residential listings v Sales Activity

March 2009 was a turning point in the Christchurch residential market, with sales activity increasing at a greater rate than the actual number of properties being listed for sale. This was driven by the low interest rates and declining median prices resulting in home affordability being greater than the 2007 boom. The increase in sales activity, combined with a reduction in available residential property supply, has not resulted in a corresponding increase in residential housing values, as the availability of credit is still an issue in this market.

Conclusions

An important aspect of the GFC and the world property markets was the fact that virtually all the major property research

firms did not predict the timing and extent of this downturn. Even by as late as mid 2008, not all property markets had been substantially impacted by the GFC. However, the overall forecasts had become very negative by June 2008, especially in the office property market.

The decline in the property sector was not consistent geographically or on a land use basis. The Chicago market had been weak prior to the GFC but there was still a reasonable amount of office accommodation supply to come on the market in 2008 and 2009, which only exacerbated the impact on the overall market.

In New Zealand, during the initial stages of the GFC, concerns were predominately focussed on the fringe and lower grade office property. However, by late 2008 the prime office sector was suffering to a similar degree as the lower quality office markets. Commentators who stated that this sector of the market would perform better than other property assets were proven to be incorrect.

In markets such as Brisbane CBD, the GFC was delayed due to a resource boom fuelling the property market but this was short lived with effective rents for Prime office building falling 30% or greater and yields softening to levels similar to equivalent markets in Australia.

One flow on affect of these declining markets was also felt in the valuation and investment sectors of the property industry. The reduced sales activity has resulted in valuers having to assess values in a declining market on less than 10 genuine sales in the Brisbane and Chicago CBD office markets and an analysis of the sales of prime buildings in Auckland reveals that in 2008 valuers only had one genuine prime office sale to use as the basis for valuing property in the Auckland CBD.

Despite the strong performance of office market in the developed countries, few market research analysts considered that there could be a possible downturn in 2008. However, there were a number of analysts and researchers who stated in 2007, that the CBD office markets would suffer a significant correction in 2010 or 2011.

This optimistic view of the property markets was also shared by the investment sector, who stated that they were comfortable with both indirect and direct property and would be investing in these markets in 2007 and

2008. This view was completely reversed by late 2008, with the same investors now stating that at best they will be holding their current property assets with a large percentage divesting these assets in the short term.

The final victims of the GFC and property industry have been the large number of people that have lost their jobs with virtually all property firms downsizing throughout late 2008, 2009 and continuing to do so in the early months of 2010.

References

- Bayleys Research, (2009), Commercial Property Research. Second half, 2008
- Bayleys Research, (2008), Commercial Property Research. Second half, 2007
- BIS Shrapnel Pty Ltd. (2008), Auckland Commercial Property, 2008-2013.
- Blundell, L. (2009), Design and Build: Hot Predictions. Property Australia. February 2009
- Bradford Allen. (2007), Chicago CBD Office Market Report. Vol 3, 2nd Quarter 2007.
- CB Richard Ellis. (2007) Chicago Market Outlook 2006. CBRE Chicago
- CB Richard Ellis (2008), Auckland Market Outlook 2008. CBRE Auckland
- CB Richard Ellis. (2009), 2009 Market Outlook, Chicago. CBRE Chicago.
- Colliers B & K. (2010), Market Research Metropolitan Chicago: Downtown Office Year end 2009. Colliers B & K, Chicago
- Colliers B & K. (2008), Market Research Metropolitan Chicago: Downtown Office First Quarter 2008. Colliers B & K, Chicago
- Colliers International (2007), Colliers International Market Indicators Report. Auckland CBD Office. Winter 2007.
- Colliers International (2008) Colliers International Market Indicators Report. Auckland CBD Office. Autumn 2008.
- Colliers International (2009), Colliers International Market Indicators Report. Auckland CBD Office. Quarter One, 2009.
- Colliers International (2010), Colliers International Market Report. February 2010
- Colliers International (2009), Colliers International Market Indicators Report. Brisbane CBD Office. Spring 2009.
- Diesenhouse, S. (2007). "Chicago Expected To Fare Well In A Downturn. Inside Commercial Real Estate". Chicago tribune. October 24, 2007

- Eves, C. (2009), " Residential Property Market Performance In A Declining Market: Christchurch Case Study. Australian And New Zealand Property", Journal. Vol2, No. 4, pp 226-233.
- Jones Lang Lasalle, (2006), On Point: Survey Of Investor Sentiment Australia. JLL 4th Quarter 2006
- Jones Lang Lasalle, (2008), On Point: Survey Of Investor Sentiment Australia. JLL 4th Quarter 2008
- Knight Frank. (2008), Brisbane CBD: Office Market Overview. September 2008
- Knight Frank. (2007), Brisbane CBD: Office Market Overview. November 2007
- Knight Frank. (2009), Brisbane CBD: Office Market Overview. March 2009
- Knight Frank. (2009a), Brisbane CBD: Office Market Overview. October 2009
- New York Real Estate News (2007), National Market Report. February 01, 2007.
- Property Council Of New Zealand And Investment Property Date.(2007), Investment Performance Index. 4th Quarter, 2007
- Savills. (2007), Brisbane CBD Overview. 2007
- Wood, R. (2008), "Americas Market Outlook". CBRE, www.cbre.com/research