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FINANCIAL REVIEW

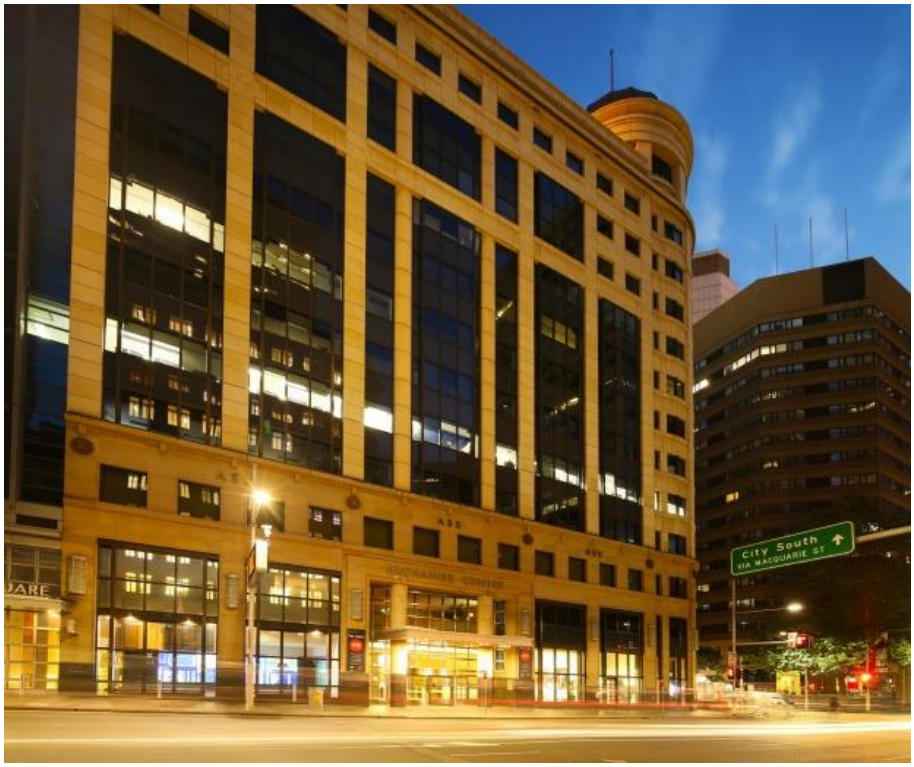
Best and worst real estate deals of 2017

As the Reserve Bank of Australia closely monitors the commercial real estate sector – with a fresh warning about valuations – The Australian Financial Review has looked at some of the key commercial real estate deals of 2017 that surprised market participants and gave some insight into how far the market could go in 2018.

These six deals – potentially both the best and worst deals of the year depending on what side of the fence you are looking from – were mainly in Sydney where there has been extraordinary growth based on rent forecasts. Most of the deals were office related but with big questions over the health of physical retailing, a few shopping centre deals had to be included.

Toy story

The first big deal of the year to reprice the market was the purchase of the ASX headquarters in Sydney by Hong Kong-based Early Light International Group, backed by billionaire toy maker Francis Choi.



20 Bridge Street fetched $335 million. **Supplied**

The investor paid $335 million for 20 Bridge Street on a 4.5 per cent fully leased yield and a passing yield of 3.9 per cent. At 20,329 square metres, the rate paid equated to $16,478 per sq m. At the time it seemed like the agents, Savills' Simon Fenn, Ian Hetherington and Ben Azar, had cracked the big one at the top of the market, but it was just the beginning.

Mr Choi went on to buy private equity group Blackstone's 1 Castlereagh Street tower in Sydney for about $220 million later that year at a higher price per sq m. It's hard to work out how much leverage the investor has taken on – the Financial Review suspects very little – to buy the properties, but that is a key determinant in how far the market can run.

The local real estate investment trusts learnt their lesson from the financial crisis and have all reduced gearing into the low 20 per cent range from 40 per cent. The RBA warns on this issue most of all: "If these higher commercial valuations are not sustained, say because of a marked increase in global long-term interest rates, highly leveraged investors close to the maximum LVR covenants on bank debt could become vulnerable to breaching loan covenants."

Nexus Dexus

The so called "Westfield" of office towers in Australia – Dexus – made one of its biggest calls in several years by buying a 25 per cent stake in the MLC Centre at 19 Martin Place for $361.3 million, with its wholesale fund taking the other quarter share for the same price. As first reported by AFR Property, the deal included a fully underwritten $500 million institutional placement.

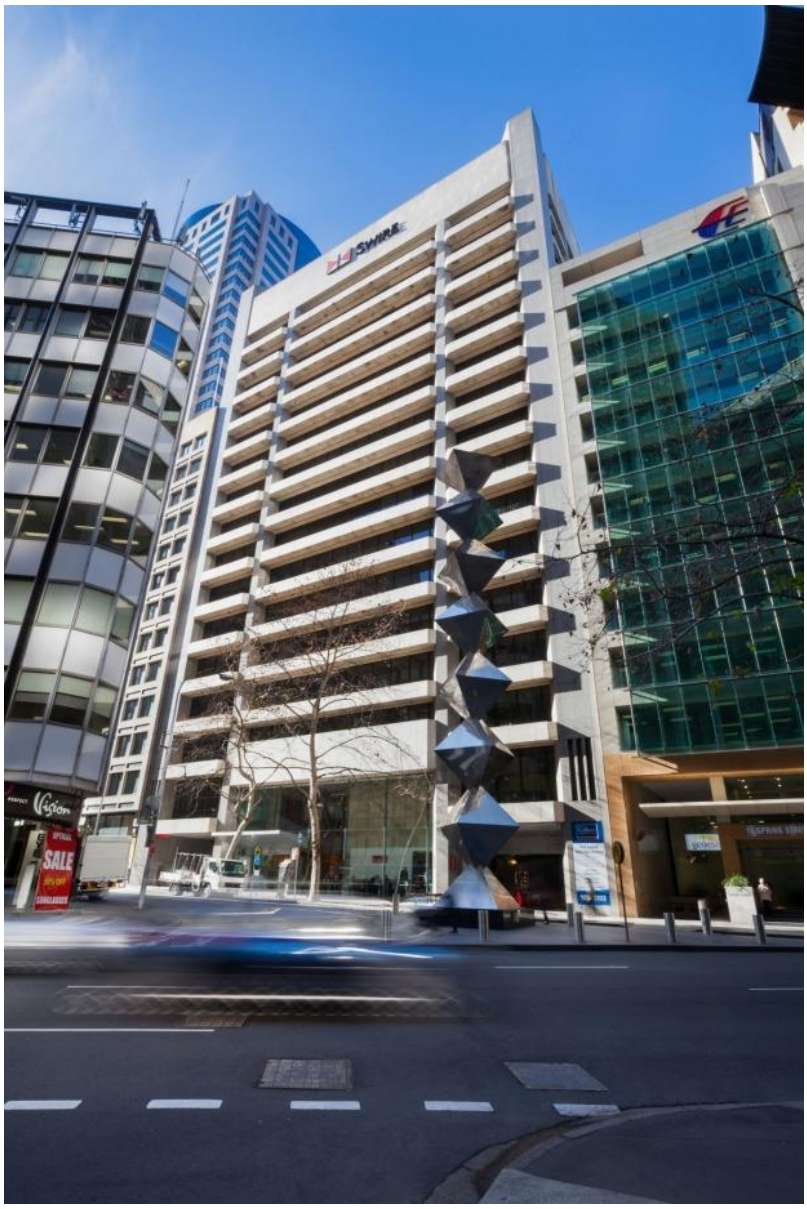
Dexus CEO Darren Steinberg in front of the MLC Centre in Sydney. **Peter Braig**

It was a big call and one that met some criticism from analysts at UBS: "While the price for the MLC Centre was sharper than we anticipated, we were more surprised Dexus was the buyer.

"Dexus has previously shown more price discipline which may now be in question."

Other landlords thought the price was too much, others thought it was good buying. The price per square metre is difficult to work out because of a retail component but it's clear that since the MLC deal, negotiated by JLL's Rob Sewell and Simon Rooney and Savills led by Ian Hetherington, there has been much sharper pricing.

Dexus chief executive Darren Steinberg is at the nexus of deal making in Sydney and will no doubt be vindicated when the MLC stakes are shown to have higher valuations at Dexus' next financial results.



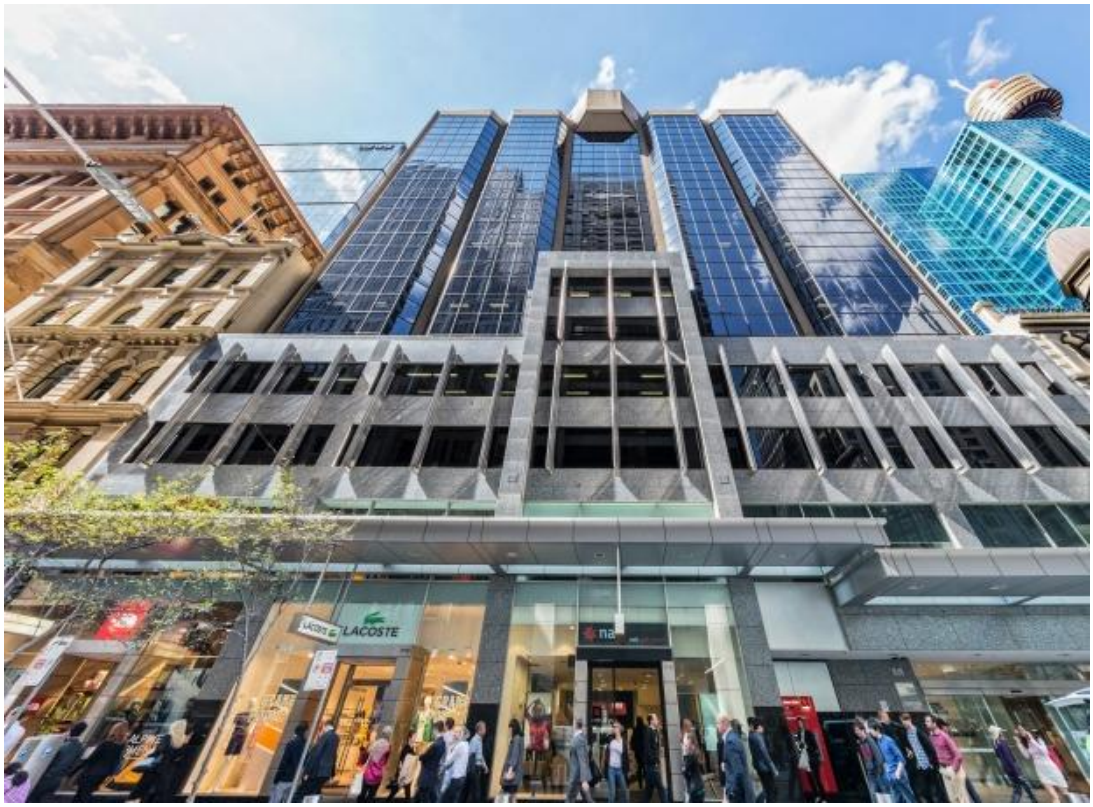
Centuria sold Swire House at 10 Spring Street and tripled its money.

Sale of the Centuria

In what could be seen as the best and the worst deal of the year, property funds manager Centuria tripled its money after selling Sydney landmark Swire House to Lendlease's investment arm in a $270.05 million deal.

Centuria purchased the tower at 10 Spring Street in 2013 for $91.64 million, but Lendlease, which was looking to amalgamate properties on Spring Street for a super development site, had to beat the competition. It did, but whether the price paid is worthwhile may not be seen for many years. Any development there will also crucially depend on inner-city planning laws that are still to be introduced.

Pitted



Close to a record: 130 Pitt Street in Sydney sold for $21,000 per square metre in December. **Hamilton Lund**

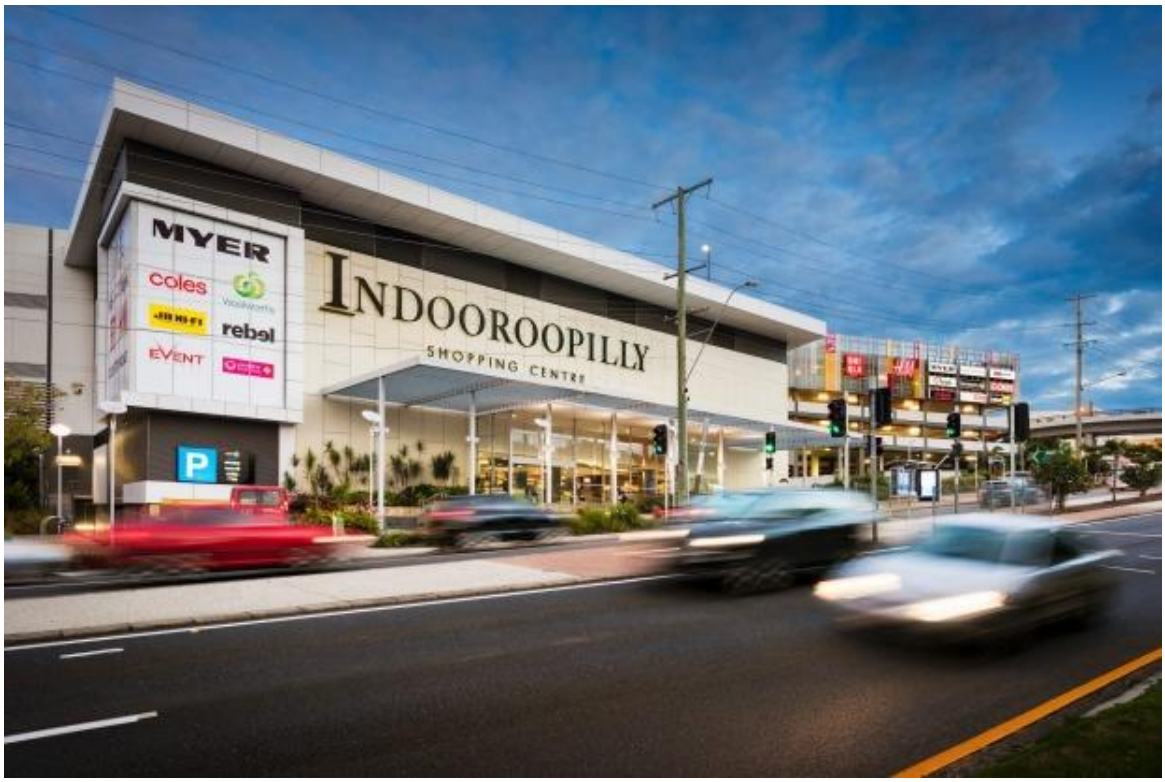
The record in Sydney is said to have been 3 Spring Street, a small building which sold for $44 million back in the late 1980s (after the equities market crashed) on a capitalisation rate of 3.5 per cent. However, that record is getting a few nudges and the sale of 130 Pitt Street, Sydney, in December 2017 saw just how close those records are to being broken.

The 10,893 square metre building sold for $229 million to PA Realty, a joint venture between Mitsubishi Estate Co and CLSA Real Estate, on an initial yield of 3.7 per cent.

The deal reflected pricing of about $21,000 per square metre – well and truly above the deal struck for 20 Bridge Street with toy maker Mr Choi. Ben Azar and Ian Hetherington of Savills Australia and Josh Cullen and Rick Butler of Inc RE negotiated the Pitt Street deal, which shows that the cash flowing in from Asia could well continue into the 2018 year and potentially help see records broken.

Gully of the leeches

In the local indigenous language, the Brisbane suburb of Indooroopilly means "gully of the leeches". And for some, the purchase of a 50 per cent stake in and management rights of the Indooroopilly Shopping Centre by AMP Capital could be a very draining experience. Many property players say the management of the centre has been poor – there have been some big arguments with tenants and as a local who grew up travelling through the centre (and just returned from a spot of Christmas shopping there), I can say it has become a very ordinary centre from what was once a great Westfield-managed operation.



Indooroopilly Shopping Centre sold for a regional record but there is still a lot of work to be done. **Urban Angles**

AMP struck its deal on a yield of 4.25 per cent through JLL's Simon Rooney in what is the country's biggest ever single-asset retail property deal. Scentre, which operates Westfields in Australia, was understood to be more than $100 million softer on pricing. Just how much time and money will be leached from AMP to turn that asset around is something that is going to be watched very, very closely, especially given the growing pressures from online retailing. At least AMP can take management control of the centre from here on and benefit from a strong trading catchment area.

For the RBA there are still concerns over retail assets: "Rents have been flat and price growth has lagged that of other commercial property segments. Liaison with industry suggests that strong competition in the retail sector, particularly from online and new entrants, is compressing retailers' margins, constraining their ability to accommodate rent increases. In liaison, banks have also expressed concern over the outlook for the retail sector due to this increased competition."

Note: We left the Westfield takeover out as there is not any Australian property in that takeover deal.

Garden variety

There is bound to be a big Chinese development deal in there somewhere. The board of ASX-listed Phileo Australia were overjoyed when major Chinese developer Country Garden agreed to pay a record $400 million for its 363-hectare land parcel on Black Forest Road in Wyndham Vale in Melbourne's outer west.

Phileo paid just $14.5 million for the site back in 2004 when it was farmland, before its recent rezoning to a future residential estate (with the capacity for around 5000 dwellings) exponentially increasing its value.

The deal equates to around $1.1 million a hectare – in line with what other sites in Melbourne's growth corridors have sold for recently – but none have been nearly as big, nor will take as long to develop – meaning it's a major punt by Country Garden on the land market remaining buoyant (as it currently is) for the next 15 to 20 years.

Some insiders claim Country Garden offered as much as $100 million more than the next highest bidder, and there has been some suggestion – denied by Country Garden – that it sought to renegotiate the terms of the sale.

Country Garden Australia managing director Guotao Hu expressed excitement at the opportunity to deliver a major housing project, but even more excited would surely have been Phileo managing director Rudy Koh and the board, who hold over 60 per cent of the stock in the media-shy company and will make a motza from the deal. The board has already been splashing the cash about, awarding director Alfred Sung a whopping bonus of $5 million in November for "long-standing involvement" and "excellent past performance".