

# Quality's up, yield's down and competition is fierce

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Australians soaked up \$1.1 billion in direct property offerings in the first six months of this year as many maintained a defensive play out of equities.

But whereas five years ago investors set their return benchmark from direct property investment at 10 per cent, competition and rising prices are clawing back profitability.

Mark Wist, a director of the independent Property Investment Research, says returns from the direct property sector now average between 8.5 per cent and 8.75 per cent.

"Yields have headed south," he says.

"That's a result of property getting more expensive. It's also a result of the properties being offered to the market getting to be much better quality. And that has a lot to do with the introduction of institutions to this part of the market - they won't deal with crap.

"What the institutions have done is raised the bar."

But they've also brought competition. And with the appetite for quality property stronger than ever, boutique fund managers are struggling to make their numbers work.

Take **Century Funds Management**, the boutique funds management company of Sydney property players John McBain and Jason Huljich, for example.

When *The Australian Financial Review* profiled Century in 2001, it said it wanted property worth \$150 million under management. It's not far short of that target - its portfolio is worth about \$130 million - but McBain says he needs to be conservative.

"The market is characterised by vendors whose expectations are unfathomably high and is underpinned temporarily by purchasers desperate to make acquisitions irrespective of market fundamentals," he says.

"What's changed, particularly in the office market, is that we can't just carry on paying the prices some are paying. I just can't see where the growth is going to come from.

"We'll continue to acquire passive investments with upside, but we're also looking for some alternative acquisitions where we can utilise the value-add skills our team has to reposition prominent commercial and retail blocks for strata title or bulky goods centres where we see room to improve value by rebranding and upgrading."

Ultimately, McBain sees Century operating about 20 individual funds - some passive, some opportunistic. For now, though, he's treading carefully.

"If we don't add \$50 million or \$60 million more property this year, so what?" he says. "Our investors want returns."

Despite the syndication boom across the country over the past five years, Century has opted to target a small band of wealthy clients.

Just 140 investors hold a stake in Century's 10 individual trusts. As each of those offerings has between 10 and 40 participants, it's not difficult to work out the type of investor with which Century is most familiar: the wealthy.

In a particularly busy year, Century picked up four office buildings and a homemakers centre in Sydney

last year, as well as an office building in South Melbourne.

They comprise 122 Walker Street, North Sydney; 16 Byfield Street, North Ryde; 357 Military Road, Cremorne; 511 Pacific Highway, Crows Nest; Warwick Farm Homemakers Centre, Warwick Farm; and 17 Market Street, South Melbourne.

What's different about these properties - most of them considered medium-term investments - is that they all offer opportunities for redevelopment. That way, a low income yield can be offset by a value-adding exit strategy, such as strata titling.

McBain points to an office block Century bought at Cremorne in Sydney. It paid \$3000 a square metre, with 100 car parking spaces included in the price. Now, having strata titled the building, it is fielding offers of \$5000 a square metre plus \$30,000 for every car space.

"We have to find properties that are run down, have some vacancies or have a better exit strategy, like strata titling," he says.

PIR's Wist says that, unlike in the horror days of the 1980s and early 1990s, when many property syndicates turned in poor results, most of the modern syndicates looked promising.

"We still get a couple of bad ones across our desk, but we just don't look at them," he says.

"Yields are pretty tight now. There's not much fat on the bone once you get below 8 per cent."

