

# VALUATION AND ADVISORY

## FIGURING OUT ACTUAL RETURNS IN TODAY'S COMMERCIAL PROPERTY MARKETS



2018 was a strong year for Australian Commercial Real Estate with yields in many sectors and markets reaching record lows. While the current 2019 outlook shows some risk issues emerging, Australian commercial real estate yields remain relatively attractive compared to interest rates, bonds and many offshore property markets.

**In strong market conditions yields are often reported and achieve widespread media attention and headlines. But what are these reported yields and investment returns exactly?**

**Historically the property industry has quoted a variety of yields when referring to commercial property, creating ambiguity about metrics and trends in the market.**

**Often when yields are reported there is no specification as to which kind of yield is being referred to, possibly misleading investors unfamiliar with the market regarding achievable returns and creating poorer pricing transparency.**

With the most common yield quoted being the "initial" or "passing" yield, simply representing the rate that is derived by dividing the net passing income by the sale price, without any adjustment for vacancies or rental fluctuations, it's easy to see why the market at times benchmarks incorrectly.

Other widely used yields are "market", "reversionary", "equated" and "equivalent". The yield that reflects most accurately the real return of an asset is the "equivalent" yield, also referred to by Cushman & Wakefield as "core market" yield.

Yields quoted in the media are not always "core market" yields unless specified and cannot simply be applied to other properties to assist with pricing as there is no consistent "like for like" comparison.

The "passing" or "initial" yield is the most basic of yields and may inflate the return of the property as it does not factor in any other contributors to the bottom line. Industry outsiders neglect to consider factors such as vacancy, letting up allowances required capital expenditure and rental incentives, which all contribute to the true return. Also, any variances between passing rentals and market rentals, reflected in the reversionary yield, are disregarded.

Given the inaccuracies that can result from quoting yields, all yields should be calculated as "core market" yields or equivalent terminology, painting a comprehensive and more accurate picture of the real rental return of the asset.

The property professionals of our industry need to ensure that yields are reported consistently to provide transparency and present an accurate market snapshot.

Should you have any queries in relation to this update, please do not hesitate to contact the undersigned.

**Cushman & Wakefield Valuations look forward to providing you with other sector updates across 2019, particularly as our Valuation team expands nationally.**



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