Landlords with long leases to be 'smashed': Ebert

Logistics

Larry Schlesinger

Fund managers that purchased industrial property at the peak of the market, and with tenants locked in for years on fixed rental increases, are going to get "smashed" by rising inflation and falling values, predicts veteran real estate investor Warren Ebert.

"Those that purchased property on 3.5 per cent yields won't get any more yield compression, so there won't be any capital growth." Mr Ebert, founder of Brisbane-based fund manager Sentinel, told *The Australian Financial Review*.

Also, while industrial rents are forecast to surge in the coming years due to record low vacancy rates, Mr Ebert said many landlords would not be able to capture this rental uplift because many had tenants locked in on 10- to 15-year leases with fixed annual increases well below inflation.

"A lot of leases over the last few years have been structured with fixed annual increases of 2.5 per cent, when inflation is running at 7 per cent. The longer the lease, the further behind they will get," Mr Ebert said.

The comments came as investors continue to buy industrial property on yields below 4 per cent – a return unheard of before the pandemic.

Driven by a huge influx of institutional capital into logistics on the back of the e-commerce boom, average yields on prime industrial properties in Australia have fallen to about 4.5 per cent, lifting capital values by more than 26 per cent a year over the past two years.

However, rising government bond yields, which are risk-free investments, have made commercial real estate less attractive to investors, and so yields on industrial property and other assets are beginning to soften, pushing down values.

"The one saving grace for industrial property capital values is stronger rental growth," property economist Lee Walker of BIS Oxford Economics said. "Prime net stated rents are forecast to rise by circa 30 per cent in Sydney's outer west and Melbourne's south-east over the next two years, working to offset the phase of yield softening."

However, investors that bought property with a tenant locked in for 10 to 15 years on 2 per cent annual rental increases will not be able to take advantage of that surge, Mr Ebert argued. "A lot of them are going to get smashed," he said.

Sydney-based fund manager EG echoed the sentiments of Mr Ebert, noting that demand for "stabilised industrial assets with long leases seems to be easing".

"Shorter weighted average lease expiry (WALE) assets are better placed to capture market rental growth and offset any softening in cap rates," an EG spokeswoman said.

Veteran investor Warren Ebert.

David Libling, CEO at industrial property specialist Pipeclay Lawson, said industrial property yields had risen 25 to 50 basis points since it sold a portfolio of four warehouses in Sydney and Brisbane to global investment firm Hines for $211.5 million in April (on a yield understood to be below 4 per cent).

"Pipeclay's forecast is of a further rise in industrial property yields of around 150 basis points," Mr Libling said.

Sentinel has about $500 million invested in industrial assets across its funds, but Mr Ebert said it had purchased nothing on low yields. "Our lowest yield is 6.5 per cent," he said. "We bought at 9.3 per cent in Darwin and in Mackay at 7 per cent. That's a big difference compared with 3.5 per cent."

Mr Ebert also questioned why the likes of GPT was selling malls to Sentinel, including Darwin's $420 million Casuarina Square shopping centre, that offered returns of 6 per cent and "massive growth", and was instead purchasing industrial assets on tighter yields with – in his view – lower growth prospects. A GPT spokeswoman declined to comment.

Yields have risen 25 to 50 basis points since Pipeclay Lawson sold a portfolio of four warehouses in April, says CEO David Libling.