Charter Insight

In essence, there are two classes of property assets: Commercial & Residential.

The value of commercial real estate (including retail, industrial and office) is driven by fair market/income and yield. Consequently, global events such as movements in interest rates, global economic growth, Australia's recent favourable terms of trade and international perceptions about our economy are more significant for this asset class.

In contrast, residential property is less affected by global events than commercial property and mostly influenced by domestic economic, tax policy and demographic impacts.

There is therefore a very significant difference between these two classes of real estate, commercial versus residential, that are effectively unhinged from each other, and depend on different factors for their performance.

Since the depths of the GFC, the upward repricing of most assets, subdued equities, and to a lesser extent, property has all been because of fiscal and relaxed monetary policy, not because of increased productivity. We are now appear to be at the bottom of the interest rate cycle, from which interest rates will probably rise over the next two to three years, and as they do albeit slowly, there will again be a repricing of assets.

Those assets which are not able to show real productivity gains are most vulnerable, as in a higher interest rate environment their capital value will be vulnerable. Those that can only maintain profitability will also weaken, although not as badly. It is those assets that can achieve significant growth that will post an increase in value in a higher interest rate environment. Make no mistake, in exactly the same way that low interest rates have boosted values in the last few years, those gains can just as quickly be eroded when interest rates rise.