SUMMARY

This study focuses on the ex-post analyses of the initial yield and equated yield of prime office properties in the Raffles Place micromarket from 1977 to 1999 covering three property cycles.

As initial yield is directly derived from the market evidence of rental and capital value, it reflects a good snapshot of short-term market movements over time. However, it is not the appropriate parameter to measure the return or investment value of properties with income growth. The value of initial yield is determined by the risk profile and the expected rental growth of the investment property.

Market evidence show that price and rent vary in tandem. Hence, they have opposing effect on the values of initial yield which varies proportionately with rent but inversely with price. The resultant decrease or increase in initial yield will be determined by the differential between rent and price variations.

Equate yield is the required rate of return equating with or comparable to other required returns of alternative investments. As equated yield is a combination of expected rental growth and the initial yield, it explicitly takes into account the important factors that affect the value of property, namely the risk and net income growth. It is therefore the right measure of return as it reflects the underlying investment value.

As a widely-held belief, there should be a constant long-term average premium on property investment. However, as a result of the shocks to the economic system, there will be short-term fluctuations around the long-term trend as the market adjusts to its equilibrium state. For computation of equated yield of prime office which measures long-term expected returns, it is postulated that the expected premium varies within the band 2 – 4% with an average value of 3% over one or more complete property cycles. It is found that equated yield, computed retrospectively on such a range estimate, can explain the past market behaviour better compared to the case in which constant average premium of 3% is adopted for each stage of the cycle.

It is noted that equated yield is relatively simple to calculate retrospectively but difficult to estimate prospectively as the latter requires a good estimate and understanding of the risk and forecasting of the market movements.

In the light of the recent increase in investment sales, the introduction of Real Estate Investment Trusts (REITs) and the securitisation of commercial properties, the use of equated yield as a comparative tool for evaluating the rate of return of real estate investment with alternative investment opportunities will become more imperative for investors.