

The following represents a monthly snapshot of how we see the property markets across the country along with the near-term outlook. For a more detailed commentary, please visit our website [thinktank.net.au](http://thinktank.net.au) for our Quarterly Market Update.

The Westpac-MI Consumer Sentiment Index fell sharply by 6.1% in July to 87.9 reversing last month's gain as consumers reacted to the reimposition of restrictions and it is quite likely that the volatility experienced will be repeated as the current situation in Victoria plays out. The AiG PMI Manufacturing Index was up by another 2.0 points to 53.5 moving slightly further into expansion above 50. The Services Index was up 12.5 to 44.0 and the Construction Index was up a further 7.2 to 42.7 with all the gains in housing but with apartments weakening further. AiG noted that the surveys were completed ahead of news of the Victorian shutdown which is important.

At its August meeting, the RBA Board held the Cash Rate at its record low of 0.25% as expected and confirmed its ongoing Quantitative Easing (QE) in maintaining 3 year Treasury yields at that same level of 0.25%. The RBA also released its quarterly Statement on Monetary Policy later that same week and together with various speeches confirmed its current stance of maintaining ultra-low interest rates for the foreseeable future and with unemployment now forecast to rise to 10% this year, that is completely understandable. The US Fed has said the same about interest rates and monetary policy in a statement coming from the July FOMC meeting. 10 year US Treasuries were last traded at yields of 0.55% and AUS 10 year Gov't bonds at 0.88% both steady. Not surprisingly markets continue to expect interest rates to remain at these levels for some years to come. Since last month the AUD has risen to USD 0.72 on continued weakness of the US dollar.

CoreLogic housing prices for July once again as expected showed a fall for Houses in Sydney of 1.0% and Melbourne down 1.4%. Units were also down in both capitals, by the same 0.7%. We note more comment on unit rents with Sydney down 3.2% from March to July and Melbourne 3.1%. The month-on-month drop of 0.6% in national housing values was up from 0.7% in June. These figures will no doubt continue to be under pressure as the impact of COVID-19 is felt and we have continued our Fair rating and Softening trend for all capitals.

There have been some further changes in our ratings and trends following those of last month after our Quarterly Update. At that time we mentioned that we were cautious about other sectors after having downgraded Retail which had already been struggling is now headed for even more difficult times ahead. While there are changes taking place in all property sectors, they are certainly different from other downturns and Industrial continues to appear quite resilient. We noted that Office was awaiting the response of businesses to work from home attitudes and the new Victorian Stage 4 restrictions have caused us to downgrade ratings in Melbourne and Sydney to Fair but we are maintaining a Stable trend despite some ominous signs in locations such as the Docklands in Melbourne. We take a closer look at the Office sector in our News and Views section.

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEO)		PERTH	
Resi- Homes	Fair	Softening	Fair	Softening	Fair	Softening	Fair	Softening	Fair	Softening
Resi- Units	Fair	Softening	Fair	Softening	Fair	Softening	Fair	Softening	Fair	Softening
Office	Fair	Stable	Fair	Stable	Fair	Stable	Fair	Stable	Fair	Stable
Retail	Weak	Deteriorating	Weak	Deteriorating	Weak	Deteriorating	Weak	Deteriorating	Weak	Deteriorating
Industrial	Good	Stable	Good	Stable	Weak	Stable	Fair	Stable	Weak	Stable

Sources: ABS, ACCI, AiG, ABS, AFR, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic, Cushman & Wakefield, HTW, IMF, MSCI, JLL, Knight Frank, Melbourne Institute, OECD, PCA, Preston Rowe Patterson, RBA, RLB, Savills Research, Westpac Economics, World Bank

## News and views

- This month we are focussing on the Office market which until very recently has been the strongest sector in Sydney and Melbourne and attractive across the country for A-REITs and institutional investors. Coverage of this sector has suddenly changed largely it would seem as a result of the COVID-19 induced work-from-home wave that has swept most capital cities and now in Melbourne has become law for at least the next few weeks. The proposition is that as workers and businesses get used to working from home, less will return to the office once the pandemic is over and companies will reduce their office space requirements resulting in increased vacancy rates, lower face rents and higher incentives. How capitalisation rates fare may be the key factor.
- We have chosen three recent articles from the Australian Financial Review to illustrate different aspects of this discussion and have shown the headlines that appeared in the AFR below The first featured research from JLL highlighting increased vacancy rates across most capital cities but especially Sydney and Melbourne. Chart 1 on the opposite page shows what is happening as described in the article: "The vacancy rate in Sydney has been inching upwards for several quarters before jumping from 5.8% to 7.5%. The situation in Melbourne is more dramatic yet, where the vacancy rate has more than doubled from 3.4% to 7.7%. In Brisbane, Perth and Adelaide, vacancy has also increased but more moderately." Nationally, the CBD office market vacancy rate increased by 1.8% points from 8.4% to 10.2% in the second quarter of 2020. JLL noted that In the Sydney CBD, available sublease space has exceeded the flood of space tipped into the market during the GFC and was fast approaching the record highs of the 1990s recession. Sublease availability is a carefully watched metric because it gives a sharp read-out on the market for office space. The PCA Office Market Report is out later this month.
- Chart 2 is taken from the second article noted below which featured a research note issued by Goldman Sachs which represented a very considerable change of sentiment against CBD Office property, in part driven by the JLL report outlined above. Apart from COVID-19, they said: "We believe investors should be far more concerned by the severe cyclical downturn in office rents and values that has commenced." Goldman Sachs expects vacancy in the Sydney CBD to peak about 13% by the end of 2022, when net effective rents will fall by 40%. Peak vacancy, also close to 13%, will hit the Melbourne CBD a year earlier, with net effective rents to drop by 42%. The various graphs in Chart 2 show the forecast surge in vacancy from this year in Sydney through to 2022 as net absorption plummets and net supply rises exceeding take-up for four consecutive years.
- Last month we noted on this page that a great deal was being written about the impact of work-from-home on Office occupancy. There is no doubt the short term impact is very considerable but investors and developers appear more confident in the future and the recent confirmation of a 42 story Office tower in North Sydney above the new Metro Station evidences that. The Chanticleer article noted below took up the same theme from Tony Boyd's new office pictured below in North Sydney opposite the Metro Station under construction. His comments are very interesting and as Think Tank is located very close by we can confirm the observations as being accurate. Empty office floors abound but all are leased and the example used in Chanticleer was the NBN in a new Mount Street building who would certainly be a paying tenant on a long-term lease. The question remains as to how long lasting the effects of COVID-19 will be and arguably only time will tell or is Goldman Sachs view right.



## FINANCIAL REVIEW

### Vacancy rises as virus hangs over CBD office market

AFR 24 July 2020, JLL

### Tower values to tumble as rents crumble

AFR 27 July 2020, Goldman Sachs

### Office values face virus heat

AFR 5 August 2020, Chanticleer

Chart 1: Capital City CBD Office Vacancy Rates

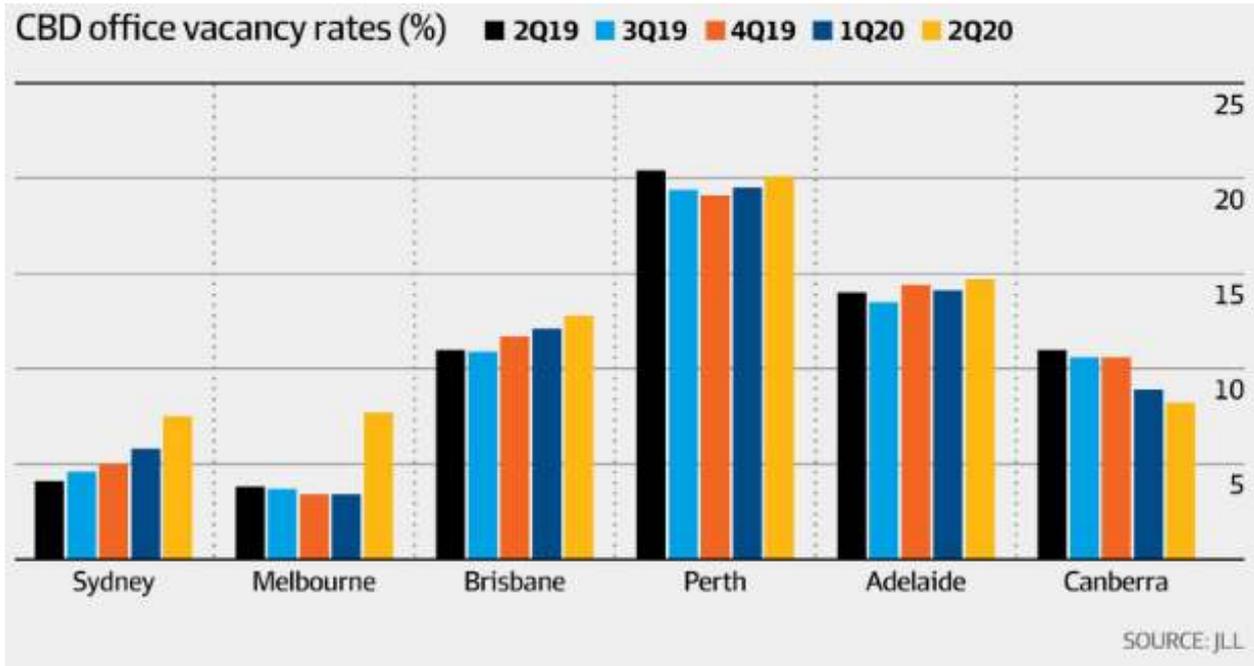
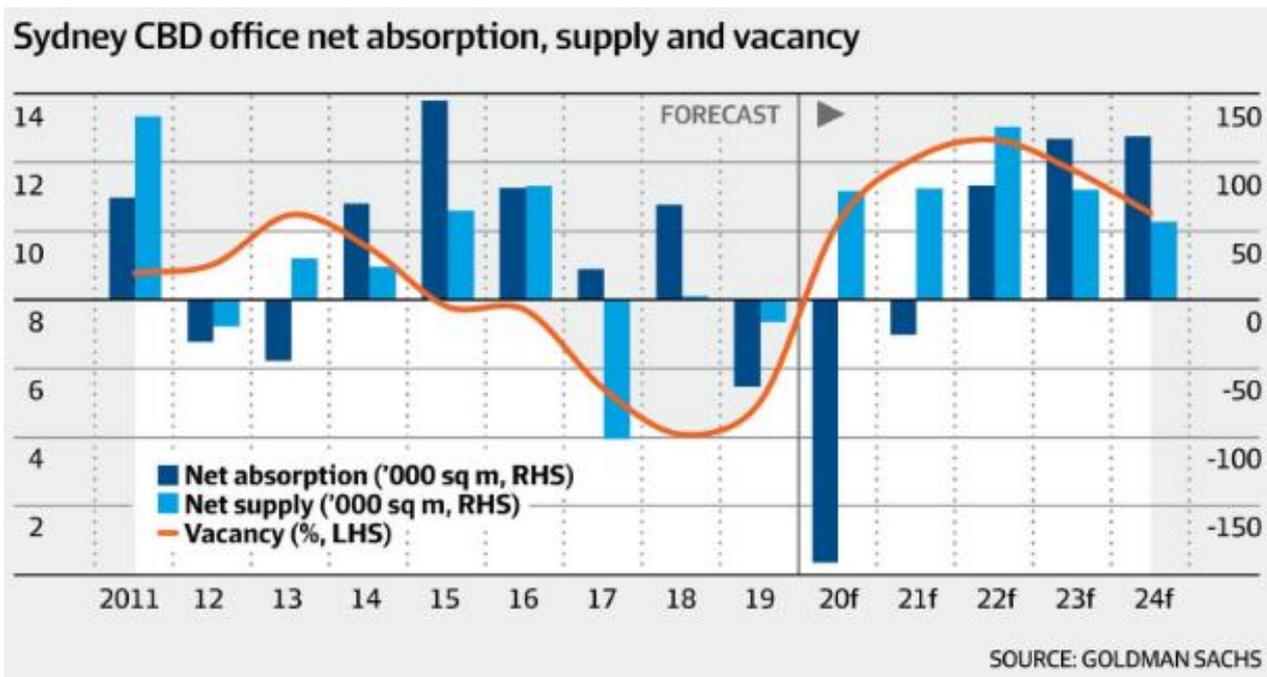


Chart 2: Sydney CBD Office Vacancy 2011 to 2024 forecast



Source: Australian Financial Review

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