Thinktank
Leading Commercial Finance

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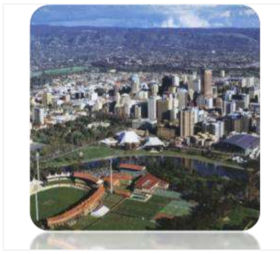
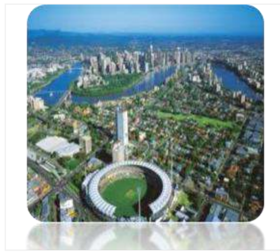
Australian Real Estate Market Focus





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 for our Quarterly Market Update.

The Westpac-MI Consumer Sentiment Index fell in January by 4.7 to 99.6 moving into pessimistic territory below 100 but the AiG PMI for January was up by 2.5 points to 52.5 after two months of declines which had seemed to reflect political and economic uncertainty. However the Westpac-MI Leading Index was down in December to -0.27 from 0.42 in November but Stephen Koukoulas of "illion" advised their preliminary 2Q Business Expectations Index indicated a marked improvement in the economic outlook.

At its first meeting of the year in February the RBA Board left rates unchanged at the record low of 1.50%. Economic data continues to fluctuate with GDP actual Q3 0.3%, yoy 2.8% and unemployment down to 5.0%. Retail Sales in December continued to be weak falling by 0.4% with annual growth at 2.5%. Inflation is set to remain below 2% for another year following an increase of 0.5% in Q4 which brought the annual headline rate to 1.8%. This together with soft housing markets appears to be the major brake on an increase in rates here in Australia. The US Fed made no change to rates at their January meeting and Chairman Powell's remarks suggested a slowing in expected rises this year. AUD/USD appeared heading to $0.70 in 2018 but went back to above $0.72 before falling below that level after RBA Governor Lowe's latest "neutral" position on rates.

CoreLogic housing price statistics for January again showed falls in Sydney and Melbourne houses for the start of the year, this month by 1.4% and 1.7% respectively and for units 1.2% and 1.3%. The quarterly figures tell a similar story being down 4.9% and 4.8% and annually down 10.9% and 10.6%. Units were down 6.9% for the year in Sydney and 3.0% in Melbourne. Nationally the housing market weakened by 5.6% for the year, confirming a broad based downturn. The latest Residential Buildings approvals for December were down 8.4% and 22.5% yoy. Our News and Views inside covers the PCA semi-annual Office Market Report with trends continuing to improve everywhere.

There have been a number of changes in our market ratings and trends flowing from our Quarterly Update and adding separate categories for Houses and Units. Melbourne and Sydney staying Fair for both but with their trends having fallen back to Deteriorating. We now rate five markets as Strong or Good and four are in Sydney and Melbourne. Adelaide and Perth have six Weak ratings. Brisbane has three Improving trends as does Adelaide. Retail is Fair and Stable except Adelaide which is Weak. Retailers are struggling in most locations and recent sales indicate some softening of yields for sub-regionals and the recent downward revaluation of some assets by Vicinity has caught the market's attention.

	Sydney		Melbourne		Adelaide		Brisbane (SEQ)		Perth	
Resi- Houses	Fair	Deteriorating	Fair	Deteriorating	Fair	Improving	Good	Improving	Weak	Stable
Resi-Units	Fair	Deteriorating	Fair	Deteriorating	Fair	Improving	Soft	Deteriorating	Weak	Deteriorating
Commercial	Strong	Improving	Strong	Improving	Fair	Improving	Fair	Improving	Weak	Stable
Retail	Fair	Stable	Fair	Stable	Weak	Stable	Fair	Stable	Fair	Stable
Industrial	Good	Improving	Good	Improving	Weak	Stable	Fair	Improving	Weak	Stable

Sources: ABS, ACCI, AiG, ABS, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic RP Data,Cushaman & Wakefield, HTW, IMF, MSCI/IPD, JLL, Knight Frank, Melbourne Institute, OECD, PCA, RBA, RLB, Savills Research, Westpac Economics, World Bank

News and Views

- The January semi-annual Property Council of Australia (PCA) Office Market Report (OMR) leads off the New Year and showed improvements in all CBD markets' vacancy rates. In an article for the Australian Financial Review (AFR), Nick Lenaghan headlined "The big squeeze: less room for office tenants in Sydney and Melbourne" and went on to write: "Vacancy rates in the Sydney and Melbourne CBD office markets are at their lowest in a decade. At the same time, resource-based capitals of Brisbane, Perth and Adelaide showed the greatest vacancy rate declines over the second half of the year." Overall, Australian office vacancy fell by 0.7% in the six months to January 2019 to 8.5%. Savills Quarter Time National Office update reported further yield compression of from 35bps to 20 bps in these markets including fringe areas.

- With Melbourne at 3.2% and Sydney dropping to 4.1% as shown in Chart 1, both markets are now at "incredibly low levels", said PCA chief executive Ken Morrison. "While their headline vacancy results are similar, the supply and demand dynamics of Sydney and Melbourne are really a tale of two cities. Both markets have strong economic fundamentals, but the Melbourne CBD has seen both strong supply of new office space and strong demand for that space. In the Sydney CBD the combination of a net withdrawal of office space and a tight market has left demand nowhere to grow into."

- The Sydney CBD vacancy is 4.1% down from 4.6% in July last year due to withdrawals of space in the market. Sydney, however, is expecting another 80,000sq m to 100,000sq m of space between 2019 and 2020. The shortage lies with the premium to B-grade level spaces which have all had a drop in vacancy in the six months to January. C and D-grade vacancy have risen in the same period. The outcome of space constriction will be a further increase in rents, the Property Council said. The rise in rent is evident in 2018 when rents for prime offices rose 14.6 % while B-grade rents rose 13%. Other than Darwin CBD, Crows Nest showed the biggest improvement of any office market in the country over the past six months falling by nearly 4% while Parramatta at just below Melbourne CBD achieved the lowest vacancy rate in the country.

- With the tightest office market in the country, tenants and landlords in the Melbourne CBD are not surprised to see rents surging higher. As vacancy slipped further from 3.6% to 3.2%, average prime net effective rents increased by 7% over the past year to reach around $430 per square metre. Average incentive levels are edging to around 26.5%, although incentive levels continue to be higher for pre-committing tenants, according to Knight Frank's Hamish Sutherland. "Prime net face rents are forecast to increase by a further 9% by the end of 2019, with prime incentive levels forecast to trend down marginally towards 26% over the same period."

- While improving over the last 6 months, vacancy rates remain high in the other major Capital Cities we cover. Perth has dipped a little further below 20% at 18.5% and Adelaide has also improved moving down further below 15% at 14.2% as the build-up of momentum in the defence and mining sectors helped office vacancy rates fall slightly and incentives had dropped by between 5% to 8% in the past six months. Landlords with office buildings in city fringe locations are feeling the pinch as fringe vacancies increased from 11.0% to 12.6% in the six months to January, 2019. Brisbane has also done the same coming in a good bit lower at 13.0%. The improving economic environment has pulled the vacancy rate down 1.7% from 14.7% in July and over 3% down from a year ago. The demand that absorbed 25,192 square metres was a great indicator of positive activity in the economy and pushed Brisbane's CBD vacancy rate to its lowest level since mid-2013.

- Chart 2 shows the differences in performance between prime and secondary properties with all the Capital Cities showing higher vacancies in the latter. The stronger capitals of Sydney and Melbourne show similar patterns for both sectors with secondary vacancies below 5% while in Perth and to a somewhat lesser extent in Brisbane, prime vacancies are showing improvement but at the expense of secondary properties with tenants upgrading as leases mature and taking advantage of lease incentives reported as 50% in Perth and 35% in Brisbane. Secondary vacancies in Perth have now come down below 25% and are also reducing in Brisbane at well below 20% while Adelaide is just under 15%.

Chart 1: CBD Vacancy Change –Six Months to January 2019

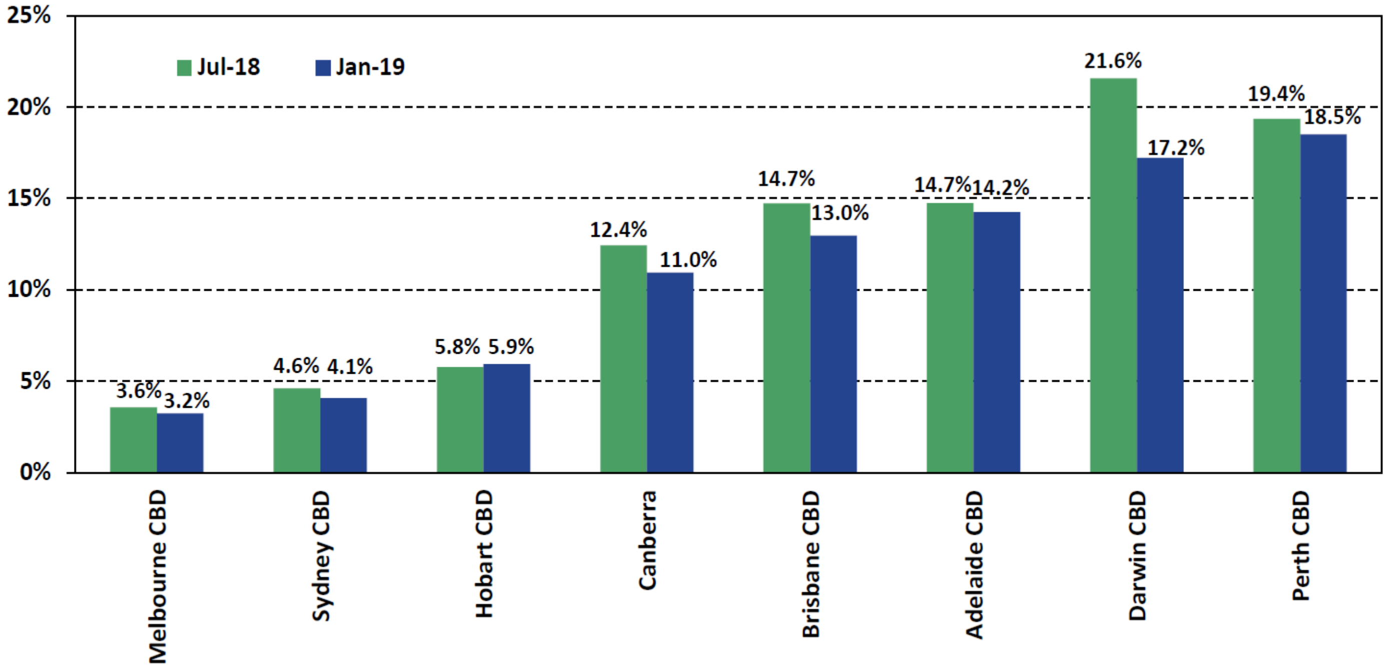
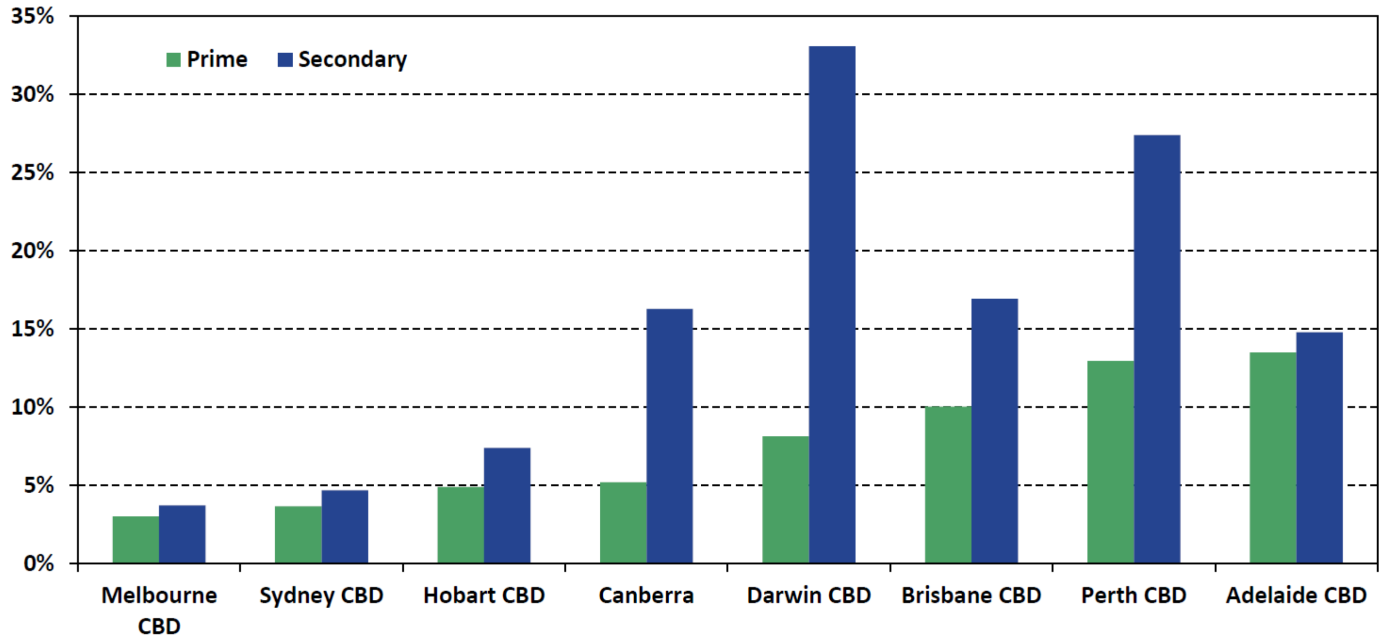


Chart 2: CBD Vacancy Rate –Prime vs Secondary –January 2019



Source: Property Council of Australia, Office Market Report January 2019

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- Set and forget loan terms up to 30 years with no ongoing fees or annual reviews
- Self-Managed Superannuation Fund (SMSF) loans up to 75% LVR, and
- Loan options ranging from fully verified to self-certification of income.

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