Thinktank

February 2020

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 by 1.8% in January to 93.4 well below 100 following a 1.9% decline in December. The AiG PMI for January was down by 2.9 points to 45.4 and staying in contraction below 50. The Westpac-MI Leading Index lifted slightly in December from -0.62 to -0.32 but still materially below trend. Westpac's current forecast for GDP growth in 2020 is 2.4%. The IMF announced global growth for 2020 expected to slow to 3.3% down by 0.1% on its last forecast and then rise slightly to 3.4% in 2021.

At its first meeting of 2020 in February the RBA Board held the Cash Rate steady for the time being at the record low of 0.75%. The following day Governor Lowe spoke of the possibility of further easing and the February quarterly SoMP will no doubt shed further light on future policy moves. The Q4 CPI came in at a slightly improved 0.7% with the annualised rate rising to 1.8%. Retail sales for November picked up thanks to "Black Friday" but was followed by a weak December. Importantly for interest rate forecasters, the Unemployment Rate for December dipped to 5.1%. The US Fed did not cut at its December meeting and Chairman Powell's remarks appeared to signal doubt about more cuts. Markets are expecting further easing by the RBA and the AUD has been falling below USD 0.68 with many senior economists now looking to a cut in April followed by another a few months later bringing the Cash Rate to only slightly above zero at 0.25%.

CoreLogic housing prices for January showed further strong gains in Sydney and Melbourne with houses up 1.5% and 1.4% respectively. Units were up as well, 0.3% for the month in Sydney and 0.7% in Melbourne but we remain concerned about the ongoing supply of newly completed apartments. The month-on-month lift of 0.9% in national housing values was also good and brought the annual recovery to 4.1%. Our News and Views section covers the semi-annual Property Council of Australia's Office Market Report.

There have been no changes in our ratings and trends this month following a holiday break in January. Melbourne and Sydney Residential remain at Good for Houses and with an Improving trend while Units are Fair and Stable in both cities. Industrial ratings in both cities also remain Strong matching the Office sectors there making four markets rated as Strong and Improving with all in Sydney and Melbourne. Perth's Resi-Homes rating moved to Fair back in December and Adelaide has three Improving trends and Brisbane has two. Retail is Fair and Stable except Adelaide which is Weak. Retail trends remain a concern and we discussed that in more detail in our Quarterly Update. Lendlease's sale of some assets in its APPF Retail are interesting to follow as is its ongoing retail strategy.

	Sydney	Melbourne	Adelaide	Brisbane (SEO)	Perth
Resi- Homes	Good Improving	Good Improving	Fair Improving	Fair Stable	Fair Stable
Resi- Units	Fair Stable	Fair Stable	Fair Improving	Fair Stable	Weak Deteriorating
Office	Strong Improving	Strong Improving	Fair Improving	Fair Improving	Fair Stable
Retail	Fair Stable	Fair Stable	Weak Stable	Fair Stable	Fair Stable
Industrial	Strong Improving	Strong Improving	Weak Stable	Fair Improving	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

- The January semi-annual Property Council of Australia (PCA) Office Market Report (OMR) was recently released and showed Australia's office markets remain strong, with Sydney and Melbourne CBDs at less than 4% vacancies and strong tenant demand in most other markets. Office vacancy rates fell in five of the eight capital city markets surveyed while more than one million square metres of new office space prepares to come onto the market this year. The report shows the national vacancy rate decreased marginally over the last six months to 8.3% compared to 8.4% in the previous period. The CBD vacancy rate was stable at 8%, while non-CBD vacancy decreased to 9.1% driven by increased demand which was at its strongest level in eight years.

- As shown opposite in Chart 1, the Melbourne CBD office vacancy rate of 3.2% is the lowest in the nation and at its record-low level having fallen by 0.2% over the past 6 months. Almost 400,000 sqm of new supply will come to the market in 2020, the biggest annual increase in three decades for which almost 90 per cent is pre-committed. Office vacancy in Sydney's CBD increased slightly to 3.9% from 3.7% mainly due to negative demand with major relocations to Parramatta and tenant consolidations. A large pipeline of premium office space is expected to come onto the market over the next few years, including 150,000 sqm in 2020, which will unlock major opportunities in the CBD. As was the case 6 months ago the five capitals we cover clearly fall into two categories with the other three all in double digits.

- Office vacancy increased by 0.8% in the Brisbane CBD to 12.7% despite historically strong levels of demand. The headline vacancy figure has been influenced by the addition of the 300 George St tower to the market, but absorption over the past six months has been well over double the historical average for the Brisbane CBD. Perth's CBD vacancy rate has fallen by 0.8% but remains high at 17.6%. Having said this, vacancy decreases and positive tenant demand have now been recorded over six consecutive periods. Adelaide has added almost 30,000 sqm of office supply additions which has seen an increase in the CBD vacancy rate by 1.2% to 14.0%. Additional supply of almost 27,000 sqm to come online this year and more than 50,000 sqm from 2022 reflecting optimism about the future of the Adelaide CBD but putting pressure on vacancy rates.

- 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 around 5% in both cities. In Adelaide and Brisbane as well as to a lesser extent in Perth, prime vacancies are showing improvement but still sometimes at the expense of secondary properties with tenants upgrading as leases mature and taking advantage of strong lease incentives. Secondary vacancies in Perth remain at 25% and are also little changed in Brisbane at 15% while Adelaide is at 14%. Almost all locations including Perth reported some improvement in face rents but only minor reductions in incentives with Perth's still being reported at 50%.

- Amongst the Chartbook released by the PCA with its report are several graphs including fringe market statistics along with the CBD markets. These range from demonstrating both actual levels of vacancies as well as rates of change. While as you would expect, most fringe markets run slightly higher vacancy rates than the CBD sectors in their cities but there are some exceptions. Of the 10 markets below the national average of 8.3% only Hobart was outside Victoria or New South Wales with non-CBD markets East Melbourne and Parramatta the two lowest. North Sydney where Thinktank is based and recently relocated within is just below the national average of 8.3%. Four of the five markets with the largest vacancy decreases were non-CBD markets including Southbank in Melbourne and Chatswood in Sydney. Our Melbourne office recently moved to Docklands which is reported as a precinct of the Melbourne CBD but its vacancy rate is practically nil.

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Chart 1 – CBD Vacancy Change –Six Months to January 2020

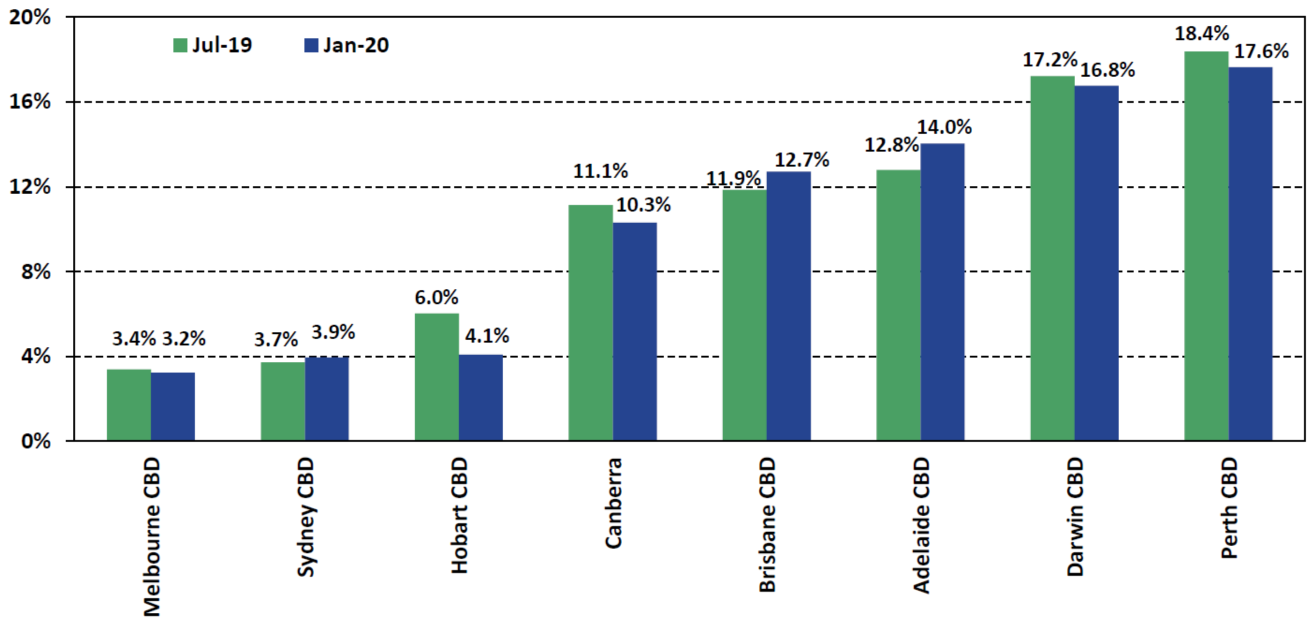
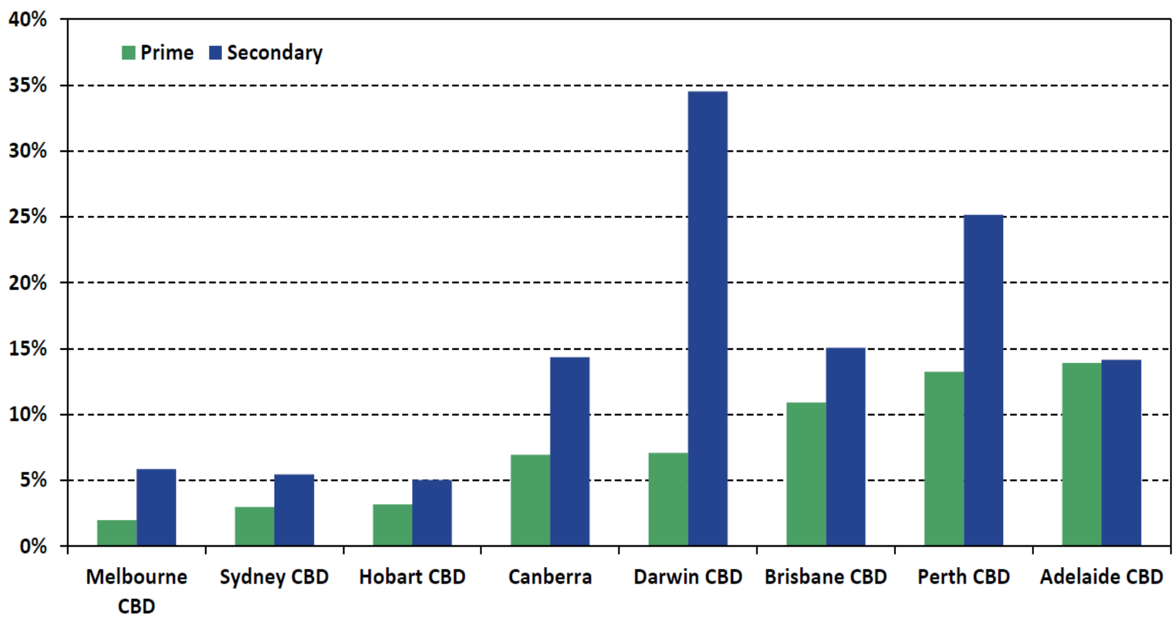


Chart 2 – CBD Vacancy Rate –Prime vs Secondary –January 2020



Sources: Property Council of Australia, Australian Financial Review

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February 2020

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- Self-Managed Superannuation Fund (SMSF) loans; and
- Loan serviceability options ranging from fully verified to self-certification of income.

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