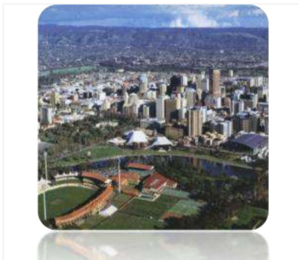
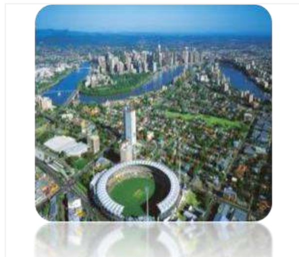
Thinktank

October 2019

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 1.7% in September after an unexpected rise in August; it now stands at 98.2 just slightly in negative territory . The AiG PMI for September was up by 1.6 points to 54.7 and moving further into expansion above 50. The Westpac-MI Leading Index was down in August to -0.35 from +0.01 in July, back below trend as it had been since November'18. The illion Business Expectations Index was also down to 7.6 its lowest since March'17 although the Actual Index was less hard hit at 19.7 .

At its October meeting, the RBA Board cut the Cash Rate for the third time this year to a new record low of of 0.75% with a further cut considered likely. Governor Lowe has already re-affirmed the prospect of further easing and the key was the pressure from higher unemployment. The Q2 GDP came in at 0.5% with annual growth slipping to 1.4%. The US Fed made its much anticipated change to rates at their September meeting but Chairman Powell's remarks appeared to signal some doubt about more cuts despite urgings from President Trump. With markets still pricing in further cuts to rates by the RBA the AUD dropped sharply after the FOMC action to below USD 0.68 and has stayed there for now.

CoreLogic housing prices for September showed further gains in Sydney and Melbourne houses at 1.9% for both. Units were up as well, 1.1% for the month in Sydney and 1.4% in Melbourne although we are still concerned about the ongoing supply of newly completed apartments. The month-on-month lift of 0.9% in national housing values was the largest monthly gain since March 2017 and has seen a shift to an Improving trend in a number of capital cities. Our News and Views section covers SMSF lending which has been topical recently as the regulator, the ATO has queried Trustees about portfolio diversification and the Federal Government has announced an inquiry into Superannuation.

There have been a couple of changes in our ratings and trends this month. Melbourne and Sydney Residential are confirmed as Fair for Houses but with an Improving trend. Units remain Fair and Stable, in both cities, despite comments above. Industrial ratings in both cities were upgraded to Strong earlier last quarter matching the Office sector there making four markets rated as Strong and Improving with all in Sydney and Melbourne. Perth's Weak Office rating moved to Fair. 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 discuss that in more detail in our Quarterly Update as we do all sectors.

	Sydney	Melbourne	Adelaide	Brisbane (SEO)	Perth
Resi- Homes	Fair Improving	Fair Improving	Fair Improving	Fair Stable	Weak 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, Cushaman & 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

- Each quarter SMSF statistics are published by the regulator, the Australian Tax Office (ATO). Figures for the June quarter are usually available by August however this is not the case this year so the quarterly March 2019 numbers have been used for our charts opposite. Quarterly numbers provided by the ATO are estimates and accordingly not a great deal of change is evident from one period to the next however the relationships between various asset classes is useful as is the comparison of funds invested in SMSFs versus other superannuation vehicles.

- On 27 September 2019, the Treasurer announced a Federal inquiry into the Superannuation System which is to report to the Government by June 2020. The Treasurer has already made clear that certain issues such as the exclusion of the family home from asset test levels will not change and it has also been assumed that the previously controversial franking credit tax treatment will remain. Compulsory superannuation is to be reviewed as will the level of contributions currently set to rise from 9.5% to 12% between 2021 and 2025. According to APRA's latest report, SMSFs makeup 26% of the Superannuation System, Industry Funds account for 25%, Retail Funds 22% and Public Sector Funds 18%. As shown in Chart 1, Total Assets and Members of SMSF are growing but remain relatively stable.

- One action previously suggested in regard to SMSFs by the Council of Financial Regulators in its February 2019 report was to ban borrowing within SMSFs and if that was not adopted then to prohibit the use of personal guarantees to support LRBAs and/or to use other regulatory responsibilities to reduce high leverage and concentration risk within SMSFs associated with LRBAs and investment in real property. The ban was specifically rejected by the Coalition Government with further review in three years.

- On the former point of members' guarantees, the report did not appear to recognise that this is common practice with almost all lending to small businesses. This is for the reason that the ultimate beneficiaries are those individuals whose guarantees are sought. Guarantees used to support LRBAs are specifically provided for in the SIS Act and ensure that their recourse to other SMSF assets is no less limited than the original lender and if funds are provided as a source of repayment these are then deemed to be contributions to the SMSF. More appropriately with respect to the latter issue asset allocation, the ATO has recently highlighted the obligation that Trustees have to prepare and review on a regular basis an Investment Strategy. Not only is this a sensible approach, it has addressed something that has been a long-standing problem and we would suspect will now be rectified quite quickly through firm regulatory action.

- The conclusion reached that LRBAs posed no systemic risk to the superannuation system reflects the fact that real property investment represents only a relatively small proportion of total SMSF assets as shown in Chart 2, being 14.3% as at March 2019 compared to 56.7% for cash, deposits and listed shares & trusts. Real property investment is broken down to 4.9% residential and 9.4% non-residential. According to the ATO, non-residential real property at the time made up 46% of that supported by LRBAs and is known as "business real property" (brp) when used "wholly and exclusively" for business purposes. It is recognised that owner occupied business premises make up a large part of this type of funding and that SIS Act regulations were specifically designed to allow for them. The benefits this offers to SME operators in planning and providing for their retirement are undoubted.

- The statistics published by the regulator continue to show that LRBAs remain at a level that is nowhere near problematic for SMSFs and that the real problems identified can and should be effectively dealt with through regulation and enforcement to eliminate any identified abuses. The ATO's efforts with respect to Investment Strategies and the late submission of Annual Returns is a great start to this as are ASIC's enforcement actions in recognition of failings by Licensed Advisers and others who owe a duty of care to Trustees and Members.

Chart 1 - SMSF Total Assets and Numbers

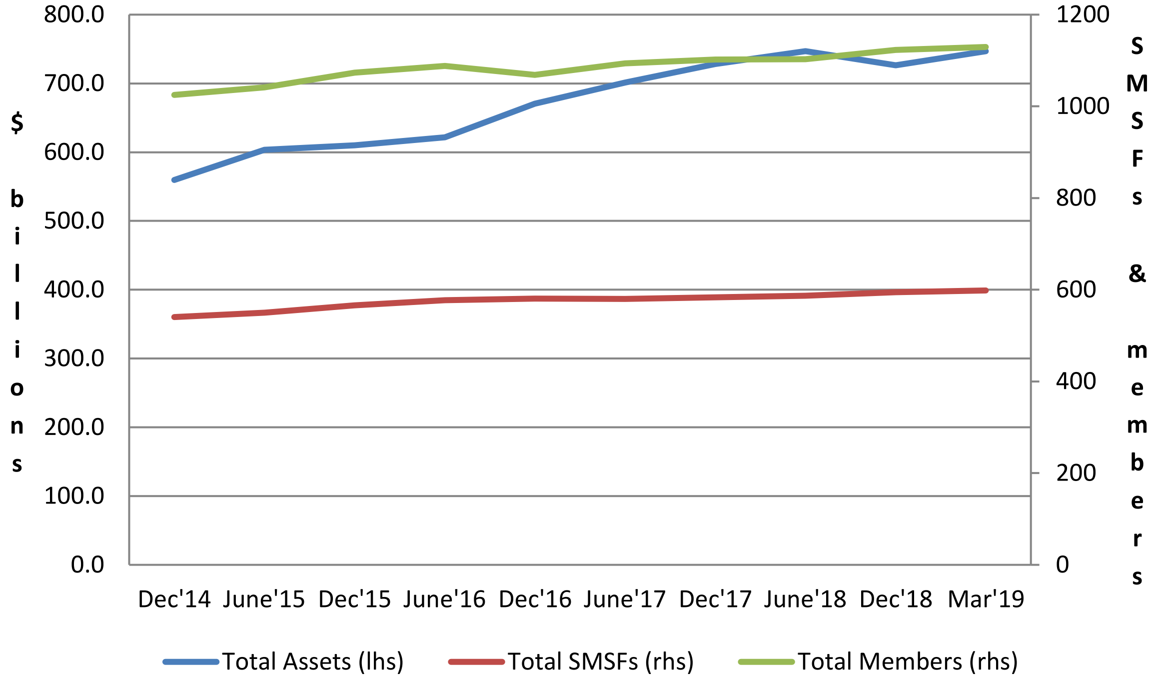
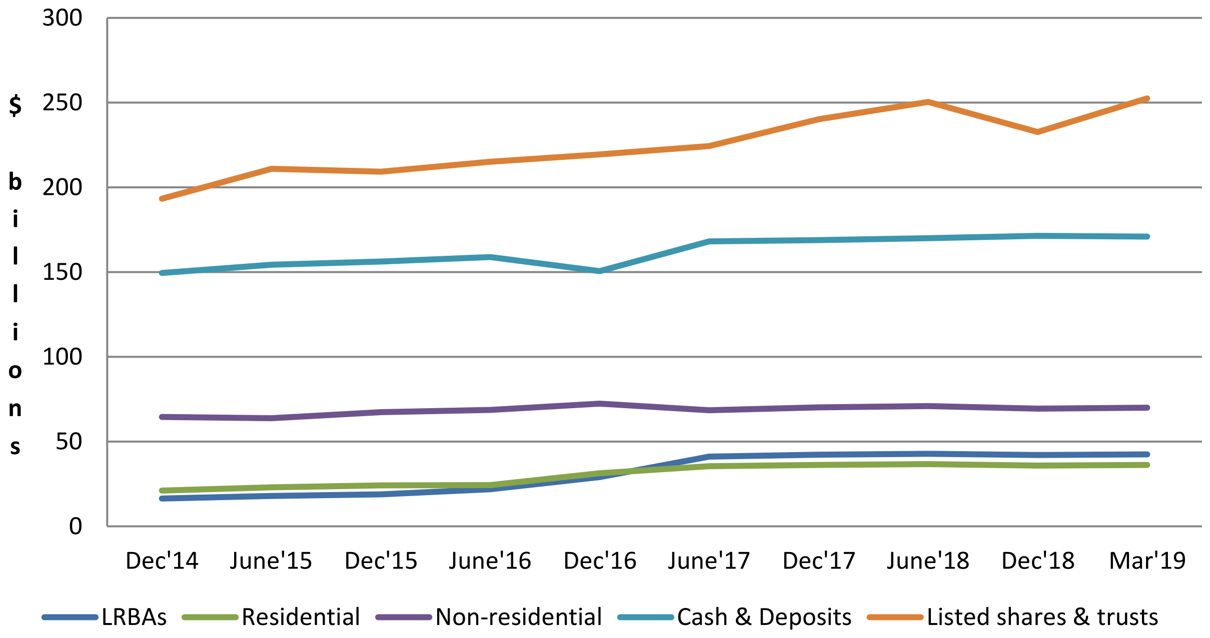


Chart 2 - SMSF Investment Portfolio Data



Source: ATO

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Thinktank Property Finance

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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; and
- Loan serviceability options ranging from fully verified to self-certification of income.

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