Australian real estate market focus

February 2022

Thinktank..

The following represents a monthly snapshot of how we see the property markets across the country along with the near-term outlook. For more in depth commentary, please visit our website thinktank.net.au for our latest Quarterly Market Update. This month in News and Views we take a look at some recent research that focusses on the Office sector and vacancy rates across the country as reported by the Property Council of Australia.

The Westpac-MI Consumer Sentiment Index fell by 1.3% this month to 100.8 after last month's fall, as did the Quarterly Index for December down to 50.8 from 51.2 in September. January's result for the AiG Manufacturing Index after a one month break saw it fall significantly by 6.4 points to 48.4 taking it back into negative territory below 50. Three of six sectors expanded with building materials up but with food and beverages falling sharply more than offsetting a good gain in November. After a spectacular rise of 14.9 points to 53.3 last October, the PCI Construction Index has started the year with a large fall of 11.1 points to 45.9 back into negative territory. Housing, commercial and particularly apartments recorded strong contractions. Very positively however, the PSI Services Index rose 6.6 points to 56.2 to get back into expansion with the best result since June last year and with all five activity indicators being positive.

At its first meeting of the year following its January break, the RBA Board as widely expected once again left the Cash Rate at the record low of 0.10%. However Governor Lowe's remarks updated comments found in the Statement on Monetary Policy (SMP) in which the RBA flagged some of the key changes to its economic forecasts all of which were positive. This led to a view that interest rates may rise earlier than expected later this year. Unemployment of 4.2% for December reinforced this view but was a very positive sign for the economy in general. While the December CPI of 3.5% was high it does not appear to have disturbed the RBA. 10 year US Treasury Yields were last traded up at 1.97% while AUS 10 year Gov't bonds were at 2.16%., a big increase and a high since March 2019. The AUD is now trading up again slightly at USD 0.7138.

CoreLogic dwelling prices for January continued the same trend of the past few months. National Housing values were up by 1.1% for the month and 3.4% for the quarter. In Sydney, House prices were up 0.8% for the month and a very strong 29.8% for the last 12 months. The results were a little less in Melbourne up 0.5% for the month and 17.8% for the past year. CoreLogic describes the market as "starting the year similar to where they finished 2021. The pace of capital gains remains positive, but increasingly diverse and generally slowing." There continues to remain a difference between Houses and Units with Units on a national basis up 14.3% for the year. The lending controls introduced by APRA last quarter do not appear to have had much impact and the question is what will an increase in interest rates do? The NAB has forecast a drop of 11% in housing values in 2023 on the basis of increased interest rates by the end of this year; we think this is overly pessimistic.

We continue to reflect the extension of the rise in Residential and retain confidence in the sector but have slightly modified our Ratings and Trends to good and stable across the board as noted above reflecting a gradual slowdown. Retail continues to be showing the expected signs of volatility. The December Retail numbers just released were down 4.4% on November which were up 7.3%. On an annual basis though sales were up 4.8%. No changes yet to our table until things stabilize. Industrial continues to be very strong and remains the market favourite and strengthening in all geographies in our view and as reflected in a recent CBRE national review. Office is recovering as workers return to the CBD with reports of improved leasing activity and major investments by sovereign wealth funds. The PCA OMR is reviewed in our News and Views section inside.

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
Resi- Homes	Good	Stable	Good	Stable	Good	Stable	Good	Stable	Good	Stable
Resi- Units	Fair	Stable	Fair	Stable	Good	Stable	Good	Stable	Good	Stable
Office	Fair	Stable	Fair	Stable	Strong	Stable	Fair	Stable	Fair	Stable
Retail	Weak	Stable	Weak	Stable	Good	Stable	Fair	Stable	Good	Stable
Industrial	Strong	Improving	Strong	Improving	Strong	Improving	Good	Stable	Good	Stable

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

News and Views

o With the start of a new calendar year it is always helpful to have the semi-annual Office Market Report (OMR) from the Property Council of Australia (PCA) to help assess how the sector is performing right across the country. The graph below shows over 30 years of results for CBD and non-CBD office properties nationally with the current rate for the non-CBD sector being 13.9% and the CBD at 11.3% with both up slightly in the past year and historically high at over 10%. Looking back to the early 1990s one can see what a huge shock the markets suffered as CBD vacancies rose above 20% but then recovered by the end of the decade.

o As noted in an AFR article recently, Chart 1 shows that demand for space in CBD towers has risen in every capital city across the country, defying concerns that the pandemic-inspired work-from-home trend would decimate office markets and bolstering confidence in central city real estate. Tenant demand rose an average 1% across the CBDs, and by 0.7% in suburban office markets over the last six months, according to the Property Council of Australia's latest office market report. With demand holding up, vacancy levels rates bumped up only slightly from 11.9% to 12.1% at a national level, with that uptick the result of new supply in office space. Vacancy rates rose in the last six months in only two CBDs: Melbourne, from 10.4% to 11.9%, and Brisbane, from 13.6% to 15.4%. Supply significantly outstripped demand in those CBDs. The resilience of CBD office markets amid the turbulence of COVID-19, with vacancy rates increasing by just 3.3% overall in the past two years, compares favourably with the 1990s recession, when vacancy rates blew out by 15.6% over three years.

o Chart 2 shows one clear trend emerging from the disruption, according to JLL Head of Office Leasing – Australia, Tim O'Connor, is the flight to quality as corporate tenants seek to woo their people back to the workplace. "Organisations are gravitating towards higher quality office assets with strong amenity, technology and ESG credentials. Space availability in office assets less than 10 years old is limited, and we expect to see new pre-commitment activity over 2022." This is reflected in most capital cities by the significantly higher vacancy rates experienced by secondary offices. The exceptions were Melbourne and Brisbane where vacancy rates rose in the last six months from 10.4% to 11.9% in Melbourne, and in Brisbane, from 13.6% to 15.4%. Supply significantly outstripped demand in those CBDs and vacancies in secondary properties were slightly less in both capitals.

o The AFR also carried an interesting article on the Parramatta Office market. "Property Council of Australia (PCA) data shows that vacancy rates across all office grades for the fast-growing western suburb, promoted as Sydney's second CBD, rose from 9.9% to 13.4%." Mark Martin, director of office leasing at CBRE, said the long-term outlook for the Parramatta office market remained positive, but it could be three years before A-grade vacancy rates fell in a meaningful way. A-grade rents have held firm so far, agents say, at between $640sq m to $650sq m with net incentives ranging between 35%to 42%.

PROPERTY COUNCIL of Australia

Australian CBD v Non-CBD Vacancy: 1990 – 2022

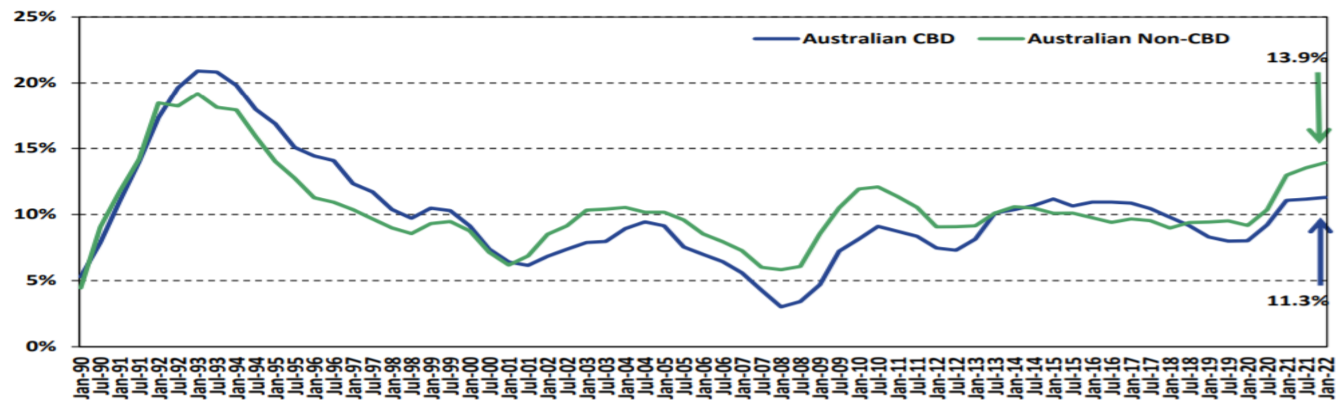

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Chart 1: CBD Vacancy Change – Six Months to January 2022

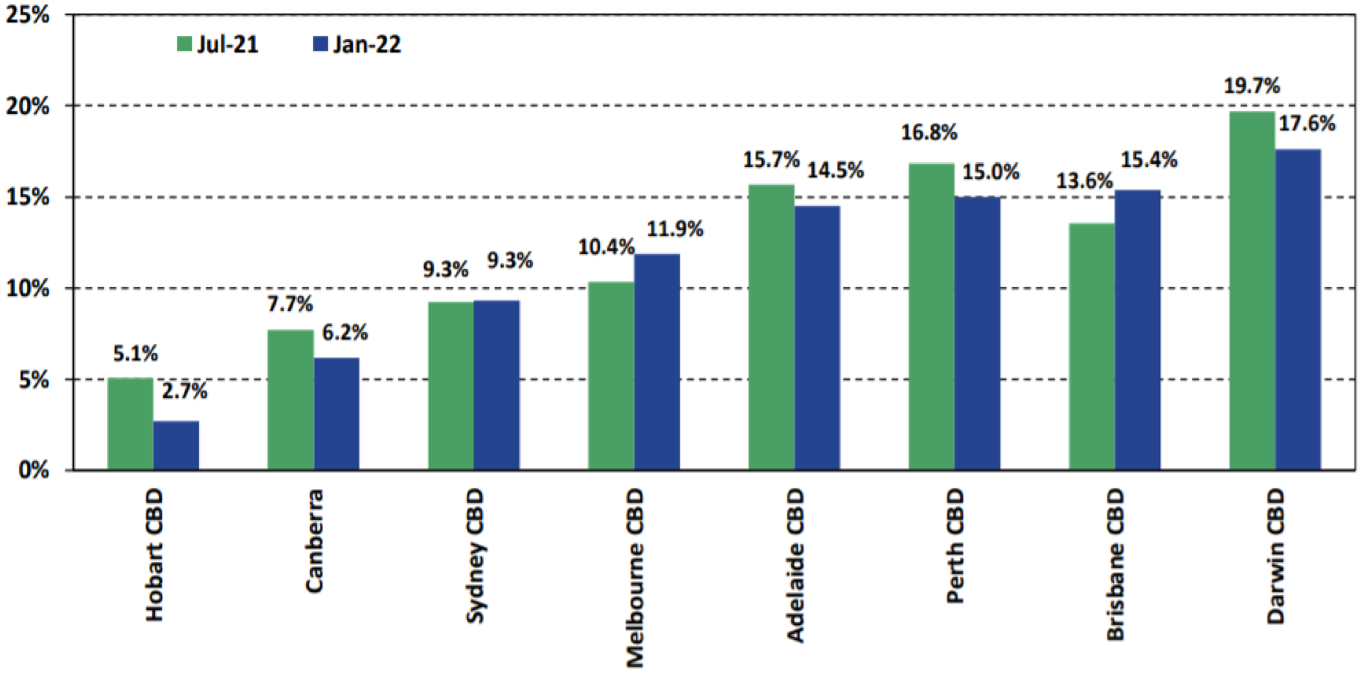
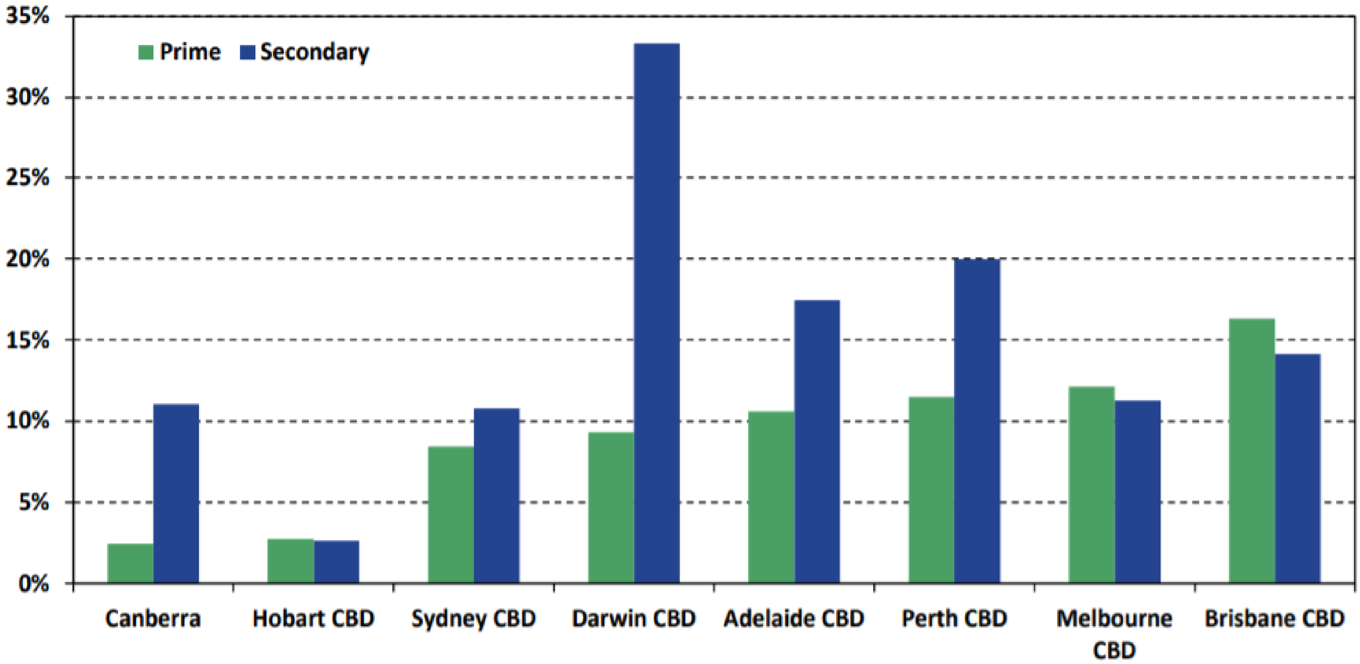


Chart 2: CBD Vacancy Rate – Prime vs Secondary – January 2022



Source: Property Council of Australia, Office Market Report January 2022

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