

Australian Commercial Real Estate Market Focus

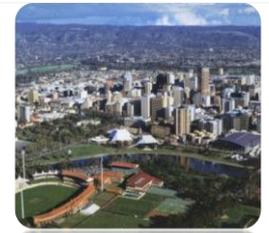
The following represents a monthly snapshot of how we see the commercial property markets across the country along with the near term outlook. For a more detailed commentary, please visit our website thinktank.net.au for our Quarterly Market Update.

The W-MI Consumer Sentiment Index made up all the loss in January and more with a 4.5 point increase in February bringing the index to 101.8 and above the 100 level of optimism. The AiG-PMI for February also rose by 2.0 points to 53.5 its highest level since July 2010. In contrast the latest 2016 Global Growth forecast from the OECD was pulled back again by 0.3% to 3.0%. This time however the drop was mainly in US GDP down 0.5% to 2.0% from its November outlook and Europe, down 0.4% to 1.4%.

The RBA Board met for the second time in 2016 on 1 March and as most expected the Cash Rate was left at a record low 2.0% for another month. More economists though are starting to agree with the market and are now forecasting a drop in rates later in the year. This has always been the view of the ANZ's Chief Economist Warren Hogan but his counterparts at Westpac and CBA are sticking to a cautious view of no change. Unemployment rose in January by 0.2% to 6.0% which seemed somewhat at odds with the RBA's quarterly SoMP. The 2.0% result for the quarterly underlying CPI released in late January was in line with recent RBA targets and leaves room for interest rate cuts if needed. While the January meeting of the FOMC indicated that their March meeting was still "live" for a possible further increase in the Fed Funds rate this now looks a lot less likely; tellingly, the AUD/USD has moved from just under 0.69 to just under 0.72.

The most recent residential auction results in Sydney and Melbourne appear to support our ratings for both markets despite new claims of a 'bubble' in Australian housing markets. The RBA's Assistant Governor recently spoke of regulatory measures taken to mitigate risks in the housing market. He also identified a second area of risk focus as being in commercial property. The RBA issues its semi-annual Financial Stability Review in March and is almost sure to outline any concerns it may have at that time. Current property yields continue to make Australia a popular destination for investors both in direct property and property debt but with strong regional preferences. This is well illustrated in the PCA Office Market Report which is the focus of our News and Views segment.

With two changes this month, we have seven markets that are Good and six that are Weak. Sydney and Melbourne Residential trends are Stable with Good ratings and all of the rest of their sectors are Improving. This compares to Perth and Adelaide which have ten ratings Weak and/or Deteriorating. In Brisbane with Residential now Stable, Good/Improving ratings and trends now equal Weak/Deteriorating ones. Adelaide Industrial moved to Weak similar to the Perth market. The weakness in their Commercial sectors, and that of Brisbane is also reflected in the PCA Office Market Report.



	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
RESIDENTIAL	Good	Stable	Good	Stable	Fair	Stable	Good	Stable	Fair	Deteriorating
COMMERCIAL	Good	Improving	Good	Improving	Weak	Deteriorating	Weak	Deteriorating	Weak	Deteriorating
RETAIL	Fair	Improving	Fair	Improving	Weak	Stable	Fair	Stable	Fair	Stable
INDUSTRIAL	Good	Improving	Good	Improving	Weak	Deteriorating	Fair	Improving	Weak	Deteriorating

Sources: ABS, ACCI, AiG, ABS, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic RP Data, HTW, IMF, IPD, JLL, Knight Frank, Melbourne Institute, OECD, PCA, RBA, , Savills Research, Westpac Economics

News and Views

- The Property Council of Australia issued their semi-annual Office Market Report in February and it proves to be a good follow-up to our last month's News and Views on the two or three speed economy that exists in Australia. Property Council Chairman Ken Morrison said in the PCA's news release "Demand for offices in Sydney and Melbourne is roaring along – but the story is not even. Office vacancies in Brisbane, Perth, Canberra, Adelaide and Darwin are more than double that of Sydney." Nationally the vacancy rate was almost static, rising very slightly from 10.4% in July 2015 to 10.5% in January 2016. Mr Morrison said the flat national vacancy rate belied the significant differences between the cities and regional areas as well as the different capital cities.
- Sydney continues to lead the country with the lowest vacancy rate of 6.3% which is steady with its result six months ago as shown in Chart 1. In noting that the Sydney CBD office market is experiencing its strongest demand in a decade Acting NSW Executive Director Felicity Wilson said; "Sydney's CBD saw positive demand at the top end of the market, matched by strong supply additions. Net absorption totalled 96,745sqm in the six months to January 2016 – more than triple the historic average. While the vacancy rate for premium grade assets increased from 5.2 per cent to 8.1 per cent, reflecting the timing of new supply, the A grade vacancy rate fell from 6.7 per cent to 5.4 per cent". These differences don't show up in the rates for Prime and Secondary properties which are shown in Chart 2 but that certainly isn't the case in some other cities. Together with the Melbourne Commercial sector shown below, we rate Sydney and its southern neighbour as Good markets with Improving trends.
- Melbourne recorded a surprising drop in vacancy over the past six months and is now down to 7.7% with this trend expected to continue. There is quite a significant variance depending upon the locale within the CBD with increased vacancy in the Western Core and Spencer but well balanced by very tight availability of space in the rest of the CBD with Docklands as an example falling from 7.0% vacancy in July 2015 to 5.0% in January 2016. Secondary vacancies are somewhat higher than for Prime space but not nearly to the extent of say Brisbane or Perth. It would not be difficult to see Melbourne and Sydney moving to a Strong market rating dependent upon some rental growth and lessening of incentives.
- Adelaide reveals some very wide differences in vacancies by grade of office building in the six months to January 2016, with D-Grade vacancy increasing from 19.7% to 20.6% eclipsing the 20.4% vacancy set more than two decades ago in July 1995. The overall Adelaide CBD office market vacancy in the six months to January 2016 hit 14.1% - up from 13.5% in July last year - and is now at its highest level of vacancy since July 1999. The CBD premium building stock vacancy however decreased from 9.4% to 7.7% and was the only segment to record a decrease. Concerning the overall upward movement in vacancy, the report noted Adelaide's vacancy levels will continue to trend upward due to low demand.
- Brisbane and Perth are the last of the five capital cities we cover for Commercial and together with Adelaide are rated by us as Weak with Deteriorating trends. Unfortunately the latest vacancy figures do not give us any reason to consider a change. While Brisbane has remained steady over the past six months at 14.9%, the market is bracing for a long expected influx of new space over the next 12 months. Perth's vacancy is almost at 20% rising from 16.6% in July 2015 to 19.2% however a diminishing pipeline of new supplies indicates that Perth can expect the market to stabilize in the year ahead. As shown in Chart 2 both Brisbane and Perth secondary office vacancy is much higher than prime.



Chart 1: Office Vacancy, July 2015 & January 2016

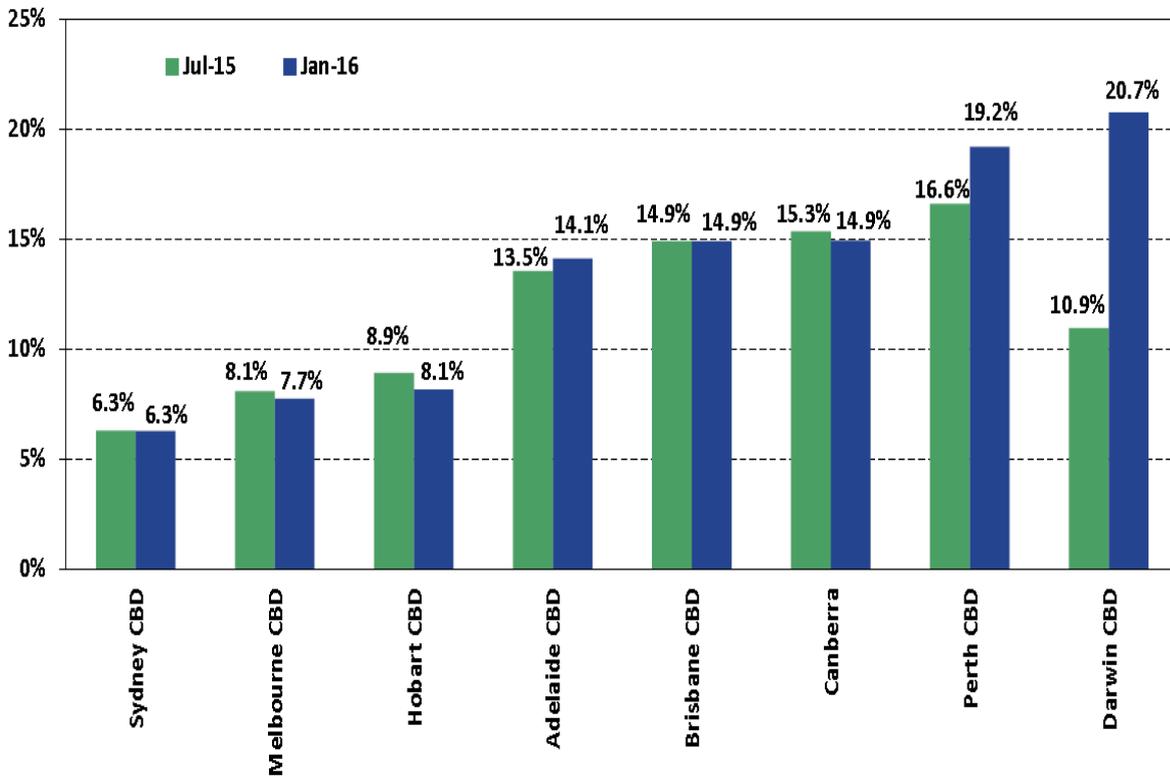
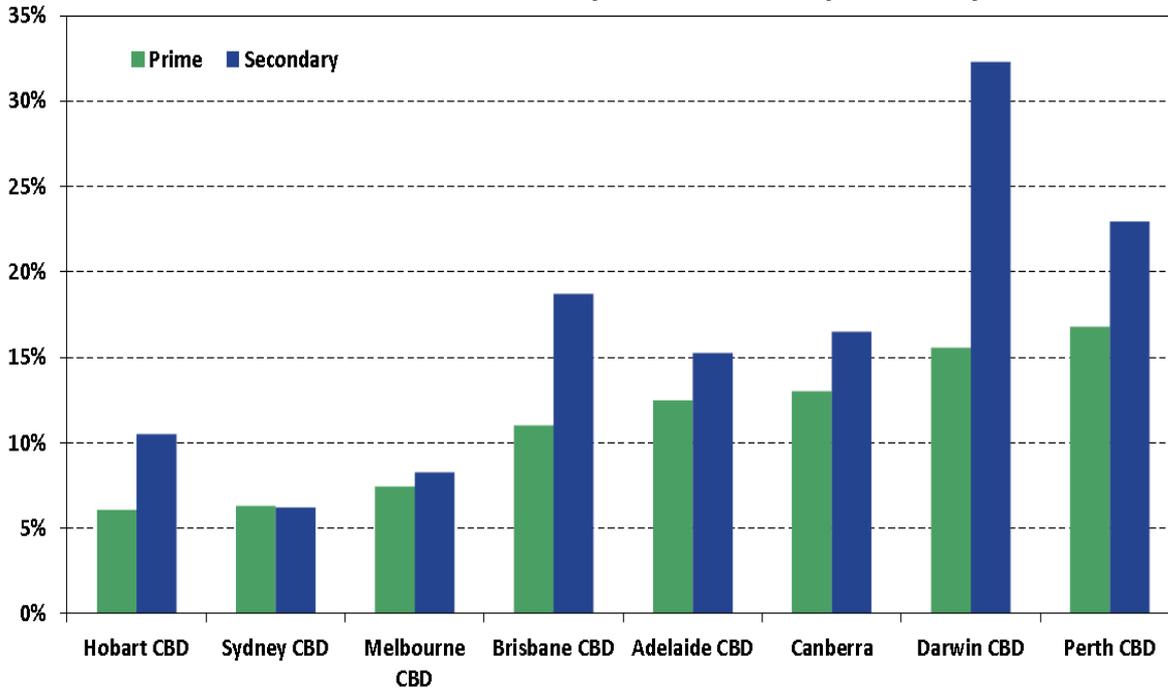


Chart 2: Prime and Secondary Office Vacancy, January 2016



Source: Property Council of Australia

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