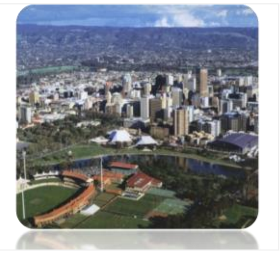
Australian Commercial Real Estate Market Focus

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 fell 4.0 points in April bringing the index to 95.1 well below the 100 level of optimism. The AiG-PMI for April also fell by 4.7 points to 53.4 reversing recent gains. The looming election and the 3 May budget quite naturally leads both consumers and business to be more cautious and with the long lead-up to the expected polling date of 2 July, the April-June quarter is shaping up to be one in which everyone sits on the sidelines. The Budget itself was quite uneventful except for 'smokers' and 'retirees' who bore the brunt of increased taxes and changes to superannuation rules.

The RBA Board met on the same day that the budget was delivered and in response to the shock deflationary result in the quarterly CPI figures, the Board cut the Cash Rate by 0.25% to 1.75% for the first change in a year. While many market economists surveyed had expected a cut, some were still sticking to a cautious view of no change for 2016. The RBA's quarterly SoMP to be released at the end of the first week of May will no doubt contain many answers as to the RBA's thinking. The -0.2% result for the first quarter headline CPI and the annual underlying rate of 1.5% certainly leaves room for further interest rate cuts if needed and many are already calling for a second 0.25% cut in August. The April meeting of the US Federal Reserve's FOMC indicated that their June meeting was still "live" for a possible further increase in the Fed Funds rate but the AUD/USD had remained at a higher than wanted 0.76 until the Cash Rate cut when it fell to 0.74. A Fed increase in rates at their September meeting appears more likely, if at all.

We have seen plenty of research this past month following our latest Quarterly Update but nothing that has led us to adjust any of our sector ratings or trends. The RBA issued its semi-annual Financial Stability Review (FSR) in April which is the subject of our News and Views section. We feature comments made in it about the property markets which indicate some concern about the rise of values in spite of rising vacancies and falling rents in some markets. The observations will be familiar to those who follow our own monthly and quarterly comments. After more than a year of concentrating heavily on residential markets the focus is shifting somewhat to commercial which we discuss overleaf.

With no changes to our ratings this month, we have seven markets that are Good and six that are Weak. Sydney and Melbourne Residential trends remain 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. Brisbane lies somewhere in between with Commercial vacancies heading up but with other sectors Stable or Improving.

	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

- Every six months, the Reserve Bank of Australia (RBA) issues its Financial Stability Review (FSR). Maintaining the stability of the financial system is a longstanding responsibility of the Reserve Bank and is most prominently documented in this semi-annual publication. Its most recent FSR was issued on 15 April 2016 and amongst a number of other issues, it highlighted comments on the Australian property markets, both residential and commercial in its Overview. “Over the past six months, domestic financial risks have shifted from housing lending towards lending for residential development and some other commercial property markets. …the tighter access to credit for households could pose near-term challenges in some medium and high-density construction markets given the large volume of building activity that was started several years ago. Risks seem greatest in the inner-city areas of Melbourne and Brisbane, where new supply is most geographically concentrated, and increasingly in Perth.”

- Concerning the dilemma of tighter yields while vacancy rates are rising and rents stagnating in some locations it had the following comments that accompanied Chart 1: “This is most noticeable for office buildings in the resource intensive states, where vacancy rates remain very high as further supply continues to come on line. More broadly, commercial property yields have compressed across a range of market segments and there are some questions over their sustainability at these levels once global interest rates normalise.” With respect to Charts 2 & 3 and Western Australia and Queensland the FSR had the following to say: “Conditions and risks in the non-residential property market vary across the major cities although a broad-based phenomenon has been declining yields as prices and rents diverge. Prices for office, industrial and retail property continue to rise sharply on the back of strong investor demand. Conditions are particularly weak in the Perth and Brisbane office markets. Resource related tenants and, in Brisbane, the public sector, have scaled back office space requirements at a time when significant new supply continues to come on line. The vacancy rate is climbing sharply in Perth, reaching almost one-quarter of properties, and remains high in Brisbane, and rents are falling.”

- Comparing the above to New South Wales and Victoria: “In contrast, conditions in the Sydney and Melbourne office markets are much firmer and have improved over the past year, reflecting the stronger economic conditions in these cities. Vacancy rates have declined and rents have risen as tenant demand for space has increased strongly, both within and outside the CBD areas. For industrial and retail property, yields have also fallen as continued strength in investor demand, including from foreign investors, has driven solid price growth in these sectors, while at the national level rents have been flat. Consistent with economic conditions, investor and tenant demand have been solid in Melbourne and much weaker in Brisbane and Perth. In the retail sector, conditions have also been noticeably firmer in Sydney and Melbourne than in Brisbane and Perth.”

- This dilemma which is reflected in our property markets is central to the RBA’s monetary policy which will be updated on 6 May 2015 with the release of its latest Statement on Monetary Policy. Across a country as large and diverse as Australia it is inevitable that regional disparities will exist and as a result setting monetary policy that suits each market equally is simply not always achievable. Just the week after the release of the FSR, RBA Governor Stevens delivered a major speech to a global conference in New York highlighting the need for policies beyond central bank actions in order to keep a strong focus on durably lifting growth prospects. This suggests that the further cut in the Cash Rate was considered to be key in contributing to a higher level of economic activity than currently forecast by the RBA.

Chart 1: Australian Commercial Property, Prices and Rents

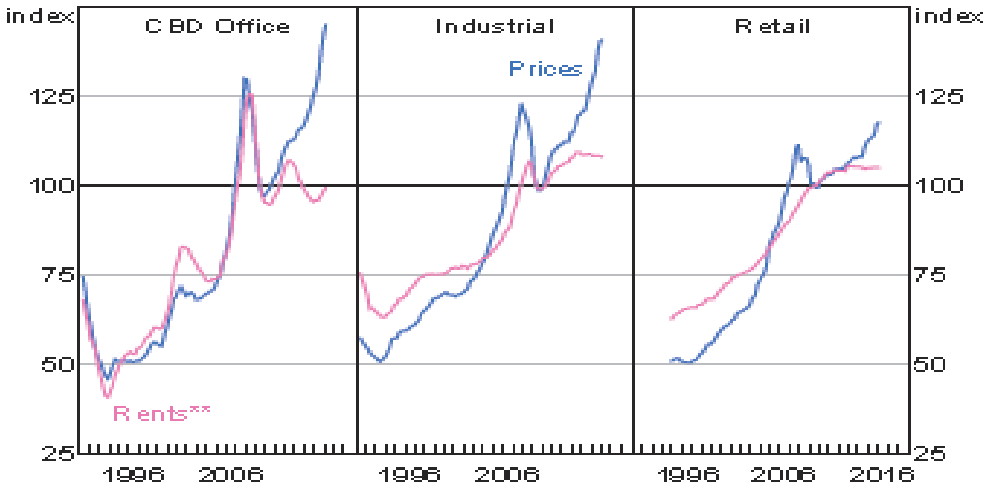


Chart 2: Prime Capital City CBD Office Property, Prices and Rents

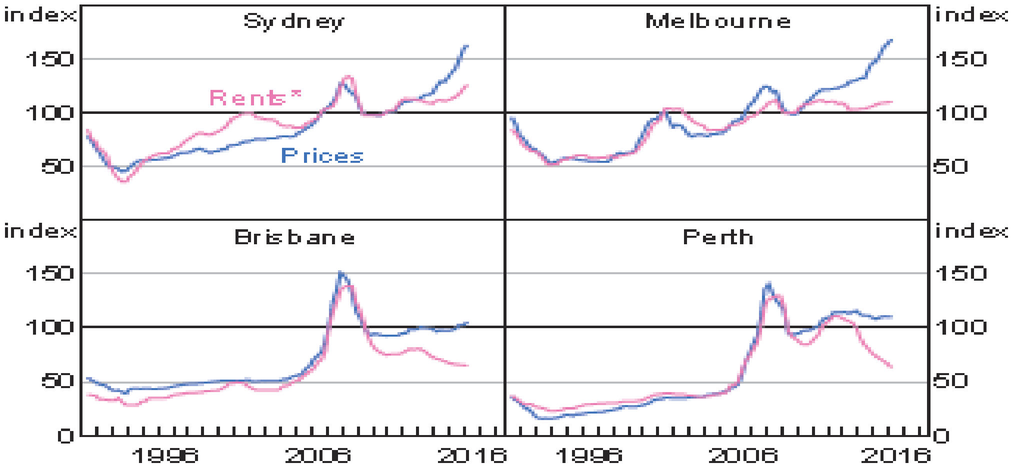
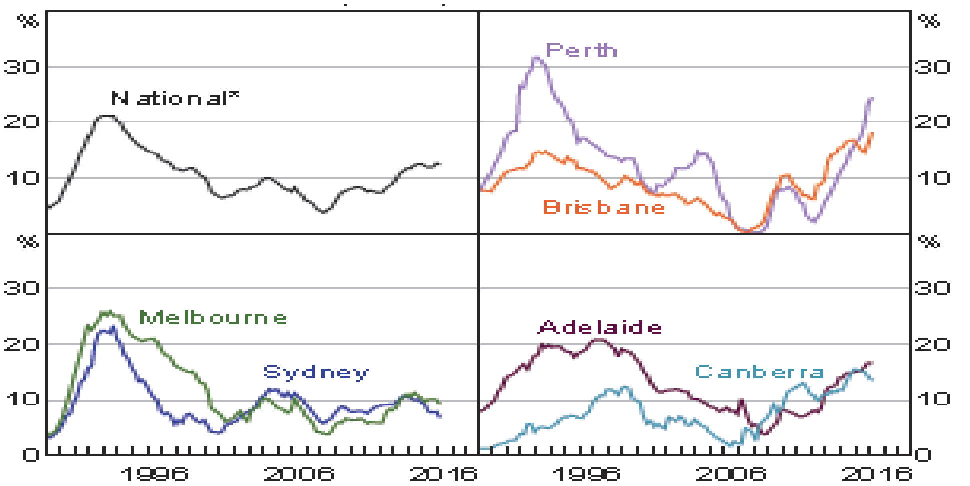


Chart 3: Office Vacancy Rates – Capital City CBD Markets



Source: Reserve Bank of Australia, JLL Research

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