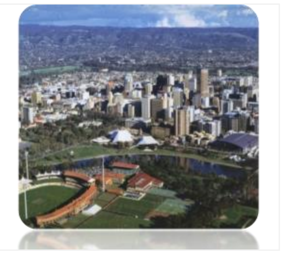
Thinktank

Leading Commercial Finance

July 2016

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 back by 1.0 points in June after a big rise in May on the back of the RBA's interest rate cut. This brings the index back to 102.2 but still above the 100 level of optimism. The AiG-PMI for June rose by 0.8 points to 51.8 and remains in expansion above 50 points. No doubt the anti-climax of the very long Federal election campaign on 2 July with the very real prospect of a hung parliament will fail to bring with it any renewed confidence in the economy. The expected very slim margin in the House of Representatives and the lack of any resolution to the Senate stale-mate will fail to build on the surprisingly strong first quarter GDP growth of 1.1% bringing annual growth to an above trend 3.1%. The impact of Brexit also remains an unknown and perhaps was a precursor to our own election surprise that many failed to recognise.

The RBA Board kept rates steady again this month at their July Board meeting immediately after the election. They are widely expected to cut again in August if the second quarter CPI figures which are due for release on 27 July confirm the ultra-low cost of living statistics which were -0.2% in the first quarter. One might expect that the election result will make such a cut even more probable. The Brexit vote in the UK has also seemed to put any chance of an interest rate increase by the US FOMC out of the question for the immediate future thus easing any upward pressure on our rates.

Not unexpectedly, residential homes prices and auction clearance rates have picked up again in Melbourne and Sydney. Many of us however continue to be concerned about the state of the multi-unit high-rise development market. Both unit and house markets have reacted predictably to the May cut in interest rates. The trouble is there is evidence of looming oversupply in a number of inner-city unit markets. We look at this in more detail in our Quarterly Market Update. The subject of our News and Views section overleaf is SMSFs with analysis and comment on the most recent statistics released by the ATO. We also look at the future of the Superannuation budget measures in light of the surprise election result and the possible impact these may have had on the vote.

Somewhat surprisingly we have made no changes to our ratings/trends this month. As a result we still have seven markets that are Good slightly outnumbering the six that are Weak. Sydney and Melbourne Residential trends remain Stable with Good ratings although our focus is more on homes than it is units which as mentioned above are a worry to us. Five of the eight Sydney and Melbourne sectors are Improving. Perth and Adelaide still have ten ratings Weak and/or Deteriorating. Brisbane's Commercial is still Deteriorating with 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	Stable	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 Australian Tax Office (ATO) now releases quarterly statistics on the Self-managed Superannuation Funds (SMSFs) that have been established and remain current together with their asset allocation and any liabilities reported including Limited Recourse Borrowing Arrangements (LRBAs). We have chosen to graph these statistics on a semi-annual basis to allow for a five year view of activity since June 2011. The charts overleaf provide a good illustration for the commentary that follows on the growth of SMSFs in general and more specifically how they are managed by their trustees/members with respect to Investment Strategy and Asset Allocation.

- What is show in Chart 1 is the growth of SMSFs which is continuing at a steady pace since the GFC and at an even faster rate with respect to the growth of assets held within SMSFs. No doubt those choosing to manage their own superannuation savings in this way would certainly in part be motivated by the attractiveness of having a direct say and control in the assets that their superannuation funds invests in. The reported number of SMSFs has grown from 440,400 in June 2011 to 566,000 last December. Members per SMSF remains just under two will total assets have grown by nearly 50% from around $400 billion to just under $600 billion with assets per SMSF now exceeding an average of $1 million.

- Chart 2 shows the outcomes of the Investment Strategies established by SMSF Trustees and how the high levels of Cash & Deposits has been maintained over the years reflecting the relatively conservative nature of most SMSFs. With interest rates at historic lows however we can see that Listed Shares is growing more quickly over the last few years adding $59.6 billion since June 2012 while Cash & Deposits have only grown by $17.8 billion. Together these two asset classes represent well over 50% of Total Assets. The other asset class that has grown quickly over the past five years is Direct Property which is only accessible in superannuation through SMSFs. Direct Property has grown by over 50% from $62.3 billion to $97.9 billion but as a percentage of Total Assets has only moved from 15.5% to 16.5%.

- Often mentioned in any statistical analysis of SMSF portfolios is the growth in LRBAs which have gone from a modest $1.4 billion in June 2011 to $18.8 billion in December 2015. This rate of growth received a lot of attention in the Murray Financial System Inquiry (FSI) but largely ignored the small percentage that it represented of Total Assets at 3.2%. These LRBAs are secured mostly by Direct Property, both Residential and Non-residential and of these assets it represents only 19.2%. Our expectation is that this will continue to grow in large part as a result of the attraction of long-term owner-occupied investment in ‘business real property’. The structural advantages of such an investment for retirement planning are significant especially in the current low growth environment which is likely to last for some time.

- A very prominent issue of late for SMSFs has been the potential impact of the May Federal budget measures on superannuation which caused considerable concern particularly with respect to the retrospectivity of the proposed lifetime limit on non-concessional contributions to $500,000 dating from 2007. An article in The Australian entitled “SMSF ‘golden age’ over: Credit Suisse” just before the election, quoted analysts from the international investment bank as claiming that the SMSF sector will be hardest hit, with growth in the asset base tipped to slow sharply. While we found the comments rather excessive before the election, it is clear now that almost all of the measures will never be legislated; of them the tax free ‘pension phase’ limit of $1.6 million is not dissimilar to Labour’s $75,000 tax free pension income threshold and could remain. The rest have little or no support from any side of politics.

Chart 1 - SMSF Total Assets and Numbers

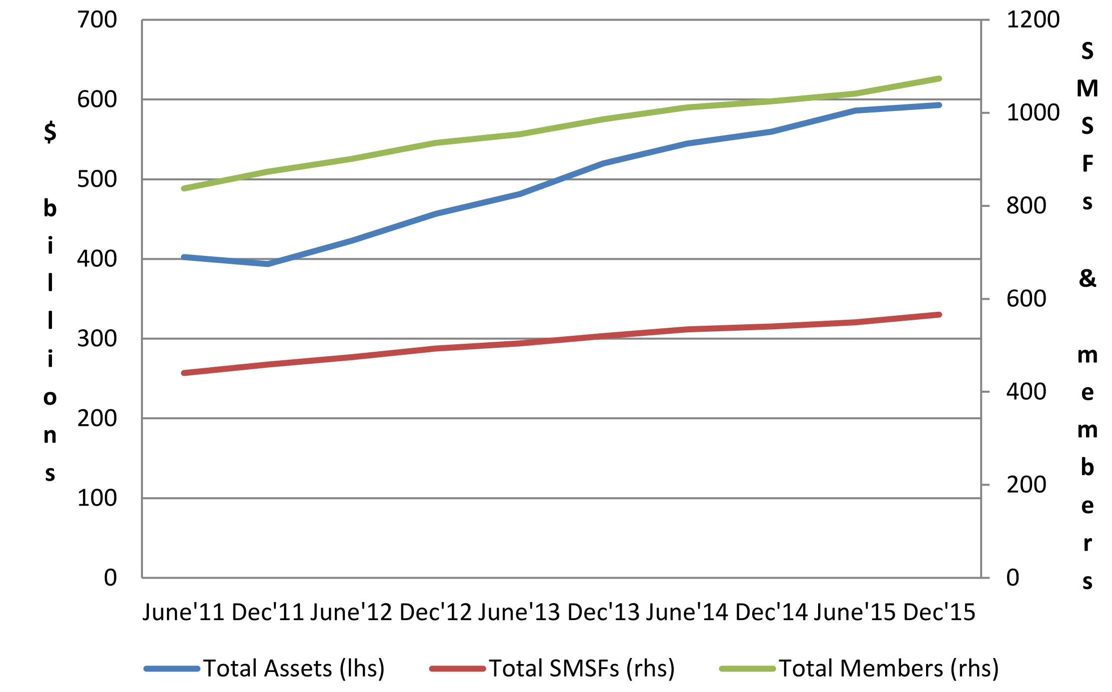
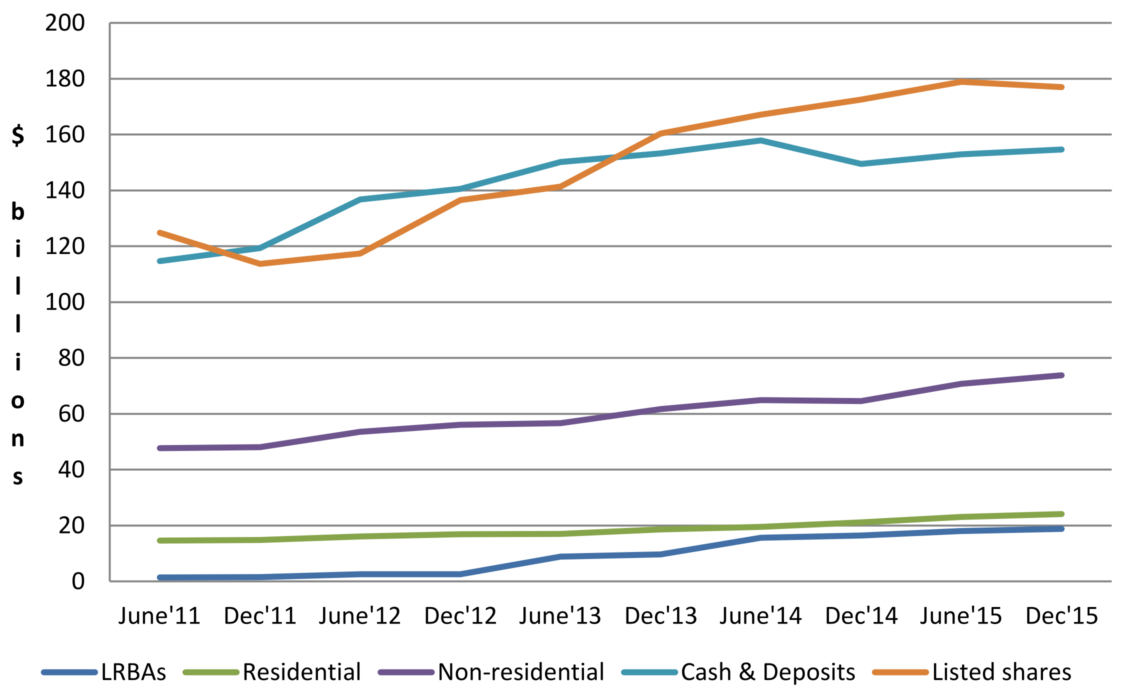


Chart 2 - SMSF Investment Portfolio Data



Source: Australian Tax Office website

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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 up to 75% LVR, and
- Loan options ranging from fully verified to self certification of income.