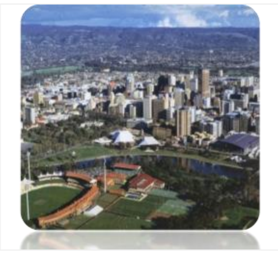
Thinktank

Leading Commercial Finance

September 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 rose by 1.9 points in August bringing it back over the 100 level of optimism to 101.0. This was in contrast to the AiG-PMI for August which plummeted by 9.5points to 46.9 well into contraction territory below 50. At the same time the D&B Expectations Index rose 5.5 points to 17.8. It is interesting to observe the varying trends in consumer and business sentiment. Consumers appear encouraged by the August rate cut by the RBA although far less so than the earlier May cut when the index rose 8.1 points. Westpac puts this down to political unease with the election result. A further contradiction is that both AiG and D&B also attribute their results to the election.

As expected the RBA Board left rates unchanged in September following its cut in August to a new record low of 1.50% after another low CPI figure for the June quarter. We took a closer look at CPI in last month's News and Views segment and no doubt it will play an important part in contributing to the RBA's decision on Melbourne Cup Day in November which will be its first meeting following release of the third quarter CPI statistics. Market economists see no chance of a move before then at the October meeting but are evenly split as to a November cut. We think this is the bottom of the current cycle and are expecting an increase in rates by the US Federal Reserve FOMC in December which will start a steady reduction in the AUD/USD exchange rate which is back up to around 0.76.

The semi-annual PCA Office Market report was issued in early August and is featured in our News and Views section. The two speed economy once again features prominently with Melbourne and Sydney strengthening and other capital cities weakening. Residential homes prices and auction clearance rates have risen even more in Melbourne and Sydney. Other States have enjoyed little of the same push from lower interest rates and WA is falling and will continue to do so for a while yet. The trouble is the evidence of looming oversupply in a number of inner-city unit markets which we have noted for some time now. This is finally getting more widespread attention and will be an issue for Melbourne and Sydney in the future and perhaps even more so for the smaller Brisbane.

We have made no changes to our ratings this month despite plenty of additional information and research as noted above. As a result we still have seven markets that are Good and seven that are Weak. Sydney and Melbourne Residential trends remain Stable with Good ratings noting that our focus is more on homes than it is units which remain a concern for us. Five of the eight Sydney and Melbourne sectors are Improving. Perth and Adelaide still have eleven ratings Weak and/or Deteriorating. Brisbane's Commercial remains Weak and Deteriorating with vacancies heading up as noted overleaf as they are in Perth and Adelaide. The trends for other Brisbane sectors remain Stable or Improving.

	Sydney		Melbourne		Adelaide		Brisbane (SEQ)		Perth	
Residential	Good	Stable	Good	Stable	Fair	Stable	Good	Stable	Weak	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 Property Council's half yearly *Office Market Report*, released in early August, revealed starkly different fortunes for the nation's leading office precincts depending on the interplay of supply and demand, driven by the city economies. The AFR's headline was "Sydney top, Perth bottom: leasing is city by city affair." Sydney's CBD office towers are finally filling. As shown in Chart 1, the vacancy has fallen to 5.6 per cent, tenants are competing for space, rents are rising and investors are keen to get set. In Perth, the opposite is happening. The towers are emptying and across the city the vacancy rate is 21.8 per cent, the worst in 20 years. Rents are falling and building values are on the slide. "What we are seeing is a major divergence of performance between the states, between CBD and non-CBD markets and in the supply outlook for each city."

- The Sydney and Melbourne have the strongest numbers, with Sydney facing some new supply and Melbourne challenged by a surprising weakness in demand. In Brisbane the demand has been surprisingly strong but the challenge has been, and continues to be, new space coming on-line. And Perth has been hit by the double whammy of collapsing demand just as new towers are finished. Rents follow the vacancy. According to JLL, Sydney prime gross effective rents rose 12.2% over the past year. Much lesser increases have been recorded in Melbourne, 2.6%, Canberra, 2.5% and Adelaide, 1.4%. But in Brisbane rents have fallen by 2.1%, and in Perth by 13.7%.

- The Secondary vacancy rates shown in Chart 2 are higher than Prime except in Sydney where permanent office stock withdrawals are having quite an impact. This will be ongoing for some years to come, according to research from Knight Frank, with record withdrawals forecast over the period of 2016-2019. At a national level, the CBD vacancy rate increased slightly to 11 per cent, due to the completion of new towers. In the non-CBD precincts, like Parramatta and West Perth, the vacancy rate fell to 9 per cent as buildings were taken out of the market for redevelopment or refurbishment.

- The Knight Frank research referred to above identified 29 office properties in the Sydney CBD and a further 11 in the Sydney North Shore as being withdrawn from the market with only 10 of the 40 in total identified as being for office redevelopment. Four are for the Metro Rail project and four for hotel development supported by the resurgent tourism sector. 45% of office stock removed is for residential conversion/redevelopment. While not as large as Sydney, withdrawals in Melbourne are still significant numbering 21 in the CBD and St Kilda with another eight in Southbank and other suburban office markets. Only five are identified as being for hotel or student accommodation with all the rest being residential with no office redevelopment. This has been noted as a real concern in Melbourne where five years ago, as the apartment boom was taking hold, residential floor space was growing at 2.5 times the rate as commercial space and now the ratio of residential development to commercial is approaching five times. Brisbane features the same trend with 17 CBD buildings to be withdrawn.

- The AFR also noted that national demand, which reflects the strength of white-collar employment, is half the historic average while 520,800sq m of new office space will be open in the next six months, which is 60 per cent higher than the average. Colliers International, said that while the markets outside Sydney and Melbourne had ground to make up, "in the medium to long term they will follow suit, particularly Brisbane." On the Colliers numbers, the national demand for office space was strong in the first half with space leased up 17% on 2015 and the inquiries, as recorded in the Colliers Office Demand Index, were 22% higher in the June quarter than in March.

Chart 1: CBD Vacancy Change – Six Months to July 2016

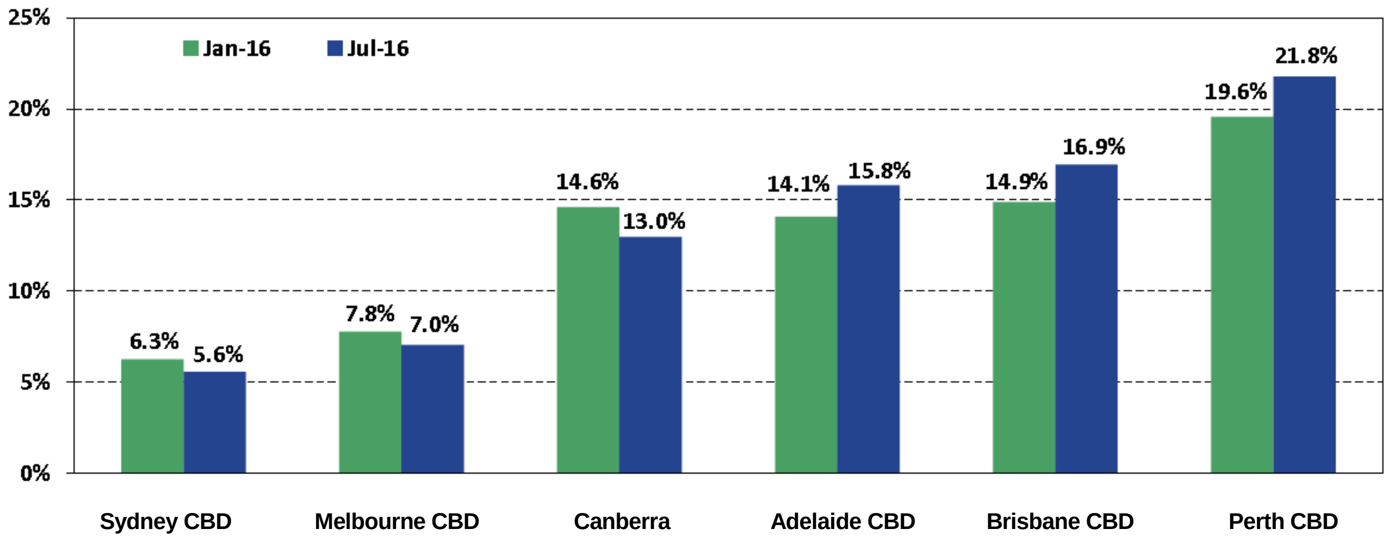
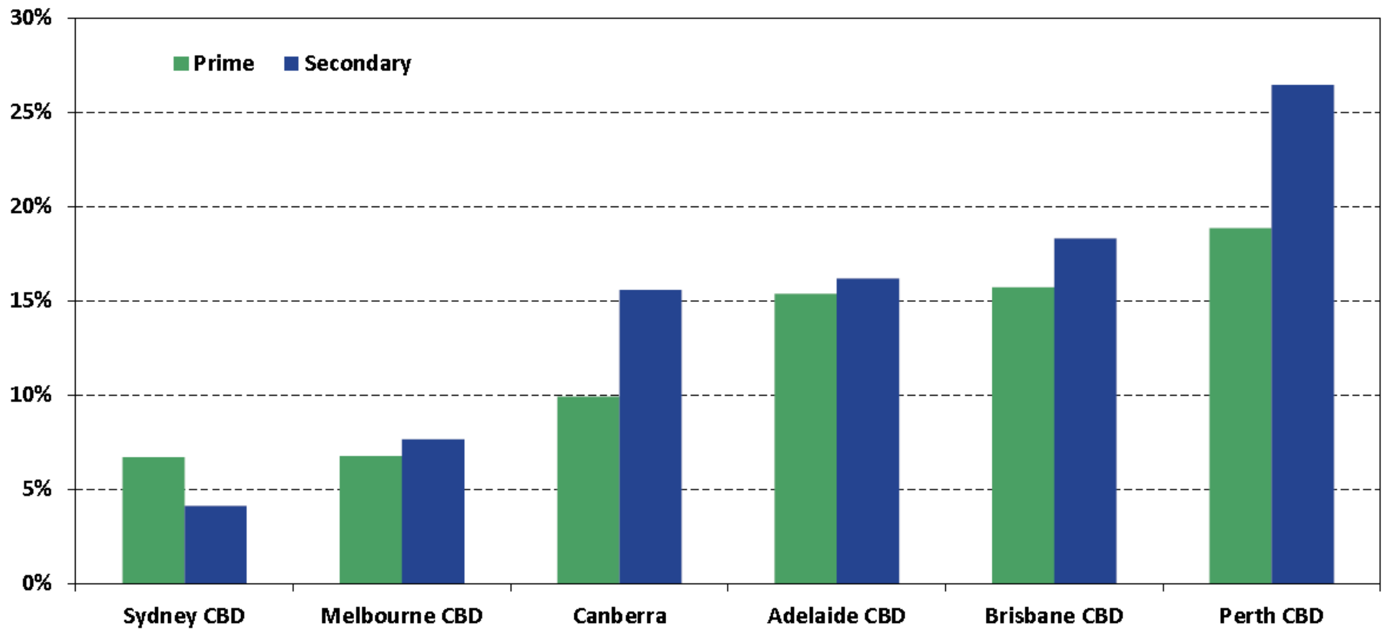


Chart 2: CBD Vacancy Rate – Prime vs Secondary – July 2016



Source: Property Council of Australia

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