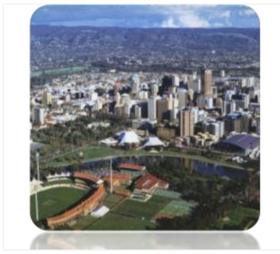
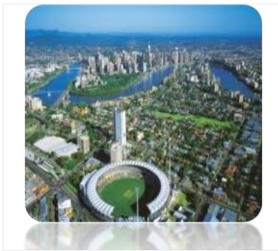
Thinktank
Leading Commercial Finance

August 2018

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 in July by 3.9 to 106.1 and well into optimistic territory above 100. The Westpac Leading Index however was down for a second month to -0.33% from 0.11% and the AiG PMI for July was also down by 5.4 points to 52.0 but still in positive territory above 50. The Services PSI fell heavily in July by 9.4 points to 53.6 from a record high of 63.0 in June. The Retail Trade sub-sector index rose 1.3 to 50.2 just into expansion. Retail sales for June also picked up at 0.4% and for the quarter were up 1.2% after a first quarter of just 0.2%. The Construction PCI rose 1.4 points to 52.0.

At its August meeting the RBA Board left rates unchanged for another month at the record low of 1.50% now marking two years at that level. Unemployment remained 5.4% following positive first quarter GDP figures of 1.1% gain for an annual rate of 3.1% and inflation remains low at 1.9% for the same period. The US Fed after raising rates in June left them unchanged in August but is widely expected to raise rates again later in the year. AUD/USD which had contradicted most economists earlier, has stayed down around the $0.75 to $0.74 level but is now forecast by Westpac to drop to $0.72 by the end of the year. Ten year Treasury bond rates in the US have remained high but still below 3.00% at 2.92%, but well above comparable Australian bond yields that are at 2.65%.

CoreLogic housing price statistics for July again showed a fall of 0.6% in Sydney and 0.9% in Melbourne. The quarterly figures tell the same story being down 1.1% and 1.8% respectively. Nationally the market weakened by 1.6% for the year, the fastest annual rate since 2012. The "Softening" trend established last year continues in the Sydney and Melbourne markets which we rate as Fair with further similar price movements expected. While the Construction PCI mentioned above rose in July, the Apartment sub-index plummeted by 11.7 points to 36.7 having experienced steady or declining activity in 11 of the past 12 months. In this month's News and Views we are reviewing the results of the PCA Office Market Report which has confirmed the continued improvement in all markets but with Sydney and Melbourne remaining way out in front of the other capital cities.

There have been no further changes since last month's Quarterly Update Melbourne and Sydney Residential fell to Fair from Good with their trends still Softening. We still rate four markets as Strong or Good and all are in Sydney and Melbourne. Adelaide and Perth have six ratings Weak and all trends are Stable. Brisbane has one Improving trend which is Industrial and Commercial that remains Weak but Stable. Retail is Fair and Stable except Adelaide which is Weak. Retailers continue to struggle despite Stable property prices and a pick-up in second quarter sales. We continue to watch the sector closely.

	Sydney		Melbourne		Adelaide		Brisbane (SEQ)		Perth	
Residential	Fair	Softening	Fair	Softening	Fair	Stable	Fair	Stable	Weak	Stable
Commercial	Strong	Improving	Strong	Improving	Weak	Stable	Weak	Stable	Weak	Stable
Retail	Fair	Stable	Fair	Stable	Weak	Stable	Fair	Stable	Fair	Stable
Industrial	Good	Improving	Good	Improving	Weak	Stable	Fair	Improving	Weak	Stable

Sources: ABS, ACCI, AiG, ABS, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic RP Data,Cushaman & Wakefield, HTW, IMF, MSCI/IPD, JLL, Knight Frank, Melbourne Institute, OECD, PCA, RBA, RLB, Savills Research, Westpac Economics, World Bank

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News and Views

- At the beginning of August, the Property Council of Australia (PCA) released their semi-annual Office Market Report (OMR) which showed improvements in all CBD markets' vacancy rates. In an article for the Australian Financial Review (AFR), Matthew Cranston headlined "A moment in the sun for landlords" and went on to write: "Every capital city in Australia now has a lower percentage of available office space to rent out than it did six months earlier following big shifts in supply levels and strong demand from businesses. Around the country demand from the resources, state governments, infrastructure and engineering have driven the demand. The average vacancy across the country is now 9.1%, down from 9.8% in January."

- Chart 1 overleaf shows the individual comparative numbers for all Capital Cities. While demand has been the key driver around the country, the PCA statistics show that any reduction in vacancy from changes in supply was largely confined to Sydney. There, the amount of withdrawn office space was the same level of the newly built office supply coming into the market. Concerns about future supply levels should also be brought to attention. These are sharpest in Melbourne, which is expected to produce around 500,000 square metres of new space in at least 12 new buildings in the current two to three-year cycle.

- Landlords are forecasting vacancy in Australia's largest office space market, Sydney, will drop to "well below" 4% after the latest PCA figures showed another tightening in available space due chiefly to withdrawals. The city's vacancy rate tightened to 4.6% from 4.8% in the six months to July. CBRE noted Sydney was in a strong position when it came to charging tenants rents. "We are in unprecedented territory with respect to the low, long-term vacancy which is continuing to drive rentals. We have already witnessed 7.5% net effective rental growth in the prime grade market in the first half of 2018 and we are forecasting 12.5% growth in total for the year ending December 2018." Outside the Sydney CBD, North Sydney showed the biggest improvement of any office market in the country over the past six months falling 1.6% to 6.3% while Parramatta at 3.2% achieved the second lowest vacancy rate in the country after the Melbourne CBD.

- Melbourne's office market vacancy has hit at a 10-year low of 3.6% as white-collar jobs growth drives the take-up of commercial space. It is the tightest vacancy rate in the country, down from 4.5% six months ago and nearing the record low of 3% a decade ago. The squeeze has pushed average prime net effective rents up by 7.2% over the past year and incentive levels are now around 26%. Knight Frank's Hamish Sutherland said, "Looking ahead, with the shortage of supply in the medium term, prime net face rents are forecast to increase by a further 7% by the end of 2018 and Prime incentive levels were forecast to trend down towards 24% over the same period.

- At the other end of the spectrum, Perth has dipped a little further below 20% at 19.4% and Adelaide has also improved moving down below 15% at 14.7% as the build-up of momentum in the defence and mining sectors helped office vacancy rates fall slightly. Brisbane has also done the same coming in just a bit lower at 14.6%. The improving economic environment pulled the vacancy rate down 1.5% from 16.1 % in January and reversed the deterioration the city suffered in the previous six-month period, when demand for lower-grade office stock fell.

- Chart 2 shows the differences in performance between prime and secondary properties depending on the Capital City you are looking at. The stronger capitals of Sydney and Melbourne show similar patterns for both sectors while in Perth and to a somewhat lesser extent in Brisbane, prime vacancies are showing some modest improvement but at the expense of secondary properties with tenants upgrading as leases mature and taking advantage of lease incentives reported as 50% in Perth and 35% in Brisbane. Secondary vacancies in Perth have now come down below 30% and are also reducing somewhat in Brisbane at below 25%. In Sydney we have the rare situation of vacancy rates for secondary property at 4.2% being just slightly lower than prime which is at 4.6% largely because of supply constraints and rapidly rising net effective rents.

Chart 1: CBD Vacancy Change –Six Months to July 2018

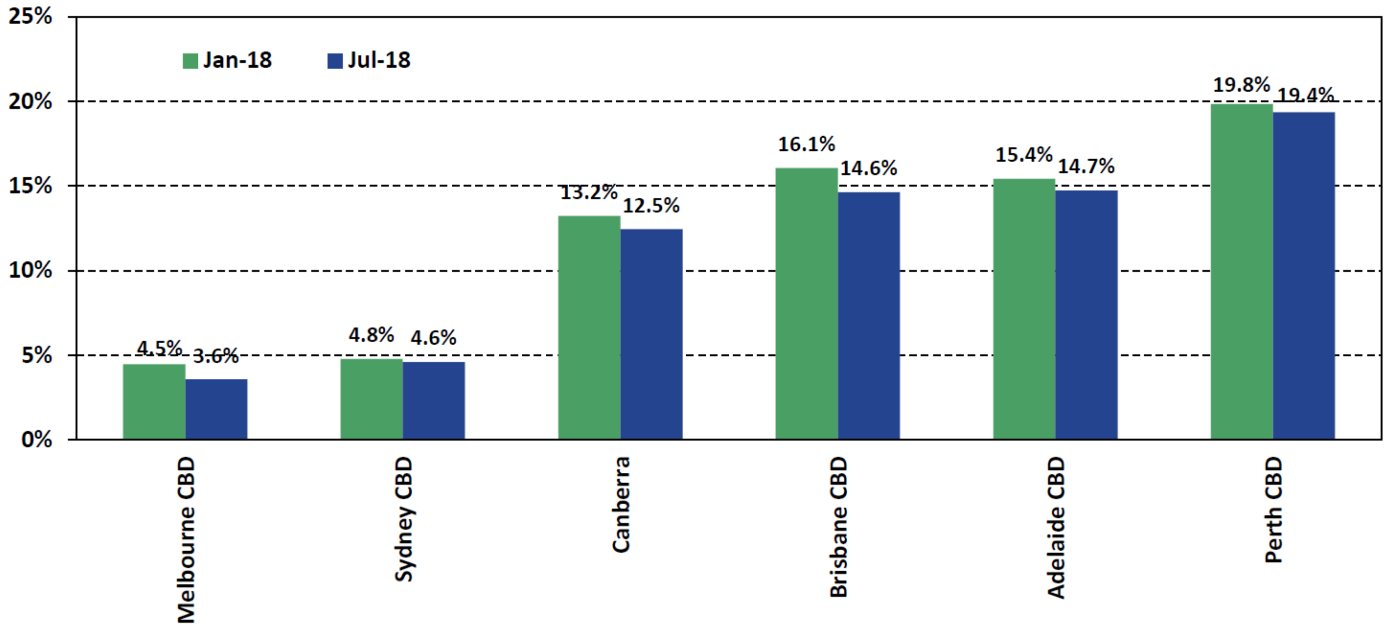
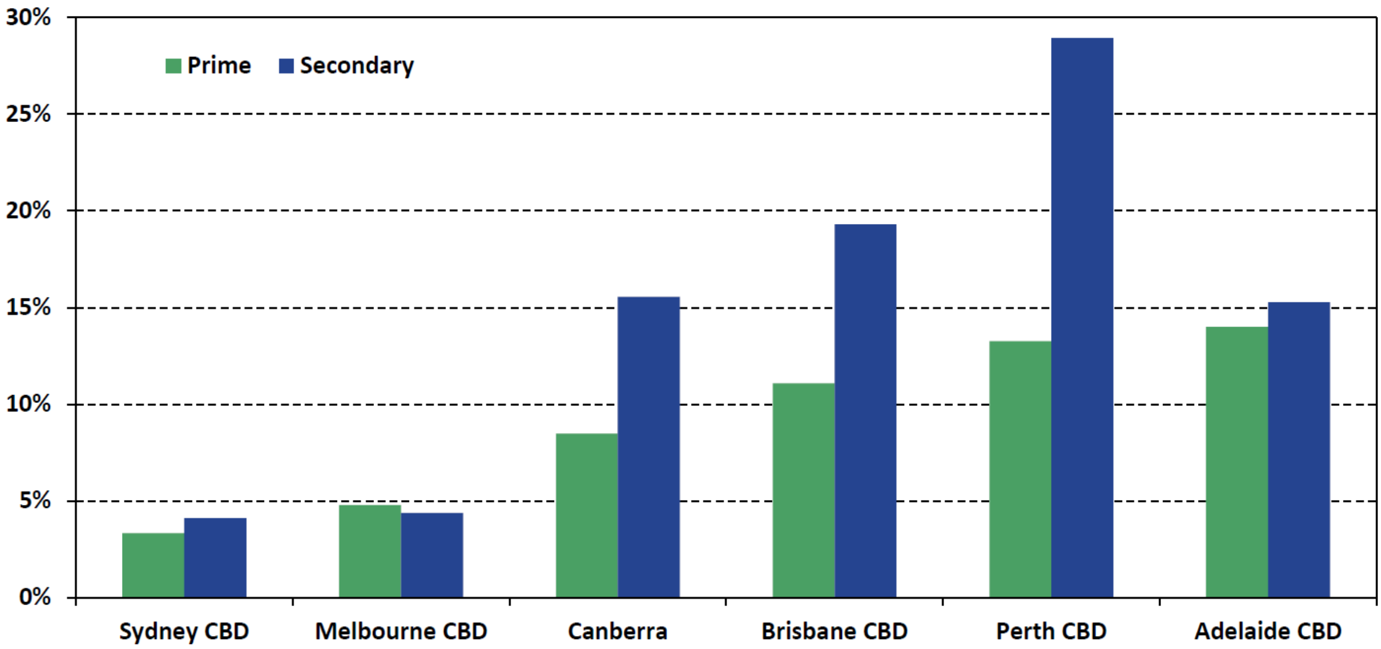


Chart 2: CBD Vacancy Rate –Prime vs Secondary –July 2018



Source: Property Council of Australia, Office Market Report

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