Thinktank

Leading Commercial Finance

March 2019

Australian Real Estate Market Focus

The following represents a monthly snapshot of how we see the 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 Westpac-MI Consumer Sentiment Index rose in February by 4.3% to 103.8 moving out of pessimistic territory below 100 at the start of the year and the AiG PMI for February also recovered by a further 1.5 points to 54.0 after moving back into positive territory last month. However the Westpac-MI Leading Index was down in January to -0.43 from -0.29 in December. Stephen Koukoulas of "illion" surprisingly advised their preliminary 2Q Business Expectations Index indicated a marked improvement in their outlook.

At its March meeting the RBA Board left rates unchanged at 1.50% after having shifted to a neutral bias last month and fuelling speculation of cuts later in the year. Economic data continues to fluctuate with GDP actual Q4 0.2%, yoy 2.3% with the IMF and OECD reducing its forecast growth as well. Retail Sales in January continued to be weak rising by just 0.1% with annual growth at 2.7%. Inflation is set to remain below 2% until the end of the year as forecast by the RBA in its February SoMP. This together with ongoing soft housing markets has been the major brake on an increase in rates here in Australia which has now shifted to a view that rates will fall. The US Fed made no change to rates at their January meeting and Chairman Powell's remarks indicate a slowing in expected rises later this year. AUD/USD appeared heading to $0.70 in 2018 but went back to above $0.72 before falling below that level after RBA Governor Lowe's latest "neutral" position on rates.

CoreLogic housing price statistics for Febuary again showed further falls in Sydney and Melbourne houses this month by 1.1% and 1.2% respectively and for units 0.8% and 0.6%. The quarterly figures for Houses tell a similar story being down 4.3% and 4.8% and annually down 11.5% in both Capitals. Units were down 7.8% for the year in Sydney but only 3.7% in Melbourne. The latest ABS Construction activity for the December quarter was down 3.1% and 2.6% for the year. Our News and Views inside covers the MSCI semi-annual Property Index Report with Industrial up strongly, Office firm and Retail weakening.

There have been no changes in our market ratings and trends following a number resulting from our last Quarterly Update. Melbourne and Sydney Residential stay Fair for both Houses and Units on the basis they are experiencing a correction but with Deteriorating trends. Five markets are rated as Strong or Good and four are in Sydney and Melbourne. Adelaide and Perth have six Weak ratings. Brisbane has three Improving trends as does Adelaide. Retail is Fair and Stable except Adelaide which is Weak. Retailers are struggling in most locations and recent sales indicate some softening of yields for sub-regionals and the recent A-REIT results which have caught the market's attention.

	Sydney		Melbourne		Adelaide		Brisbane (SEQ)		Perth	
Resi - Houses	Fair	Deteriorating	Fair	Deteriorating	Fair	Improving	Good	Improving	Weak	Stable
Resi - Units	Fair	Deteriorating	Fair	Deteriorating	Fair	Improving	Soft	Deteriorating	Weak	Deteriorating
Office	Strong	Improving	Strong	Improving	Fair	Improving	Fair	Improving	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

© 2019 ~ **Thinktank Property Finance** ® ~ AFSL 333 163

News and Views

- Our usual follow-up to the semi-annual Property Council of Australia (PCA) Office Market Report (OMR) is the MSCI All Property Index. The recent release of the Index shows the first fall below 11% in the rate of return in 15 quarters of All Property to 10.3% compared to 11.9% of a year earlier and below the 5 year average of 11.7%. The Total Return is fairly evenly split between Capital Growth of 4.6% and Income Return of 5.5%. As reported in the AFR by Ingrid Fuary-Wagner at the report's release recently: "Yield compression has driven the majority of the growth in asset values this cycle and kept Total Returns high. On average asset values have increased about 40 per cent over the last five years and about three quarters of that increase has been driven by yield compression," MSCI vice-president research Bryan Reid said.

- Chart 1 compares Asset Class returns including Direct Real Estate, Listed Real Estate (A-REITs) and Equities which shows significant change as the listed components sufferred negative Capital Return during 2018. Income Return/Distribution Yield/Dividend Yield were all fairly close with the Real Estate sectors at 5.5% for Direct and the same for Listed. This compared to 5.7% and 5.9% respectively six months ago. Returns on Bonds rose from 4.0% to 6.8% more in line with that of 12 months ago which was 5.8%. Equities recorded a Dividend Yield of 4.3% compared to 4.5% six months ago but suffered Capital Losses of 7.0% to bring Total Returns into negative territory of -2.9%. Listed Real Estate also suffered from the same negative impact as Equities with Capital Losses of -2.9% taking away from 5.5% in Distribution Yield for a Total Return of 2.7%.

- The AFR article referred to earlier was headlined: "Industrial Property records strongest Total Returns" and went on to say Industrial property is going from strength to strength in the Australian market, recording the strongest total returns across the sector of 14.8% over the year. In the weeks prior to the MSCI report, Knight Frank released several pieces of research covering specific locally based Industrial markets including the sector leading Sydney and Melbourne as well as the recovering Perth market which was described as "…..driving business confidence and expectation indexes to levels not seen for 6 years." In both Sy dney and Melbourne yields continued to experience compression of approximately 30 basis points (bps) across both prime and secondary properties in Sydney while in Melbourne prime yields fell by approximately 10 bps while secondary was reported as tightening by slightly over 75 bps due to strong demand and limited opportunities.

- Chart 2 shows the MSCI breakdown of individual capitals for the fourth quarter of 2018 not surprisingly shows Total Returns for Sydney and Melbourne are still way out in front at 15.5% and 13.4% respectively. All of the capitals show an even and steady Income Return from 5% to 7% but with very substantial differences in Capital Growth. Sydney is just over 10% and Melbourne just over 8%. Brisbane's Total Return is shown as 9.9% and Perth is at 8.1% after having recovered from negative Capital Growth last year with vacancy dropping from 19.4% to a still high 18.4%.

- Chart 2 also shows the evenness of Income Returns around the 5.5% average across the various sectors while Capital Growth varied widely. The presentation by Bryan Reid of MSCI given at the report's release included an excellent comparison of historical cap rates for each core sector and sub-sector since March 2006. The range for All Property Types was a little over 2%, dropping from a post-crisis maximum of 7.5% to a current 5.3%. Retail – Super & Major is currently showing the lowest cap rate of 4.7% while Office - CBD is at 5.2% and Industrial – Warehouse is at 5.7% also at the low of the 12 year range for that sub-sector which peaked at just over 9%. The narrowest range across all measures is for Retail of approximately 2%.

- The AFR in its article wrote, "The outlook is expected to worsen for investors – property returns across the board are expected to halve over the next five years, according to a recent forecast by BIS Oxford Economics." This was just before renewed / changed views with respect to the likelihood of lower interest rates later this year with Westpac and a number of other leading economists shifting to this view. Knight Frank recently issued their inaugural "Australian Capital View Outlook:" with positive views on Office and Industrial but describing Retail as "under pressure". The analysis includes frequent reference to the MSCI report.

Chart 1: MSCI 2018 Asset Class Comparison

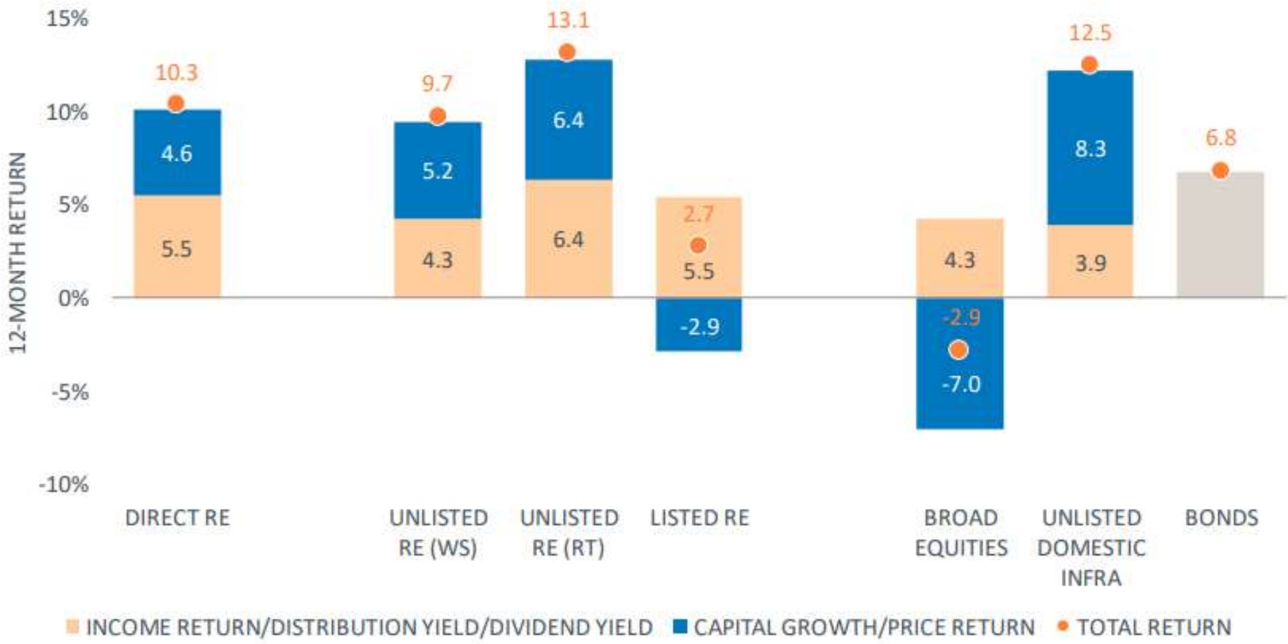

Chart 2: MSCI 2018 Sector Performance

Source: MSCI, AFR

Thinktank
Leading Commercial Finance

March 2019

Business Relationships and Loan Inquiries

Heather Noonan
Regional Sales Executive – VIC, TAS, SA
M: 0435 960 646
E: hnoonan@thinktank.net.au

Tony Zaccari
Senior Relationship Manager – VIC/SA
M: 0403 758 514
E: tzaccari@thinktank.net.au

Joel Harrison
Relationship Manager – VIC/TAS
M: 0410 861 540
E: jharrison@thinktank.net.au

Cath Ryan
Regional Sales Executive – NSW, ACT, WA
T: (02) 8669 5524 M: 0433 862 944
E: cryan@thinktank.net.au

Ranei Alam
Senior Relationship Manager – NSW
T: (02) 8669 5502 M: 0434 609 240
E: ralam@thinktank.net.au

Paul Burns
Senior Relationship Manager NSW/ACT
T: (02) 8669 5510 M: 0434 609 241
E: pburns@thinktank.net.au

Claire Byrne
Relationship Manager - NSW/WA
T: (02) 8669 5522 M: 0414 235 478
E: cbyrne@thinktank.net.au

Adam Hutcheson
Senior Relationship Manager – QLD
T: (07) 3117 3787 M: 0434 609 239
E: ahutcheson@thinktank.net.au

Chrissi Sutherland
Partnership & Media Manager
T: (02) 8669 5516
E: csutherland@thinktank.net.au

For additional information, please contact

Publications & Market Update
Per Amundsen
Company Secretary
T: (02) 8669 5515 M: 0417 064 252
E: pamundsen@thinktank.net.au

Credit & Operations
Peter Kearns
General Manager
T: (02) 8669 5501 M: 0434 609 238
E: pkearns@thinktank.net.au

Funding & Strategy
Jonathan Street
Chief Executive Officer
T: (02) 8669 5505 M: 0438 319 432
E: jstreet@thinktank.net.au

Partnerships & Distribution
Peter Vala
General Manager, Partnerships & Distribution
T: (02) 8669 5512 M: 0468 989 555
E: pvala@thinktank.net.au

Institutional Relations
Cullen Hughes
Chief Financial Officer & Treasurer
T: (02) 8669 5518 M: 0406 258 256
E: chughes@thinktank.net.au

Investor Relations
Lauren Ryan
Business Development Manager-Investments
T: (02) 8669 5532 M: 0401 974 839
E: lryan@thinktank.net.au

Thinktank Property Finance is the leading independent lender specialising in commercial property in Australia. Thinktank offers a wide range of tailored mortgage product options including:

- Finance for the purchase, equity release and refinance of commercial and residential property;
- Set and forget loan terms up to 30 years with no ongoing fees or annual reviews;
- Self-Managed Superannuation Fund (SMSF) loans; and
- Loan serviceability options ranging from fully verified to self-certification of income.

Important Note
This report does not constitute or form a part of, and should not be construed as an offer to sell or solicitation of an offer to buy investments or any fund and does not constitute any form of commitment, recommendation or advice on the part of Think Tank Group Pty Ltd ("Thinktank").

www.thinktank.net.au

© 2019 ~ **Thinktank Property Finance** ® ~ AFSL 333 163