Thinktank

April 2020

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.

As noted last month, the COVID-19 outbreak had started to dominate both the economy and our lives. This has only become more so. The Westpac-MI Consumer Sentiment Index fell by 3.6 points in March to 91.9 to fall further below 100. Surprisingly the AiG PMI for March was up by a large 9.4 points to 53.7 and moving into expansion above 50. Both of the other AiG indices fell further into contraction with the Services PSI down 8.3 to 38.7 its lowest level since March 2009 and the Construction PCI down 4.8 to 37,9 which was its lowest level since May 2013. We will look at all of our usual indices in our Quarterly Update.

At its April meeting the RBA Board left the Cash Rate at an unchanged record low of 0.25% after cutting it by 25 basis points in an emergency mid-month meeting in March. Governor Lowe spoke of Quantitative Easing measures on the basis of the coronavirus and the RBA's Financial Stability Review to be released just before Good Friday will be interesting as will the IMF Global Economic update out just after Easter. The prospect of a negative GDP figure for the first quarter is very real and the near certainty of a significant negative second quarter would signal a technical recession. The Unemployment Rate for February had fallen to 5.2% but will now go much higher. The US Federal Reserve has cut rates aggressively outside normal meetings as did the RBA and other central banks. The AUD has moved quite wildly over the past month as shown in Chart 1 inside falling rapidly from USD 0.65 to below 0.55 and then back up well above 0.60 with a latest reading above 0.62.

CoreLogic housing prices for March showed further increases in Sydney and Melbourne with houses up 1.1% and 0.4% respectively. Units were up the same in both Capitals however we remain concerned about the ongoing supply of newly completed apartments and the fresh unknown of the COVID-19 pandemic. The RLB Q1 Crane Index shows 27 less cranes in use for residential projects in Melbourne but actually up a few in Sydney. They still total 356 with 149 news ones put up last quarter balancing 173 taken down in our two largest Capital cities. The month-on-month lift of 0.7% in national housing values was also good but the uncertainty currently present has led us to put a Watch on all our Residential Trends and put all Ratings as Fair other than Perth Units which remain Weak–Deteriorating having fallen by 0.3% in March, the only decline amongst the five we cover.

There have been many other changes in our ratings and trends this month. Industrial ratings in both Melbourne and Sydney are Good matching the Office sectors there making four markets rated as Good and Stable with all in Sydney and Melbourne. Retail is Weak and Deteriorating everywhere and already poor consumer sentiment has only suffered further as noted above. As you would expect our News and Views section covers COVID-19.

	Sydney	Melbourne	Adelaide	Brisbane (SEO)	Perth
Resi- Homes	Fair Watch	Fair Watch	Fair Watch	Fair Watch	Fair Watch
Resi- Units	Fair Watch	Fair Watch	Fair Watch	Fair Watch	Weak Deteriorating
Office	Good Stable	Good Stable	Fair Stable	Fair Stable	Fair Stable
Retail	Weak Deteriorating	Weak Deteriorating	Weak Deteriorating	Weak Deteriorating	Weak Deteriorating
Industrial	Good Stable	Good Stable	Weak Stable	Fair Stable	Weak Stable

Sources: ABS, ACCI, AiG, ABS, AFR, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic, Cushman & Wakefield, HTW, IMF, MSCI, JLL, Knight Frank, Melbourne Institute, OECD, PCA, Preston Rowe Patterson, RBA, RLB, Savills Research, Westpac Economics, World Bank

News and Views

- Our We are used to discussing vacancy rates, yields, clearance rates and things like cranes in the sky each month but all that has suddenly changed. COVID-19 is exacting a heavy toll on our economy with new cases reported spiking in mid-March as shown in Chart 1. This also shows a levelling off in early April and commercial property appears well positioned to emerge as a sound investment for some sectors.

- It is our belief the health and economic crises will peak in the June quarter, and that while there will be a recovery in the September quarter it will be soft. It is not until the December quarter that the economy will start to pick up and return to positive growth, with shutdowns just a memory and unemployment receding. We have drawn on a number of commentators to reach this conclusion but principally Westpac and CBA and have also included the charts opposite which have been sourced from CBA's Coronavirus Daily Tracker.

- The graph showing the forecast unemployment rate is particularly stark with the sudden spike shown in Chart 2 and then a decline next quarter down below 7%. There are two other factors at play here. First, we now have the Federal Government's $130 billion JobKeeper payment, which, when coupled with earlier stimulus packages will provide vital support to businesses and their employees, especially many small to medium-sized enterprises (SMEs). Second, Westpac estimates job losses in the June quarter will hit 9% -- still below the double-digit number we experienced during the "recession we had to have" in the early 1990s and nearly half of what they had predicted pre the JobSeeker announcement. The bank is predicting 7% by year-end but the RBA has made clear interest rates are staying where they are until we reach their full-employment target. Westpac's pre-JobSeeker forecast was a startling 17%!

- One thing we can be quite confident about is that interest rates will remain at current historic lows for a long time to come with unemployment needing to fall dramatically from those forecast highs before the RBA would act to start the process of returning to more normal levels. We can see what has happened here in Chart 4 with already low rates falling further, although 10 year rates are staying higher as the RBA's intervention is focused on 3 year yields. This is expected to continue to be the case even when we begin to see the impact of our form of Quantitative Easing on inflation. This should ensure that capitalisation rates for most sectors stay firm in line with long-term interest rates.

- In this economic scenario, what is the outlook for commercial property? The difference between this looming recession and its predecessors is that we don't expect a glut of property vacancies. As evidence of confidence in the Office market we would point to the announcement on 6 April of GIC, Singapore's sovereign wealth fund investing to acquire 50% of Melbourne's Rialto Tower at a yield of 5%. We think this demonstrates the confidence in our market by a global player with access to world markets and the resources to choose wherever it wishes to invest.

- A pick-up in business activity should also equate to a resumption in demand for industrial property. It seems logical to assume that the enforced social isolation of recent weeks would have accelerated the move to online shopping that can only support demand for warehousing space. The downside to an uptick in online buying is further erosion of the retail sector. This ongoing decline will not be uniform, with supermarkets and grocery stores, for example, prospering. Chart 3 shows how different Spending by Category has developed. Also, it is reasonable to expect smaller retail units in inner city areas to recover. However, shopping centre tenants are likely to suffer in the near term and landlords are having their challenges as tenants both big and small push back on leasing costs.

- On another positive note, our experience is that landlords/investors are seeking a deferral of mortgage payments in order to allow tenants to survive this crisis. Both State and Federal governments have announced legislation to protect tenants and lenders have supported these moves with their own hardship relief as has Thinktank. This welcome initiative is currently playing out across office, industrial and retail properties and it is our view from our direct communication with our Borrowers that most businesses have very sound prospects for a return to healthy business activity once the crisis ends.

Chart 1 – Australian COVID-19 Cases

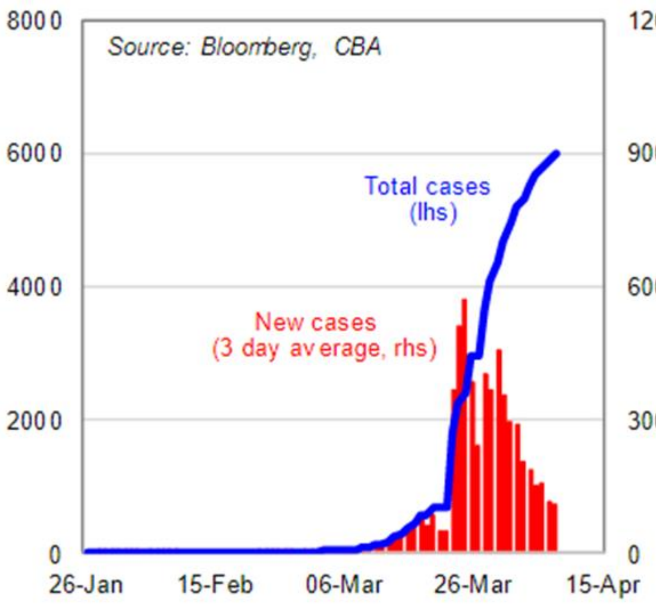


Chart 2 - Forecast Unemployment Rate (%)

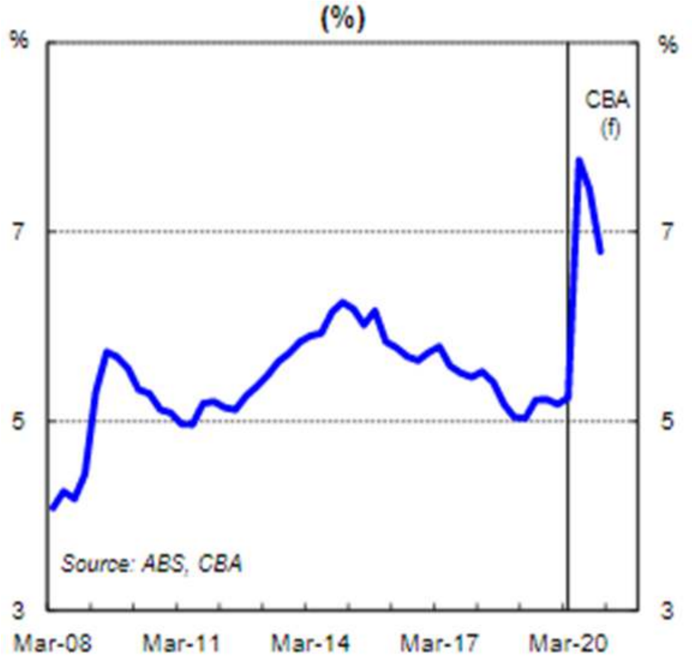


Chart 3 – Spending by Category

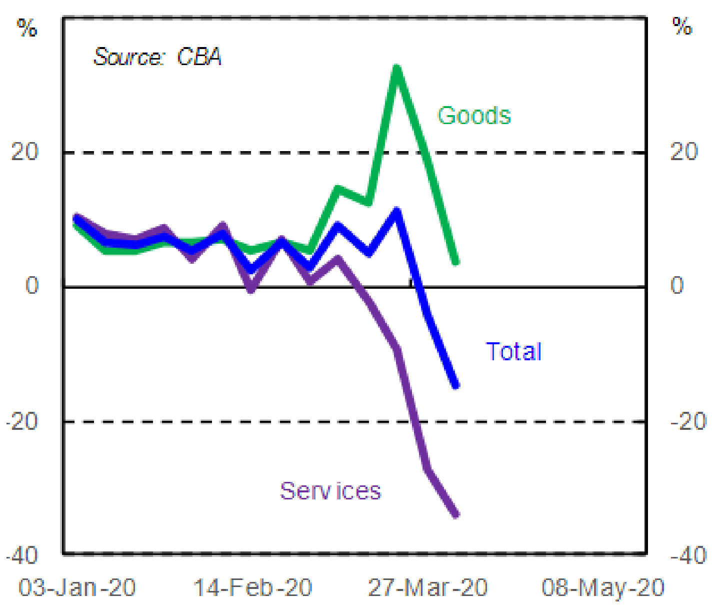
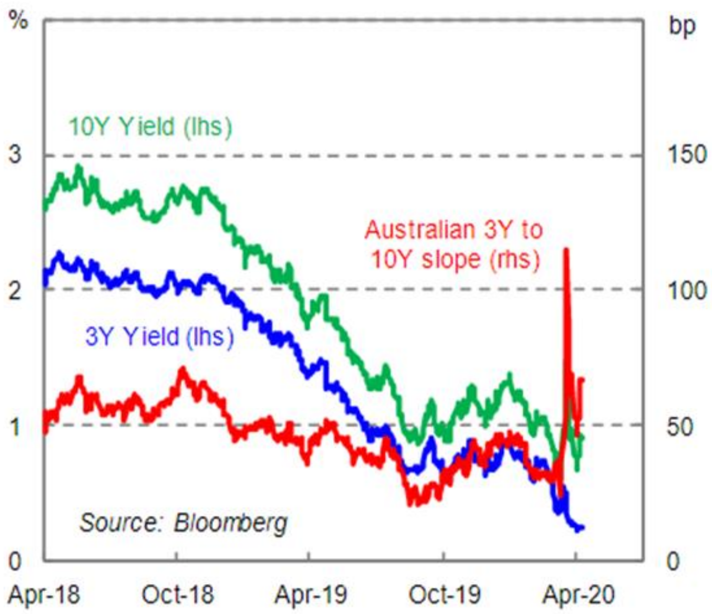


Chart 4 – Slope of the Yield Curve



Source: CBA Coronavirus Daily Tracker

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Thinktank Property Finance

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.