Thinktank

July 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 fell in June by 0.6% to 100.7 just staying in optimistic territory above 100. The AiG PMI for June was down by 3.3 points to 49.4 and falling into contraction below 50 and the Westpac-MI Leading Index was up slightly in May to -0.45 from -0.49 in April but still marked six months in negative territory indicating slower future growth ahead. The other measure to fall was the "illion" Expectations Index which fell by 13.2% for the June Quarter.

At its July meeting, speculation had grown of a second consecutive cut in the Cash Rate by the RBA Board following a clear bias for further easing expressed in late June. In the end, the Cash Rate was cut by 0.25% to a new record low of 1.00% and Governor Lowe re-affirmed the prospect of further easing in his Darwin speech. Inflation appears set to remain well below 2% until the end of the year and the longstanding 2-3% target a possibility to be adjusted with the August SoMP forecast. The US Fed made no change to rates at their June meeting but Chairman Powell's remarks appeared to signal the possibility of a cut by the end of the year. AUD/USD have remained just below $0.70 with markets still pricing in further cuts to rates by the RBA and US rates now expected to see the start of a new easing cycle much sooner than

	SYDNEY	MELBOURNE	ADELAIDE	BRISBANE (SEQ)	PERTH
Resi - Houses	Fair Stable	Fair Stable	Fair Improving	Fair Stable	Weak Stable
Resi - Units	Fair Stable	Fair Stable	Fair Improving	Fair Stable	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	Strong 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

December and possibly as soon as the July FOMC meetings. Our News and Views this month looks at the future direction of interest rates with more cuts expected from the RBA and prospects of the same in the US.

CoreLogic housing prices for June showed little change in Sydney and Melbourne houses at 0.0% and 0.1% respectively. Clearance rates continue to firm and this has led us to upgrade our ratings to Fair from Weak. Units were up 0.3% for the month in Sydney and 0.5% in Melbourne. We remain concerned about the supply of newly completed construction but have moved to a Stable trend. Industrial remains a top performer and has been upgraded to Strong in both cities. Our Quarterly Update provides more details.

There have been several changes in our ratings and trends this month. Melbourne and Sydney Residential have moved to Fair for houses and the trend has remained Stable. Units have stayed Fair in both cities and also moved to Stable trends. Industrial ratings in both cities have been upgraded to Strong making four markets rated as Strong and Improving with all in Sydney and Melbourne. In contrast, Adelaide and Perth still have six Weak ratings. Adelaide has three Improving trends and Brisbane has two. Retail is Fair and Stable except Adelaide which is Weak. Retail trends remain Stable but are of concern with respect to trading performance but with capitalisation rates balancing weak income.

News & Views

» In December last year we wrote how the RBA had just ended well over two years of maintaining a stable 1.5% Cash Rate and noted how most analysts had concluded it looked likely that we would see more of the same for 2019 and possibly into 2020. Well, how things have changed as we take another look at domestic and international interest rates and how they are impacting property markets.

» A very good place for the start of such a review are the RBA's Statements on Monetary Policy issued in November and May. In Nov '18 the RBA took a very close look at Central Bank activity globally in terms of their adjustment to Base Rates. Almost all predicted increases over the next year including the RBA itself.

By May '19 this had all changed and the RBA had reduced the Cash Rate by 25 basis points with further reductions expected. In the US, forecasts had also reversed from tightening/stable to cuts by the end of 2019 which now are more likely to come within months.

» Knight Frank recently published a Capital Markets Insight titled "Lower Rates, Longer Cycle". KF noted, "Yields on some commercial property assets, notably prime office property in Sydney and Melbourne, have tightened to record lows, causing many to question how long the current cycle of yield compression has to run. However, the shift to further easing by the RBA, and guidance by major global central banks that policy will remain very accommodative for the foreseeable future, has seen rates in short-term money markets and long-term bond yields decline dramatically. Yields on 10-year Australian government bonds have declined from 2.9% to 1.5% over the past 12 months, a historic low, and this represents a significant change in the contextual setting for property yields."

» Graph 2 on the right hand page shows what has happened to market rates domestically both short-term 90 day rates and long-term 10 year bond yields both falling quite dramatically over the past six months. Graph 1 beside it shows total returns on real property investments as measured by the MSCI Australia Property Index

News & Views continued

This graph measures all sectors and eliminates rather large differences between say Industrial and Retail with the former enjoying strong capital growth while the former is contracting under soft sentiment and falling sales of late. We will take a closer look at the MSCI indices next month.

» As with bonds, capital values move inversely to interest rates so if rates go down bond prices go up. The same is true of commercial property and we can see in graph 3 how commercial property yields have fallen over the past few years. There is no doubt that investors are certainly drawn to property investments when interest rates are low and the returns available from Bank Deposits or Government Bonds are low and do not even match inflation. Graph 4 shows how the spread of commercial yields to 10-year Government Bonds has widened and with recent interest rate movements and current expectations, we can see yields and capitalisation rates falling further.

The attraction in terms of yield for commercial property is immediately obvious with residential rental levels being low with an expectation of steady capital growth year to year which is now being called into question. Yields available within the commercial property sector vary considerably ranging from regional retail centres and prime CBD offices at the low end to industrial office/warehouses at the high end.

» Drawing from a recent research report from BIS Oxford Economics the Australian Financial Review's Larry Schlesinger wrote "Industrial property's run as one of the hottest real estate sectors in Australia (and globally) will go on for at least another three years with both rents and capital values set to rise over this time. The research house's latest forecasts are for prime industrial rents in Sydney to rise between 7.8% and 12.5% over the next three years, with yields to firm by another 15 to 25 basis points over the coming 18 to 24 months before flattening out." As KF wrote, Lower Rates, Longer Cycle !

CHART 1
Commercial Property Returns

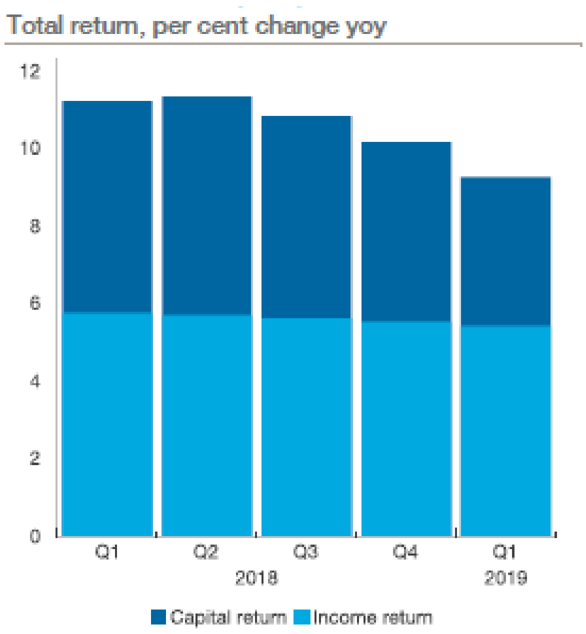


CHART 2
Market Interest Rates

CHART 3
Property Office Yields

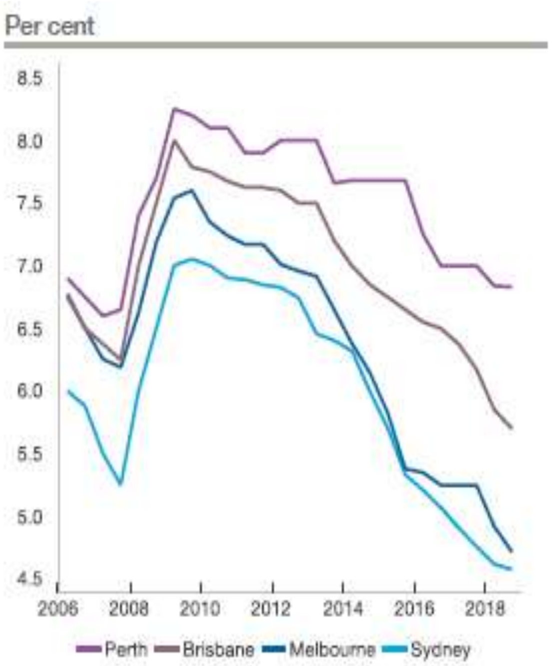
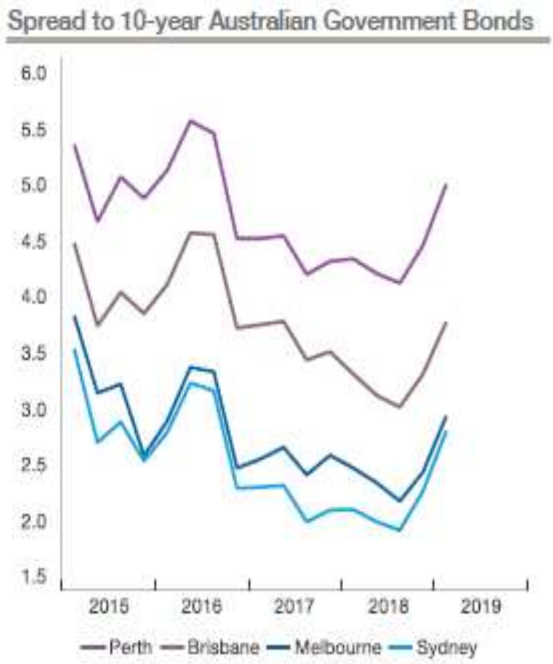


CHART 4
Prime Office Property Yields



Source: MSCI. Knight Drank, Macrobond

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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.

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