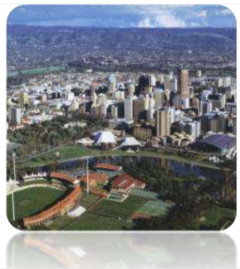
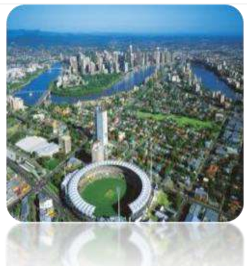
Thinktank

September 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 unexpectedly rose in August by 3.5 points to exactly 100. The AiG PMI for August was also up by 1.8 points to 53.1 and moving further into expansion above 50 as was the PSI Services Index which jumped 7.5 points to 51.4 and just into expansion. The Westpac-MI Leading Index was up in July to +0.05 from -0.09 in June, its first move above trend since November'18. Heading in the other direction, the illion Business Expectations Index was down to 7.6 its lowest since March'17.

At its September meeting, the RBA Board held the Cash Rate steady at a record low of 1% after a total of 50 basis points cuts last quarter. Governor Lowe has already re-affirmed the prospect of further easing and Retail Sales for July weakend further, falling 0.1% for the month while annual growth slipped to 2.4%. The Q2 GDP came in at 0.5% with annual growth slipping to 1.4%. The US Fed made its much anticipated change to rates at their July meeting but Chairman Powell's remarks appeared to signal some doubt about more cuts despite urgings from President Trump. With markets still pricing in further cuts to rates by the RBA the AUD has dropped sharply after the FOMC action to below USD 0.68.

CoreLogic housing prices for August showed further positive numbers in Sydney and Melbourne houses at 1.5% and 1.3% which we expected and had led us to upgrade our ratings. Units were up as well, 1.8% for the month in Sydney and 1.5% in Melbourne. We are still concerned about the supply of newly completed construction but have maintained a Stable trend. The combined capitals were up 1.0%, the largest monthly increase since April 2017. Our News and Views section covers the semi-annual MSCI All Property Index and the various sectors continue to perform in line with our ratings and trends.

There have been no changes in our ratings and trends this month. Melbourne and Sydney Residential are confirmed as Fair for Houses and Units and the trend has remained Stable despite comments above on Units in both cities. Industrial ratings in both cities were upgraded to Strong last month matching the Office sector there 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 are of concern with many earnings results reflecting what is shown overleaf in the MSCI sector returns.

	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	Strong Improving	Strong Improving	Weak Stable	Fair Improving	Weak Stable

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

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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 a further fall below the 5 year and 10 year average rates of return down to 8.3% compared to 11.6% last year and 10.3% six months ago. The Total Return is less evenly split between Capital Growth of 2.7% and Income Return of 5.4% with yield compression less of a factor and Retail faltering. As reported in the AFR by Su-Lin Tan at the report's release recently: " With total returns slowing and capital growth diminishing, some investors are worried that the cycle may be nearing the peak " MSCI vice-president research Bryan Reid said. The Total Return of 8.3% was the lowest since September 2010 when it was 8.0% and almost all made up of Income Returns at 7.5%.

- Chart 1 shows results over the past ten years with Total Returns peaking nearly four years ago at 13.7% with both Income and Capital Growth fairly even at 6.8% and showing slight but steady declines since then. Income Returns have all been fairly close over the years ranging from a peak of 7.5% in June 2010 and then starting an almost quarterly decline of 0.10% until hitting 5.4% in this repoprt. As can be expected, Capital Returns are much more volatile and even if we eliminate the negative returns of June 2009 to June 2010 they have been subject to a lot more fluctuation, peaking at 6.8% in March 2016 and then falling gradually to 3.4% in June 2019.

- The AFR article referred to earlier was headlined: "Commercial Property Returns Slump to Nine-Year Low" and went on to say "All property sectors except Industrial property suffered a decline but the real drag came from the Retail sector where total returns have fallen to 3.7% from 8.4% a year ago as Retail Capital Growth turns negative." The July Retail Sales slump of 0.1% reported by the Australian Bureau of Statistics together with announced plans by major retailers such as David Jones to substantially cut back on the number of stores they operate and the space that they rent is clearly having an impact on both consumer and investor sentiment.

- Chart 2 shows the MSCI breakdown of individual sectors for the year to June 2019 and not surprisingly shows better than average returns for Industrial and Office at 13.0% and 11.6% respectively, reversing the ranking of a year ago, while Retail has fallen sharply as noted above. All of the capitals still show a fairly even and steady Income Return across the various sectors from a low of 4.8% in Sydney CBD Office to a high of 7% in Perth. There are however very substantial differences in Capital Growth by Capital City, with Melbourne at 7.5% and Perth is at 1.5% after having recovered from negative Capital Growth from June 2014 to March 2018 and with vacancy still at a high 18.3%. Total Returns for Perth were the lowest at 2.8% while Sydney was highest at 10.2%. Adelaide at 6.5% beat out Brisbane which recorded 5.2%. Melbourne was second at 9.4%.

- Chart 2 once again shows the evenness of Income Returns evident in Chart 1 around the 5.4% average across the various sectors down just slightly each quarter over the past eighteen months. Capital Growth varied widely from the 6.6% high in Industrial to the negative 1.4% in Retail. The presentation by Bryan Reid of MSCI given at the report's release included comments about the reductions in Total Returns that have been seen: "With total returns slowing and capital growth diminishing, some investors are worried that the cycle may be nearing the peak. Fears about the impact of e-commerce on the sector have continued to weigh on retail asset performance and cap rate compression appears to have abated over the last quarter."

- The AFR in its article wrote, "Other indicators corroborate the MSCI Index results. The NAB Commercial Property Index for the second quarter of the year that was released earlier this month says investor sentiment about retail assets is negative and confidence in hotels has "slipped deeper negative" reflecting the potential impact of higher supply. Office and industrial property continue to remain popular but mainly in NSW and Victoria. Investors expect office property in these areas to provide the highest rental returns in the next two years."

Chart 1: Australian Property Total Return –Twelve Months to June 2019

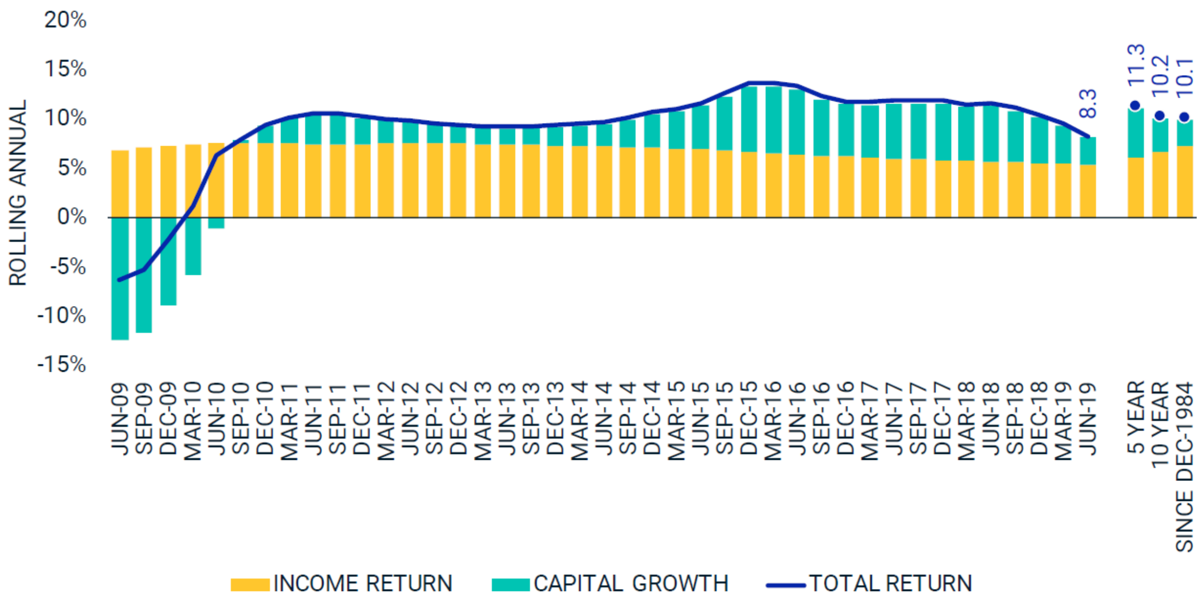
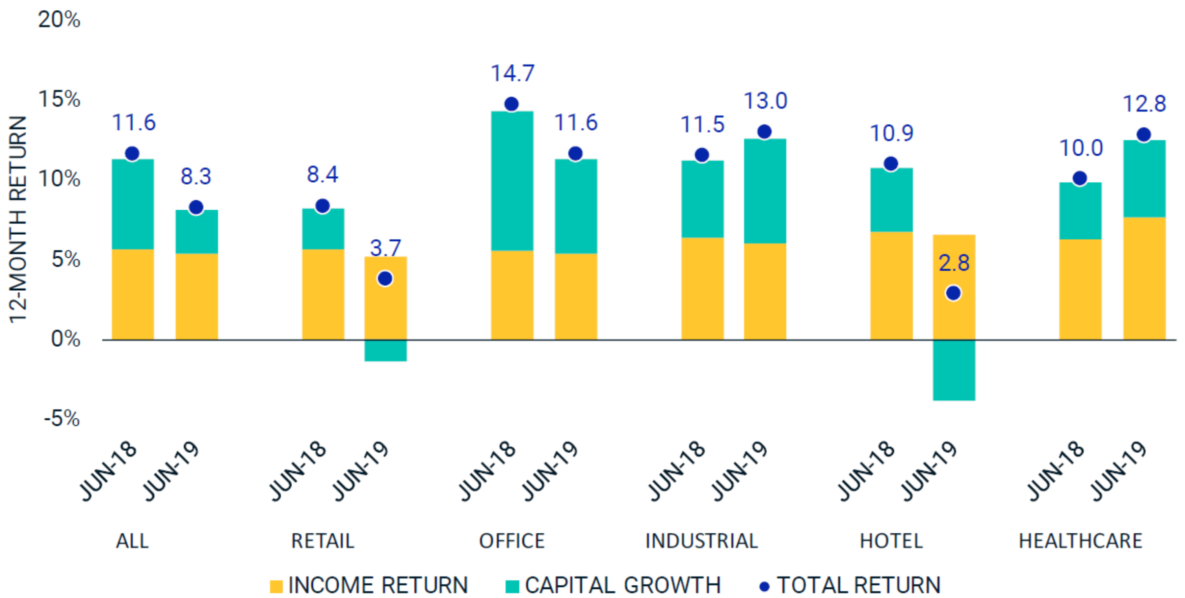


Chart 2: Australian Property Sectors Total Return –June 2019



Sources: MSCI and AFR

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Thinktank Property Finance

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- 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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