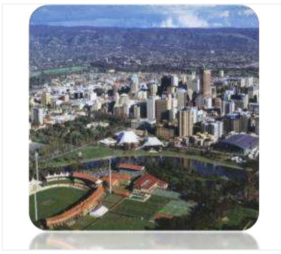
Thinktank
Leading Commercial Finance

April 2019

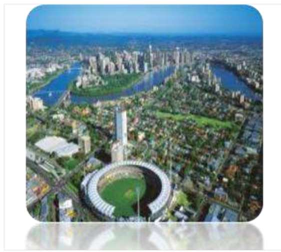
Australian Real Estate Market Focus

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 March by 4.8% to 98.8 more than reversing its gain last month and moving back into pessimistic territory below 100. The AiG PMI for March also fell by a 3.0 points to 51.0 but remained in positive territory for another month above 50. However the Westpac-MI Leading Index was down in February to -0.56 from -0.37 in January indicating slower future growth while the Westpac Quarterly Survey of Industrial Trends was similarly down to 61.7 in March from 63.0 in December.

At its April 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. This was further reinforced by changes in wording in the accompanying statement. Retail Sales in February however surprised on the upside by rising 0.8% with annual growth at 3.2%. Inflation appears set to remain below 2% until the end of the year and this together with ongoing soft housing markets had been the major brake on an increase in rates despite falling unemployment. The US Fed made no change to rates at their March meeting but Chairman Powell's remarks signalled a major change with no rises for the rest the year; as a result yield curves briefly inverted. AUD/USD immediately jumped close to $0.72 with markets pricing in lower interest rates both in the US and here but fell back since to $0.71.



CoreLogic housing price statistics for March again showed further falls in Sydney and Melbourne houses this month by 0.7% and 1.1% respectively. The quarterly figures for Houses tell a similar story being down 3.2% and 4.0% and annually down 11.8% and 12.4%. Units were down 8.9% for the year in Sydney but only 3.8% in Melbourne. The latest ABS Construction activity for the December quarter was down 3.1% and 2.6% for the year and dwellings approvals in February were down 12.5% yoy. Our News and Views next month will look at construction activity via the RLB Crane Index report. This month we have the latest ATO SMSF statistics and comments on the ongoing debate on LRBAs.

There have been some changes in our market ratings and trends resulting from our April Quarterly Update. Melbourne and Sydney Residential have moved to Weak for Houses but Units stay Fair but both with ongoing Deteriorating trends. Four markets are rated as Strong or Good and all are in Sydney and Melbourne. Adelaide and Perth have six Weak ratings. Adelaide has three Improving trends and Brisbane has two. Retail is Fair and Stable except Adelaide which is Weak. Retailers continue to struggle in most locations and there has been a softening of yields for sub-regionals. Action by some A-REITs have caught the market's attention as has Woolworth's announced closure of 30 Big-W outlets.

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

News and Views

- On 22 March, the Treasurer and Assistant Treasurer released the report by the Council of Financial Regulators (CFR) and the Australian Tax Office (ATO) on SMSF Borrowing Arrangements which had determined that Limited Recourse Borrowing Arrangements (LRBA) are unlikely to pose a systemic risk to the financial system at this time. We have commented on this subject many times over the past few years against the back-drop of the ATO's ongoing release of SMSF quarterly statistics including LRBAs.

- The basis of this conclusion and the resulting position of the current Coalition Federal Government that in light of the report they will not be making any changes to LRBAs, is the analysis of these same SMSF statistics which are shown overleaf and which we have been utilising to demonstrate the same conclusion.

- It remains both quite astonishing and mystifying to us that the complete opposite conclusion can be drawn from the same information by the Federal Labor Opposition and some of the regulators on the CFR. The report concludes that the preferred course is to remove the option to allow LRBAs but if this is not accepted to prohibit the use of personal guarantees to support LRBAs and/or to use other regulatory responsibilities to reduce high leverage and concentration risk within SMSFs associated with LRBAs and investment in real property.

- The analysis used in reaching these conclusions agrees with our own that real property investment represents only a relatively small proportion of total SMSF assets being 14.9% according to the most recent statistics for December 2018 compared to 55.6% for cash, deposits and listed shares & trusts. Real property investment is broken down to 5.1% residential and 9.8% non-residential. Importantly, according to the CFR and ATO, non-residential real property makes up 46% of that supported by LRBAs and is known as "business real property" (brp) when used "wholly and exclusively" for business purposes under the SIS Act.

- The statistics in the report and our own observations over several years in working with hundreds of LRBAs is that owner occupied business premises make up a large part of this type of funding and that SIS Act regulations were specifically designed to allow for them. This topic is mentioned once in a two sentence paragraph within the 21 page report and while the comments appear positive no similar conclusion is drawn nor is any further mention of "brp" made elsewhere in the report.

- What is mentioned more frequently is the less common "one stop shop" marketing of LRBAs for small residential units and "off the plan" pre-sales. These have long been recognised as undesirable within the industry but even when notably flagged by ASIC in their recent *Report 575 "SMSF: Improving the quality of advice and member experiences"* no action appears to have been taken to remedy the situation such as developing mechanisms to ensure Statements of Advice meet existing standards.

- On the related subject of requiring personal guarantees of members to support LRBAs, the CFR appears to ignore that this is common (if not standard) practice with secured lending to businesses in almost all circumstances. This is for the simple reason that the ultimate beneficiaries are indeed those same individuals from whom the guarantees are sought. The concept of fully non-recourse borrowing involving privately owned assets or through privately owned companies or trusts is almost completely unknown in Australia and extends even to residential mortgage lending where in the United States the concept of "giving back the keys" to the Bank is common but basically unheard of here in Australia. Interestingly the ATO estimates only 30% of LRBAs are supported by personal guarantees however we would estimate that figure to be far higher in reality.

- The statistics presented and the CFR report itself show that LRBAs are nowhere near approaching a systemic risk to the superannuation structure that Australia has and that the real problems identified can be quite easily dealt with through more effective regulation and enforcement to eliminate identified abuses. While dealing with a different topic these comments sound quite similar to the selectively considered recommendations Commissioner Hayne reached in the conclusion of his recent Royal Commission.

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Chart 1 - SMSF Total Assets and Numbers

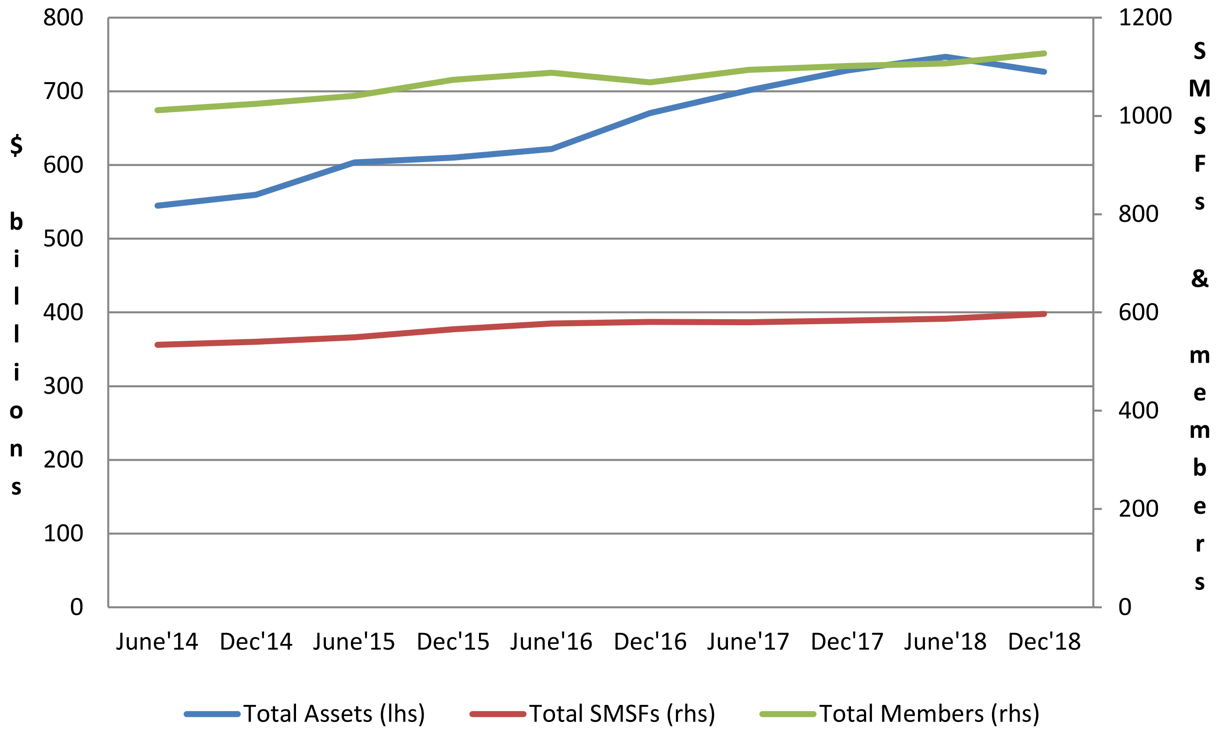
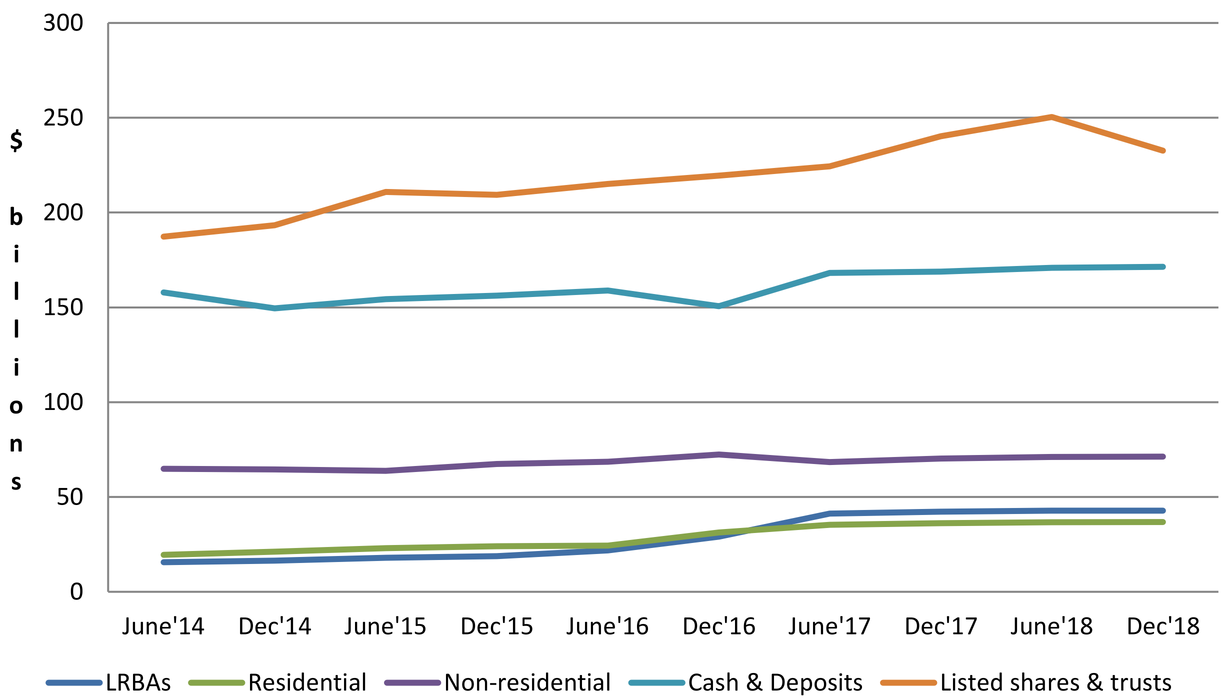


Chart 2 - SMSF Investment Portfolio Data



Source: ATO SMSF Quarterly Statistics

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