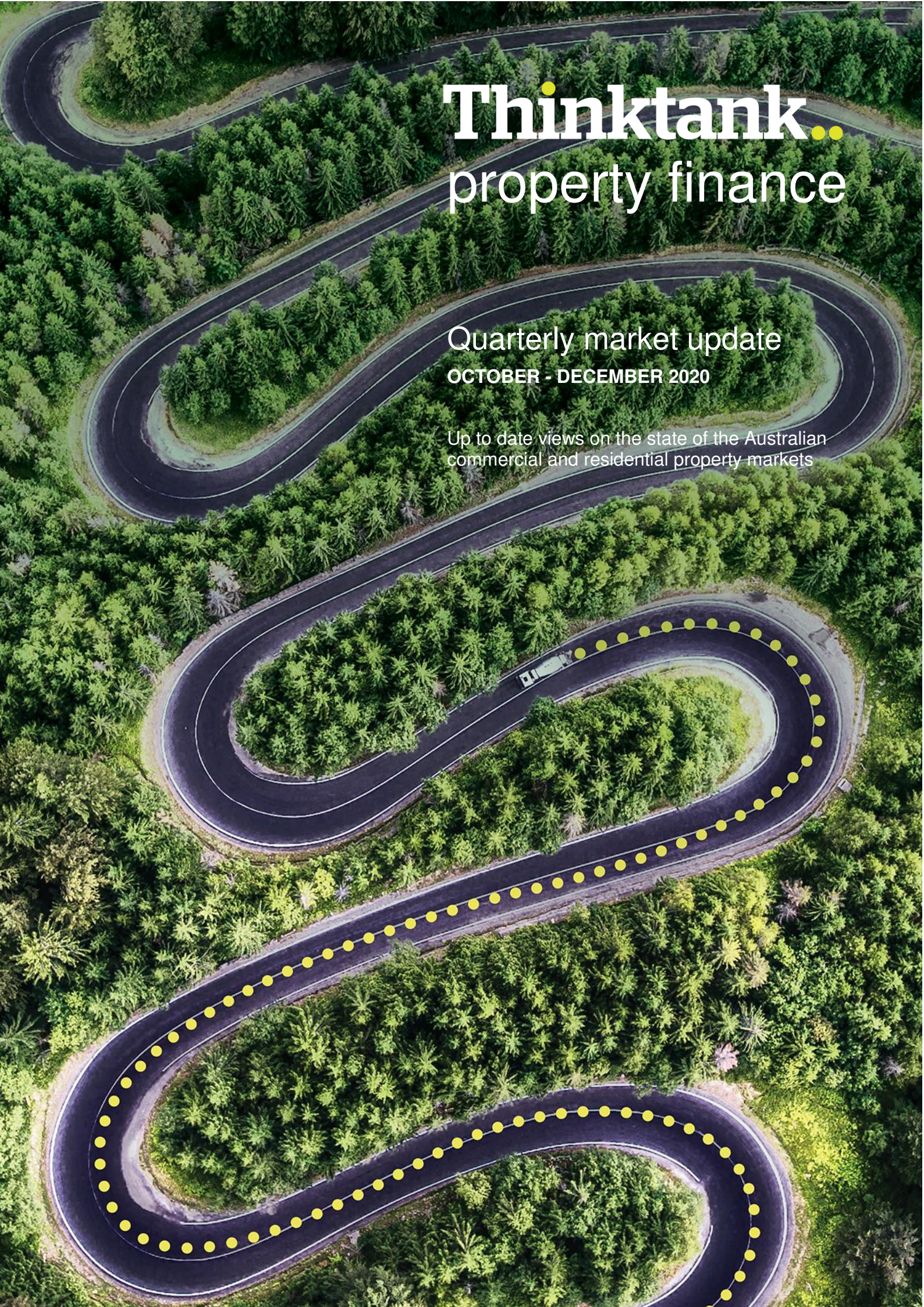

Thinktank property finance

Quarterly market update

OCTOBER - DECEMBER 2020

Up to date views on the state of the Australian commercial and residential property markets

Quarterly market update

OCTOBER - DECEMBER 2020

Thinktank..

1. The Global and Australian Economies

The third quarter of 2020 saw a continuation of the dramatic shift of policy focus from a variety of global and domestic issues to the coronavirus pandemic declared by the WHO on 11 March 2020. Domestically we have seen interest rates kept at all-time record lows and as discussed in more detail later in this update they will likely fall slightly shortly and are expected to stay at these ultra-low levels for a very long time. The resurgence of reported COVID-19 cases in Victoria earlier in the year led to the re-implementation of various restrictions including lockdowns and the closure of State borders. These all had very negative consequences for the local Victorian economy and flow-on impact nationally but there are certainly signs of recovery now.

IMF World Economic Outlook, October 2020

"A Long and Difficult Ascent."

Global output -4.4% in 2020 but +5.2% rebound in 2021

In its latest World Economic Outlook just released the IMF estimated that global gross domestic product (GDP) will shrink by 4.4% (previously forecast: -5.2%) this year followed by an above trend recovery of 5.2% in 2021 (previously forecast: +5.2%).

In its outlook, the IMF had this to say: "The global economy is climbing out from the depths to which it had plummeted during the Great Lockdown in April. But with the COVID-19 pandemic continuing to spread, many countries have slowed reopening and some are reinstating partial lockdowns to protect susceptible populations."

Improved forecasts for the United States economy now call for negative growth -5.8% in 2020 (up by 2.3%) and rebounding to 4.5% in 2021. China is now forecast to grow slightly better at 1.9% in 2020 (up 0.9%) and surge 8.2% in 2021 while India is now worse and forecast for a negative -10.3% for 2020 (down 5.8%) but pick-up strongly to 8.8% in 2021 (up 2.8%).

Second quarter national accounts released by the ABS on 2 September 2020 recorded quarterly negative growth of -7.0% (-6.3% annual) compared to -6.3% contraction in the first quarter of this calendar year. Unemployment fell by 0.7% to 6.8% in August and like all other statistics, expectations are drastically changed.

Forecasts had varied but many had been in the area of a peak of 10% in June and these have since been pulled back considerably. The CPI for the second quarter was down -1.9% and the annualised core rate fell -0.3 yoy. Major contributors were household goods and services -11.3%, transport -6.8, and education -3.7%. Unemployment will doubtless remain the key factor in keeping interest rates at their record low for a very long time to come and the change in the treatment of inflation by the RBA to actual from forecast is very important.

2nd quarter GDP 7.0%, -6.3% yoy and CPI -1.9%, -0.3% yoy

August unemployment 6.8%

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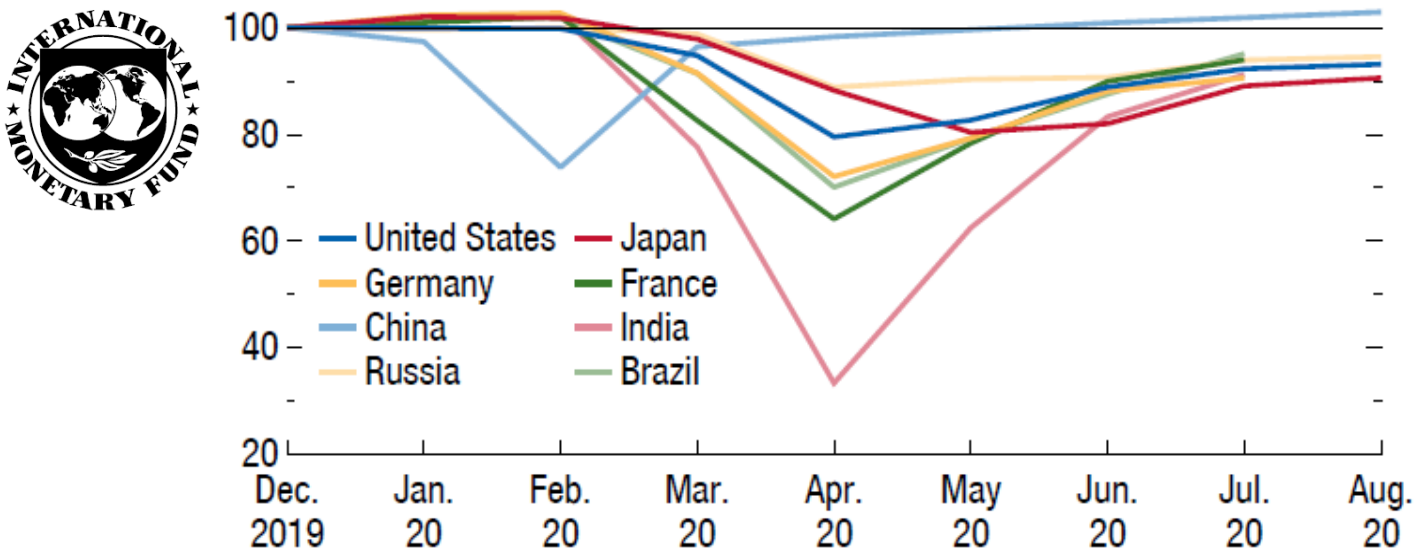
Westpac and AiG surveys are volatile but W-MI and PCI lift as COVID-19 impact drives sentiment

Three Westpac economic surveys were recently released. The quarterly Westpac – ACCI Survey of Industrial Trends index was up strongly to 42.4 from its dramatic fall to 24.0 in June. The monthly Westpac – MI Leading Index also rose to minus 0.48 from minus 2.56 in August and minus 4.42 in July. Remarkably the Westpac – MI Consumer Sentiment Survey rose in September to 93.8 and then again in October to 105.0, its highest level since July 2018 as the resurgence of cases in Victoria had seen a return of negative volatility in earlier months. The three monthly Australian Industry Group (AiG) Performance Indices saw two decline and one, the PCI move up in September. Manufacturing fell slightly for the month down by 2.6 points ending at 46.7 points. Services was down heavily, falling 6.3 points ending well below the 50 mark at 36.2. Construction was up strongly for the month by 7.3 but stayed in contraction at 45.2.

We discuss these survey results in the rest of our update given the high level of volatility we are seeing which reflects Consumer and Business sentiment better than just the historical data on which we typically rely for our analysis.

Industrial Production - Manufacturing



2. Capital Markets and Interest Rates

We continue to look at capital markets as part of our regular summary of economic and financial conditions in Australia as the third quarter of 2020 saw world and domestic markets remain volatile as a result of COVID-19. Along with listed equity markets we look at listed Australian Real Estate Investment Trusts (A-REITs). The ASX and equity markets globally have featured daily volatility well beyond what might have been expected even once markets became aware of the coronavirus back in the first quarter of 2020. The ASX 200 was little changed in the third quarter after a good rebound in the 2nd quarter but was still down 13% for 2020. The decline in the major banks share prices had levelled out earlier in the year but in addition to new breach revelations and action by regulators uncertainty about dividend policy and future bad debts has seen the ASX Bank Index fall by 20% in the year to date but after 30 September 2020 has rebounded by 11%. The impact of COVID-19 loan repayment deferrals will remain unclear until 2021 and half-year results about to be announced will be very important in driving market sentiment.

ASX 200 down 13% in 2020 ytd but flat for the 3rd qtr

A-REITs down 25% ytd; Banks remain weak down 20% ytd but up 11% since 30/9

COVID-19 continues to change everything. ASX 200 Indices (ex income)

Direct Real Estate's performance remains uncertain and one of our preferred measures from MSCI had signalled last quarter that while they expected to release their quarterly indices as usual valuations would contain a "material uncertainty" disclaimer. Listed Real Estate as shown above by the ASX A-REIT 200 Index as shown above has had a very negative 2020 thus far. The MSCI All Property total returns were down to 1.4% for the 12 months end 30 June 2020 and those in the Retail sector who were already struggling were further hit as earnings continued to be squeezed and write downs as a result of revaluations of major regional shopping centres.

RBA August SoMP showed Cash Rate at 0.25% but has now fallen to 10 bps; October FSR reflects positive Federal Budget

Quarterly market update

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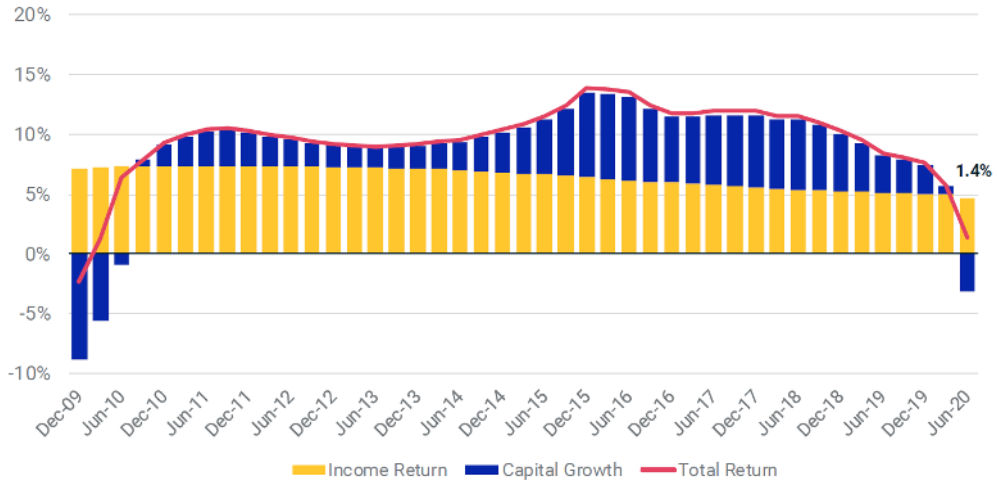
Thinktank..

Australian All Property Historic Annual Returns



MSCI

The RBA in its August quarterly Statement on Monetary Policy (SoMP) had its usual set of forecasts for economic indicators which were much changed from the May edition but in line with the October Financial Stability Review (FSR) which further addressed the coronavirus pandemic. By the time of the FSR release the RBA had this to say about it; “The shock to global financial markets from the COVID-19 pandemic has been very large…. The Australian financial system enters this challenging period in a strong starting position. Financial markets in Australia have been dysfunctional at times but banks are well placed to navigate difficulties in funding markets.”

The FSR also spoke of the non-Bank sector of which Think Tank is a participant and the role of the Australian Office of Financial Management; “The initial transactions from the Australian Government’s $15 billion fund for investing in asset-backed securities and warehouse facilities has already resulted in a significant easing in funding conditions for these lenders.” The May SoMP went on to say; “The AOFM invested in its first deal in late March and expressed support for upcoming deals with a particular focus on mezzanine tranches. In addition, the AOFM noted that unfavourable market conditions have resulted in distorted pricing in the secondary market for ABS. As a result, it will also purchase existing securities from investors who commit to supporting activity in the primary market.” This has continued in the period since those remarks were made and the AOFM has contributed greatly to the liquidity of securitised mortgage markets.

The RBA brought rates down earlier in the year to 0.25% solely as a result of COVID-19. The AUD/USD exchange rate which had drifted down fell more sharply to just below USD 0.55 and then rose just as suddenly as the impact of the coronavirus on the US economy became clearer and now sits at USD 0.71. Speeches from Governor Lowe and other RBA figures confirmed the RBA would keep three-year Treasuries at the same level as the Cash Rate and market rates have seen shorter term rates like BBSW fall below that. Five and ten year treasuries have fallen further below 1% while the Cash Rate has also now fallen to 0.10% and is expected to remain at that level until 2023.

3. Residential

Residential markets continued to fall during the third quarter of 2020 as prices for housing softened nationally and more so in Sydney and Melbourne. The long-term impact of COVID-19 on property prices is still not known but we have moved from a Softening trend across the board as further declines are less dire and retained it for Sydney units and both Melbourne residential sectors. Overall the Capital Cities were down 1.5% for the quarter and also down nationally by 1.1%. For the month of September, Melbourne and Sydney were down 0.9% and 0.3% respectively but nationally only 0.1%.

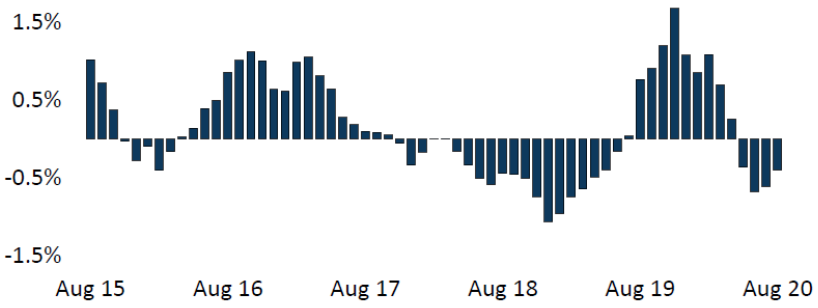
Houses: Houses in Sydney were down 1.7% for the past 3 months and In Melbourne they were down 3.7%. For the nation as a whole the fall was less at 1.0%. Only one of eight capital cities houses were down in price for the year which was Perth which fell by -0.9%. Notably Adelaide was up 3.5% while Brisbane was up 4.5% for the year. Regional prices were up 4.5%.

Units: Unit prices as reported by Core Logic are down by less than houses in both Sydney and Melbourne for the last quarter being down 1.5% and 2.3% respectively. Adelaide was up 1.3% and the combined capitals down - 1.5%. The AIG/HIA PCI Index for September recovered by 7.3 points but is still in contraction below 50 at 45.2. AiG reported that conditions improved in every State except for Victoria. Our concern for unit prices remains in the large supply of settlements of newly completed apartments over the next two years and our October Monthly Market Focus has some interesting observations from the RLB Crane Index. CoreLogic reports national house rents have risen by 0.4% from March to September while unit rents have fallen by 3.3% in that same period.

National dwelling values fell by 1.1% in the Sept qtr. but 0.1% in the last month. Sydney down 1.6% & Melbourne down 3.3% for the qtr - CoreLogic RP Data

The RBA had a number of comments about housing in their August SoMP;
"The modest decline in established housing prices at the national level, and the partial recovery in financial asset prices such as equities since March, mean that household wealth was broadly unchanged in the June quarter and increased a little over the past year. Rental vacancy rates rose further in recent months in Melbourne and Sydney, and advertised rents continued to move lower. The increase in the vacancy rate in Sydney has been driven by a larger number of vacant properties – primarily apartments – in the inner and middle ring suburbs. One important factor affecting rental market conditions has been the decline in international visitors and domestic business travel because of travel restrictions. This has encouraged some landlords to offer their short-term rental accommodation on the long-term market, increasing the available rental stock."

Monthly Change in Dwelling Values



HTW in their most recent Capital City Property Market research continue to reflect the views in our ratings with all Capital Cities shown as at the start of decline or just peaking for houses and units.

Demand is still shown as being soft for units but fair for houses in Melbourne while in Sydney it is soft for both units and houses. Brisbane houses are seen as declining while Adelaide houses are seen as being at the bottom of the market. Perth still appears to be at the bottom of its market cycle for houses and declining for units. Perth's rating for units is Weak and houses are Fair. Perth's trend for Units remains Deteriorating.

All other ratings are Fair and trends Softening. We shifted from an overall Watch for most of the trends in the Residential sector as the impact of COVID-19 becomes clearer. Longer term the issue of population growth and migration is central to the supply and demand equation of housing and even with a strong V shaped recovery which is looking much less likely, growth will be diminished.

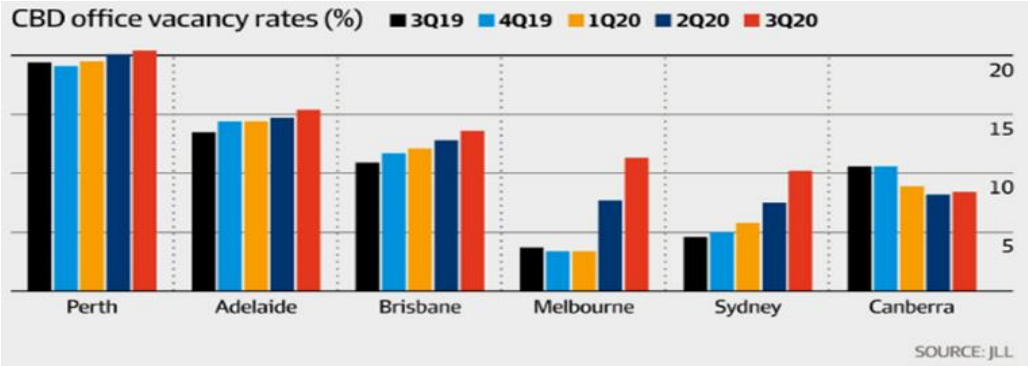
4. Office

Office vacancies rise across the country. Sydney at 5.6% and Melbourne at 5.8% up the most. Perth, Brisbane and Adelaide much higher especially in secondary market.
PCA Office Market Report, July 2020

The Property Council of Australia released its Office Market Report in July and not surprisingly vacancies rose in all capital cities. The survey which was conducted in June provided some interesting views of investor sentiment especially comparing them to the results of six months earlier. Nationally levels of vacancy rose from 8.3% to 9.5% in the OMR but the largest increases were seen in Sydney and Melbourne at 5.6% and 5.8% respectively. All capitals rose except for Canberra which fell marginally and Brisbane and Adelaide experienced increases of only 0.2% each. PCA CEO Ken Morrison said "Vacancy rates have increased over the past six months, but overall vacancies are still below the historic average." He also noted the uptick in sublease space is still relatively modest compared to previous downturns. In the early 1990s, when overbuilt markets were caught in a recession, sublease vacancy peaked at around 2.5% compared to the current level of 0.8%." It is fair to say that since then both statistically and from a sentiment point of view things have changed somewhat especially in Melbourne.

JLL conducted their own more recent vacancy survey and again not surprisingly the numbers were up in all capital cities with related impact especially on incentives and net effective rents. "The vacancy rate in Sydney has been inching upwards for several quarters before jumping from 5.8% to 7.5%. The situation in Melbourne is more dramatic yet, where the vacancy rate has more than doubled from 3.4% to 7.7%. In Brisbane, Perth and Adelaide, vacancy has also increased but more moderately." Knight Frank have also published a number of research notes on capital city CBD Offices and also a separate one on Sydney North Shore Offices. They highlight firm yields but note the impact of incentives on net effective rents despite face rents mostly holding. HTW in their most recent Month in Review economic conditions while Melbourne has large oversupply and

faces severe economic contraction. Their markets are both described as starting to decline while the other capital cities are further into the cycle including Perth focused on the Office sector and now describes Sydney as facing rental oversupply and described as being at the bottom of the market. Yields are now softening slightly in most locations, but ultra-low interest rates which are expected to last for years are offsetting lower returns. As a result we have made some changes to our Ratings and Trends with Sydney moving down to Good from Strong and Melbourne with Brisbane Fair together with Adelaide and Perth. All five enjoy a Stable trend but subject to rapid change.

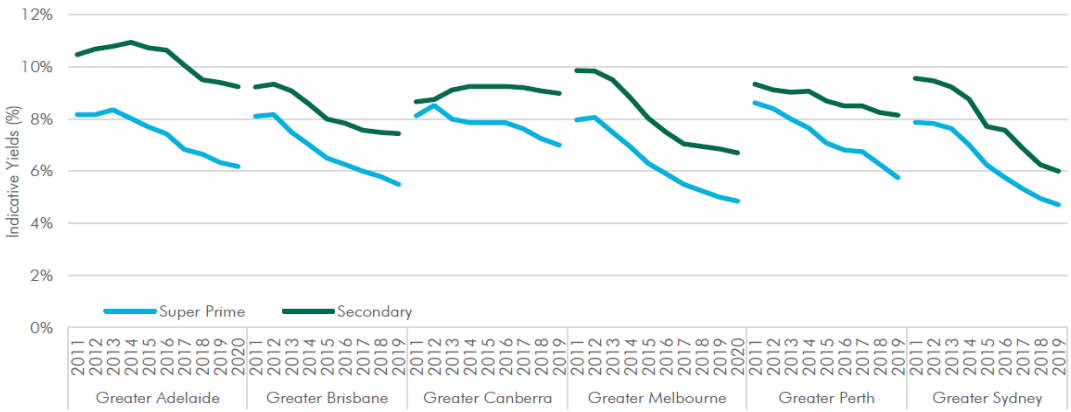


5. Industrial

"Yields compress to record lows amid growing demand" CBRE

The ACCI – Westpac Survey of Industrial Trends for the September rose strongly from 24.0 in June to 42.4 recovering from the most negative reading since the series began. This is consistent with the Westpac – MI Leading Index which also recovered to minus 0.48 from minus 2.56 in August and minus 4.42 in July. From other surveys we follow however the AiG PMI dropped slightly in September by 2.6 points to be in Contraction at 46.7 . CBRE reported it was the story of the commercial property market in a pandemic: Industrial is surging as investment in Office property slowed to a trickle amid uncertainties over longer term workplace occupancy. Likewise lockdowns have put a brake on Retail investments. According to the CBRE report, yields are tightening in all locations and for both Prime and Secondary properties. Rents for Prime properties will show little change, while secondary properties would initially see yields tighten by 50 basis points and face rents would stay the same but with incentives rising slightly to 16.6% . HTW in their most recent monthly review of the Industrial sector sees Perth remaining in oversupply and is rated as Weak and at the bottom of the market. We have kept our ratings for Sydney at Good and Stable as is Adelaide with a similar trend for Brisbane but rated Fair. Melbourne understandably has been cut to Starting to Decline but we have kept it at Good expecting a short-term recovery once restrictions are lifted.

Industrial and Logistics Yield by Region



Source: CBRE Research Q3 2020

6. Retail

Consumers hesitant as Australia unwinds lockdown CBRE

Recently released ABS figures for retail sales for August, in current prices, the seasonally adjusted estimate for Australian turnover fell by 4% in what was described as a second wave setback, following a rise of 3.2% in July. Victoria was down steeply by 12.6% following its second lockdown. The variances by category were again quite wide reflecting recoveries by those that had fallen most in earlier months but all categories were up. Despite being up 7.1% for the year weak private sector business surveys suggest conditions will remain difficult. By state, Victoria predictably lagged other states; Victoria was down a massive 12.8% and NSW down 2.0%. WA was down only 0.4%, SA down 0.9% and QLD down 1.1%.

Indicators further reflecting the volatility of this sector were the Westpac-MI Index of Consumer Sentiment rose for a second month in a row by 6.3% in September to 93.7 remarkably reversing the impact on consumers of COVID-19 earlier in the year which saw a 20% fall. This appears to be consumers' reaction to the early lifting of some restrictions and it is quite likely that the volatility experienced may be repeated as the current situation in Victoria plays out. The AiG had this to say as the PSI for September fell by 6.3 to 36.2 well into contraction below 50; "The muted optimism seen in July diminished across August and September, as the depth and longevity of activity restrictions and border closures continued to weigh on demand nationally. All indicators were firmly negative in September, with the indices for sales, new orders and supplier deliveries decreasing significantly from the previous month.

Store closures are announced almost every day and the AFR quoted JLL as follows; "We remain cautious about the outlook for discretionary retail as stimulus measures roll off later in the year, which is likely to contribute to an upward trend in vacancy rates," said Andrew Quillfeldt, JLL's senior director of retail research in Australia. "The events throughout the past few months, which have led to many discretionary retailers planning to shrink their store network which will likely polarise the retail property sector even more."

CBRE reported yields have fallen by 35 basis points in the Retail sector since the end of last year with rents also falling by up to 10% year over year. This is with the exception of Neighbourhood Centres which they expect to remain steady. Year to date turnover is best in Household Goods and worst in Clothing and Cafes. HTW featured the Retail sector in September and had it in decline or at the bottom of the property cycle in all capital cities. We have kept all of our Retail ratings and trends at Weak and Deteriorating on the basis that eventually we would expect declining earnings must lead to a further softening of yields and we will see lower capital values in general as reflected by listed entities recent reported valuations.

YTD Change in Retail Trade Volumes

Source: ABS, CBRE Research, Q3 2020.

7. Thinktank Market Focus

The third quarter of the year saw Australian interest rates remain at all-time lows in response to the coronavirus pandemic. Economically we remained in a period of below trend growth both domestically and internationally and even though Australia formally moved into recession by comparison we have been better off than most and the same can be said of both how we are dealing with the coronavirus and its impact on the health of Australia and its economy. The fourth quarter will see the United States hold its federal election on the first Tuesday of November which may bring substantial change. The certainty is that international growth has plummeted, with high unemployment and underemployment with interest rates to stay low for some years to come. Housing prices domestically are now being challenged and some sectors such as CBD units may suffer. With regards to Fiscal Policy, COVID-19 forced the Federal Budget to be moved to October. Many policies such as JobKeeper have saved us from a devastating rise in unemployment and allowed SME businesses to retain contact with staff for when restrictions are lifted and gradually businesses can begin to operate productively once again including in Victoria.

We have mentioned previously a positive note of our experience with landlords/investors seeking a deferral of mortgage payments during this crisis. Both State and Federal governments had announced legislation to protect tenants and lenders have supported these moves with their own hardship relief as has Thinktank. These initiatives have worked well across all property sectors and as we said at the time, from our direct communication with our Borrowers, most businesses have sound prospects and a good percentage are already returning to normal repayment terms. Others require a further period of support for a return to healthy business activity once the crisis ends and it needs to be recognised that this may require a period beyond the end of the year and into 2021.

The better outlook for national housing values and the improvement in sentiment recorded recently has led us to re-evaluate seven out of ten of our Residential Trends from Softening to Stable. Ratings are now Good for five and five remain Fair. There have been a few other changes in our ratings and trends this quarter. Retail remains Weak and Deteriorating everywhere and while consumer sentiment has lifted, as noted in our earlier comments the outlook is not good. Industrial ratings in both Melbourne and Sydney are Good matching the Office sector in Sydney and comment appears to be much more positive about the Industrial sector but no doubt time will tell. That makes nine markets rated as Good and Stable with four of them in Sydney and Melbourne. Adelaide is doing well with three followed by Brisbane at two while Perth appears to struggle with over-supply except in Residential.

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
Resi- Homes	Good	Stable	Fair	Softening	Good	Stable	Good	Stable	Fair	Stable
Resi- Units	Fair	Softening	Fair	Softening	Fair	Stable	Good	Stable	Fair	Stable
Office	Good	Stable	Fair	Stable	Strong	Stable	Fair	Stable	Fair	Stable
Retail	Weak	Deteriorating	Weak	Deteriorating	Fair	Deteriorating	Weak	Deteriorating	Weak	Deteriorating
Industrial	Good	Stable	Good	Stable	Strong	Stable	Fair	Stable	Weak	Stable

Sources and References

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Dun & Bradstreet
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International Monetary Fund
JLL
Knight Frank Research
MSCI
OECD
PCA / IPD Research
Preston Rowe Patterson
Reserve Bank of Australia
Rider Levett Bucknall
Savills Research
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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.