Thinktank property finance

Quarterly market update

JANUARY - MARCH 2021

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

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1. The Global and Australian Economies

The fourth quarter of 2020 saw a further continuation of the dramatic shift of policy focus from a variety of global and domestic issues to the coronavirus pandemic which was declared by the WHO at the end of the first quarter on 11 March 2020. Domestically we have seen interest rates cut to all-time record lows and as discussed in more detail later in this update they are expected to stay at these ultra-low levels for a very long time. The "second wave" of 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 and this has been repeated more recently with outbreaks in New South Wales. These all had very negative consequences for the local economies and flow-on impact nationally. Compared to other countries however Australia is doing extremely well with the United Kingdom and the United States struggling to cope with mass infection rates and resulting deaths.

The World Bank Global Economic Prospects, January '21

"Subdued Global Economic Recovery"

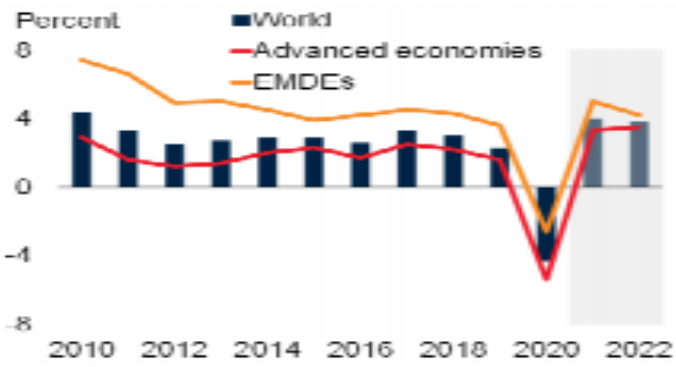
Global output -4.3% in 2020 but +4.0% rebound in 2021 and 3.8% in 2022

In its latest Global Economic Prospects just released by The World Bank, it has estimated that global gross domestic product (GDP) will shrink by -4.3% (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 World Bank had this to say: "COVID-19 caused a global recession whose depth was surpassed only by the two World Wars and the Great Depression over the past century and a half. Although global economic activity is growing again, it is not likely to return to business as usual for the foreseeable future."

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 -9.6% for 2020 (down 6.4%) but pick-up strongly to 5.4% in 2021 (up 2.3%).

World Bank Projected Global Growth



WORLD BANK GROUP

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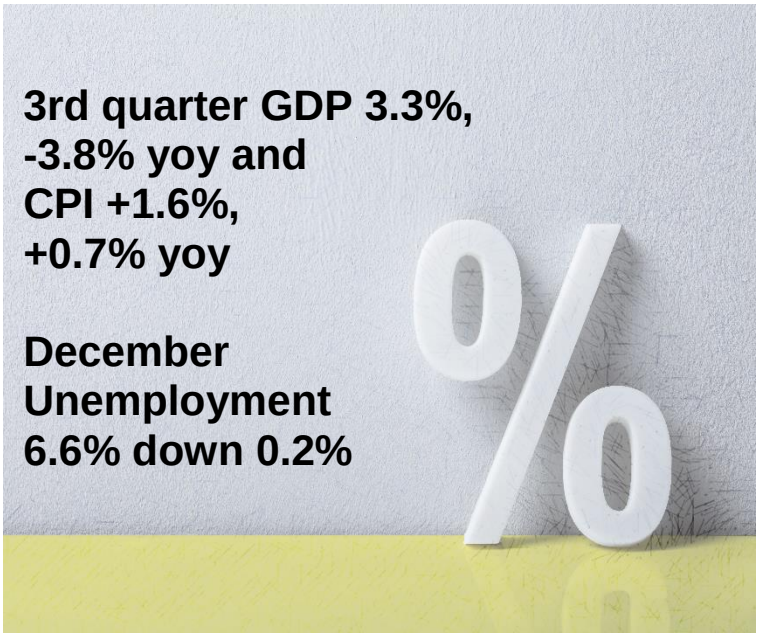
Third quarter national accounts released by the ABS on 2 December 2020 recorded quarterly positive growth of 3.3% (-3.8% annual) compared to -7.0% contraction in the second quarter of this calendar year. Unemployment fell by 0.2% to 6.6% in December and like all other statistics, expectations have drastically changed.

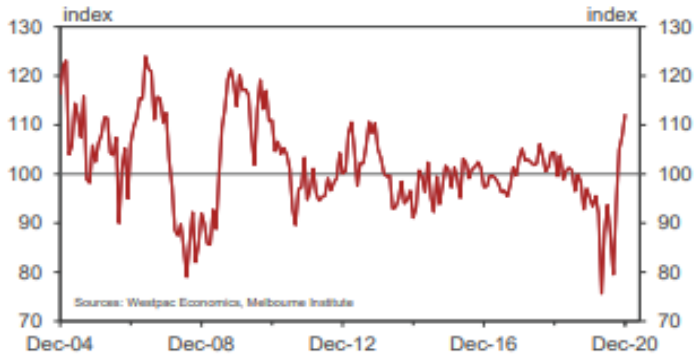
Forecasts for unemployment had varied widely but many had been in the area of a peak of 10% in June and these have since been pulled back considerably. The CPI for the third quarter was up 1.6% and the annualised core rate rose 0.7 yoy. Major contributors were household goods and services +12.0%, transport +3.4, and education +2.1%. 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.



Westpac and AiG surveys are positive but New Year's data may reflect COVID-19 volatility

Three Westpac economic surveys were recently released. The quarterly Westpac – ACCI Survey of Industrial Trends index was up again to 48.4 from 42.8 in September. The monthly Westpac – MI Leading Index also rose to plus 4.38 in November from minus 2.56 in August and minus 4.42 in July. Remarkably the Westpac – MI Consumer Sentiment Survey continued to rise in December up 4.1% to 107.2 a 10 year high. The suppression of cases in Victoria has seen a return of positive sentiment compared to earlier months.

Westpac – Melbourne Institute Consumer Sentiment Survey



The three monthly Australian Industry Group (AiG) Performance Indices from early December saw two rise and one, the PMI fell but all three remained in expansion above 50. Manufacturing fell for the month down by 4.2 points ending at 52.1 points and Victoria recorded its first month of expansion since last March. Services moved up slightly by 1.5 points to be further into expansion at 52.9. The services sector recorded its best result since November 2019. Not surprisingly retail trade and hospitality remained in contraction. Construction was also up for the month by 2.6 and moved further into expansion at 55.3. This was the second month of growth and the strongest result since April 2018. Industry conditions (outside apartment construction) were positive nationwide.

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 fourth quarter of 2020 saw world and domestic markets remain volatile as a result of COVID-19 but are definitely recovering. Along with listed equity markets we look at listed Australian Real Estate Investment Trusts (A-REITs). The ASX and equity markets globally continue to feature 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 down 3.2% in the second half after a good rebound in the 2nd quarter and was only down 1.8% 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 Financials Index fall by 9.0% in the year to date but after 30 June 2020 has rebounded by 13.4%. The impact of COVID-19 loan repayment deferrals continues to be closely followed and is showing good progress plus positive views on dividends.

ASX 200 down just 1.8% in 2020 but off 3.2% for the second half.

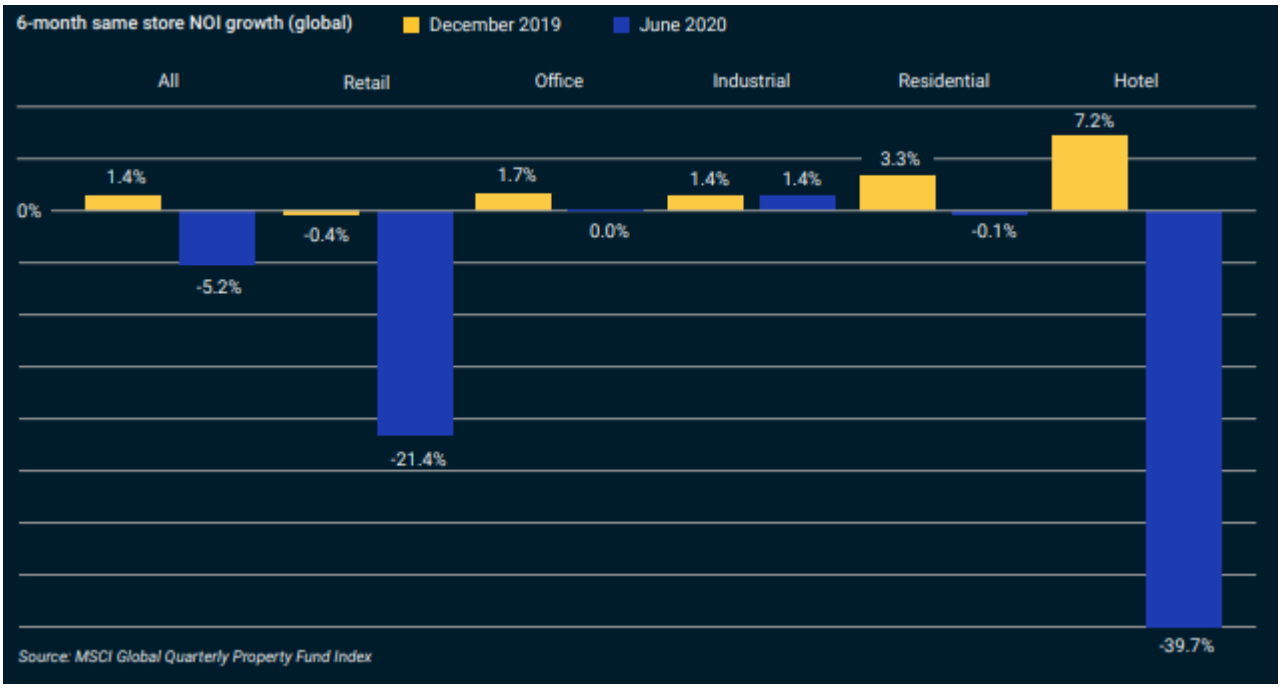
A-REITs down 8.0% for the year but up 19.2% since 30 June; Financials remain weak down 9.0% ytd but up 13.4% since 30/6

COVID-19 continues to impact everything.

ASX 200 Indices (ex income)

Listed Real Estate as shown above by the ASX A-REIT 200 Index had a very negative first half of 2020 but recovered well since then to end up only down 8.0%. 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. The full year results to be released shortly will be closely scrutinised but expectations continue to be for weak Retail performance and strong Industrial returns. Global sector returns are shown below with the Hotel group leading the falls together with Retail. Industrial has been steady with Office down slightly with no growth.

Global Sector Property Returns - MSCI



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RBA November SoMP showed Cash Rate at an all time low of 10 bps; October FSR reflected positive Federal Budget

The RBA in its November quarterly Statement on Monetary Policy (SoMP) had its usual set of forecasts for economic indicators which were again changed from the August edition but in line with the October Financial Stability Review (FSR) which further addressed the coronavirus pandemic. The forecasts were still quite conservative with unemployment still expected to be 7.5% by June '21 but CPI at 2.25%. By the time of the FSR release the RBA had this to say in comments about commercial property; "Some commercial real estate also poses significant risks for lenders and leveraged investors. Prior to the pandemic, structural change in the retail sector was contributing to rising retail property vacancy rates and falling valuations."

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; "Funding availability has since improved, partly as a result of the Government's Structured Finance Support Fund (SFSF), which is administered by the Australian Office of Financial Management (AOFM). The SFSF has purchased ABS directly at issuance and in the secondary market (freeing up capacity for investors to recycle these funds into new issuance), and invests in securitisation warehouses. RMBS (and other ABS) issuance by non-bank lenders has now resumed and is at similar levels to recent years, although pricing is still at higher spreads than prior to the pandemic. This improvement in funding availability has allowed non-bank lenders to start pricing loans more competitively. 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 again for the second time this year to a record low 0.10% solely as a result of COVID-19. The AUD/USD exchange rate which had drifted down initially 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 0.77; quite a remarkable shift. 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 stayed around 1% while the Cash Rate has also now fallen to 0.10% and is expected to remain at that level until 2023. Managing longer term rates through an Australian form of quantitative easing (QE.)

3. Residential

Residential markets started to rebound during the final quarter of 2020 as prices for housing continued to firm nationally and started to recover in Sydney and Melbourne. While the long-term impact of COVID-19 on property prices cannot be assured we had moved from a Softening trend across the board last quarter but retained it for Sydney units and both Melbourne residential sectors. Overall the Capital Cities were up 1.8% for the quarter and also up nationally by 2.3% with a strong regional performance of 4.0%. For the month of December, Melbourne and Sydney were up 1.0% and 0.7% respectively and nationally also 1.0%.

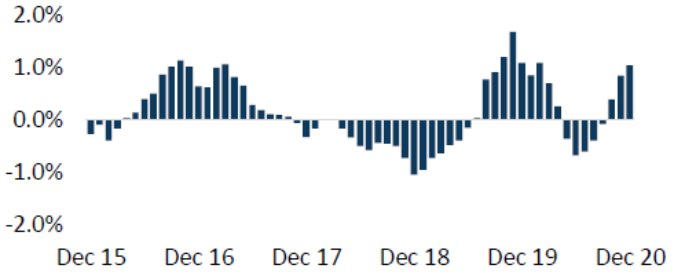
National dwelling values rose by 2.3% in the Dec qtr. And by 1.0% in the last month. Sydney was up 1.3% & Melbourne rose 1.5% for the qtr. – CoreLogic RP Data

Houses: Houses in Sydney were up 2.5% for the past 3 months and In Melbourne they were up 1.5%. For the nation as a whole they were up even more at 2.4%. Only one of eight capital cities houses were down in price for the year which was Melbourne which fell by -2.0%. Notably Adelaide was up 5.9% while Brisbane was up 4.6% for the year. Regional prices were up an impressive 7.1%.

Units: Unit prices as reported by Core Logic were not as good as houses in both Sydney and Melbourne for the last quarter being down 1.4% and up 1.4% respectively. Adelaide was up 1.9% and the combined capitals flat at 0.0%. The AIG/HIA PCI Index released in early December recovered a further 2.6 points to be further into expansion above 50 at 55.3, the best result since April 2018. AiG reported that conditions improved nationwide other than for apartments, including in Victoria. Our concern for unit prices remains in the large supply of settlements of newly completed apartments over the next two years. CoreLogic reports rents down by 7.6% for the calendar year in Melbourne and down by 5.7% in Sydney in that same period. In Perth however Unit rents are up 6.8% and rents for Houses up a remarkable 10.1%.

The RBA had a number of comments about housing in their November SoMP;
“Housing market conditions across the country are uneven. Housing prices in Melbourne and Sydney have declined since the August Statement, while prices have increased in the other capital cities and regional Australia. Rental vacancy rates remain elevated in Sydney, and have increased further in Melbourne. Advertised rents in Sydney and Melbourne have declined, driven by apartment rents. By contrast, vacancy rates have declined and rents have increased strongly in Perth, where lower dwelling investment in previous years has limited the supply of new rental stock. More generally, lower rental income could present cash flow challenges for some property investors if weak rental market conditions continue, and may also weigh on investor demand for new properties. The housing market poses risks to the outlook in both directions. Although the national decline in housing prices has been limited to date, it is possible that conditions could weaken if there is a sharp increase in households that are unable to meet their mortgage obligations.” Subsequently the RBA released internal analysis showing that a permanent 1% cut in the overnight cash rate would increase real house prices by 30% after about 3 years. If the interest rate reduction was temporary, house prices would rise by about 10% over 3 years.

Monthly Change in Dwelling Values



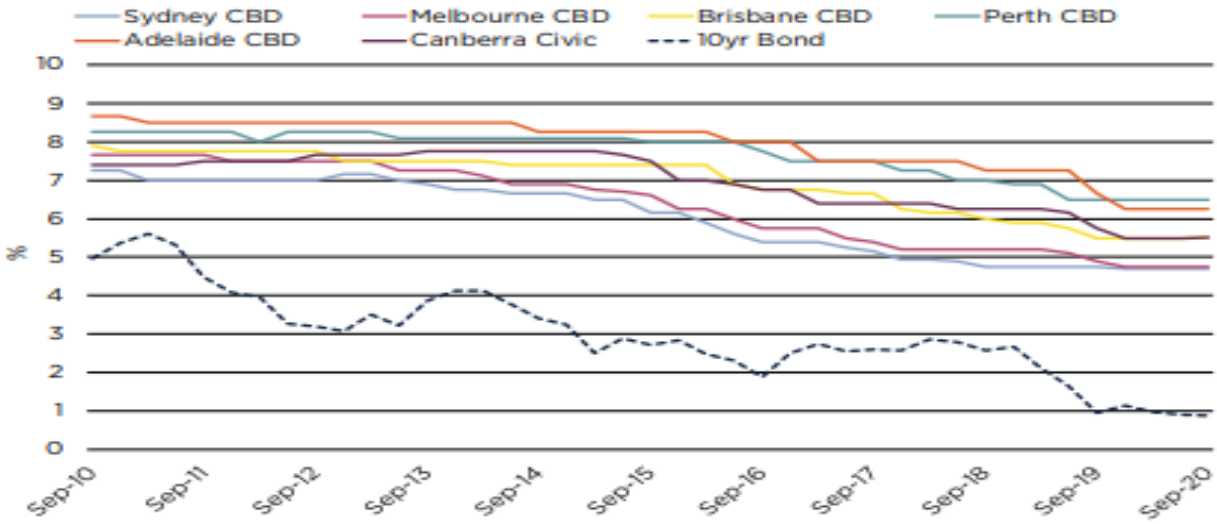
HTW in their December Capital City Property Market research continue to reflect the views in our ratings with Capital Cities ranging from start of recovery to rising markets for Houses while Units are near the bottom of the market in Sydney and Melbourne but rising in other capital cities. Demand is still shown as being soft for units but fair for houses in both Melbourne and Sydney. Demand in other capitals is Fair for Units and Strong for Houses which is very encouraging. We shifted from an overall Watch for most of the trends in the Residential sector earlier in the year as the impact of COVID-19 became clearer. Longer term the issue of population growth and migration remains central to the supply and demand equation of housing but Houses appear much more resilient than the inner city units of Melbourne and Sydney.

4. Office

Savills recently issued a summary of the Australian Office market as part of their Asian Cities coverage. Vacancy rates quoted were from June 2020 as reported by us last quarter 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."

Demand for quality office assets in Australia remains high.
Savills Research, December 2020

A-grade Office Yields v 10 year Govt. Bonds – Savills Research



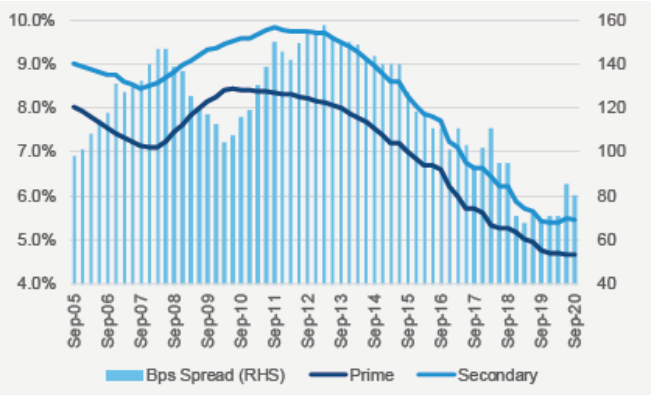
Knight Frank have also published a number of research notes on capital city CBD Offices and also a separate one on Sydney North Shore Offices. They highlight firm yields but note the impact of incentives on net effective rents despite face rents mostly holding. HTW in their most recent Month in Review 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.

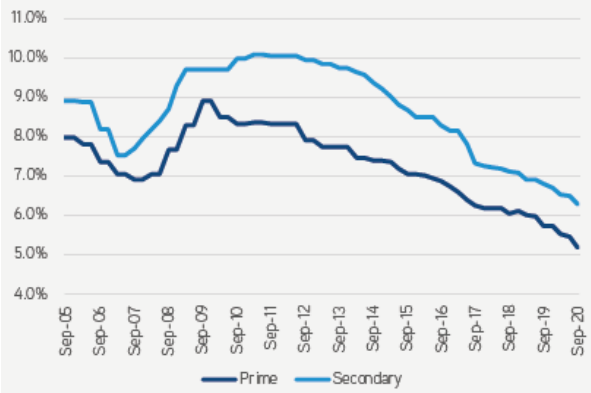
5. Industrial

Capital markets to remain strong. The outlook for the industrial and logistics investment market remains positive.
Colliers International

The ACCI – Westpac Survey of Industrial Trends for the December quarter rose again from 42.8 to 48.4 as it continued to recover from the most negative reading since the series began back in June of 24.0. This is consistent with the Westpac – MI Leading Index which also recovered to +4.38 in November, the strongest growth in the 60 year history of the measure. From other surveys we follow however the AiG PMI dropped slightly in December by 4.2 points but remained in Expansion at 52.1. Colliers International reported in recent research much the same opinion as CBRE last quarter that the story of the commercial property market in a pandemic is that the Industrial sector is surging as lockdowns have put a brake on Retail investments. According to the report, yields are tightening in all locations and for both Prime and Secondary properties and we show graphs for Melbourne and Sydney below. 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 November 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 and Adelaide is Strong with a similar trend for Brisbane but rated Fair. We have kept Melbourne at Good expecting a short-term recovery now that restrictions have been lifted.

Sydney and Melbourne Industrial Yields – Colliers International





6. Retail

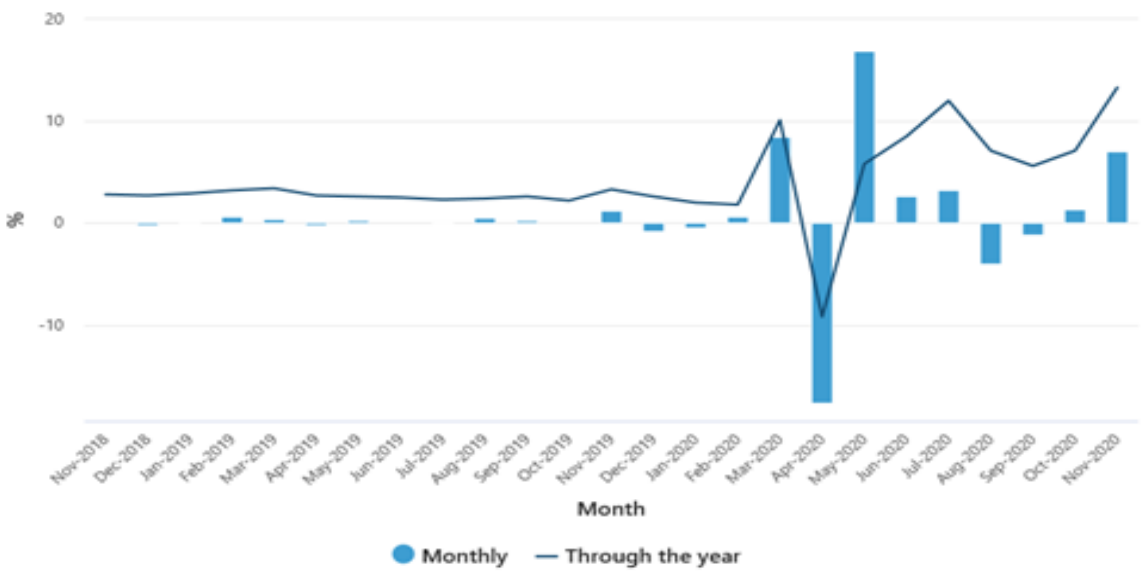
Consumers reflect sector volatility; up in Nov. and expected to fall in Dec.
ABS (see graph below)

Recently released ABS figures for retail sales for November, in current prices, the seasonally adjusted estimate for Australian turnover was up by 7.1% in what was a great result but expectations are for continued volatility with December expected to be down and preliminary estimates have confirmed that with a 4.3% fall. 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 again strongly in December by 4.1% to a ten year high of 112.0, 48% above its April 2020 low, 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.

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 December 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.

Monthly Change in Retail Trade Volumes - ABS



7. Thinktank Market Focus

The fourth quarter of 2020 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 had 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 as we emerge to positive growth. The fourth quarter saw the United States hold its federal election on the first Tuesday of November and the election of Democratic President-elect Biden with a slim control of Congress. The certainty is that international growth has plummeted, with high unemployment and underemployment with interest rates to stay at historic lows for some years to come. With regards to Fiscal Policy, COVID-19 forced the Federal Budget to be moved to October. Many policies such as JobKeeper, despite the recent cuts, 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 right across the nation and particularly in Victoria which has suffered greatly from its lockdowns.

We have mentioned on several occasions our own positive 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 most property sectors and as we said in our direct communication with our Borrowers, most businesses have sound prospects and a high percentage have already returned to normal repayment terms. Some however will require a further period of support for a return to healthy business activity once the pandemic is under control. It needs to be recognised that this may require a period beyond the end of 2020 and the current Government indication of 31 March 2021 looks reasonable.

The better outlook for national housing values and the improvement in sentiment recorded recently had led us to re-evaluate eight out of ten of our Residential Trends from Softening to Stable. Ratings are now Good for six and four remain Fair. There have been no 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 still remains soft. Industrial ratings in both Melbourne and Sydney are Good matching the Office sector in Sydney and comment continues to be much more positive about the Industrial sector but no doubt time will tell. That makes eleven markets rated as Good &/or Strong and Stable with four of them in Sydney and Melbourne. Adelaide is doing well with four followed by Brisbane at two while Perth continues to struggle with over-supply except in Residential where it is reported as suffering from a shortage.

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
Resi- Homes	Good	Stable	Fair	Stable	Good	Stable	Good	Stable	Good	Stable
Resi- Units	Fair	Softening	Fair	Softening	Good	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

ACCI – Westpac
Australian Industry Group
ANZ Research
Australian Bureau of Statistics
Commonwealth Bank
CBRE Research
Colliers International Research
CoreLogic RP Data
Cushman & Wakefield
Dun & Bradstreet
Herron Todd White
International Monetary Fund
JLL
Knight Frank Research
MSCI
OECD
PCA / IPD Research
Preston Rowe Patterson
Reserve Bank of Australia
Rider Levett Bucknall
Savills Research
Westpac Economics
World Bank

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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.