Australian real estate market focus

July 2021

Thinktank..

The following represents a monthly snapshot of how we see the property markets across the country along with the near-term outlook. For more in depth commentary, please visit our website thinktank.net.au for our Quarterly Market Update. This month in News and Views we are taking our first look at Real Investment Analytics who were introduced to us by Opteon Valuers recently in one of the first live face to face presentations in some time.

The Westpac-MI Consumer Sentiment Index fell by 5.2 % in June to 107.2; a fall of this size is significant being 9.7% over the past two months and coming between the most recent Melbourne lockdown and that in Sydney that followed. This month's results for the AiG Manufacturing Index however saw a further increase of 1.4 points to 63.2 for a ninth month of expansion above 50 and reaching a series high for the index. Five of the six manufacturing sectors expanded. The PCI Construction index however fell again slightly in June to be down a further 2.8 points to 55.5. Not surprisingly the apartment sector moved back into mild contraction below 50. The PSI Services index also fell by 3.4 points to 57.8 but surprisingly all five sectors are still in expansion above 50.

At its July meeting the RBA Board left the Cash Rate at the record low of 0.10% to no one's surprise but the attention was all on Governor Lowe's remarks afterwards. "The Board will not increase the Cash Rate until actual inflation is sustainably within the 2–3% target range. The Bank's central scenario for the economy is that this condition will not be met before 2024". The day before the ABS released Retail Trade figures for the month of May up 0.4% for the month and 7.7% yoy but with lots of state based variance led by a 1.6% rise in QLD and 1.3% lift in WA with both states coming out of mini-lockdowns. Last month's GDP figures for the March quarter of a 1.8% rise (1.1% annual) was greeted as good news with forecasters now looking for up to a 3.5% increase for the full year 2021. 10 year US Treasury Yields were last traded at 1.35% down 25 bps from last month; AUS 10 year Gov't bonds matched that at 1.38% the lowest since February. As a result the AUD had fallen significantly over the past month to 0.75 and then fell another cent to 0.74 reflecting falling bond rates.

CoreLogic housing prices for June continued the exceptionally strong run of the past few months confirming the positive view of most with their recovery. National Housing values were up by a further 1.9% for the month and a total of 13.5% for the fiscal year end. In Sydney House prices were up 3.0% for the month and a remarkable 19.3% for the year. The results were somewhat less in Melbourne up 1.8% for the month and 5.5% for the quarter but only 8.9% for the year. The rest of the capital cities were all up for the month, the quarter and the past year and apart from Melbourne all were in double digit growth for houses for the past twelve months. There continues to remain a difference between Houses and Units with Houses on a national basis up 15.6% for the year while Units were also up but by considerably less at 6.8%. We continue to be encouraged by these results despite our concern for Units in Sydney and Melbourne especially in CBD locations.

We are very pleased to see the extension of a strong recovery in Residential and have maintained our recent changes. Retail continues to struggle; we are waiting for signs of a turnaround which may only come with longer term changes to sector strategy. Despite the 7.7% annual growth in May sales the current NSW lockdown will be damaging. Industrial remains very resilient and continues to be the market favourite including RIA in our News and Views section inside. Office is responding to more favourable comments from businesses and analysts to work from home attitudes and we remain positive for a recovery. There have only been a few changes in our Ratings & Trends this month as per our full review in this month's July Quarterly Market Update.

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

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

News and Views

o Last month we had the pleasure of attending our first research breakfast in a very long time, generously put on by Opteon Valuers and featuring Anthony De Francesco of Real Investment Analytics (RIA) as the main speaker. It was a tremendous opportunity to once again gather with others involved in the property sector and our thanks go out to Chris Mitrothanasis for organising the event. One of the great aspects of the research undertaken by Anthony and RIA is its focus on smaller sized property segments which differentiates itself from many others who look mainly at larger ticket size transactions to determine trends in such key measurements as vacancy and capitalisation rates.

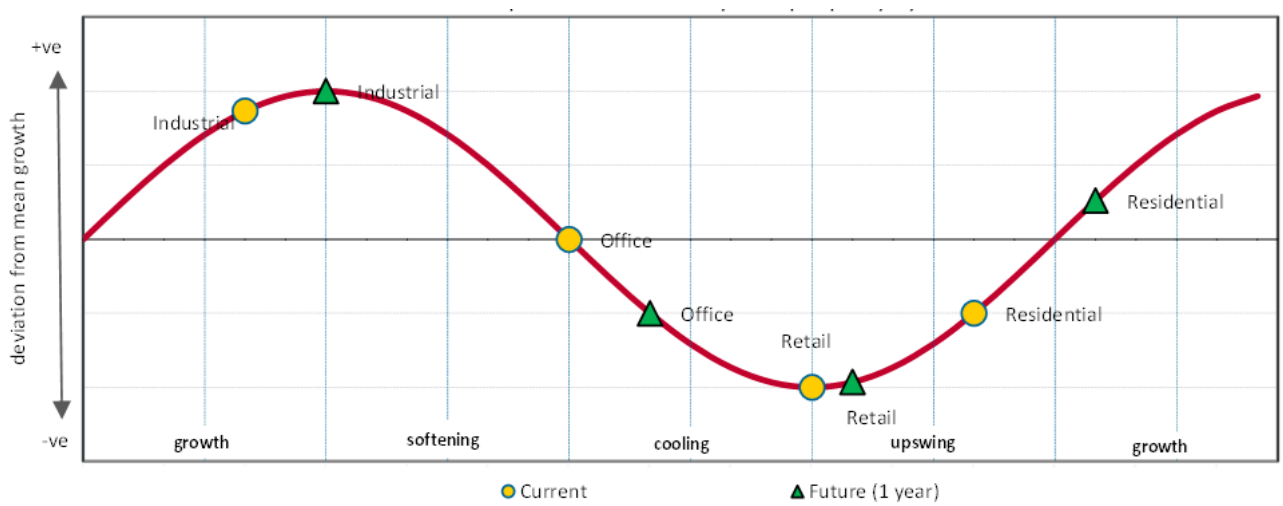
o One of the many charts presented by Anthony that we particularly liked was the Market Cycle one shown below. It presents very graphically what we try to communicate in our table at the bottom of page one. Our table presents the same property sectors for each Capital City while the chart below brings these together for one national view but presents the same assessment of both Current and Future (1 year) performance. Industrial is at the top of the cycle and looks to remain so for the next year. Similarly Retail is at the bottom of the cycle and not expected to see much change. Office is forecast to cool while the big improver is Residential which has already seen an upswing leading to good growth.

o Graph 1 opposite highlights the divergence in sectoral returns since late 2017 when they were all in a relatively tight range just under 15%. Total returns for the property sector as a whole began a steady downturn from that point but with quite different outcomes for the three sectors shown with the sharpest decline in Retail in fairly dramatic contrast to Industrial which continues to produce 10% total returns.

o Over a similar period of time, Graph 2 shows the movement of capitalisation rates since the early 2000s and highlights what happened during the GFC and compares that period with now and COVID19. It is very interesting to see the clustering of Office, Industrial and Retail around the 5% level when traditionally there has been a significant spread between the sectors. The graph includes Alternatives with such properties as service stations, childcare and pubs at a higher yield. The RIA database includes 2,435 such properties with a total value of $40 billion. The larger sectors consist of 2,113 properties valued at $294 billion.

o RIA's assessment of macroeconomic risk covers domestic, global and pandemic risks, focussing on factors which could stifle economic growth. These include the impact of the end of domestic government stimulus, low migration, the presence of geo-political risks and confronting low vaccine efficacy. The short-term outlook foresees a number of positives as economic growth rebounds together with consumer spending; all occurring within an environment of ultra-low interest rates. The medium term outlook sees economic and employment growth reverting to trend but below the long term average. Expected yield curve strengthening is perhaps the greatest unknown as evidenced by current speculation on the first increase in official rates.

Property Space Market Cycle – Real Investment Analytics



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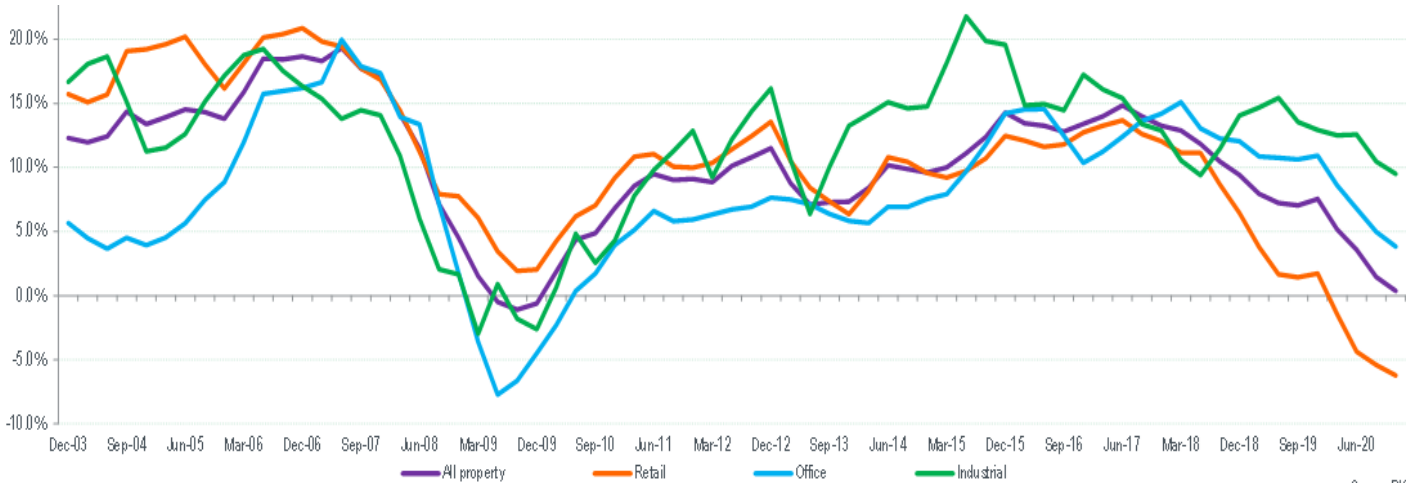
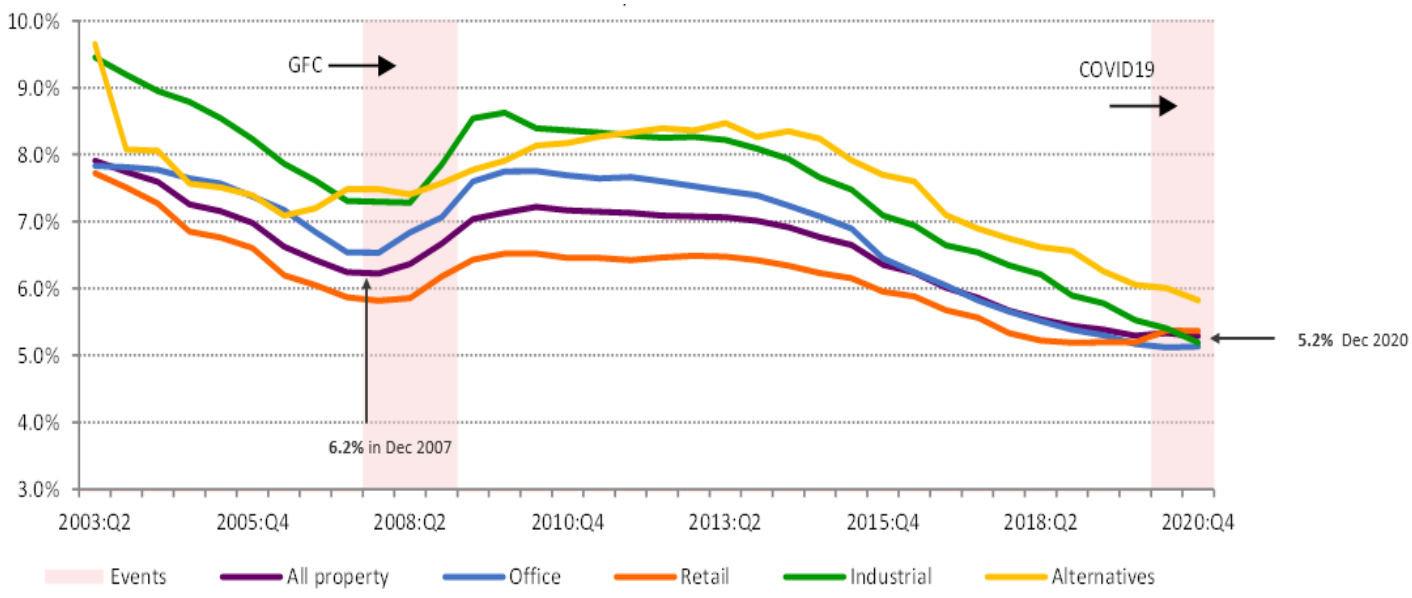
Graph 1: Australian Commercial Property Return by Key Sectors – annualised total return



Graph 2: Property Capitalisation Rates by Sector – bi-annual periods



RIA Real Investment Analytics

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- Self-Managed Superannuation Fund (SMSF) loans; and
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