Australian real estate market focus

September 2022

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 latest Quarterly Market Update. This month in News and Views we take a look at the most recent research provided by MSCI on Australian Commercial property markets for the second quarter of 2022.

The Westpac-MI Consumer Sentiment Index fell sharply once again in August by 3% to 81.2 remaining well below the 100 level of confidence, impacted by inflation and interest rate increases. The Westpac Melbourne Institute Leading Index rose to 0.63% in July from 0.48% in June. August's result for the AiG Manufacturing Index was down by 3.2 points to 49.3 moving into negative territory below 50. The AiG PCI construction index was in August by 2.6 points to 47.9, but remained in contraction below 50. The PSI covering services and retail was up by 1.6 points to 53.3 and further into expansion above 50 consistent with Retail Sales reported below.

Once again at its September meeting the RBA Board raised the OCR by 0.50% for a fourth time taking it from 1.85% to 2.35% while further increases are expected this year by most market economists. This was another large increase but Governor Lowe's remarks later in the week after the meeting left some economists predicting a reduced ¼% increase in October. The 2nd quarter GDP results at 0.9% for the quarter and 3.9% yoy; were good but on the back of a high quarterly CPI for June of 6.1%, the strongest rise since 2001 which is the RBA's focus. Retail sales for July were also positive being up 1.3% for the month and 16.5% yoy. The unemployment rate of 3.4% in July, down again from 3.5% also evidenced the resilience of the Australian economy. Elsewhere in the world, interest rates are also rising rapidly with increases later this month expected in both the USA and in Canada. The Bank of Canada increased its Cash Rate by 75 bps this week and since March this year from 0.25% to its current 3.25%. A little later the US Federal Reserve will meet and is also expected to again raise its base rate. 10 year US Treasury Yields traded at 3.18% at the start of the month while AUS 10 year Gov't bonds were at 3.63%. The AUD was falling at the start of this month below USD 0.68.

CoreLogic dwelling prices for August continued their decline at an accelerated pace. National Housing values posted a 1.6% fall for the month, and after last month's fall was down 3.4% for the quarter with a fall of 5.9% in Sydney and 3.8% in Melbourne. In Sydney, House prices were down 2.6% for the month with units down 1.5% and the results were similar in Melbourne for houses being down for the month 1.5% while units were down by 0.8%. Adelaide and Perth also fell into negative territory this month with dwellings down 0.1% and 0.2% respectively and Brisbane Houses fell 2.1% for the month. Regionals outperformed Capitals but were still down by -1.5% to -1.8% for August and -2.1% to -3.8% for the quarter. Rents continue to rise across the country.

We have reflected the further decline of Residential in almost all areas and have modified our ratings and trends accordingly across all capitals. Sydney and Melbourne houses and units remain Weak and Declining. Retail continues to be showing the expected signs of volatility as sales continue to improve as noted above. Office continues its slow but steady recovery from the pandemic lockdowns while Industrial remains very strong and we are maintaining our Ratings and Trends which are either Strong or Good with an Improving Trend in each of the capitals. It still remains to be seen how interest rate increases will impact on commercial capitalisation rates but a relatively flat yield curve appears to be encouraging as well as strong rental growth in the Industrial sector. We take a closer look at sector performance in our News and Views section inside with comments and graphs from MSCI taken from their recent 2nd quarter research on Australian commercial property markets.

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

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

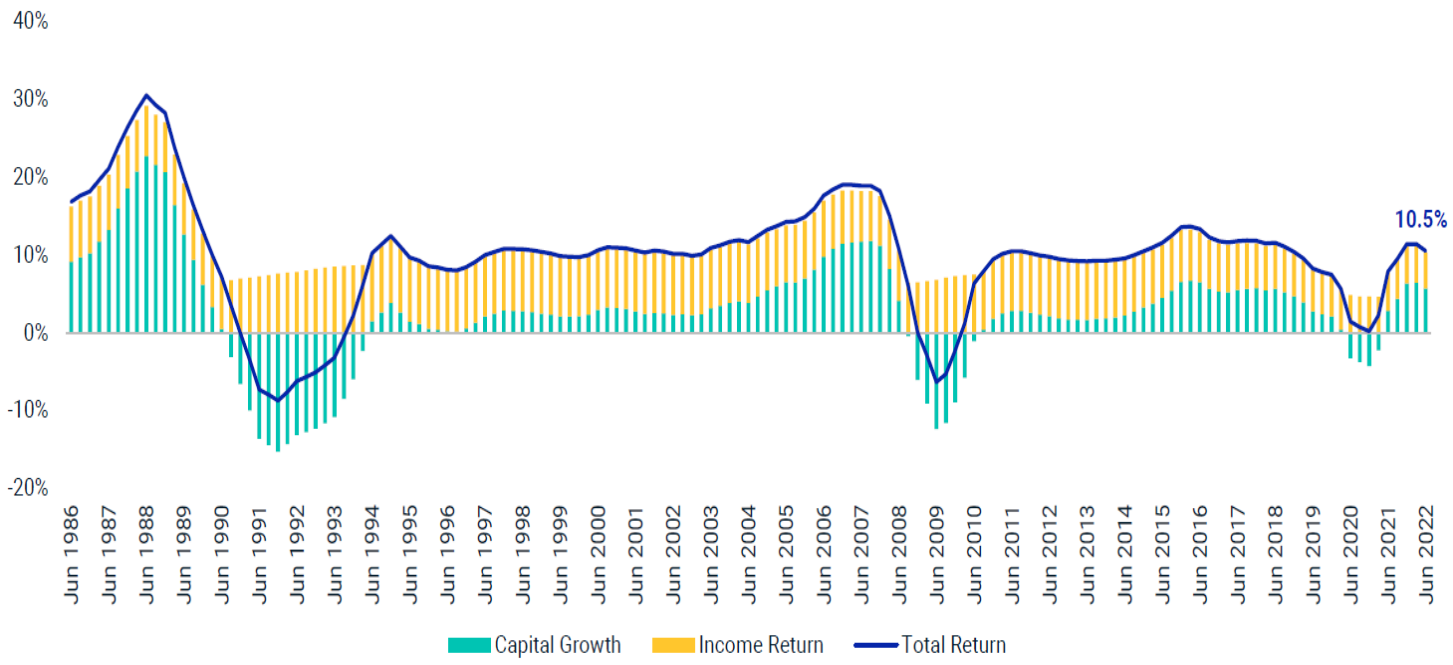
o During the past month MSCI produced its Property Research data for the second quarter here in Australia and confirmed some continuing trends but with the signs of what rising interest rates will do to capitalisation rates but then also the impact of increasing rents in some sectors. Total returns slipped slightly from last quarter to 10.5% with a fairly even split between Income Growth and Capital Return which has been the trend for the past three quarters. Over the longer term we can see from the graph below how those returns have fluctuated widely over 35 years but with periods of stability showing overall sector returns similar to what we are experiencing currently.

o Graph 1 opposite however shows how just over the last 18 months the volatility of commercial property as a whole and the extremely wide variance between sectors with Industrial leading the way and hitting a high in the December 2021 quarter with in excess of 30% Total Return and Capital Growth contributing 25% as capitalisation rates for the sector fell (although since rising slightly). At the other end of the spectrum was Retail showing negative Capital Growth for the first 3 quarters and then just producing small gains on top of quite steady Income Returns.

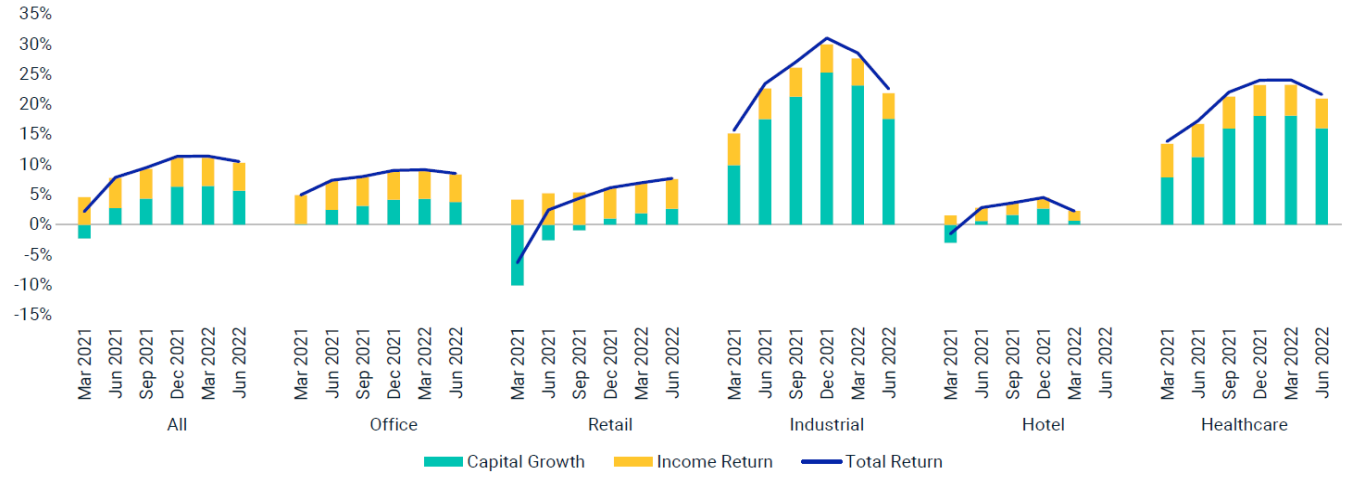
o What is even more interesting we think is Graph 2 which breaks down the traditional Commercial sectors down to their sub-sectors. This way the chart that is presented requires a bit more than usual attention as it covers Income Return and Capital Growth for the past year and Total Return for each of 1 year, 3 years and 5 years. We can see the 1 year Total Returns (the dark blue dot on top of the bar chart) for most of the leading sub-sectors on the left are from Industrial with only Healthcare breaking into the 20–25% grouping. However the next sub-sector is Neighbourhood Retail which is just about 15% Total Return for 1 year and showing good recovery in Capital Growth. Sub-regional and Regional Retail join Non-CBD and CBD Office in the 5-10% grouping but with good recovery evident from 3 and 5 year Total Returns. Super and Major Retail remains the largest drag on the sector and while Income Returns are reasonable Capital Growth remains depressed.

o Another chart used in the MSCI presentation, Graph 3 showed the impact of each sector on individual capital cities. This confirms the performance of Industrial across the country but also shows the relatively small size of the sector compared to say Office which is quite a large component in just about all capitals. The impact of Retail in Melbourne is quite noticeable and its relative size and good performance in Adelaide is also significant. The large presence of Retail in non-capital cities shown as Other is also very significant.

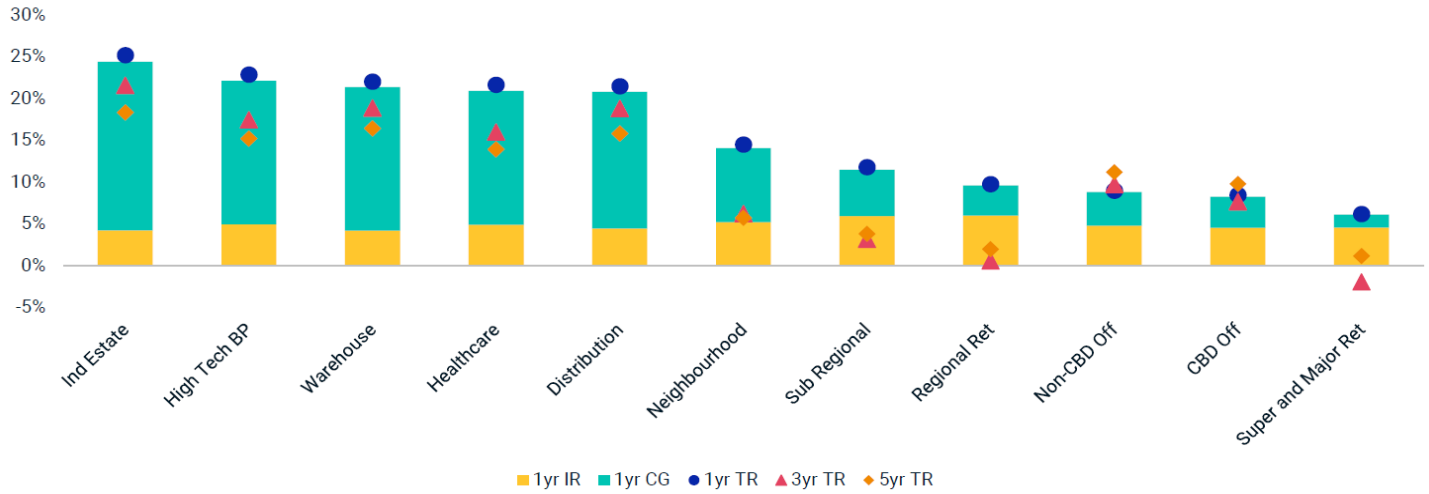
Rolling Annual Returns – Australia Q2 2022



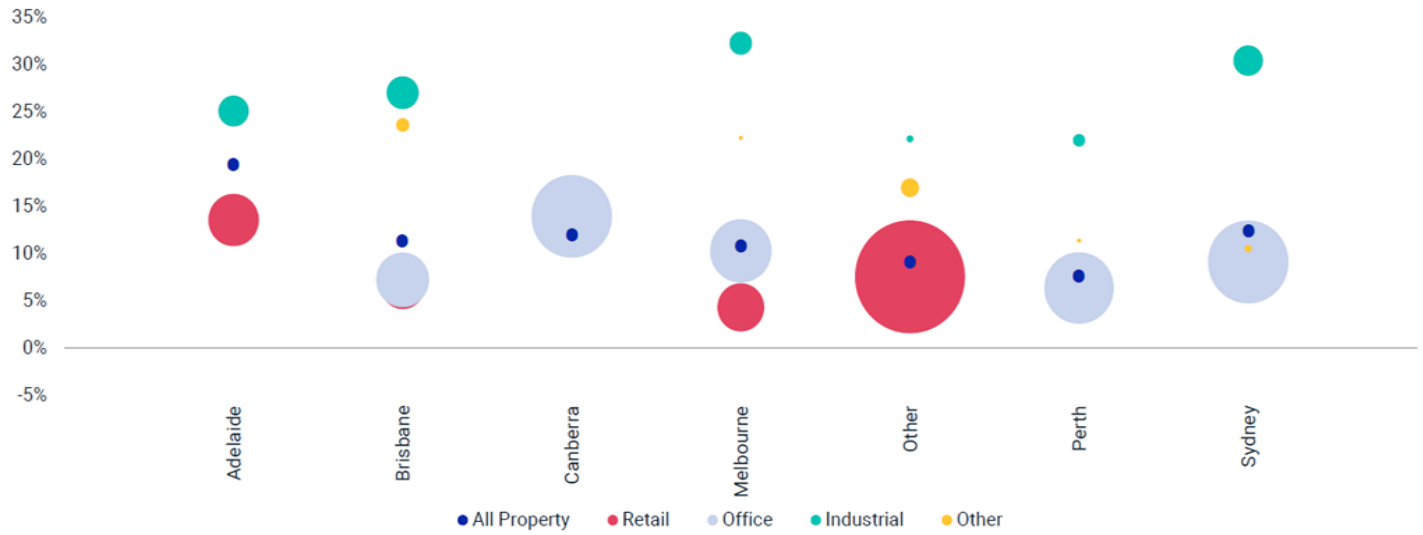
Graph 1: Rolling Annual Returns by Sector, Australia Q2 2022



Graph2: Breakdown by Sub-Sector, Australia Q2 2022



Graph3: Breakdown by Sector and Capital City, Australia Q2 2022



Source:

MSCI

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