Australian real estate market focus

June 2023 draft

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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 look at the Knight Frank 1st Quarter National Industrial Report which once again highlights the strength of that particular sector right across the country.

The Westpac-MI Consumer Sentiment Index was down 7.9% in May at 79.0 reversing last month's gain as consumers react to the RBA's interest rate decisions. The Westpac Leading Index was also down to -0.78 in April from -0.69 in March which was its ninth consecutive negative print. The AiG Australian Industry Index was launched in a different format back in February and in May gained 9.3 points to -10.9 after April's steep fall. as new orders continued to fall. The index has now been in contraction for thirteen months. The sub-indicators also both rose but remained in overall contraction with the PMI up 15.1 to – 5.1 and the PCI also up 5.8 to -6.6.

At its June meeting, the RBA Board surprised some commentators and raised the Cash Rate by another 0.25% to 4.10% after having raised by the same amount in May following the pause at its April meeting. While the April pause had not been forecast by all commentators it was seen as a welcome relief and a signal adopted by many even though further increases had been suggested by quite a few market economists and the Governor himself. While further increases are now expected by many; basically, there is a great deal of uncertainty over what the terminal OCR may be. The following day, the ABS released the 1st quarter GDP result of a disappointing 0.2% for the 3 months to March and 2.3% year over year. The unemployment rate of 3.7% in April was up slightly from 3.5% and forecast to be little changed during 2023 rising slightly by the end of the year to 4%. The Bank of Canada also raised rates by the same 25 basis points after having paused for some time and the US FOMC will likely do the same. 10 year US Treasury Yields are trading at 3.71% and AUS 10 year Gov't bonds were at 3.94% with the US yield still inverted from the 2 year at 4.53% by 82 bps with AUD 3 year Gov't bonds at 3.82%. All these rates are up slightly recently. The AUD is largely up above USD 0.67 after having fallen to USD 0.65.

CoreLogic dwelling prices for May continued their recovery across the broad spread of Capitals. National Housing values posted a 1.2% gain for the month following a 0.5% rise in April. They are now up 2.3% for the past quarter. The improvement was based on gains in Sydney and Melbourne of 1.8% and 0.9% respectively for the month with Brisbane up 1.4%, Perth 1.3% and Adelaide 0.9%. We see this as a continuation of the last two months initial recovery and don't believe it will be overly impacted by this month's RBA decision on a further interest rate increase. In Sydney, House prices were up 2.1% for the month with units up 1.1% and the results for Melbourne were also improved with houses up for the month 0.9% and units up by the same amount. Adelaide, Perth and Brisbane all did better this month in Houses with only Adelaide down slightly by 0.2% in Units. Rental growth slowed slightly to 0.8% for May but still at a high 3.9% National gross rental yield.

We continue to reflect the improvement of Residential in almost all areas and have maintained our Ratings and Trends across all Capitals with none showing a negative CoreLogic Housing result for the month. We will wait with cautious optimism for further steady results. Retail continues to be showing some recovery especially secondary although sales are flat. Office continues its slow recovery from the pandemic lockdowns but remains just Fair with weakness in Secondary CBD properties and the very different levels of vacancies and rentals depending upon which Capital you are in. Industrial remains very strong and we are maintaining our Ratings and Trends which are either Strong or Good with an Improving or Stable Trend in each of the Capitals consistent with the Knight Frank research featured in our News and Views inside this report.

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

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News & Views

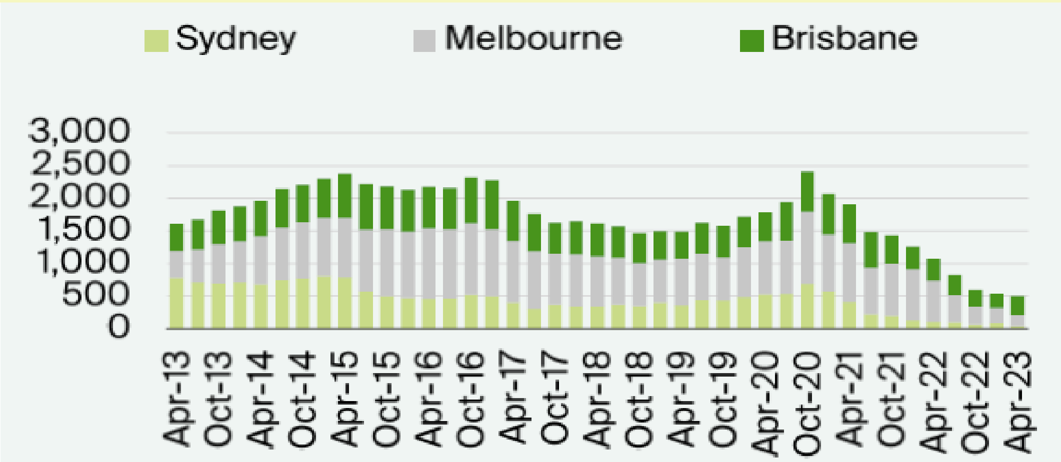
- Knight Frank Research recently issued its First Quarter Review of Australia's Industrial property sector. The report covered national trends as well as a review of five Capitals and was widely reported by the press. The Australian Financial Review (AFR) featured an article on the 5th of June by Nick Lenaghan entitled "Vacant Logistics Space Hits a Low" and including the chart shown below. While the chart covers only the Eastern Seaboard Capitals the report covers all capitals and the article includes the following remarks on the resulting rentals increases from low vacancies: "In Sydney, the country's tightest Industrial market, Prime rentals have jumped 38% over the past year. Over the March quarter, Brisbane's overall rental growth was the strongest at 8.6%, followed by Sydney at 8.2%. Adelaide and Perth reported 2.5% and 2.0% over the same period with Melbourne a more moderate 1.5%". The AFR article also comments on Incentives as follows: "Incentives offered by landlords – such as rent-free periods or fitouts – also contracted as the race for space heated up. They now average 10% across the Eastern Seaboard stimulating growth in effective rents over the quarter."

- The report itself featured a number of useful graphs and opposite in Graph 1 we can see the Average Prime Yields of the sector in the Major Capital Cities and while all are rising, the remarks below on Rentals in Graph 2 explain how values are impacted. On yields and interest rates it had this to say: " Prime yields are judged to have risen further in Q1 with the average prime yield shifting up in Sydney .(to 4.8%) and in Melbourne (to 4.9%) and Brisbane (to 5.8%) while Adelaide (6.0%) and Perth (6.3%) held firm." The report went on to say: " While debate continues over the level at which the Cash Rate will peak, funding costs have remained relatively stable in recent months, reflecting a balance between the potential for higher interest rates in the near term and market expectations that rates will be cut in 2024-25 once inflation eases."

- Overall, the sector has performed very well and shows all the signs of continued strength regardless of short-term developments. It is also interesting that the factors driving this performance are not limited to particular cities or regions but are seen to varying degrees in all locations. The report goes into detail on each of the five Capital Cities it covers and provides extensive comments on local areas with details of a number of transactions for each location. The following are brief remarks noted in introducing each Capital's review.
  - Sydney- Acute supply shortage and availability constraints drive rents to a new high.
  - Melbourne – Market starts 2023 hunting for space as vacancy levels fall below 200,000 sqm, limiting take-up.
  - Brisbane – Rental growth surges again, as cost of new development is setting rental levels due to limited existing vacancy.
  - Adelaide – Land values continue to rise while demand from both tenants and owner occupiers is strong.
  - Perth – After consecutive periods of strong growth Perth has moved to a position of stability.

Eastern Seaboard Industrial Vacancy 1st Quarter – 2023, Knight Frank

(.000, sqm.quarterly, 5,000 sqm +)



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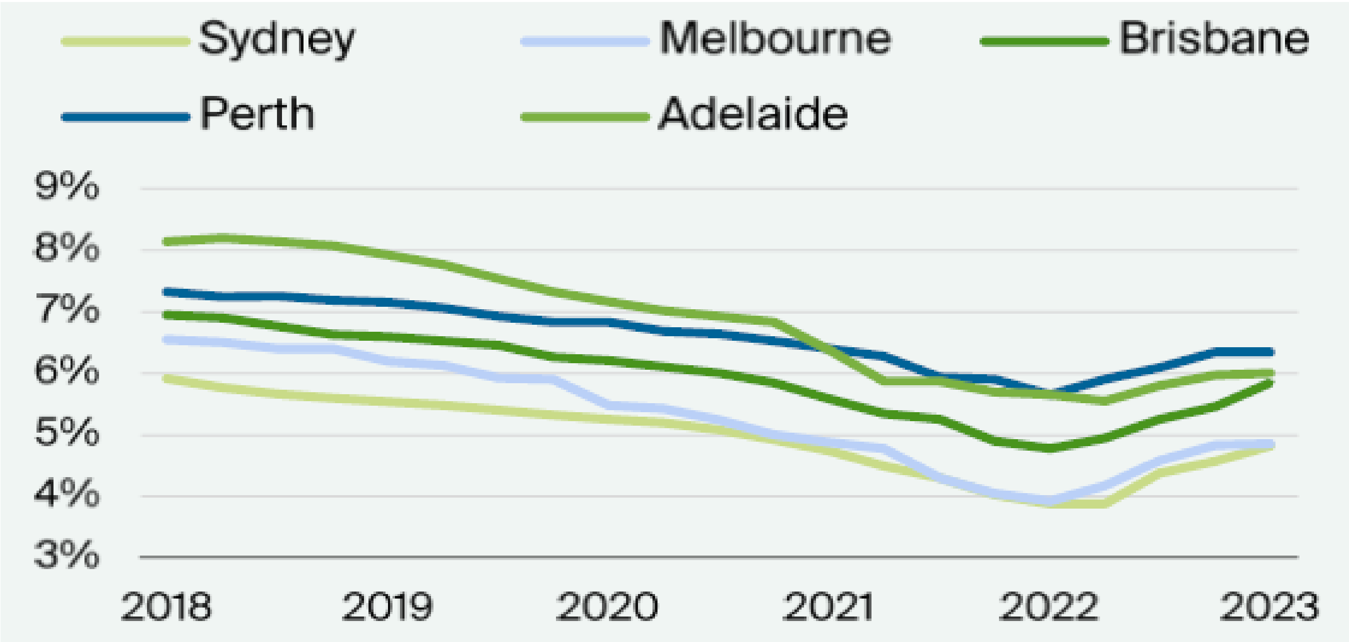
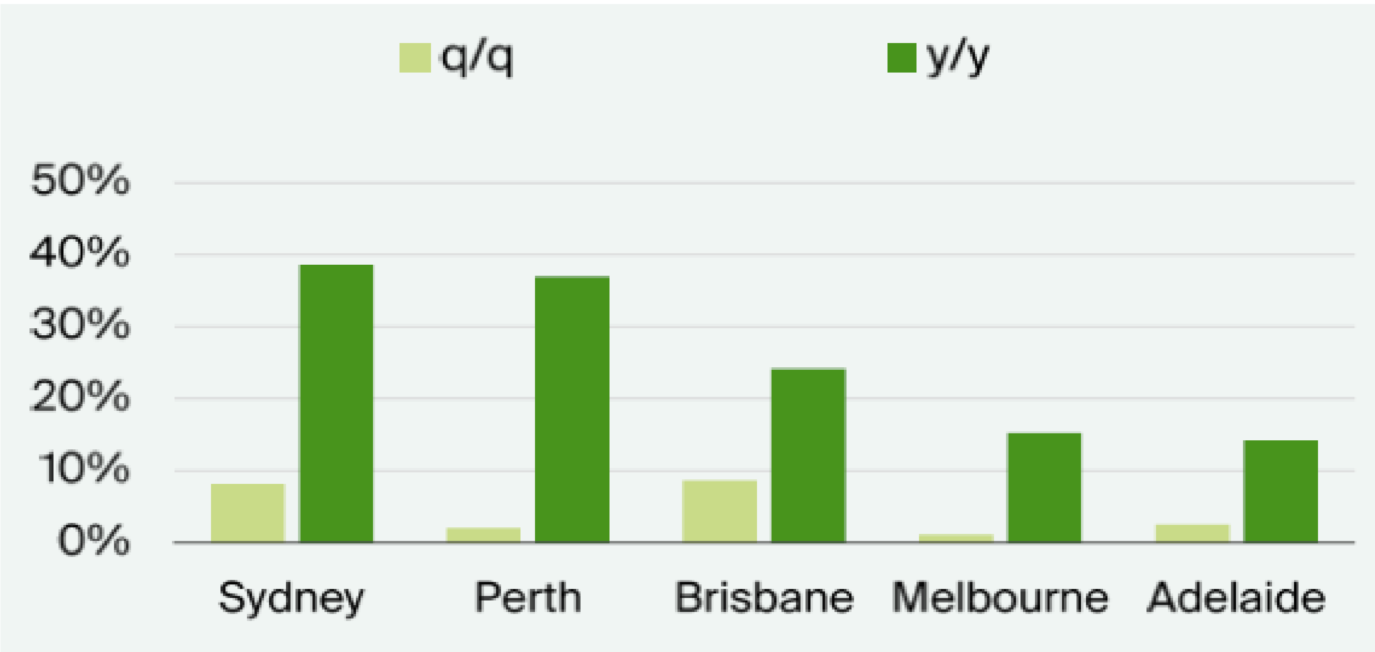
Graph 1: Average Prime Yields (average across major capital cities)



Graph 2: Prime Rental Growth (average across major capital cities)



Source: Knight Frank National Industrial Report Q1 2023

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- ✓ Limited Recourse Borrowing Arrangement (LRBA) loans with terms up to 30 years with no ongoing fees or annual reviews