Australian real estate market focus

July 2023

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 Cushman Wakefield and CBRE latest updates on the Commercial Office market with the stresses on rents and the impact of incentives.

The Westpac-MI Consumer Sentiment Index was up slightly by 0.2 points to 79.2 but remains near recession level lows recorded for the last year. The ACCI-Westpac Survey of Industrial Trends fell in June to 50.7 stepping down from a robust 53.9 in the March quarter and close to the break-even point of 50. The AiG Australian Industry Index now well into its new format launched back in February fell slightly in June by 1.1 points to -11.9 after having gained 9.3 points in May and remains in contraction where it has been for the past fourteen months. The sub-indicators were split with the PMI down 14.7 points to -19.8 and the PCI up 17.2 to +10.6 and expansion.

At its July meeting, the RBA Board again surprised some commentators this time by pausing on raising the Cash Rate and keeping it at 4.10%. This came after having raised by 0.25% in May and June following the pause at its April meeting. This pause had not been forecast by all commentators but was seen as a welcome relief even though further increases have been forecast by many market economists and the Governor himself. With at least one further increase expected the terminal OCR would be 4.35%. The 1st quarter GDP result of a disappointing 0.2% for the 3 months to March and 2.3% year over year has raised the spectre of recession. The unemployment rate of 3.6% in May was down slightly from 3.7% and forecast to be little changed during 2023 but monthly CPI was down to 5.6%. The Bank of Canada raised rates by 25 basis points to 4.75% in June but is expected to pause on 12 July. The US FOMC is thought likely to raise rates again when it meets on 25-26 July. 10 year US Treasury Yields are trading at 4.04% and AUS 10 year Gov't bonds were at 4.25% with the US yield still inverted from the 2 year at 4.99% by 95 bps with AUD 3 year Gov't bonds at 4.24%. All of these rates are up to their highest level in years. The AUD is down to USD 0.6599 having fallen from USD 0.67.

CoreLogic dwelling prices for June continued their recovery across the broad spread of Capitals. National Housing values posted a 1.1% gain for the month following a 1.2% rise in May. They are now up 2.8% for the past quarter. The improvement was based on gains in Sydney and Brisbane of 1.7% and 1.3% respectively for the month with Adelaide and Perth both up 0.9% and Melbourne 0.7%. As commented last month, this is seen as a continuation of the last quarter's initial recovery and was not overly impacted by last month's RBA decision on a further interest rate increase in May and should only benefit from this month's pause by the Central Bank. In Sydney, House prices were up 2.0% for the month with units up 1.2% and the results for Melbourne were also good but slightly lower with houses up for the month 0.6% but units up by more at 1.0%. Adelaide, Perth and Brisbane all did well this month with all three up in both Houses and Units for both the month and the quarter. Rental growth slowed slightly to 0.7% for June but still at a high 3.8% 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 maintain our cautious optimism. Retail continues to be showing some recovery although volatile, especially secondary although sales are flat. We discuss Office more in our News and Views section inside. Industrial remains very strong and we are maintaining our Ratings and Trends which are either Strong or Good. Overall little has changed and we will be taking a closer look at all sectors in our Quarterly Market Update later this month.

	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	Good	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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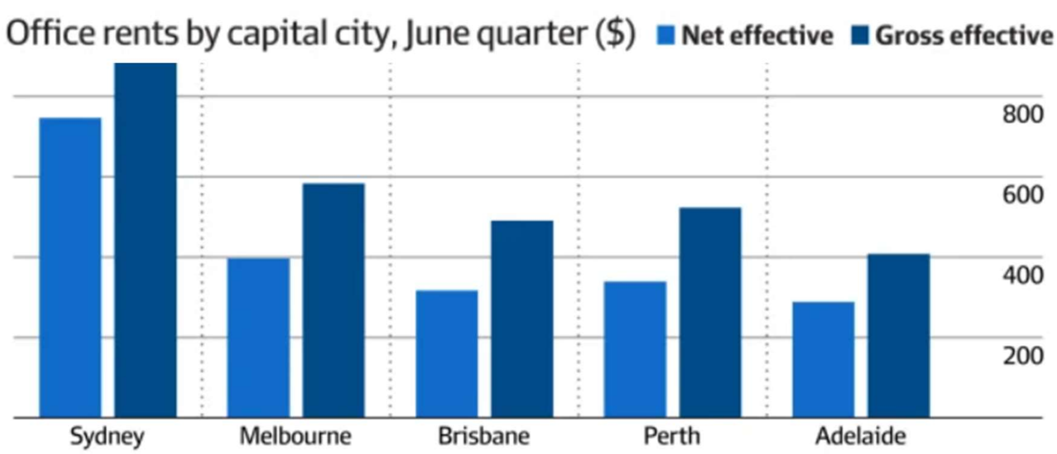
News & Views

- Cushman Wakefield recently issued its First Quarter Market Beat and featured a number of different research articles covering various commercial property sectors. The Australian Financial Review (AFR) featured an article on the 29th of June by Larry Schlesinger entitled “Incentives keep lid on real office rents” and including the chart shown below. The chart covers the impact of the cost of rental incentives across the Capital City markets highlighting how much in each market, gross annual returns are reduced by the amount of incentives paid by landlords to new tenants in the form of fitouts or cash payments, to sign on to leases.

- Melbourne office rents fell in the second quarter, and even cities that lifted rents did so in the face of significant incentives to attract tenants, according to Cushman Wakefield. Competition among landlords across most CBD office markets remains strong, and that’s keeping incentives at elevated levels. The update showed a modest uplift in effective rents in Sydney and Brisbane, and a solid gain in Adelaide. Office rents went backwards in Melbourne, where the work-from-home trend is more entrenched, and remained unchanged in Perth. In the Sydney CBD, prime gross effective rents climbed 2% in the second quarter to reach $975 per square metre per year – a rise partly attributed to “quality uplift as a result of new buildings being completed in the second half of 2022”. In Melbourne, where the CBD vacancy rate hovers around 14%, prime net effective rents fell 3.7 % over the second quarter to $395 per square metre. This drop was due to the high volume of quality vacant stock, which led to prime net incentives rising from 39.5%to 42% over the quarter while face rents remained steady.

- In the Brisbane CBD, prime gross effective rents increased 1.2% in the second quarter to $490 per square metre, as face rents increased while incentives remained steady. Over the past 12 months, rents are up 7.5% in the Brisbane CBD – an increase driven by a lack of supply and inflationary pressure. In Adelaide, prime net effective rents rose almost 9% in the June quarter to $290 square metres per annum, and 14% on an annual rolling basis. This was the strongest growth nationally, driven by the “superior quality of stock now being provided,” according to the report. Prime net effective rents in the Perth CBD remained unchanged over the second quarter at $338 per square metre, despite the city recording the highest worker occupancy in the nation at 80% at the end of 2022. Incentives in Perth ranged from 45-50%, the report said.

- CBRE also covered the same topic in its quarterly research and included the two graphs shown on the opposite page. It reported that rental growth was mixed across markets and had this to say: “National rental growth stabilised with CBD effective rents up just 0.2% q-o-q in Q1 2023. However there has been a large discrepancy between markets with Sydney, Brisbane, Canberra and Perth recording healthy growth. Meanwhile, Melbourne and Adelaide have seen a mild softening of effective rents as the supply outlook and subsequent backfill availability is giving more power to tenants. Incentives stabilised across most markets in Q1 2023. Melbourne observed an increase of incentives to average 41.2% (up 104 bps) as vacancy continues to trend upwards in that market, as shown in Graph 2. On the other hand, Perth’s strong leasing activity and rental growth has continued to cause incentives to decline, albeit off a high base of 47.8%.”



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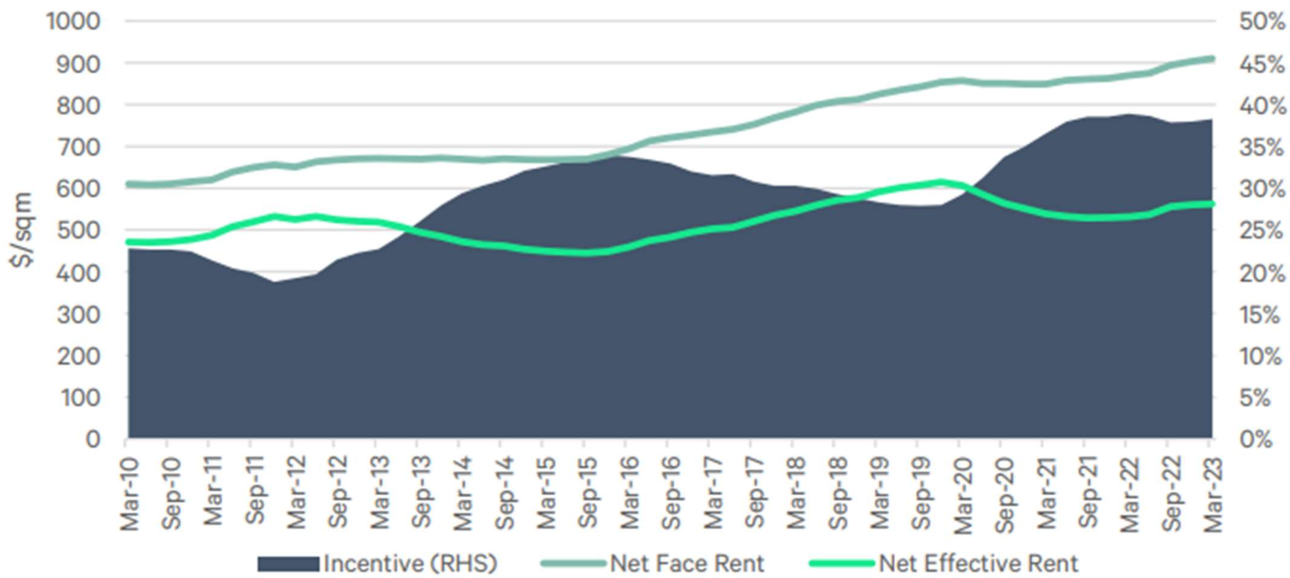
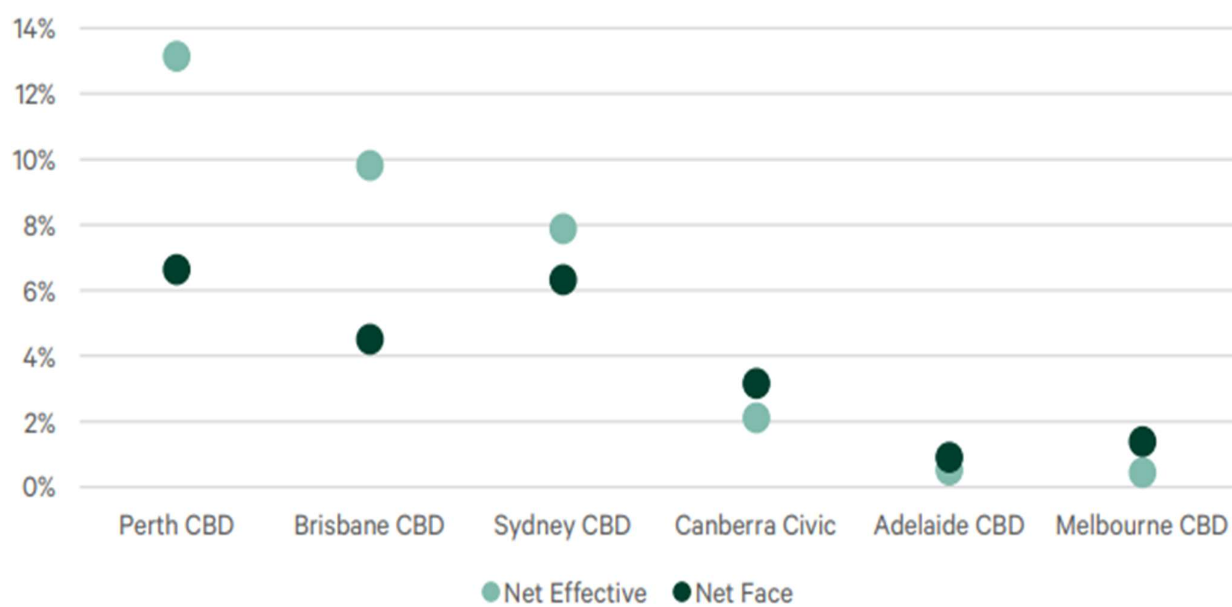
Graph 1: Australian CBD Prime Office Rents and Incentives



Graph 2: Office Rental Growth by Market (Y-O-Y)



Source: CBRE Research

CBRE

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