EMBARGOED UNTIL 11.30 AM THURSDAY 27 JULY 2017

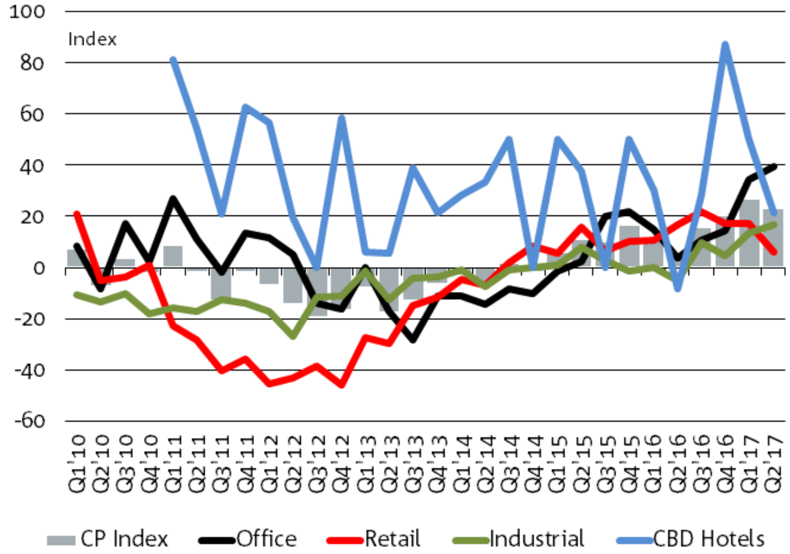
NAB COMMERCIAL PROPERTY SURVEY Q2 2017

Date **July 2017** | NAB Behavioural & Industry Economics

KEY FINDINGS

- **Overall sentiment** in commercial property markets moderated a touch in the June quarter, with **NAB's Commercial Property Index** down 4 to +23.
- **By sector**, the Index was supported by gains in Office and Industrial. Retail sank to its lowest level since late-2014 amid restrained consumer spending and difficult retail trade conditions. CBD hotels also down, but still relatively strong.
- **By state**, the overall index was dragged lower by NSW (but still strongest overall). Improvements were reported in all other states, particularly VIC (and in all sectors). Sentiment lifted in WA and SA/NT, but still very weak.
- **Confidence** has however moderated in all sectors - especially CBD hotels (where new supply may be impacting some cities). Property experts in Office now the most upbeat (ahead of CBD hotels), and Retail the least confident.
- By state, confidence moderated in NSW (from very high levels) and improved most in VIC. Confidence also lifted in QLD and WA (with positive signs in Office).
- **Capital growth expectations** were pared back for Office, Industrial and CBD hotels property. Office returns expected to remain highest in NSW and VIC and resume growing in WA in 2 years' time (after a long decline). Industrial returns are tipped to fall heavily in WA and slow in VIC, but improve in QLD and NSW. Retail returns to improve a little, led by upward revisions in QLD.
- Office **rents** are also expected grow fastest, led by NSW and VIC. Prospects for Retail rents were pared back, with outlook weakest for WA and strongest in VIC. NSW and QLD to provide the best income returns for Industrial property.
- National Office **vacancy** crept up in Q2 (9.7%) and in all states bar NSW (where tenant demand very strong) and WA (steady at high levels). Office vacancy to fall in next 1-2 years, with NSW and VIC the tightest markets. Vacancy also expected to fall in QLD, WA and SA/NT, but remain elevated, especially in WA.
- CBD Hotels sectors rated "somewhat" over-supplied - likely reflecting major new supply coming into the market in 2017. Office rated "neutral" - but big differences by state, particularly in WA and SA/NT where over-supply remains an issue, and in NSW where market tipped to remain "somewhat" under-supplied.
- As dwelling construction cycle appears to be topping out, fewer **developers** are intending to start new building works in the short-term - just 42% (52% in Q2).
- **Funding conditions** have worsened, particularly for debt. Property experts said the ease of obtaining debt is now harder than at any time since late-2011.
- **Lending terms** for development loan approval also more difficult with average pre-commitments climbing to highest level since mid-2012 - and set to climb higher in next 12 months.

NAB COMMERCIAL PROPERTY INDEX



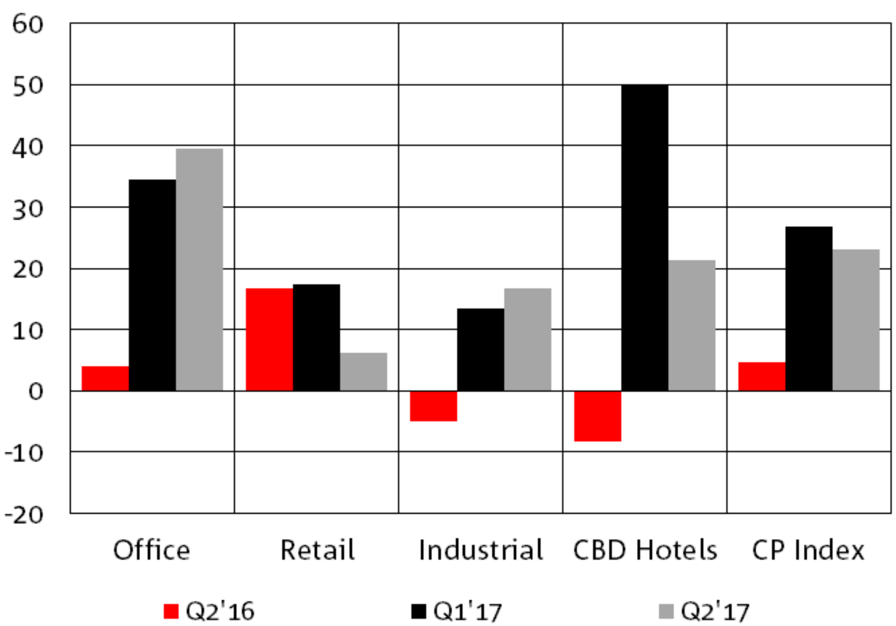
	Q4 2016	Q1 2017	Q2 2017	Next 12m	Next 2yrs
Office	14	35	39	43	51
Retail	17	17	6	12	16
Industrial	5	14	17	26	26
CBD Hotels	88	50	21	36	43
CP Index	**21**	**27**	**23**	**30**	**35**

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

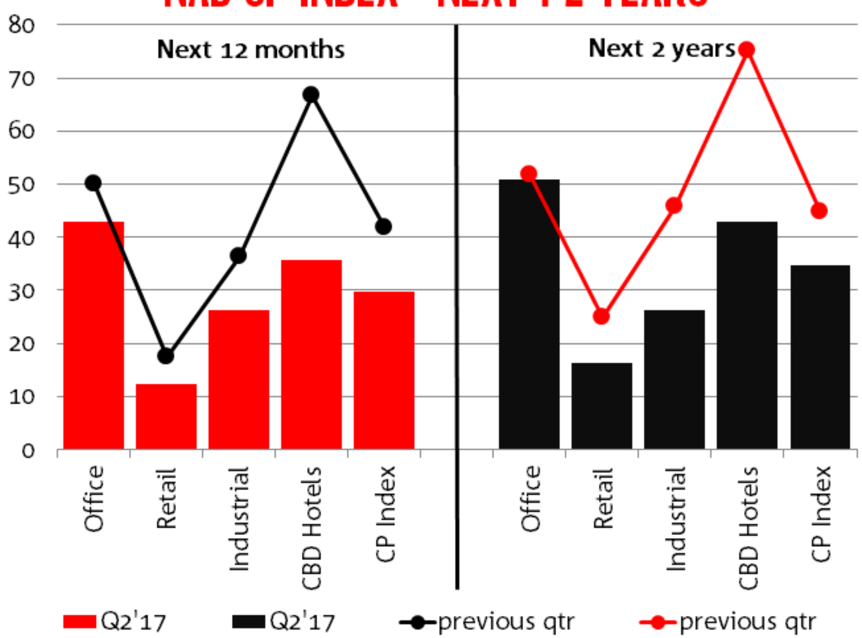
Overall sentiment in commercial property markets (measured by NAB's Commercial Property Index) moderated a touch in Q2 (down 4 to +23), but remains well above its long-term average (+1). Sentiment continues to vary widely by sector. The uptrend in Office that began in mid-2016 has continued (up 4 to +39), and Office has now overtaken CBD hotels as the most positive. Office sentiment lifted sharply in VIC (up 35 to +60) and remains very strong in NSW (up 9 to +83). It also improved in all other states, but is still negative in WA (up 10 to -57). Industrial sentiment also lifted (up 3 to +17) in Q2. It remains highest in NSW (down 13 to +42), but improved most in QLD (up 40 to +40) and SA/NT (up 33 to 0). Retail sentiment however sank to its lowest level since late-2014 (down 11 to +6) amid constrained consumer spending and difficult retail conditions. It fell in all states bar VIC (up 2 to +11) and SA/NT (up 17 to -33). Sentiment also fell again in CBD hotels (down 29 to +21), but is still relatively strong.

Overall confidence levels in commercial property markets also fell in the June quarter - the index is now expected to rise to just +30 in the next 12 months (from +42 previously) and +35 in 2 years' time (+45 previously). Confidence moderated in all sectors - most notably in the CBD hotels sector - which may be reflecting the potential impact of significant new supply additions this year on room rates and occupancy in some cities. Overall confidence levels in Office were slightly less buoyant in Q2 as weaker outcomes in QLD and SA/NT offset modest improvements in VIC, NSW and WA. In Retail property markets, confidence levels fell in all states, bar WA (although still negative). This weakening in confidence mirrors NAB's own lacklustre outlook for household consumption given headwinds from elevated household debt and a continuation of subdued wages growth. Confidence in the Industrial property sector also fell in all states except QLD, which has now overtaken NSW as the strongest.

NAB COMMERCIAL PROPERTY INDEX



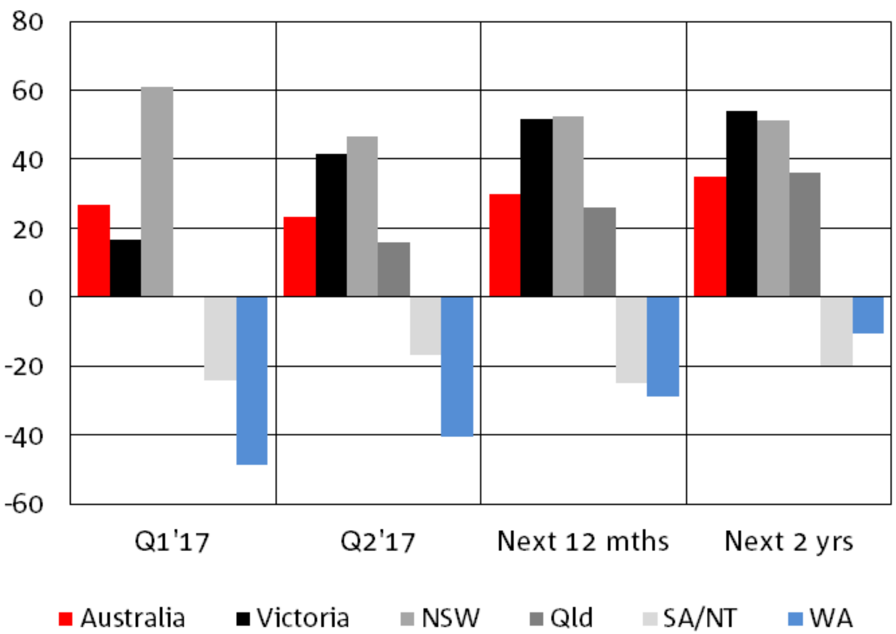
NAB CP INDEX - NEXT 1-2 YEARS



MARKET OVERVIEW - INDEX BY STATE

By state, the decline in overall market sentiment was dragged lower solely by NSW, with improvements reported in all other states. Although still strongest overall, the NSW state index fell (down 14 to +47), as an uplift in Office sentiment was offset by falls in Retail and Industrial. Sentiment improved most in VIC (up 24 to +41) and was higher in all sectors. Improved sentiment was also noted in all sectors in WA and SA/NT in Q2 at very weak levels. Overall confidence moderated in NSW and improved in VIC - and they remain the most upbeat states in the next 1-2 years, supported by rising confidence in Office (particularly in VIC). Overall confidence also lifted in QLD, with Industrial and Retail offsetting modest falls in Office. Overall confidence in WA also improved but was still negative - especially in Industrial and Retail with more encouraging signs in Office.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	60↑	83↑	23↑	-57↑	-17↑	**39↑**
Q2'18	80↑	85↑	23↓	-29↑	-42↓	**43↓**
Q2'19	90↑	81↑	32↓	14↑	-33↓	**51↓**

RETAIL PROPERTY MARKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	11↑	17↓	-4↓	-13↑	-33↑	**6↓**
Q2'18	18↓	13↓	17↔	-13↑	-33↓	**12↓**
Q2'19	32↓	7↓	25↑	-13↑	-33↓	**16↓**

INDUSTRIAL PROPERTY MARKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	33↑	42↓	40↑	-69↑	0↑	**17↑**
Q2'18	33↓	58↓	60↑	-69↓	0↑	**26↓**
Q2'19	17↓	58↓	80↑	-63↓	0↔	**26↓**

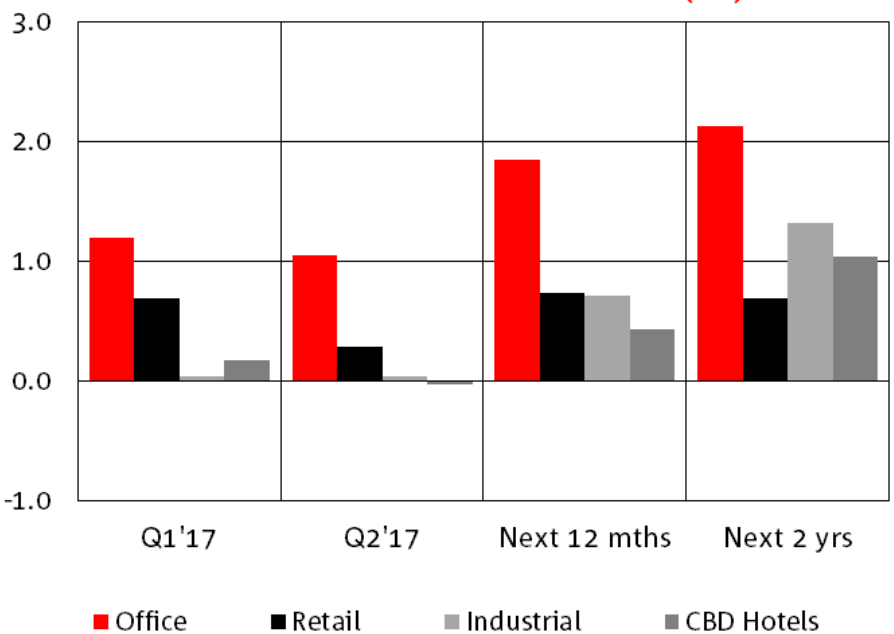
LEGEND: ↑ up since last survey ↓ down since last survey ↔ unchanged

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

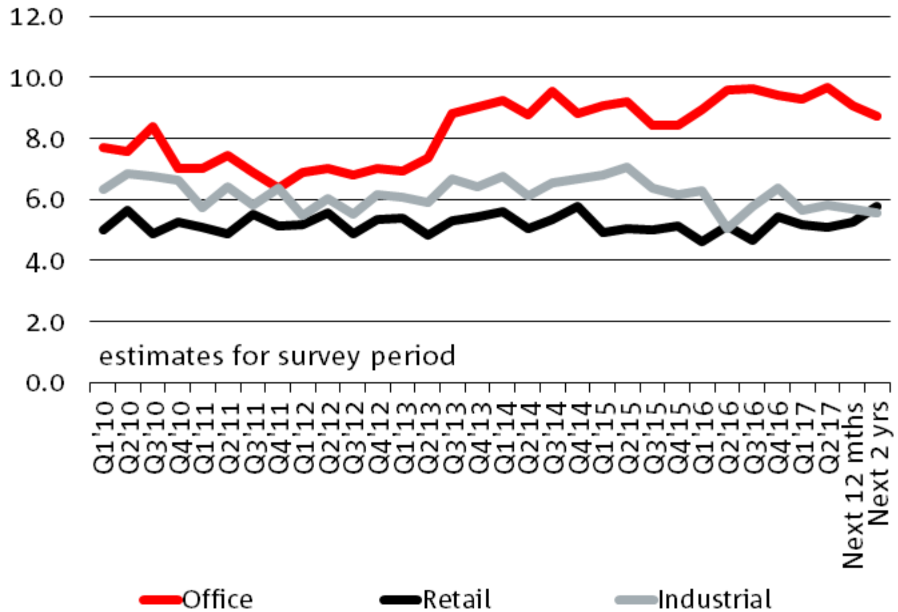
On average, property experts have lowered their expectations for capital growth in the next 1-2 years for Office (1.8% & 2.1%), Industrial (0.7% & 1.3%) and CBD Hotels (0.4% & 1.0%). Expectations for capital growth in Office remain highest in NSW (4.1% & 3.8%) and VIC (1.9% & 3.2%). They were revised down in QLD (0.5% in both years), but are expected to turn positive in WA in 2 years time (-1.4% & 0.3%) after a long period of decline. Capital growth expectations in Industrial markets were mixed by states. They are predicted to fall heavily in WA (-3.2% & -2.1%) and slow in VIC (1.1% & 1.5%), but improve in QLD (1.8% & 2.7%) and NSW (2.3% & 2.8%) amid reports of strong take-up and demand in the June quarter. Capital growth expectations in Retail improved (0.7% in both years), led by a sharp upward revision in expectations in QLD (see p.10 for full details).

National Office increased slightly to 9.7% in Q2'17 (9.3% in Q1), with rates creeping up in VIC (6.6%), QLD (13.4%) and SA/NT (13.0%), relatively stable at very high levels in WA (15%) and down slightly in NSW (6.5%) due to continued strong tenant demand. In Retail, overall vacancy was broadly steady at 5.1% in Q2'17 despite subdued conditions in the retail trade sector. Vacancy increased most in NSW (6.1%) and was lowest in WA (4.0%) and VIC (4.5%). In Industrial markets, vacancy was also broadly unchanged at 5.8% in Q2'17, although it continued to climb in QLD (9.0%) and SA/NT (8.0%). Looking forward, Office vacancy is expected to drift down in the next 1-2 years, with markets tightest in NSW and VIC. Vacancy is also expected to improve in QLD, WA and SA/NT, but remain high amid elevated supply, particularly in WA (see p.10 for full details).

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)

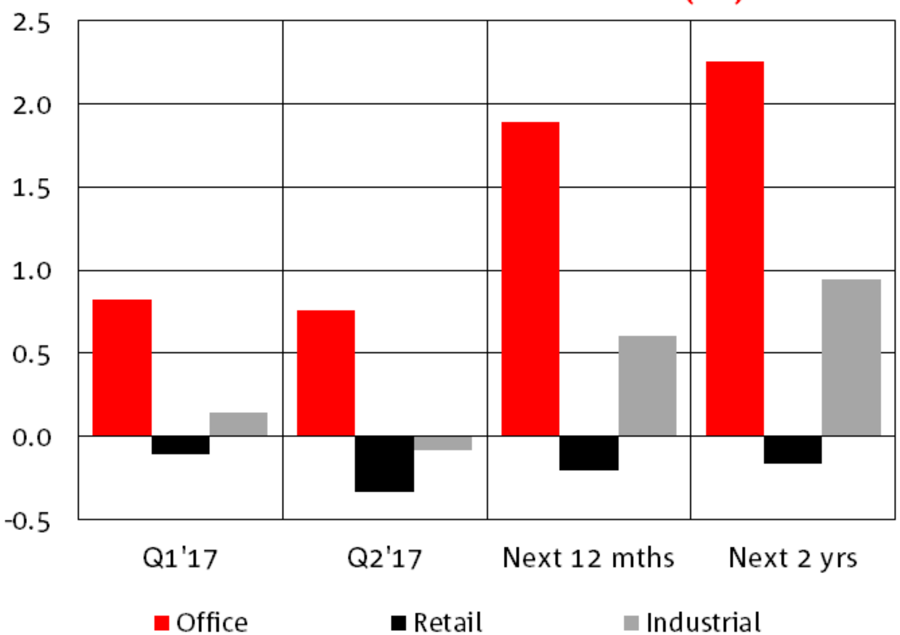


MARKET OVERVIEW - RENTS & SUPPLY

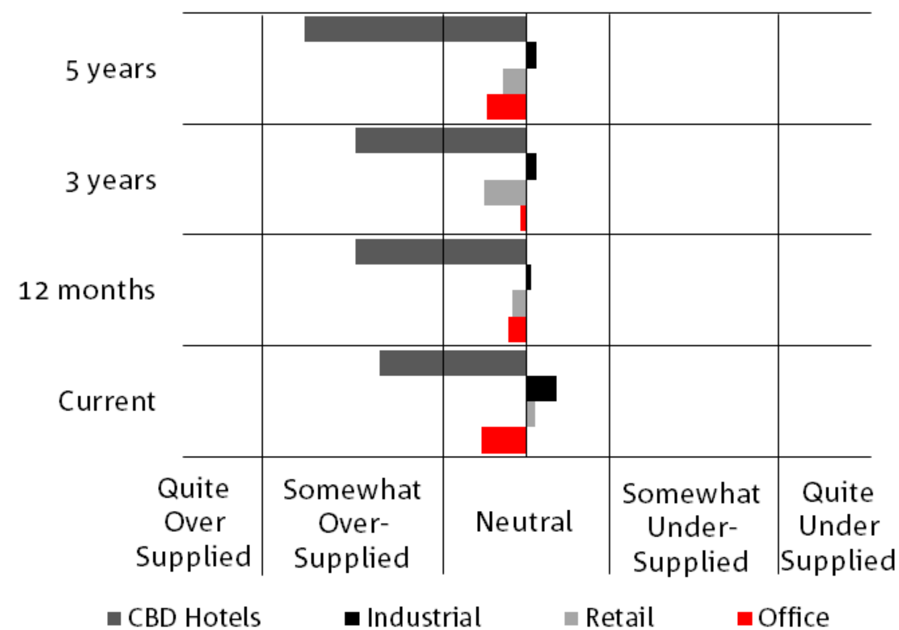
Office property continued to record the fastest growth in nominal rents in Q2'17 (0.8%), with NSW (2.6%) and VIC (1.5%) leading the way. Rental growth was also reported in QLD (0.2%), but rents fell further in WA (-3.0%) and SA/NT (-2.2%). Property experts believe that Office property will provide the best income returns over the next 1-2 years (1.9% & 2.3%), with the best returns forecast for NSW (4.4% & 4.1%) and VIC (3.1% & 4.4%). Income returns in Retail were weakest of all sectors in Q2'17 (-0.3%). Expectations were also pared back (-0.2% in both years), but varied widely by state. The outlook was weakest for WA (-3.1% in both years) and strongest for VIC (0.5% & 0.7%). Overall, rental growth for Industrial property was down a little in Q2 (-0.1%), with NSW (2.2% & 2.3%) and QLD (1.1% & 2.7%) tipped t0 be the best states for rental growth in the next 1-2 years and WA the weakest (-3.0% & -1.7%).

Property experts assessed the CBD Hotels market as currently being "somewhat" over-supplied and expected to remain so over the next 1-5 years. It seems major new supply coming into the market in 2017 is having an impact - and it is also being reflected in expectations for lower occupancy (set to fall from around 80% at the start of 2017 to 69.3% in 2 years time) and modest expectations for revPar growth (0.4% and 1.0%). Overall, Office market supply is "neutral" and set to remain so over the outlook horizon. But this masks big differences by state - over-supply to remain an issue in WA and SA/NT (particularly in the next 1-3 years), with NSW "somewhat" under-supplied. Retail markets are expected to be balanced, except in SA/NT and to a lesser extent in WA where supply overhangs will persist. Industrial supply to also remain "neutral", but some over-supply persisting in WA, SA/NT and QLD in the near-term.

GROSS RENTAL EXPECTATIONS (%)



SUPPLY CONDITIONS

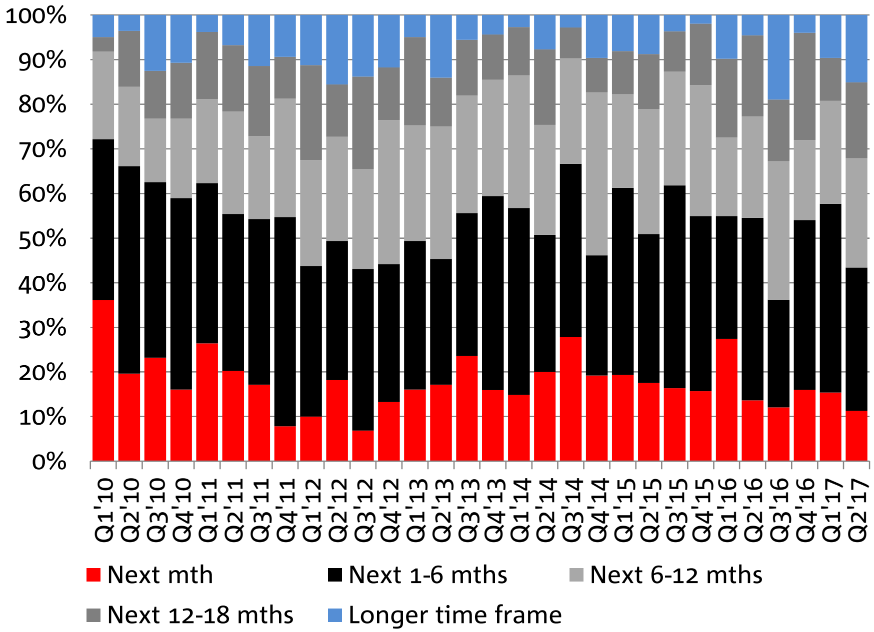


MARKET OVERVIEW - DEVELOPMENT INTENTIONS

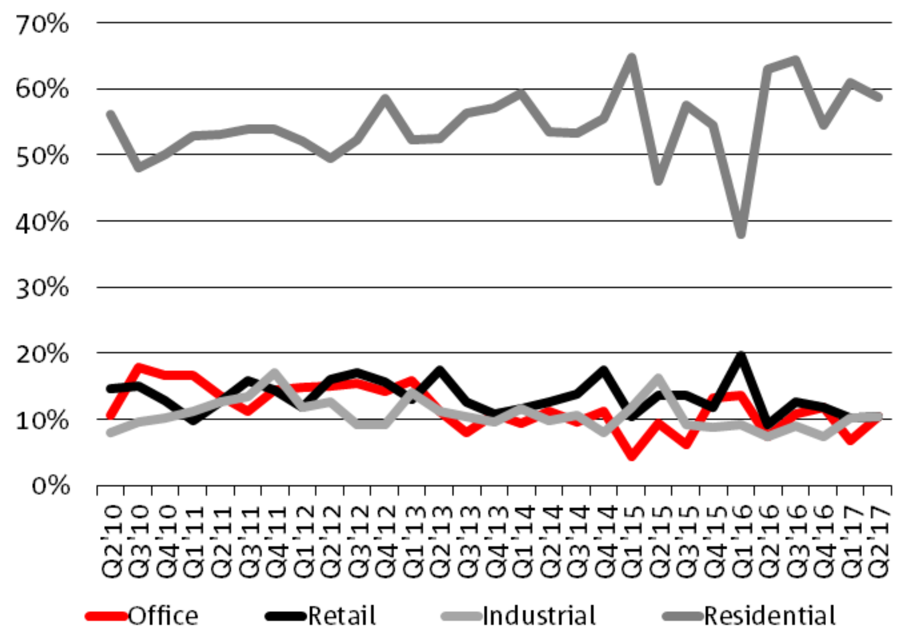
Australia wide, fewer surveyed property developers are intending to commence new building works in the next 6 months - the latest results show just 42% are planning to start new works (down from 52% in the previous quarter and the lowest read since Q3'16). While this could signal that some developers are already stretched, the results come on the heels of weaker than expected construction data in the March quarter national accounts (particularly in the residential sector) and more recent falls in building approvals. So the fall in the number of developers starting new works in the short-term is more likely to support to the view that the housing construction cycle has topped out. Around 1 in 4 (24%) also said they plan to start new projects in the next 6-12 months (21% in Q1'17), 16% in the next 12-18 months (9% in Q1) and 15% a longer timeframe (9% in Q1).

While the development pipeline continues to be dominated by residential projects, among those who indicated that they were planning to start new works, fewer developers said they were targeting residential projects. In Q2'17, just 59% of developers said they intended to commence work on new residential projects, down from 61% in Q1 and 63% at the same time last year. This adds further weight to the argument that the housing construction cycle has topped out. We also suspect that concerns about an over-supply of apartments may have played a role, particularly in Brisbane and Melbourne. In commercial property markets, around 10% said they were looking a projects in the Office sector (up from 7% in Q1), 10% in Retail (unchanged from Q1) and 10% in industrial (also unchanged from Q1) and 10% in Industrial (up from 7% in Q4'16).

COMMENCEMENT INTENTIONS - TIME



COMMENCEMENT INTENTIONS - SECTOR

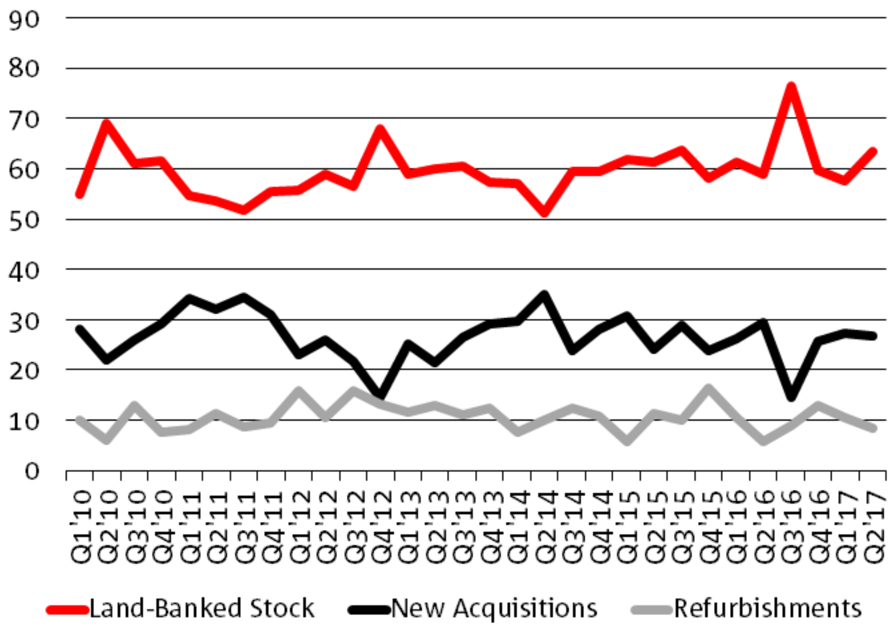


MARKET OVERVIEW - LAND SOURCES & CAPITAL INTENTIONS

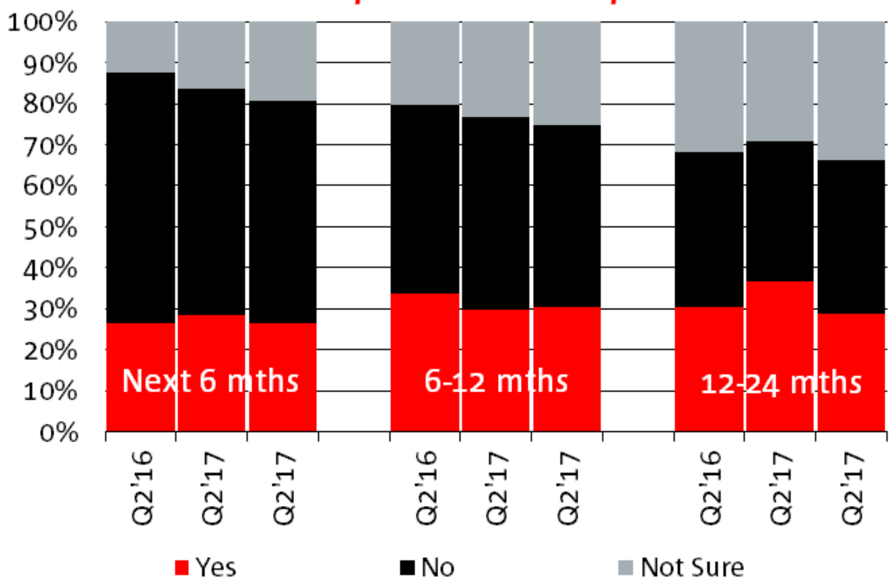
The number of surveyed property developers who said they were looking to use land-banked stock for their new projects increased to 63% in Q2'17 - after having falling to a near 3-year low 58% in the previous quarter. This may suggest a shortage of available new land stock for sale. It may also be a sign of growing concern among property developers that holding costs of land are rising, particularly given recent interest rate increases on investor housing loans and more difficult conditions for accessing both debt and equity (see below). The number of developers that said they said they were looking at new acquisitions was unchanged at 27%. In contrast, only 8% of property developers were looking at refurbishments, down from 11% in Q1.

While more property developers said they were intending to start new projects in the near-term, those looking to source more capital in the next 6 months fell to 26% in Q2'17 (28% in Q1). It appears some developers ready to start their next project may have already accumulated sufficient capital from recent completions to start their next project without financing. The survey also found that around 45% of property developers were "unsure" of their intentions to source more capital in the next 0-12 months (up from 39% in Q1) and 34% unsure about the next 12-24 months (29% in Q1). Clearly, there is a greater deal of uncertainty around how the current construction boom will unfold. Consequently, more developers are exercising greater caution.

SOURCES OF LAND DEVELOPMENT (%)



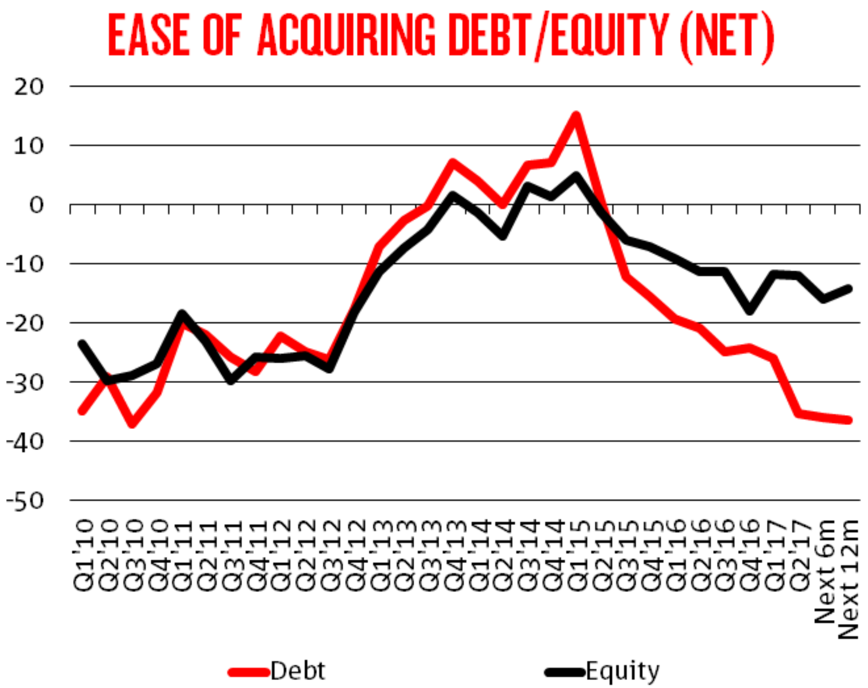
INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS

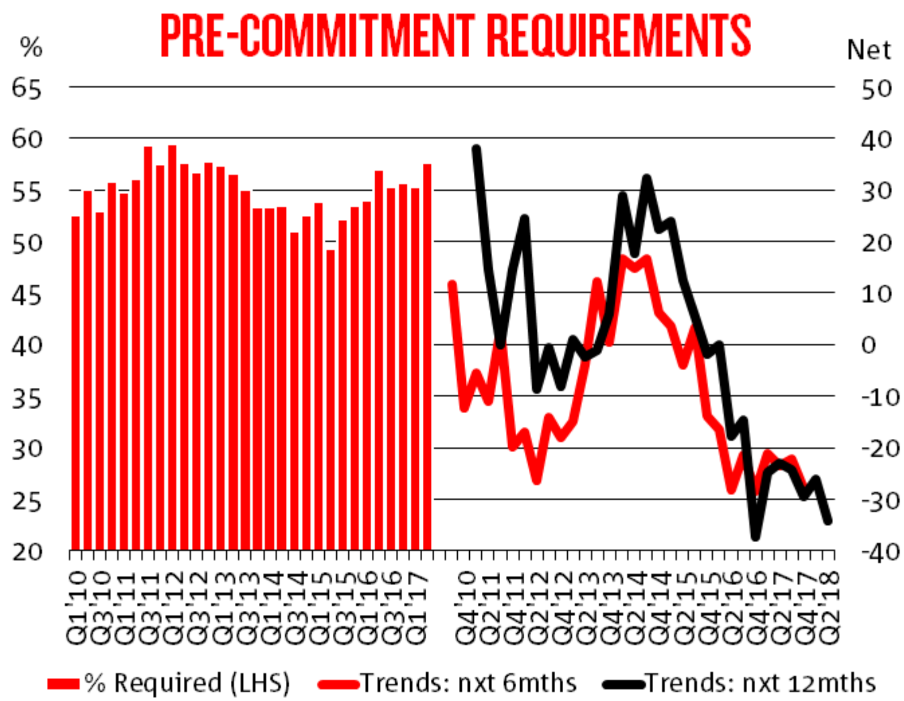


MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

Funding conditions are still very difficult and have in fact worsened according to our latest survey. In net balance terms, -36% of surveyed property experts said it was harder to obtain borrowing or loans (debt) needed for their business - down from -24% in Q1 and the weakest result since the second half of 2010. This is consistent with the latest APRA data which shows actual lending for commercial property by major banks has barely moved in the past year, with commercial property investors and developers facing tougher terms from local lenders. Obtaining equity was also considered to be difficult by a net -12% of property experts (unchanged). Looking forward, property experts on balance are expecting funding conditions to become harder in the next 6-12 months, particularly for debt financing.

Lending terms for development loan approval have also become more difficult. According to surveyed property developers, the average pre-commitment required to meet their external debt funding requirements rose to 57.6% in Q2'17 (55.3% in Q1). This was the second highest reading since the survey began in Q1 2010 and the highest level in since the June quarter 2012. By state, however, pre-commitment requirements ranged widely from 61.9% in QLD and 60.0% in WA to just 53.6% in NSW and 58.8% in VIC. Overall, property experts do not expect lending terms to improve any time soon, with a net -28% expecting it to worsen over the next 6 months (compared to now) and a net -34% expecting it to deteriorate further over the next 12 months.





SURVEY RESPONDENTS EXPECTATIONS (AVG) Q2 2017

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	1.1	2.8	0.5	-3.2	-0.8	**1.0**
Q2'18	1.9	4.1	0.5	-1.4	-1.3	**1.8**
Q2'19	3.2	3.8	0.5	0.3	-0.6	**2.1**

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	1.5	2.6	0.2	-3.0	-2.2	**0.8**
Q2'18	3.1	4.4	0.6	-1.9	-2.8	**1.9**
Q2'19	4.4	4.1	1.3	-0.5	-2.4	**2.3**

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	0.6	0.8	-0.3	0.0	-2.5	**0.3**
Q2'18	0.8	1.0	1.2	0.0	-2.5	**0.7**
Q2'19	0.9	0.6	1.5	0.0	-2.5	**0.7**

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	0.3	-0.2	-0.8	-3.1	-0.7	**-0.3**
Q2'18	0.5	-0.5	-0.2	-3.1	-0.8	**-0.2**
Q2'19	0.7	-0.5	-0.3	-3.1	0.0	**-0.2**

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	1.0	1.0	1.1	-3.6	0.0	**0.0**
Q2'18	1.1	2.3	1.8	-3.2	-1.0	**0.7**
Q2'19	1.5	2.8	2.7	-2.1	-1.0	**1.3**

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	0.6	1.2	0.4	-3.8	0.0	**-0.1**
Q2'18	1.0	2.2	1.1	-3.0	-1.0	**0.6**
Q2'19	0.3	2.3	2.7	-1.7	-1.0	**0.9**

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q2 2017

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	6.6	6.5	13.4	15.0	13.0	**9.7**
Q2'18	6.2	6.0	12.2	15.0	12.3	**9.1**
Q2'19	6.2	6.0	11.4	14.7	11.3	**8.7**

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	4.5	6.1	4.8	4.0	7.0	**5.1**
Q2'18	5.0	6.6	4.6	3.0	6.3	**5.3**
Q2'19	5.7	7.2	5.0	3.0	6.3	**5.8**

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'17	4.8	3.7	9.0	7.3	8.0	**5.8**
Q2'18	5.0	3.2	8.6	7.5	8.0	**5.7**
Q2'19	5.3	3.9	7.4	6.3	8.0	**5.5**

NOTES:

Survey participants are asked how they see:

- Capital values;
- Gross rents; and
- Vacancy rates

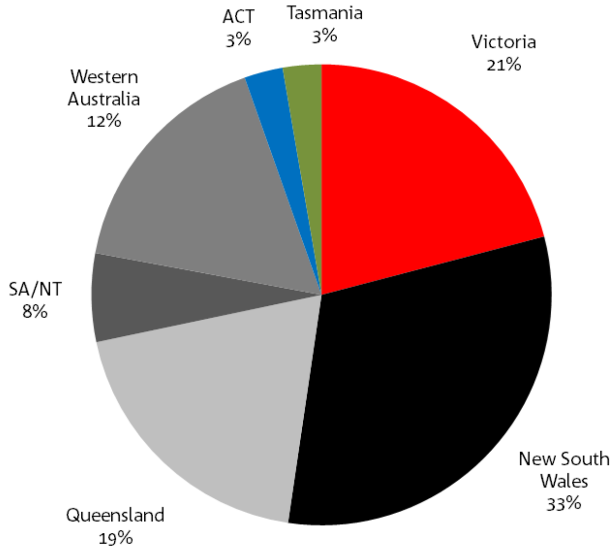
In each of the commercial property markets for the following timeframes:

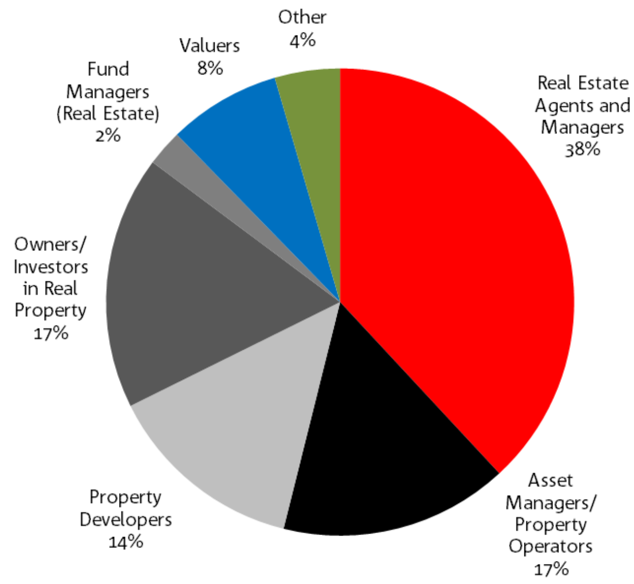
- current quarter
- next quarter
- next 12 months
- next 12-24 months

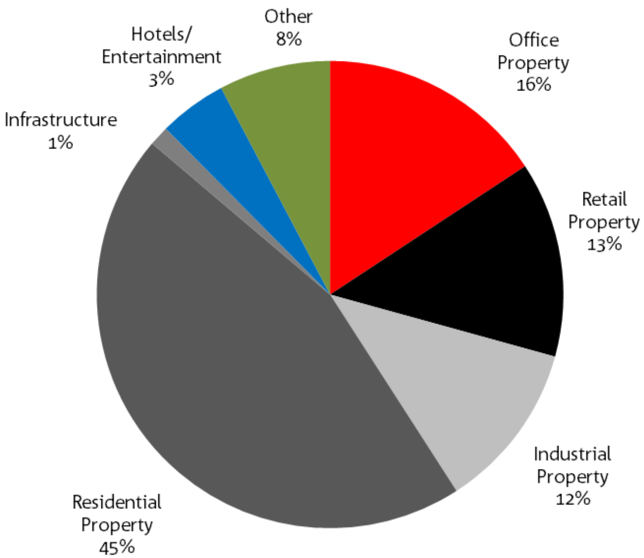
Average expectations for each state are presented in the accompanying tables.

*Results for SA/NT may be biased due to a smaller sample size.

ABOUT THE SURVEY







In April 2010, NAB launched the first NAB Quarterly Australian Commercial Property Survey with the aim of developing Australia's pre-eminent survey of market conditions in the commercial property market.

The large external panel of respondents consists of Real Estate Agents/Managers, Property Developers, Asset/Fund Managers and Owners/Investors.

Around 260 panellists participated in the Q2 2017 Survey.

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