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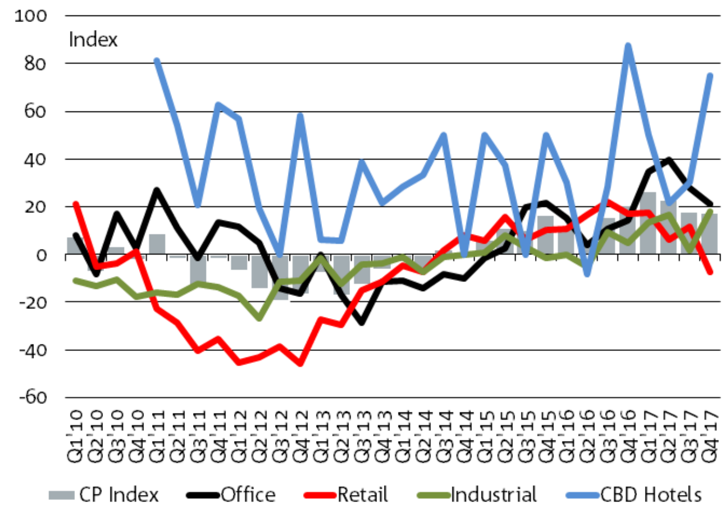
NAB COMMERCIAL PROPERTY SURVEY Q4 2017

Date **February 2018** | NAB Behavioural & Industry Economics

KEY FINDINGS

- The NAB Commercial Property Index (a measure of market sentiment) fell slightly in Q4 (down 1 to +17) but remained well above average (+2). This positive outcome probably reflected a steady economy, healthy employment growth and strong business conditions in all major industry groups (except Retail).
- By sector, CBD Hotels lifted on strong growth in tourism and occupancy. Industrial also up on reports of warehousing and logistics activity linked to online retail and e-commerce. Office eased (but out-performing). Retail fell sharply with challenging industry conditions helping sentiment turn negative for first time since mid-2014.
- By state, sentiment was broadly unchanged (and strongest) in NSW and QLD. It fell in all other states and still weakest (and negative) in WA by some margin.
- Confidence fell to its lowest levels in 2 years. It fell in all sectors - except CBD Hotels - and fell most in Retail - unsurprising given NABs own outlook for wages suggests that any improvement in consumer spending will be slow, especially if wealth effects have an impact as house prices ease.
- Capital growth expectations were revised up and are highest for CBD Hotels. Prospects for industrial also higher for next year but down in 2 years' time. Office outlook softer (but positive) in the next 1-2 years. Retail also lower and very weak.
- Property experts believe rental growth will be fastest for Office property in the next 1-2 years, led by VIC and NSW. Industrial rents are also expected to grow, led by QLD and NSW. But Retail rents are expected to fall or remain flat in all states.
- Office vacancy fell to 8.6% in Q4, mainly due to tightening in NSW and QLD (but still elevated). High vacancy persisted in WA and SA/NT. Office vacancy is expected to fall in the next 1-2 years, with tightness most apparent in NSW and VIC and small improvements in QLD, WA and SA/NT. Despite tough industry conditions, overall vacancy in Retail relatively resilient in Q4, while industrial vacancy fell in most states.
- Property developers planning to start new works and targeting residential projects increased slightly to 53% in Q4 - but well down on Survey high 64% in H2'16 suggesting residential construction cycle has flattened. In commercial markets, there was sharp increase in developers looking at new Industrial projects relative to last year, probably reflecting strong demand being reported in the Eastern states.
- Accessing funds for their business is still a major challenge. A net -28% of property experts said it was harder to obtain debt and -19% equity in Q4 - and most do not expect any improvement in funding conditions over the next 6-12 months.
- Australia wide, pre-commitment requirements for new developments rose to 64% for residential, but fell to 55.3% for commercial property. On balance, more developers see these requirements worsening in both markets in next 6-12 months.

NAB COMMERCIAL PROPERTY INDEX



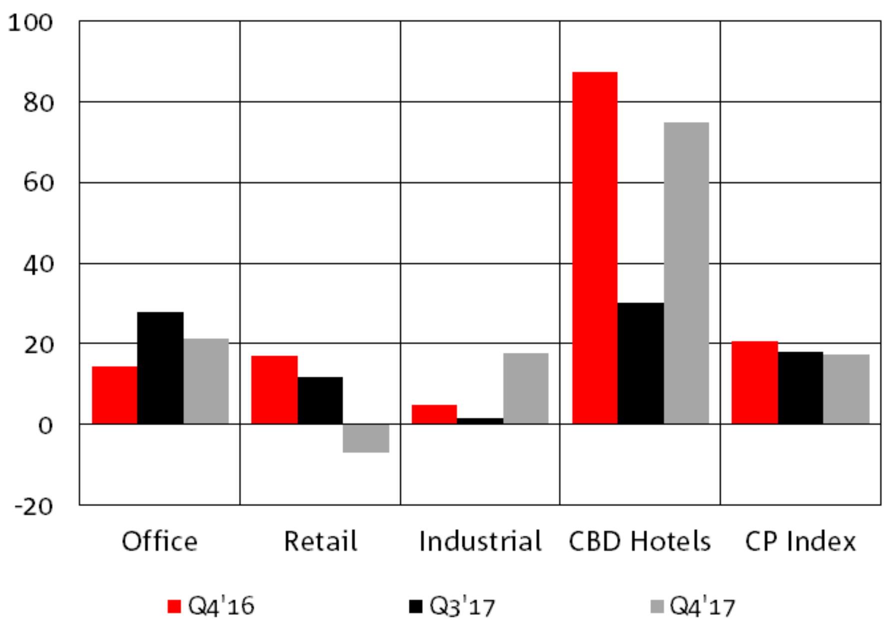
	Q2 2017	Q3 2017	Q4 2017	Next 12m	Next 2yrs
Office	39	28	21	30	35
Retail	6	12	-7	6	5
Industrial	17	2	18	25	31
CBD Hotels	21	30	75	88	81
CP Index	**23**	**18**	**17**	**28**	**30**

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

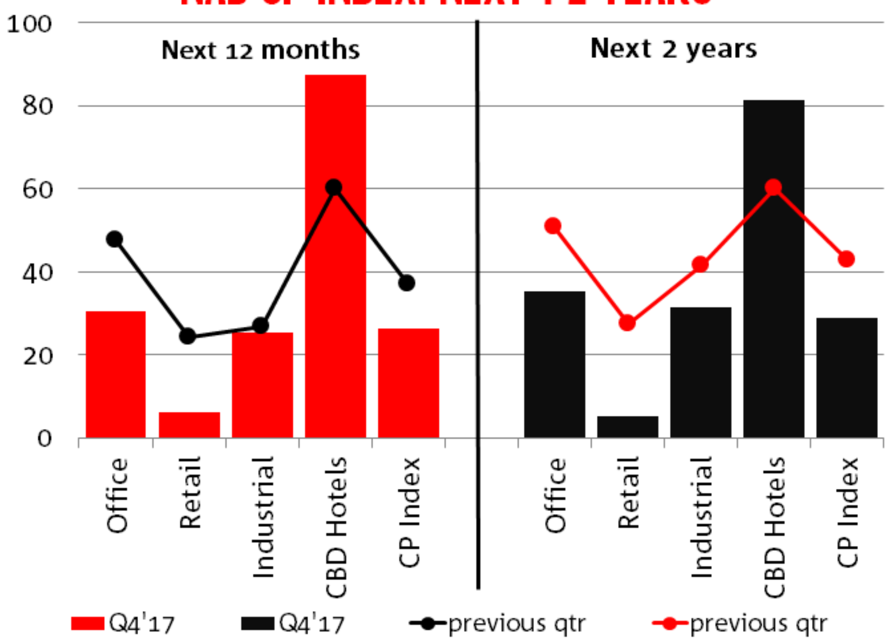
Overall sentiment in commercial property markets (measured by NAB's Commercial Property Index) fell a little in Q4 (down 1 to +17) but remained well above its long-term average (+2). But sentiment continues to vary widely by property type. In the CBD Hotels sector, sentiment rose sharply (up 45 to +75), likely reflecting continued strong growth in tourism and high occupancy rates. Industrial property sentiment also rose (up 16 to +18) amid agency reports of high demand for warehousing arising from strong online retail (including Amazon). Sentiment fell in Office (down 7 to +21), but remained well above average (+5). Retail market sentiment also weakened in Q4 (down 19 to -7) and was lower in all states. Moreover, challenging industry conditions also saw Retail market sentiment turn negative for the first time since mid-2014.

Overall confidence levels also fell in Q4 - with NABs Commercial Property Index now expected to rise to just +28 in the next 12 months (+38 in Q3) and +30 in 2 years' time (+43 in Q3) - their lowest levels in around 2 years. Confidence fell in all sectors - except CBD Hotels (which is being supported by strong out-performance in Sydney). Overall confidence declined most in Retail, and is perhaps unsurprising given NABs own forecasts for wages suggest that any improvement in consumer spending will be glacial, especially if wealth effects have an impact as house prices slow. Overall confidence in Office also weakened somewhat, mirroring NAB's own business confidence index which also moved down during the December quarter. In the Industrial sector, confidence levels were basically unchanged for the next 12 months but the outlook has weakened 2 years' ahead.

NAB COMMERCIAL PROPERTY INDEX



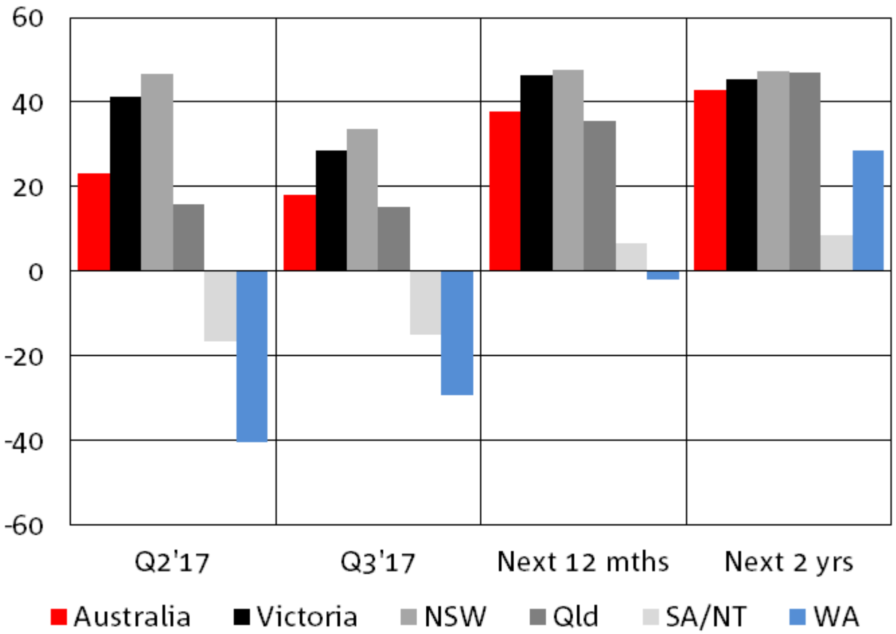
NAB CP INDEX: NEXT 1-2 YEARS



MARKET OVERVIEW - INDEX BY STATE

By state, moderating sentiment nationwide mainly reflected weaker outcomes in WA (down 15 to -44), VIC (down 9 to a still solid +20) and SA/NT (down 5 to -20). It was broadly unchanged (and strongest) in NSW (+33) and QLD (+15). Interestingly, sentiment around Office and Retail property also fell in all states in Q4 (except QLD Office and SA/NT Retail). In contrast, Industrial market sentiment improved in all states (except QLD). Property experts in all states are less confident about the overall commercial property market in the next 1-2 years. NSW is the most upbeat state and WA and SA/NT the least confident (and negative). By sector, confidence around Office and Retail markets fell in all states (except SA/NT Retail), while higher confidence in Industrial property in VIC and SA/NT was offset by weaker outcomes in other states.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	19↓	48↓	17↑	-50↓	-63↓	**21**↓
Q4'18	25↓	63↓	25↓	-50↓	-75↓	**30**↓
Q4'19	13↓	61↓	39↓	0↓	-75↓	**35**↓

RETAIL PROPERTY MARKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'17	-13↓	-8↓	14↓	-50↓	0↑	**-7**↓
Q3'18	-3↓	0↓	23↓	-8↓	13↑	**6**↓
Q3'19	-7↓	8↓	18↓	-25↓	25↑	**5**↓

INDUSTRIAL PROPERTY MARKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'17	41↑	32↑	23↓	-44↑	0↑	**18**↑
Q3'18	41↑	41↓	38↓	-39↑	0↑	**25**↓
Q3'19	36↑	39↓	50↓	-6↓	0↑	**31**↓

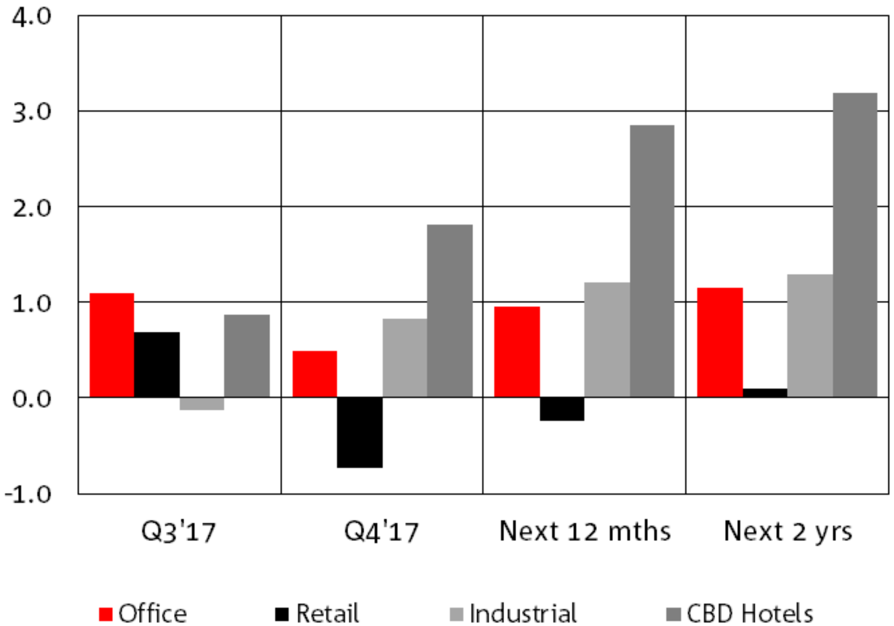
LEGEND: ↑ up since last survey ↓ down since last survey ↔ unchanged

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

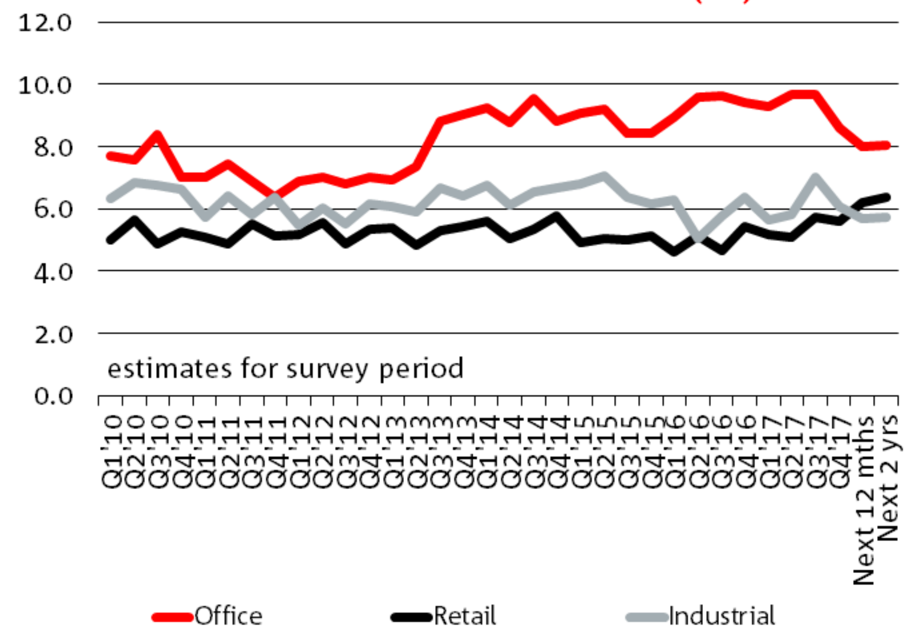
On average, property experts have lowered their expectations for capital growth in Office markets for the next 1-2 years (0.9% & 1.1%). Expectations were cut in all states except QLD, but remain strongest in NSW (2.1% & 2.3%) and weakest in WA (-3.1% & 0.0%) and SA/NT (-1.8% & -2.3%). Expectations for Retail property were also cut (-0.2% & 0.1%), with negative returns predicted in NSW (-1.7% & -1.4%) and VIC (-0.2% & -0.5%), with the strongest returns in QLD (0.7% & 1.3%). Capital growth expectations remain strongest for CBD Hotels and were revised up in Q4 (2.8% & 3.2%). Industrial market expectations were also revised up for the next 12 months (1.2%), but were cut back in 2 years time (1.3%). Capital gains are expected to be highest in QLD (2.0% & 2.1%), NSW (2.0% & 1.7%) and VIC (2.0% & 1.6%) and lowest in WA (-1.6% and -0.4%).

Strong leasing activity in most capital cities helped push the national Office vacancy rate down to 8.6% in Q4 (9.7% in Q3). This result reflected some market tightening in NSW (5.3%) and QLD (12.3%), as vacancy rates remained high in WA (15%) and SA/NT (13.5%), and rose a little in VIC (5.7%). Looking ahead, Office vacancy is expected to drift down in the next 1-2 years. Markets will be tightest in NSW and VIC, with small improvements in QLD, WA and SA/NT. Despite challenging industry conditions, the overall vacancy rate in the Retail property market was relatively resilient at 5.6% in Q4 (5.7% in Q3), with QLD (4.7%) leading the way. In the Industrial sector, average vacancy fell to 6.1%. Reductions in available space were reported in all states bar VIC which increased slightly to 5.0% but was the nest tightest market after NSW (4.6%).

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)

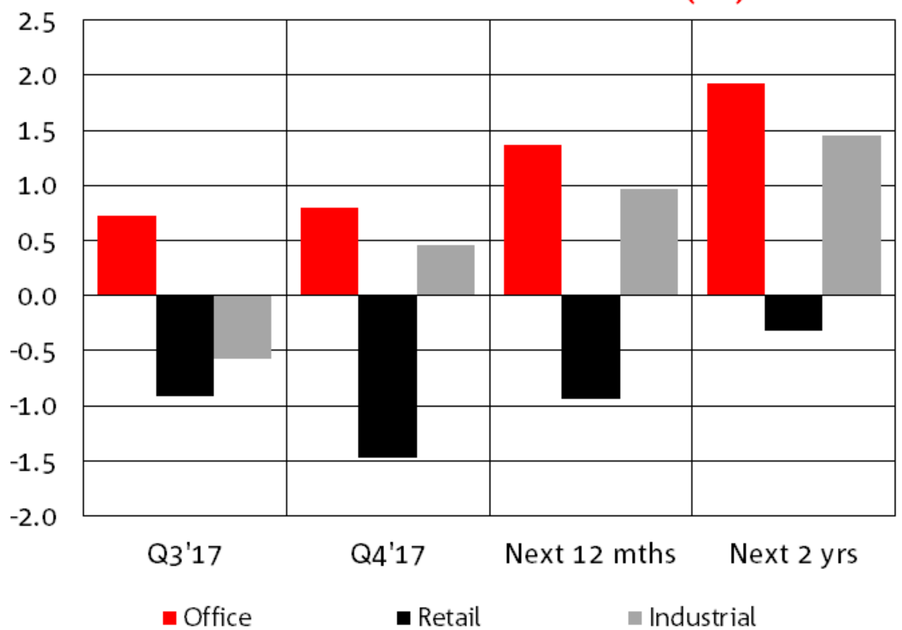


MARKET OVERVIEW - RENTS & SUPPLY

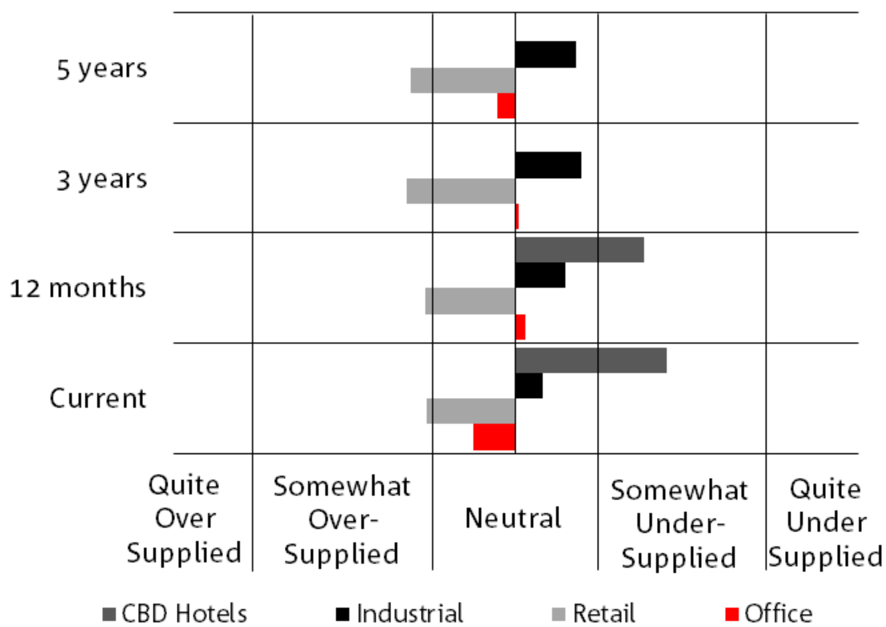
Office property again recorded the fastest growth in rents in Q4 (0.8%). NSW (2.0%) and VIC (1.6%) continued to lead the way on the back of strong market fundamentals as WA languished (-3.1%). Property experts think Office rents will grow fastest in the next 1-2 years (1.4% & 1.9%), with the VIC (2.3% & 3.0%) and NSW (2.5% & 2.8%) out-performing. Rental growth for Retail property was slowest of all sectors in Q4 (-1.5%), and the outlook for future growth is weakest of all sectors (-0.9% & -0.3%). Retail rents are expected to fall or remain flat in all states. In the Industrial property market, rents grew in Q4 (0.5%), led by NSW (1.5%). Rents in QLD (1.6% & 2.7%) and NSW (2.0% & 1.8%) are expected to grow fastest over the next 1-2 years, as rents fall in WA (-1.1% & 0.3%) and SA/NT (-0.5% in both years).

Property experts think the CBD hotel market is currently "somewhat" under-supplied and it will remain so in the next 12 months before returning to balance in 3-5 years' time as new supply comes on stream. Overall, the Office market was assessed as "neutral" in Q4 and expected to remain so over the outlook horizon. But there are big differences across states. Over-supply is still a major issue in WA and to a lesser SA/NT and QLD. In NSW the market is "somewhat" under-supplied (and expected to remain so in the next 12 months), with conditions in VIC "neutral". Over-supply expected to feature in all state Retail markets in next 1-5 years, bar QLD ("neutral") and WA ("somewhat" under-supplied). Industrial markets "neutral" with over-supply in WA and SA/NT offset by shortages in NSW.

GROSS RENTAL EXPECTATIONS (%)



SUPPLY CONDITIONS

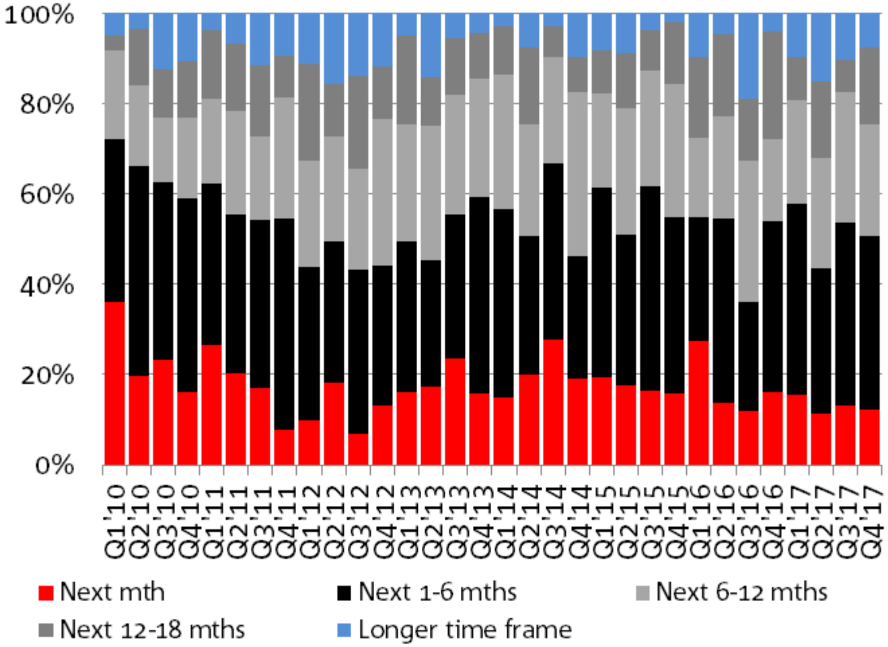


MARKET OVERVIEW - DEVELOPMENT INTENTIONS

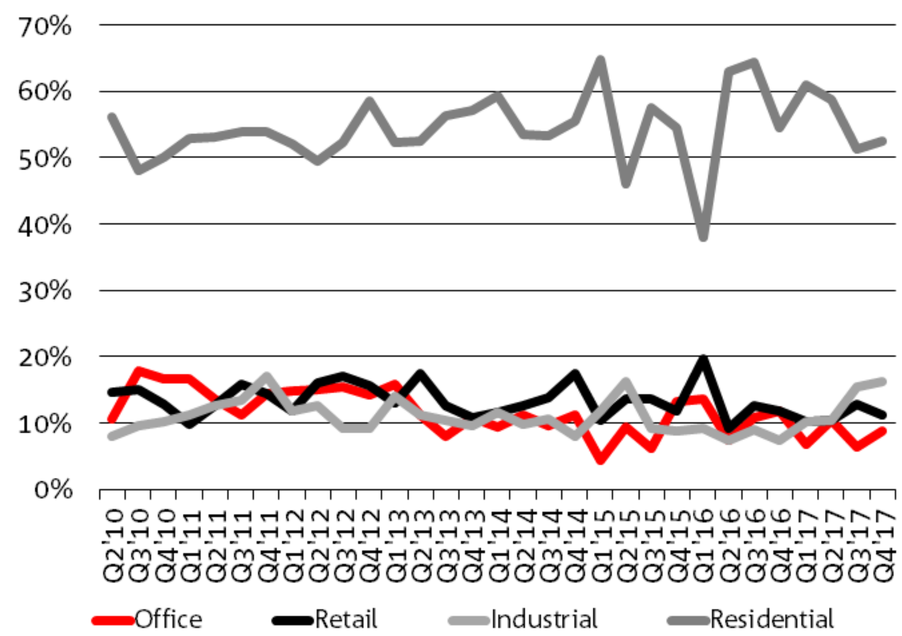
Property developers appeared to be somewhat more hesitant about entering the market in Q4, perhaps reflecting concerns about over-supply in some market segments such as high density apartments. Australia wide, the number of surveyed property developers who said they were intending to commence new building works in the next 6 months fell to 47% in Q4 (49% in Q3) - below its long-term average (51%). Slightly less than 1 in 4 (23%) also planned to start new projects in the next 6-12 months (27% in Q3). But 16% said the would start in the next 12-18 months (7% in Q3) as development intentions are pushed out.

The number of property developers who were planning to start new works and were targeting residential development projects increased slightly to 53% in Q4 (51% in Q3). This is well down from Survey high levels of around 64% in the second half of 2016 and may be suggesting that the residential construction cycle has flattened. In commercial property markets, around 16% of developers said they were looking to start new works in the Industrial space (up from 7% a year ago), probably reflecting strong demand conditions for this type of property being reported in the Eastern seaboard states. In other sectors, around 9% were looking to start work on Office projects and 11% on Retail projects.

COMMENCEMENT INTENTIONS - TIME



COMMENCEMENT INTENTIONS - SECTOR

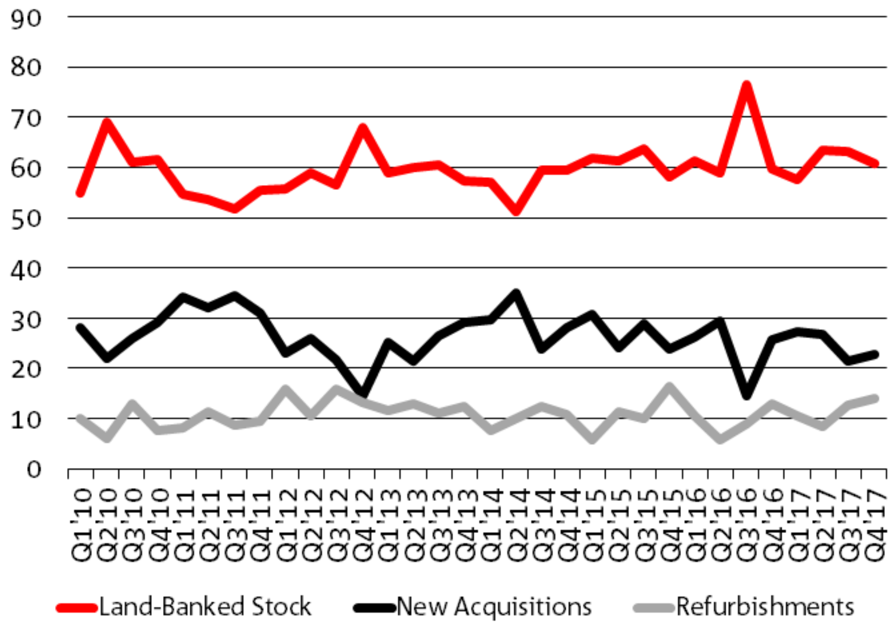


MARKET OVERVIEW - LAND SOURCES & CAPITAL INTENTIONS

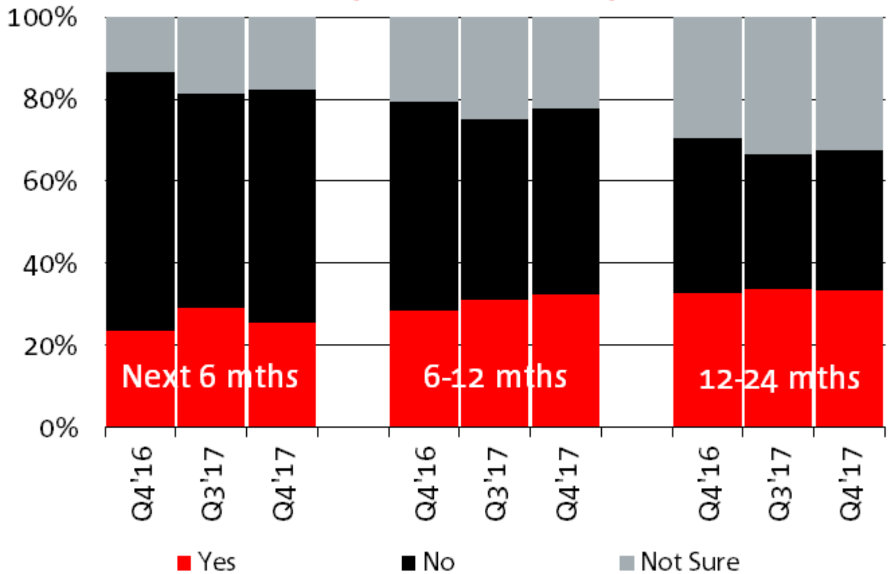
There was little movement in how property developers expected to source land for development in Q4. Overall, the percentage of developers who said they were looking to use land-banked stock for their new projects fell to 61% in Q4 (63%) - just above its long-term average (60%). The number who were seeking new acquisitions was broadly unchanged at 23% (22% in Q3). The number of developers looking at refurbishments climbed a little to 14% in Q4 (13% in Q3). This is somewhat above Survey average levels (11%) suggesting that more developers may believe the market potential for refurbished property is becoming more cost effective.

With development commencement intentions being pushed out in Q4, the number of property developers that were planning to source more capital to fund their developments in the next 6 months also fell to 25% (30% in Q3). Around 57% had no intention to source capital in the short-term (54% in Q3) and 18% were unsure (19% in Q3). Medium-term sourcing intentions in the next 6-12 months were however broadly unchanged - 32% yes, 45% no and 22% unsure. Developers were also evenly split about their longer-term intentions - 33% yes, 34% no and 32% unsure.

SOURCES OF LAND DEVELOPMENT (%)



INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS

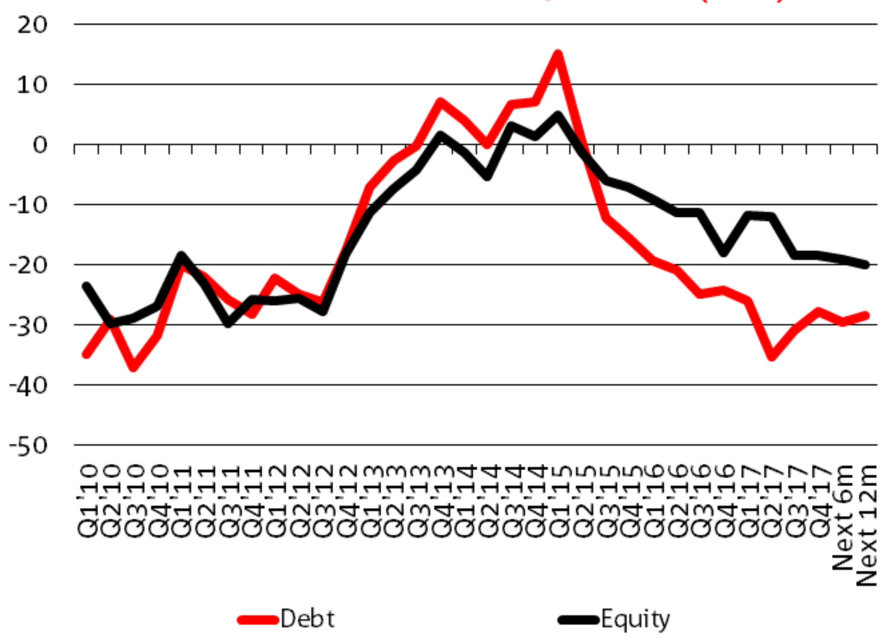


MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

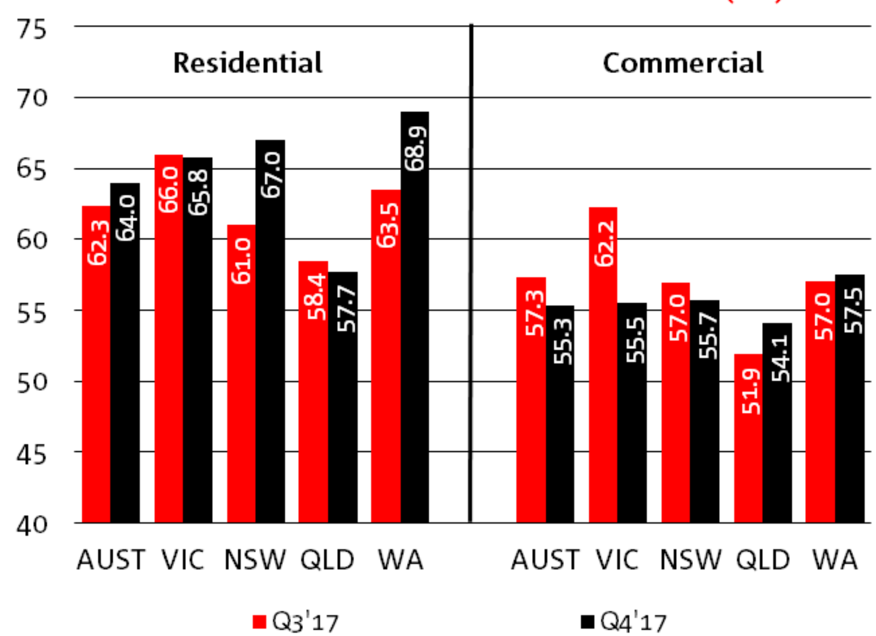
Accessing funds continues to a major challenge. In net balance terms, -28% of surveyed property experts said it was harder to obtain borrowing or loans (debt) needed for their business, although this represented a slight improvement from Q3 (-31%). Equity funding conditions were unchanged according to a net -19%. Looking forward, more property experts on balance also do not expect to see any improvement in their funding conditions over the next 6-12 months - a net -28% see debt funding conditions worsening over the next 6-12 months while -20% think it will be harder to obtain equity financing.

Australia wide, the average pre-commitment required to meet external debt funding requirements for new developments rose to 64.0% for residential property in Q4 (62.3% in Q3), but fell to 55.3% for commercial property (57.3% in Q3). Residential requirements were largely unchanged in VIC (65.8%) and QLD (57.7%), but increased significantly in NSW (67.0%) and WA (68.9%). For commercial property, average pre-commitments fell in VIC (55.5%) and NSW (55.7%), was steady in WA (57.5%) and increased in QLD (54.1%) - but was lowest of all states. Property experts do not expect their lending terms to improve in the next 6-12 months - a net -20% expect it to worsen for residential property and -23% to deteriorate for commercial property.

EASE OF ACQUIRING DEBT/EQUITY (NET)



PRE-COMMITMENT REQUIREMENTS (%)



SURVEY RESPONDENTS EXPECTATIONS (AVG) Q4 2017

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	0.0	1.6	0.8	-5.0	-1.4	0.5
Q4'18	0.5	2.1	1.0	-3.1	-1.8	0.9
Q4'19	-1.1	2.3	1.5	0.0	-2.3	1.1

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	1.6	2.0	0.2	-3.1	-2.3	0.8
Q4'18	2.3	2.5	0.8	-2.0	-2.3	1.4
Q4'19	3.0	2.8	1.7	0.0	-2.8	1.9

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	-0.6	-2.0	0.7	-1.9	-0.7	-0.7
Q4'18	-0.2	-1.7	0.7	-0.1	0.3	-0.2
Q4'19	-0.5	-1.4	1.3	1.0	1.4	0.1

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	-1.6	-0.9	0.0	-3.7	-3.9	-1.5
Q4'18	-1.2	-0.8	0.0	-1.3	-2.8	-0.9
Q4'19	-0.8	0.2	-0.3	0.3	-1.8	-0.3

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	0.9	1.8	1.8	-2.1	0.0	0.8
Q4'18	2.0	2.0	2.0	-1.6	3.8	1.2
Q4'19	1.6	1.7	2.1	-0.4	0.0	1.3

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	0.7	1.5	0.8	-2.1	0.0	0.5
Q4'18	0.9	2.0	1.6	-1.1	-0.5	1.0
Q4'19	1.3	1.8	2.7	0.3	-0.5	1.4

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q4 2017

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	5.7	5.3	12.3	15.0	13.5	8.6
Q4'18	5.6	4.8	11.1	14.5	13.5	8.0
Q4'19	5.9	5.3	10.4	14.5	13.0	8.1

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	5.9	5.6	4.7	8.0	6.2	5.6
Q4'18	5.2	7.5	5.9	5.0	9.0	6.2
Q4'19	5.9	7.5	5.9	5.0	8.3	6.4

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'17	5.0	4.6	6.8	8.5	8.3	6.1
Q4'18	4.3	4.5	6.5	7.8	8.3	5.7
Q4'19	4.1	5.1	6.0	7.3	7.7	5.7

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 300 panellists participated in the Q4 2017 Survey.

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