EMBARGOED UNTIL 11.30 AM WEDNESDAY 25 JULY 2018

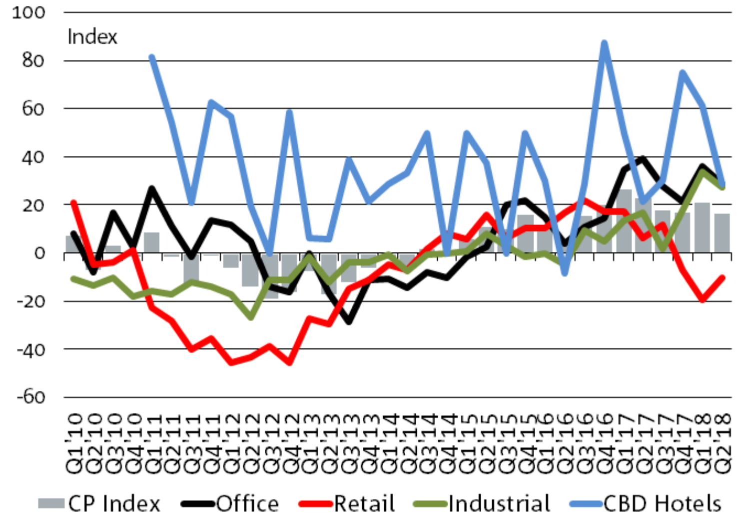
NAB COMMERCIAL PROPERTY SURVEY Q2 2018

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

KEY FINDINGS

- The **NAB Commercial Property Index** fell 4 points to +17 in Q2 but remains well above its long-term average (+3). State indices declined across the country, except in VIC.
- **Sectoral indices** for CBD Hotels, Office and Industrial property converged in Q2, but remain much lower for Retail. CBD Hotels eased despite solid occupancy and a favourable tourism outlook. Office and Industrial indices also fell - even with positive lead indicators in Office and online and warehousing demand for Industrial. Retail better (but negative) as subdued retail business conditions and slow wages growth hurt consumer sentiment.
- **Confidence** was largely unchanged in VIC and QLD, but slightly weaker in NSW. SA/NT was the least confident by some margin (and in all sectors), with WA also trailing.
- Confidence fell most in CBD Hotels (from high levels) but is still highest overall. Industrial also lower and now on par with Office after out-performing in Q1. Office little changed, with sector benefitting from demand in key states and nascent signs of recovery in under-performing states. Retail improved a little, but is still negative and weakest of all sectors.
- Expectations for **capital growth** in the next 1-2 years are strongest for Office property at 1.6% & 1.7% (replacing CBD Hotels), with VIC & NSW leading the way. They are weakest for Retail (-0.8% & -0.7%), with values tipped to fall or stay flat in all states.
- National Office **vacancy** fell to 8.5% in Q2 (9.0% in Q1) - lowest since Q4'15. Despite small increases in VIC and NSW, they remain the tightest markets for space. Vacancy also fell further in QLD (lowest level in 4 years) and looks to have stabilised in SA/NT and WA.
- Office property also expected to lead way for **rental growth** in the next-12 years (1.5% & 2.0), followed by Industrial (1.2% & 2.1%), with NSW and VIC out-performing in both markets. In Retail, the outlook is for rents to continue falling.
- **Special Question - Interest rates and hedging strategies**. Around 2 in 3 property professionals think next RBA move on rates will be up. Only 4% see a cut and 23% no change. Most (53%) believe next move will occur in 6-12 months (NAB's view (up) also sits in 6-12 month range but at latter end). If rates continue rising in medium to long-term, 18% think it will cause property values to fall over 10% and 51% less than 10%.
- Less than 1 in 10 (9%) property professionals use interest rate hedging to mitigate risk. Almost 6 in 10 (59%) said they did not hedge and did not expect to do so in the future.
- When asked how their view on rates was impacting their hedging decision, 44% said they did not intend to change their position. But 36% planned to increase the amount of hedging and 11% would increase the length of interest rate hedging.
- Despite a cooling housing market, a survey high 65% of **developers** starting new projects are still targeting residential development.
- The recent improvement in **accessing funds** has reversed in Q2. In net terms, -29% said it was harder to obtain loans (-21% in Q1) and -16% equity (-14% in Q1). More property professionals now also expect funding conditions to worsen in next 6-12 months.

NAB COMMERCIAL PROPERTY INDEX



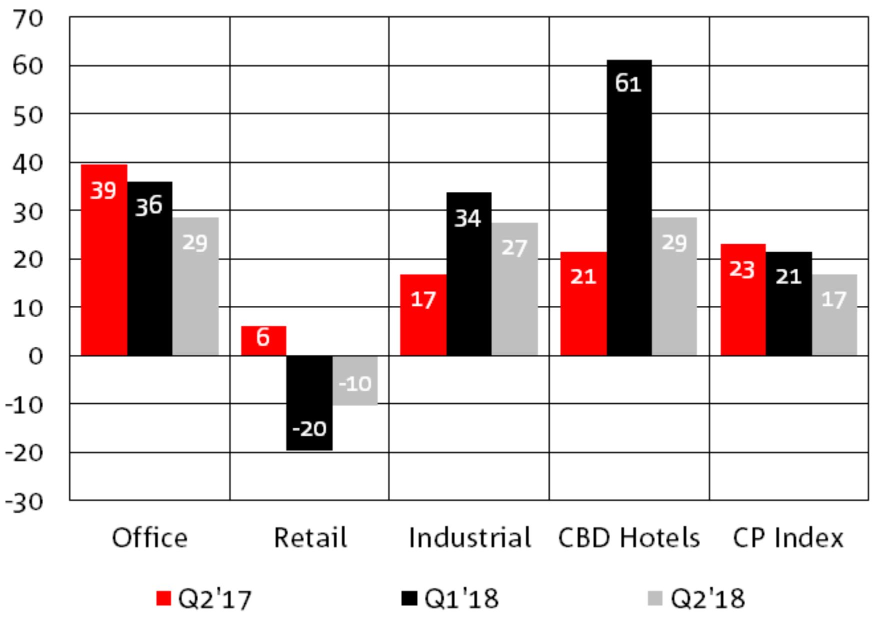
	Q4 2017	Q1 2018	Q2 2018	Next 12m	Next 2yrs
Office	21	36	29	39	42
Retail	-7	-20	-10	-8	-3
Industrial	18	34	27	40	38
CBD Hotels	75	61	29	50	43
CP Index	**17**	**21**	**17**	**26**	**28**

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

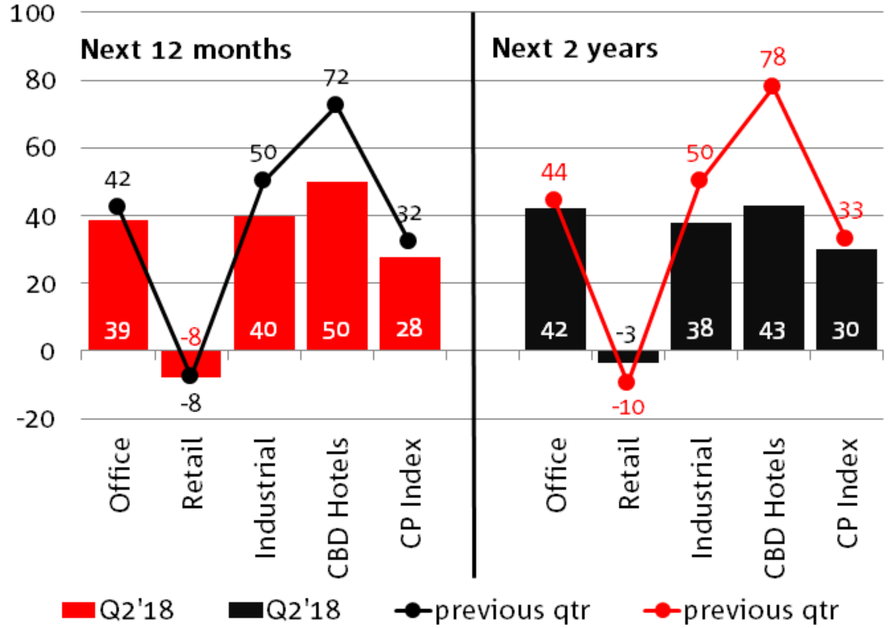
Overall sentiment (measured by NAB's Commercial Property Index) fell 4 points to +17 in Q2 but continues to hold well above its long-term average level (+3). Sentiment in the bouncy CBD Hotels segment fell (down 32 to +29) despite continued high occupancy and a favourable outlook for international tourism. Sentiment around Office property fell (down 7 to +29), despite still enjoying a period of above average capital and rental growth. Sentiment in the Industrial property space also moderated (down 7 to +27), but remains well above Survey average levels (-2), supported by online and growing warehousing requirements. In contrast, sentiment among Retail property professionals improved, but was still overall negative (up 10 to -10). Subdued retail business conditions and slow wages growth flowing through to weak consumer sentiment are clearly still weigh heavily on this sector.

Overall confidence in commercial property markets softened in Q2. NAB's Commercial Property Index is expected to fall to +28 in the next 12 months (+32 in Q1) and +30 in 2 years' time (+33 in Q1). Confidence fell most in the CBD Hotels sector (but from very high levels) as property professionals scaled back their expectations for capital growth and occupancy. That said, they continue to be the most optimistic over the next 1-2 years. Confidence in the Industrial sector also turned down as is now back on par with Office property after having out-performed in the previous quarter. Confidence in office markets was little changed with the sector continuing to benefit from strong demand in key states and nascent signs of recovery in previously under-performing states. In contrast, Retail market confidence improved a little but is still negative and by far the weakest of all sectors.

NAB COMMERCIAL PROPERTY INDEX



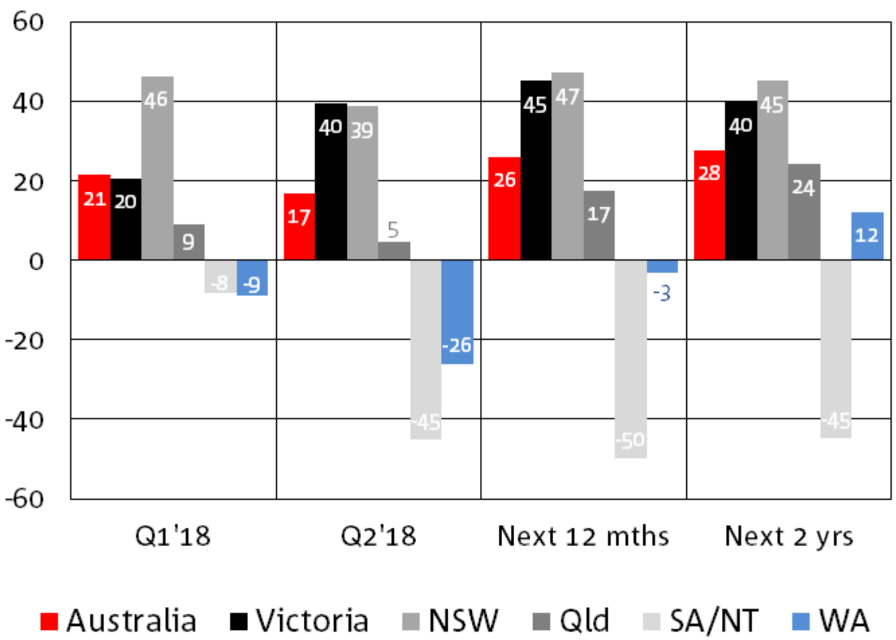
NAB CP INDEX - NEXT 1-2 YEARS



MARKET OVERVIEW - INDEX BY STATE

Lower sentiment nationwide was driven by weaker outcomes in all states except VIC (up 20 to +40) with stronger outcomes also recorded in all state property market sectors. NSW was next best (down 7 to +39) with sentiment lower in all sectors. QLD was slightly softer (down 4 to +5), but sharper falls were seen in SA/NT (down 37 to -50) and WA (17 to -26). Office sentiment weakened in all states except VIC but it remained strongest in NSW (+72). Retail sentiment was negative in all states. Industrial sentiment climbed in VIC (+63) and QLD (+38) but fell in all other states. Overall confidence levels in commercial property markets in the next 1-2 years were basically unchanged in VIC and QLD and slightly weaker in NSW. SA/NT is least confident sector by some margin (and in all market sectors), with overall confidence also trailing in WA.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	60↑	72↓	8↓	-21↓	-43↓	**29**↓
Q2'19	70↑	71↓	23↑	14↔	-36↓	**39**↓
Q2'20	80↑	62↓	33↑	29↓	-29↓	**42**↓

RETAIL PROPERTY MARKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	-15↑	-9↓	-3↑	-25↓	-75↓	**-10**↑
Q2'19	-10↓	-5↓	0↔	-25↑	-100↓	**-8**↔
Q2'20	-20↓	5↓	13↑	-13↓	-100↓	**-3**↑

INDUSTRIAL PROPERTY MARKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	63↑	50↓	38↑	-50↓	-40↓	**27**↓
Q2'19	63↑	64↓	42↓	-7↓	-40↓	**40**↓
Q2'20	44↓	57↓	38↓	21↓	-30↓	**38**↓

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

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

On average, property professionals left their expectations for capital growth in Office markets for the next 1-2 years basically unchanged (1.6% & 1.7%). But there was significant movement across states.

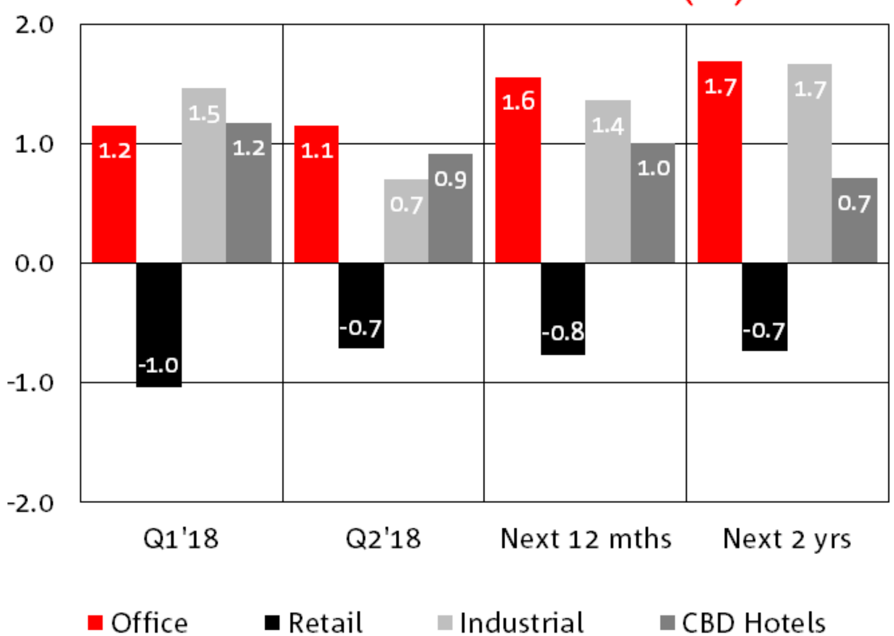
Expectations were revised up VIC (3.7% & 3.3%) and cut back in NSW (3.0% & 2.7%) and SA/NT (flat and -0.3%). QLD and WA also lower next year, but better in 2 years' time. Overall expectations for industrial property were shaved back (1.4% & 1.7%) and in all states bar VIC (3.3% & 3.6%) - now also leading the country for capital returns in the next 1-2 years. In Retail however expectations remain negative (-0.8% & -0.7%) and in all states bar WA (flat). Capital growth expectations were also pared for CBD Hotel property (1.0% & 0.7%) - see page 12 for detail.

National Office vacancy fell to 8.5% in Q2 (9.0% in Q1) - its lowest level since Q4'15. Small increases were reported in VIC (5.4%) and NSW (5.7%), but they remain the tightest markets for Office space and are expected to remain tight in the outlook period. Office vacancy continued to fall in QLD (10.1% - its lowest level in 4 years) and also looks to have stabilised in SA/NT (12.7%) and WA (13.3%).

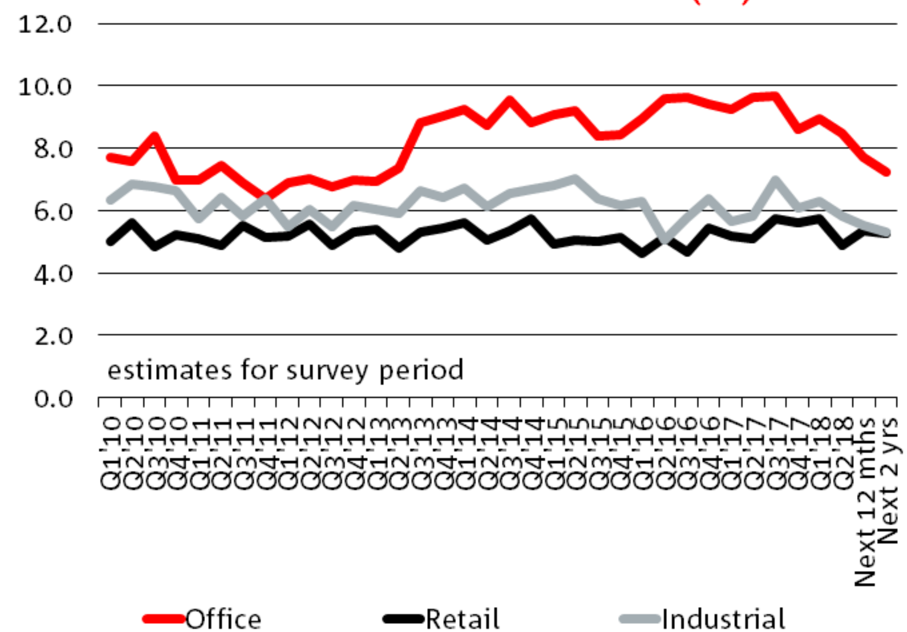
Overall vacancy in Retail markets also fell slightly to 4.9% in Q2 (5.7% in Q1), but ranged from around 4½% in QLD and NSW to 8.0% in SA/NT.

In the Industrial sector, overall vacancy fell to 5.8% in Q1 (6.3% in Q1) and is expected to fall further in the next 1-2 years with market tightness most apparent in NSW - see page 13 for detail.

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)



MARKET OVERVIEW - RENTS & SUPPLY

Office property rents slowed a little in Q2 (0.9%) but led the way for income growth. NSW (3.1%) and VIC (1.5%) continue to out-perform amid low vacancy rates. Industrial rental growth also slowed (0.4%) - and in all states bar VIC and QLD. Rents in the Retail sector fell a further -0.8% in Q2, with negative returns reported in all states.

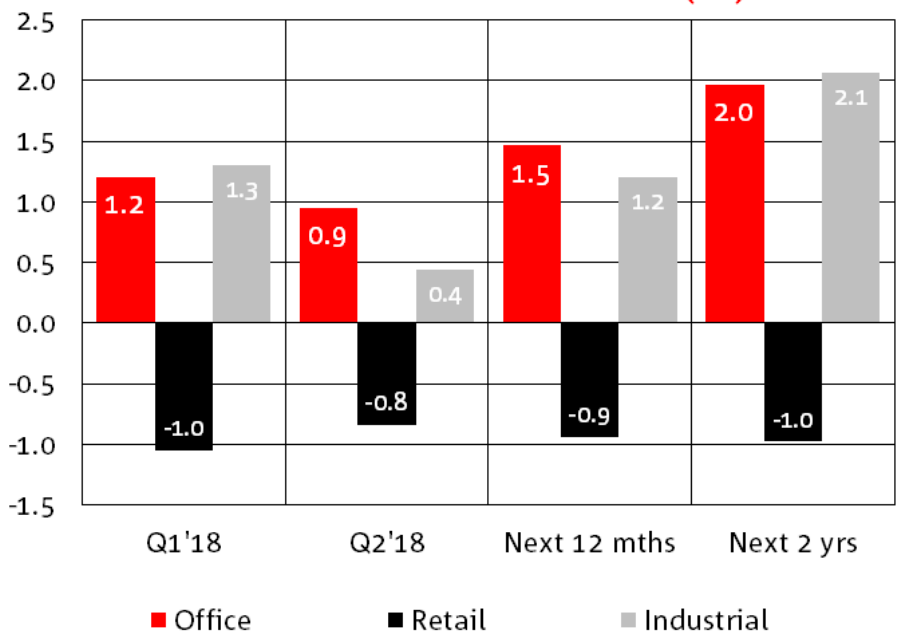
Looking ahead, property professionals still believe Office (1.5% & 2.0%) and Industrial (1.2% & 2.1%) rents will grow fastest in the next 1-2 years, with VIC and NSW out-performing in both sectors. In contrast, the outlook for Retail rents (-0.9% & -1.0%) is expected to remain challenging, although a little less negative than in the last survey (-1.4% & -1.2%). Retail rents are expected to fall in all states except QLD (flat) in the next 1-2 years - see page 12 for detail.

At a national level, property professionals on average believe all commercial property market sectors are in balance and will remain that way over the next 1-5 years. But there are very apparent differences across the states.

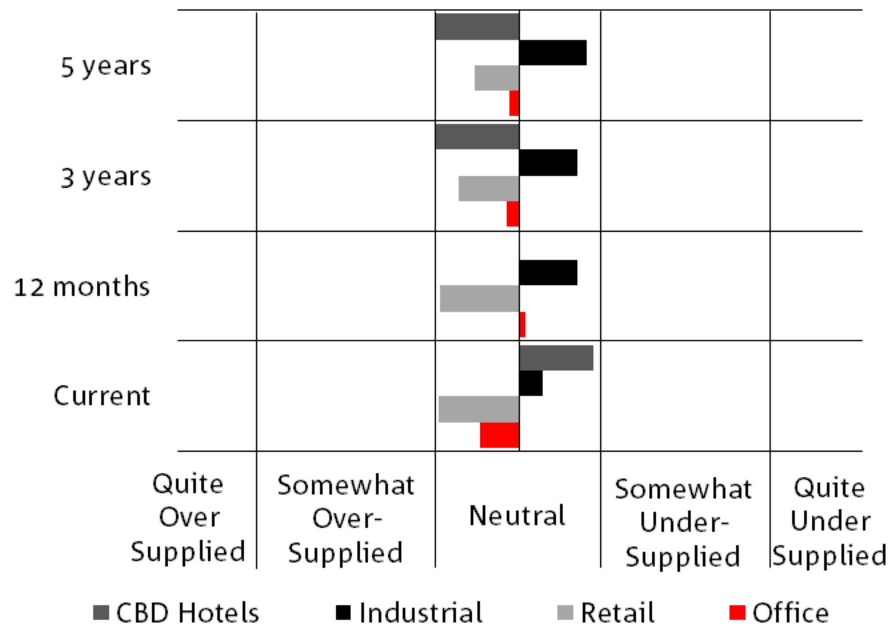
In Office markets, NSW is ‘somewhat’ under-supplied now and in the next 1-3 years. VIC is balanced through the next 5 years, but markets in WA and QLD are ‘somewhat’ over-supplied in the next 1-3 years and SA/NT ‘quite’ over-supplied. Retail markets in NSW and VIC are expected to be ‘somewhat’ over-supplied through the outlook period, with QLD and WA ‘neutral’. In Industrial markets, under-supply is expected to persist in NSW and emerge in WA in 5 years.

CBD Hotels markets will remain in balance over the next 1-5 years.

GROSS RENTAL EXPECTATIONS (%)

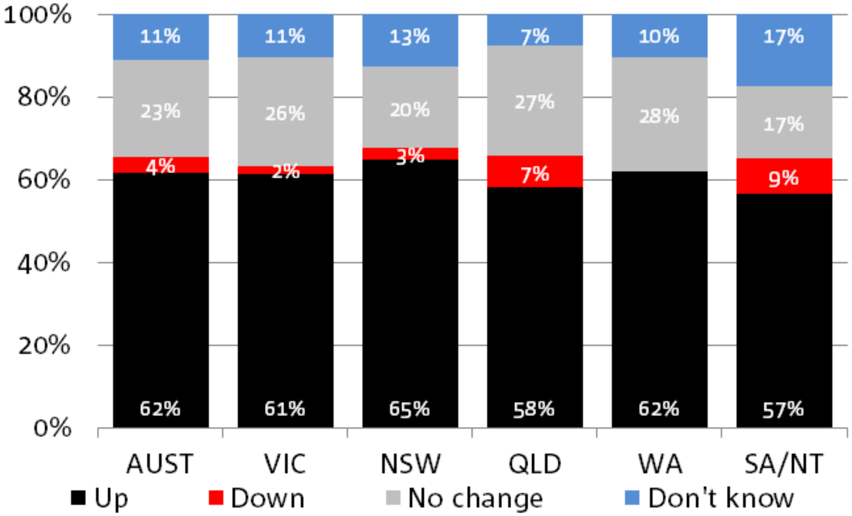


SUPPLY CONDITIONS

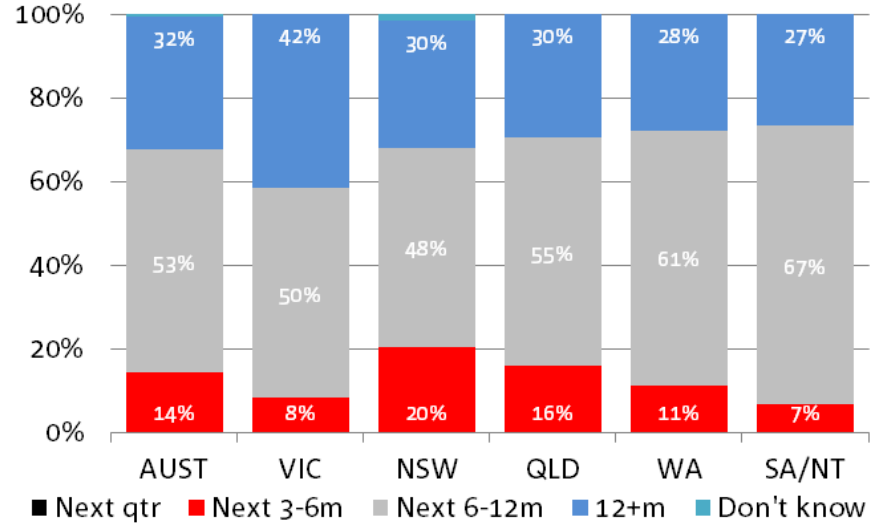


SPECIAL QUESTION - INTEREST RATES

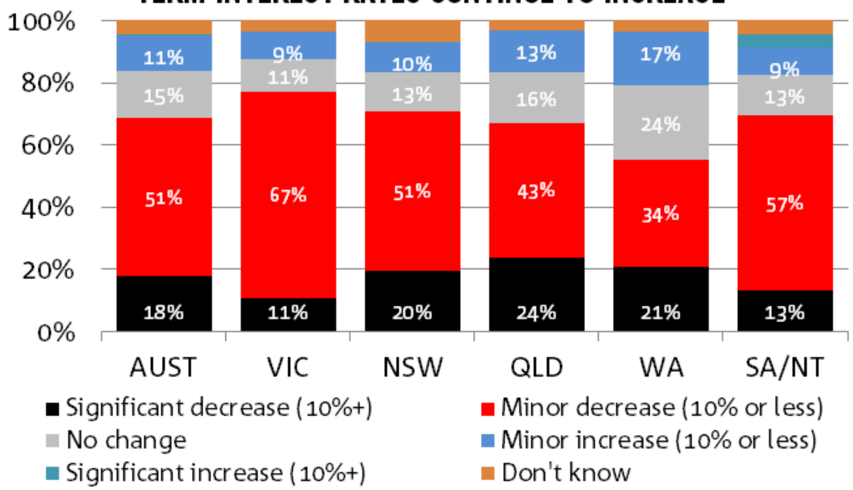
DIRECTION OF NEXT MOVE IN RBA CASH RATE



TIMING OF NEXT MOVE IN RBA CASH RATE



IMPACT ON PROPERTY VALUES IF MEDIUM TO LONG-TERM INTEREST RATES CONTINUE TO INCREASE



Around 2 in 3 (62%) property professionals think the next RBA move on cash rates in the next 1-2 years will be an increase. Around 1 in 4 (23%) see no change and 1 in 20 (4%) a cut. When asked when the next move will occur, 14% expect it to happen in the next 3-6 months, 53% in 6-12 months and 1 in 3 (32%) in more than 12 months' time.

NAB's official view on rates also sits in the 6-12 month range - but at the latter end of this timeframe . Although our outlook for monetary policy is highly data dependent, we think at this stage the RBA will have seen enough of a pick-up in wages growth and gained enough confidence in its inflation forecasts to increase rates for the first time in mid-2019 and a second possible increase later that year contingent on the data flow and impacts from the initial tightening.

If medium to long-term interest rates continue to rise, 1 in 5 (18%) property professionals think this will cause property values to fall more than 10%, and 1 in 2 (51%) by less than 10%.

SPECIAL QUESTION - INTEREST RATE HEDGING

Fewer than 1 in 10 (9%) surveyed property professionals said they currently use interest rate hedging to mitigate interest rate risk.

And very few property professionals (just 3% overall) who don't currently hedge interest rates intend to do so in the future.

In contrast, almost 6 in 10 (59%) property professionals indicated that they did not hedge interest rates and that they also did not expect to do so in the future.

Almost 1 in 3 (29%) were however unsure of their intentions.

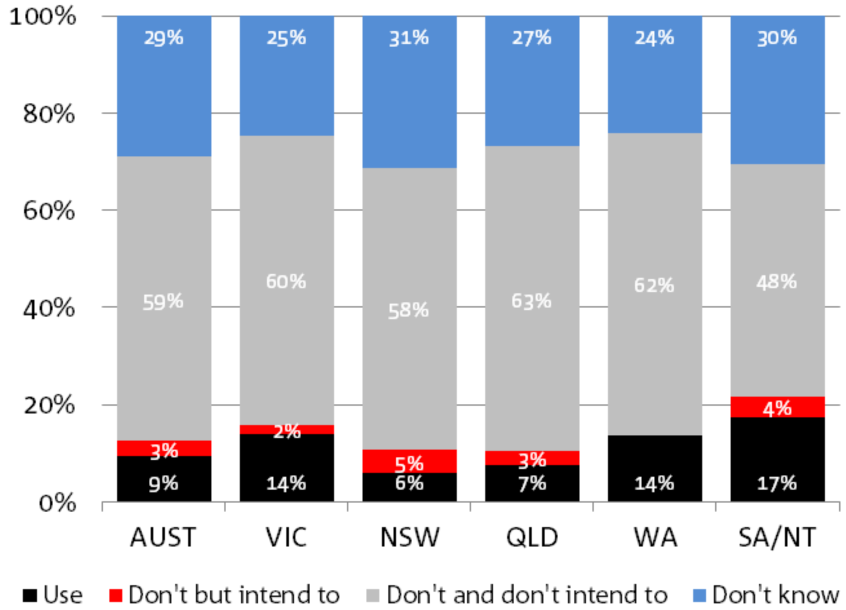
When asked how their view on medium to long-term interest rates was impacting their decision on interest rate hedging, around 44% of surveyed property professionals said they did not intend to change their hedging position at all.

But over 1 in 3 (36%) said they were planning to increase the amount of hedging, with a further 11% indicating they would increase the length of interest rate hedging.

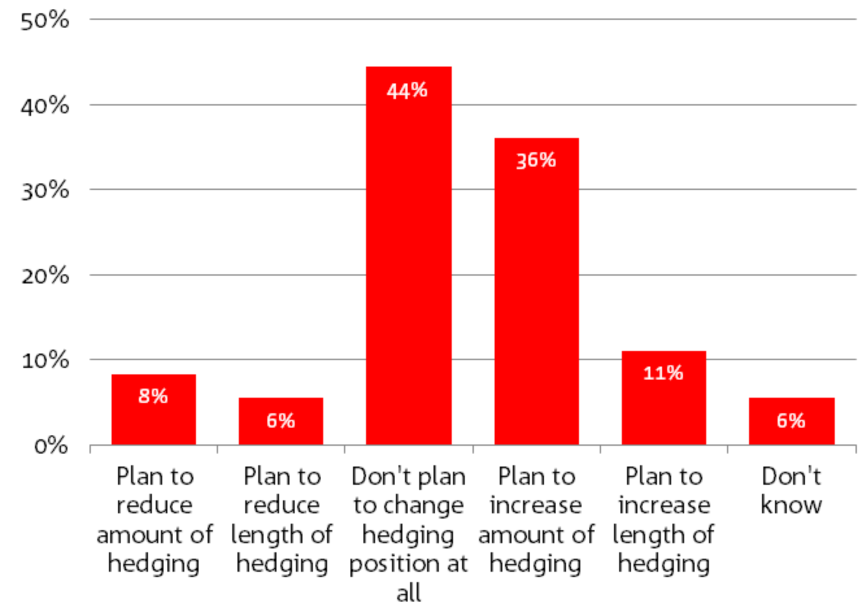
Around 8% planned to reduce the amount of hedging and 6% planned to reduce the length of their hedging.

Only 6% were unsure of their intentions.

USE OF HEDGING



INTEREST RATE HEDGING INTENTIONS



MARKET OVERVIEW - DEVELOPMENT INTENTIONS

Development commencement intentions were less positive in Q2. Overall, the number of property developers expecting to begin new works in the next month fell to a Survey low 4% in Q2 (13% in Q1). This could be suggesting less successful developers may be leaving the market.

The number of developers planning to start in the next 1-6 months was unchanged at 36%.

Around 1 in 3 (31%) plan to start new projects in the next 6-12 months (25% in Q1).

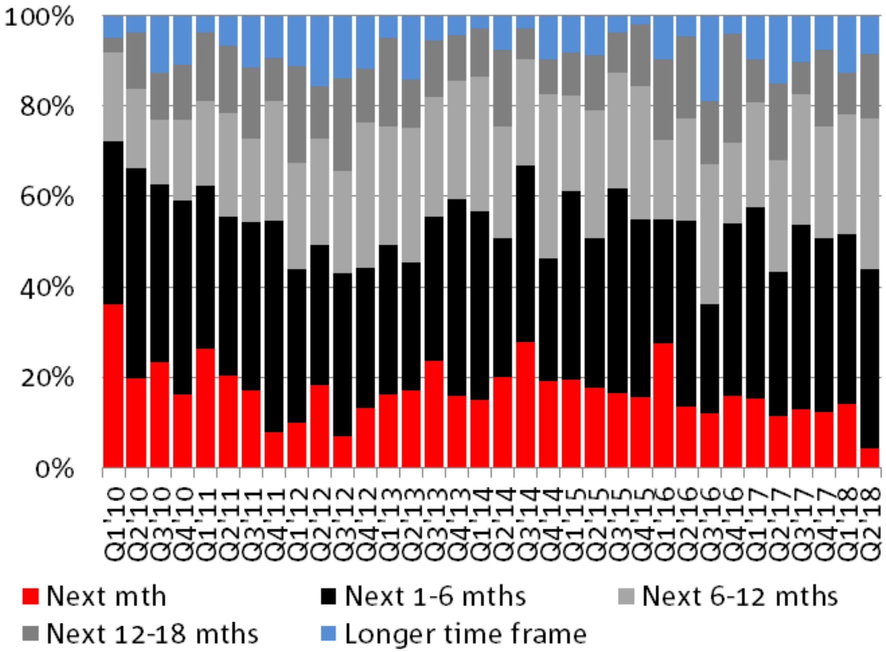
However, just over 1 in 5 (21%) said they planned to start in the next 12 months or beyond - 13% said they would start in the next 12-18 months (9% in Q1) and 8% had a longer-time frame (12% in Q1).

The number of property developers planning to start new projects and targeting residential development projects increased to a survey high 65% in Q2 (59% in Q1) - well above long-term average levels (55%).

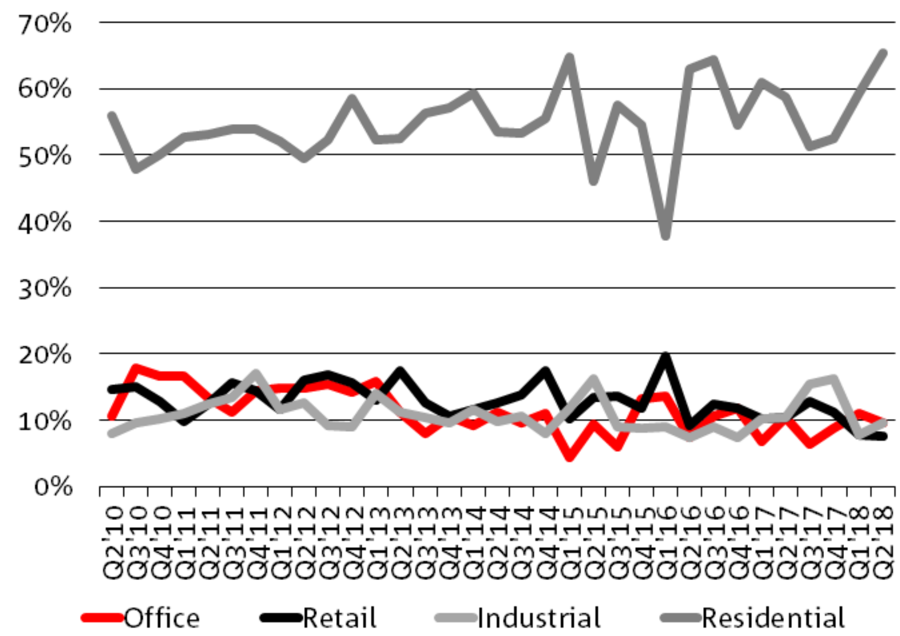
Despite a cooling housing market, the latest official data from the ABS also showed that residential building approvals also increased 3.1% over the year to May, with the previous downturn in apartment approvals showing more stability. Non-residential building approvals were however still flat.

NAB's latest Survey results also reported largely unchanged development commencement intentions in all commercial property sectors - Office (10%), Retail (8%) and Industrial (10%).

COMMENCEMENT INTENTIONS - TIME



COMMENCEMENT INTENTIONS - SECTOR



MARKET OVERVIEW - LAND SOURCES & CAPITAL INTENTIONS

There was a further reduction in the number of property developers looking to use land-banked stock for their new projects in Q2, It stood at an equal survey low 51%, down from 55% in Q1 and 63% at the same time last year.

In contrast, the number of developers seeking new acquisitions continued to grow, reaching a 4-year high 34% - a trend we suspect has occurred because some developers have exhausted or drawn down their current land stocks in this construction cycle and are looking to rebuild them.

The number of developers looking at refurbishment opportunities however fell to 8% in Q2 (13% in Q11).

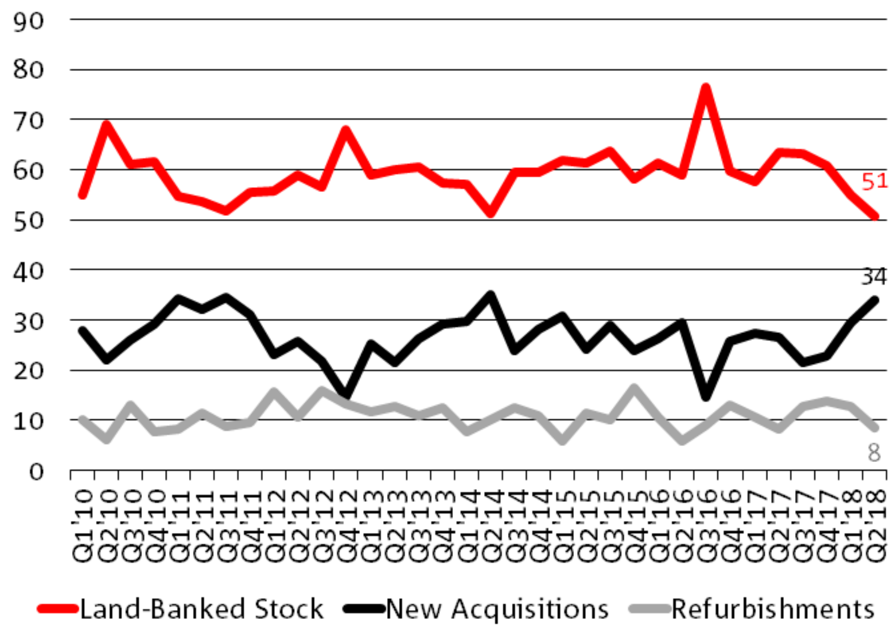
The number of property developers that were planning to source more capital to fund their developments in the next 6 months fell slightly to 25% in Q2 (26% in Q1).

Around 60% had no intention to source capital in the short-term (57% in Q1) and 15% were unsure (17% in Q1).

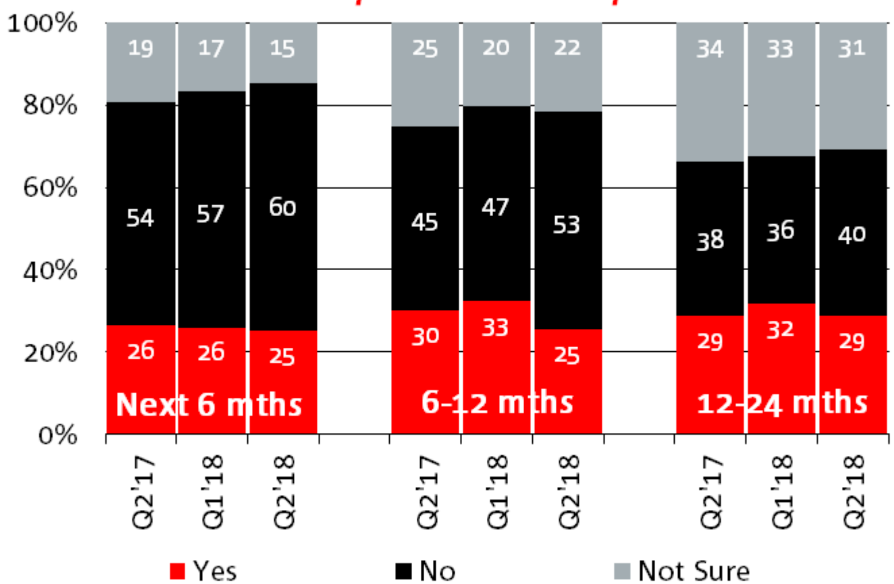
Medium-term sourcing intentions in the next 6-12 months softened - 25% yes, 53% no and 22% unsure.

Fewer developers also intend to source more capital in the longer-term - 29% yes, 40% no and 31% unsure.

SOURCES OF LAND DEVELOPMENT (%)



INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS



MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

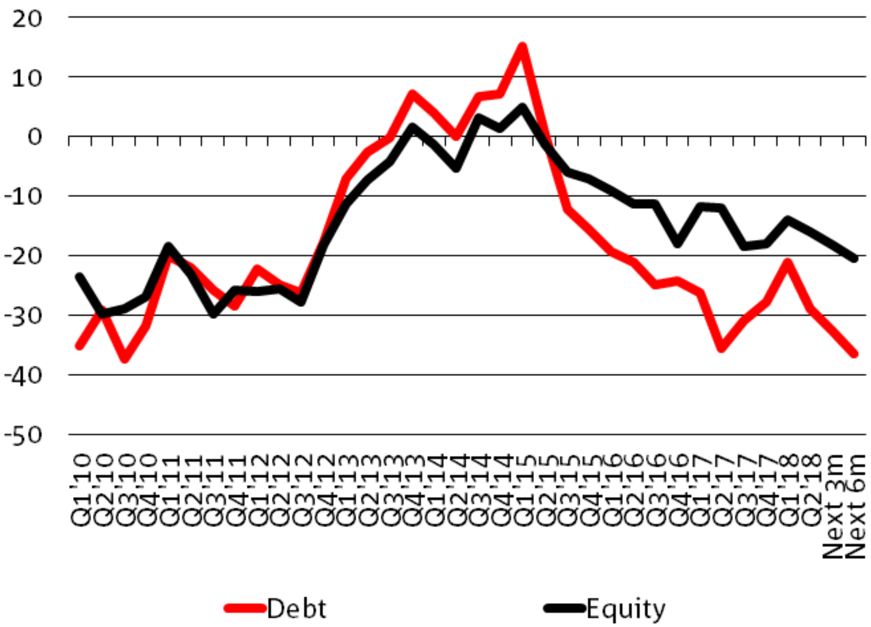
The improvement seen in accessing funds in recent quarters reversed in Q2. In net balance terms, -29% of surveyed property professionals said it was harder to obtain borrowing or loans (debt) needed for their business in Q2 - rising from -21% in Q1. Equity funding conditions were also a little harder according to a net -16% (-14% in Q1).

Looking forward, more property experts on balance expect their funding conditions to worsen further over the next 6-12 months - a net -36% see debt funding conditions worsening over the next 6-12 months while -21% think it will be harder to obtain equity financing.

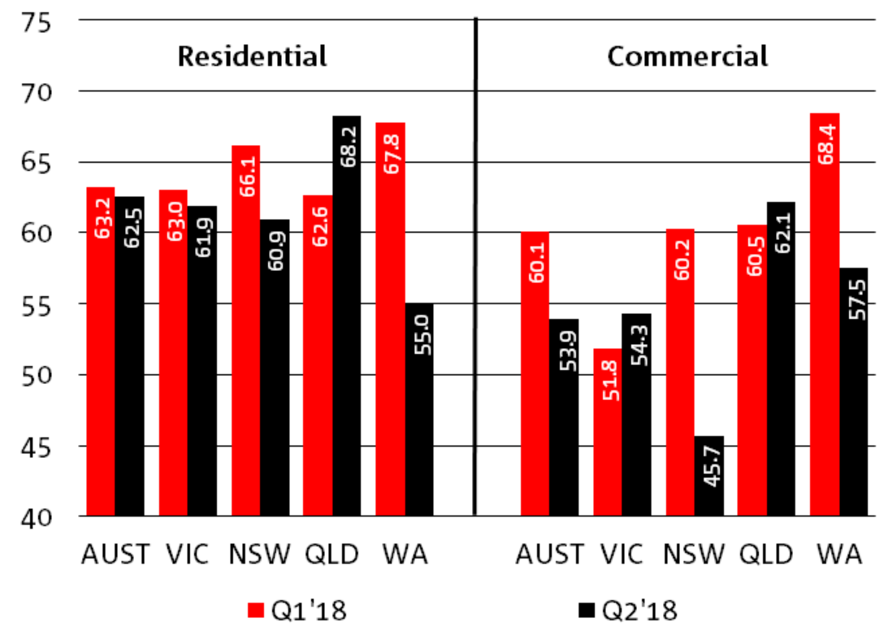
Australia wide, the average pre-commitment to meet external debt funding requirements for new developments rose to 62.5% for residential property in Q2 (63.2% in Q1) but fell to 53.9% for commercial property (60.1% in Q1). Residential requirements were noticeably lower in WA (55.0%) and NSW (60.9%) but somewhat higher in QLD (68.2%). For commercial property, pre-commitments fell in NSW (45.7%) and WA (57.5%) and rose a little in VIC (54.3%) and QLD (62.1%).

More property experts these requirements to worsen going forward - net -34% for residential in the next 6 months (-15% in Q1) and -30% in 12 months (-8% in Q3) and -27% in 6 months (-14% in Q1) and -23% in 12 months (-9% in Q1) for commercial property.

EASE OF ACQUIRING DEBT/EQUITY (NET)



PRE-COMMITMENT REQUIREMENTS (%)



SURVEY RESPONDENTS EXPECTATIONS (AVG) Q2 2018

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	2.9	2.8	0.1	-1.2	-0.3	1.1
Q2'19	3.7	3.0	0.3	-0.3	0.0	1.6
Q2'20	3.3	2.7	0.8	1.1	-0.3	1.7

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	1.5	3.1	0.1	-1.1	-2.9	0.9
Q2'19	2.6	3.1	0.7	0.3	-2.5	1.5
Q2'20	3.9	3.1	1.8	0.8	-2.3	2.0

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	0.0	-2.1	-0.4	0.0	-1.9	-0.7
Q2'19	-0.5	-1.3	-0.6	0.0	-2.9	-0.8
Q2'20	-1.2	-1.2	0.0	0.0	-3.8	-0.7

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	-1.0	-0.1	-0.1	-3.8	-6.5	-0.8
Q2'19	-1.8	-0.1	-0.3	-3.1	-6.5	-0.9
Q2'20	-2.3	-0.2	0.1	-2.7	-6.5	-1.0

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	2.8	1.8	0.9	-2.4	-2.0	0.7
Q2'19	3.3	2.3	1.5	-1.5	3.8	1.4
Q2'20	3.6	2.2	1.3	0.5	0.2	1.7

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	2.3	1.5	0.8	-2.6	-2.0	0.4
Q2'19	3.0	2.3	1.0	-0.9	-1.5	1.2
Q2'20	3.7	3.1	1.4	0.8	0.1	2.1

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q2 2018

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	5.4	5.7	10.1	13.3	12.7	**8.5**
Q2'19	5.0	4.8	9.5	12.7	12.7	**7.7**
Q2'20	5.0	5.1	8.3	11.9	11.3	**7.3**

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	5.7	4.6	4.5	5.0	8.0	**4.9**
Q2'19	5.7	5.4	5.1	4.3	9.0	**5.4**
Q2'20	5.7	6.1	4.6	3.7	8.0	**5.3**

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q2'18	5.0	4.1	6.3	8.0	9.0	**5.8**
Q2'19	5.0	3.9	5.9	7.3	8.6	**5.5**
Q2'20	5.0	4.4	5.2	6.0	7.8	**5.3**

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:

- annual growth to the current quarter
- annual growth in the next 12 months
- annual growth in the 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 Q2 2018 Survey.

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