EMBARGOED UNTIL 11.30 AM 19 OCTOBER 2018

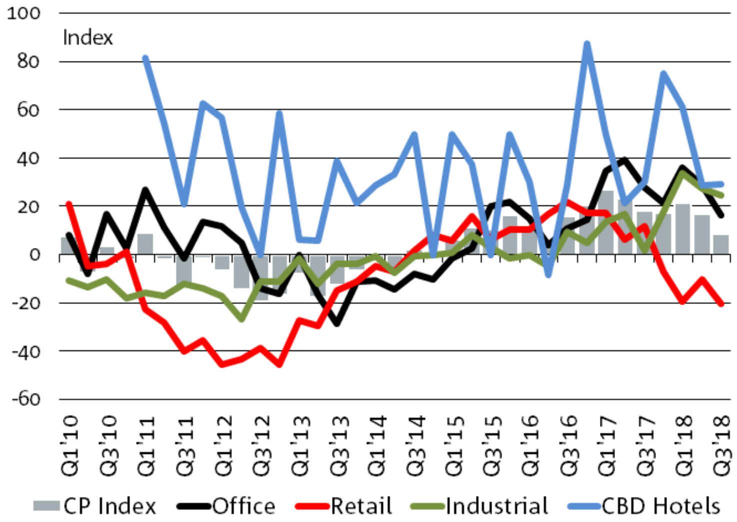
NAB COMMERCIAL PROPERTY SURVEY Q3-2018

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

KEY FINDINGS

- The **NAB Commercial Property Index** fell 9 points to a 2-year low +8 in Q3, but is still well above long-term average levels (+3).
- **Sentiment** was lower in all sectors, except CBD hotels (unchanged and strongest), ahead of Industrial (down slightly). Office sentiment fell sharply (weakest read in almost 2 years), while Retail sentiment dived further into negative territory.
- **Confidence** in commercial property markets fell to new Survey lows. It was weakest in Retail (new lows) and fell sharply (but positive) in the bouncy CBD Hotels sector. More moderate falls were noted in Office and Industrial property markets, and they are expected to be the best performing asset classes over the next 1-2 years.
- **By state**, overall sentiment fell in VIC and NSW (strongest overall). QLD was slightly higher. Sentiment also improved in SA/NT and WA (but negative). Confidence fell in all states, bar SA/NT (but weakest state and negative). Confidence highest in NSW.
- Average Survey expectations for **capital growth** over the next 1-2 years were revised down for Office property (1.1% & 1.1%). Expectations for Industrial property were also shaved a little (1.0% & 1.2%), and Retail more negative (-1.4% & -1.7%). Expectations for CBD Hotel property were unchanged (1.0% & 0.7%).
- National **Office vacancy** fell to 8.0% in Q3 (lowest since mid-2013). Lower vacancy was reported in VIC (4.7%) and NSW (5.2%) amid sustained tenant demand. In QLD, it rose a little (10.4%) and also in WA (14.7%) amid subdued occupier activity.
- Office (1.2% & 1.8%) and Industrial (1.2% & 1.9%) **rents** expected to out-perform in next 1-2 years. The outlook for Retail rents (-1.5 % & -1.4%) has weakened further and even more negative. Retail rents are expected to fall in all states.
- Special question: **Biggest risks facing commercial property investors and developers in next 12 months**. For investors, changing bank risk appetite is the biggest risk, followed by increased debt funding costs and domestic/international political uncertainty. For developers, availability of debt capital for development finance affecting ability to start new projects is the biggest risk, followed by availability of debt capital for unit purchasers affecting end demand, delays in obtaining satisfactory pre-sale levels and rising construction costs.
- Fewer property **developers** are looking to commence new projects or source more capital in the short-term. Developers targeting residential projects fell to Survey low 44% - consistent with recent data showing new dwelling approvals also dropping.
- Property professionals said **accessing debt** in Q3 was the hardest since the Survey began in 2010, while **equity funding** was also more difficult than at any time in past 6 years. They also think it will be harder to obtain debt or equity in next 3-6 months.

NAB COMMERCIAL PROPERTY INDEX



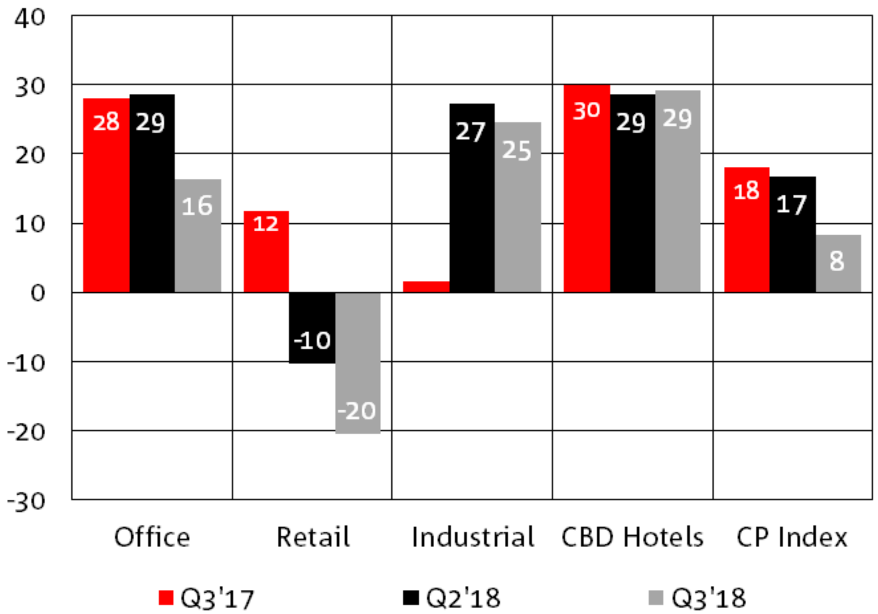
	Q1 2018	Q2 2018	Q3 2018	Next 12m	Next 2yrs
Office	36	29	16	35	37
Retail	-20	-10	-20	-37	-37
Industrial	34	27	25	32	40
CBD Hotels	61	29	29	29	21
CP Index	**21**	**17**	**8**	**12**	**14**

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

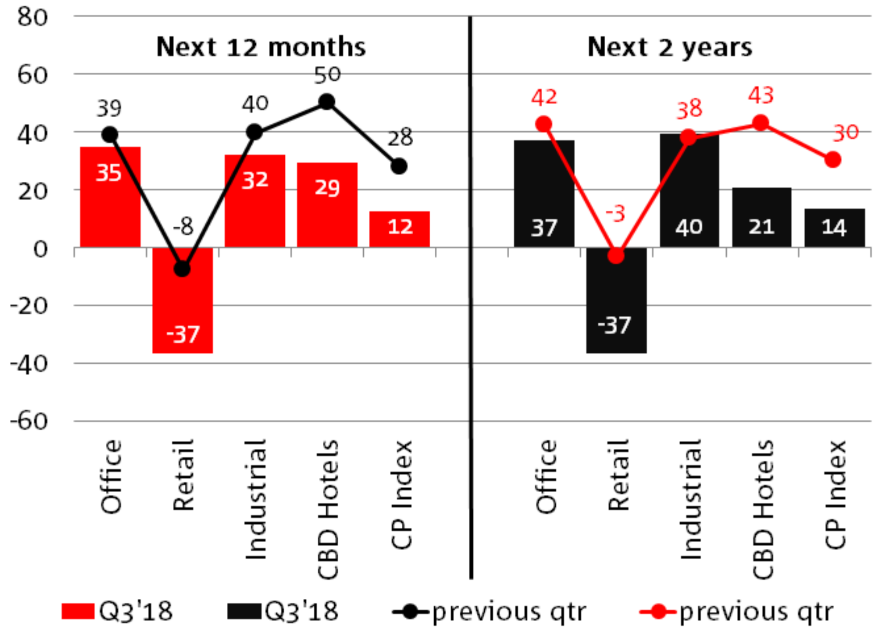
Overall sentiment (measured by NAB's Commercial Property Index) fell 9 points to a 2-year low +8 in Q3, but is still well above long-term average levels (+3). The fall was consistent with weaker business conditions seen in NAB's Q3 Quarterly Business Survey. Sentiment fell in all sectors, bar CBD hotels (unchanged at +29) which continues to benefit from booming international tourism. Industrial property was the next best performer, supported by e-commerce demand (particularly along the Eastern seaboard), although sentiment moderated a touch (down 2 to +25). Sentiment in the Office property sector fell quite sharply, recording its weakest read in almost 2 years (down 13 to +16). In Retail markets, sentiment fell 10 points to -20. As has also been the case for some time in NAB's Business Survey, retail trade is the weakest sector and the only industry reporting negative conditions.

Overall confidence in commercial property markets fell notably in Q3, dipping to Survey low levels - down 16 to +12 in the next 12 months and down 16 to +14 in 2 years' time. Confidence was weakest - and fell to new lows - in Retail. Clearly, a subdued outlook for retail trade is playing a role, with NAB also expecting the retail trade sector to remain under pressure from weak wages, cost of living concerns and wealth impacts from a cooling housing market. Confidence also fell sharply (but remains positive) in the bouncy CBD Hotels sector as expectations for revPar growth for the next 1-2 years were scaled back. More moderate falls in confidence were observed in Office and Industrial property markets. Confidence in both sectors slipped back to Survey average levels in Q3 after a period of out-performance. But they are expected to remain the best performing asset classes over the next 1-2 years.

NAB COMMERCIAL PROPERTY INDEX



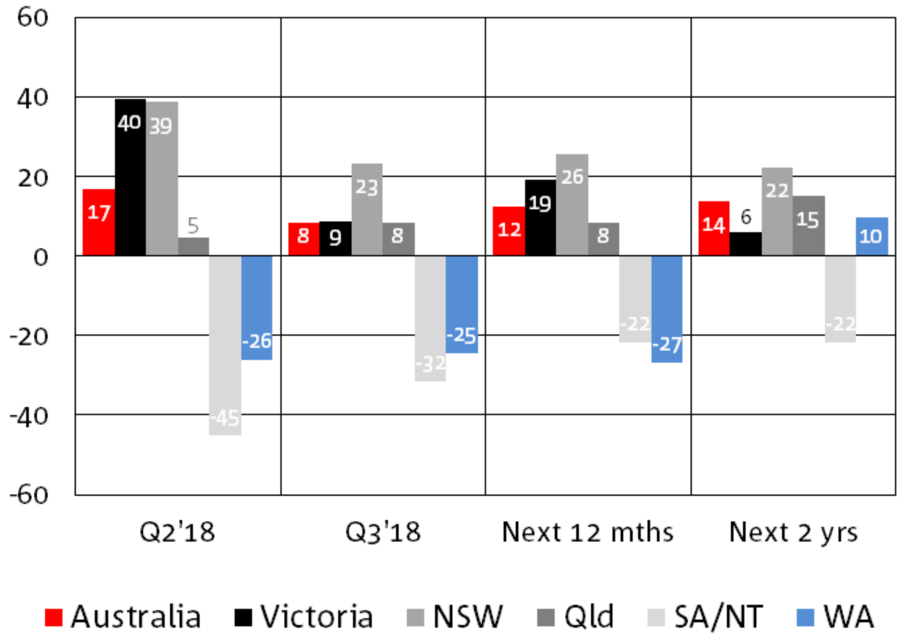
NAB CP INDEX - NEXT 1-2 YEARS



MARKET OVERVIEW - INDEX BY STATE

Overall sentiment was led down by weaker outcomes in VIC (down 31 to +9) and NSW (down 16 to +23). In both states, sentiment fell in all sectors, except Industrial in NSW (unchanged). Sentiment in QLD was however slightly higher (up 3 to +8), led by gains in the Office and Retails sectors. Overall sentiment also improved in SA/NT (up 13 to -32) and WA (up 1 to -25) but was still negative. Overall confidence levels in the next 1-2 years were scaled back heavily in VIC and to a lesser extent in NSW. By sector, Retail sentiment was cut back very sharply in NSW, while Office sentiment was scaled back heavily in VIC but from very high levels. Property professionals in QLD were more confident about the outlook for Office and Industrial property in 2 years' time. In WA, confidence around Office and Retail property fell, but it improved for Industrial property.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	25↓	34↓	13↑	-21↔	-17↑	16↓
Q3'19	55↓	55↓	23↔	-7↓	8↑	35↓
Q3'20	30↓	50↓	35↑	21↓	8↑	37↓

RETAIL PROPERTY MARKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	-27↓	-35↓	0↑	-50↓	-83↓	-20↓
Q3'19	-35↓	-60↓	-18↓	-83↓	-83↑	-37↓
Q3'20	-42↓	-55↓	-24↓	-17↓	-83↑	-37↓

INDUSTRIAL PROPERTY MARKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	29↓	50↔	16↓	-5↑	0↑	25↓
Q3'19	33↓	58↓	25↓	5↑	0↑	32↓
Q3'20	33↓	53↓	41↑	30↑	0↑	40↑

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

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

On average, property professionals lowered their expectations for capital growth in Office markets in the next 1-2 years (1.1% & 1.1%). Expectations were revised down heavily in VIC (1.3% & 0.9%) and to a lesser extent in NSW (2.1% & 2.2%) and WA (-0.5% & 0.3%). Results were mixed in QLD (0.6 &-0.2%).

Overall expectations for industrial property were also shaved back (1.0% & 1.2%), dragged down mainly by a very sharp downward revision in VIC (0.8% & 0.5%). In Retail, capital growth expectations were also revised deeper into negative territory (-1.4% & -1.7%). Expectations were negative in all states, led by NSW (-2.8% & -3.8%).

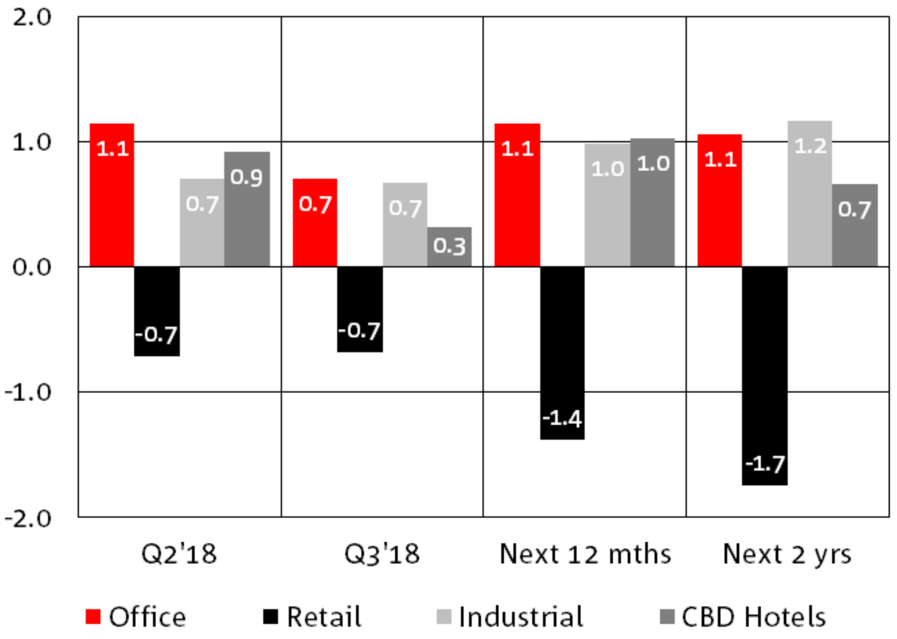
In the CBD Hotel property sector, capital growth expectations were unchanged (1.0% & 0.7%) - see page 12 for detail.

National Office vacancy fell to 8.0% Q3 (8.5% in Q2) - its lowest level since mid-2013. Lower vacancy was reported in VIC (4.7%) and NSW (5.2%) amid sustained tenant demand. They remain the tightest markets for Office space and are expected to remain so over the outlook period. In QLD, Office vacancy rose a little (10.4%). It also increased in WA (14.7%) amid subdued occupier activity.

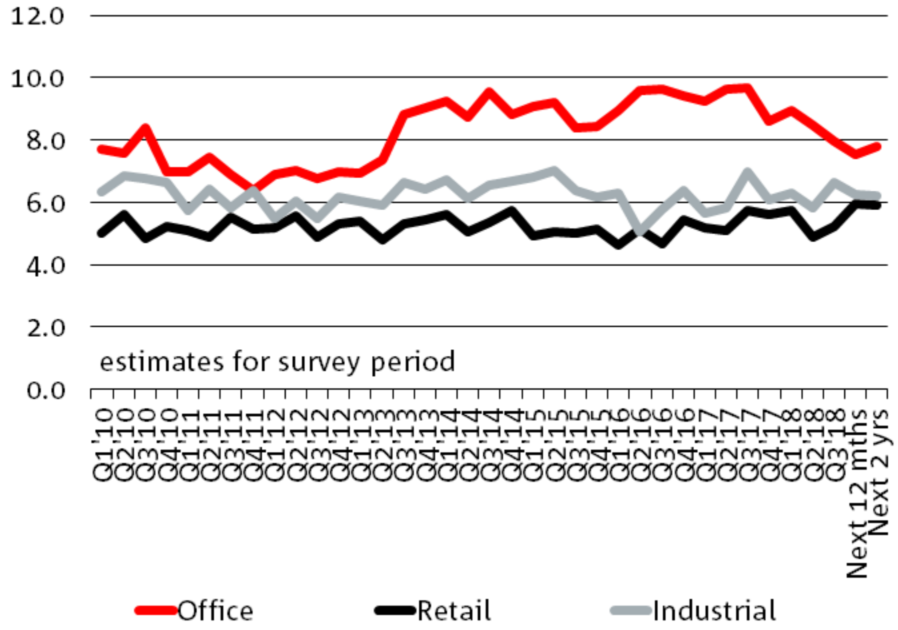
Overall vacancy in Retail markets climbed to 5.2% in Q3 (4.9% in Q2), but vacancy rates ranged from around 4½% VIC and NSW to 11.0% in SA/NT.

In the Industrial sector, overall vacancy also rose to 6.6% in Q3 (5.8% in Q2) but is expected to fall in the next 1-2 years with market expected to be tightest in NSW - see page 13 for detail.

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)



MARKET OVERVIEW - RENTS & SUPPLY

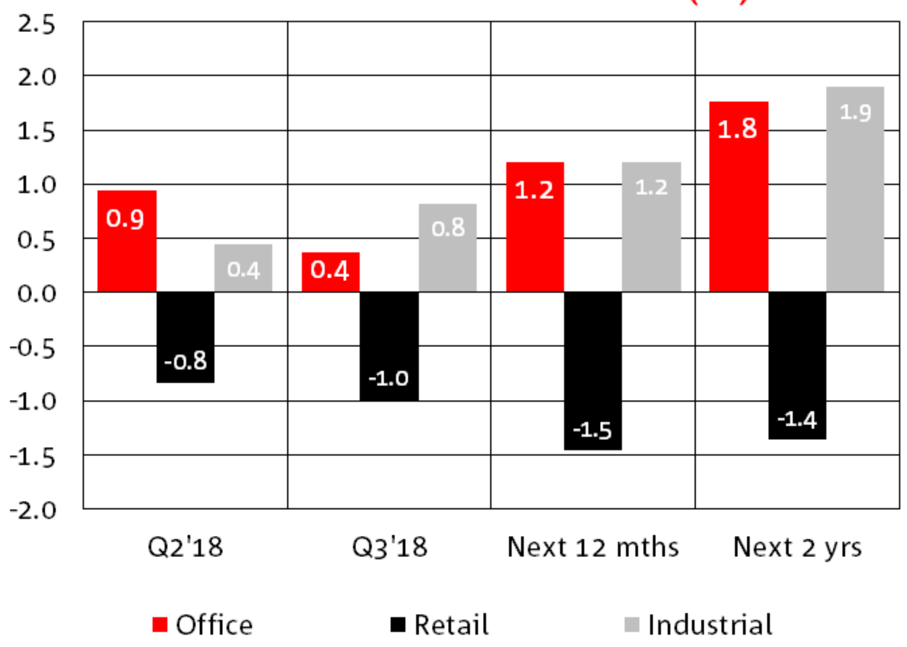
Industrial property led the way for rental growth in Q3, with rents up 0.8% (0.4% in Q2). Growth was fastest in NSW (1.6%) and VIC (1.3%). Office rents slowed to 0.4% (0.9% in Q2). NSW (1.2%) and VIC (0.7%) continued to out-perform, but growth slowed notably from Q2. Retail leasing conditions remain challenging, with rents falling -1.0% in Q3 (-0.8% in Q2), and reportedly falling in all states.

Looking ahead, property professionals believe Office (1.2% & 1.8%) and Industrial (1.2% & 1.9%) rents will out-perform in the next 1-2 years, although expectations are a little weaker. NSW and VIC are expected to generate the highest returns in Office, underpinned by population and jobs growth, with NSW also providing the best returns for Industrial property. The outlook for Retail (-1.5 % & -1.4%) weakened further and is more negative than the last survey. Retail rents are expected to fall in all states - see page 12 for detail.

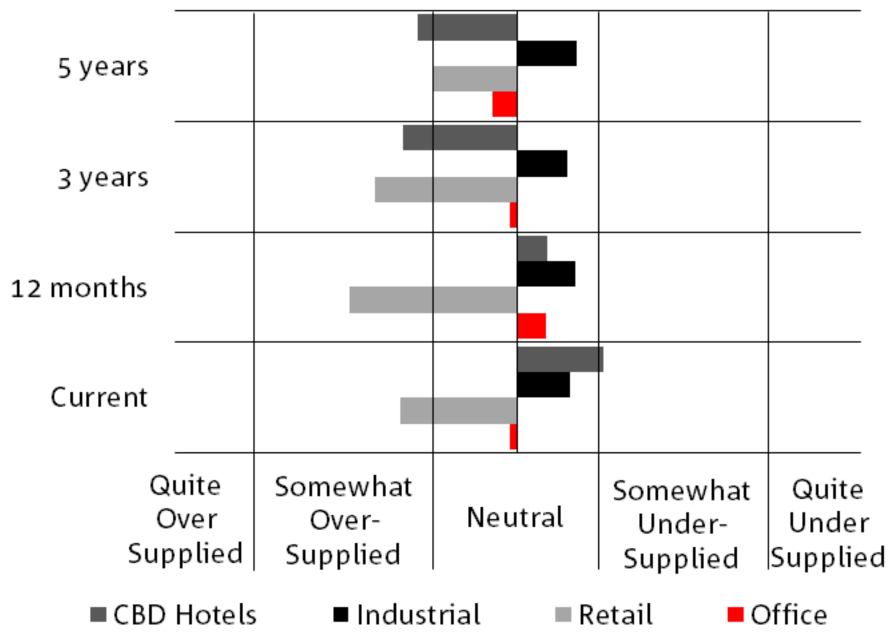
Professionals believe supply conditions in Office and Industrial markets are 'neutral' and will remain that way in the next 1-5 years. Retail markets are 'somewhat' over-supplied and will remain so, but CBD Hotels will move from being 'somewhat' under-supplied to 'somewhat' over-supplied in 3 years as stock enters market.

But are differences across states. In Office markets, over-supply will remain a key feature in WA over the next 5 years, but VIC will move from a 'neutral' position over the next 3 years to 'quite' under-supplied in 5 years time. QLD will move from over supply to 'neutral' and NSW from under-supplied to 'neutral' in 3 years time. Retail markets are expected to be 'somewhat' over-supplied through the outlook period in all states in the next 3 years, but under-supply of Industrial property will persist in NSW in the next 1-5 years.

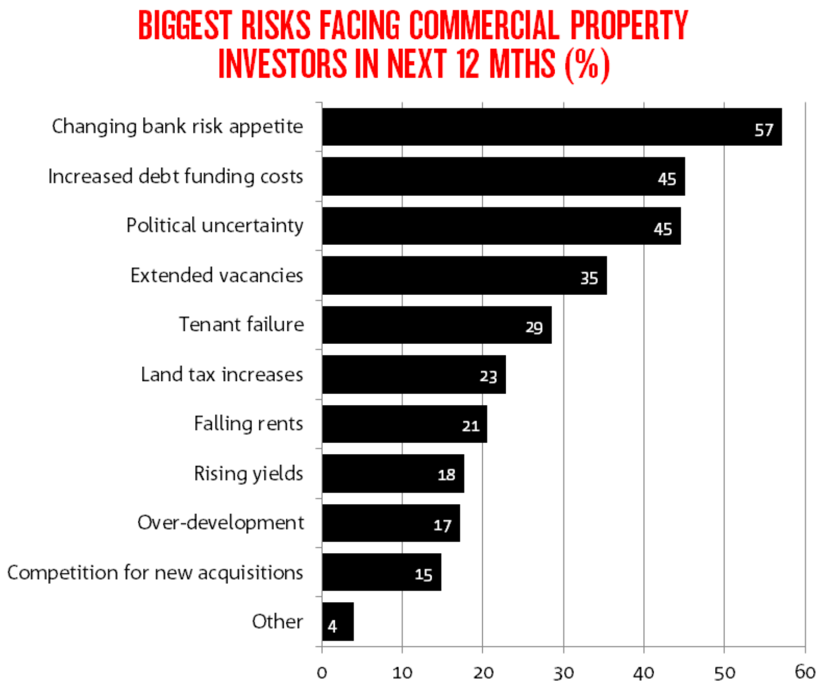
GROSS RENTAL EXPECTATIONS (%)



SUPPLY CONDITIONS



SPECIAL QUESTION: RISKS FACING CP INVESTORS NEXT 12M



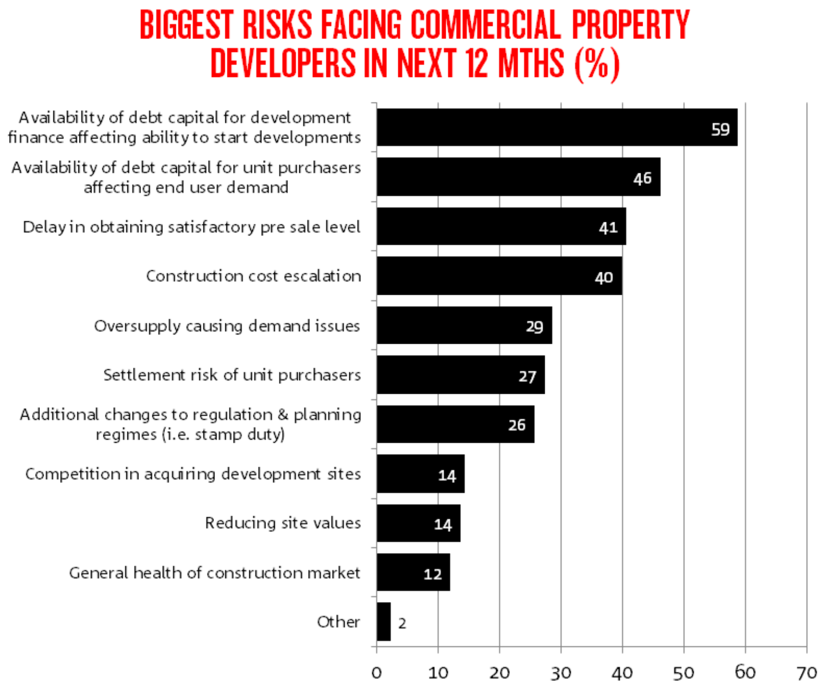
Property professionals operating in the commercial property space were asked to nominate the key risks facing investors in commercial property in the next 12 months. Overall, almost 6 in 10 (57%) said changing bank risk appetite was the biggest issue, followed by increased debt funding costs (45%) and domestic/international political uncertainty (45%).

By state, changing bank risk appetite (69%) and debt funding costs (59%) were considered to be a risk by far more property professionals in VIC than in other key states. In WA, extended vacancies (79%) and falling rents (53%) were seen as key risks - likely reflecting current over-supply and high vacancy in the local Office market. In QLD, rising yields (24%) was a bigger challenge, but they were least worried about competition for new acquisitions.

There was greater consensus across individual property sectors, but also some notable differences. More property professionals operating in Industrial markets saw increased debt funding costs (52%) as a risk in the next 12 months, but they were also least worried about over-development (10%) and competition for new acquisitions (10%). More Retail market participants worried about the potential impact of tenant failure (35%) and land tax increases (24%), and more Office market players by competition for new acquisitions (17%).

BIGGEST RISKS FACING COMMERCIAL PROPERTY INVESTORS	VIC	NSW	QLD	WA	Office	Retail	Industrial
Changing bank risk appetite	69	53	51	53	62	62	61
Increased debt funding costs	59	45	38	42	44	46	52
Political uncertainty	49	50	40	37	46	45	46
Extended vacancies	23	29	33	79	34	37	37
Tenant failure	23	28	33	37	26	35	31
Land tax increases	33	21	24	11	22	25	20
Falling rents	18	17	13	53	22	24	24
Rising yields	21	10	24	11	21	23	14
Over-development	23	19	20	0	13	15	10
Competition for new acquisitions	21	19	9	16	17	13	10
Other	0	3	7	0	4	5	4

SPECIAL QUESTION: RISKS FACING CP DEVELOPERS NXT 12M



Property professionals operating in commercial property markets were also asked to nominate the risks faced by commercial property developers in the next 12 months.

By far the biggest risk according to 6 in 10 (59%) property professionals was availability of debt capital for development finance affecting the ability to start new projects. This was followed by availability of debt capital for unit purchasers affecting end user demand (46%), delays in obtaining satisfactory pre-sale levels (41%) and rising construction costs (40%).

Availability of debt capital to start new developments was a much bigger issue in WA (74%), while accessing capital for unit purchasers was bigger in QLD (51%). Over-supply was highlighted as an issue for more property professionals in QLD (33%) and WA (32%). Settlement risk of unit purchases was highest in QLD (36%) and regulatory changes in NSW (31%). VIC was most worried about competition in acquiring development sites (21%) and significantly more so than in WA (5%).

By sector, respondents shared broadly similar views on all issues, except for Retail market participants and delays in obtaining satisfactory pre sale levels (46%) and the general health of the construction market (15%). Competition for development sites was of slightly more concern among Office market players in VIC (15%).

BIGGEST RISKS FACING COMMERCIAL PROPERTY DEVELOPERS	VIC	NSW	QLD	WA	Office	Retail	Industrial
Availability of debt capital for development finance affecting ability to start developments	64	45	67	74	64	62	65
Availability of debt capital for unit purchasers affecting end user demand	49	45	51	42	48	49	50
Delay in obtaining satisfactory pre sale level	44	29	47	47	41	46	40
Construction cost escalation	41	50	38	21	45	44	36
Oversupply causing demand issues	28	21	33	32	28	28	28
Settlement risk of unit purchasers	31	22	36	26	26	28	30
Additional changes to regulation & planning regimes (i.e. stamp duty)	26	31	24	21	24	27	27
Competition in acquiring development sites	21	17	13	5	15	12	10
Reducing site values	21	10	11	21	14	14	13
General health of construction market	13	9	11	16	10	15	10
Other	0	2	4	0	3	4	3

MARKET OVERVIEW - DEVELOPMENT INTENTIONS

Overall, the number of property developers expecting to begin new works in the next month rose to 11% in Q3, up from a Survey low 4% in Q2. The number of developers planning to start in the next 1-6 months however fell to 32% (37% in Q2). Overall, 42% were planning to start new projects in the next 6 months, well below Survey average levels of 50%.

At the same time, around 32% plan to start new projects in the next 6-12 months (31% in Q2) and just 7% in the next 12-18 months (13% in Q2).

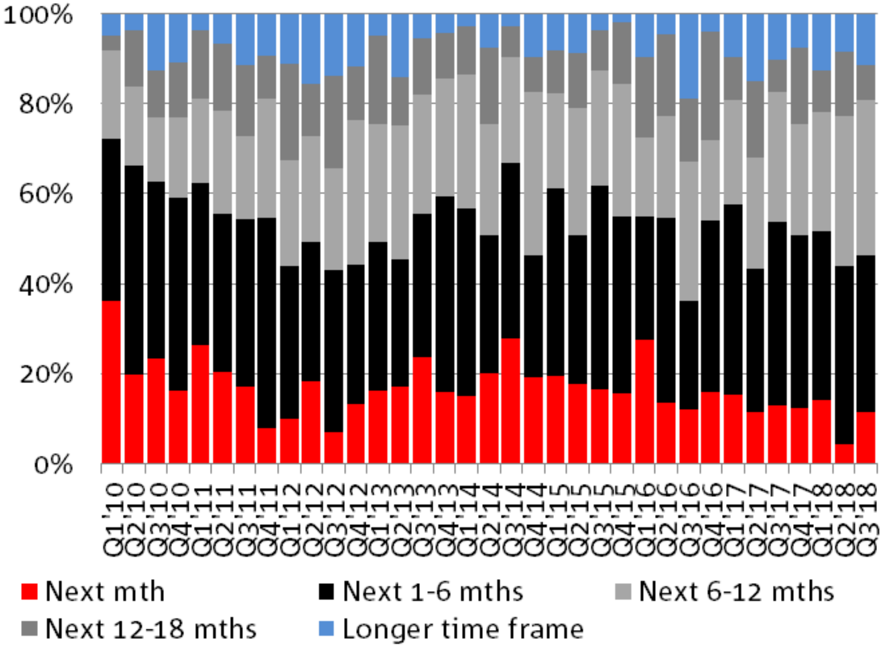
Factors contributing to softer development commencement likely include weakening house prices, over-supply of apartments in some areas and difficult funding conditions which are making it harder to get new projects up and running.

The number of property developers who said they were planning to commence new projects and targeting residential development projects fell to a survey low 44% in Q3. This was significantly below long-term average levels (55%).

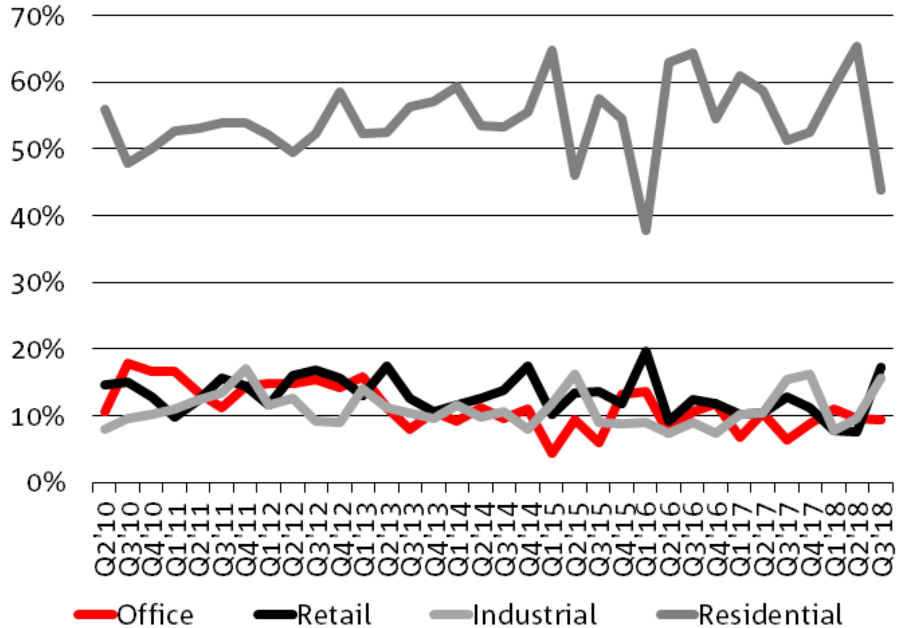
This result is consistent with the latest data from the ABS which also shows that approvals for new dwellings dropped to their lowest level in two years in August, with apartment approvals falling the hardest. Detached housing approvals also fell.

NAB's latest Survey results also reported an unchanged numbers of developers targeting Office property (9%), but higher numbers of developers intending to start new projects in the Retail (17%) and Industrial (16%) space.

COMMENCEMENT INTENTIONS - TIME



COMMENCEMENT INTENTIONS - SECTOR



MARKET OVERVIEW - LAND SOURCES & CAPITAL INTENTIONS

The number of property developers looking to use land-banked stock for their new projects in Q3 ticked up a little to 55%, from an equal survey low 51% in Q2. However, it remains below Survey average levels (59%) and considerably lower than at the same time last year (63%).

In contrast, the number of developers seeking new acquisitions fell to 27%, after reaching a 4-year high 34% in Q2.

The number of developers looking at refurbishment opportunities rose to 14% in Q3 (8% in Q2).

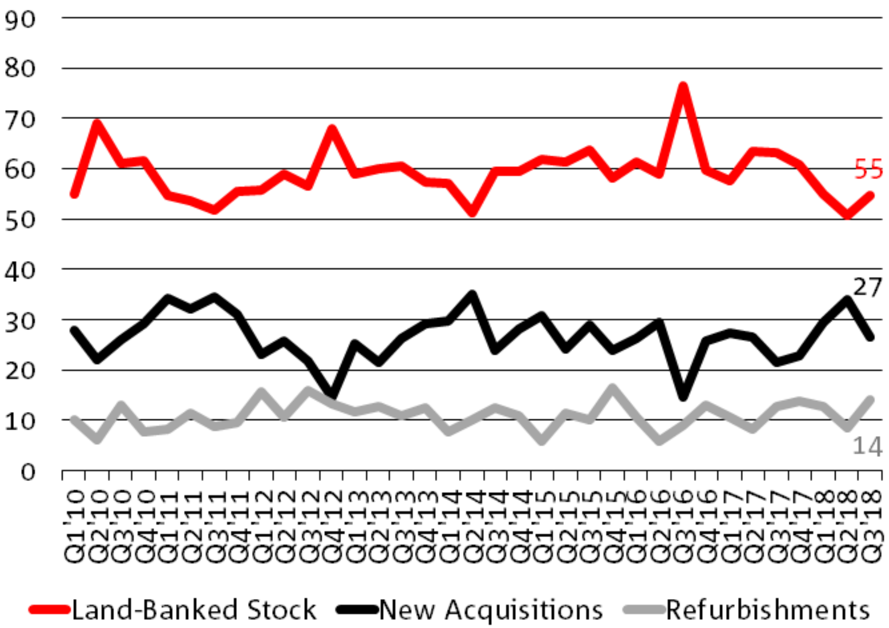
The number of property developers that said they were planning to source more capital to fund their developments in the next 6 months fell slightly to 23% in Q3 (25% in Q2), consistent with a fall in the number of developers also planning to start new works in this timeframe.

Around 58% had no intention to source capital in the short-term (60% in Q2) and 20% were unsure (15% in Q2).

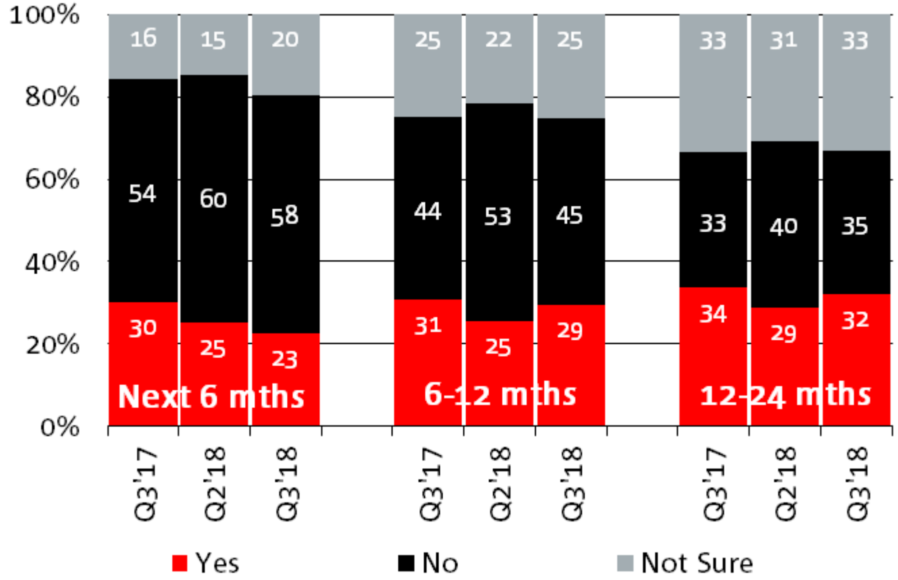
Medium-term sourcing intentions in the next 6-12 months improved a little - 29% yes, 45% no and 25% unsure.

Slightly more developers also intend to source more capital in the longer-term (12-24 months) - 32% yes, 35% no and 33% unsure.

SOURCES OF LAND DEVELOPMENT (%)



INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS



MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

Property professionals said access to credit was harder in Q3 and they see no improvement in the next 3-6 months.

In net balance terms, a survey low -39% said it was harder to obtain borrowing or loans (debt) needed for their business in Q3 - down from -29% in Q2.

Equity funding was also harder according to a net -24%, also the weakest result in 6 years and down from -16% in Q2.

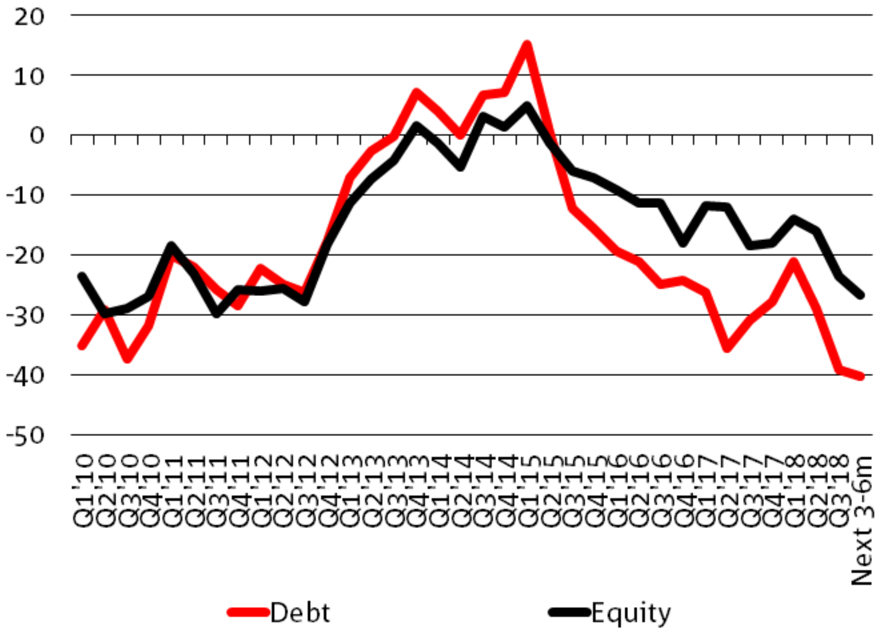
Looking ahead, property professionals expect funding conditions to worsen further over the next 3-6 months - a net -40% see debt funding conditions worsening and -27% said it will be harder to obtain equity financing.

Australia wide, the average pre-commitment to meet external debt funding requirements for new developments rose to 63.5% for residential property (62.5% in Q2) and to 58.7% for commercial (53.9% in Q2).

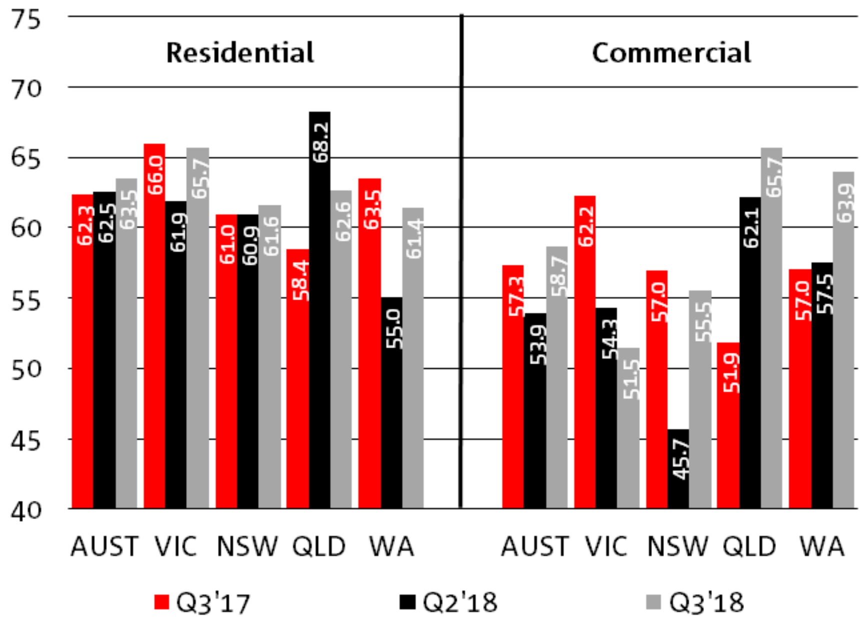
Residential requirements fell in QLD (62.6%) but were higher in VIC (65.7%) and WA (61.4%) Commercial property pre-commitments fell in VIC (51.5%), but rose in NSW (55.5%), QLD (65.7%) and WA (63.9%).

On balance, more property professionals expect pre-commitment requirements to worsen going forward - a net -33% for residential property in the next 6 months and -38% in 12 months, and -31% in 6 months and -33% in 12 months for commercial property.

EASE OF ACQUIRING DEBT/EQUITY (NET)



PRE-COMMITMENT REQUIREMENTS (%)



SURVEY RESPONDENTS EXPECTATIONS (AVG) Q3-2018

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	0.4	1.2	0.9	-0.8	0.3	0.7
Q3'19	1.3	2.1	0.6	-0.5	0.6	1.1
Q3'20	0.9	2.2	-0.2	0.3	0.9	1.1

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	0.7	1.2	0.3	-0.5	-2.8	0.4
Q3'19	2.7	2.0	0.8	0.0	-1.8	1.2
Q3'20	2.7	2.5	1.3	0.9	-0.7	1.8

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	-0.9	-1.4	0.4	-0.6	-5.0	-0.7
Q3'19	-1.7	-2.8	-0.4	-1.2	-2.5	-1.4
Q3'20	-2.3	-3.8	-0.6	0.0	-1.8	-1.7

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	-0.3	-0.7	-0.8	-2.7	-5.6	-1.0
Q3'19	-0.8	-1.9	-1.2	-3.3	-3.8	-1.5
Q3'20	-1.3	-2.2	-1.0	-0.6	-2.5	-1.4

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	0.9	1.7	0.4	-0.4	-0.7	0.7
Q3'19	0.8	2.2	0.6	0.0	3.8	1.0
Q3'20	0.5	2.3	1.0	0.2	0.0	1.2

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	1.3	1.6	0.5	-0.2	-0.7	0.8
Q3'19	0.4	2.6	1.2	0.0	-0.7	1.2
Q3'20	0.7	3.4	2.0	0.7	0.0	1.9

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q2 2018

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	4.7	5.2	10.4	14.7	11.8	8.0
Q3'19	5.0	5.1	9.3	14.3	11.4	7.5
Q3'20	6.3	5.7	9.0	14.0	11.0	7.8

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	4.6	4.6	5.3	5.0	11.0	5.2
Q3'19	5.4	5.2	6.3	5.0	11.0	5.9
Q3'20	5.0	6.0	6.1	5.0	9.7	5.9

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'18	5.2	5.5	6.8	9.9	9.0	6.6
Q3'19	5.4	5.4	6.1	8.7	9.0	6.2
Q3'20	6.1	5.8	5.8	7.9	11.0	6.2

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.

Over 300 property professionals participated in the Q3 2018 Survey.

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