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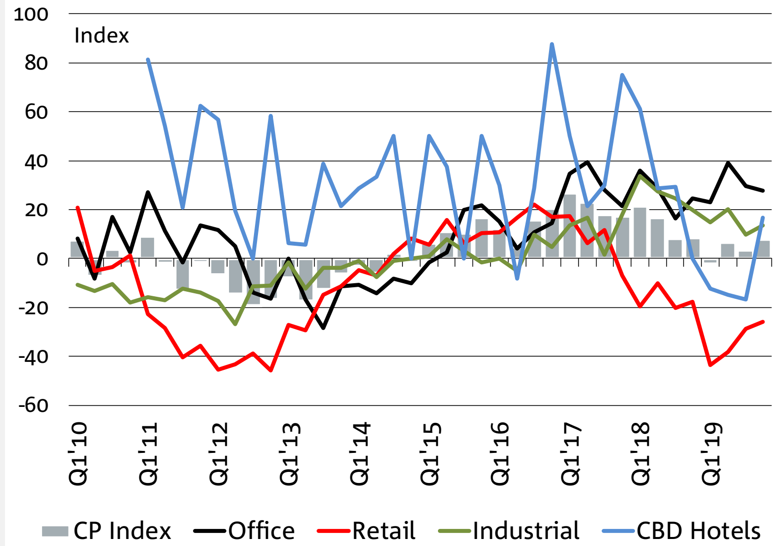
NAB COMMERCIAL PROPERTY SURVEY Q4-2019

Date February 2020 | NAB Behavioural & Industry Economics

KEY FINDINGS

- The NAB Commercial Property Index rose 5 points to an above average +8 in Q4, underpinned by a surprise rebound in sentiment in the CBD Hotel sector. Industrial sentiment also rose a little, but it moderated for Office property (but still out-performing). Retail sentiment remains very weak.
- By state, the Index rose sharply in NSW (highest in the country). It also lifted in VIC and WA (but still negative). In QLD it fell, and it moved further negative in SA/NT.
- Overall confidence was largely unchanged at below average levels, and likely dampened by widespread expectations for below trend economic growth to continue. But results were mixed across sectors. Confidence improved (and was highest) for Office property, but still very poor for CBD Hotels and Retail property.
- Capital value expectations for the next 12 months stronger for Office property, led by VIC and NSW. Industrial values also higher, with SA/NT and VIC out-performing. In Retail and CBD Hotels, values are expected to fall, but less so than predicted in the last survey. The outlook in 2 years' time is brightest for Industrial, with VIC the clear standout. Office values also expected to grow, led by VIC and WA. The outlook for Retail and CBD Hotels however is broadly unchanged and negative.
- Property professionals still expect office and Industrial property to lead the way for rental growth in the next 12 months, with highest returns expected in VIC and NSW. Office property to lead the way for rental growth in 2 years' time, with WA and QLD growing fastest. Industrial rents are also expected to grow, with VIC clearly out-performing. The overall outlook for Retail rents in the next 1-2 years is however negative and expected to fall in all eastern seaboard states.
- The national office vacancy rate inched up to 8.0% in Q4, but conditions remain very tight in VIC and NSW. Overall vacancy is expected to increase to 8.5% in 2 years' time, with rising vacancy in NSW and VIC (to still relatively low levels) offset by modest tightening in QLD, SA/NT and WA.
- One in 2 developers now expect to commence new works in the next 1-6 months (up sharply from 35% in Q3). This is likely reflecting a number of factors including growing confidence around the property and construction market as lending restrictions eased and interest rates fell during the quarter.
- For developers planning to commence new works, the number targeting residential projects fell to a survey low 43% in Q4, and it is now well below the survey average (53%). This affirms our own view of the market, where we continue to see a fairly rapid adjustment with work done to continue falling over 2020.
- Debt and equity funding conditions improved in Q4, with a big fall in the net number of property professionals indicating it was harder to obtain financing. They also expect funding conditions to improve further in the next 3-6 months.

NAB COMMERCIAL PROPERTY INDEX



	Q3'19	Q4'19	Next 12m	Next 2y
Office	30	28	42	42
Retail	-29	-26	-23	-11
Industrial	10	14	26	39
CBD Hotels	-17	17	-17	-33
CP Index	**3**	**8**	**13**	**18**

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

Overall sentiment (measured by NAB's Commercial Property Index) increased 5 points to an above average +8 in Q4.

This was largely underpinned by a surprise rebound in sentiment in the CBD Hotel sector (up 34 to +17) following a noticeable weakening in sentiment in the past year amid a glut of new supply.

Industrial sentiment also improved a little (up 4 to +14), supported by e-commerce demand and associated growth in supply chains, with the eastern seaboard markets leading the way.

In contrast, sentiment around Office property moderated but continued to out-perform (down 2 to +28). Office market sentiment remains strongest in NSW and VIC where tight leasing markets and strong demand are generating income and capital growth.

Retail sentiment remains very weak (up 3 to -26). The Retail market in Australia is clearly struggling as consumer spending continues to be dampened by sluggish wages growth and elevated debt.

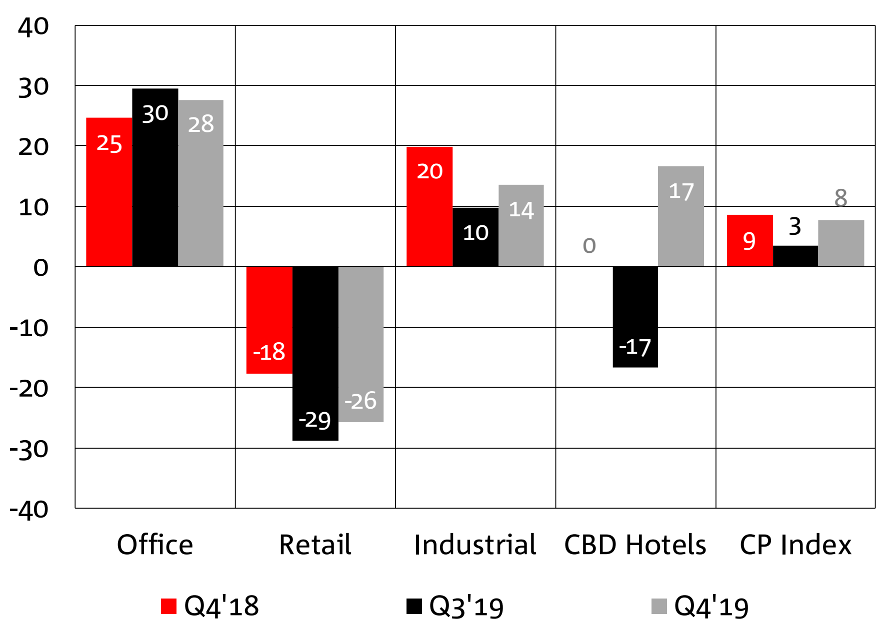
Overall confidence levels in commercial property markets were largely unchanged at below average levels. The 12 month measure stood at a pedestrian +13, and the 2 year outlook +18. We suspect confidence is being dampened by widespread expectations for below trend economic growth to continue.

Results were mixed across sectors. Confidence was highest in Office (up 5 to +42 in 12 months and up 6 to +42 in 2 years), then Industrial (down 2 to +26 in 12 months and down 3 to +39 in 2 years).

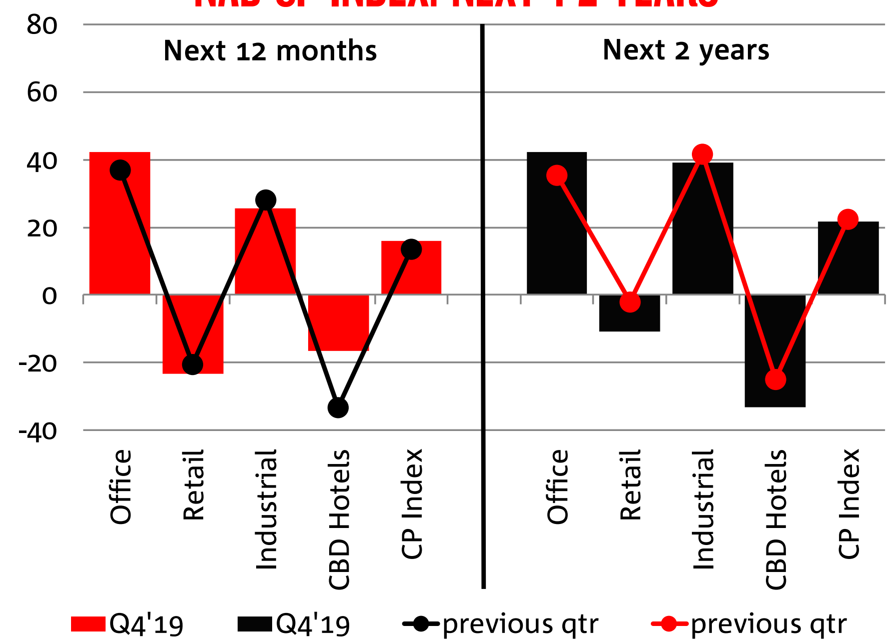
Confidence levels in the CBD Hotels sector remain negative (up 16 to -17 in 12 months and down 8 to -33 in 2 years), as property professionals revised down their expectations for revpar growth amid reports increased supply has caused hotels to cut rates.

Confidence in Retail markets also turned down again after a small improvement in the previous survey (down 2 to -23 in 12 months and down 9 to -11 in 2 years).

NAB COMMERCIAL PROPERTY INDEX



NAB CP INDEX: NEXT 1-2 YEARS



MARKET OVERVIEW - INDEX BY STATE

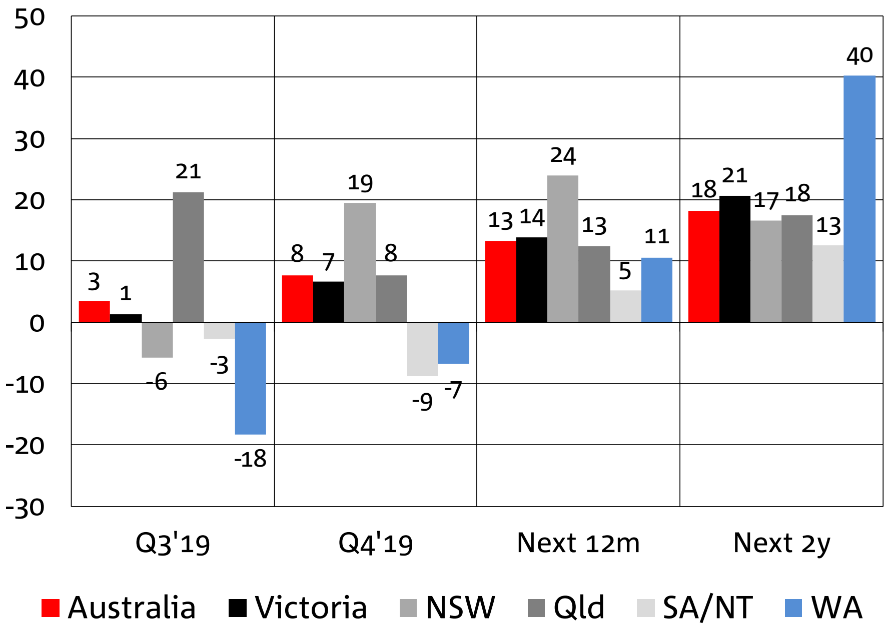
Overall market sentiment among surveyed property professionals improved sharply in NSW (up 25 to +19) and was highest in the country). Sentiment in NSW was higher in all sectors (albeit still deeply negative for Retail).

Sentiment improved in VIC (up 6 to +7), boosted by a sharp turn around in Industrial sentiment. In WA, it moderated further, but was still negative (up 11 to -7). In QLD, sentiment fell (down 13 to +8), and in all sectors. It also moved deeper negative in SA/NT (down 6 to -9).

Confidence over the next 12 months was positive in all states for the first time since Q1 2018. It was highest in NSW (+24) and lowest in SA/NT (+5).

Property professionals in WA (+40) are the most optimistic state in 2 years' time, particularly for Office property, where they are on average forecasting significantly stronger capital and income growth.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	39↑	44↑	24↓	0↑	-22↓	**28↓**
Q4'20	56↑	47↑	50↑	31↑	6↓	**42↑**
Q4'21	44↑	38↑	53↓	69↑	17↓	**42↑**

RETAIL PROPERTY MARKET INDEX – STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	-41↓	-27↑	-33↓	-13↑	13↑	**-26↑**
Q4'20	-35↓	-17↑	-36↓	-6↑	13↑	**-23↓**
Q4'21	-6↑	-17↓	-28↓	13↑	13↑	**-11↓**

INDUSTRIAL PROPERTY MARKET INDEX - STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	42↑	24↑	17↓	-15↓	-43↓	**14↑**
Q4'20	62↑	38↑	17↓	0↓	-29↓	**26↓**
Q4'21	73↑	44↑	23↓	45↓	-14↓	**39↓**

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

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

Capital value expectations for the next 12 months improved for Office property (1.6% vs. 1.4% in Q3), with the best returns tipped for VIC (2.5%) and NSW (2.0%). Industrial values are also expected to be higher (1.1% vs. 0.9% in Q3) with SA/NT (3.8%) and VIC (2.8%) out-performing. In Retail, values are tipped fall (-0.5% vs. -0.6% in Q3), led down by NSW (-1.7%). CBD Hotels values are also expected to fall, but by a more modest -0.3% (-2.5% in Q3).

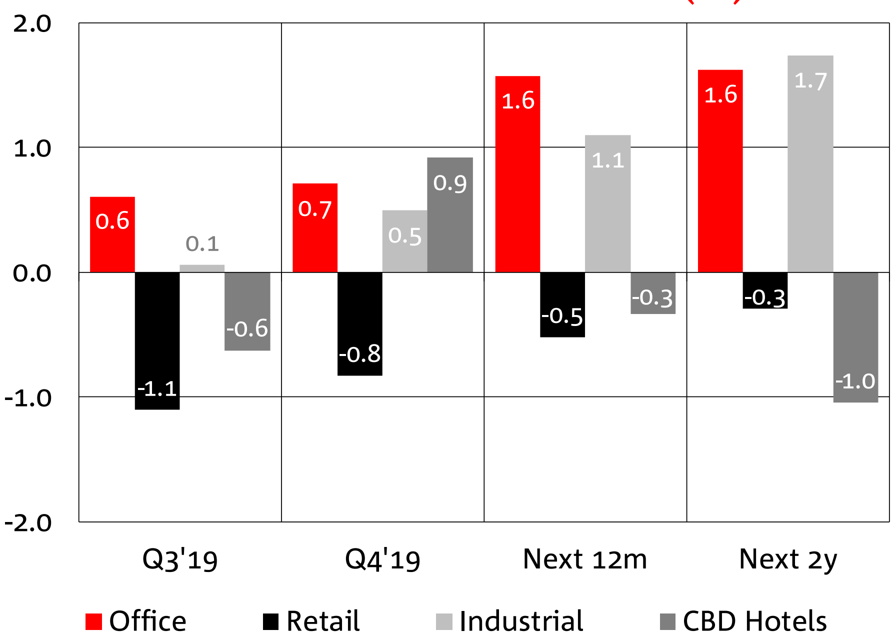
The outlook for capital growth in 2 years' time is now highest for Industrial (1.7%), with VIC (4.3%) the clear standout. Office values are expected to grow 1.6% (1.5% in Q3), led by VIC (2.6%) and WA (2.2%). The outlook for Retail property is broadly unchanged (-0.3% vs. -0.4% in Q3), with NSW (-1.5%) and QLD (-0.8%) under-performing. Expectations for CBD Hotels were also broadly unchanged (-1.0% vs. -0.9% in Q3- **see page 10 for detail**.

The national office vacancy rate inched up to 8.0% in Q4 (7.6% in Q3), but conditions remain very tight in VIC (4.1%) and NSW (4.2%). Vacancy rates were unchanged in QLD (11.4%) and WA (15.0%) but lifted in SA/NT (12.8%). Overall vacancy is expected to inch rise to 8.5% in 2 years' time, with rising vacancy in NSW and VIC (to still low levels) offset by modest tightening in QLD, SA/NT and WA.

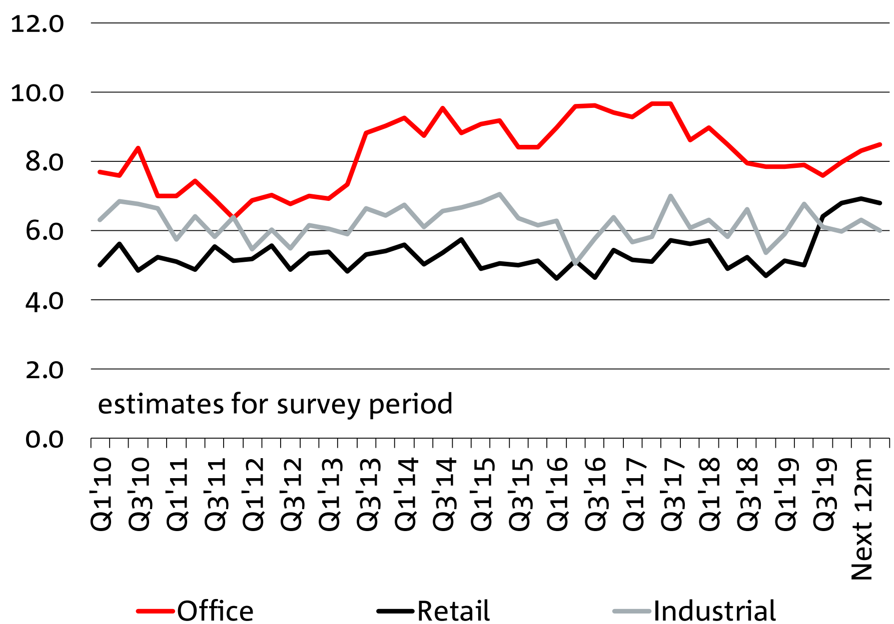
Overall Retail vacancy hit a new survey peak 6.8% in Q4 (after hitting a survey high 6.4% in Q3. Vacancy increased in all states bar NSW (unchanged at 6.1% - its highest level in 3 years). Retail vacancy is expected to be broadly steady over the next 1-2 years, with rising vacancy in SA/NT and VIC offset by lower vacancy in all other states.

Industrial vacancy was steady at 6.0% in Q4, but tightened in eastern seaboard states amid reports of supply constraints. National vacancy to be broadly steady in the next 1-2 years - **see page 11 for detail**.

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)



MARKET OVERVIEW - RENTS & SUPPLY

Property professionals still expect office and Industrial property to lead the way for rental growth in the next 12 months, on average growing 1.0% and 0.6% respectively. In Office markets, expectations are highest in VIC (1.8%) and NSW (1.5%), with SA/NT (-1.2%) trailing. In the Industrial property sector, rents are expected to grow in VIC (2.4%) and NSW (1.0%) and fall in all others states.

Office property is also expected to record the highest rental growth in 2 years' time (1.4%), with WA (2.1%) and QLD (1.8%) and WA (1.5%) generating the best returns. Industrial rents are forecast to grow 1.2% on average, with VIC clearly out-performing (3.4%).

The outlook for Retail rents in the next 1-2 years is negative at -1.4% and -1.0% respectively, Retail rents are expected to fall in all eastern seaboard states over this period, remain flat in SA/NT and grow modestly in WA - **see page 10 for detail**.

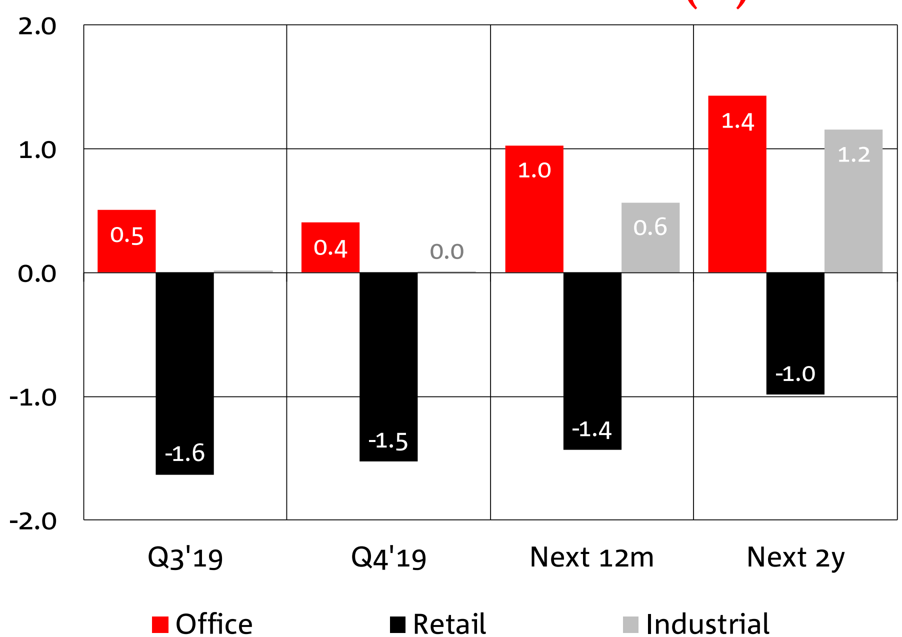
National supply conditions in Office and Industrial markets were 'neutral' in Q4 and will remain so in the next 1-5 years. But big differences by state. The Office market in NSW is currently now under-supplied, but will return to balance in 1-5 years. Over-supply still an issue in WA, but the market tipped to balance in 5 years time. Over-supply in QLD also set to be worked out of market in 3-5 years.

Industrial markets are broadly balanced in the eastern seaboard states and are set to remain so over outlook period, but oversupply is expected to persist in the WA and SA/NT markets.

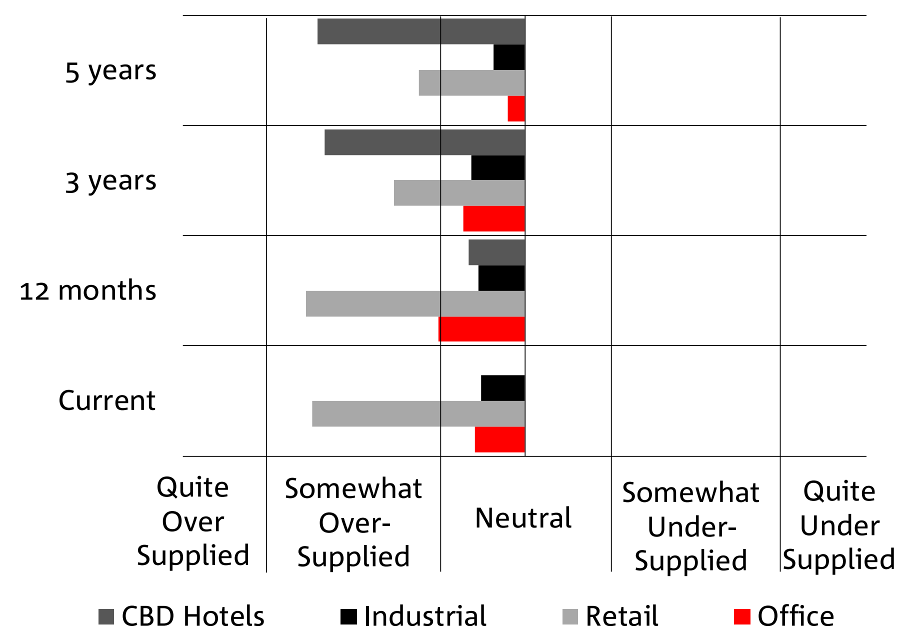
All state Retail markets are currently over-supplied, and are expected to remain so over the next 1-5 years (except in QLD and WA).

Property professionals indicated that the CBD Hotels markets is currently balanced, but will be somewhat over-supplied in the next 1-5 years, amid reports of new supply additions in major markets.

GROSS RENTAL EXPECTATIONS (%)



SUPPLY CONDITIONS



MARKET OVERVIEW - DEVELOPMENT INTENTIONS

The number of property developers expecting to start new works in the next month increased to 13% in Q4 (6% in Q3), and those planning to start in the next 1-6 months to 37% (29% in Q3). Overall, 50% plan to start new works in the short-term (or next 6 months). This is up from just 35% in Q3 and back to average levels (50%).

The number who said they plan to start new projects in the next 6-12 months was broadly unchanged at 26% (28% in Q3). Those planning to start in the next 12-18 months fell sharply to just 3% (18% in Q3), but those with a longer time increased to 12% (10% in Q3).

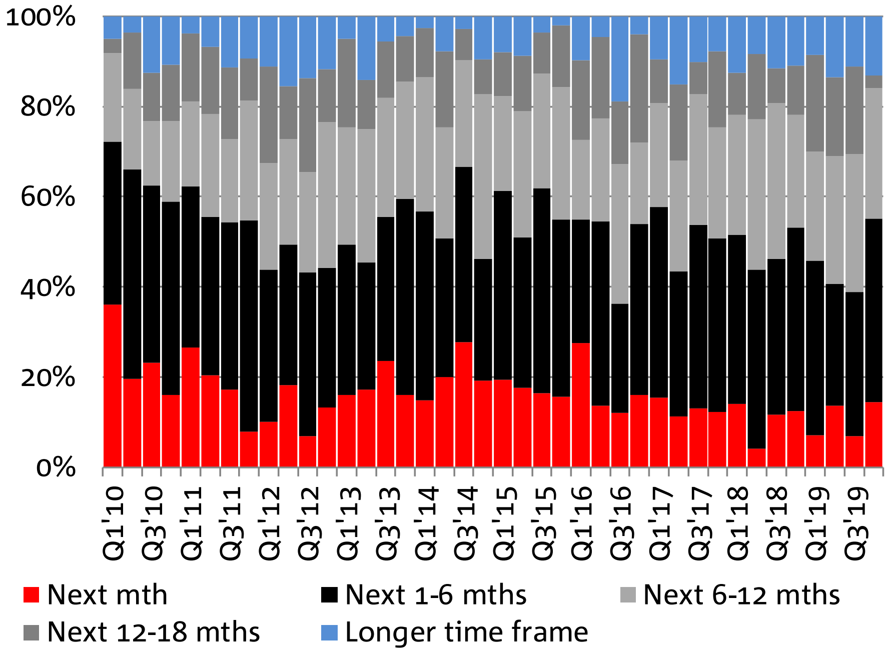
The narrowing in timeframes for new building projects is likely reflecting a number of factors including growing confidence around the property and construction market as lending restrictions eased and interest rates fell during the quarter.

For property developers planning to commence new works, the number targeting residential development projects fell to a survey low 43% in Q4 (47% in Q3), and is now well below the survey average (53%).

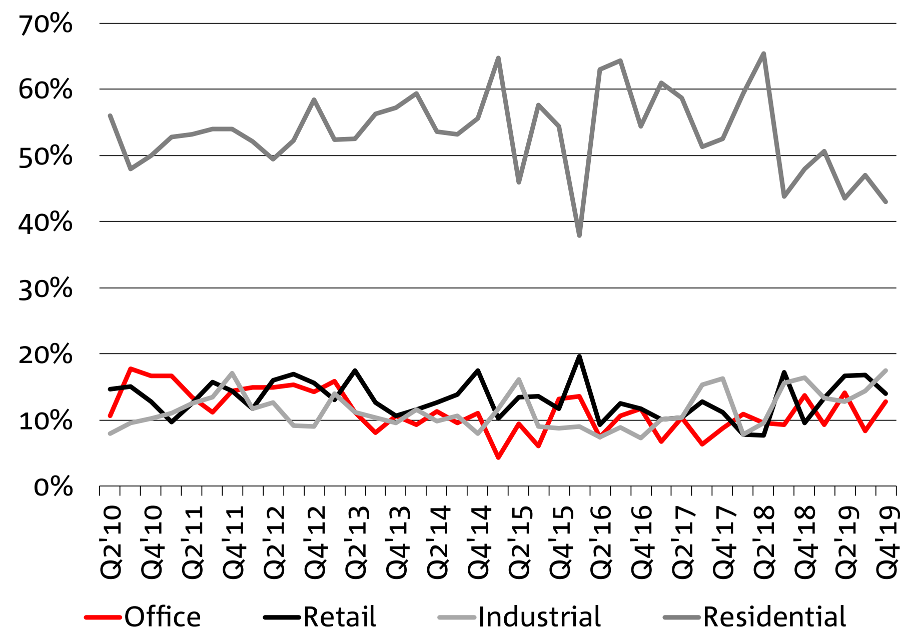
This affirms our own view of the market. On the supply side, we continue to see a fairly rapid adjustment with work done (and the broader national accounts measure of dwelling investment) to continue to decline over 2020. Following a 7% decline this year, we expect dwelling investment to level off.

In other sectors, however property professionals pointed to an above average number of developers targeting Industrial (17%) and Office (13%) property, where continued optimism is likely driving market expansion.

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 increased to an above average 62% in Q4 (53% in Q3).

The number who said they were seeking new acquisitions fell to 21%, from 23% in Q3 and 29% at the same time last year. It was also well below average (26%).

The number of developers looking at refurbishment opportunities also fell to 17%, down from a survey high 19% in Q3, but still ahead of average (11%).

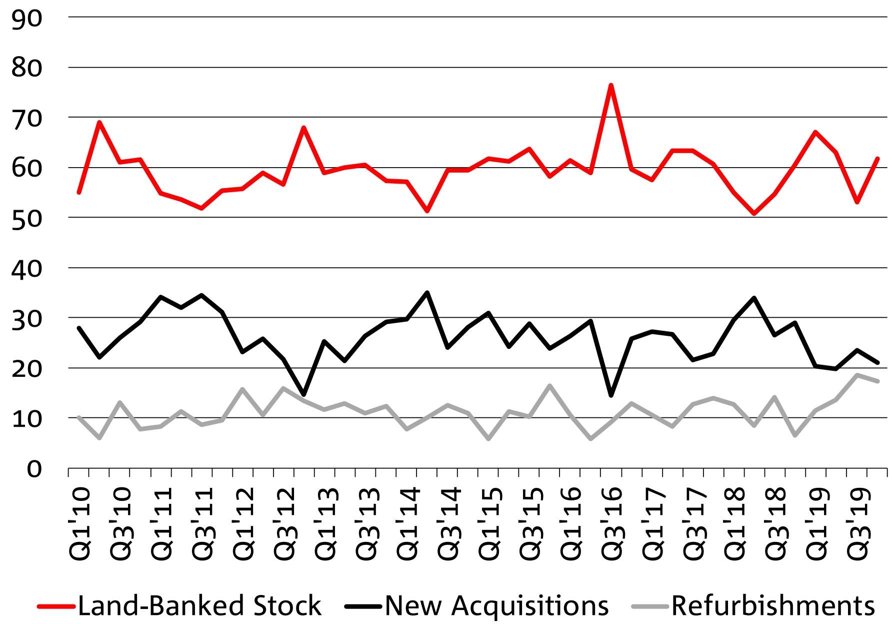
These results suggest developers may be struggling to find feasible sites that stack up.

The number of property developers planning to source more capital to fund their developments in the next 6 months increased slightly to 26% in Q4 (23% in Q3). Around 56% had no intention to source capital in the short-term (59% in Q3) and 17% were unsure (18% in Q3).

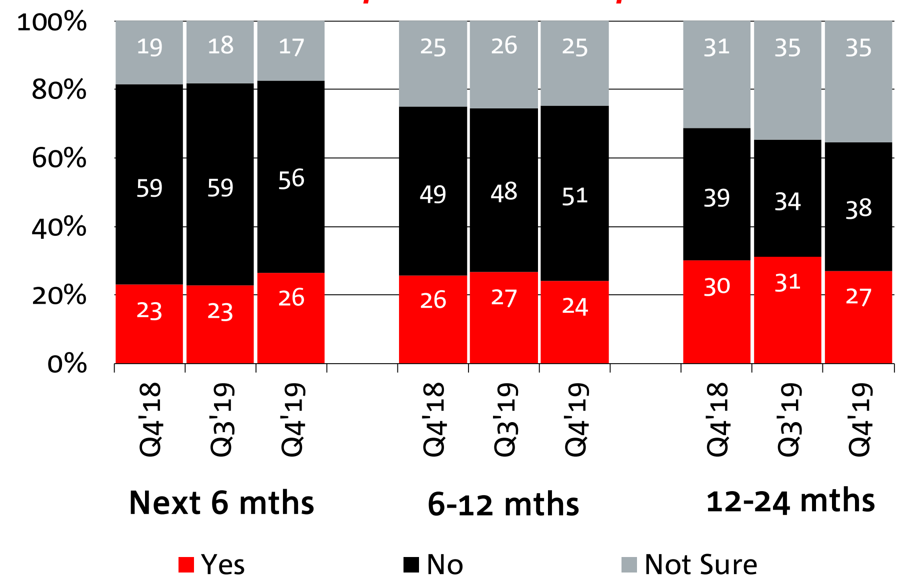
The number planning to source capital in the next 6-12 months fell slightly to 24% in Q4 (27% in Q3), Around 51% had no intention to source funds (48% in Q3) and 25% were unsure (26% in Q3).

Fewer developers intended to source more capital in the next 12-24 months (27% vs. 31% in Q3), but more said no (38% vs. 34% in Q3) and 35% were unsure (unchanged from Q3).

SOURCES OF LAND DEVELOPMENT (%)



INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS



MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

Debt and equity funding conditions have continued to improve. In Q4, the net number of property professionals who indicated it was harder to obtain borrowing or loans (debt) needed for their business fell to -19% (-32% in Q3) - its strongest result since Q1 2016.

The net number of property professionals who said it was harder to obtain equity funding also fell sharply to -12% (-21% in Q3) - also its strongest result since Q2 2017.

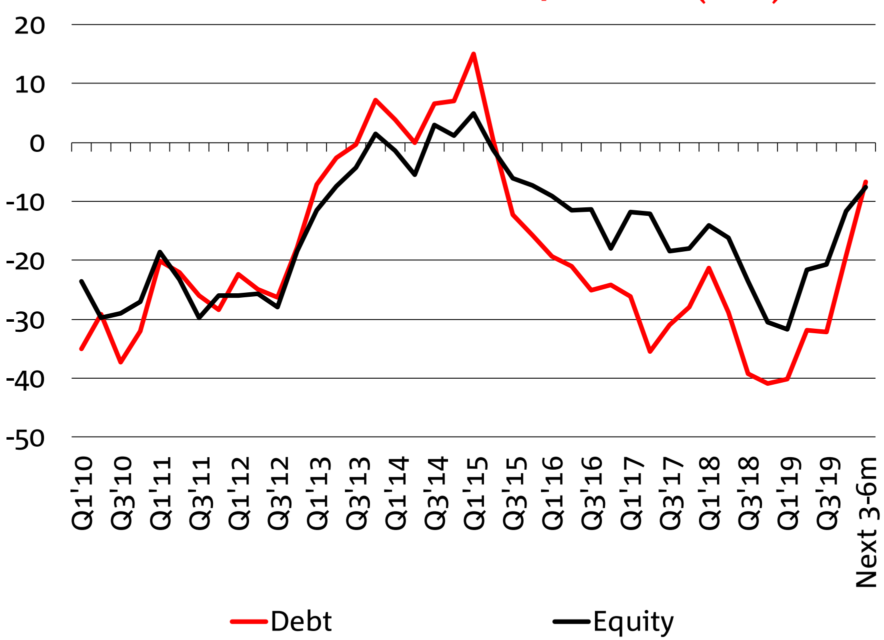
Looking ahead, the outlook is for debt and equity funding conditions to improve further over the next 3-6 months. Only a net -7% of property professionals see debt funding conditions worsening over this timeframe, and -8% said it will be harder to obtain equity financing. This would put funding conditions back to where they were in late-2015/early-2016.

The average pre-commitment to meet external debt funding requirements for new developments across Australia increased to 62.5% for residential property (61.9% in Q3), but fell to 55.3% for commercial property (57.5% in Q3).

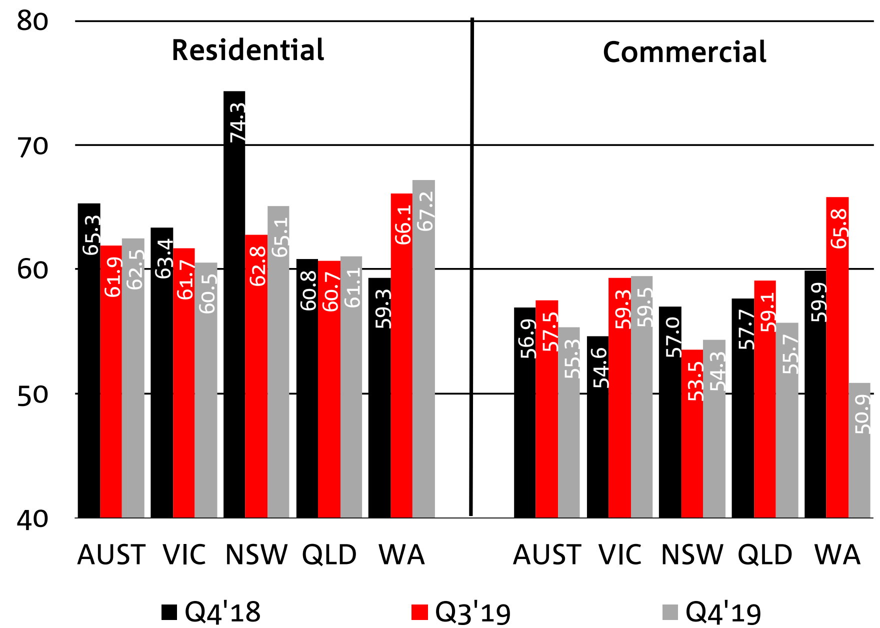
Residential requirements fell in VIC (60.5%), but increased in WA (67.2%), NSW (65.1%) and QLD (61.1%). Commercial property pre-commitments were lower in WA (50.9%) and QLD (55.7%), but increased slightly in VIC (59.5%) and NSW (54.3%).

On balance, more property professionals expect pre-commitment requirements to improve going forward (but less so than in Q3 - a net +3% for residential property in the next 6 months and +4% in 12 months' time (+3% & +21% respectively in Q3), and +2% in 6 months and +4% in 12 months for commercial (+7% & +19% respectively).

EASE OF ACQUIRING DEBT/EQUITY (NET)



PRE-COMMITMENT REQUIREMENTS (%)



SURVEY RESPONDENTS EXPECTATIONS (AVG) Q4-2019

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	0.8	1.4	0.7	-0.8	-0.6	0.7
Q4'20	2.5	2.0	1.5	0.4	0.5	1.6
Q4'21	2.6	1.5	1.6	2.2	1.0	1.6

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	0.9	1.1	0.3	-0.4	-1.8	0.4
Q4'20	1.8	1.5	1.2	0.5	-1.2	1.0
Q4'21	1.4	1.7	1.8	2.1	-0.5	1.4

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	-1.3	-2.5	-0.6	1.4	0.9	-0.8
Q4'20	-0.6	-1.7	-0.7	0.8	0.9	-0.5
Q4'21	0.4	-1.5	-0.8	0.4	0.9	-0.3

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	-2.0	-1.1	-2.1	-1.1	-0.5	-1.5
Q4'20	-2.2	-1.4	-2.0	0.0	0.0	-1.4
Q4'21	-1.3	-1.0	-1.9	0.9	0.0	-1.0

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	2.2	1.0	0.3	-0.8	-2.0	0.5
Q4'20	2.8	1.6	0.8	-0.4	3.8	1.1
Q4'21	4.3	1.4	1.9	0.7	-0.3	1.7

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	1.2	0.4	-0.4	-0.2	-2.3	0.0
Q4'20	2.4	1.0	-0.3	-0.2	-1.3	0.6
Q4'21	3.4	1.6	0.0	0.4	-0.6	1.2

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q4-2019

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	4.1	4.2	11.4	15.0	12.8	8.0
Q4'20	5.0	5.3	10.9	14.8	11.8	8.3
Q4'21	5.9	6.3	10.2	13.3	11.5	8.5

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	6.2	6.1	7.1	7.0	9.5	6.8
Q4'20	7.2	6.3	7.1	6.4	9.5	6.9
Q4'21	7.5	5.8	7.0	5.9	10.0	6.8

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'19	3.8	3.8	5.9	10.6	10.6	6.0
Q4'20	4.6	4.4	5.9	9.8	11.0	6.3
Q4'21	4.6	4.6	5.9	8.6	9.4	6.0

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 330 property professionals participated in the Q4 2019 Survey.

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