EMBARGOED UNTIL 11.30 AM 26 NOVEMBER 2020

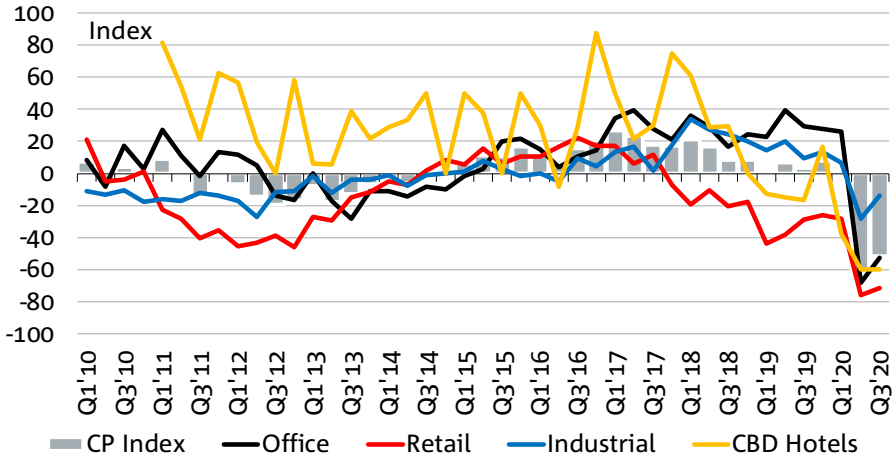
NAB COMMERCIAL PROPERTY SURVEY Q3-2020

Date November 2020 | NAB Behavioural & Industry Economics

KEY FINDINGS

- The COVID-led economic downturn continued to weigh heavily on commercial property market sentiment in Q3. NAB's Commercial Property Index remained deeply negative at -51 points (from a survey low -62 in Q2).
- Sentiment remained weak in most sectors - led by Retail (-71), CBD Hotels (-60) and Office (-53). Industrial was the most resilient market under COVID, with sentiment far less subdued (-14) as rising e-commerce activity continued to support strong demand for warehousing and logistic requirements.
- With uncertainty surrounding the economic outlook, market confidence is very weak. The 12 month measure was -52, and the 2 year measure -29, indicating property experts are not expecting commercial markets to improve soon.
- The 12-month confidence measure is weakest for Retail (-71), followed by Office (-63) and CBD Hotels (-60). The 2 year measure was broadly unchanged at near record lows in Retail -47 and Office -40. But Industrial confidence was positive (and improved) in the next 12 months (+4) and in 2 years' time (+26).
- Market sentiment improved in most states in Q3, but was still deeply negative - ranging from -57 in SA/NT to -28 in WA. VIC was the exception, with sentiment touching a record low -70 in testing local circumstances. Market conditions are also expected to be challenging in the next 1-2 years in all states except WA.
- The outlook for capital growth in Office improved a little in Q3 but is still very weak (-3.0%) in the next 12 months. Expectations are negative in all states, led by VIC (-4.8%). Retail expectations were unchanged at -5.0%, with heavy falls in all states bar WA (flat). Expectations for CBD Hotels also unchanged (-4.5%), and Industrial basically flat (-0.3%), ranging from -1.5% in VIC to 3.8% in SA/NT.
- The national Office vacancy rate lifted to a 2½ year high 9.0% in Q3 (8.5% in Q2), driven by an increase in QLD (11.8%). Overall vacancy is expected to climb further to around 10% in the next 1-2 years, with increases in VIC (around 8.7%), NSW (around 8%) and QLD (around 13½%).
- With many commercial tenants still struggling in a challenging economic environment, the rental outlook remains weak for Retail and Office property. The outlook for Industrial rents has however improved.
- Overall, a below average 79% of property developers plan to start new projects within the next 18 months, suggesting the disruption caused by COVID will continue to impact the construction industry in the near to medium-term.
- Property experts said their debt funding conditions worsened in Q3, with the net number who said it was harder to obtain debt rising to -31% (-27% in Q2). The net number who said it was harder to obtain equity financing however improved a little to -22% (-25% in Q2). Property experts do not see any improvement in debt and equity funding conditions over the next 3-6 months.
- New research revealed that over 1 in 3 Industrial property experts believe rent collections were unchanged or increased in Q3. Around 1 in 2 estimate enquiry levels had also not changed or increased, with enquiry driven by logistics (83%) and supply chain businesses ()67%. Around 1 in 4 industrial businesses are also preparing for future expansion in 2021 and beyond.
- Survey respondents who considered VIC the most important state to their business were asked how their business reacted to Stage 4 Lockdown. Almost 1 in 2 said there was no change. The impact was most significant for their labour force, with 1 in 3 reducing their workforce by some degree. Around 12% shut down their business for the entire lockdown period, and 5% said the long-term viability of their business was permanently impacted.
- Their main concerns from a business perspective to lockdown were about maximising sales and no open homes (17%) and funding or cashflow (15%).

NAB COMMERCIAL PROPERTY INDEX



	Q2'20	Q3'20	Next 12m	Next 2y
Office	-68	-53	-63	-40
Retail	-76	-71	-71	-47
Industrial	-28	-14	4	26
CBD Hotels	-60	-60	-60	-40
CP Index	**-62**	**-51**	**-52**	**-29**

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

Despite a modest improvement, the COVID-led economic downturn continued to weigh heavily on commercial property market sentiment in Q3. NAB's Commercial Property Index (a measure of sentiment based on expectations for capital values and rents) remained deeply negative at -51 points, up from a survey low -62 points in Q2.

Sentiment was very weak in most market sectors - led by Retail (-71), CBD Hotels (-60) and Office (-53) - sectors most negatively impacted because of changing work arrangements (from office to home), new social distancing norms and limits on hospitality and retail, and ongoing border and travel restrictions that saw occupancy rates in CBD Hotels down to 42.5% (compared to a survey average 74.8%).

The downturn in Industrial property market sentiment was however more subdued (-14), as rising e-commerce activity continued to support strong demand for warehousing and logistic requirements.

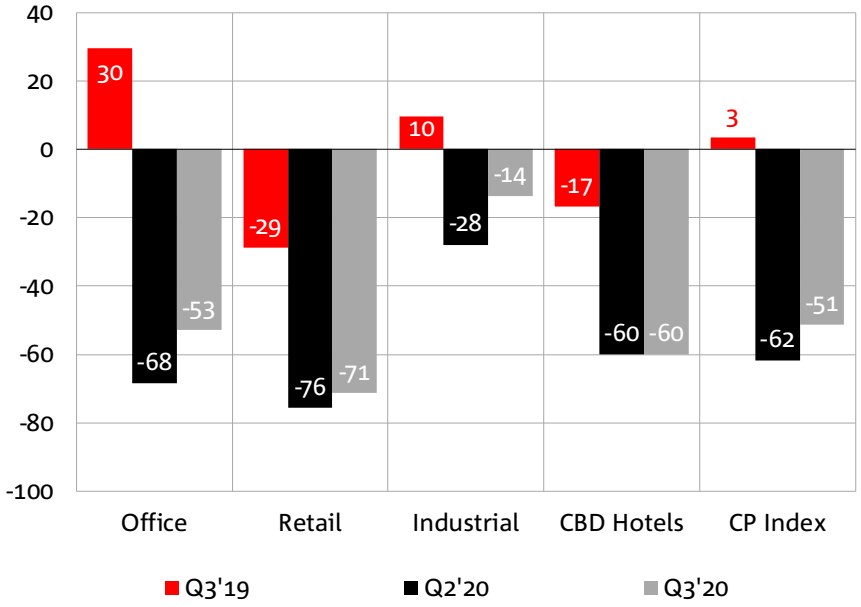
With large uncertainties still surrounding the economic outlook, overall market confidence is also still weak. The 12 month measure fell stood at -52, and the 2 year measure at -29, suggesting property experts do not expect to see a marked improvement in commercial property markets any time soon.

The 12-month confidence measure was weakest for Retail (-71) property, followed by Office (-63), with confidence levels in both sectors little changed from the record low levels reported in Q2. The 2-year measure was also broadly unchanged at near record lows in both sectors (Retail -47; Office -40).

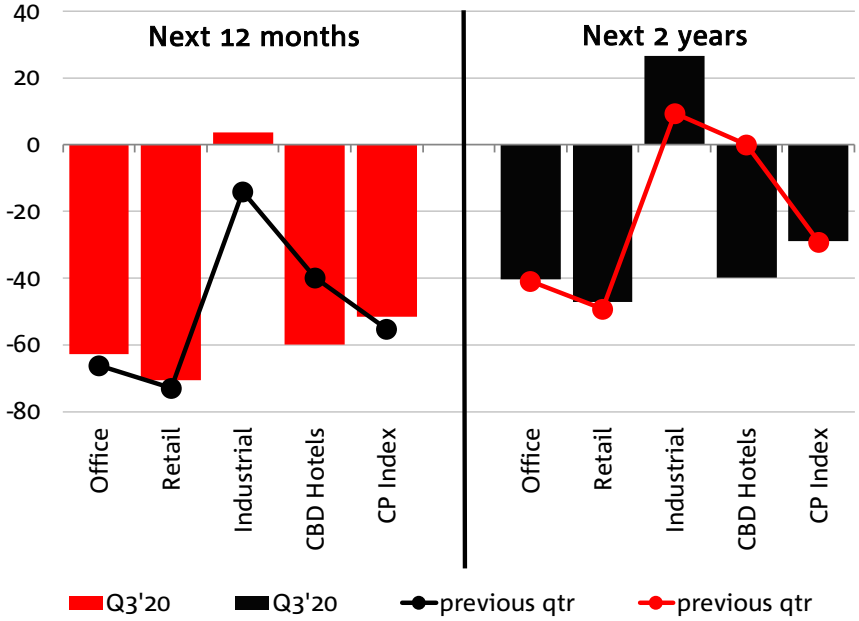
In CBD the Hotels sector, short-term confidence fell to -60 (-40 in Q2), with long-term confidence also revised down heavily to -40 (flat in Q2), as expectations around capital growth were cut.

Confidence in industrial property is however positive (and higher) in both the next 12 months (+4) and in 2 years' time (+26).

NAB COMMERCIAL PROPERTY INDEX



NAB CP INDEX - NEXT 1-2 YEARS



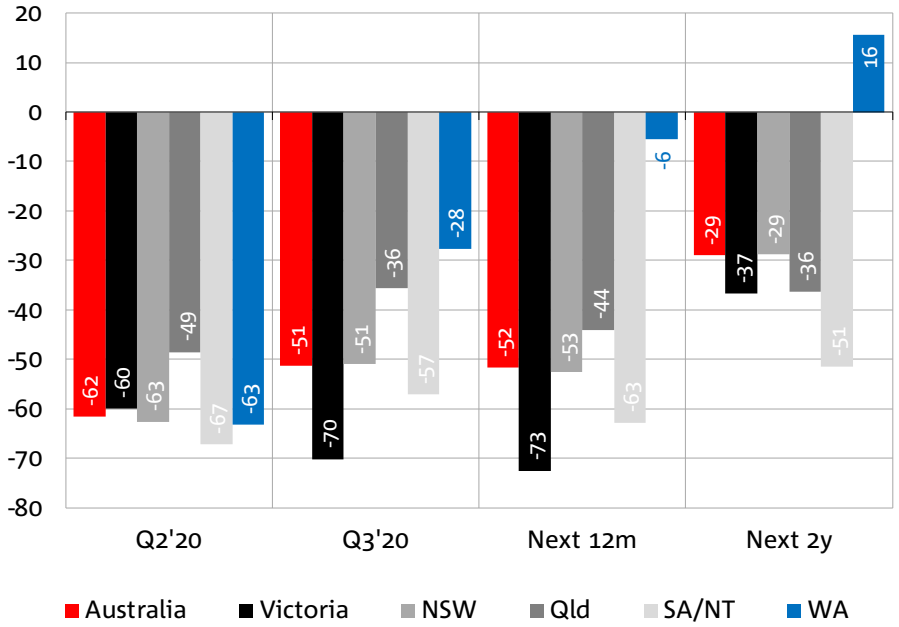
MARKET OVERVIEW - INDEX BY STATE

Market sentiment improved in most states in Q3, but is still deeply negative - ranging from -57 in SA/NT to -28 in WA. VIC was the exception, with sentiment falling to a record low -70 in testing local circumstances.

Property professionals expect market conditions to remain challenging over the next 1-2 years. Short-term confidence is still very weak in most states, ranging from -73 in VIC to -6 in WA. Longer-term confidence is also negative across the country, except in WA (+16), with VIC, NSW and QLD weakening further relative to Q2.

The table on the right shows that current market sentiment and confidence readings were essentially negative in all states in both the Office and Retail property market sectors (except in WA where the outlook is positive in both sectors). But the outlook for Industrial property is essentially positive in all states except VIC.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX: STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-79↓	-54↑	-35↑	-46↑	-50	**-53↑**
Q3'21	-88↓	-69↓	-53↑	-21↑	-71↓	**-63↑**
Q3'22	-48↑	-46↓	-45↑	4↑	-57↓	**-40↑**

RETAIL PROPERTY MARKET INDEX: STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-83↓	-75↑	-79↔	-19↑	-100↓	**-71↑**
Q3'21	-90↓	-72↑	-82↓	6↑	-100↓	**-71↑**
Q3'22	-65↓	-31↓	-66↓	25↑	-100↓	**-47↑**

INDUSTRIAL PROPERTY MARKET INDEX: STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-20↓	2↑	-14↔	-18↑	-36↑	**-14↑**
Q3'21	-27↓	32↑	7↓	5↑	-21↑	**4↑**
Q3'22	-3↓	45↑	32↑	32↓	7↑	**26↑**

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

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

The outlook for capital growth in Office markets improved a little in Q3 but is still very weak, with values expected to fall -3.0% in the next 12 months (-4.4% in Q2). Expectations are negative in all states, led by VIC (-4.8%). Retail expectations were unchanged at -5.0%, with heavy falls expected in all states bar WA (flat). Expectations for CBD Hotels were also unchanged (4.5%). Industrial values are expected to fall slightly (-0.3%), but range from -1.5% in VIC to 3.8% in SA/NT.

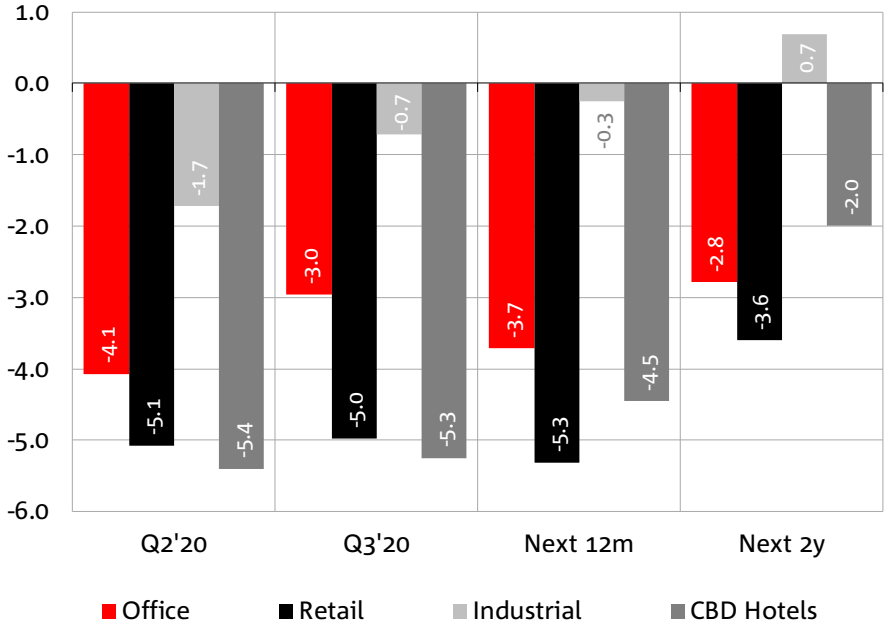
The outlook in 2 years' time is positive for Industrial property (0.7%), with NSW (1.5%) leading the way and VIC under-performing (-0.9%). Expectations for CBD Hotels weakened (-2.0%), reversing expectations for a flat outcome in Q2. Expectations are weakest for Retail (-3.6% vs. -2.8% in Q2), led by SA/NT (-6.3%) and QLD (-5.1%). Office expectations were largely unchanged at -2.8%, with values tipped to fall around -3½% in VIC and NSW - **see page 13 for detail**.

The national Office vacancy rate lifted to an equal 2½ year high 9.0% in Q3 (8.5% in Q2), as modest tightening in VIC (7.1%), NSW (6.2%), SA/NT (9.3%) and WA (12.3%) was offset by higher vacancy in QLD (11.8%). Overall, Office vacancy is expected to climb to around 10% over the next 1-2 years, mainly due to increases in VIC (around 8.7%), NSW (around 8%) and QLD (around 13½%).

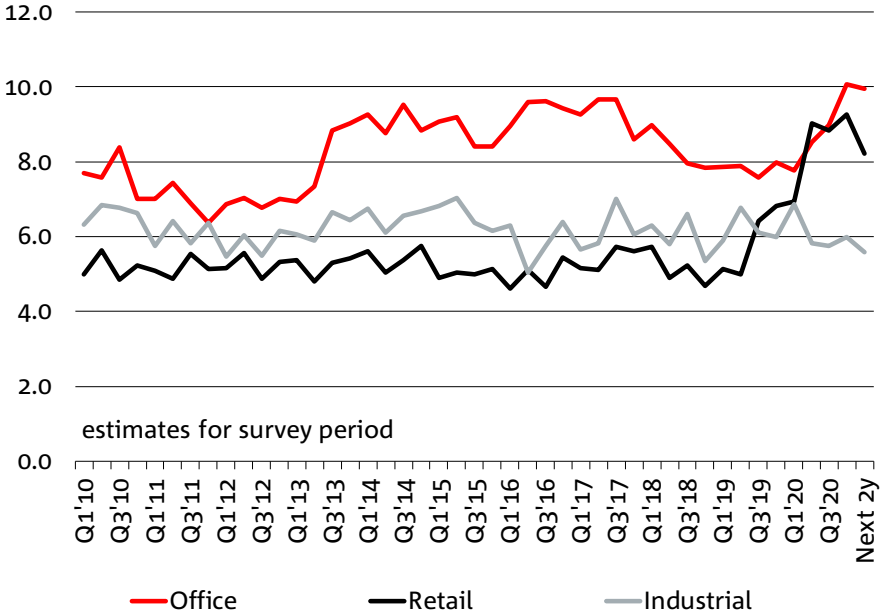
Overall Retail vacancy remained at a near survey high at 8.8% in Q3, despite improvement in NSW (7.7% vs. 9.7% in Q2). Overall vacancy is expected to climb to 9.3% next year, before easing to 8.2% in 2 years' time, with all states passing through their expected peak.

The industrial sector remains the most insulated, with vacancy broadly unchanged at 5.7% in Q3 - and falling in VIC (3.8%) and NSW (4.7%). Industrial vacancy is also expected to remain steady at around 5½-6% over the next 1-2 years - **see page 14 for detail**.

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)



MARKET OVERVIEW - RENTS & SUPPLY

With many commercial tenants still struggling in the wake of the COVID-led economic downturn, the rental outlook remains weak for Retail and Office property. Over the next 12 months, rents are expected to fall -6.2% in Retail and -3.5% in Office.

Rental growth is expected to continue falling in both sectors over the next 1-2 years, and in all states, with VIC (next 12 months at -4.9%) and QLD and SA/NT (in 2 years at -3.5%) under most pressure in Office markets, and SA/NT (around -9%) in Retail markets

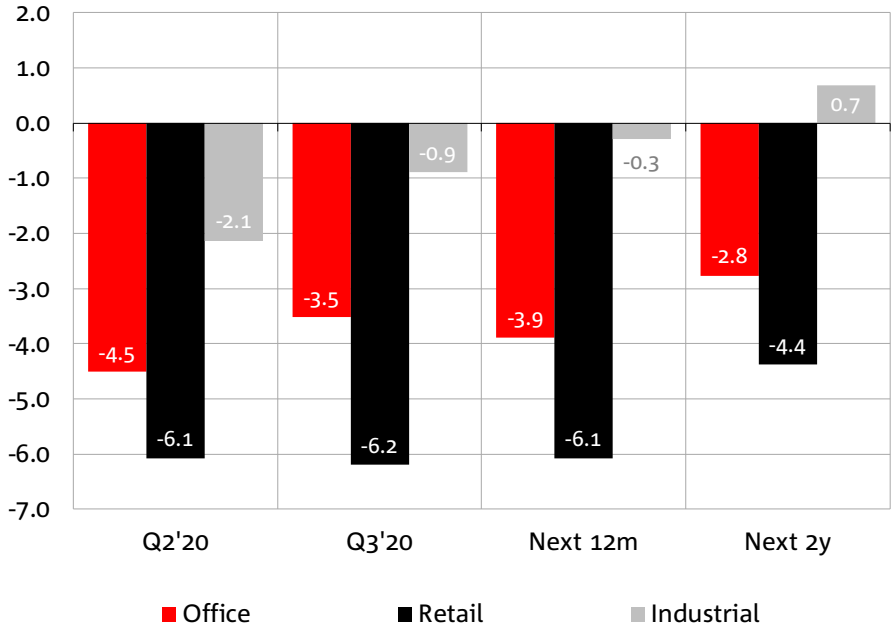
The outlook for Industrial rents has improved, with rents expected to now fall just -0.3% in the next 12 months (-1.4% in Q2), with growth of 0.9% predicted in NSW. Rents are expected to grow by around 0.7% in 2 years' time (flat in Q2), with positive or flat outcomes predicted in all states except VIC (-0.5%) - **see page 13 for detail**.

The supply over-hangs that emerged in all sectors (bar Industrial) last quarter have persisted, with both CBD Hotels and Retail markets (in all states) also assessed as "quite" over-supplied. Industrial market supply is currently "neutral".

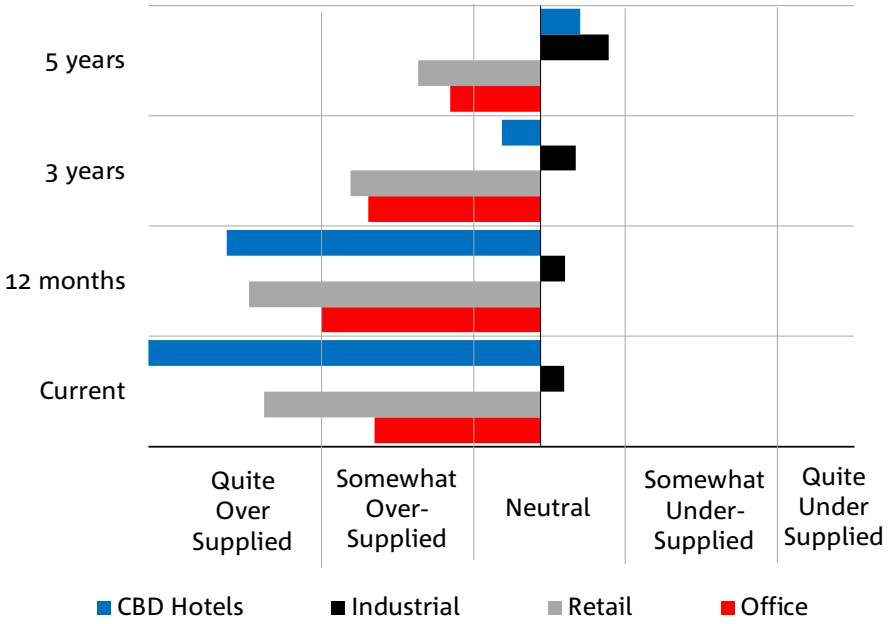
Property professionals see Office markets remaining "somewhat" over-supplied over the next 1-5 years in all states bar NSW ("neutral" in 5 years). Over-supply is expected to persist in Retail in all states in the next 1-5 years, bar VIC ("neutral" in 5 years).

Industrial markets are expected to remain in balance over the next 1-5 years, except in NSW ("somewhat" under-supplied), with under-supply also emerging in VIC and QLD in 5 years. Property professionals also expect excess supply in CBD Hotels to work out of the market in 3 years' time.

GROSS RENTAL EXPECTATIONS (%)



SUPPLY CONDITIONS



MARKET OVERVIEW - DEVELOPMENT INTENTIONS

The number of property developers expecting to start new works in the next month was basically unchanged at 15% (14% in Q2), but those planning to start in the next 1-6 months fell to 25% (30% in Q2). Overall, 39% plan to start new works in the short-term (next 6 months) down from 30% in Q2 - and well below the survey average (49%). But 26% now also plan to start new projects in the next 6-12 months (13% in Q2 but still below the survey average 36%), and 12% in the next 12-18 months (22% in Q2).

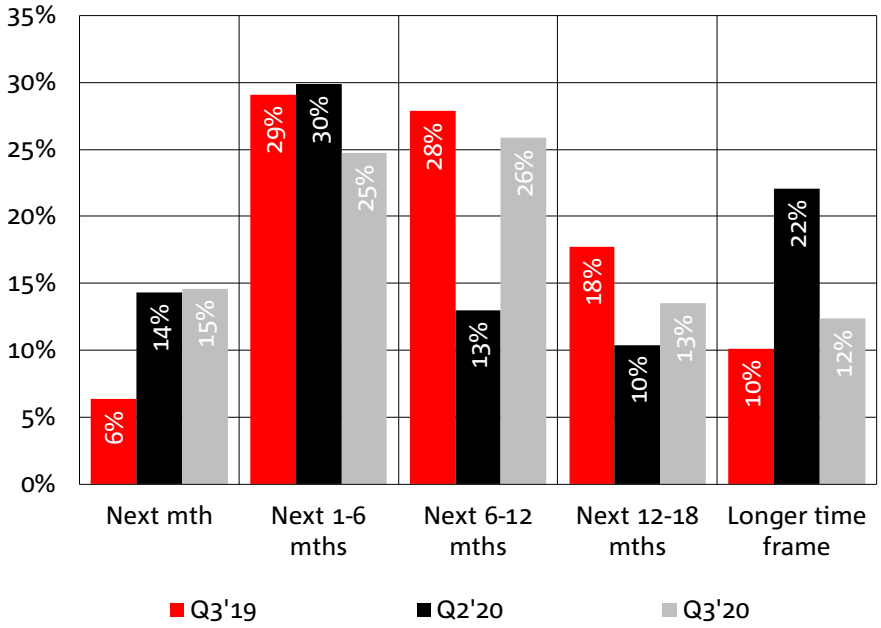
Overall, only 79% plan to start new projects within the next 18 months (survey average 85%), suggesting the economic disruption caused by COVID will continue to impact the building construction industry over the near to medium-term.

Among property developers planning to start new works, the number who said they were targeting residential developments rose to 53% (46% in Q2) - in line with the survey average.

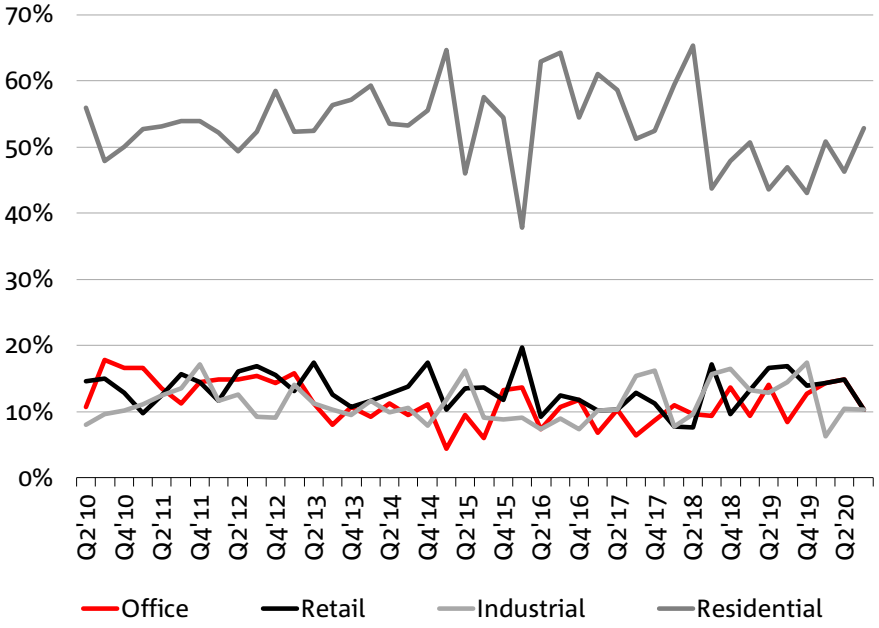
Building approvals have also risen in recent months (likely supported by the Government's HomeBuilder scheme), but they are still low compared to recent history. As such high rates of work done are likely to continue to erode the pipeline of work, we expect dwelling investment to keep falling in the near-term before stabilising.

In other sectors , intentions were unchanged for Industrial property (10%). But the number of developers who indicated they were looking at starting new Office or Retail projects dropped by one-third - from 15% to 10%.

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 fell to a below average 55% in in Q3 (65% in Q2 and 53% at the same time last year).

As the economic downturn continues to hurt commercial property prices, the number of property developers who said they were seeking new acquisitions in Q3 rose sharply to 31% (from 24% in Q2 and 23% at the same time last year). This was the first time this number rose above survey average levels in almost 2 years.

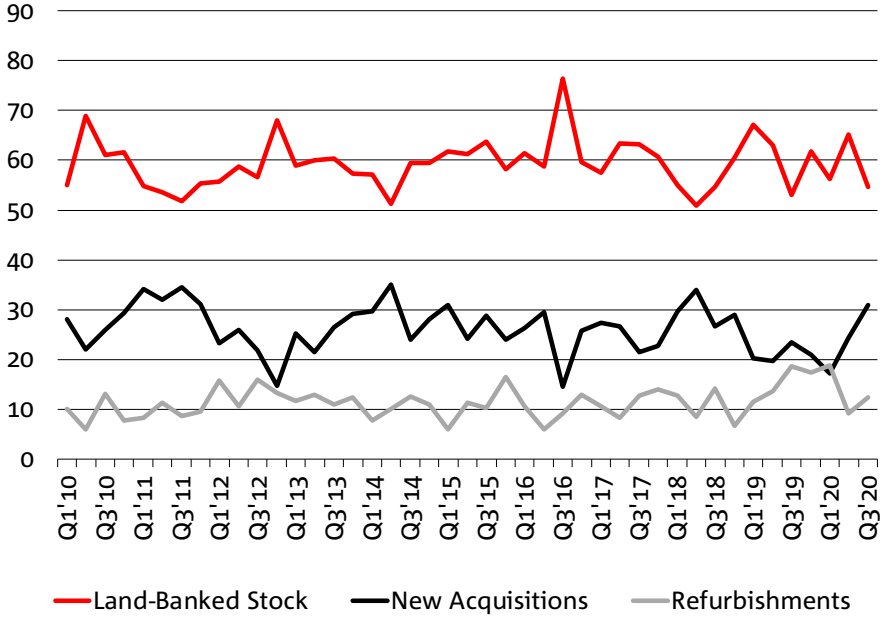
The number looking at refurbishment opportunities also rose slightly to 12% (from 9% in Q2 but down from 19% at the same time in 2019).

In line with an increase in the number of developers planning to start new works in the next 6 months, the number of developers planning to source more capital to fund them in this time period also rose to 25% (21% in Q2). Around 59% had no intention to source capital in the short-term (63% in Q2).

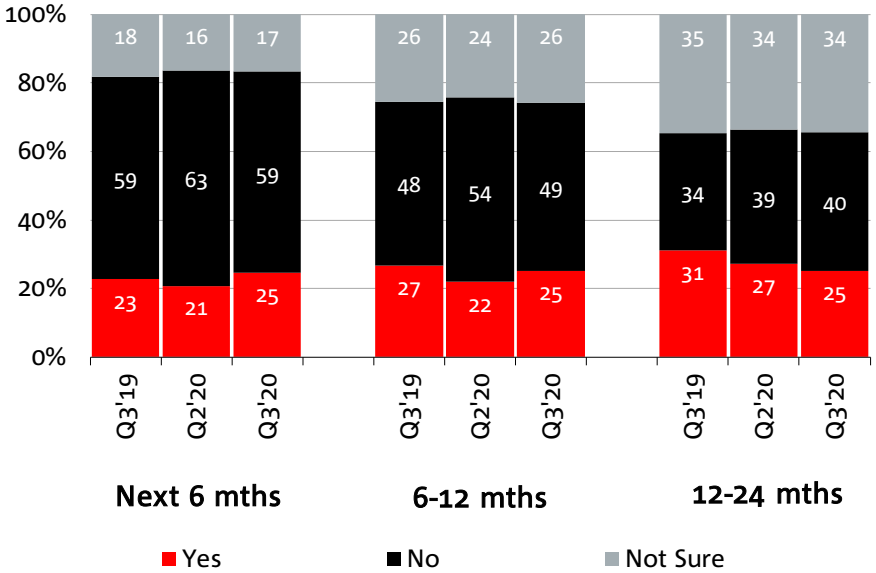
The number planning to source capital in the next 6-12 months also rose slightly to 25% (22% in Q2), while 49% had no intention to source funds (54% in Q2). Around 1 in 4 developers were unsure.

Slightly fewer developers intend to source more capital in the next 12-24 months (25% vs. 27% in Q2), while the number who were unsure was unchanged at 40%.

SOURCES OF LAND DEVELOPMENT (%)



INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS



MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

With lenders reportedly reining in their exposure to the hard hit Retail and Office property market sectors amid pressure on landlords and owners, property experts also indicated their debt funding conditions worsened further in Q3.

The net number who said it was harder to obtain borrowing or loans (debt) needed for their business out-weighed those who said it was easier rose to -31% in Q3 (-27% in Q2).

But the net number who said it was harder to obtain equity funding improved a little to -22% (-25% in Q2), as equity markets continued to recover previously lost ground.

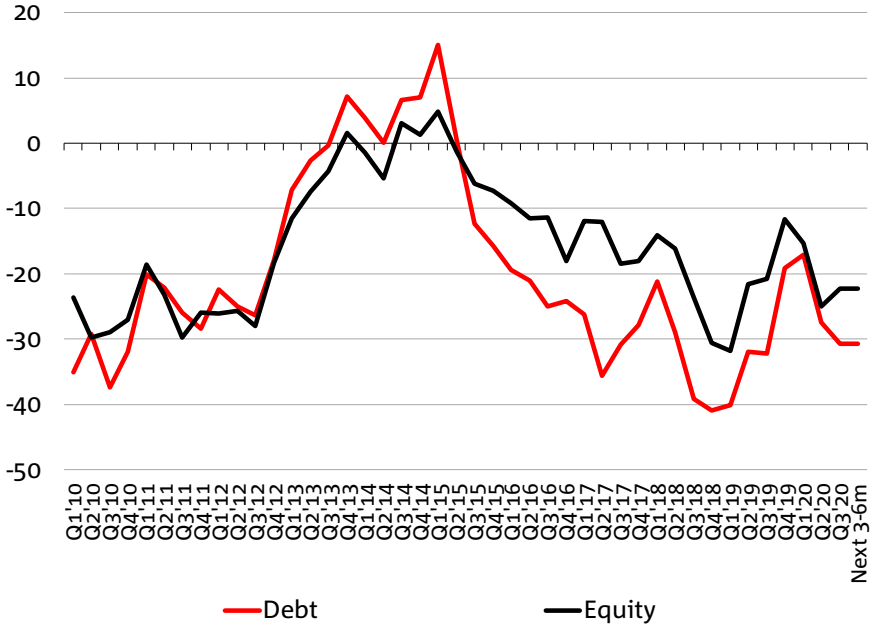
On average, property professionals expect debt and equity funding conditions in the next 3-6 months to remain unchanged from current levels over the next 3-6 months.

Despite persistent market uncertainty, the average pre-commitment to meet external debt funding requirements for new developments across Australia fell in both residential (64.1%) and commercial (59.4%) property in Q3.

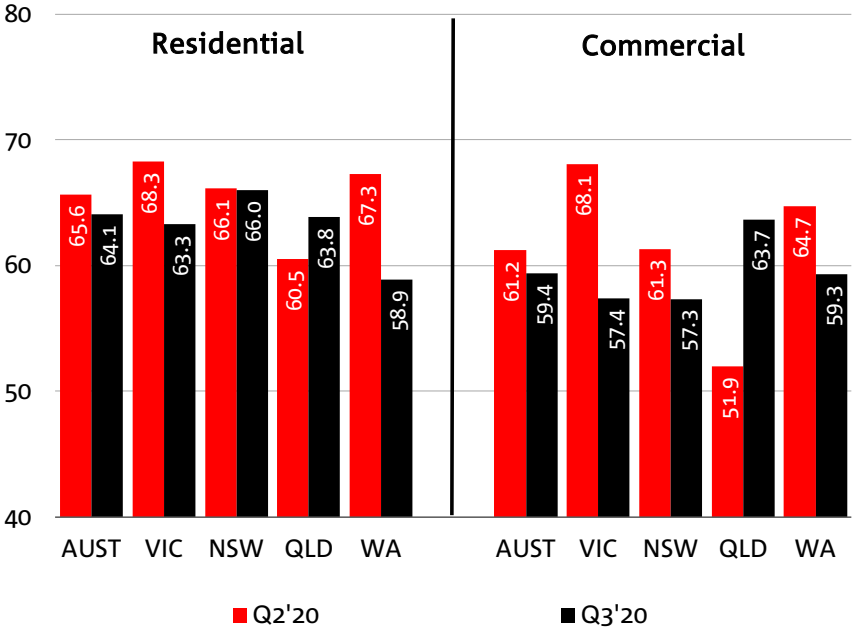
Residential requirements fell in VIC (63.3%) and WA (58.9%), were unchanged in NSW (66.0%) and rose in QLD (63.8%). Commercial pre-commitments also fell in all states (bar QLD), and was lowest in NSW (57.3%) and VIC (57.4%) - by some margin.

Looking ahead, the net number expecting requirements to worsen compared to those expecting an improvement for residential property was -27% in the next 6 months and -15% in the next 12 months (-30% & -15% in Q2). For commercial property, it was -29% in 6 months and -20% in 12 months (-31% & -20% in Q2).

EASE OF ACQUIRING DEBT/EQUITY (NET)

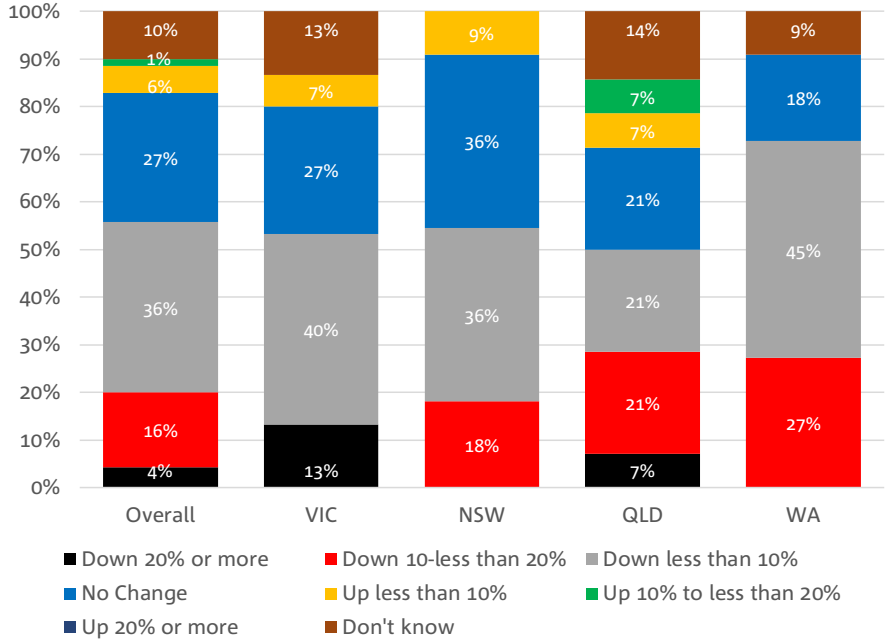


PRE-COMMITMENT REQUIREMENTS (%)

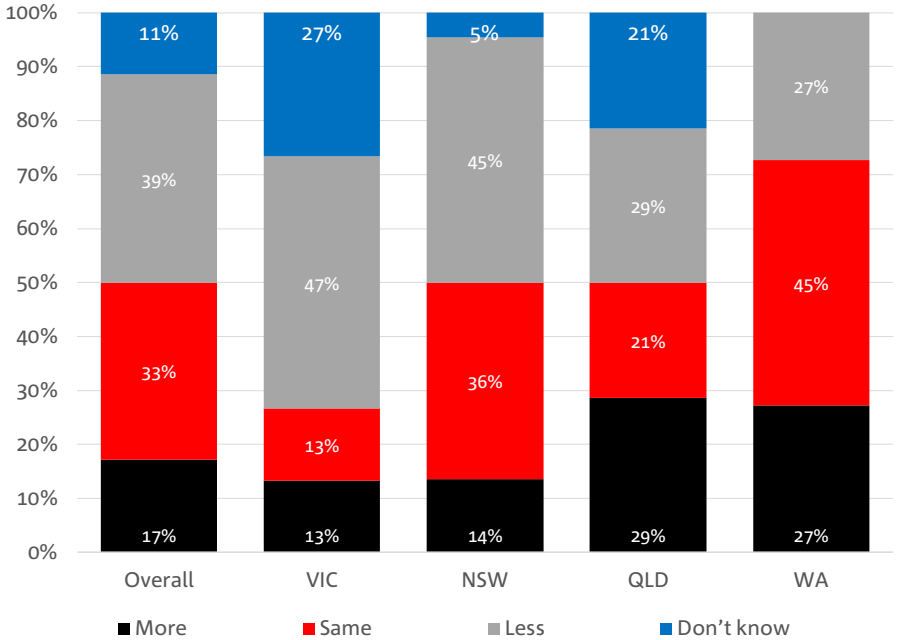


SPECIAL QUESTIONS: INDUSTRIAL PROPERTY

WHAT CHANGE HAVE YOU SEEN IN RENT COLLECTED FROM INDUSTRIAL PROPERTIES



HOW HAS THE LEVEL OF ENQUIRY IN INDUSTRIAL PROPERTY MARKETS CHANGED RECENTLY?



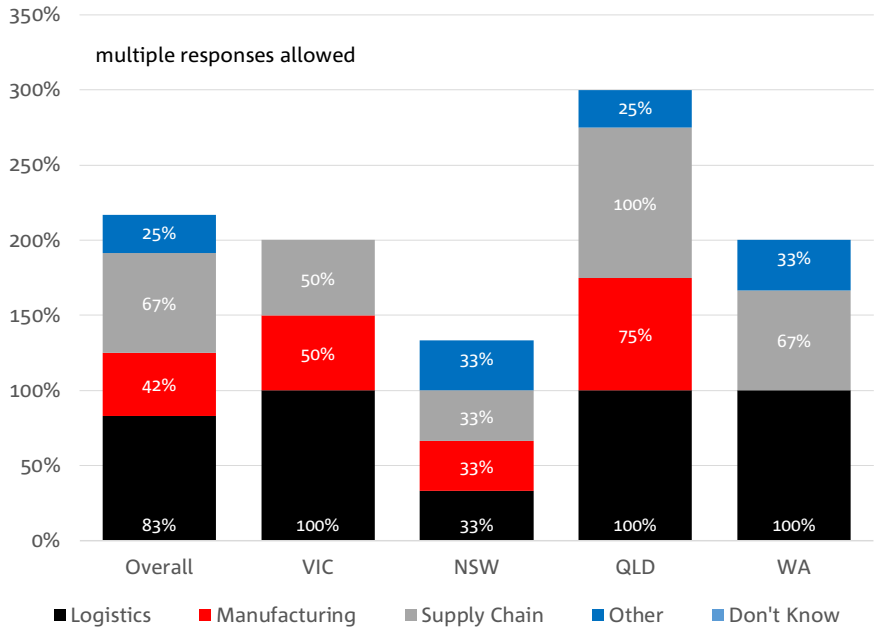
The COVID-19 pandemic had a sudden and significant impact on local commercial property markets. But the impact has been muted in the industrial property space, which has benefited from strong demand for warehousing and logistics requirements with the rapid increase in online sales.

Consequently, while rental collections fell heavily in Retail property (see NAB Commercial Property Survey Special Question on Impact of COVID on Retail), over 1 in 3 property professionals operating in the Industrial space estimate their was no change in rent collected (27%) or had increased (7%) from industrial properties (compared to less than 1 in 10 in Retail formats like Strip, Regional and Neighbourhood shopping centres). In NSW, that number climbed to 45% in NSW, but in WA was much lower at just over 18%.

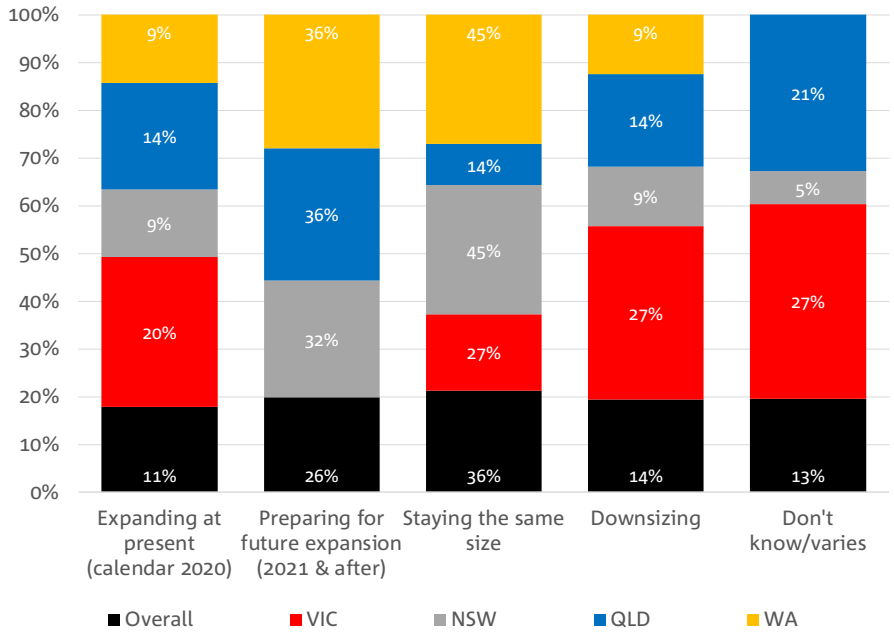
In addition, when asked how the level of enquiry around Industrial property has changed recently, 1 in 2 property professionals said it had remained the same (33%) or increased (17%). By state, this number ranged from 66% in WA, where around 7 in 10 said enquiry levels had been maintained (45%) or increased (27%), to just 26% overall in VIC where local markets were hamstrung by lockdown conditions which restricted business movement.

SPECIAL QUESTIONS: INDUSTRIAL PROPERTY (CONTINUED)

FROM WHAT TYPES OF INDUSTRIAL BUSINESSES HAVE YOU HAD MORE ENQUIRIES?



WHICH STATEMENTS BEST DESCRIBES INDUSTRIAL BUSINESSES IN YOUR STATE?

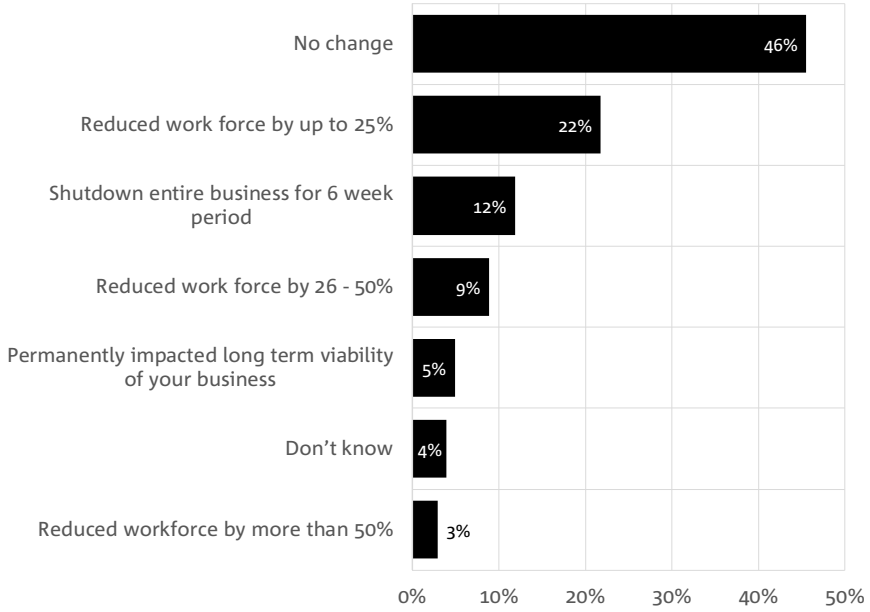


With traditional brick-and-mortar retailers moving online at a faster rate because of COVID, it is not surprising that demand for industrial property is being driven by logistics and warehousing businesses. When property professionals who indicated enquires had risen were asked from what types of businesses they had more enquires from, over 8 in 10 (83%) said they came from logistics businesses and 2 in 3 (67%) from supply chain businesses. Around 4 in 10 (42%) were from Manufacturing and 1 in 4 (25%) from Other businesses. By state however noticeably more industrial market participants in QLD said enquires had come from manufacturing (75%) and supply chain businesses (100%) than in other states, whereas those in NSW said the balance was mixed across logistics, manufacturing, supply chain and other businesses. In VIC and WA, it was mainly driven by logistics firms.

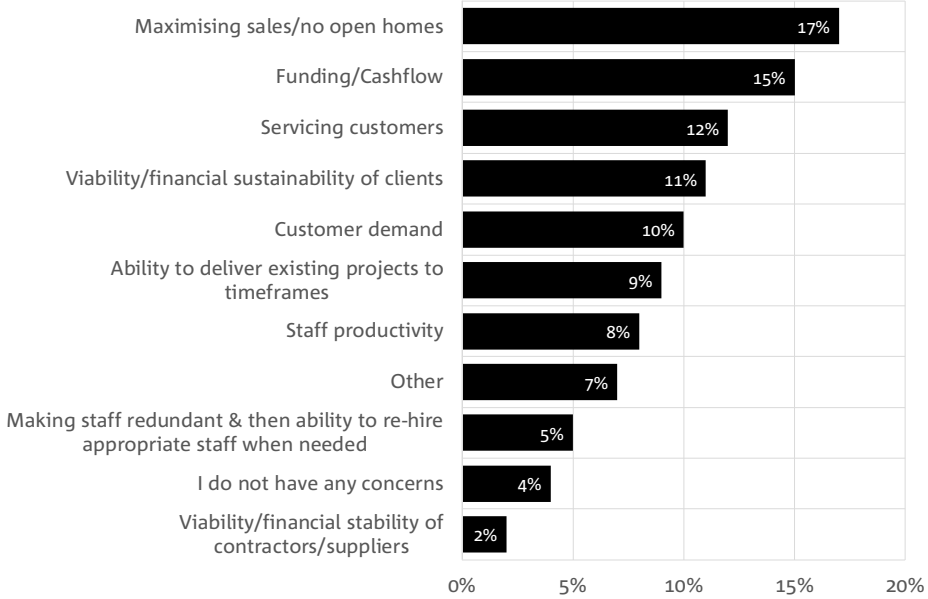
Finally, industrial market participants were asked to best describe the state of their local market. Overall, around 1 in 3 (36%) business said things were staying the same, but that ranged from 45% in WA and NSW to just 14% in QLD. One in 4 (26%) industrial businesses were preparing for future expansion in 2021 and beyond, with this number somewhat higher in WA (36%) and QLD (36%), with no one from VIC selecting this response. Around 1 in 10 (11%) industrial businesses said they were expanding at present, but that number doubled in VIC (20%). Around 14% overall were downsizing, but that number almost doubled to 27% in VIC, and was lowest in WA (9%) and NSW (9%).

SPECIAL QUESTIONS: LOCKDOWN IMPACT ON VIC BUSINESSES

IN TERMS OF BUSINESS OPERATIONS HOW HAS YOUR BUSINESS REACTED TO STAGE 4 LOCKDOWN VICTORIA?



WHAT IS YOUR MAIN CONCERN FROM A BUSINESS PERSPECTIVE TO STAGE 4 LOCKDOWN VICTORIA?



Survey respondents who considered VIC to be the most important state to their business were asked how their business reacted to the announcement by the Victorian government to the Stage 4 Lockdown. Almost 1 in 2 (46%) indicated there was no change. The reaction was most significant for their labour force, with 34% of all businesses signalling they intended to cut back - over 1 in 5 (22%) by up to a quarter, 9% by 26-50%, and a further 3% by more than 50%. Over 1 in 10 (12%) businesses said they would shut down their business for the entire lockdown period, and 1 in 20 (5%) indicated the long-term viability of their business was permanently impacted.

When asked about their main concerns from a business perspective to the lockdown, most worried about maximising sales and no open homes (17%) and funding or cashflow (15%). Other key concerns revolved around servicing customers (12%), the viability or sustainability of their customers (11%), customer demand (10%), the ability to deliver existing projects on time (9%) and staff productivity (8%). The impact was clearly pervasive with only 4% indicating they had no concerns.

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q3-2020

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-3.6	-2.9	-3.4	-2.4	-1.5	-3.0
Q3'21	-4.8	-3.7	-3.7	-2.4	-3.2	-3.7
Q3'22	-3.4	-3.4	-3.3	0.0	-2.6	-2.8

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-3.4	-3.4	-3.3	0.0	-1.5	-3.0
Q3'21	-4.9	-3.8	-4.0	-2.4	-3.2	-3.7
Q3'22	-2.9	-2.6	-3.5	-1.5	-2.6	-2.8

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-5.1	-4.6	-6.3	-1.1	-8.1	-5.0
Q3'21	-5.9	-5.2	-6.8	0.0	-8.1	-5.3
Q3'22	-4.0	-2.9	-5.1	0.6	-6.3	-3.6

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-7.0	-5.3	-6.4	-4.9	-8.8	-6.2
Q3'21	-7.2	-4.8	-6.4	-3.9	-8.8	-6.1
Q3'22	-5.0	-3.6	-5.0	-1.0	-8.8	-4.4

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-0.9	0.0	-0.4	-2.2	-1.0	-0.7
Q3'21	-1.5	0.8	0.2	-1.0	3.8	-0.3
Q3'22	-0.9	1.5	1.1	0.7	0.0	0.7

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	-0.6	0.0	-1.8	-1.4	-1.6	-0.9
Q3'21	-0.9	0.9	-0.7	-0.7	-1.0	-0.3
Q3'22	-0.5	1.3	0.9	1.1	0.0	0.7

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q3-2020

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	7.1	6.2	11.8	13.3	9.3	**9.0**
Q3'21	8.7	7.9	13.0	12.3	10.4	**10.1**
Q3'22	8.7	8.0	13.4	11.0	10.4	**9.9**

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	8.9	7.7	8.5	11.3	10.5	**8.8**
Q3'21	9.0	8.9	9.1	10.4	11.5	**9.3**
Q3'22	8.3	7.7	8.2	8.3	11.0	**8.2**

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q3'20	3.8	4.7	6.8	9.7	6.0	**5.7**
Q3'21	5.0	5.4	6.1	9.4	5.3	**6.0**
Q3'22	5.7	5.4	5.2	8.3	5.7	**5.6**

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 380 property professionals participated in the Q3 2020 Survey.

CONTACT THE AUTHORS

Alan Oster
Group Chief Economist
Alan.Oster@nab.com.au
+(61 0) 414 444 652

Dean Pearson
Head of Behavioural & Industry Economics
Dean.Pearson@nab.com.au
+(61 0) 457 517 342

Robert De Iure
Senior Economist - Behavioural & Industry Economics
Robert.De.Iure@nab.com.au
+(61 0) 477 723 769

Brien McDonald
Senior Economist - Behavioural & Industry Economics
Brien.McDonald@nab.com.au
+(61 0) 455 052 520