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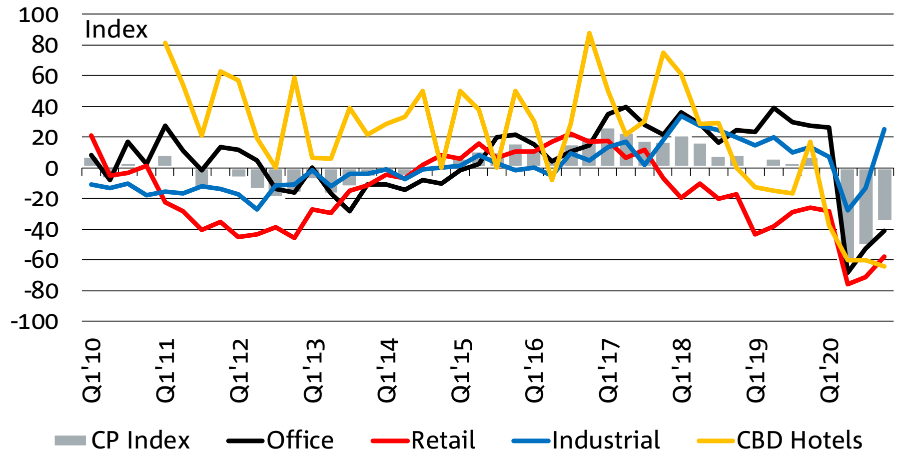
NAB COMMERCIAL PROPERTY SURVEY Q4-2020

Date February 2021 | NAB Behavioural & Industry Economics

KEY FINDINGS

- Recovery from the pandemic-driven recession is slowly filtering through into commercial property market sentiment. But while NAB's Commercial Property Index (based on expectations for capital values and rents) lifted for the second straight quarter, it was still weak (-35 pts) and well below average (0 pts).
- Sentiment is diverging across sectors. Amid ongoing travel restrictions, it fell further for CBD Hotels (-64 pts), but lifted (although still in contractionary territory) for Retail (-58 pts) and Office (-41 pts). Industrial sentiment however rose sharply (+25 pts), supported by ever growing demand in online retail and continued requirements for available warehouse and logistics space.
- With expectations improving for a stronger near-term recovery in economic activity and a lower peak in unemployment, overall confidence levels in commercial property markets improved. The 12-month measure lifted to -23 pts and the 2 year measure to +2 pts, largely supported by the very favourable outlook for Industrial property. Confidence lifted in all other sectors, but is still at contractionary levels suggesting a full recovery may still be some way off.
- Overall sentiment lifted in all states in Q4, but was negative - ranging from -64 pts in VIC to -11 pts in QLD and WA. Market conditions are expected to remain negative in all states in the next 12 months except in WA (+8 pts), with VIC (-51 pts) the least confident. Longer-term confidence however turned positive in most states, except VIC (-16 pts) and NSW (-5 pts), with WA (+34 pts) highest.
- The outlook for capital growth for the next 1-2 years is for contraction in Office (-1.5% & -0.2%), Retail (-2.5% & -0.7%) and CBD Hotels (-1.8% &-0.8%), but at a slower rate than forecast in Q3. Industrial property expectations were however upgraded (1.9% & 3.0%), and raised (and positive) in all states.
- The national Office vacancy rate was unchanged at 9.0% in Q4. Higher vacancy in VIC (7.6%), NSW (7.4%) and SA/NT (9.8%), was offset by modest falls in QLD (11.5%) and WA (12.5%). Overall vacancy is expected to climb to 9.4% in the next 12 months and ease to 8.9% in 2 years' time. Vacancy is expected to continue rising in NSW (8.5% & 9.1%), and stabilise or fall in all other states.
- The rental outlook across commercial markets is mixed. In the next 1-2 years, rents are set to fall most in Retail (-3.9% & -1.8%) and Office (-2.7% & -1.4%), with the outlook weakest in the Eastern seaboard states. The outlook for Industrial rents (1.4% & 2.1%) has however improved sharply.
- On the development front, an above average 54% of property developers plan to start new works in the short-term (next 6 months), up from 39% in Q3.
- The Q4 survey highlights a shift in emphasis among property developers planning to start new works from residential to commercial building. In Q4, a below average 43% of developers said they were targeting residential developments (53% in Q3), but more were planning to start new works in the Industrial (15%), Office (14%) and Retail (13%) sectors.
- Property professionals also pointed to a big improvement in the ease of acquiring debt and equity to run their businesses in Q4. They also expect debt (-4) and equity (-1) funding conditions to continue improving in the next 3-6 months, bringing them back to levels not seen since mid-2015.
- Property professionals said the average pre-commitment to meet external debt funding requirements for new developments in Australia fell to 63.3% for residential property, but increased to 60.6% for commercial in Q4.
- COVID has forced the adoption of new ways of working. In new research, the NAB survey found property professionals believe only 3 in 4 (77%) white collar workers will return to CBD offices post-COVID, and that firms will only require 80% of their existing CBD office foot print. They also expect the configuration of offices of the future to be split 68% working space and 32% communal space.

NAB COMMERCIAL PROPERTY INDEX



	Q3'20	Q4'20	Next 12m	Next 2y
Office	-53	-41	-31	-8
Retail	-71	-58	-53	-14
Industrial	-14	25	43	53
CBD Hotels	-60	-64	-29	-14
CP Index	-53	-41	-31	-8

MARKET OVERVIEW - NAB COMMERCIAL PROPERTY INDEX

The recovery from the pandemic-driven recession in Australia is well underway in all states and territories, and this is filtering through into commercial property market sentiment. But while NAB's Commercial Property Index (a measure of sentiment based on expectations for capital values and rents) lifted for the second straight quarter in Q4, it is still very negative (-35 pts) and well below the long-term survey average (0 pts).

Sentiment has started to diverge quite distinctly across sectors. Amid continuing restrictions on travel and low occupancy, it was weakest in CBD Hotels (down 4 pts to -64). It lifted (but remained in negative contractionary territory) for Retail (up 13 pts to -58) and Office (up 12 pts to -41). Industrial market sentiment however rose sharply (up 39 pts to +25) - posting its highest read since mid-2018, supported by ever growing demand in online retail and continued requirements for available warehouse and logistics space.

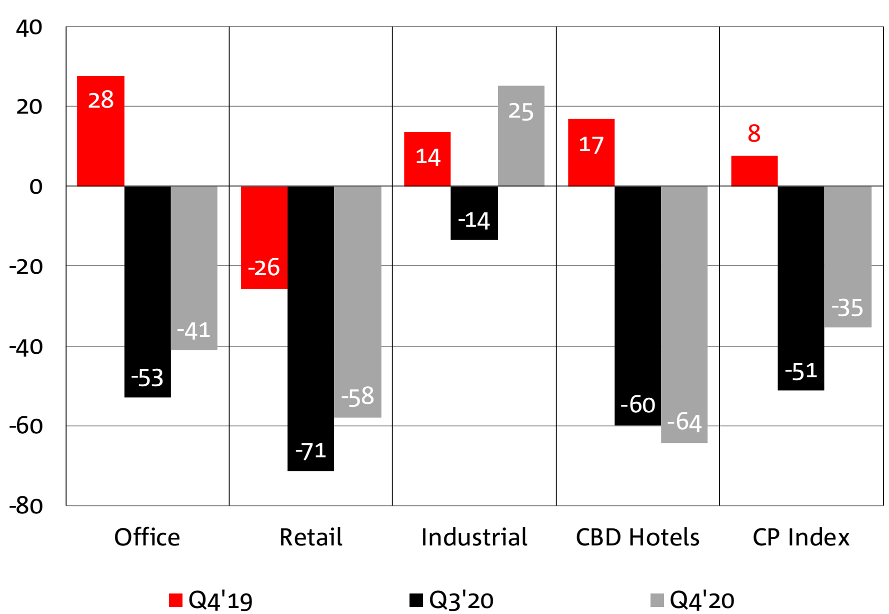
NAB currently sees a stronger near-term recovery in economic activity and a lower peak in unemployment. This may help explain an improvement in overall market confidence around commercial property markets in Q4. The 12 month measure lifted 29 pts to -23 and the 2 year measure was up 31 pts to +2.

Confidence is being largely boosted by a very favourable outlook for Industrial property (up 39 pts to +43 in 12 months and up 27 pts to +53 in 2 years).

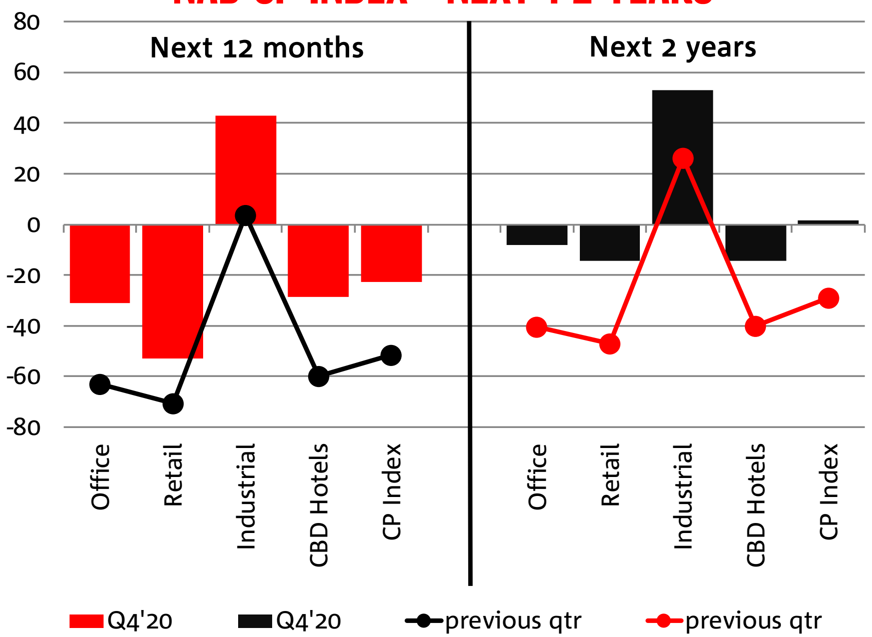
Confidence in other sectors rose, but is still at contractionary levels signalling a recovery in these sectors may be some way off. Short-term confidence is still lowest in Retail (up 18 pts to -53), then Office (up 32 pts to -31) and CBD Hotels (up 31 pts to -29).

Longer-term confidence is lowest for Retail (up 33 pts to -14) and CBD Hotels (up 26 pts to -14) property, followed by Office (up 32 pts to -8).

NAB COMMERCIAL PROPERTY INDEX



NAB CP INDEX - NEXT 1-2 YEARS



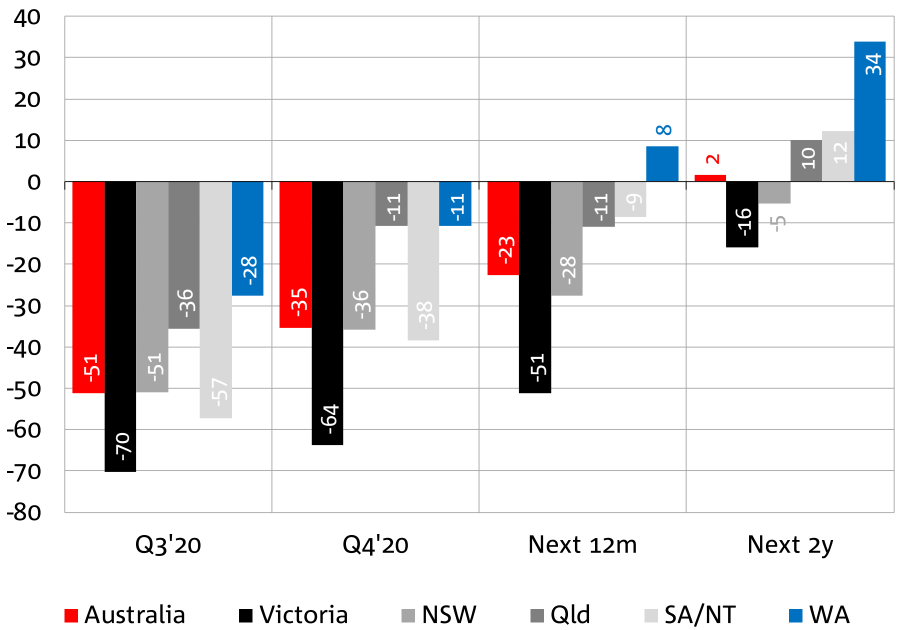
MARKET OVERVIEW - INDEX BY STATE

Overall market sentiment lifted in all states in Q4, but was still contractionary - ranging from -64 pts in VIC to -11 pts in QLD and WA. Market conditions are expected to remain negative in all states over the next 12 months except in WA (+8 pts), with VIC (-51 pts) the least confident state. Longer-term confidence has however turned positive in most states except for VIC (-16 pts) and NSW (-5pts), with confidence highest in WA (+34 pts).

While the table on the right shows an uplift in confidence all states across most market sectors relative to Q3, Office confidence is negative along the Eastern seaboard but positive in WA and SA/NT. Retail sentiment is also contractionary across the country in the next 1-2 years (except in WA in 2 years' time at +31 pts).

Confidence levels in Industrial is however positive (and has lifted) in all states, with the outlook particularly strong in QLD and NSW.

COMMERCIAL PROPERTY INDEX - STATE



OFFICE PROPERTY MAKET INDEX: STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-84↓	-36↑	-47↓	-22↑	-4↑	**-41↑**
Q4'21	-69↑	-33↑	-50↑	11↑	8↑	**-31↑**
Q4'22	-22↑	-17↑	-20↑	33↑	13↑	**-8↑**

RETAIL PROPERTY MARKET INDEX: STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-73↑	-68↑	-47 ↑	-6↑	-75↑	**-58↑**
Q4'21	-65↑	-55↑	-47↑	-13↓	-88↑	**-53↑**
Q4'22	-33↑	-10↑	-17↑	31↑	-38↑	**-14↑**

INDUSTRIAL PROPERTY MARKET INDEX: STATES

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-4↑	44↑	60↑	0↑	-21↑	**25↑**
Q4'21	17↑	52↑	65↑	39↑	21↑	**43↑**
Q4'22	38↑	56↑	65↑	56↑	43↑	**53↑**

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

MARKET OVERVIEW - CAPITAL & VACANCY EXPECTATIONS

The outlook for capital growth over the next 1-2 years is for contraction in most sectors.

Industrial is the exception (1.9% & 3.0%), with the outlook also upgraded from Q3 (-0.3% & 0.7%). Growth is expected in all states, with QLD leading the way (4.6% & 5.8%).

The outlook for Office property is negative (-1.5% & -0.2%) but softer than in Q3 (-3.7% & -2.8%). Expectations are highest in WA (0.2% & 1.7%), and lowest in VIC (-2.7% & -0.6%) and NSW (-2.2% & -1.4%).

In Retail, more modest falls of -2.5% & -0.7% are now expected (-5.3% & -3.6% in Q3), with values falling most in VIC (-3.4% & -1.6%) and NSW (-3.2% & -0.9%), and highest in WA (0.9% & 0.8%).

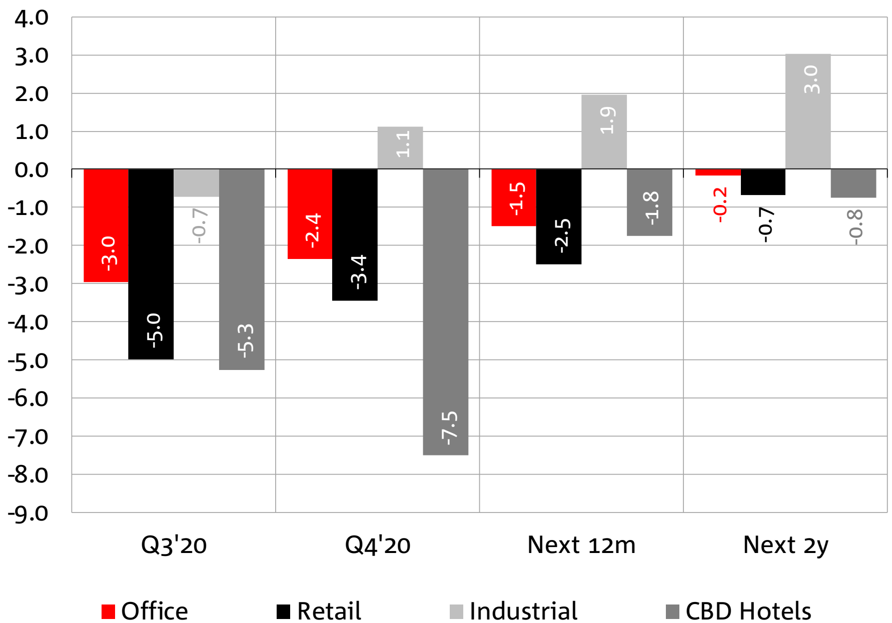
Expectations for CBD Hotels also improved relative to the previous quarter at -1.8% & -0.8% (4.5% & -2.0% in Q3) - **see page 12**.

The national Office vacancy rate was unchanged at 9.0% in Q4. While it climbed in VIC (7.6%), NSW (7.4%) and SA/NT (9.8%), it tightened modestly in QLD (11.5%) and WA (12.5%) Overall vacancy is expected rise to 9.4% in 12 months' time, then ease to 8.9% in 2 years' time. Office vacancy is however expected to continue rising in NSW (8.5% & 9.1%), but stabilise or fall in all other states.

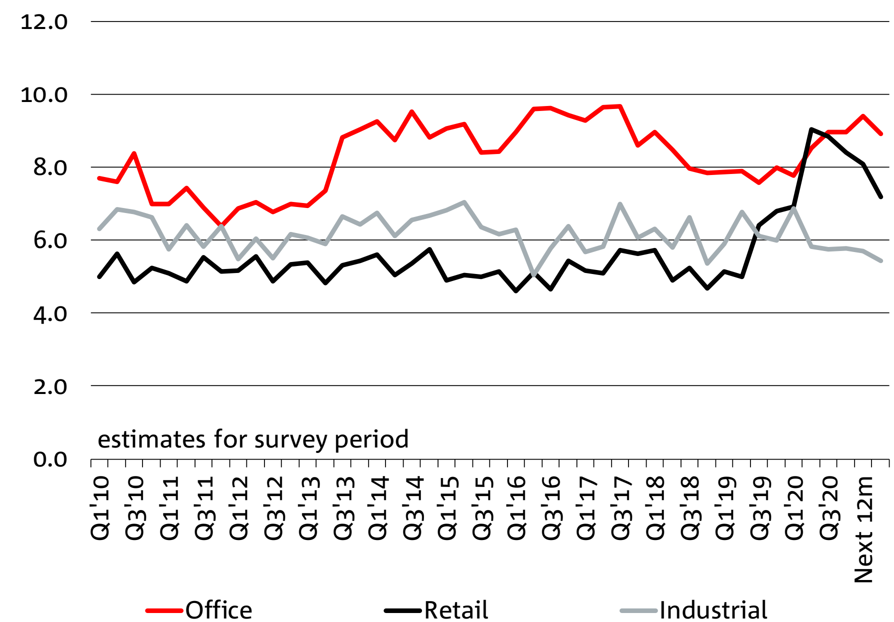
Retail vacancy improved a little to 8.4% (8.8% in Q3) as higher vacancy in NSW (8.3%) and SA/NT (11.0%) was offset by falls elsewhere. Overall Retail vacancy is expected to fall over the next 1-2 years (8.1% & 7.2%), with improved or stable outcomes in all states.

The industrial sector remains the most insulated, with vacancy broadly unchanged at 5.8% in Q4 - but falling in NSW (3.9%). The market is expected to tighten over the next 1-2 years (5.7% & 5.4%), and in all states bar QLD - **see page 13**.

CAPITAL VALUE EXPECTATIONS (%)



VACANCY RATE EXPECTATIONS (%)



MARKET OVERVIEW - RENTS & SUPPLY

The rental outlook in commercial markets is mixed. In the next 1-2 years, rents are expected to fall most in Retail (-3.9% & -1.8%), with returns falling across the country (except in WA in 2 years' time +0.6%). The outlook for Retail rents is weakest in VIC (-5.1% & -3.0% and SA/NT (-4.2% & -3.6%).

Office rents are also expected to contract (-2.7% & -1.4%), but the contraction is expected to be less severe than forecast in Q3 (-3.9% & -2.8% respectively). The outlook is weakest in the Eastern seaboard states, with rents falling through the forecast period. But modest growth is expected to resume in WA and SA/NT in the next 1-2 years.

The outlook for Industrial rents (1.4% & 2.1%) has improved sharply from Q3 (-0.3% & 0.9%). Rents are now expected to grow in all states, with QLD (2.2% & 2.8%) and NSW (1.9% & 2.3%) out-performing - **see page 12**.

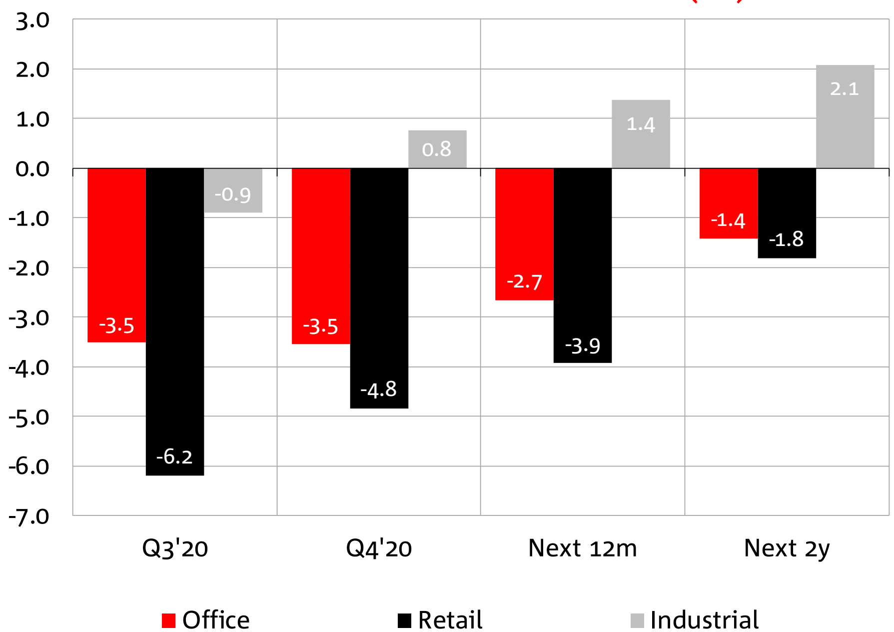
Amid still low vacancy (50%) and reduced demand, very large supply over-hangs were identified in the CBD Hotels sector, and they are expected to persist in the next 12 months.

Office markets are also "somewhat" over-supplied and expected to remain so in the next 1-3 years, with large over-hangs in WA and to a lesser along the Eastern Seaboard states. Property professionals in all states see markets returning to "neutral" in 5 years time.

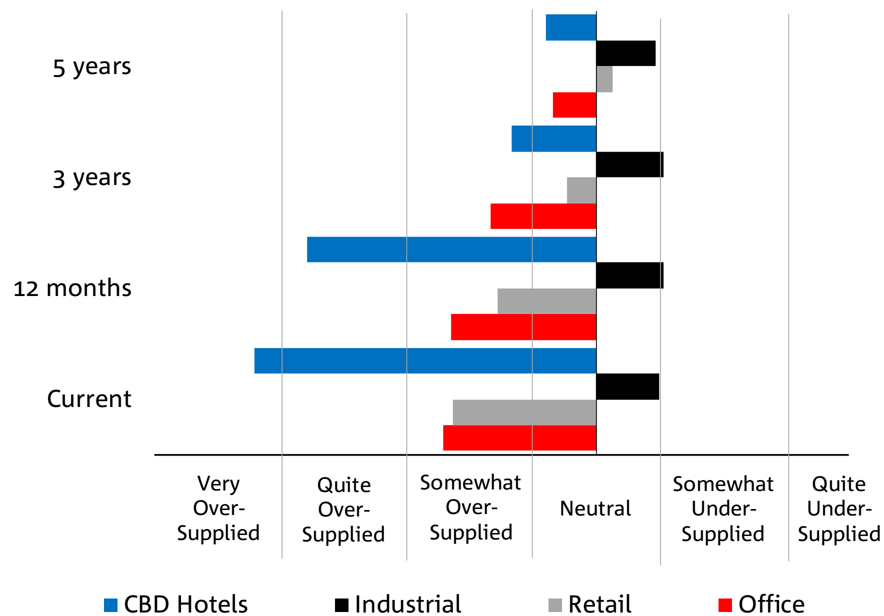
Conditions in Retail are mixed, with over-supply much more evident in VIC and SA/NT, and set to persist over the next year. Property professionals in QLD see under-supply emerging in 5 years, with markets broadly balanced elsewhere in the next 3-5 years

Industrial property markets are expected to be "somewhat" under-supplied in QLD and NSW in the next 1-5 years, and balanced in all other states.

GROSS RENTAL EXPECTATIONS (%)



SUPPLY CONDITIONS



MARKET OVERVIEW - DEVELOPMENT INTENTIONS

The number of property developers expecting to start new works in the next month fell to 12% (15% in Q3), but those planning to start in the next 1-6 months rose sharply to 42% - the highest number since Q3 2015. Overall, an above survey average 54% said they plan to start new works in the short-term (next 6 months), up from 39% in Q3. Around 17% plan to begin in the next 6-12 months (26% in Q3) and 20% in the next 12-18 months (13% in Q3).

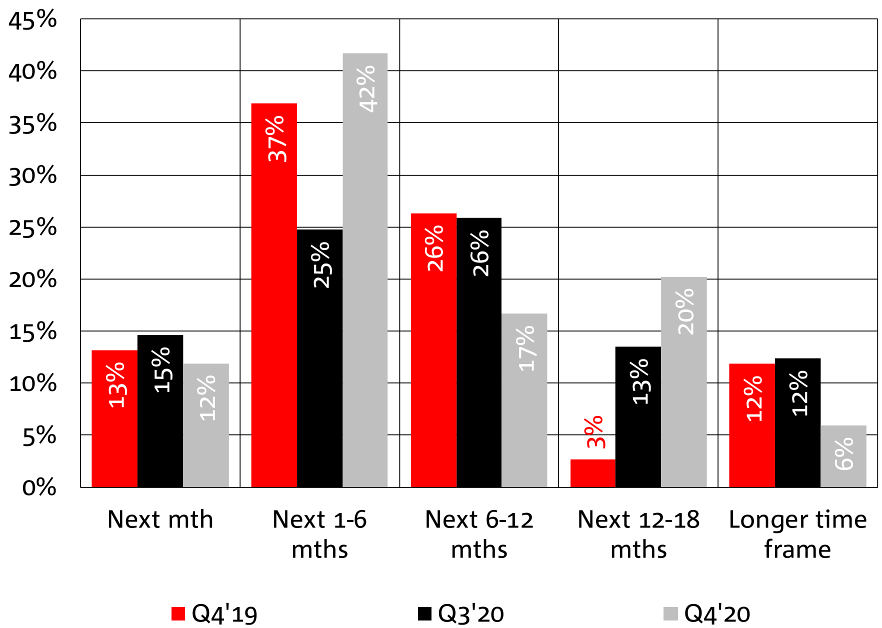
In total, around 90% of developers expect to start new projects within the next 18 months - the highest number since Q4 2015 and above the survey average (85%). This suggests the economic disruption caused by COVID in the building industry may start to abate in the near to medium-term.

The Q4 survey highlights a large shift in emphasis among property developers planning to start new works from residential to commercial building.

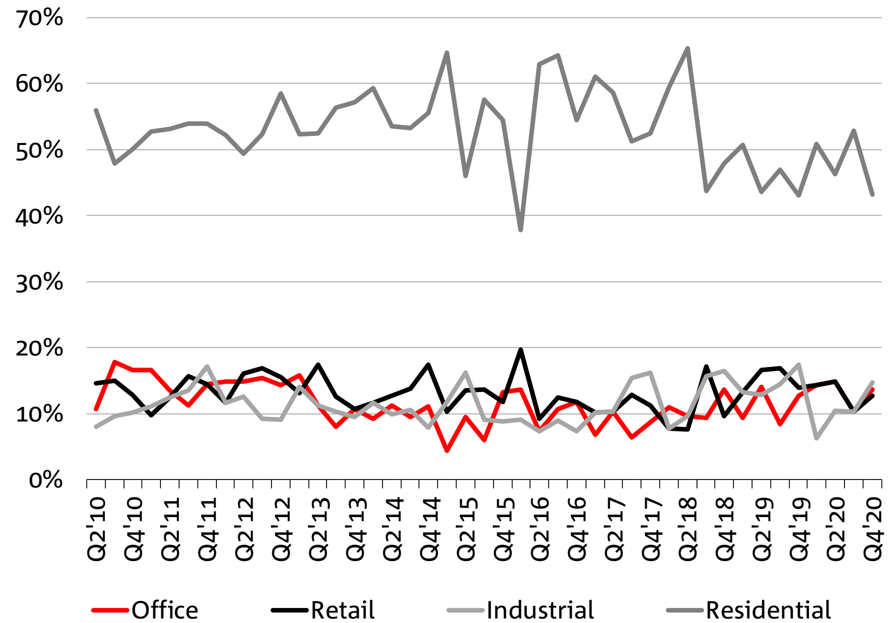
In Q4, around 43% of property developers said they were targeting residential developments. This was down from 53% in the Q3. It was also the weakest result since Q4 2020, and well below the survey average (53%).

In contrast, the number of developers who said they were planning to start new works in the Industrial sector rose to 15% (10% in Q3), to 14% in the Office sector (10% in Q3) and 13% in the Retail sector (10% in Q3).

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 rose to 58% in Q4, from 55% in Q3 but was down from 62% at the same time in 2019.

Those seeking new acquisitions in Q4 fell slightly to 28% (31% in Q3 and 21% in Q4 2019). But it remained above average (26%) for the second straight quarter, after having been below the survey average for almost 2 years prior to that.

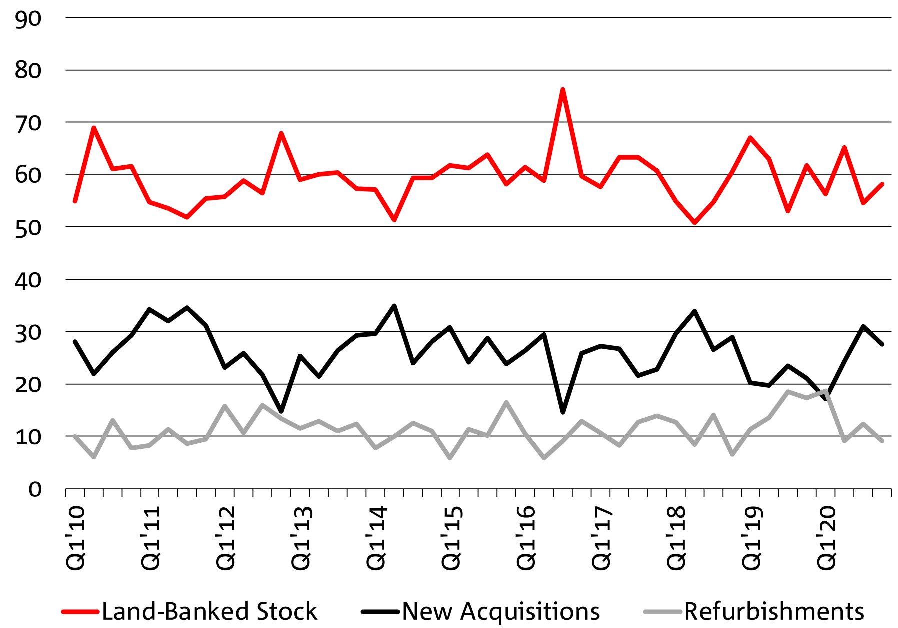
The number looking at refurbishment opportunities was also lower at 9%, down from 12% in Q3 and 17% in Q4 2019.

Despite the sharp increase in the number of developers planning to start new works in the next 6 months, those planning to source more capital to fund them in this time was unchanged at 25%. Around 58% had no intention to source capital in the short-term (broadly unchanged from 59% in Q3).

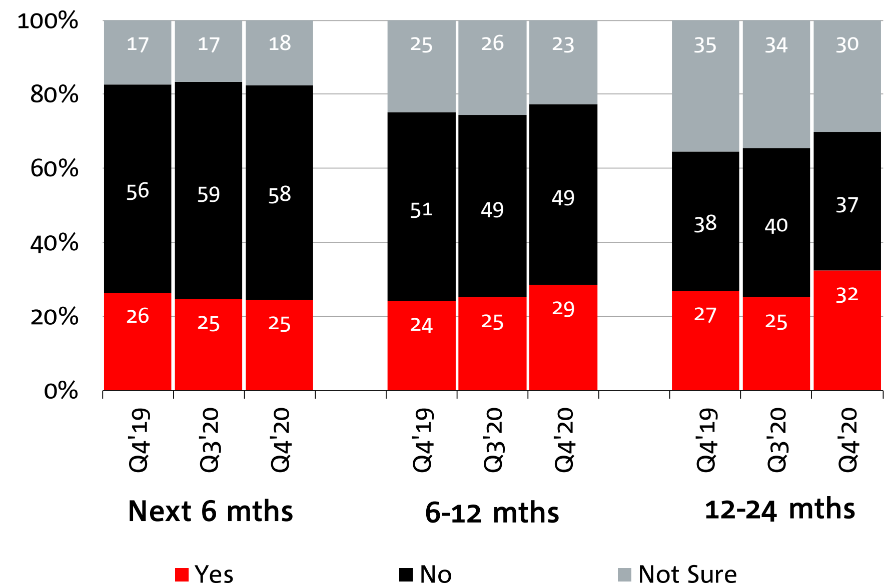
The number planning to source capital in the next 6-12 months however increased to 29% (from 25% in Q3), 49% had no intention to source funds (unchanged), and 23% were unsure (26% in Q3).

There was also a noticeable increase in the number intending to source more capital in the next 12-24 months to 32% (25% in Q3).

SOURCES OF LAND DEVELOPMENT (%)



INTENT TO SOURCE MORE CAPITAL FOR DEVELOPMENT/ACQUISITIONS/PROJECTS



MARKET OVERVIEW - FUNDING & PRE-COMMITMENTS

Property professionals reported a big improvement in the ease of acquiring both debt and equity to run their businesses in Q4. Overall, the net number who said it was harder to obtain borrowing or loans (debt) continued to out-weigh those who said it was easier. However, the net number improved to -19, after having fallen sharply -27 in Q2 and -31 in Q3.

Perceptions of equity funding conditions turned even more sharply. In Q4, the net number who indicated it was harder to obtain equity funding fell to -8 (-25 in Q2 and -22 in Q3) - the strongest result since late-2015.

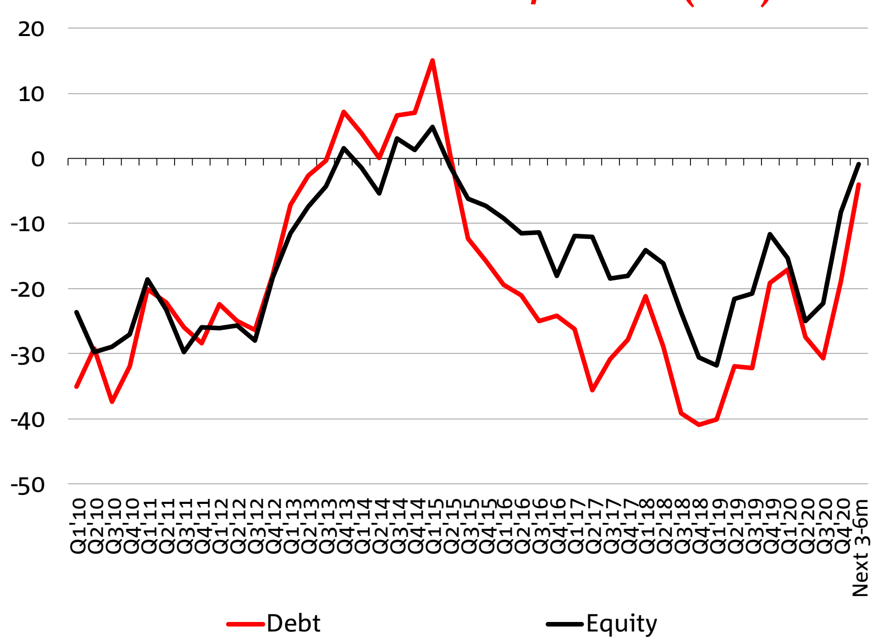
Property professionals also expect debt (-4) and equity (-1) funding conditions to continue improving in the next 3-6 months, bringing them back to levels not seen since mid-2015.

The average pre-commitment to meet external debt funding requirements for new developments in Australia fell for residential property (63.3%), but increased for commercial (60.6%) in Q4.

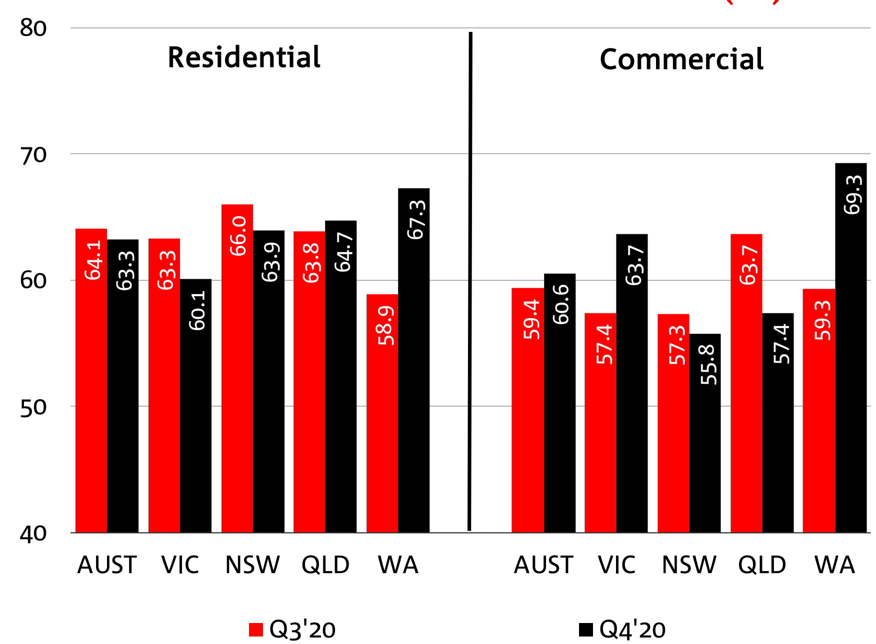
Although residential requirements fell in VIC (60.1%) and NSW (63.9%), they increased noticeably in WA (67.3%) and slightly in QLD (64.7%). In commercial markets, pre-commitment requirements rose noticeably in WA (69.3%) and VIC (63.7%), but were down sharply in QLD (57.4%), with NSW (55.8%) reporting a small improvement.

Looking ahead, the net number who expect requirements to improve outweigh who expect it a deteriorate in both residential (+10% in next 6 months & +21% in next 12 months) and commercial (+10% & +20% respectively) property markets.

EASE OF ACQUIRING DEBT/EQUITY (NET)

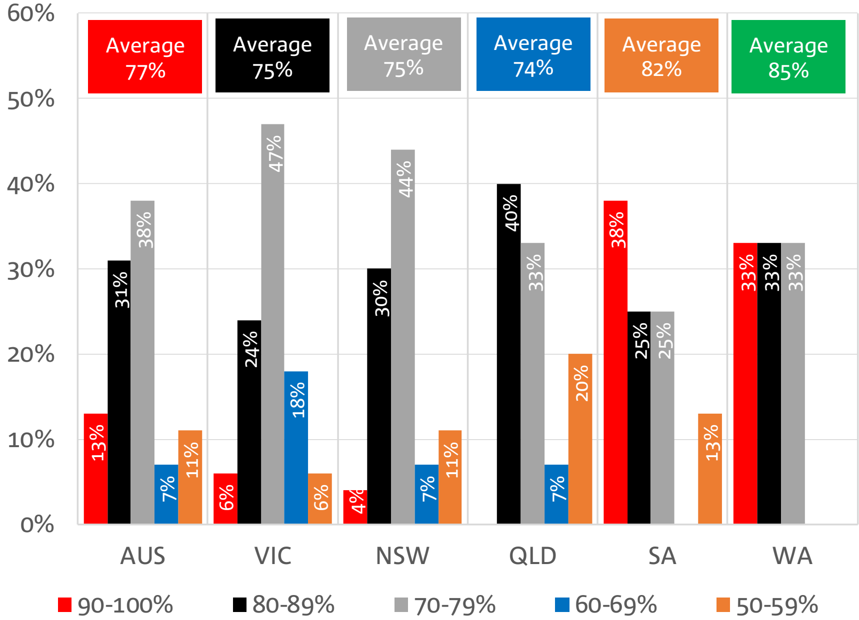


PRE-COMMITMENT REQUIREMENTS (%)

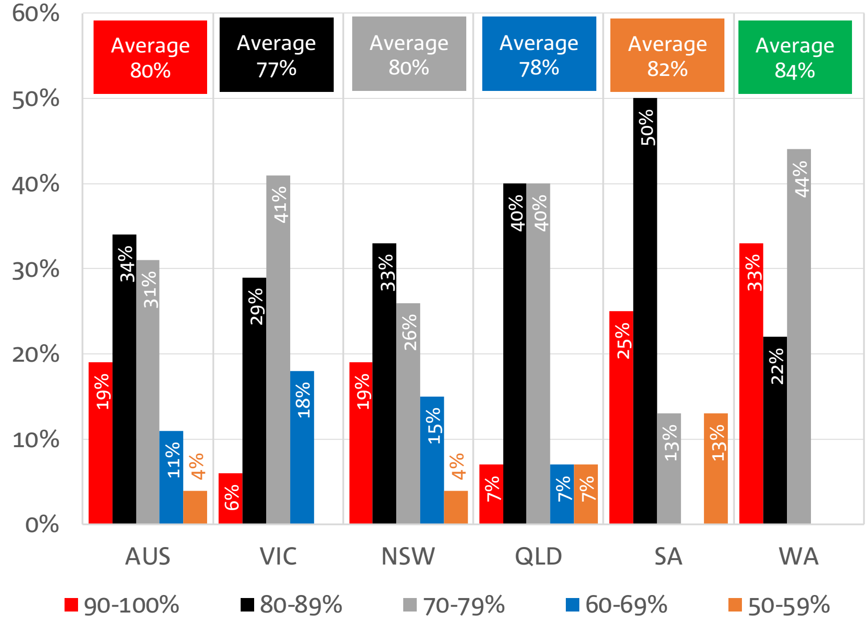


SPECIAL QUESTIONS: OFFICE PROPERTY

PROPORTION OF WHITE COLLAR OFFICE WORKERS EXPECTED TO RETURN TO CBD OFFICES POST COVID IN NEXT FEW YEARS



PROPORTION OF EXISTING CBD FOOTPRINT WILL BUSINESSES REQUIRE POST COVID



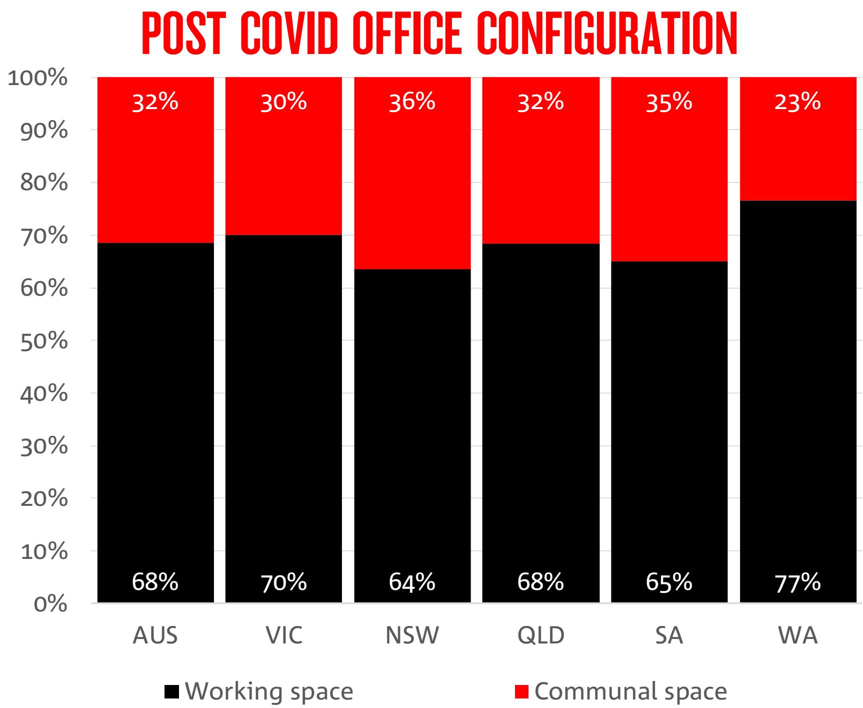
The COVID pandemic forced the adoption of new ways of working, with white collar office workers among the most impacted. Following the outbreak, many CBD office workers around the country were forced to work from home and many continue to do so. The pandemic also forced companies to reimagine how corporate offices will look and operate post-COVID.

In this survey, NAB asked property professionals operating in the Office space what proportion of white collar office workers they expected to return to CBD offices post-COVID, what proportion of their existing CBD office footprint will their business require post-COVID, and what share of offices of the future will be allocated between office working space and communal office space.

On average, property professionals said just over 3 in 4 (77%) white collar workers will return to CBD offices post-COVID. Property professionals in VIC (75%), NSW (75%) and QLD (74%) were in broad agreement, while property professionals in SA/NT (82%) and WA (85%) expect a higher proportion of the white collar CBD workforce to return to the office.

With fewer workers expected to return to the office, property professionals on average estimate firms will only require 80% of their existing CBD office foot print post-COVID. VIC (77%), QLD (78%) will need slightly less (77%) and SA/NT (82%) and WA (84%) where more workers are expected to return, will need a little more.

SPECIAL QUESTIONS: OFFICE PROPERTY (CONTINUED)



Given the nature of the pandemic, many firms were also forced to re-imagine what the office space of the future post-COVID will look like.

When property professionals where asked about the share of office space that will be allocated between working space and communal space such as meeting rooms, break-out areas etc., the split was 68% working space and 32% communal space.

This configuration did however vary somewhat across states. In NSW for example the split was 64% working space and 36% communal space. In WA however the split was estimated at 77% working space and 23% communal space.

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q4-2020

OFFICE CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-4.7	-2.0	-2.2	-1.1	-1.6	-2.4
Q4'21	-2.7	-2.2	-1.4	0.2	0.0	-1.5
Q4'22	-0.6	-1.4	0.1	1.7	1.4	-0.2

OFFICE RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-6.4	-3.3	-3.5	-1.3	-2.1	-3.5
Q4'21	-4.0	-2.9	-3.2	-0.6	-1.4	-2.7
Q4'22	-2.0	-2.2	-2.0	1.0	0.2	-1.4

RETAIL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-4.2	-4.4	-2.8	0.8	-4.7	-2.5
Q4'21	-3.4	-3.2	-1.1	0.9	-3.9	-2.5
Q4'22	-1.6	-0.9	0.0	0.8	-0.5	-0.7

RETAIL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-6.0	-4.9	-4.3	-2.0	-4.2	-4.8
Q4'21	-5.1	-3.8	-3.7	-0.8	-4.2	-3.9
Q4'22	-3.0	-1.1	-1.9	0.6	-3.6	-1.8

INDUSTRIAL CAPITAL VALUES (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	-0.5	1.4	4.1	0.2	-0.5	1.1
Q4'21	0.8	2.4	4.6	0.9	3.8	1.9
Q4'22	2.1	3.3	5.8	1.8	1.3	3.0

INDUSTRIAL RENTS (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	0.1	1.1	2.1	0.0	-0.3	0.8
Q4'21	0.4	1.9	2.2	0.9	0.2	1.4
Q4'22	1.6	2.3	2.8	1.6	1.7	2.1

SURVEY RESPONDENTS EXPECTATIONS (AVG) Q4-2020

OFFICE VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	7.6	7.4	11.5	12.5	9.8	9.0
Q4'21	7.6	8.5	11.9	12.0	9.7	9.4
Q4'22	6.3	9.1	10.9	10.5	8.7	8.9

RETAIL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	8.8	8.3	7.6	8.7	11.0	8.4
Q4'21	8.4	8.1	7.2	8.7	10.0	8.1
Q4'22	7.1	7.6	5.9	7.9	10.0	7.2

INDUSTRIAL VACANCY RATE (%)

	VIC	NSW	QLD	WA	SA/NT	AUS
Q4'20	4.3	3.9	7.5	9.3	8.6	5.8
Q4'21	4.3	3.8	7.8	9.0	7.8	5.7
Q4'22	4.3	3.6	7.5	8.3	7.0	5.4

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 370 property professionals participated in the Q4 2020 Survey.

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