Q2 2018: Australia Commercial Property Monitor

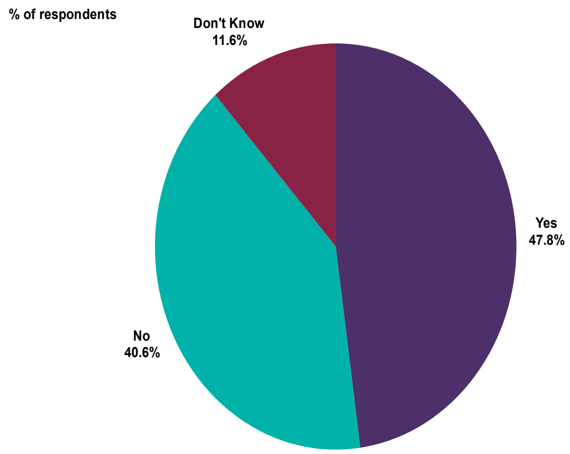
Momentum remains positive despite continued deterioration in credit conditions

In Q2 of 2018 Australia's commercial property market maintained modestly positive momentum. The economic expansion has been underpinned by exports and business investment, while a slowdown in consumer expenditure continues to be a headwind for the retail sector. Amid caution over the impact of the Royal Commission, higher wholesale funding costs for banks appear to be having some effect on credit conditions.

Occupier Market

- The Occupier Sentiment Index (an amalgamated measure of occupier market indicators) was unchanged in Q2 at +8, (Chart 1). Occupier demand continued to rise at a headline level over the quarter led by office and and industrial space,
- The supply of properties to let remained unchanged at a headline level. When broken down, the continued increase in retail availability was offset by tighter supply of office and industrial space.
- Contributors still believe headline rents will increase over the next three months, as shown by Chart 2. Meanwhile, Chart 6 shows that rent forecasts over the next twelve months are nuanced, with rents on prime office space seen increasing 4.5% over this period while the outlook is subdued for retail.

Do you expect that Australia's Royal Commission will have a significant impact on the commercial property markets over the next 12 months?



Investment Market

- The Investment Sentiment Index (an amalgamated measure of occupier market indicators) fell to +11 in Q2 from +20 in Q1, indicating a slowdown in positive momentum in the investment market (Chart 1).
- The pace of increase in headline investor demand slowed from Q1 as the previously robust increases in office and industrial demand eased, and demand for retail space turned negative.
- Respondents reported that foreign demand fell across all three categories (office, industrial, retail) in Q2. However, supply also remained tight, particularly for office space.
- Chart 4 shows that valuations remain skewed towards being seen as expensive, with 44% of respondents viewing them above fair value vs 43% who see properties as being fairly valued. However, this is more pronounced in Sydney and Melbourne than it is in Brisbane and Perth.
- The share of respondents who saw credit conditions deteriorate to some extent increased from 51% in Q1 to 68% in Q2. This is the tenth consecutive quarter that more than half of respondents reported some degree of deterioration.
- In Q2, 48% of respondents said that they expect the Royal Commission to have a significant impact on commercial property markets. Respondents in Brisbane were slightly more concerned over potential fallout from the Royal Commission than their counterparts in Sydney, Melbourne and Perth.
- Against this backdrop, short-term expectations for capital values remain positive (Chart 2), though longer-term forecasts were revised marginally lower from Q1 (Chart 5). Prime office valuations in Melbourne are expected to increase more than other Australian cities, 4.2% over the next year.

Commercial Property Market

Chart 1: Occupier, Investment Sentiment Indexes

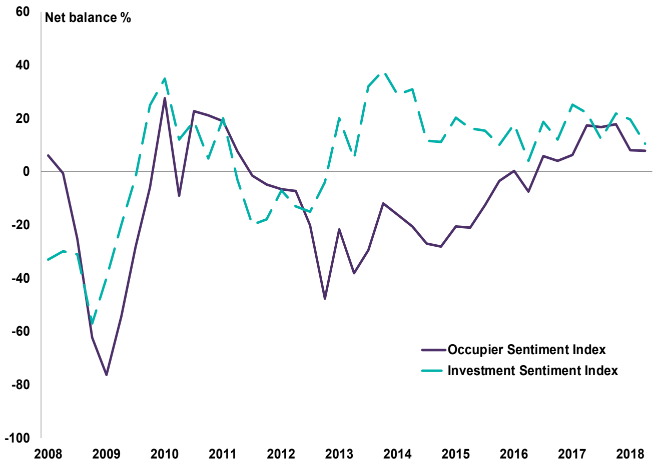


Chart 2: 3-month Rents, Capital Values

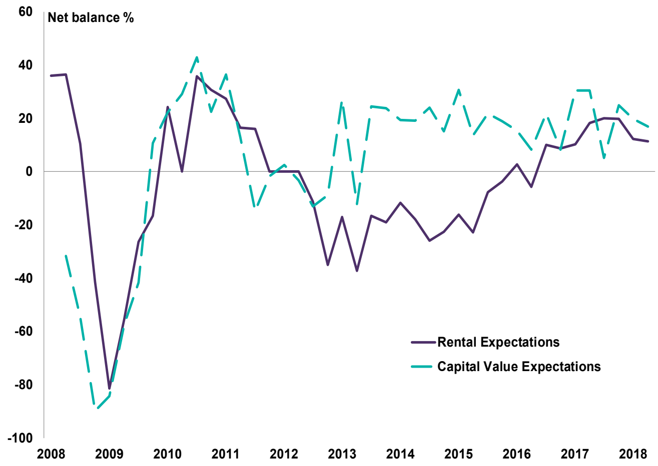


Chart 3: Credit Conditions

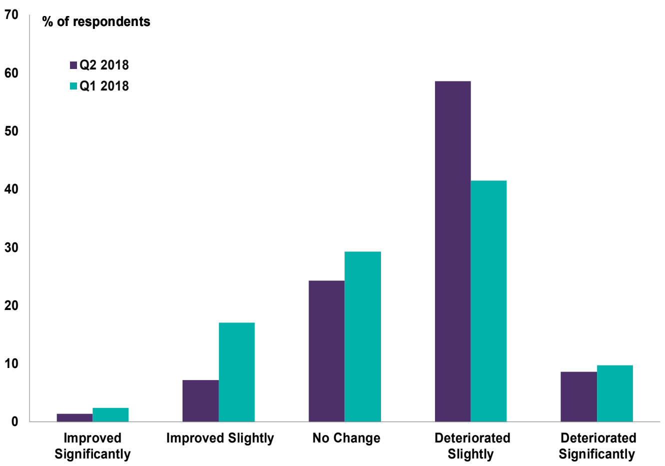


Chart 4: Valuations

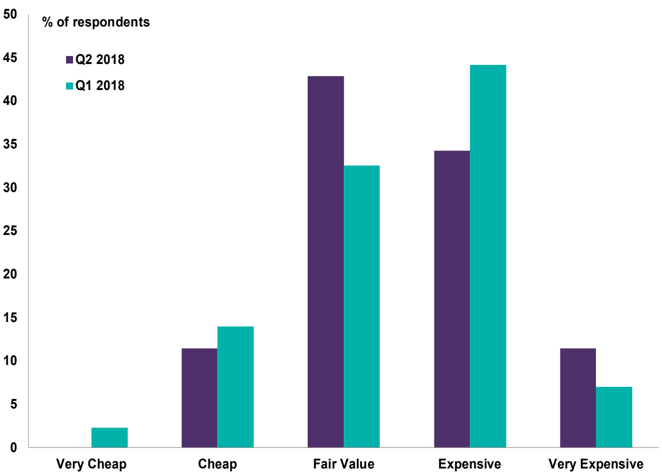


Chart 5: 12-month Capital Values Forecast

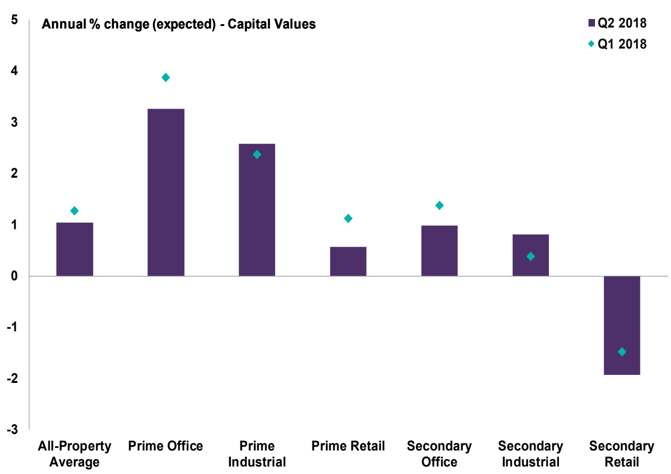
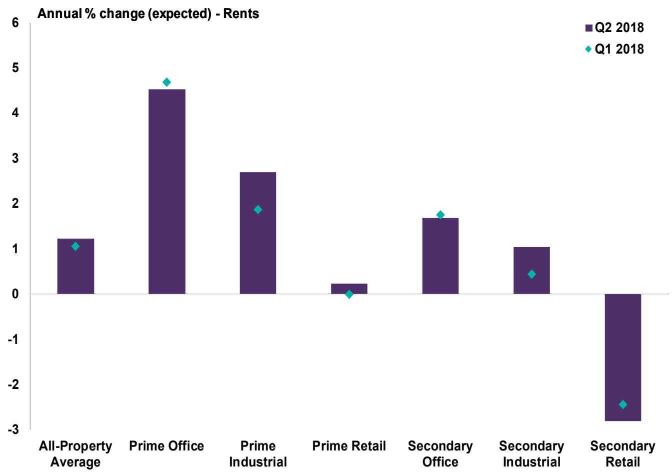


Chart 6: 12-month Rent Forecast



Information

Global Commercial Property Monitor

RICS' Global Commercial Property Monitor is a quarterly guide to the trends in the commercial property investment and occupier markets. The report is available from the RICS website www.rics.org/economics along with other surveys covering the housing market, residential lettings, commercial property, construction activity and the rural land market.

Methodology

Survey questionnaires were sent out on 14 March 2018 with responses received until 11 April 2018. Respondents were asked to compare conditions over the latest three months with the previous three months as well as their views as to the outlook. A total of 1748 company responses were received, with 385 from the UK. Responses for Ireland were collated in conjunction with the Society of Chartered Surveyors Ireland. Responses for Spain and Portugal were collated in conjunction with Iberian Property. Responses for New Zealand were collated in conjunction with Property Council New Zealand.

Responses have been amalgamated across the three real estate sub-sectors (offices, retail and industrial) at a country level, to form a net balance reading for the market as a whole.

Net balance = Proportion of respondents reporting a rise in a variable (e.g. occupier demand) minus those reporting a fall (if 30% reported a rise and 5% reported a fall, the net balance will be 25%). Net balance data can range from -100 to +100.

A positive net balance reading indicates an overall increase while a negative reading indicates an overall decline. The RICS Occupier Sentiment Index (OSI) is constructed by taking an unweighted average of readings for three series relating to the occupier market measured on a net balance basis; occupier demand, the level of inducements and rent expectations. The RICS Investment Sentiment Index (ISI) is constructed by taking an unweighted average of readings for three series relating to the investment market measured on a net balance basis; investment enquiries, capital value expectations and the supply of properties for sale.

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We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

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