Australian Property

Market Predictions

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How will Australian Property Markets fare in the face of COVID-19?

In these unprecedented times, it becomes increasingly difficult to predict the outlook for Australian property markets. However, at the Australian Property Institute we are fortunate to have access to some of the country's most experienced commentators. Earlier this year, we held events across the country to gain their insights for 2020. The world has changed greatly in the past few months since we heard from them, due to COVID-19, so we touched base with some of the presenters to see how their predictions had changed.

Besa Deda, Chief Economist for St. George, highlighted the long-term impacts of the looming recession on the country:

A recession is unfolding in Australia. Despite the massive waves of stimulus from the Federal government, State governments, Reserve Bank and banking industry – a recession is unlikely to be averted. In order to contain the virus, restrictions on societal movements are needed, which depress spending and economic activity. Moreover, the virus is causing heightened uncertainty, engendering caution among consumers and businesses. An economic contraction is currently underway, and we do not expect the economy to return to growth until the December quarter. But the timing and pace of this recovery remains dependent on how long it takes to effectively contain the virus. The exact profile of the recovery also relies on easing the uncertainty felt by people about the future.

Some of the restrictions in place are hitting activity in the housing and construction sectors directly. With the social distancing measures now in place, transacting for property has become more difficult and some construction projects have been extended, delayed or cancelled.

However, the sharp drop in demand and incomes is what will be felt most acutely across the sector.

We expect dwelling prices to fall this calendar year, as the loss of incomes, rising unemployment and a sharp population slowdown curb demand. We anticipate the fall could be as large as 7-10%, although forecasting is subject to higher variability than usual.

Residential vacancies are expected to rise, reflecting weaker incomes, slower population growth and as owners of short-term accommodation look to secure longer-term stays. Downward pressure on rents is likely over the year ahead as a result.

However, there is unprecedented assistance which will cushion the downturn. Deferrals on mortgage payments for those who have lost income due to COVID-19 could limit forced sales. Also, some sellers might wait for a better time to sell their dwellings, if they are in a position to, cushioning the extent of price falls.

Stimulus measures will provide some fuel for housing price growth once the broader economic recovery begins, as will low interest rates; however, weak wages growth, a slowing in population growth and an unemployment rate that might remain high and sticky for longer could foil a recovery in dwelling prices.

Interest rates are set to remain low while the substantial level of additional liquidity provided from monetary authorities will take time to unwind. But this crisis will cast a shadow on the economy for some time.

Australian Residential Property Markets

Besa's predictions for residential markets were largely reflected in commentary provided by other industry commentators. Both Angie Zigomanis, Director at Charter Keck Cramer and Andrew Shields, Interim General Manager of the Real Estate Institute of South Australia agreed that a lack of demand among both buyers and tenants would impact the market, but remained hopeful that the Government stimulus measures and Australia's success in containing the virus to date would cushion the impacts.

Angie Zigomanis's commentary is further outlined below:

The main impact of the COVID-19 crisis on the residential market in the short term will be through the resulting economic shock of the lockdown and rising unemployment. This is impacting in multiple ways. Many renters don't have the income to remain as tenants, which is affecting cashflows of investment properties. Similarly, home owners (both owner occupiers and investors) who are highly geared and who have lost their job will also struggle to maintain mortgage repayments.

At this stage, there are fewer buyers in the market due to employment/income risk and the potential for further price declines. Lenders are being accommodating to borrowers who are struggling to meet repayments by providing a repayment break (although this still gets capitalised into the loan), and this in turn should result in fewer forced sales onto the market to create a sharp drop in prices. However, unemployment is likely to stay elevated for at least the next couple of years which suggests that there will be a steady flow of properties onto the market which is likely to place downward pressure on prices over time.

There is likely to be greater downside in the apartment space, where there is typically a higher percentage of investor owners. Tenant demand is falling due to rising unemployment and falls in overseas migration. This will impact rents, as will high levels of supply - both through new completions in Sydney and Melbourne where the construction pipeline is still substantial, as well as through the addition of short-stay rentals to the traditional rental stock. This will result in falls to apartment values as incoming investors will discount the price they are willing to pay in this environment.

The new apartment sector will also struggle. New apartment buildings that are approaching completion are expected to see some apartments fail to settle.

In the medium to longer term, there may also be more aversion to debt than before and this may impact people's willingness to borrow to bid up prices and dampen the pace of any recovery.

On the positive side, Australia seems to have done very well in containing the spread of COVID-19. Compared to other countries, the Federal Government is in a better financial position and this gives it some firepower in terms of applying intelligent fiscal stimulus such as an infrastructure program. Having hopefully negotiated the COVID-19 crisis better than most countries, it is also likely to make Australia a more attractive destination for both migration and foreign investment, which should also be a long term positive for both the economy and residential market.

When asked how COVID-19 will impact the South Australian residential property market, and how fast recovery will be, Andrew Shields had the following to say:

Firstly, we need to consider the two previous quarters - December 2019 (Quarter 4) and March 2020 (Quarter 1). The median house in metropolitan Adelaide recorded was \$485,000 (Quarter 4) and \$480,000 (Quarter 1), respectively. Sales recorded in metropolitan Adelaide were 5,834 (Quarter 4) and 5,434 (Quarter 1). Both sales volumes and median prices held up surprisingly well – especially as the first quarter is traditionally much lower than the last quarter in the preceding year. It should be noted the effects of social distancing on the real estate sector only came into effect towards the end of Quarter 1, 2020. Therefore, the full impacts on the market has not been accurately recorded as yet.

However, data from a recent REISA survey (17 April), shows 55% of real estate businesses noted a decrease in buyer/tenant enquiries of more than 50% with a further 20% experiencing a decrease of 25-50%. In effect, three quarters of our REISA members' businesses have seen a significant decline in buyer/tenant opportunity.

Fundamentally, consumer confidence (job security/level of unemployment), the accessibility of low-interest funding and essentially how long the pandemic necessitates social distancing restrictions will determine market recovery. Government too must play it part in recovery by expediently delivering stimulus packages, landlord relief and tax incentives to shift the economy from crisis mode to recovery.

Australian Retail Property Markets

Retail has obviously been greatly affected by the pandemic, with Zelman Ainsworth, Director at CBRE, stating it had been the "hardest hit in the COVID pandemic." Both Zelman and Kate Gray, Director, Research at Colliers International, discussed the devastating impacts on bricks and mortar retail, while acknowledging that the COVID-19 pandemic would likely shift retail preferences permanently, with high street retail strips expected to increase in attractiveness over large shopping centres.

Zelman Ainsworth further highlights long-term impacts for the retail property market in his following commentary:

The retail market has been the hardest hit in the COVID Pandemic, there are certainly going to be major changes and shifts to the retail market, that will likely live on. High street retail in both CBDs and suburbs are expected to be winners from the social distancing we have all become so used to.

Online retail has seen massive growth in the COVID period when we have all been stuck at home.

Many retailers have scaled their online business to deal with the demand, which has helped many businesses, however in most cases it is still far less than the sales being achieved in retail stores. Hence retailers are rushing to get their doors open. Social distancing inside retail stores will have an impact on sales volume in the short term, although we are seeing retail quickly adapting their retail formats to accommodate this change.

CBRE is very bullish about the retail market, the retailers that are coming out of COVID are nimble, profitable and super-efficient. We are excited to see this market bounce back over the next 12 to 24 months.

Kate Gray focused on the impacts to retail tenants and landlords, as well as the long-term effects on consumer spending:

We are seeing a high level of volatility and dislocation in most markets which has left investors, occupiers and advisors trying to understand the impact that this will have on commercial real estate sector.

The restriction of movement to limit the spread has impacted both the tourism and retail sectors significantly. We have seen many tenants unable to pay rent as a result of the sharp downturn in trade. Landlords and tenants are currently very focused on working their way through this period. The code of conduct has provided a framework for landlords and tenants to negotiate and as a result we expect that there will be a significant impact on landlord income over this period. Longer term our view is that there will be a fall in rents across most retail asset classes, however those that are higher risk are likely to see much greater falls. We expect that consumer spending is likely to be slow to recover, due to falls in wages (less hours worked), higher unemployment and higher savings ratios. Discretionary spending is likely to be the slowest to recover.

We expect that sales volumes will be lower through this pandemic period as many owners are focused on working through tenant rental abatements. Cap rates are likely to hold over the next 6 months, however expect some softening in cap rates in the December quarter. We see stand alone supermarkets and good neighbourhood centres as being the exception as these are likely to be in higher demand from investors. Those that have long term leases in place and limited exposure to discretionary spend tenants are likely to trade well.

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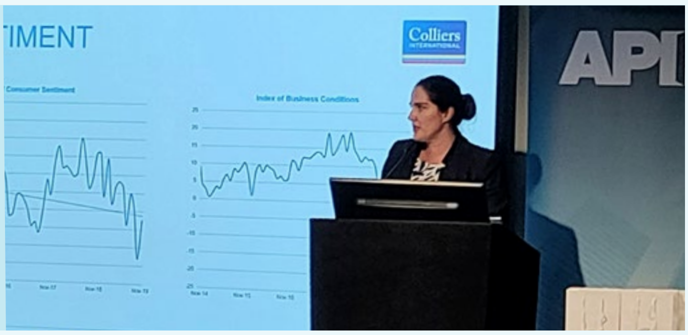
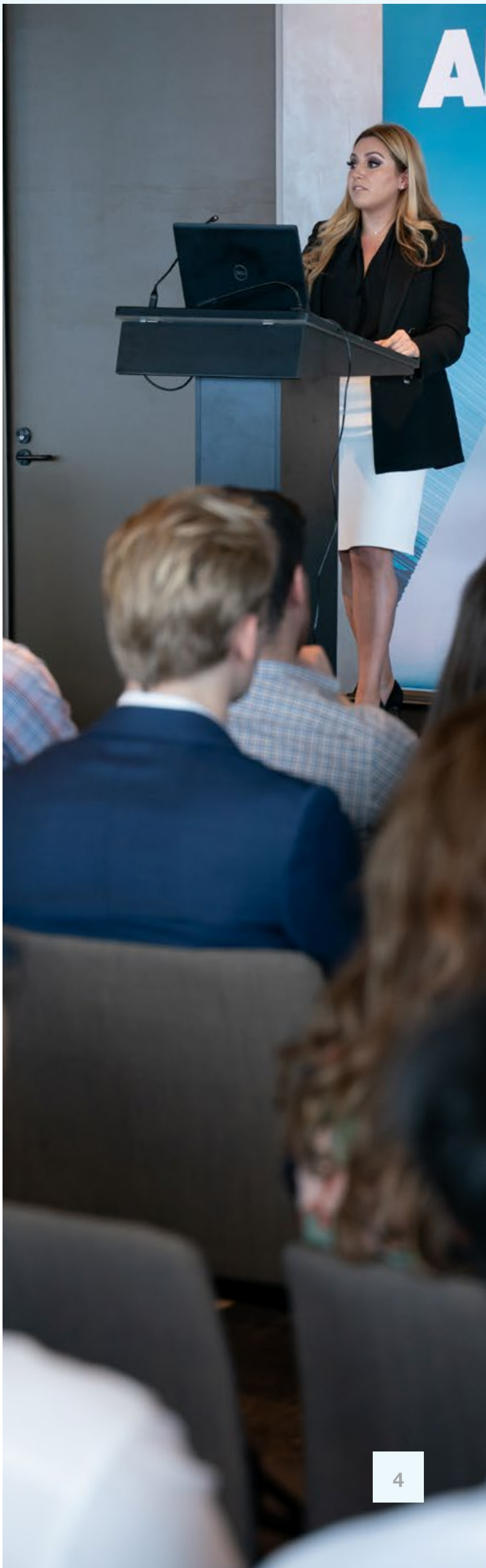


[Sass J-Baleh, Head of Industrial and Logistics Research at JLL Australia, was positive about the outlook for industrial and logistics growth:]



Australian Industrial Property Markets

Australia's global competitive advantage in food production highlights the reliance of food logistics and scope for eCommerce growth. Even in this current uncertain economic environment we have observed consumers increasing their consumption expenditure on food items (i.e. non-discretionary retail goods).

As more consumers begin to stay or work at home due to lockdowns and office closures, this should mean a greater number of people will opt to purchase items via online channels for home delivery thus avoiding non-essential travel.

Supermarkets have seen a significant rise in activity for online groceries. The pandemic is generating new people to the online shopping experience, which in the future could potentially add to the existing pool of online shoppers' as preferences change. The share of online retail trade to total retail trade stood at 9.6% (or AUD 31.9 billion), as at March 2020. We hit the AUD 30 billion mark at the end of 2019, and this is certainly likely to reach, if not exceed, AUD 32 billion by the end of 2020. As a result, eCommerce will continue to play a supporting role to growth in industrial and logistics real estate in the short to medium run.

The stable long-term driver to industrial and logistics growth remains in occupiers directly within, or connected to, food and pharmaceuticals due to both domestic and global demographic factors. This entails manufacturing, storage, and distribution of these types of products. However, more importantly, if you pull back medium-term demand drivers and look to long term - by 2050 the world population is forecast to increase by 2 billion people and most of the new demand will come from the Asia Pacific region for food service. This region exhibits an evolving economy and demography with respect to rapid urbanisation and a growing middle-class population. Australia is in a unique position in the long term to cater for the offshore middle-class population, particularly since Australia currently exports 65% of all domestically produced food products (importing only 15%). This is going to propel Australia as a more dominant force in the export market, which leads to growth in food logistics.

While those that provided commentary were quick to point out the devastating impacts of COVID-19 on Australian property markets, it is also encouraging to see many focus on the success of Government stimulus and the potential for markets to recover. State and Territory Governments are set to further relax restrictions this week and we watch with interest to see the impact of this on property markets across the country.