Outlook for Australian property

Executive Summary
2010-2012

Welcome to the 2010 issue of Westpac's 'Outlook for Australian Property Markets'

In this years executive summary we provide a brief overview of where the four major property market sectors are heading between 2010 and 2012, analysed by capital city.

As usual we supplement this executive summary with our eOutlook, which provides a more detailed view on our outlook for the various markets. This is located at www.westpac.com.au, within the research section of the Corporate Banking area of the internet site.

Outlook and eOutlook are just part of Westpac's commitment to keeping our customers and the market fully informed, so that we can make better decisions together.

Throughout the year Westpac Property also produce market updates, topical papers or views on various markets that are available to customers, if required. Please contact your Westpac Relationship Manager to organise either receiving our electronic updates or for a presentation from one of our Property Markets team.

Westpac strives to bring property experience, insight and innovation to each of our customer relationships.

National overview

In spite of the weakest global economy in 70 years, Australia was the only member of the G20 to avoid recession in 2009. That's not to say it didn't slow significantly - being only 0.6% higher in Q3 2009 than a year earlier, but the anticipated job losses that could have devastated the country's property markets did not eventuate. Although there was a shift from full to part-time employment for many, the 50-year low mortgage rates plus the government handouts ensured limited distressed property returned to the markets. In fact prices surged in the residential sector from Q1 2009 and there were signs that the commercial market had begun to bottom out from its seven quarter slump in the final quarter of the year.

The outlook for the economy over the next three years is one of continued growth. GDP is forecast to rise to a more normal 3% in 2010 and 3.2% in 2011, with an above average 4% expected in 2012. Expectations are for job growth to once again surge and some of the projections for Australia's population will need a continuation of the record high immigration figures of 2009 to be achieved. The challenge for the property market is to ride the stronger economic fundamentals in a period when the stimulus is being removed. The cash rate has already been lifted 3 times in late 2009 and further hikes are expected through to 2012. However, the lift has been from emergency lows and is expected to be gradual. Similarly, fundamentals are in reasonable shape for most markets, with few experiencing too much supply. Expectations are that tenant demand will lift and although the flow through to rents and values is usually delayed in a commercial property recovery, some growth could well start to emerge towards the second half of this year.

Residential

The residential sector, which was the star of 2009, has the challenge of maintaining demand in an environment of reducing stimulus. The first home buyer (FHB) boost ended on 1st January and although the FHBs could be attributed with the lift in demand in 1H 2009, as they grew by 96% from the start of the stimulus, it was always going to be a short-term factor, given the finite number of FHBs that could bring forward plans to buy. The biggest threat comes from rising mortgage rates, which increased 3 times in Q4 2009 and are expected to rise gradually through to 2012. While a dampening factor, the expected rise in job creation could counter the full impact of higher mortgages. It should also be considered that the cash rate is being lifted from emergency lows to a normal rate. At the start of 2010 the standard variable mortgage was 6.65%, with a discounted average rate of just over 6%. Either rate is low, but the discounted rate is at 2002 levels. However, rising interest rates and recent hikes in prices will start to pull forward the affordability issue, which in turn should result in a greater level of stability in prices from at least mid 2010.

Office

Office vacancy is near the peak in most markets, as expectations for demand to improve and supply levels remain relatively low. The exceptions remain those markets of previous years, where supply is too high. The Brisbane markets have seen the peak of supply, but more additions in 2010 will lift vacancy further. However, Perth CBD with over 10% due in 2010 has the highest level of potential completions, followed by Canberra at 7%. While market vacancy may have peaked in most, evidence of a recovery in rents or values is not expected until later in the year or even 2011. The impact of the global slowdown has pushed vacancy close to or above equilibrium in most markets. Once excess stock has been leased, pressure on rents, or initially incentives, should commence. However, investors have anticipated some improvement, with flat yields in most markets in Q4 2009. With yields above average, some firming and minor increase in value may start to occur in 2H 2010.

Retail

The stimulus in 2009 kept retail spending far higher than expected, but this is now likely to impact on spending growth into 2010. Challenging this view is a strong and surprisingly, at least so far, resilient level of consumer sentiment. This, combined with expectations that job growth will increase and lift household income, plus the consideration that population growth will continue, should help keep retail sales healthy. Further positives can be taken from the continued slowdown in development through the GFC, other than from some of the major retail owners who continue to look to capture greater market share. Rents are likely to remain subdued, although the falls recorded in many centres through 2009 should end. Yields, which continue to appear too low against the 10-year average, stabilised in Q4 2009. With investor appetite increasing and confidence growing, competition for prime retail properties may even lead to falling yields towards the end of 2010.

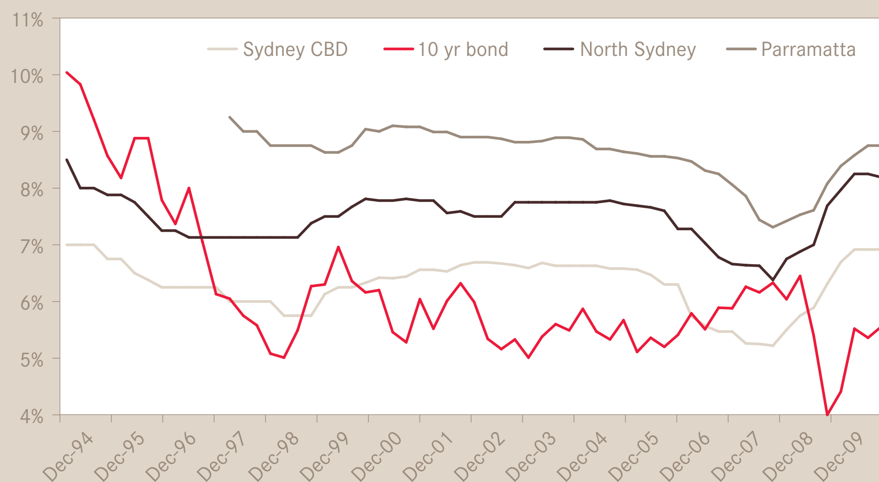
Industrial

The industrial market, which has been hit hardest by the market downturn, was showing signs of stabilising at the end of 2009. With expectations that the economy will lift in 2010, demand should increase. This will help reduce any overhang remaining from the oversupply on the eastern seaboard from the mid 2000s. Fortunately supply levels have been slowing significantly since 2008 and with only 642,000m^2 under construction in projects over 5,000m^2, future supply is low. While projects on hold and with development approval can add to this total, the recovery is likely to remain cautious and speculative supply should be low in 2010. This should ensure continued stability in land values, as seen in the latter half of 2009 for most markets. As the oversupply is absorbed, incentives could start to ease as the year progresses. With yields having eased by the greatest amount of all sectors and sitting around or above their 10-year averages, renewed investor confidence should start to drive yields lower for well leased, secure income properties.

Sydney

The impact of the global slowdown was expected to drive the NSW economy into recession, which being the largest State economy would drag the rest of the country down. While gross state product (GSP) was the lowest since the 1990s recession in the 2008/9 year, at 0.16% it avoided recession. As with the rest of the country the economy has picked up in 2H 2009 and is expected to gather momentum into 2010 and 2011, with GSP growth forecast at 1.5% and 2.7% respectively. The fear for the property markets was that employment levels would fall, reducing the need for commercial property and also placing pressure on demand for residential. While 1H 2009 did show a fall in total jobs of 5,300, with full time declining by almost 31,000, 2H 2009 saw rising employment levels of 35,200, with 2,500 full time jobs created. There is still room for improvement, but 2009 was not as bad as initially predicted.

The result of a healthier than expected economy and job market was a better than expected outcome for property. While vacancies still rose and values fell, the extent was not as severe as expected. With low supply levels, at least in the short term, and a rising economy, NSW property markets should improve from 2010.



Sydney prime office yields look attractive

SOURCE: CB RICHARD ELLIS, RBA

Residential

- Strong fiscal and monetary stimulus, plus record population growth helped boost demand, particularly from end Q1 2009. Prices surged to year end.
- Stimulus is being removed through the forecast period, but healthier economy should drive activity. Price growth to slow, if not stabilise, in 2010 as rates rise.

We had considered that while the fundamentals for the Sydney residential market in 2009 were very positive; under supply, continued population growth, falling mortgage rates and no price growth for five years, that the fear of a recession could hold back activity. While true for the first quarter, 50-year low mortgages and the first home buyers (FHB) boost lifted activity in 1H 2009, with rising confidence helping in 2H. FHBs (up 106% to June) helped boost the finance commitment to construct a dwelling by 93% and to buy a new dwelling by 87% from the lows of 2008. The larger market of existing buyers also lifted by 31% in the first three quarters while investors were up 27%. As expected FHBs slowed significantly (-34%) from mid year, despite an extension to the boost, while three consecutive interest rate rises in Q4 slowed the existing owners and investors by between 5% and 9%.

Our expectations are for demand to remain healthy as job growth accelerates over the next two years. Further interest rate rises should ensure the market doesn't over heat. Investors are expected to continue to return and take up some of the loss in activity from FHBs.

Sydney continues to undersupply in terms of new dwellings. Although approvals picked up in the second half of the year, total dwellings for the year fell to a 24 year low of 15,902. With strong population growth, dwelling approvals need to be 29,230. With not enough new supply, vacancy remained low at 1.3%. However, as forecast last year, rents were largely stable as the consideration of losing a tenant to the FHB boost, plus falling mortgage repayments reduced pressure on landlords. While we expect dwelling approvals to pick up through 2010, unless population growth slows substantially, under supply is likely to continue. With rising interest rates and fewer FHBs, landlords may start to lift rents from 2010.

An unexpected surge in prices from Q2 2009 resulted in house price growth of over 7% and almost 10% for other dwellings in the year to Q3 2009. ABS data suggests the growth accelerated into Q4 2009. With limited rental growth, yields fell to 5.2%, still one of the highest in the country. However, affordability is starting to decline again, as the price growth and higher interest rates outpace income growth. While there may be some momentum coming into 2010 for price growth, it is likely to slow as interest rates rise further during the year. If we are correct yields will start to increase again during 2010. However, in the January 2010 Westpac consumer sentiment survey, over 80% of NSW respondents consider price gains will continue into 2010, with over 20% expecting rises of 10% or more.

Offices

- Vacancy did not rise as high as expected in 2009. With demand lifting, vacancy may have peaked for now.
- Easing in yields could have been overdone. Improving fundamentals could drive yields down in late 2010.

Following a decline of 40,000m^2 in 2H 2008, net absorption fell by 142,500m^2 in 2009. However, the majority, 120,000m^2, occurred in 1H 2009, with considerations that occupancy started to increase in Q4. Vacancy lifted to 8.1% against our forecast of 8.9% by end 2009, with higher withdrawals than expected delivering the lower vacancy. Although supply due over the next two years remains manageable at under 2% per annum once withdrawals are accounted for, Sydney could well be embarking on the next development cycle from 2012. Large pre-commitments have started two major projects and Lend Lease won the contract to develop the Barangaroo project, although that has yet to start. Fortunately tenant demand is expected to continue to gather momentum over the forecast period and exceed supply in 2010, lowering vacancy to 7.5%, before stabilising in 2011. Rising supply in 2012 could lift vacancy back closer to 10%. Our demand forecasts could be viewed as conservative compared to previous recoveries, but similarly the decline in occupancy during the downturn was not as high as previously experienced.

Vacancy in Sydney's suburban markets was mixed, with Sydney's North Shore markets rising as occupancy fell, while Parramatta posted a minor fall in vacancy to 9.8%, despite high supply. While we also expect a pick up in tenant demand in the suburban markets over the next three years, the extent of supply in North Sydney is likely to outpace demand in 2010, even with tenants attracted from outside the market to the new completion. We forecast North Sydney vacancy to rise to 13.3% by year end, from the current 11.1%. However, limited supply thereafter should allow vacancies to decline. Limited supply and steady demand should allow Parramatta vacancy to continue to ease to 9.1% by year end and 6% by 2012.

Rents fell in all markets over the year. Incentives rose higher than expected, driving rents lower by 20% in the CBD, 8% in North Sydney and 5% in Parramatta. Falling vacancy in the CBD and Parramatta should start to push incentives lower, particularly from mid year and into 2011. We forecast prime rental growth of 6% in 2010 and double digit growth in 2011 for the CBD. Despite higher overall vacancy, North Sydney's prime vacancy is expected to remain relatively steady, resulting in prime rents stabilising over the year.

Last year we suggested that sentiment may drive yields higher, particularly in 1H 2009. Prime office yields rose until Q3 2009, with lifts of 61 basis points for CBD, 50 basis points for North Sydney and 67 basis points for Parramatta. However, there were signs of stability in Q4, and a minor firming for North Sydney. With improving market fundamentals and yields above long term averages, prime yields for CBD and Parramatta could firm from mid year.

Retail

- Spending rose steadily through the year with or without stimulus. However, markets continued to weaken early in the year, with stabilisation in Q4 2009.
- Supply remains low and despite no strong lift in fundamentals, retail's popularity with investors may drive yields lower by year end.

Retail sales in NSW held up very well during 2009 rising by some 6.9% in nominal terms and 4.9% real. Initial considerations were that the growth was largely driven by the Fiscal handouts of 1H 2009. However, analysis of the data shows relatively even growth over both half years. Our fears for smaller retailers also appeared unfounded given ABS data showing spending growth of over 13% in the year. However, Access Economics are pessimistic about future spending patterns with the stimulus removed and higher interest rates reducing disposable income, forecasting minimal growth in 2010 and below average for 2011 and 2012. We believe this is too low given the rising population and job prospects, plus likely continued aggressive marketing from retailers. As such we have factored higher growth into our forecasts.

As with last year, the level of projects under construction is surprisingly higher at end 2009 than 2008, despite the credit crunch. Some 315,500m^2 was under construction. However, analysis of the projects reveals it is mainly large centres being rebuilt or expanding. Although not high in a market the size of Sydney, localised impact needs to be considered on some of the smaller surrounding markets.

While we considered that rental growth would be low, it actually fell for most types of retail in 2009, in particular sub regional and neighbourhood centres. Improving retail sales and limited supply should help stabilise rentals, but a strong rebound is unlikely, particularly if spending is lower than we expect.

Yields also eased further in 2009 by between a further 6 basis points for CBD centres and 85 basis points for bulky goods centres. However, they remain below longer term averages and risk premiums, the exception being bulky goods centres. While we do not forecast any major pick up in fundamentals, with stable rents, the popularity of retail with investors in the past and renewed confidence around the economy could push yields down by year end.

Industrial

- A weak 1H 2009 continued to impact the market until Q4 when signs of stability emerged.
- Low future supply could stabilise rents in 2010, with possible pressure on yields from 2H 2010.

Although NSW avoided a technical recession, the drivers of industrial demand either fell or stabilised during the year. Particularly weak was the first half of the year, although an improving second half helped lift tenant demand in the final quarter, albeit from very low levels.

New supply continues to slow with 189,000m^2 under construction in late 2009, compared with 473,000m^2 under construction at the end of the 2008. As with other years, most is in the outer suburban markets. A good indicator of how developer confidence has fallen in this sector is the 1.6 million metres squared of projects on hold. While some of these will never commence, some had and were halted, while others have approval. As fundamentals improve, supply is ready to start again, although pre-commitment is once again expected to be a main requirement.

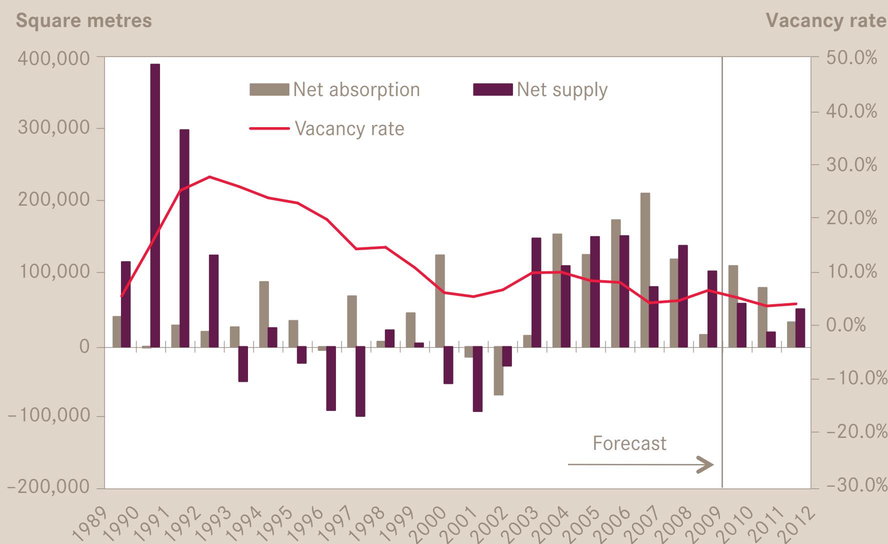
As expected, rents declined over the year across the various markets. Largest falls were, surprisingly, in the more traditional markets of the North and South at 8% and 14% respectively. However, rents on the central west markets also declined by around 7%. There were signs that rents stabilised or even increased in outer areas in Q4 2009. With low future supply and improving demand, pressure could well start to lift rents from mid 2010 and into 2011. However, strong rental growth has not historically been a factor in industrial and with the high potential development identified above, is unlikely to be in the future.

As expected Sydney's industrial yields continued to ease through 1H 2009. Yields rose by around 57 basis points for prime space and 48 basis points for secondary in 2009, to sit slightly above their 10-year average of 8.7% for prime and 9.24% for secondary properties. However, there were signs that yields had stabilised or even firmed by year end. With improving fundamentals and yields back to their long term average, the potential for yields to firm further, particularly once rental growth commences in 2H 2010 is high.

Melbourne

With the economic slowdown not as severe as expected, the property markets of Victoria will start 2010 in better shape than was forecast this time last year. Residential demand is booming as record population growth, attractive first home buyer incentives and job gains in the second half of the year lifted confidence. While supply is rising, it appears insufficient and the challenge Melbourne residential faces in the next three years is to avoid a bubble created by an improving economy and too little supply.

The commercial markets also fared much better than expected. In fact the CBD office market once again surprised on the upside with positive demand limiting the impact of high supply. The CBD appears on the cusp of strong growth as supply slows. Retail and industrial supply has slowed significantly, but a forecast slow economic recovery in 2010 should ensure no major turns in these markets. Finally following two years of rising yields, the markets appear to have reached bottom, with yields back to 10 year averages and attracting investors. Although property generally doesn't shift quickly, some of the yields appear attractive and could firm ahead of fundamentals.



Melbourne CBD office market to strengthen as supply slows

SOURCE: PCA OMR JANUARY 2010
FORECAST: WESTPAC PROPERTY MARKETS

Residential

- First home buyers, record population growth and surging confidence drove owner occupier demand to record high in 2009 and prices surged.
- Rising employment should mitigate the impact of higher interest rates and stimulus withdrawal, but price growth should revert closer to CPI.

The success of the first home buyers (FHB) boost in early 2009, followed by rising confidence in 2H 2009 boosted owner occupier activity to record highs during the year. Strongest growth was in the finance to construct, which rose 125% from the lows of early 2008 boosted by FHBs, while finance to buy a new home was also up a significant 69% from late 2008 lows. Finance to buy an existing home rose by an impressive but lesser 35% from late 2008. There was also a lift in the level of investors during Q2 09, with an increase of around 15% in activity.

While the FHB boost can be attributed with some of the lift in demand, Victoria and Melbourne's population growth in recent years also has to take some credit. In the year to June 2009 Victoria had record high population growth of 114,000 people and while Melbourne's figures are yet to be released, recent history has shown that at least 80% of the State's population growth has been located in Melbourne. Therefore despite an increase in dwelling approvals to the highest level since 2002, Melbourne continues to under supply. Vacancy has remained low and stood at 1.3% in Q3 09. Low interest rates and fear of the potential loss of tenant to the FHB grant kept rental growth low in 2009 as expected, but the surging activity has driven prices up significantly. ABS data suggests median house prices rose by almost 20% in the year, while REIA figures suggest other dwellings rose 14% in the six months to September. As such gross investment yields have fallen to 4.1%.

In an environment of rising interest rates – Westpac Economics expect the RBA to lift the cash rate to 4.5% by 2H 2009 – and wind back of the FHB boost – the Federal boost ended at year start, but the Victorian Government has offered $11,000 grant to buy or build new property until mid 2010 – demand should slow from mid year. However, rising job numbers and relatively low interest rates should keep the larger, existing owner occupier market active into 2H 09. There is also the potential that investors remain active as the ability to lift rents returns in 2H 2010. A recent political development has been the amendment to the immigration policy around offering permanent residency for students on the skilled migration program. Demand for Melbourne inner units has benefitted from the growth of these students in recent years. If the impact is to reduce the numbers, one of the drivers of the burgeoning immigration numbers could be reduced.

While the current rate of price growth is unsustainable, the momentum into early 2010 should ensure some price growth for the year. However, should the rate of growth not slow, affordability issues could create a bubble which will correct as interest rates rise further into 2011.

Offices

- Stronger than expected net absorption in 2H 2009 led to a lower rise in vacancy than expected, but rent and value falls were in line with expectations.
- Slowing supply and rising demand leaves the CBD poised for strong growth from 2011.

Melbourne's two largest office markets could not be more different. Tenant demand for CBD offices having more than matched high levels of supply to 2008 continued to outperform expectations into 2009. Net absorption for the year was 15,000m^2 against our best case scenario forecast of zero. Vacancy was helped by some slippage of completions into 2010, but still high net supply of 100,000m^2 meant vacancy rose to 6.6% at end 2009. Conversely St Kilda Road experienced falling occupancy of 27,000m^2 or around 4% of stock over the year. Despite minimal supply, vacancy rose to 11.3%.

Although CBD development into 1H 2010 remains high at 106,000m^2 projects slow significantly thereafter. With forecasts for strong employment growth in both 2010 and 2011 demand should lift, exceeding supply and driving CBD vacancy down to 5.3% by year end and 4% in subsequent years. St Kilda Rd is not expected to follow this trend with stability in vacancy forecast, although it may benefit from undersupply and rising rents in the CBD from 2011.

Helping CBD demand could be lower rents, which fell 13% in 2009 as incentives rose to 20%. As vacancies start to fall from 2H 2010, incentives should ease towards 15% by year end, lifting effective rents by 8% for the year. Prime rental growth is forecast to accelerate in 2011 to 12%. Should this eventuate, in 2011 rents will only be 5% above the 2008 peak.

As expected, yields continued to ease in 2009 although there were signs of stability in Q4. CBD prime yields eased by 68 basis points during 2009 while St Kilda Road prime office yields eased by 148 basis points. The increase has lifted yields to, or above, their 10-year average. With improving fundamentals in the CBD, yields may well start to firm once the current supply cycle ends in 2H 10. However, St Kilda Rd yields reflect the challenge of oversupply in the market and should remain unchanged until tenant demand lifts.

Retail

- Below average spending growth will be helped by low supply into 2010.
- Limited rental growth forecast should keep yields stable, but usual investor focus could suggest otherwise. Concern for older centres remains.

The government's stimulus helped buoy retail sales in 1H 2009 with growth of 4.5%. Although flat sales in 2H 2009 appear disappointing, it has to be considered that there were no cash handouts. In recent years the smaller retailer has continued to grow sales, but the slowdown in sales growth overall in 2H 2009 saw smaller retailer sales fall by 1% in Q4 when compared with a year earlier. Larger retailers continued to grow turnover by over 8%, suggesting continued increase in market share. Forecasts by Access Economics are for retail spending to stabilise at around 5% per annum over the next three years, which is below average and appears low for the later years.

Retail supply has fallen significantly with 126,000m^2 under construction at year end, down from 426,000m^2 in 2008. Bulky goods centres and neighbourhood shopping centres dominate new supply. While the slowdown in supply is welcome in an environment where sales growth of below average is expected, potential supply remains high with 380,000m^2 at development approval and more in projects on hold. As confidence around a stable economic environment picks up, some of the larger centre expansions may commence. If turnover growth does remain around 5% per annum, it is likely that further expansions will deliver greater market share to the larger retailers, impacting on turnover in the smaller centres. This again places pressure on the surrounding older and smaller centres.

Retail rents fell in all but major regional and sub regional shopping centres during the year. However, stability was noticed across all sectors during Q4. Despite low new supply the ability to lift rents in low turnover will be difficult. The exception may be major centres should they capture increasing market share. Certainly for older centres, security of tenancy will be the key in the next few years.

As expected retail yields continued to ease in 2009. Increases averaged around 60 to 63 basis points over the year, the exception being the CBD which showed little movement. Yields for CBD and regional centres remain below their 10-year average, while sub regional and neighbourhood centres are now close to average. Bulky goods yields are well above their average. While fundamentals of below average spending growth suggest yields should not move in 2010, the stronger performance of the larger retailers could deliver rental growth in centres they occupy. With sub regional yields now close to average having eased almost 150 basis points since the peak, the attraction for investors may lead to some firming in 2010.

Industrial

- With rental growth in Q4 2009, there are signs the over supply has also eased.
- High yields may attract investors for well leased properties, driving yields lower by year end.

Melbourne's industrial market continued to decline into 1H 2009, albeit at a slower rate than in the past. Part of the slowdown may be due to the general halt in any new industrial construction, which has led to supply slowing considerably. As at the end of 2009 only 255,000m^2 was under construction. This compares to almost 600,000m^2 a year earlier and over 1 million metres squared in previous years. Most of the current supply is in the western suburbs, with some in the inner city. Despite the low level under construction, potential supply remains high and a threat to momentum once the recovery starts. Projects amounting to 375,000m^2 had development approval at the end of 2009, with a further 120,000m^2 on hold.

Fortunately demand is expected to lift from the lows of 2009 as the economy recovers. Although the main drivers of industrial production, imports and exports fell in 2009, all are forecast to post increases in 2010 and over the forecast period. This should help create demand and further alleviate levels of oversupply from previous years.

Rental stability and some increases in Q4 2009 suggest that the level of oversupply has eased. Last year we suggested that further rental falls could not be ruled out, despite rents having fallen since 2007 in some markets. While this occurred in the first half of the year and sent rents lower by between 1% and 8% for year as a whole, growth of between 3% for prime warehouses and 16% for prime high tech properties occurred in Q4. If, as is suggested by growth in Q4, the oversupply is easing, rents should continue to lift in 2010 as demand rises. However, Melbourne has a history of low rental growth, which is unlikely to change in 2010.

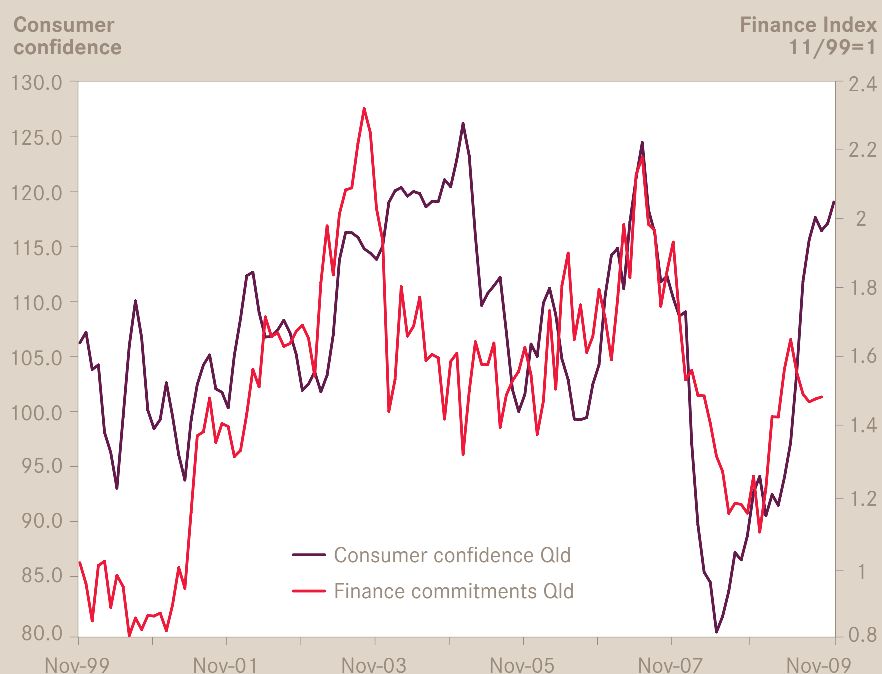
A further indicator of falling vacancy is the trend of land values stabilising from Q2 2009. While further declines were experienced in many markets, taking land values down from the peak by between 10% for Tullamarine and 25% for Dandenong, recent stability suggests the market has reached bottom. While no growth is forecast in 2010, stability is most likely for the year.

Yields continued to ease during the first 3 quarters of the year, taking values lower. Peak to trough yield easing ranged from 223 basis points for prime warehouses to 295 basis points for secondary warehouses. Individual markets posted much higher increases. However, as with other indicators, yields also stabilised in Q4 2009. Both prime and secondary yields are now well above 10-year averages. While limited rental growth suggests yields should not ease, well leased prime properties with yields of close to or over 9% are likely to attract a number of investors. This could lead to some firming of prime yields later in the year.

Brisbane

As with the rest of the country, the Queensland economy slowed significantly in 1H 2009, with GSP falling in Q2. The obvious impact on tenant demand and investor sentiment led to further declines in value across all sectors. However, as signs emerged that the downturn would not be a severe as first thought, confidence returned to the markets. By Q4 there were signs of stability in most and even growth in some sectors, the exception being the CBD and near city office market where oversupply continues to hinder any recovery.

As the Queensland economy slowly gathers pace, the flow through to property will be in the form of rising tenant demand. The lack of new supply completing over the next two years in all sectors but offices should result in the firming of yields, as investors look to potential medium term increases in income, adding to yields near or above 10-year averages.



Surging confidence to keep Brisbane residential activity near current levels into 2010

SOURCE: WESTPAC/MELBOURNE INSTITUTE, ABS
ANALYSIS: WESTPAC PROPERTY MARKETS

Residential

- Recovering economic growth and continued population growth to drive market as FHBs fall.
- Rising, but still relatively low interest rates to allow continued activity, but price growth to slow.

2009 was a story of two significantly differing periods. Initially, concerns that the weakest global economy for 70 years would feed through to the local economy led to low confidence and price falls for Brisbane residential. However, in 2H 2009, surging confidence, plus the 50 year low interest rates helped avoid a recession and spurred residential market activity. As a result, price growth surged. According to the ABS, Brisbane houses prices rose by over 10% in 2009. This is a stark contrast to the 2% fall seen in the six months to March 2009.

The First Home Buyers (FHBs) boost lifted demand when it was needed. From the low of September 2008 to the peak in May 2009 FHBs rose by 138%, before slowing, even though the boost was extended to September. However, as the FHBs fell, demand from existing owners, followed by investors, increased. Demand was helped by finance to construct a dwelling, which rose by 73% in 2009 and stood at previous highs at year end. Similarly finance to buy a new dwelling rose 66%. Historically, two key drivers of demand have been confidence and full time employment. Presently confidence remains high, while employment is expected to rise in 2010 and this should ensure demand remains active over the year. However, the extent of growth should be subdued by interest rate hikes.

The rise in finance to construct has helped boost dwelling approvals for Brisbane by 89% from the lows of February 2009, to almost 13,000 approvals. As this was a rise from the lowest level since 1987, supply is still too low to satisfy population growth. Approvals closer to 16,000-18,000 per annum are required.

Despite the undersupply, REIQ data shows that Brisbane vacancy rose to 3.3% by Q3 2009, up from 1.7% six months earlier. Even with FHBs moving from being tenants, a doubling in vacancy, given population growth and lack of supply, seems high. However, although rents were 4.7% higher over the year, they fell by 3% in Q2 2009, before lifting slightly during Q3. Rising prices exceeding the growth of rising rents for the year led to a fall in yields to 4.7% by Q3 2009. With the FHBs exodus stopping and an undersupply of dwelling completions, we consider that rental growth will commence post Q1 2010, once the vacancy rate falls. However, limited rental growth in 1H 2010 should result in a slight fall in yields by year end.

As mentioned earlier, price growth from Q2 2009 was far higher than expected. However, although the momentum is likely to have continued into Q1 2010, further increases in interest rates and concerns around affordability are likely to slow the rate of growth considerably from the quarterly rate of over 4% in Q4 2009. While positive employment growth and still comparatively low mortgage rates are likely to ensure prices do not fall, the majority of growth is likely to occur in 1H 2010.

Offices

- While the highs in vacancy predicted last year are unlikely, supply remains too high and vacancy should rise further.
- Further declines in rents and values are likely into early 2010, before they plateau.

As expected, the significant levels of new supply during the year lifted vacancy from 4.2% at year start to just under 12% by year end. However, stronger than expected demand late in the year meant that our forecast of almost 15% was not reached. In fact net absorption of over 40,000m^2 in 2H 2009 was above Brisbane CBD's long term average. This was not repeated in the Brisbane Fringe, where occupancy fell in 2H 2009 and vacancy rose to 11.6%, higher than forecast.

Although supply will slow significantly from the 202,000m^2 completed in 2009, two major projects are under construction, adding 101,000m^2 or around 5% to CBD stock by 2011. As we expect minimal withdrawals, demand will need to match levels seen in the mid 2000s resources boom to reduce vacancy. While current forecasts are for rising employment and thus rising demand over the next three years, the net absorption generated does not match supply in the CBD. In fact the relocation of Energex to Newstead will impact on the CBD this year. Our forecast is for CBD vacancy to rise to 12% this year and peak at 13% next. Fringe supply is also high in 2010, although reduces thereafter. The pre-commitment of over 82% of the supply will help reduce the impact on prime vacancy and the relocation of Energex will help reduce the impact on overall vacancy, but our forecast is for vacancy to peak at 14% by end 2011, far lower than our 19% forecast made mid last year.

Last year we forecast for peak to trough rental declines to match those of the early 1990s. Even though we expect a flight to quality as demand picks up and tenants look at attractive effective rents, which were 38% lower in Q4 2009 than at the peak, the continued supply could keep pressure on incentives. We continue to forecast a rise from the current 25% level of incentives to 30%, with further pressure on face rents. As such net effective declines of 11% are forecast for 2010, with an overall peak to trough fall of 45%, similar to the early 1990s downturn.

Yields continued to ease in 2009, but at a slower rate than in 2008. Nevertheless the 60+ basis points rise was slightly higher than we had expected. Prime and secondary yields at Q4 2009 sat 100 basis points above their 10-year averages and well above the longer term risk premium. While this will prove attractive to investors, the continued threat to income at lease expiry as vacancy rises further could drive values down further over the year, particularly for secondary properties.

Retail

- Falling rents of 2009 are not expected to continue into 2010 as supply remains low and improving spending lifts demand.
- Even though yields remain below average, a firming in Q4 2009 ahead of expectations may suggest the market has bottomed.

The Government's fiscal stimulus helped boost Queensland's retail sales in 2009 some 5.3% higher than in 2008. However, the majority of growth was in the first half of the year, as the level of sales fell by some 0.4% in the second half. Considering the lack of handouts over this period when compared with 1H 2009 (almost $13 bn, plus the impact of over $8 bn in December 2008) close to stability could be considered a reasonable result. The improving confidence levels, the limited loss of jobs over the period plus continued population growth would have helped spending to stay neutral. The outlook for 2010 is of subdued growth from Access Economics, with 4% forecast, picking up in 2011 and 2012, although remaining below the longer term average of close to 8% per annum. We consider the 2010 to be low, particularly given the lack of spending growth in 2H 2009, continued population growth and expected lift in employment and confidence.

As with last year, the lack of new projects under way or expected should allow the market to absorb slower than average retail sales growth. Data from CB Richard Ellis suggests only one major project under construction in Brisbane as at late 2009. Even projects with DA or applying for DA have slowed through the year. Some 92,000m^2 of projects have a DA in place, with under 150,000m^2 with a DA applied for. Perhaps a reflection of the continued caution in the market is the 179,000m^2 of projects with approval but on hold. Projects with a DA were largely Bulky Goods centres, while neighbourhood centres dominated applications.

Our expectation of stabilisation in rents during 2009 did not eventuate, with rents falling across most types of retail, the exception being regional shopping centres. The falls occurred mostly in the first three quarters, with Q4 recording growth in all but the CBD centres. The lift in spending, even with Access Economics slow 4% growth and lack of new supply should help buoy rents, with CPI growth likely over the year. As sales growth accelerates through 2011 and 2012, the rate of growth should increase as completions will remain low.

Our expectation of further easing in yields was also incorrect. Although they remain below 10 year averages and risk premiums, yields were either similar or firmer than at the end of 2008 in Q4 2009. The exceptions were CBD and bulky goods centres which were 21 basis points and 75 basis points higher respectively. The firming or even stabilisation of yields appears far too early, particularly given rental performance in 2009. However, such is the attraction of retail to investors that although yields appear too low they may remain unchanged in 2010 and firm thereafter.

Industrial

- New supply is now minimal and the overhang of supply between 2007 and early 2009 appears to be easing.
- Prime rents rose in Q4 and yields have reached peak. Potential for prime yields to firm in an improving market.

Following a significantly weaker 1H 2009 than expected, with GSP falling in Q2, the economic outlook is for improving demand drivers from 2010. In particular state final demand and industrial production are expected to lift from the lows of 2009.

New supply has reduced significantly over the past two years, with minimal completions in the latter half of 2009 and little under construction at the start of 2010. Data from CB Richard Ellis suggests 111,000m^2 was under way at November 2009, evenly spread through the major industrial areas. However, there is potential for supply to increase as demand lifts and the overhang of the high supply of previous years is leased. Although we do not expect a pick up in construction starts until late in 2010, the stability of land values, minor increase in rents in Q4 2009 and improving economic outlook may start to attract the attention of developers.

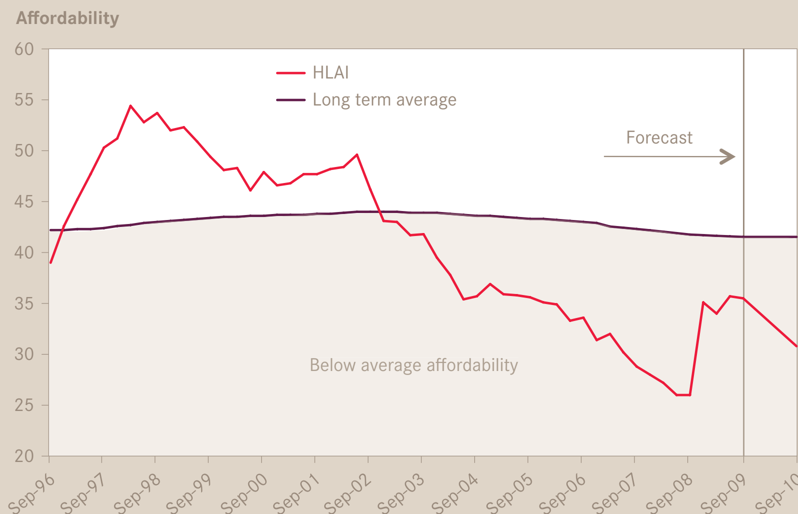
Our expectations of stability or minor falls in rents did not eventuate, with an average 17% fall in prime industrial rents and a surprisingly smaller 11% fall in secondary properties over the year. However, in Q4 2009 there were some signs that rents had stabilised or had increased, with stability occurring in the markets of previous high supply, Yatala and Western Corridor. The increase in rents was largely due to falling incentives, which suggests an improvement in vacancy for many markets. An improving economy and lack of supply should allow rents to continue to increase, although the rate of growth is likely to be cautious in early 2010.

As anticipated, yields continued to ease into 2009 at a slower rate than in 2008. However, our consideration that secondary yields would ease faster than prime did not eventuate. There were signs that the easing in yields has come to an end, with stability recorded in Q4 for most markets. At 8.9% prime yields are 50 basis points above their 10-year average. Secondary industrial yields, although at their 10-year average still appear too close to prime at around 9.5%. In an improving investment market it is likely that investors will focus on good quality prime stock and possibly drive prime yields lower in 2010, rather than secondary yields easing further.

Adelaide

Economic growth in South Australia for 2009 was at its lowest since 1992. Access Economics are suggesting economic growth for the state to have been 0.6% for the year – well below its 10-year average of 2.6%. Forecasts are for growth to pick substantially over 2010 to 3.7%, driven by private housing and equipment investment, imports and exports, although this is largely from mid year. Population growth is expected to remain strong, driven by international migrants, and employment growth is likely to pick up to above average levels, again from mid 2010.

The improving economic backdrop spurring demand, combined with low supply levels across the commercial sectors from 2010, should initially help steady and then improve market fundamentals from the second half of the year and through the forecast period.



Affordability to come under pressure over 2010 as interest rates rise

SOURCE: REIA
FORECASTS: WESTPAC PROPERTY MARKETS

Residential

- FHB boost, low interest rates and strong population growth drives record demand.
- Low dwelling approvals and continued population growth to put pressure on rents.

Despite a pick up in median house prices from Q2 2009, Adelaide's house prices grew by the lowest annual amount nationally, increasing by 1.4% in the year to September 2009. ABS data suggests that prices for existing houses increased by 2.1% over Q4 2009 and 5.1% annually, but growth was below the double digit growth in other capitals. Prices for other dwellings rose by 4.7% in the year to September 2009, despite recording a fall of 1.4% in Q3.

Overall demand for housing improved considerably over 2009, underpinned largely by first home buyers (FHBs). The majority of growth occurred in the first half of the year, driven by the demand for new dwellings. Finance commitments to purchase or construct a new dwelling are currently at 15-year highs after improving by 31% over the year. Finance commitments to purchase an existing dwelling also improved over 2009, by 16.7%.

Population growth remains strong in South Australia, driven by international migrants and is expected to grow at above trend over the forecast period. This, plus stronger employment growth are expected to support up-grader demand as FHBs exit the market and slowly help growth in demand over 2010. Interest rates are expected to rise further, but should only increase to around average during the year. Demand should carry through to 2010 as employment expectations for the year improve, resulting in annual price growth of just below 2009 levels. The majority of price growth is expected to occur in 1H 2009. Affordability is however a concern and while it is not expected to reach the lows of 2008, it will revert back to around mid 2007 levels by years end as interest rates rise.

Dwelling approvals are yet to rebound, despite the improvement in demand being driven by new dwellings. Total dwellings approved are 12.3% lower than a year ago, however a minor lift of 1.5% did occur in Q4 2009. Dwelling approvals were lower than the requirement generated by population growth by around 2,360 dwellings. A fall in Adelaide's vacancy rate of 100 basis points to 1.3% in Q3 2009 confirms the undersupply. Rents increased by 8.7% annually, the second highest growth rate nationally. This was higher than expected, particularly given the number of FHBs moving from tenancies and 50 year low interest rates. Rents are likely to remain under pressure as vacancy remains low and interest rates continue to rise through 2010.

The increase in rents has outstripped the pace of growth in prices over 2009 which has resulted in a 20 basis points increase in the gross yield to 4.5%. With growth in rents forecast to be similar to the increase in unit prices over the year, gross yields (as based on unit prices) are likely to remain around current levels. Unfortunately these are one of the lowest in the country.

Office

- CBD vacancy rose to 7.6%, but this is still well below the long-term average of 11.9%.
- Rental growth to continue as supply and vacancy falls and demand exceeds average.

Demand over 2009 in Adelaide's CBD (Core and Frame) was not as weak as we had anticipated. While annual net absorption was negative at 6,471m^2, the majority of weakness occurred in 1H 2009. Demand turned positive over 2H 2009 at 2,228m^2, driven by an improvement in the Core.

New supply in Adelaide's CBD was above average in 2009 as some 50,528m^2 completed over the year. The bulk of this supply entered the market in 2H 2009, with the completion of 400 King William Street and 147 Pirie Street. For the first time since 2003, annual supply has exceeded net absorption lifting the vacancy rate up by 4.2 percentage points to 7.6%. Although vacancy has increased substantially over the year, it rose from historically low levels and remains well below the long term average of 11.9%.

Future supply levels should fall significantly to below average levels. Around 27,400m^2 is under construction of which 8,400m^2 is due this year. A further 132,600m^2 of speculative supply has DA Approval, although the majority of these projects are not expected to come online in our forecast period. Our expectations of future demand have been upgraded significantly as a result of the forecast growth in employment. Net absorption is forecast to record above average levels through to 2012, outstripping net supply. We now consider vacancy to have peaked at the current 7.6%. Vacancy is expected to fall to 6.6% by year's end before reaching 6.0% in 2012.

Rental growth exceeded expectations, despite vacancy increasing and negative demand for the year. Core net effective rents rose by 0.4% in prime to 2.1% in secondary over the year, while growth in the frame was a surprising 6.7%, with suggestions that new completions drove the growth. Incentives increased, albeit minimally, early in 2009 which indicate owners have been able to push up face rents. Overall, rental growth in Adelaide's CBD is forecast to remain positive as a result of strong demand and a continued low vacancy rate. Growth is likely to occur from mid year, as the excess supply is soaked up. The rate of growth is expected to accelerate from 2011 as incentives fall with vacancy.

The performance of office yields varied between grades over 2009, with prime yields being 5 basis points lower than a year ago while secondary yields sit 68 basis points higher. Prime Core yields firmed over 2H 2009 by 50 basis points while secondary Core yields remained stable. Yields are likely to remain steady over 1H 2010 however investors may be attracted the prime yield of 8.7%, low vacancy and the potential for rental growth, which in turn is likely to push down yields from 2H 2009.

Retail

- Although future supply levels are low, a fall to below average retail sales will limit rental growth potential over 2010 and possibly through to 2011.
- Yields firmed prematurely across all centre types, despite sitting above their 10-year averages and risk premiums. Yields likely to stabilise in 2010.

Retail sales in South Australia held up well in 1H 2009. In the first six months of the year, retail sales grew at just below average levels, spurred by the government's cash handouts. However as the stimulus faded, retail sales weakened, recording a decline of 1.5% in Q3 2009 and volatile monthly figures in Q4. Access Economics are forecasting retail sales to remain weak through to 2012, growing at below the 10-year average of 6.5%, nominally. With employment growth expected to pick up from mid 2010, Westpac Property believes retail sales from mid year may not be as weak as anticipated.

While supply levels over 2009 were high with some 129,406m^2 completing, the majority was concentrated in the bulky goods market as Home HQ at Gepps Cross completed totalling 54,345m^2. Future retail supply has however declined considerably, with only 27,500m^2 currently under construction in comparison to 90,400m^2 a year ago. The majority of supply in 2010 will be in neighbourhood centres, which account for 70% of total stock under construction. Potential future supply also remains limited, with only 27,400m^2 with DA approval or pending approval. As the economy picks up, developers may move these to construction but most are unlikely to complete until at least mid 2011.

Quarterly rental growth varied throughout 2009, although all but sub regional shopping centres recorded positive annual growth. Should retail sales perform stronger than anticipated, the opportunity to increase rents further should occur from mid 2010, particularly as new supply remains low. However, if retail sales remain below trend, as expected by Access Economics, it is difficult to justify much growth in rents, despite low supply levels.

Retail yields remain below their 10-year averages by up to 25 basis points for most centre types. Most notable are CBD prime and neighbourhood shopping centres, which sit around 130 basis points below their 10-year averages and around 100 basis points below their average risk premium. Despite this, yields actually firmed across all centre types in 2H 2009 by between 20 basis points in sub regional centres and 91 basis points in CBD prime centres.

Retail yields do not appear to have been overdone in the easing cycle, with most appearing too low on a national comparison. The firming of yields seems to have occurred prematurely and while statistically yields appear as though they should rise further, it is more likely that yields will remain around current levels over 2010 as investment activity picks up.

Industrial

- Demand is expected to pick up from mid 2010 as the economic recovery accelerates.
- Signs that rents are stabilising emerged in Q4 2009 with the expectation that they should remain at current levels through to mid year.

As expected, the weak State economy in 2009 presented challenges to the industrial market. While industrial production fell, imports, and exports recorded weak performances over 2009, affecting demand. Forecasts for industrial demand drivers are mixed for 1H 2010 and as such demand is not expected to lift until State economic growth and industrial production improves from mid year.

While supply almost doubled in 2009, levels remained low. Just over 41,000m^2 entered the market in 2009, the majority being in the warehouse market. Supply will increase further over 2010 as 62,700m^2 of stock currently under construction enters the market. With the supply pipeline of no major concern, vacancy is unlikely to pose a problem over the forecast period, particularly as demand improves.

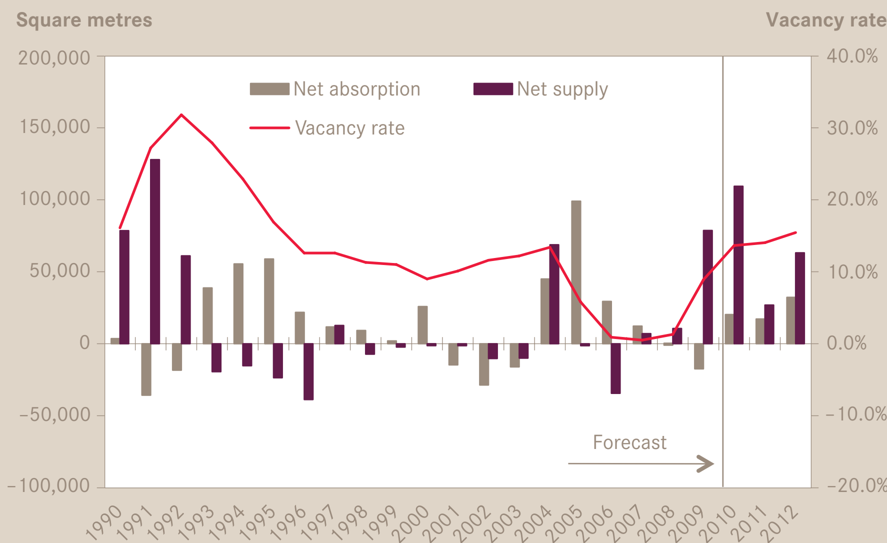
As forecast, rents continued to decline over 2009 by between -2.4% in prime distribution and -7.5% in prime unit estates. Signs that rents may be stabilising emerged in Q4 2009. With demand unlikely to notably improve until mid to late 2010, rentals are likely to stabilise in 1H 10, before growth commences mid 2010, as economic growth lifts. However following past trends over the last five years, rental growth is unlikely to be any higher than CPI.

Yields continued to ease over 2009 by between 84 basis points in secondary unit estates and 115 basis points in secondary distribution. Yields stabilised in Q4 2009 and most markets now sit at, or above, their 10-year averages. However, despite the easing over the year, secondary warehouse and distribution remain around 35 basis points below their 10-year averages and may have stabilised too early. Prime yields are likely to remain at current levels of 8.94% for warehouses and 9.09% for distribution centres over 1H 2010, however may firm from mid year as potential income growth is priced in.

Perth

The global financial crisis weighed heavily on Perth's economic growth over 2009 as the resource investment initially slowed. Despite economic growth falling to historically low levels, a number of major resource projects boosted confidence, in particular the $43 billion Gorgon LNG project, which began construction in December 2009. Gorgon is the largest single resource investment in Australia and the long-term flow on effects for Western Australia will be significant according to Access Economics. Economic growth for the State is expected to pick up to above average levels in 2010 before reverting back to just below average levels in 2011 and 2012.

Supply remains low in all markets except for CBD office, which will help both rental growth and capital value growth in some markets from mid to late 2010. The office sector is likely to remain challenged as supply levels appear too high over the forecast period.



Supply will continue to outstrip demand in Perth's CBD through 2012

SOURCE: HISTORIC DATA PCA OMR – JANUARY 2010
FORECASTS: WESTPAC PROPERTY MARKETS

Residential

- FHBs grant boosts demand, generating medium house price growth of 5.5% in the year.
- Vacancy levels reach highest levels in 15 years at 4.8% despite an under supply of new dwellings.

Median house prices in Perth performed better than we had expected over the year to September 2009. After increasing by 2.2% in Q3 2009 and 5.5% annually, median house prices are now just 2.1% below the peak of late 2007. The ABS suggests that the upswing in prices continued into Q4 2009, growing by 5.7%. Median prices for other dwellings rose by 1.9% over Q3 2009 and 7.8% annually. Price growth is likely to continue into 1H 2010, however at a slower rate than in 2009, before stabilising from mid year.

The first home buyer's (FHBs) grant successfully boosted owner occupier demand from the lows of 2008. Demand was at its strongest in 1H 2009, with finance approvals to construct a new dwelling up 65% annually. Finance to buy a new home improved by 23.4% annually while finance to buy an existing home improved by 12.4%. While impressive, these growth rates are amongst the lowest in the country.

FHBs momentum fell by 9.0% in Q4 as a result of FHBs boost phasing out. Non FHBs demand also slowed in Q4, to 0.4%. Investor finance held up over Q4, despite interest rates rising. Demand into 2010 is likely to be held up by investors. However as interest rates rise, demand overall is likely to stabilise from mid year.

Total approvals for 2009 fell by 5.8%, driven by a substantial 51% drop in unit approvals. Housing approvals have improved 8.7% annually. The change occurred from 2H 2009, where approvals grew by 21.0%, driven largely by housing.

Population growth in WA continued at a high 3.0% in the year to June 2009. However not enough dwellings are being constructed to match the requirement generated by population growth. WA continues to be undersupplied by some 7,341 dwellings.

The continued under supply of stock was not reflected in the vacancy rate which increased over the year from 2.6% to 4.8% in Q3 2009 - the highest level since late 1993. Movement of tenants to ownership throughout the year may be behind the increase. This trend is likely to be reversed over 2010 as affordability to buy a dwelling deteriorates.

Rents increased by 2.9% in the year to September 2009, however much of this growth occurred in Q4 2008 after which they remained stable. Rents are likely to see some growth over 2010, as interest rates continue to rise and vacancy begins to decline. Gross investment yields for other dwellings fell to 4.7% over Q3 2009 as price growth outstripped income growth. Yields are forecast to fall further over 2010 to around 4.5%.

Office

- Demand set to improve over 2010 however high levels of supply will result in vacancy peaking at 15.3% in 2012.
- Continued falls in effective rents over 2010 will likely bring peak to trough declines of 36% for prime and 46% for secondary.

Supply levels increased substantially over 2009 as 85,336m^2, or 6.6% of total stock completed in the midst of an economic downturn. The significant amount of new supply coupled with negative annual demand caused Perth's CBD vacancy to increase to 8.3% by year's end, close to our forecast of 8.5%. This was a rise from 1.3% a year earlier. Annual demand was at its weakest since 2002 at -17,461m^2. Demand was most weak in 1H 2009 at -22,002m^2 while a pick-up in the demand for A grade space helped turn demand positive in 2H 2009, at 4,541m^2.

Perth's CBD is set for another influx of supply this year as a historically high 144,140m^2, or 10.5% of total stock, comes online. Supply remains high into 2012. The recent setback of Raine Square, due this year, may result in this project slipping into 2011. While expectations are for a recovery in demand from 2010 as employment improves, it is unlikely to match supply. As a result, vacancy is forecast to rise to 13.6% by end 2010 and a peak by the end of 2012 of 15.4%. This is below our previous expectation of a 16.4% peak in vacancy due demand recovering faster than anticipated.

Net effective rents declined over 2009 close to levels we had expected. Over the year, prime rents declined by 28.9% whilst secondary have fallen by 37.5%. Incentives were forecast to rise to 20-25% by the end of 2009 however that did not eventuate. Incentives increased over the year from 0% to 10%, indicating that falling face rents were largely behind the effective rental falls. We maintain the view that incentives will reach up to 20% for prime by the end of 2010 as new supply pushes up vacancy. Forecast incentives for secondary have been bought down from 25% to 20% Continued falls in face rents are forecast, albeit minimal, resulting in effective rents falling by a further 12% in prime and 13% in secondary over 2010. Peak to tough we expect to see rental falls of around 36% for prime and 46% for secondary.

Since peaking in Q3 2007, prime yields have eased by 181 basis points to 8.19% and secondary by 300 basis points to 10.00% as at December 2009. The rate of easing slowed over 2009, with prime easing by 55 basis points and secondary by 50 basis points. Interestingly prime yields firmed by 12 basis points in Q4 while secondary yields remained stable. Despite market fundamentals continuing to deteriorate, yields are likely to stabilise over 2010 as they are well over their 10-year averages by 108 basis points in prime and 157 basis points in secondary.

Retail

- Declines in retail rents were not as high as in other commercial markets in Perth, despite retail sales weakening over the year.
- While yields eased further over 2009 they continue to look too low in comparison to long term averages however stabilisation is likely over 2010.

Retail sales in Western Australia held up in early 2009, growing at above average levels in Q1, however have since weakened. Despite the cash handouts and historically high population growth, quarterly retail sales have grown at below the 1.4% average over the remainder of the year. Access Economics are forecasting retail sales to remain weak over 2010, before picking up to near long-term levels from early 2011. This does not appear unreasonable given that employment growth is not expected to see any notable growth until mid 2011.

Supply levels decreased significantly in 2009 as some 72,200m^2 was completed, with supply evenly spread across all centre types. This is in comparison to 120,000m^2 that came online in the previous year, of which 75% was concentrated in bulky goods centres. Supply under construction has fallen by 42% on a year earlier to around 85,000m^2. The majority of this is expected to come online in 2010 and is again evenly spread across most centre types, excluding regional centres which will see no new supply. Lower supply levels is good news for the retail market, particularly if retail sales remain below average levels over 2010 and 2011.

Declines in retail rents have not been as severe as other commercial markets in Perth, with falls ranging from -6.2% in neighbourhood centres to -8.4% in CBD prime shops. Regional centres have actually recorded growth of 3.3% over the year as owners increased face rents. Rental growth appears to be in the very early stages of recovery as mixed results occurred in Q4 2009. Signs of stabilisation emerged in CBD prime shops and neighbourhoods over Q4 while growth of 1.1% occurred in regional shopping centres and in sub regional shopping centres. Bulky goods centres continued to record falls in rents over Q4 as a result of demand unable to fill the overhang of supply from previous years. Despite low supply levels, below average retail sales over 2010 is unlikely to result in any notable rental growth across most centre types. Bulky goods centres are the exception and rents should remain under pressure due to the over supply that occurred in 2007 and 2008.

Yields eased by between 38 basis points in regional centres and 75 basis points in CBD prime shops and neighbourhood centres. Despite all retail yields sitting below their 10-year averages by 20 to 75 basis points, yields have stabilised in all but CBD prime centres over Q4 2009. While yields do appear to be too low in comparison to their averages, it is likely that yields will remain around current levels over the year as investor confidence picks up.

Industrial

- Improving economic indicators to flow through to a pick-up in demand.
- Low supply and a pick-up in demand to have positive effects on rents over the medium term.

Despite the weakest annual economic growth on record, the local economy has showed signs of a recovery in the latter half of the year. Access Economics are forecasting for economic growth to rebound in 2010 to 5.6% which is a significant improvement on the considered -2.9% in 2009. Other demand indicators such as private consumption and industrial production are forecast to pick-up substantially from 2010, although will remain below average levels over the forecast period. Improving economic indicators, whilst generally below average, should help generate demand for industrial space over the forecast period.

New supply remained moderate in 2009 as some 175,000m^2 completed, dominated by warehouses in 1H 2009. Supply levels are expected to decline substantially through to at least the end of 2011 as only 28,426m2 is under construction and a further 15,215m^2 has DA approval.

Low supply levels and rising demand over 2010 is good news for rents, which fell by 15.4% overall in 2009. The highest falls were recorded in Perth's north east, where net effective rents declined by 22% on average. Rental falls did not stop in Q4 2009 as in other sectors. Prime rents declined by 5.4% on average and secondary by 5.2% over Q4. Improving demand and low supply should help support some growth in rents over 2010, however this unlikely to eventuate until 2H 2010.

Yields eased 42 basis points in secondary warehouses and 55 basis points over 2009. While yields continued to ease in Q4 2009, the rate of declined has slowed substantially. Although prime warehouse yields in Perth are amongst the lowest nationally, they are now above their 10-year average by around 15 basis points. On the other hand, secondary yields are around 60 basis points below their long term average and nationally appear too low. With rents unlikely to improve in 1H 2010, investors are likely to be attracted to higher yielding sectors. Therefore we consider further pressure is likely early on in 2010 for secondary warehouse yields, whilst prime warehouse are likely to stabilise.

Canberra

The ACT economy was impacted by the national slowdown far greater than we had expected. While GSP slowed, job losses were experienced through the first half of the year but were regained in the second half. However, expectations are that the local economy will gather pace through the forecast period. The risk to the economy is the impact of potentially slower government expenditure once the election has passed.

The local residential market strengthened to 10-year highs, driving up prices, as the fiscal and monetary stimulus renewed confidence. However, 2010 faces supply challenges in both office and residential, which is likely to slow rental and value growth.

Residential

- Record high approvals could oversupply the market into 2010

Record levels of international migrants, combined with continued natural growth, drove population growth up by 1.6% in the year to June 2009. While dwelling approvals have been increasing in recent years, a surge in 2009 has led to a potential, oversupply situation, should they all be completed in the next year. Population growth of 5,600 people would require around 2,165 dwellings. Approvals in 2009 amounted to 3,600. While not all will be built there needs to be a high non start rate or a surge in population to take up the supply.

Demand picked up significantly through the year, initially aided by 50 year low mortgage rates and attractive first home buyers (FHB) grants, particularly to build or buy a new dwelling. Finance commitments to construct a new dwelling rose 119% from Q3 2008, while finance for new dwellings rose 96%. However, the larger existing market also rose by 35%. While rising interest rates and the wind back of the FHB boost in Q4 slowed demand a little , the market remained strong. Expectations for 2010 are for demand to remain active as the economy improves and jobs are created. However, the extent of activity is likely to be curtailed as interest rates rise higher and the FHB boost is removed.

Despite the supposed balance between requirements from population growth and supply, REIA data suggested vacancy fell to 1% in Q3, from 3% a year earlier. While a different methodology has been used, the fall seems too high. However, strong rental growth of 8.2% in the year suggests some under supply. Expectations for 2010 are for vacancy to increase as supply rises and for rental growth to slow.

Price growth surprised on the upside in 2009, with growth of 7% for houses and 10% for other dwellings in the year to September. ABS data suggest the growth continued into Q409, despite interest rate hikes. Although average affordability measures suggest it isn't an issue in Canberra at just 17% of income, higher interest rates in Q409, plus expectations of further lifts in 1H 2010, in addition to the continued price growth in Q4 should combine to reduce the affordability over the next year. This plus the level of supply should slow price growth particularly from 2H 10.

Office

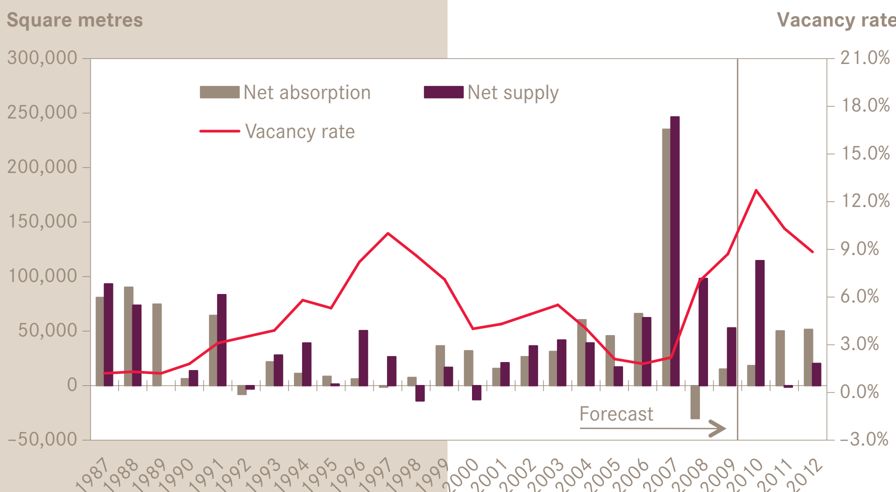
- Vacancy fell in 2H 09, but with high supply due in 2010, vacancy should rise to record highs
- Further pressure on rents and incentives, although yields have probably bottomed out.

Strong positive net absorption in 2H 09 and low supply led to a fall in vacancy in the Canberra market to 8.7%. The fall was largely in Civic. However, future supply levels remain high in 2010 at 152,000 square metres, with 142,000 square metres of this due in 1H 2010. While supply falls significantly over the final two forecast years, the completions in 2010 amount to 7.5% of stock.

As mentioned net absorption in the second half of 2009 was positive and at 15,755 square metres it was one of the highest in the country. Forecasts are that as the economy improves, employment growth also increases, particularly in 2011 and 2012. While we have concerns around forecasting strong demand when the government is likely to be cutting expenditure in the future, we have used the employment forecasts to generate demand. As such our vacancy forecast may be on the optimistic side. However, with supply exceeding demand we forecast that vacancy will rise to 12.7% by end 2010, before falling to above 10% in 2011. This would exceed the peak vacancy of 10% in the mid 1990s.

We expected that increasing vacancy through the year would drive incentives up and rentals down in 2009. Prime office rents continued to fall in 2009 by between 11% in Civic and 13% in non Civic markets. The forecast rise in vacancy is likely to push incentives higher and rents lower over the next year, with a forecast of 14% decline in prime net effective rents over 2010.

Investment yields also continued to ease through most of the year, although there were signs of stability in Q4. Canberra's prime office yields eased by a further 65 basis points in Civic and 42 basis points in non Civic over the first three quarters of 2009. While current yields remain below their ten year average, stability is likely for prime yields in 2010, despite the weak fundamentals. However, any property with challenges to income is likely to require higher yields by end 2010.



Canberra office market – supply to push vacancies higher

SOURCE: HISTORIC DATA PCA OMR - JANUARY 2010
FORECAST: WESTPAC PROPERTY MARKETS

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