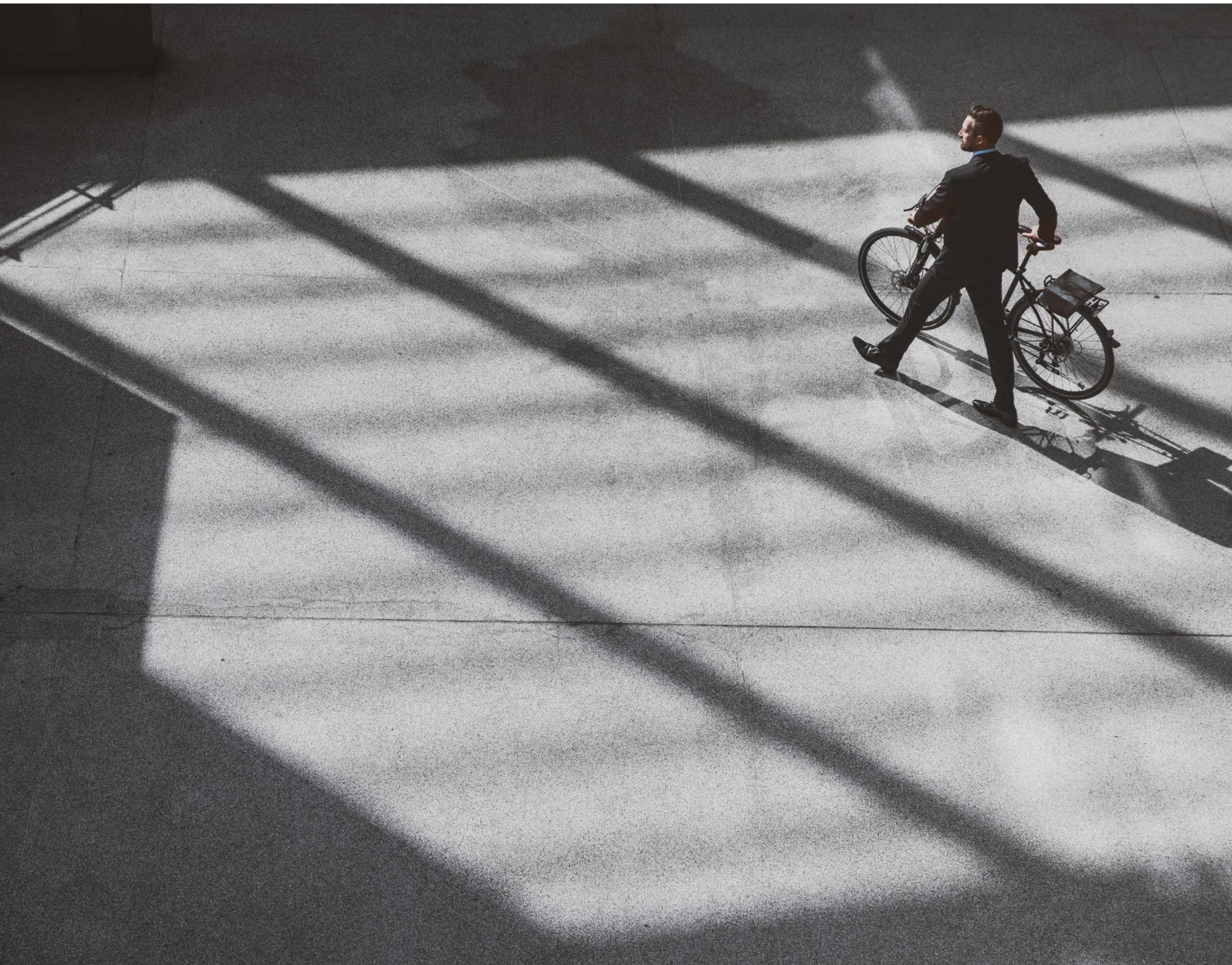
BANNER ASSET MANAGEMENT

Quarterly Property Report

JUNE 2020



Introduction

Welcome to the latest edition of Banner Asset Management's Quarterly Property Report.

At the time of writing, most of Australia (outside of Victoria) is gradually easing COVID-19 related restrictions, allowing businesses to resume trading, and people to return to work, gather, shop and play. However, rising cases of infection in Melbourne have led to a resumption of restrictions in Victoria.

Australia has fared better than many countries in containing the coronavirus pandemic. As a result, it been able to return to more normal levels of activity sooner than expected, giving the economy a head start versus many of its peers on the road to recovery. Still, outbreaks in suburbs of Melbourne and now isolated areas of Sydney pose a risk to the economic outlook.

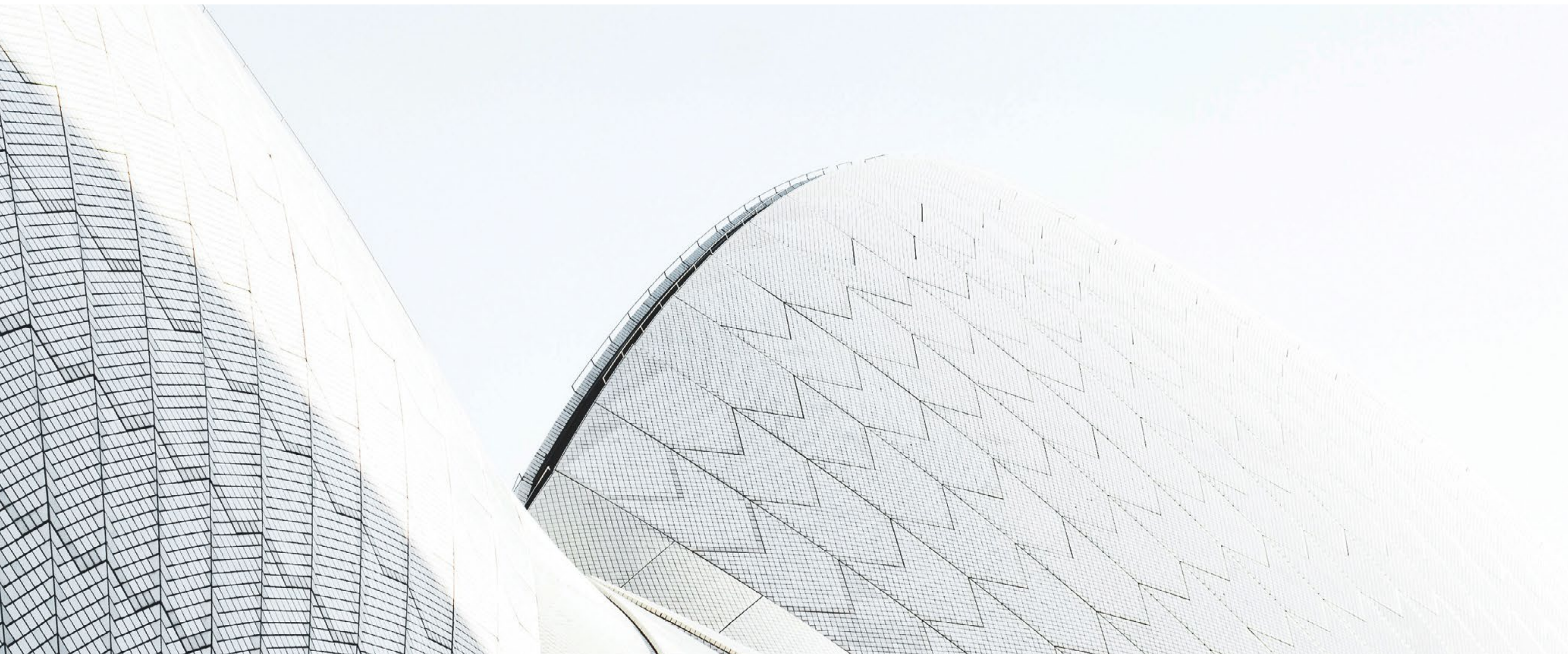
In recent weeks, activity in the residential market has begun to pick up, with the resumption of open houses and onsite auctions. Average dwelling prices edged lower in the quarter, though values remain above a year-ago in many key markets including Sydney, Melbourne and Brisbane.

While data on other real estate sub sectors following the escalation of the pandemic is limited, early indications are that industrial and logistics has proven the most resilient, as rising demand for online purchases during the pandemic has forced retailers to adapt their supply chain management.

While the extent of any further downside in values will depend on the speed of the economic recovery, yields in some property sectors remain attractive compared to other assets including government bonds and equities, suggesting investor interest in select Australian real estate will continue.

In our Spotlight section, we look at what the "new normal" will mean for various sectors of the real estate market.

We hope you find these insights useful.



Economic update

Australia has entered its first recession in nearly 30 years.

Treasury is forecasting a fall of 7% in 2Q from the prior quarter, following a 0.3% fall in 1Q.

Australia's unemployment rate rose to 7.4% in June, from 7.1% in May.

The Reserve Bank of Australia kept its target cash rate steady at a record low of 0.25% during the June quarter, after delivering two 25 basis points cuts in March.

Australia's population grew by 1.4% in the year through December 2019, slowing from 1.5% in September.

Source: Australian Bureau of Statistics, Reserve Bank of Australia

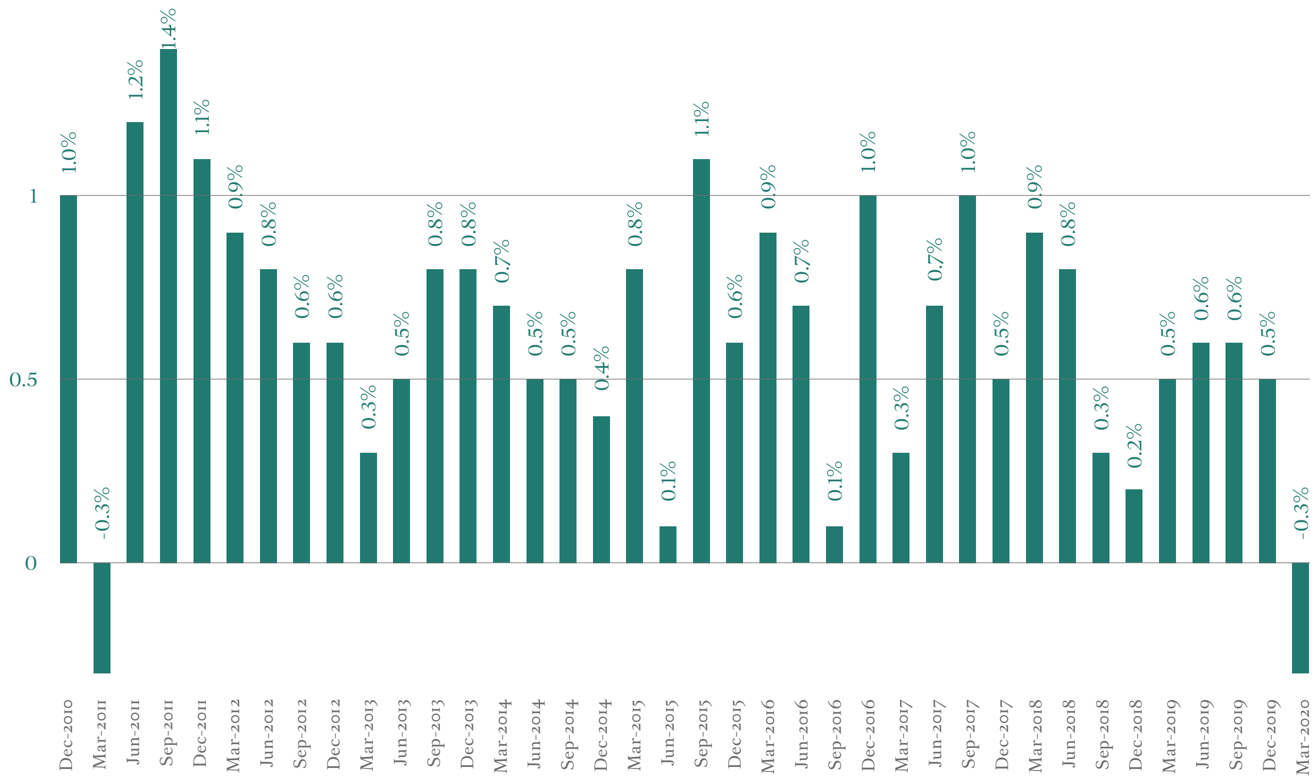
Australia has entered its first recession in 29 years due to the impact of COVID-19 on the economy. In its July Economic and Fiscal Update, Treasury estimates that GDP fell by 7% in the second quarter from the first, which would be the largest quarterly fall on record.[1] This follows a fall of 0.3% in the first quarter, which was affected by bushfires, international travel restrictions and the introduction of physical distancing measures later in the quarter.[2]

Unemployment rose to 7.4% in June from 7.1% in May as social distancing and restrictions on non-essential services impacted jobs.[3] The rise in unemployment has been somewhat contained by the Australian Government's Jobseeker wage subsidy package. However, Treasury is forecasting the unemployment rate will continue to rise, reaching 9.25% in the fourth quarter of this year.[4]

1 Australian Government, Treasury, Economic and Fiscal Update July 2020 https://budget.gov.au/2020-efu/economic-fiscal-update.htm
2 Australian Bureau of Statistics, 5206.0 – Australian National Accounts: National Income, Expenditure and Product, Mar 2020 https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5206.0Mar%202020?OpenDocument
3 Australian Bureau of Statistics, 6202.0 – Labour Force, Australia, June 2020 https://www.abs.gov.au/AUSSTATS/abs@.nsf/allprimarymainfeatures/6050C537617B613BCA25836800102753?opendocument
4 Australian Government, Treasury, Economic and Fiscal Update July 2020 https://budget.gov.au/2020-efu/economic-fiscal-update.htm

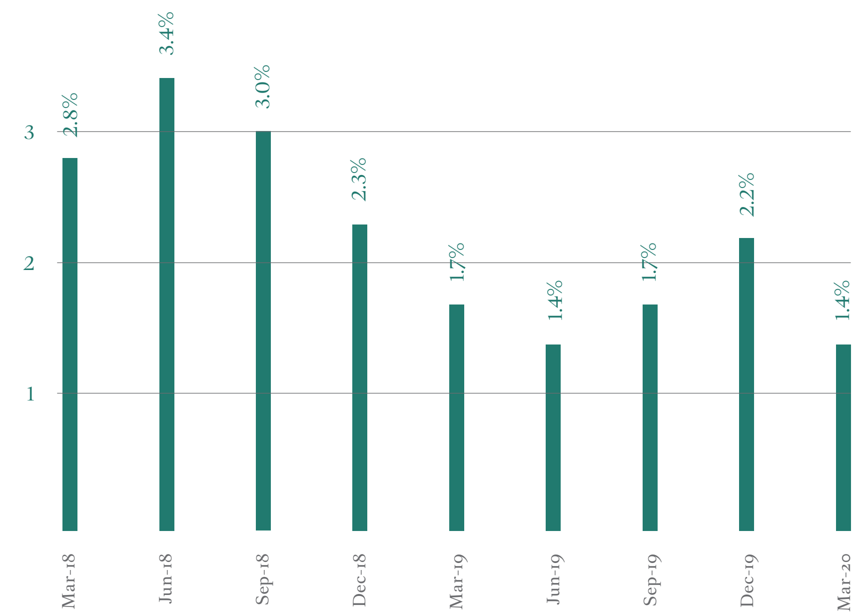
ECONOMIC GROWTH EDGED LOWER ON A QUARTERLY BASIS

Source: ABS



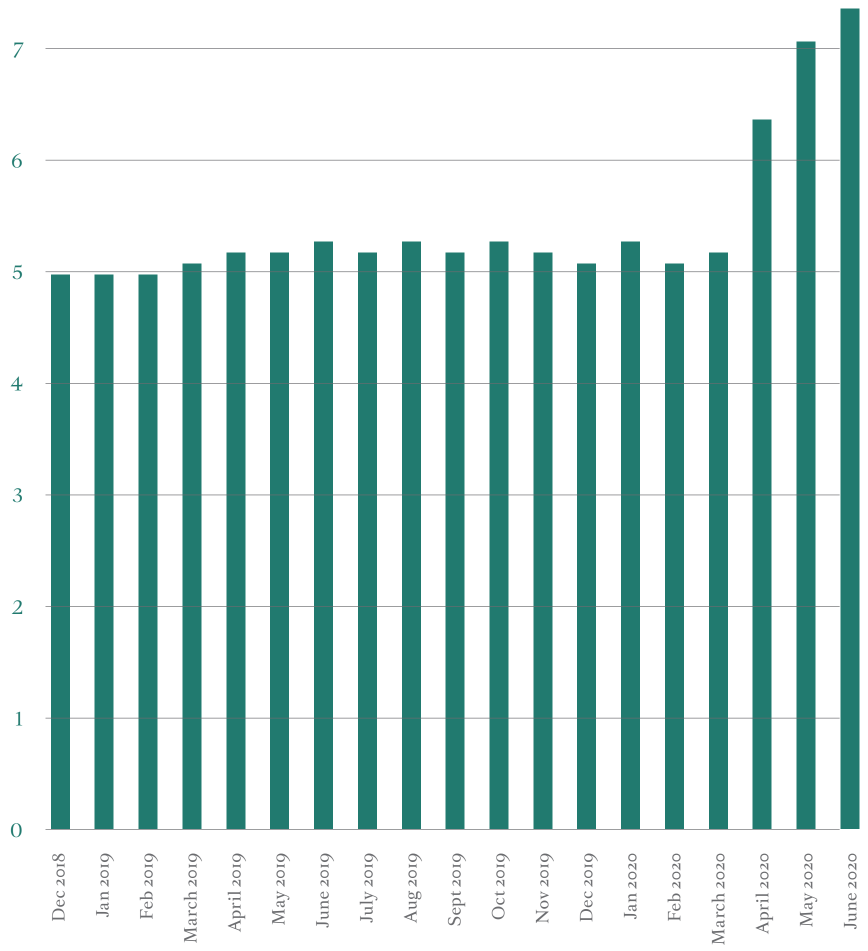
ANNUAL GDP GROWTH

Source: ABS



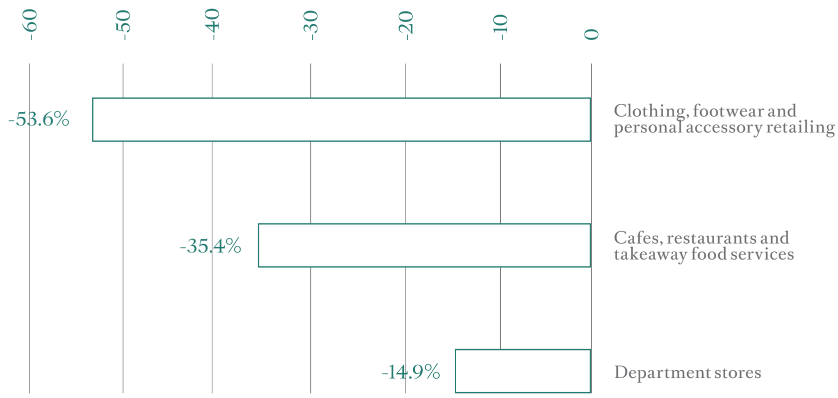
UNEMPLOYMENT RATE RISES

Source: ABS



RETAIL SECTORS EXPERIENCING RECORD FALLS IN TURNOVER IN APRIL

Source: ABS



Australia economy forecast to outperform peers in 2020, before rebounding in 2021

In its recent communications to the market, the RBA has said it appears the economy has performed somewhat better in the second quarter than feared, thanks to policy actions taken by the government and regulators on multiple fronts including fiscal, monetary and prudential.

Meanwhile, the success of health authorities in containing the pandemic has allowed restrictions to be eased sooner than expected, with the exception of Victoria.[5]

RBA Governor Philip Lowe said hours worked have begun to pick up in June after falling 10% in previous months[6] and there has also been a pickup in some forms of consumer spending.[7]

Retail trade rebounded in May, rising 16.9% amid the gradual easing of social distancing regulations and the reopening of physical stores.[8] The bounce unwound much of the 17.7% fall that occurred in April as many retailers closed their physical stores due to restrictions related to social distancing.[9] Sales may be impacted in Victoria and there will be differences across other states depending on the rate at which restrictions are eased.

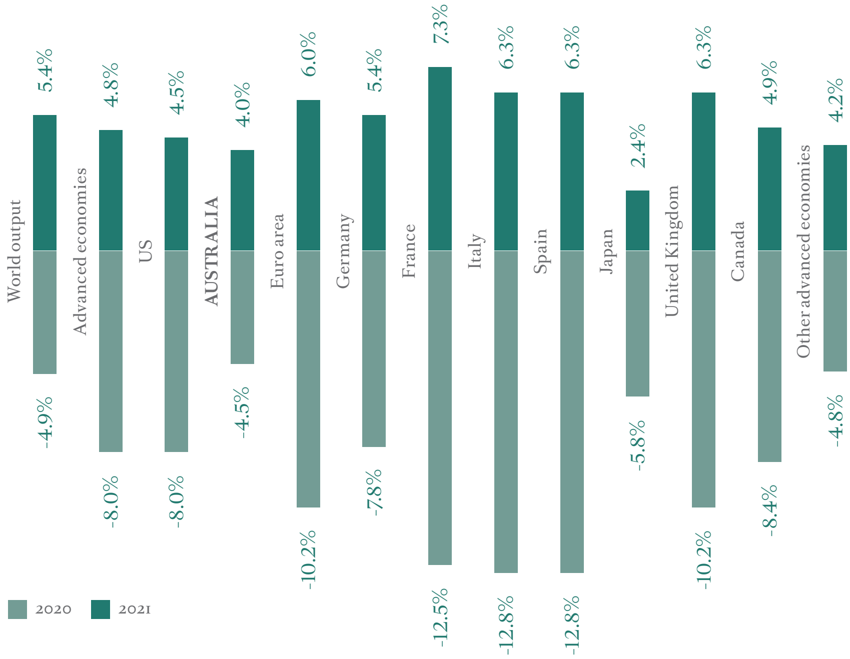
In its June World Economic Update, the International Monetary Fund forecast Australia's economy will shrink by 4.5% in 2020. This a 2.2 percentage point improvement from its April outlook, and puts Australia ahead of most of its advanced-economy peers. The IMF expects Australia's economy to rebound in 2021 with 4.0% growth.[10]

However, the RBA's Lowe noted that the shape and speed of the economic recovery remains highly uncertain and the pandemic is likely to have long-lasting effects on the economy. "In the period immediately ahead, much will depend on the confidence that people and businesses have about the health situation and their own finances," he said.

5 Guy Debelle, The Reserve Bank's Policy Actions and Balance Sheet, speech to The Economic Society Australia, 30 June 2020 https://www.rba.gov.au/speeches/2020/sp-dg-2020-06-30.html
6 RBA, Speech by Governor Philip Low to the Anika Foundation, 21 July 2020 https://www.rba.gov.au/speeches/2020/sp-gov-2020-07-21.html
7 RBA, Statement by Philip Lowe, Governor: Monetary Policy Decision, 2 June 2020 https://www.rba.gov.au/media-releases/2020/mr-20-15.html
8 Australian Bureau of Statistics, 8501.0 – Retail Trade, Australia, May 2020 https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/D101561A26022077CA25857C0018CFDA?OpenDocument
9 Australian Bureau of Statistics, 8501.0 – Retail Trade, Australia, Apr 2020 https://www.abs.gov.au/ausstats/abs@.nsf/0/3DDA13ECDC094B1CCA257734002042F2?Opendocument
10 International Monetary Fund, World Economic Outlook Update, June 2020 https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020

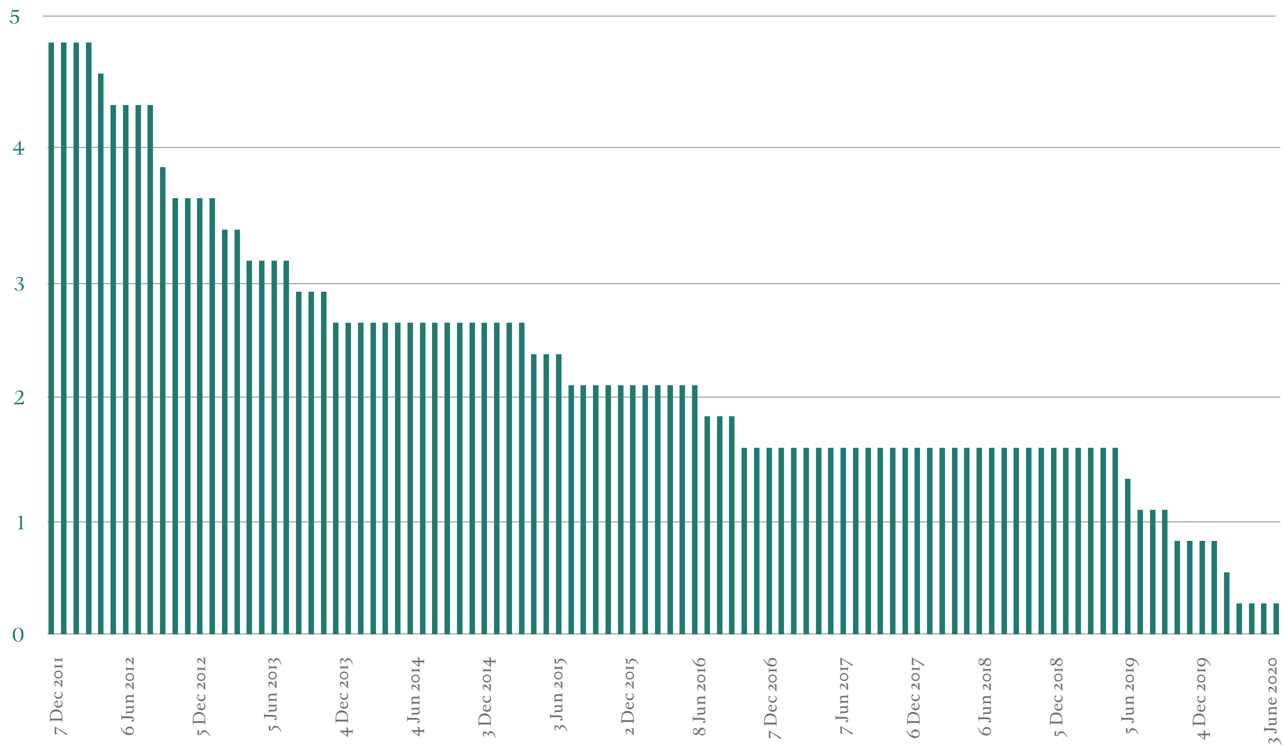
IMF GROWTH PROJECTIONS (%) – AUSTRALIA AHEAD OF MOST ADVANCED ECONOMY PEERS

Source: IMF



THE RESERVE BANK OF AUSTRALIA'S CASH RATE IS AT A RECORD LOW OF 0.25%

Source: IMF



Slowing population growth a risk

One of the biggest risks to Australia's economic outlook is a slowdown in population growth. Australia's steady population growth in recent years, which has tracked above the OECD average, has been largely driven by immigration.

With strong border controls likely to remain in place for the next 12 months, Deloitte Access Economics has forecast just 0.8% population growth in 2020 (versus 1.4% in 2019), followed by 0.6% in 2021, before the recovery beings with 1.1% growth in 2022 and population growth returns to pre-COVID levels by 2023.[11]

If border controls remain in place for longer, and people remain reluctant to relocate internationally, or a second outbreak sees extended disruptions to international movements, the slowdown in population growth could be larger and more prolonged, the research house warns.

Property activity and capital markets

The physical restrictions on movement and economic activity related to COVID-19 have impacted activity in the commercial property markets, with many investors waiting on the sidelines in recent weeks to see where deal pricing would land. An April survey by Knight Frank found that a quarter of all asset sales were on hold.[12]

JLL estimates commercial property transaction volumes will fall to $10 billion-$12 billion in 2020, from a record high of $36 billion in 2019.

Private debt markets are continuing to operate and JLL notes that for well-rated borrowers and for core assets, it has only seen a 10 to 25 basis point movement in post COVID-19 pricing for a five-year loan.[13]

Pricing has moved out more significantly for assets with income risk and development finance.

"Non-bank lenders are reviewing this part of the market closely as there will still be good lending opportunities and the potential to make attractive risk-adjusted returns," said Fergal Harris, Head of Capital Markets – Australia, JLL.

11 Deloitte Access Economics, Economic scenarios for the COVID-19 recovery, May 2020 https://www2.deloitte.com/au/en/pages/economics/articles/economic-scenarios-covid-19-recovery.html

12 Knight Frank, A quarter of sales are on hold, Capital Markets Insight, April 2020

13 JLL Research, Australia and New Zealand take their first steps towards the next normal

Residential

National dwelling values edged down 0.8% in the three months to June, led by a 1.1% decline across capital city markets.[14]

Annual growth is still up 7.3%, reflecting the improvement in the market before the onset of the pandemic and the impact of government assistance on household incomes. Mortgage deferrals provided by the banks have also helped to avoid forced selling.

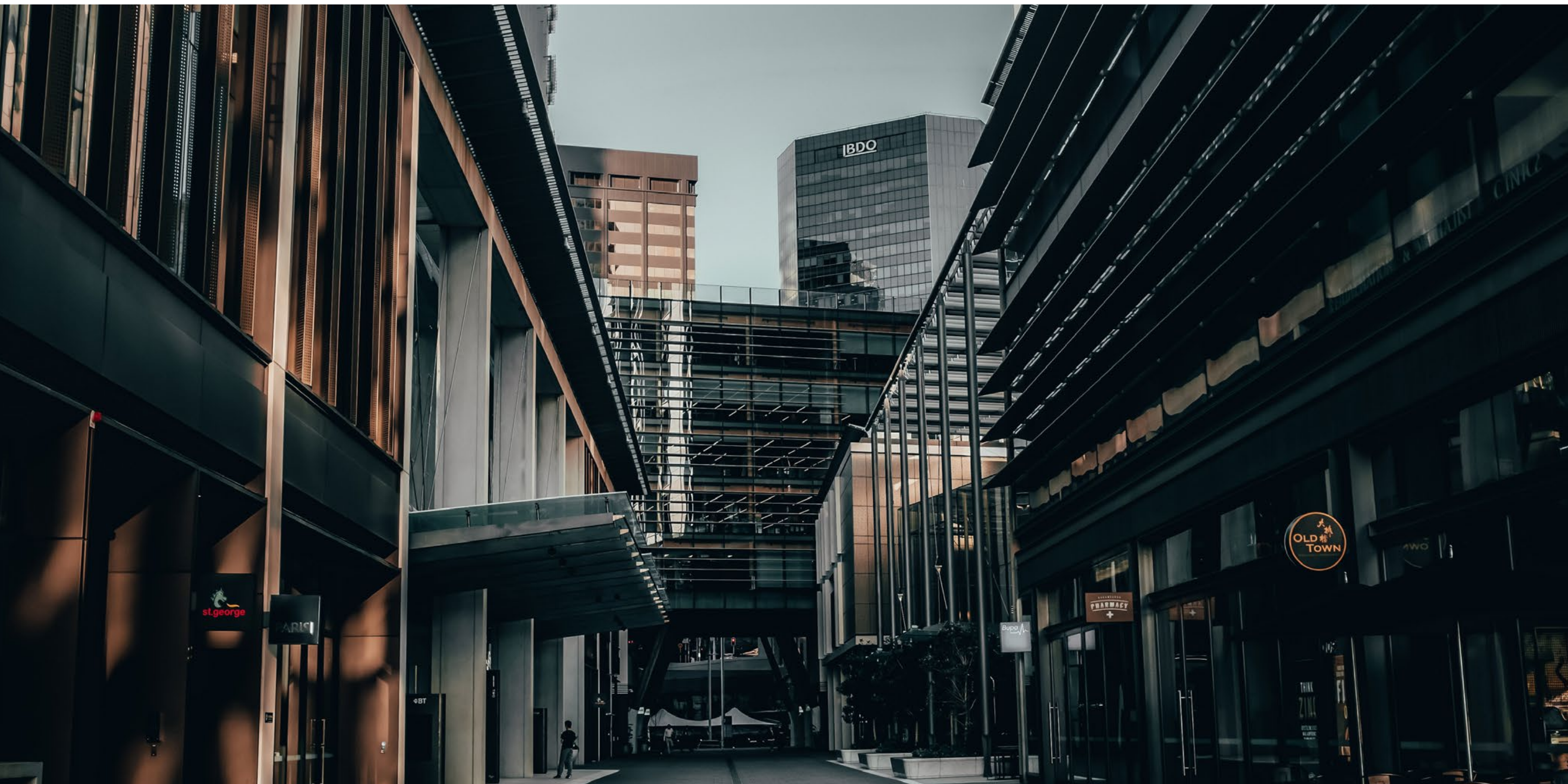
However, the outlook remains uncertain, with rising unemployment, job uncertainty, and weak consumer confidence, posing a significant risk.

A pickup in activity came as on-site auctions and open-house inspections resumed in May. CoreLogic estimates that national settled sales bounced back strongly over May (up 19%) and June (up 29.5%), after a 33% fall in April, as consumer sentiment rebounded to pre-COVID levels.18 However, the pickup in confidence has since been reversed, with the Westpac-Melbourne Institute Index of Consumer Sentiment falling 6.1% to the weak levels seen in May.[15]

Australia recorded its third consecutive week of auction clearance rates above 60% as the winter season began, Knight Frank said in its Q2 Australian Residential Review, adding:

"The shallow number of listings, especially in the rightsizing space, pent-up demand from the responsible lending phase and a favourable lending phase and a favourable currency play for expats has seen prices hold up across most cities."[16] The Australian dollar fell by 18% from its end 2019 level above US$0.7000 to a low under US$0.5800 in March before recovering much of its lost ground later in the quarter.

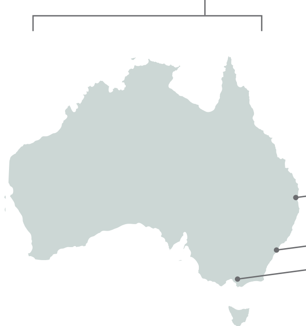
14 CoreLogic Monthly Housing & Economic Chart Pack, July 2020 https://www.corelogic.com.au/reports/housing-market-update
15 Westpac, Consumer sentiment drops again as COVID second wave hits, 15 July 2020 https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/economics-research/er20200715BullConsumerSentiment.pdf
16 Knight Frank, Australian Residential Review, Q2 2020 https://www.knightfrank.com/research/australian-residential-review-q2-2020-7242.aspx



JUNE MARKET SNAPSHOT

Source: SQM Research (Vacancy rates), CoreLogic (All other data)

NATIONAL	SYDNEY	MELBOURNE	BRISBANE
CAPITAL CITY DWELLING PRICES	DWELLING PRICES	DWELLING PRICES	DWELLING PRICES
-1.1% (ON QUARTER)	-0.8% (ON QUARTER)	-2.3% (ON QUARTER)	+0.2% (ON QUARTER)
+8.9% (ON YEAR)	+13.3% (ON YEAR)	+10.2% (ON YEAR)	+4.4% (ON YEAR)
....	....	....	....
+0.7% RENTS (ON YEAR)	-1.0% RENTS (ON YEAR)	- RENTS (STEADY ON YEAR)	+0.6% RENTS (ON YEAR)
3.4% GROSS RENTAL YIELD (CAPITAL CITIES)	2.9% GROSS RENTAL YIELD	3.2% GROSS RENTAL YIELD	4.4% GROSS RENTAL YIELD
2.2% VACANCY (DOWN FROM 2.5% IN MAY, UP FROM 2.1% IN JANUARY)	3.6% VACANCY (DOWN FROM 4.0% IN MAY, UP FROM 3.1% IN JANUARY)	3.0% VACANCY (DOWN FROM 3.1% IN MAY, UP FROM 2.1% IN JANUARY)	2.4% VACANCY (DOWN FROM 2.5% IN MAY, UNCHANGED FROM JANUARY)



Home loan commitments fall in May

The value of new loan commitments for housing fell by 11.6% in May, the largest fall in the series of the ABS series. Lending to owner occupiers fell 10.2%, while investor lending fell by a greater 15.6%. First home buyer lending also fell, by 9.3%.[17]

New home lending among investors fell by 2.5% in May, however first home buyers and owner occupiers appear to be undeterred and looking for bargains. Owner occupier lending rose 1.2%, including a 2.5% lift in the value of lending to first home buyers. According to Core Logic, first home buyer participation as a proportion of owner-occupiers is at its highest level since December.

Rents edge lower

Rents have fallen 0.5% from their recent peak in March but remain up 0.7% on year, as the new COVID-19 leasing code of conduct required landlords and tenants to negotiate in good faith. Capital city rents are up 0.2% on year.

RBA Governor Philip Lowe said in the central bank's July meeting minutes that reduced flow of new arrivals to Australia, combined with an increased supply of rental housing in some areas, is affecting some sectors of the market, driving up vacancy rates.[18]

Vacancy rates in Sydney rose sharply to 4.0% in May before retreating to 3.8%, according to SQM Research. Melbourne vacancy rates are sitting at 3.0%, down slightly from 3.1% in May but up from 2.0% a year earlier.[19]

Supply adjusts

Dwelling approvals fell by 16% in May. The decline was driven by apartments, which fell 35%. Releasing the data, the Australian Bureau of Statistics said that while minor effects of COVID-19 are apparent in the result, the fall in apartment approvals was widely expected before the pandemic.[20]

House approvals, which tend to be a reasonable indicator of underlying demand, fell by 4.4% in May, and are down 0.4% over the year.

Approvals are expected to moderate further, according to economists from Commonwealth Bank of Australia and ANZ Bank, which will help to moderate any further prices falls.[21]

17 Australian Bureau of Statistics, 5601.0 – Lending Indicators, May 2020 https://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/5601.0Media%20Release1May%202020?opendocument&tabname=Summary&prodno=5601.0&issue=May%202020&num=&view=

18 RBA, Minutes of Monetary Policy Meeting of the Reserve Bank Board, 7 July 2020 https://rba.gov.au/monetary-policy/rba-board-minutes/2020/2020-07-07.html

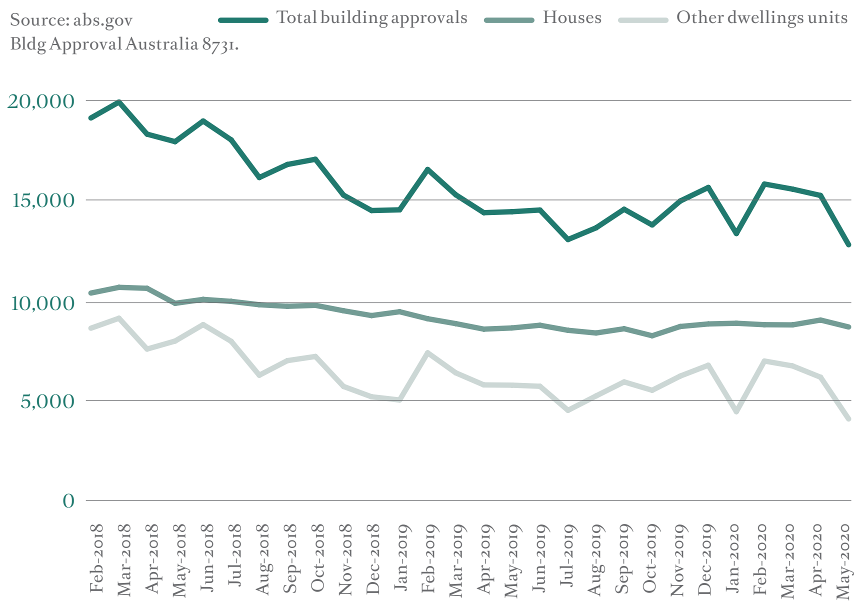
19 SQM Research media release, National Rental Vacancy Rates Decreased in June, 14 July 2020 https://sqmresearch.com.au/14%2007%2020_National%20Vacancy%20Rate%20Decreases%20in%20JUNE_2020_Media%20Release.pdf

20 8731.0 – Building Approvals, Australia, May 2020-https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/B4669E44CACBB1D5CA257E38001BDFC5?OpenDocument

21 "Apartment Approvals Plunge in May", The Urban Developer, 1 July 2020 https://theurbandeveloper.com/articles/apartment-approvals-plunge-in-may

BUILDING APPROVALS FELL SHARPLY IN MAY LED BY APARTMENTS

Source: abs.gov
Bldg Approval Australia 8731.



Industrial & Logistics

The industrial and logistics sector has been relatively resilient during the pandemic. A report by JLL Research reveals that while leasing enquiry and activity has been fragmented, there has been significant interest from operators requiring short-term space and third-party logistics to meet growth in online orders. However, some smaller operators are finding the environment challenging and the level of rent arrears has risen in this group.[22]

Australia's e-commerce penetration lags much of the rest of the world including the US and the UK but has been growing rapidly. This growth has accelerated during the pandemic, with many Australians changing the way they shop. Data from National Australia Bank shows online sales grew by 16% in April from March, the highest ever recorded monthly growth rate since the series began (in 2012). Over the year, online retail sales are up 59%.[23]

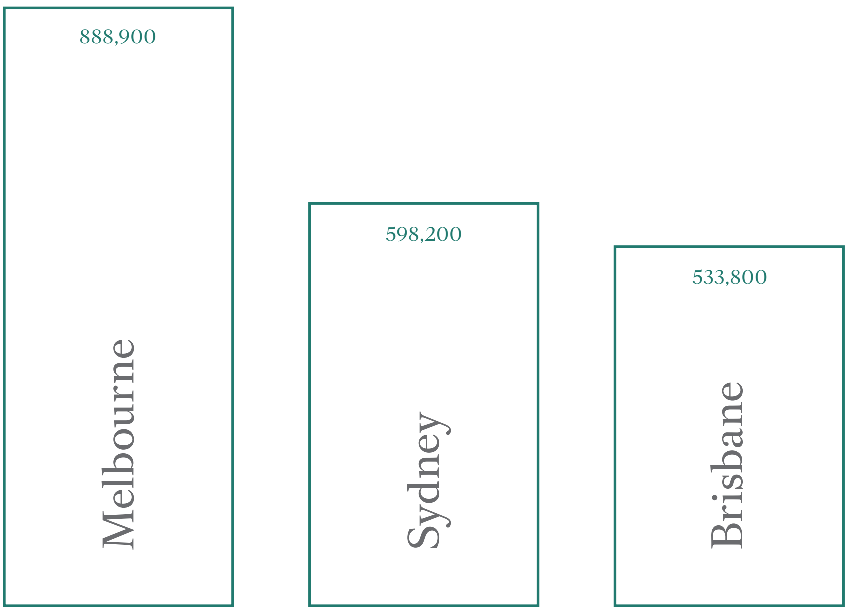
A report by Colliers confirmed that while increased online shopping has helped to shield the sector, it has not been immune from the impact of the pandemic. With almost half of those surveyed suggesting COVID-19 has impacted their revenue, leasing activity has slowed and a large number of occupiers who were previously in the market for new or expansionary space have since placed their decisions on hold.[24]

Unlike the US and some European countries, where a large share of businesses were forced to suspend activities, occupiers within the industrial and logistics market in Australia were largely able to trade through the lockdown as they were deemed "essential services", Colliers reports.[25]

There has been a noticeable shift in demand towards defensive occupiers including food and beverage retailers, e-commerce groups (including fast moving consumer goods), transport and logistics providers, data centres and cold storage occupiers, Colliers said.

2020 DEVELOPMENT PIPELINE – EXPECTED SUPPLY BY CITY (SQM)

Source: Colliers



22 JLL, Australia and New Zealand take their first steps towards the next normal
23 NAB Online Retail Sales Index, Monthly Update, April 2020 https://business.nab.com.au/nab-online-retail-sales-index-monthly-update-april-2020-40463/
24 Colliers, Innovation to be at the forefront of logistics following COVID, https://www.colliers.com.au/en-AU/News/Innovation-to-be-at-the-forefront-of-logistics-following-COVID19
25 Colliers, COVID-19 – Impacts on industrial and logistics occupiers https://www.colliers.com.au/en-au/research/covid-19-impacts-on-industrial-logistics-occupiers

Office

The most recent available data from JLL Research shows net absorption across Australia's CBD office markets was subdued in the first quarter of 2020, impacted in part by muted leasing demand as COVID-19 saw the government introduce restrictions on non-essential businesses in March.[26]

As large swathes of the population shifted to working from home, tenants, buyers and sellers in the office market largely put major decisions on hold. CBD office vacancy, having reached its cyclical low in the third quarter of 2019, rose by 0.1 percentage point to 8.4%.

While much of working Australia outside of Victoria is now beginning to return to the office with new social distancing measures in place, vacancy rates are expected to rise further amid increased unemployment.

JLL forecasts Sydney and Melbourne vacancy rates will rise into the high single digits but remain well below the peaks recorded in the mid-1970s recession, early 1990s recession and post 2000 slowdown.[27]

JLL notes that organisations have been on a 30-year journey to increase density and reduce workspace ratios. Headcount reductions, therefore, will lead to less excess space than in previous economic downturns, it says.

CBD OFFICE MARKET VACANCY RATE PEAKS IN ECONOMIC DOWNTURNS

Source: JLL Research

DOWNTURN	SYDNEY	MELBOURNE	BRISBANE
Mid-1970s	13.0%	18.3%	11.7%
Early 1980s	4.3%	7.8%	8.3%
Early 1990s	22.5%	25.8%	14.3%
Post 2000	11.9%	10.2%	7.0%
Financial Crisis	8.0%	6.4%	10.2%
Global Pandemic (f)	9.6%	9.5%	12.5%

26 JLL, Australia National Office Market Overview, Q1 2020 https://www.jll.com.au/en/trends-and-insights/research/australia-national-office-market-overview-1q200

27 JLL, Australia and New Zealand take their first steps towards the next normal https://www.jll.com.au/en/trends-and-insights/research/australia-and-new-zealand-take-their-first-steps-to-the-next-normal

Spotlight on the new normal – a by-sector perspective

As restrictions ease in some parts of Australia, the focus is now shifting to what the "new normal" or "next normal" will mean for the real estate market as the economy recovers from the stasis caused by lockdown, given some measures to contain the pandemic are likely to remain in place until a better solution such as a vaccine is found. This is varied across sectors, from industrial and logistics, which appears to be in the best position, and retail, seemingly the most exposed.

MEASURING SENTIMENT AMONG OCCUPIERS

Source: Colliers

85%

HAVE REVIEWED THEIR SUPPLY CHAIN NETWORK

31%

HAVE REVIEWED THEIR SUPPLY ARE STORING MORE STOCK LOCALLY TO AVOID FUTURE SHORTAGES

31%

ARE REQUIRING MORE WAREHOUSE STORAGE SPACE

Industrial & Logistics supported by COVID-19 related structural changes

Several structural tailwinds shifts have emerged from the pandemic that support underlying demand in the industrial sector, including accelerating e-commerce penetration and a move toward localizing supply chains.

The higher e-commerce rates that have been experienced by a range of retail sectors during the pandemic are likely to be to some extent a permanent shift, accelerating the rapid growth in ecommerce penetration already underway in Australia.

Savills predicts e-commerce growth in Australia will now accelerate as consumers previously reluctant to embrace online shopping have now been forced to become late adopters and will continue to use online as a preferred model of shopping. [28]

"A looming global uncertainty of the impacts of COVID-19 on commercial property is certainly evident, however industrial assets may be the safer play with continued demand from tenants in comparison to other asset classes where activity has slowed or been put on hold," said Savills in a recent report.

"Over the short to medium term, we anticipate prime industrial yields in these key markets will remain relatively stable. However, the spread to secondary assets will diverge as purchasers will price tenant credit risk more harshly, particularly those adversely affected by COVID-19."

As a result of the higher demand for online shopping, retailers are likely to invest more in their omnichannel platforms, increasing demand for warehouses that can reconfigure their processes flexibly and fulfil orders efficiently to meet customers' channel requirements, Savills says.

Occupiers who have relatively small e-fulfillment operations are already beginning to adjust their supply chains to cater towards online retail growth and as result they are looking to expand their warehouse footprint. On demand or short-term warehousing options are also being explored as occupiers look to house stock in periods of high demand.

The health crisis has also increased consumer acceptance of the contactless delivery model and this will assist in accelerating the e-commerce penetration rate, according to JLL.

As has occurred in more mature ecommerce markets such as the US, JLL expects a higher e-commerce penetration rate in Australia to lead to an evolution in consumer expectations. Delivery times will need to compress, and this will require more sophisticated supply chain models.

A number of organisations are expected to explore warehouse and distribution facilities closer to high population locations and develop more advanced strategies for reverse logistics. Automation, currently concentrated among supermarkets and other large retailers, is likely to become more prevalent.

28 Savills, Asian Cities Report – 1H 2020, Australia Industrial https://pdf.savills.asia/asia-pacific-research/asia-pacific-research/acr---au-ind-1h-2020.pdf

The COVID-19 pandemic has also highlighted the dangers of just-in-time principles and as a result, occupiers are beginning to store more stock locally.

A report by Colliers also found that COVID-19 has forced industrial occupiers to focus on supply chain management as they look to become more resilient to future events to avoid supply chain interruptions and difficulties in obtaining stock. A recent sentiment survey by Colliers found that 85% of occupiers have reviewed their supply chain network; 31% are storing more stock locally to avoid shortages into the future and 31% are requiring more warehouse storage space as a result.

JLL foreshadows that an evolution in Australia's industrial policy could lead to the onshoring of higher value manufacturing activities. With the pandemic exposing vulnerabilities in global supply chains, important medical and pharmaceutical manufacturing industries may start to re-emerge in Australia, boosting demand for industrial and logistics properties for production, storage and distribution.

Residential outlook improving, population growth and stimulus are swing factors

At the peak of the COVID-19 outbreak, some analysts were forecasting dwelling price falls of 10%-20%.[29] However, with the economic outlook improving in recent weeks, and activity beginning to pick up as selling restrictions ease, expectations are rising that the impact of the pandemic on the residential property market will be less severe than forecast.

Domain Economist Trent Wiltshire says the most likely outlook is for prices over the second half of the year to fall modestly in some areas and be broadly steady in others, combined with a slow increase in transactions from weak levels. He says prices are most likely to rebound in Perth, Adelaide and Canberra, whereas in inner-city Melbourne, inner-city Hobart and the Gold Coast, prices will probably fall modestly due to a heavy reliance on international tourism and migration.[30]

Among the biggest risks to the outlook are a second wave of COVID-19 infections and the possible end of government financial assistance and mortgage deferrals in September. The government is being urged to extend COVID-19 related welfare and stimulus measures, including the JobKeeper and JobSeeker programs.[31]

There are also risks to the upside. A faster-than-expected recovery in population growth would support prices, particularly in Sydney and Melbourne. "If Australia's COVID-19 infection numbers remain very low, and the economy performs better than comparable countries, this will make Australia an attractive destination for skilled migrants due to work opportunities as well as from a lifestyle and health perspective," Wiltshire says, adding that international student numbers may also rebound faster than initially expected, with pilot programs to bring students to Australia already underway.[32]

29 ANZ Research, Australian Housing Update COVID-19 derails the housing recovery, 6 May 2020
30 Trent Wiltshire, "The outlook for Australia's property market for the second-half of 2020", Domain Research House, 26 June 2020 https://www.domain.com.au/research/the-outlook-for-australias-property-market-for-the-rest-of-2020-964920/
31 Grattan Institute, The Recovery Book: what Australian governments should do now, 28 June 2020 https://grattan.edu.au/report/recovery-book/
32 Paul Karp, "Up to 350 international students to return to Australia under pilot scheme", The Guardian, 17 June 2020 https://www.theguardian.com/australia-news/2020/jun/17/up-to-350-international-students-to-return-to-australia-under-pilot-scheme-coronavirus

Office vulnerable to unemployment, change in the way we work - but resilient vs offshore peers

As office managers implement strategies to bring their workforces back into the office, questions are being raised about what the future of the office will look like.

Currently, social distancing measures are being applied and JLL reports that most organisations are adopting a split team model, with part of the workforce in the office and part at home at any time, and allocated seating that is appropriately spaced

Most industry experts agree the office will continue to have a role to play in collaboration and meeting the need for employee interaction, however, with many companies now grown more accustomed to having their employees work remotely, some may change the way they structure their workplaces or look to downsize their headquarters.

JLL predicts that many larger organisations will evolve toward the hub and spoke model, with their headquarters serving as the hub of their business and the cultural centre of their operation, often in the inner city, and a network of smaller offices acting as the spokes, which employees can access as needed. More businesses will have multiple premises, flexible space and support an element of work from home for focus tasks and work-life balance, JLL says.

A survey commissioned by Boston Consulting Group found most Australians want to return to their physical office as COVID-19 restrictions loosen, but instead of commuting every day, they would be happier to be in the office for only two or three days of a five-day working week.[33]

Besides long-term structural changes associated with social distancing and working from home, the office sector is highly sensitive to rising unemployment. JLL has revised down its office sector net absorption projections for 2020 and 2021. Across Australia's six CBD office markets, JLL has reduced its net absorption expectations by 330,500 sqm and 178,500 sqm across metropolitan office markets.

Still, Australia's conservative approach to financing and speculative development combined with a starting point of relatively low vacancy rates is likely to hold the office market in better stead during a recession compared to global office markets, analysts say.

In its latest report looking at the effect of COVID-19 on global office real estate and real estate investment trusts (REITs), credit agency S&P Global Ratings warns the pandemic will slow development pipelines and delay the planned roll-out of new offices.[34]

However, S&P's Australian analyst, Craig Parker, said Australia's office market had buffers that meant it was unlikely to suffer the slowdown in development activity seen in the rest of the world.

"The REITs [in Australia] all tend to have pre-commitments underpinning their projects, and that seems to be consistent with the approach the landlords have always taken, but in other markets it is very different, they are somewhat more speculative," Parker said.

"Landlords in other markets are probably going to adopt more of an Australian approach, which has always been traditionally more prudent in seeking a sizeable pre-commit before they put a shovel into the ground."

Prior to the pandemic, Melbourne's CBD was one of the tightest office markets in the world, with a prime grade vacancy at an 11-year low of 1.8%, and Sydney's vacancy rate stood at 4.8%.[35]

JLL predicts vacancy rates in Sydney and Melbourne will rise into the high single digits but remain well below the peaks recorded in the mid-1970s recession, early 1990s recession and post 2000 slowdown. JLL forecasts that the next phase of expansionary activity in the office market will be led by organisations in the technology, healthcare and public administration sectors.

33 Daniel Ziffer, "Most workers want 'hybrid' jobs at the office and at home after coronavirus, study finds", ABC News, 23 June 2020 https://www.abc.net.au/news/2020-06-23/most-workers-want-hybrid-of-home-and-office-post-coronavirus/12381318

34 Ingrid Fuary-Wagner, "There's strength in our more resilient officer market", Financial Review https://www.commercialrealestate.com.au/news/theres-strength-in-our-more-resilient-office-market-962246/

35 JLL Research, Australian Office Investment Review & Outlook 2020 https://www.jll.com.au/content/dam/jll-com/documents/pdf/research/apac/australia/jll-au-office-investment-review-and-outlook-2020.pdf

Retail faces mounting structural headwinds

The retail property sector entered the crisis under significant stress due to a number of structural and cyclical headwinds, with several brands including Colette, Harris Scarfe, Jeanswest, Bardot and G-Star Raw entering administration in 2020.[36]

The pandemic has seen a split between the strong performance of essential sub sectors (such as supermarkets and pharmacies) and discretionary retail, which has slowed significantly. Many discretionary retailers were forced to stand down thousands of employees due to the coronavirus restrictions, and some are closing down their business or reducing store counts as a result of the pandemic.

The easing of restrictions is now starting to see people returning to shopping centres. Major shopping centres have returned to 75%-80% store openings, and discretionary spending has begun to recover, according to JLL.

However, the structural shift toward online shopping that was pressuring retail property prior to the pandemic is likely to accelerate as many people who adopted online purchasing during the crisis will continue to prefer this model of shopping.

JLL says a number of retailers will struggle to find a pathway back to pre-crisis revenue levels and will look to reduce store numbers and increase their focus on location, e-commerce platforms, and distribution channels.

36 "Coronavirus pandemic job losses from major Australian employers", ABC News, 30 June 2020 https://www.abc.net.au/news/2020-06-30/job-losses-coronavirus-australia-covid-19/12401232

Outlook

The value of Australian real estate is highlighted when comparing property yields with yields on government bonds and equities.

Record low interest rates and the COVID-19 recession have helped to extend a bull run in government bonds globally, depressing yields. An analysis by Colliers shows industrial/logistics yields in Sydney (4.7%) and Melbourne (5.5%) and premium/grade A office yields in the same cities, of 4.6% and 4.7% respectively, compare favourably to the ten-year government bond yield around 0.9% and to average local equity yields around 3.4%.[37]

With dividend yields under threat as companies lower profit forecasts due to the recession, Australian real estate looks attractive versus other asset classes.

While Australia's economy is expected to recover from the COVID-19 related recession, interest rates in Australia are likely to remain low for several years [38], underpinning real estate asset values.

Still, prices are likely to remain subdued in the short term as the market gauges the risks of further COVID-19 spikes, the impact of ongoing restrictions on population growth, the quantum of job losses, and the likely speed of the economic recovery.

At this stage of the economic cycle, commercial real estate debt offers a lower risk entry point to the market combined with attractive risk-adjusted returns.

CBD OFFICE MARKET VACANCY RATE PEAKS IN ECONOMIC DOWNTURNS

Source: JLL Research

	10-YEAR GOVERNMENT BOND YIELD	NATIONAL EQUITY MARKET DIVIDEND YIELD	PREMIUM/GRADE A OFFICE YIELD	INDUSTRIAL/ LOGISTICS YIELD
Melbourne	0.9%	3.4%	4.7%	5.5%
Sydney	0.9%	3.4%	4.6%	4.7%

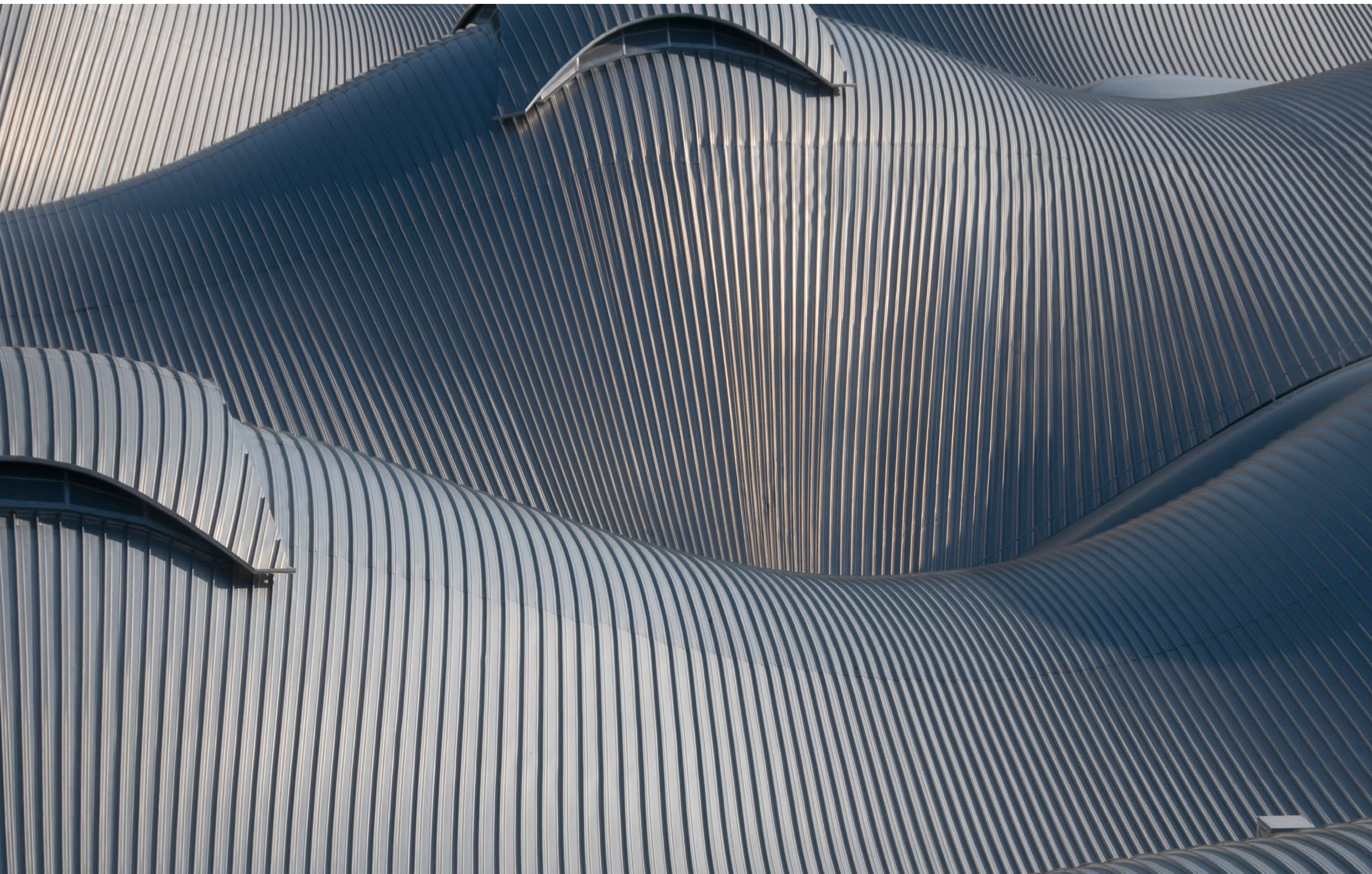
37 Paul Karp
38 Shane Wright, "Low rates for years as economy meanders: Lowe", Sydney Morning Herald, 22 June 2020 https://www.smh.com.au/politics/federal/low-rates-for-years-as-economy-meanders-lowe-20200622-p554w6.html#:~:text=By%20Shane%20Wright&text=Record%20low%20interest%20rates%20will,shadow%20over%20the%20Australian%20economy.

Our approach

At Banner Asset Management, we provide an opportunity for investors to gain exposure to the real estate debt market through lending to established and proven developers for development projects, or for strategic acquisition of sites earmarked for development in the future. We also provide opportunities to invest in direct real estate through funds alongside other project partners.

We invest in developments with a proven use, evidenced either by presales or lease agreements, as well as strong fundamentals, including proximity to population growth and the likelihood of resilient demand.

In the residential space, our focus is on medium density development (apartments and townhouses) in the bigger population centers of Sydney, Melbourne, and South East Queensland, which provide greater liquidity and depth than other markets in Australia. This includes mixed-use residential projects that incorporate uses such as office space or retail. We also invest in non-discretionary retail and the industrial sectors, as growth in ecommerce drives demand for warehousing and logistics.



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