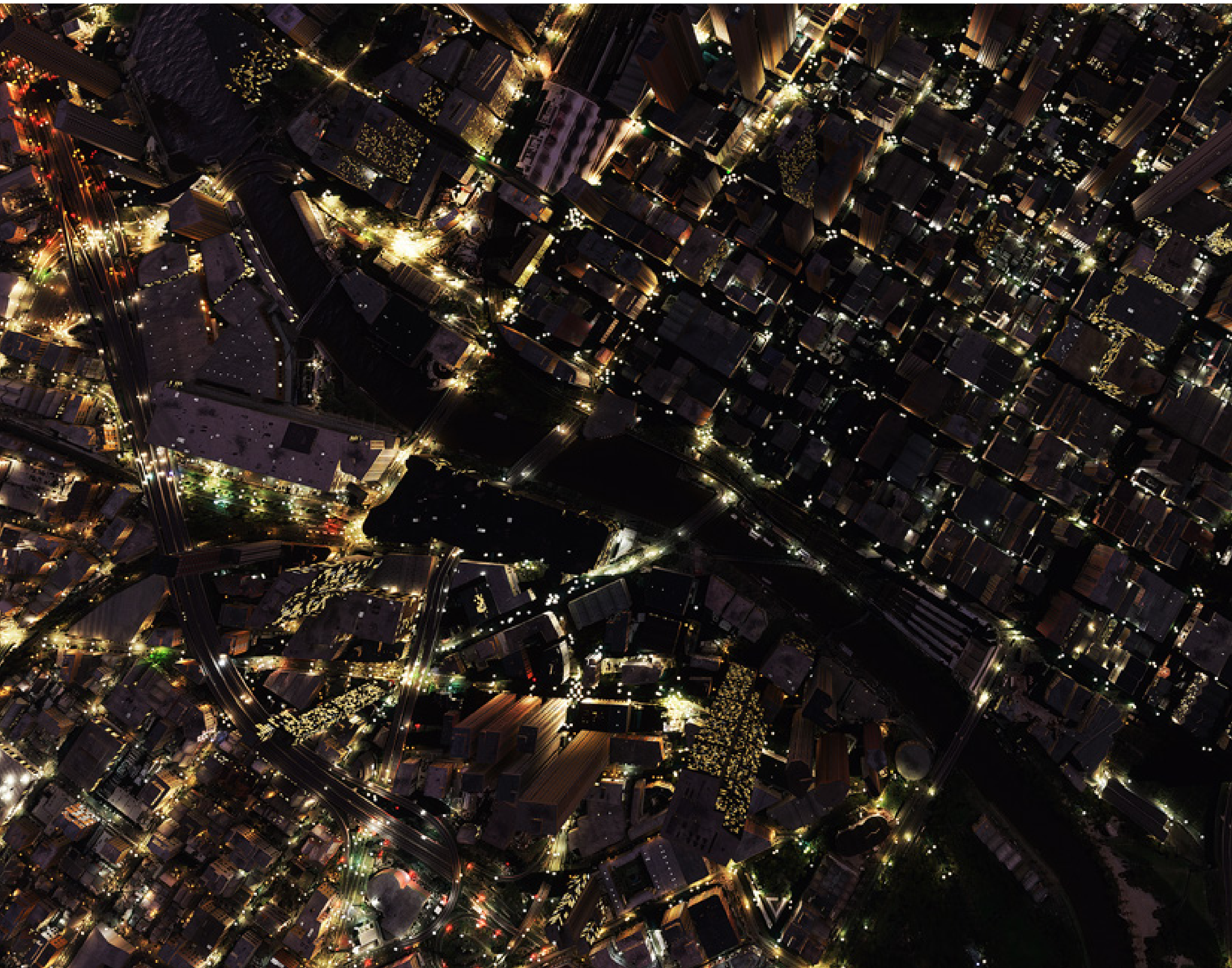
Quarterly Property Report

MARCH 2021



Introduction

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

At the time of writing, Australia's economy continues to rebound from the COVID-19 related recession after faring better through the COVID-19 pandemic than most other countries.[1]

At a time when many major economies are fighting a new wave of COVID-19 cases, Australia has largely contained the virus.

As the job market and household spending recover faster than expected, soaring confidence[2] about the economic outlook is flowing through to the property market.

Residential property prices are rising at their fastest quarterly pace in more than 17 years and most capital city values are reaching new record highs[3], after confounding forecasts made early last year of drastic falls in values associated with the pandemic.

The industrial and logistics sector remains well supported after recording strong growth in 2020 as the pandemic caused e-commerce penetration to accelerate, driving demand for well-located warehouse spaces.

Office rental growth remains under pressure after the pandemic caused a rethink of the way we work and a shift to a more hybrid model of working, where employees work partly from the office and partly from home.

In this quarter's Spotlight section, we take a deep dive into the rebound in residential market values that has confounded forecasts in the face of headwinds from immigration and a two-speed economy.

We hope you find these insights useful.

1 Matthew Craston and Tom McIlroy, "Just four countries fared better than Australia", AFTR, 2 September 2020 https://www.afr.com/policy/economy/just-three-countries-fared-better-than-australia-20200902-p55rly

2 Westpac Bulletin, "Consumer sentiment soars", 14 April 2020 https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/economics-research/er20210414BullConsumerSentiment.pdf
NAB, Monthly Business Survey: March 2021 https://business.nab.com.au/monthly-business-survey-march-2021-45724/

3 CoreLogic, Monthly Chart Pack, April 2021 https://www.corelogic.com.au/reports/housing-market-update

Economic update

GDP rose by 3.1% in Q4, extending a 3.3% gain in Q3.

The unemployment rate fell to 5.6% in March from 5.8% in February.

The RBA kept its target cash rate at a record low of 0.1% in April.

Australia's population grew by 0.9% in the year through September, slowing from a pace of 1.3% in the year through June.

Source: Australian Bureau of Statistics, Reserve Bank of Australia

Australia's economy continues to rebound from the COVID-19 related recession, with gross domestic product rising by 3.1% in the September quarter, following a 3.3% rise in the June quarter. This is the first time in the over 60-year history of the national accounts that GDP has grown by more than 3.0% in two consecutive quarters.[4]

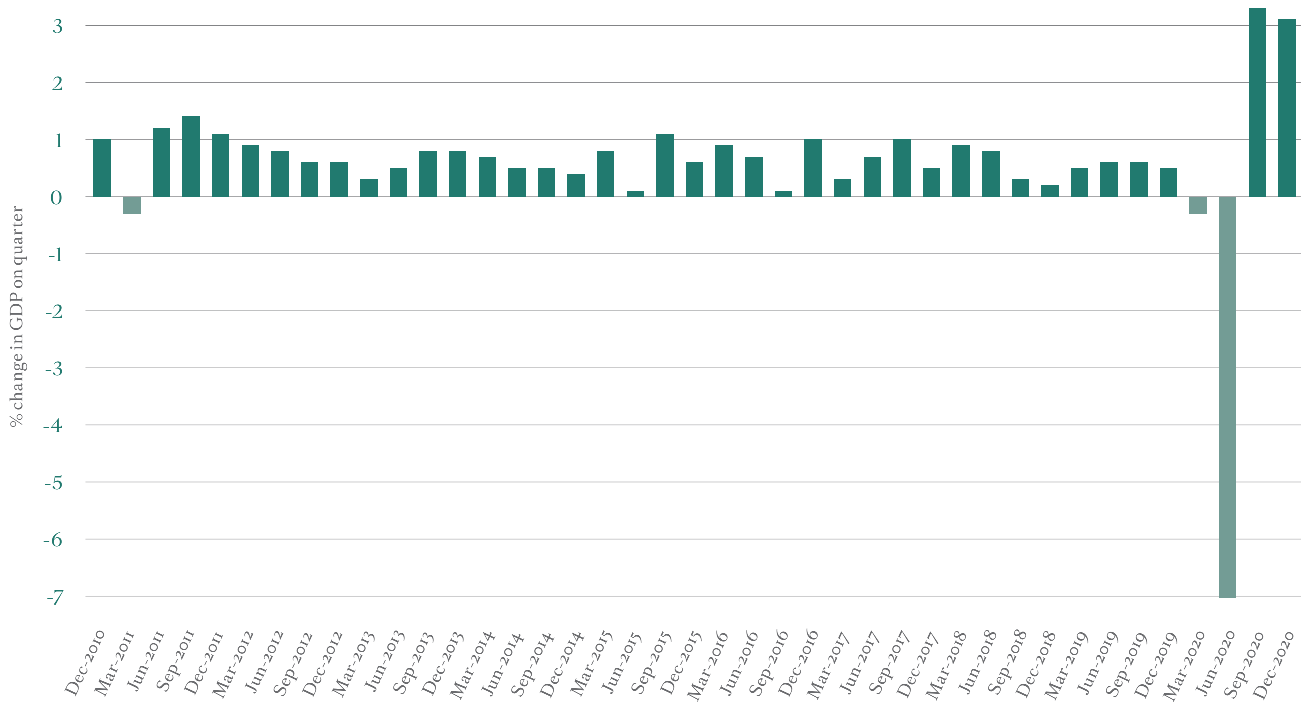
Household spending rose strongly as COVID-19 restrictions continued to ease. Victoria recorded the strongest increase after strict lockdown restrictions were lifted. Investment in housing and business also rose, as conditions were supported by government initiatives, such as the HomeBuilder grant and the expanded instant asset write-off.[5]

4 ABS, Australian National Accounts: National Income, Expenditure and Product, December 2020 https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/dec-2020s

5 ABS, Media Release, "Economic activity increased 3.1% in December quarter" 3 March 2021 https://www.abs.gov.au/media-centre/media-releases/economic-activity-increased-31-december-quarter

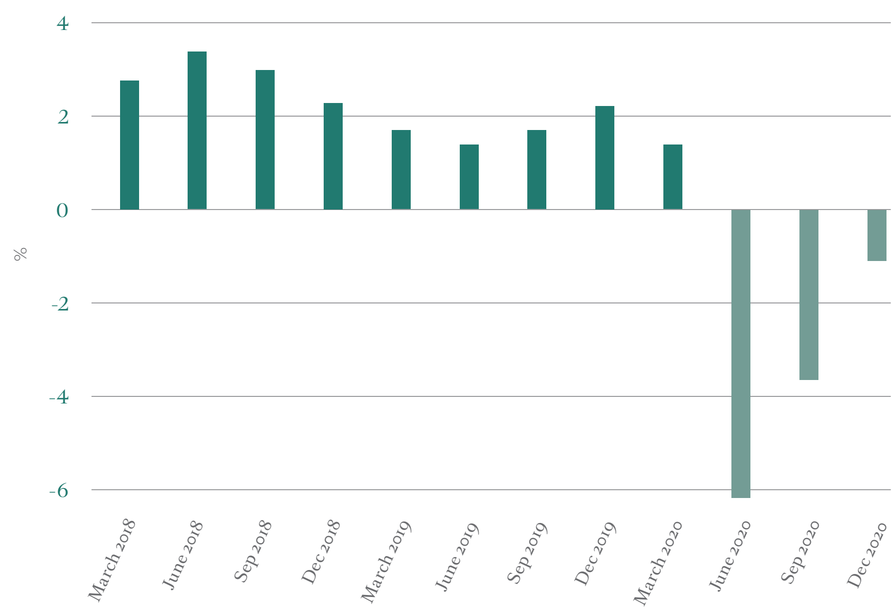
QUARTERLY GDP CONTINUES TO REBOUND

Source: ABS



ANNUAL GDP GROWTH REMAINS NEGATIVE

Source: ABS



Employment recovers to pre-COVID level

The labour market continues to recover, with employment and hours worked returning to pre-COVID levels. The unemployment rate was 5.6% in March, down from 7.5% in July, and approaching the year-ago level of 5.1%.[6] During the month, there was a 70,700 jump in total employment, taking the number of people in a job to a record 13.08 million.[7]

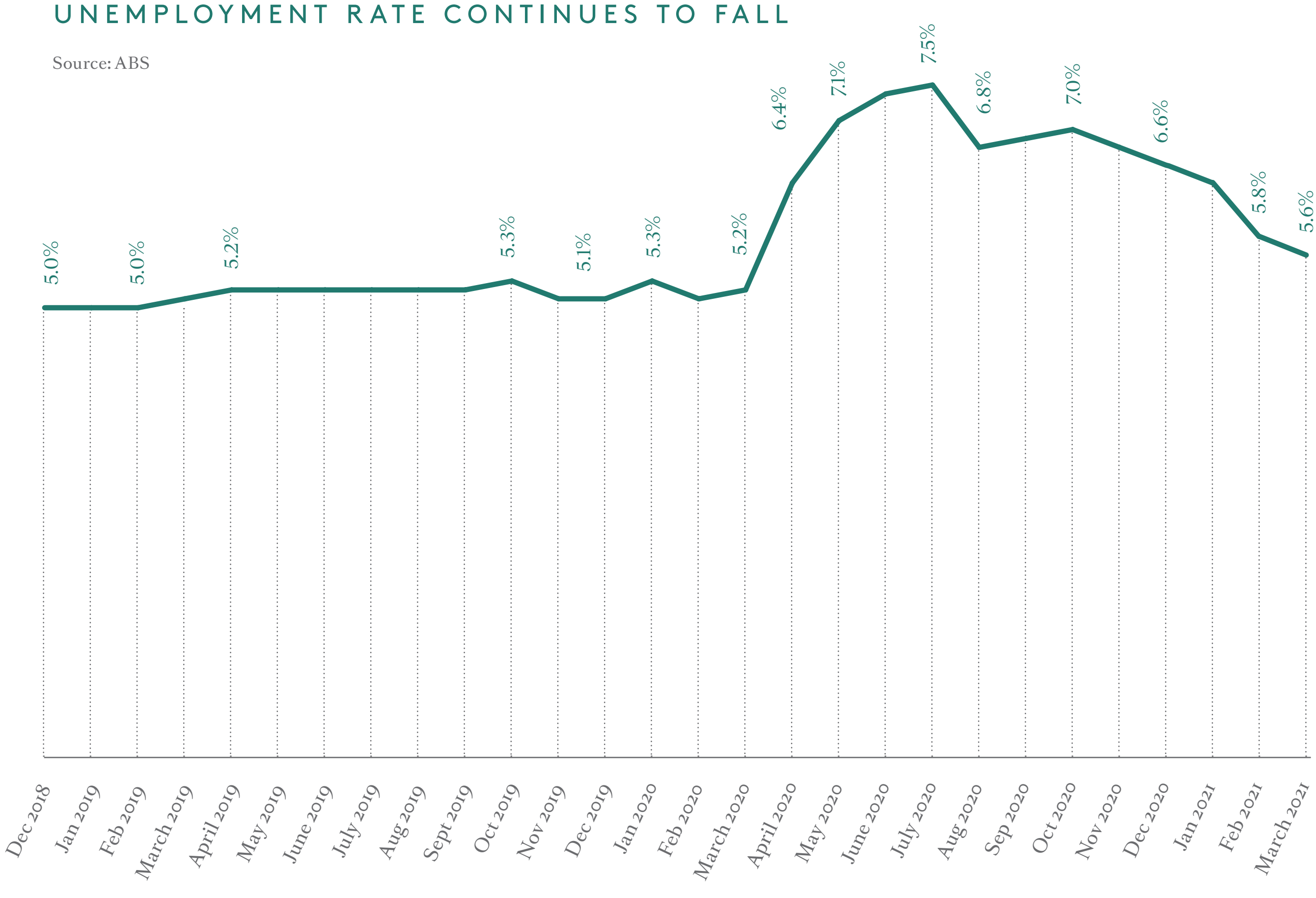
Population grows at slower pace

Australia's population continues to grow despite a decrease in overseas migration as COVID-19 related international travel restrictions continued to impact. However, the pace of growth slowed to 0.9% in the year through September, from 1.3% in the year through June.

In the three months through September, the decrease in overseas migration wasn't outweighed by a natural increase, causing the population to fall by 0.02%, marking the first decline in Australia's population since World War I.[8]

UNEMPLOYMENT RATE CONTINUES TO FALL

Source: ABS



6 ABS, Media Release, Hours worked recover to pre-COVID level, 15 April 2021 https://www.abs.gov.au/media-centre/media-releases/hours-worked-recover-pre-covid-level

7 Shane Wright, "Record number of people in work as jobless rate falls", The Sydney Morning Herald, 15 April 2021 https://www.smh.com.au/politics/federal/record-number-of-people-in-work-as-jobless-rate-falls-in-march-20210415-p57jfr.html

8 Rachel Pupazzoni, "Australia's population shrinks for the first time since WWI as COVID turns off immigration tap", ABC News, 24 March 2021 https://www.abc.net.au/news/2021-03-24/population-declines-as-covid-border-closures-bite/13256938

RBA signals rates likely to stay low for three years

The Reserve Bank of Australia (RBA) maintained its current policy settings at its April meeting, including keeping the cash rate at a record low of 0.1% and maintaining the parameters of the bond purchase program. The central bank said the rollout of vaccines is supporting the uplift of the global economy, although the recovery is uneven and there is still considerable uncertainty regarding the outlook, while the economic recovery in Australia is well underway and stronger than expected.[9]

In a statement accompanying the policy decision, RBA Governor Philip Lowe said Australia's economic recovery is expected to continue, with above-trend growth this year and next. He noted that household and business balance sheets are in good shape and should continue to support spending.

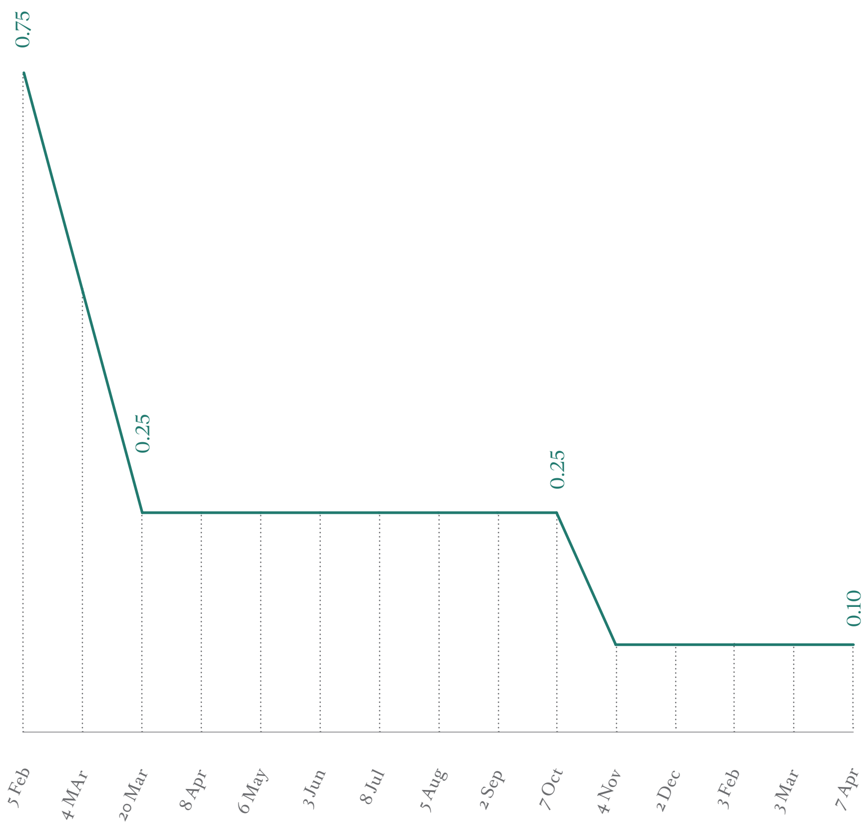
He also noted that housing markets have strengthened further, with prices rising in most markets. Housing credit growth to owner-occupiers has picked up, with strong demand from first-home buyers. In contrast, investor credit growth remains subdued. "Given the environment of rising housing prices and low interest rates, the Bank will be monitoring trends in housing borrowing carefully and it is important that lending standards are maintained," he said.

However, he added that wage and price pressures are subdued and expected to remain so "for some years". Lowe said the RBA Board will not increase the cash rate until inflation is sustainably within the central bank's 2-3% target range: "For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest."

9 RBA, Media Release, "Statement by Philip Lowe, Governor: Monetary Policy Decision", 6 April 2021 https://www.rba.gov.au/media-releases/2021/mr-21-04.html

RBA CASH RATE TARGET (2020-2021)

SOURCE: RBA



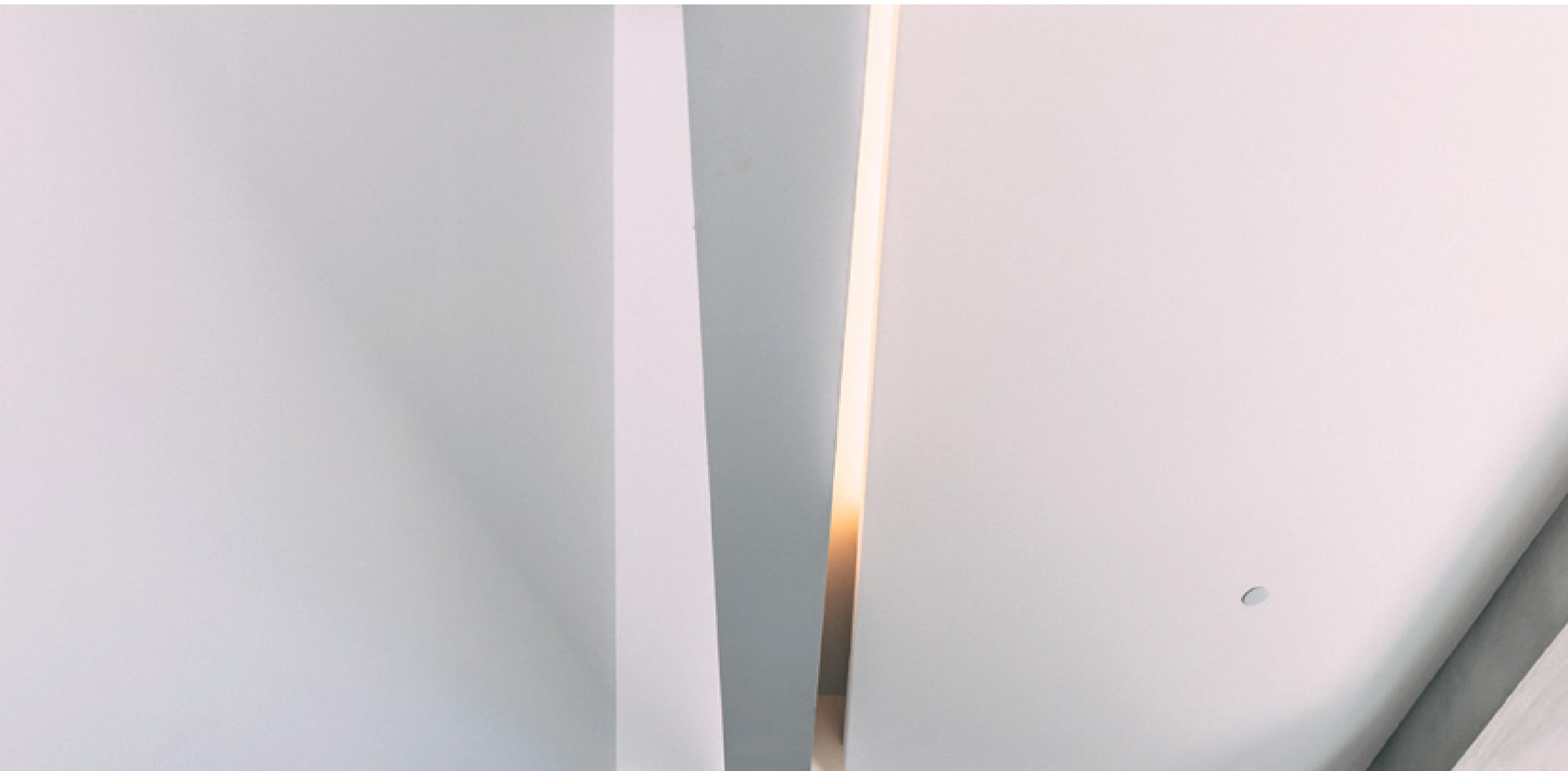
Residential

In the three months to March, national residential asset values rose by 5.8%, which is the highest quarterly growth rate since October 2003, according to data from CoreLogic. Over the year, dwelling prices rose by 6.2%, taking housing values in most capital cities to record highs.[10]

Regional markets continue to experience the biggest gains, with values rising by 11.4% over the year, compared to a 4.8% rise for capital city markets, as working-from-home arrangements make it easier for people to live outside the big cities. However, there are signs that may be starting to change. In the month of March, for the first time in a year, growth in capital city housing prices outpaced regional markets.[11] CoreLogic estimates sales volumes increased by 12.6% nationally over the 12 months to March, with more than 25% of the rise stemming from an additional 13,700 sales across regional New South Wales. Properties are typically selling in 37 days, eight days less than a year ago.[12]

The CoreLogic report said riskier types of lending are rising, "but probably not enough to trigger a regulatory response yet.... regulators and policy makers are likely to be watchful for any signs of slippage in lending standards."

10 CoreLogic, Monthly Chart Pack, April 2021 https://www.corelogic.com.au/reports/housing-market-update
11 CoreLogic, Hedonic Home Value Index, 1 April 2021 https://www.corelogic.com.au/sites/default/files/2021-03/210401_CoreLogic_HVI.pdf
12 CoreLogic, Monthly Chart Pack, April 2021 https://www.corelogic.com.au/reports/housing-market-update



MARCH MARKET SNAPSHOT

Source: CoreLogic, SQM Research

NATIONAL	SYDNEY	MELBOURNE	BRISBANE
CAPITAL CITY DWELLING PRICES	DWELLING PRICES	DWELLING PRICES	DWELLING PRICES
+5.6% (ON QUARTER)	+6.7% (ON QUARTER)	+4.9% (ON QUARTER)	+4.8% (ON QUARTER)
+4.8% (ON YEAR)	+5.4% (ON YEAR)	+0.7% (ON YEAR)	+6.8% (ON YEAR)
+2.2% CAPITAL CITY RENTS (ON YEAR)	-0.2% RENTS (ON YEAR)	-3.0% RENTS (ON YEAR)	+4.2% RENTS (ON YEAR)
2.1% VACANCY RATE	3.4% VACANCY RATE	4.4% VACANCY RATE	1.5% VACANCY RATE

Rental growth fastest in nine years

National rent values have risen by 3.9% in the year to March, which is the highest annual growth rate since September 2011. Still, with housing values generally outperforming rents, yields are trending lower, except in Perth and Darwin.

The supply pipeline is starting to pick up in response to the strong buyer demand. Over February, house approvals reached a record 14,072, which is 50.7% higher than the decade average. Unit approvals rose in the month but remain 25.7% below the decade average.

National residential vacancy rates edged higher over March, marking the first time an increase has been recorded between February and March in 14 years.[13]

The national vacancy rate, as tracked by SQM Research, rose to 2.1% in March from 2.0% in February. The rise was driven by increases in vacancies in Sydney as well as a reversal in some of the tight rental markets of regional Australia.[14]

Louis Christopher, Managing Director of SQM Research, said: "Vacancy rates remain very tight in Australia's cities excluding Sydney and Melbourne and this is creating a surge in rents in Perth, Adelaide and Brisbane. However, vacancy rates for Melbourne and Sydney remain elevated.

"The loss of international student tenants due to COVID-19 has hit both cities hard and the ongoing high rate of dwelling completions keeps these rental markets in surplus. That said we are seeing increasing signs that the absolute worse for CBD landlords has passed."

The Melbourne CBD vacancy was at 8.3% in March, while the Sydney CBD vacancy rate was 6.2%.

"While they are obviously still elevated, those figures are down from the double digits last year and fell again for the month of March," Christopher said.

While rents in inner city areas, the worst hit from falling immigration, remain subdued, there are signs that conditions may be stabilizing, particularly in Sydney. Median asking rents across units in the City and Inner South of Sydney were 14.5% lower over the year to March, but they have risen 6.0% from a recent low of $500 per week in December, according to Core Logic. In Melbourne, inner median asking rents did slip another 3.8% through 1Q, but listings stock appears to have been moderating since early February.[15]

Unit markets turn a corner

Lower density housing has continued to outpace higher density housing for capital gains. House values rose by 3.0% in March while unit values rose by a more modest 1.9%. Across the capital cities, the quarterly growth rate for houses (6.5%) is more than double that of units (3.1%).[16]

"Despite the underperformance, unit markets have turned a corner, with Sydney recording two consecutive months of rising values, while the Melbourne unit market, has seen values consistently rising since October last year, with the trend accelerating over recent months," said CoreLogic's research director Tim Lawless.

13 SQM Research, Media Release, "National Rental Vacancy Rate Rises in March", 13 April 2021 https://sqmresearch.com.au/13_02_21_National%20Vacancy%20Rate%20Rises%20in%20March_2021_FINAL.pdf

14 SQM Research, Media Release, "National Rental Vacancy Rate Rises in March", 13 April 2021 https://sqmresearch.com.au/13_02_21_National%20Vacancy%20Rate%20Rises%20in%20March_2021_FINAL.pdf

15 oreLogic, "CoreLogic data shows signs of stabilising in inner city rental markets" https://www.corelogic.com.au/news/corelogic-data-shows-signs-stabilising-inner-city-rental-markets?utm_medium=email&utm_source=newsletter&utm_campaign=20210419_propertypulse&utm_content=pp_blog%20

16 CoreLogic, Hedonic Home Value Index, 1 April 2021 https://www.corelogic.com.au/sites/default/files/2021-03/210401_CoreLogic_HVI.pdf

Industrial & Logistics

Australia's industrial and logistics sector grew strongly in 2020 as the pandemic caused e-commerce penetration to accelerate, driving demand for well-located warehouse spaces.

Adding to the trend, a resurgence in local food processing and government stimulus in the housing infrastructure sector is driving demand in the manufacturing and construction sectors, supporting a recovery in the industrial and logistics economy, according to CBRE.[17]

National investment volumes have risen to a decade high, reaching $8.8 billion in 2020, according to Knight Frank, reflecting the rising popularity of the sector.[18]

Increased spending on consumer staples and a rise in the manufacturing and storage of pharmaceutical goods is helping to drive tenant demand.

17 CBRE Market Outlook 2021 Australia Industrial Logistics https://www.cbre.com.au/research-reports/australia-real-estate-market-outlook-2021/industrial-and-logistics

18 Knight Frank, National Industrial, March 2021 https://www.knightfrank.com.ro/research/national-industrial-march-2021-7877.aspx?search-id=5d3f2e60-c634-4a08-a283-1afe008bd5b2&report-id=2186&rank=2

4Q 2020 RENTS AND YIELDS

Source: Knight Frank

MELBOURNE

88
PRIME NET FACE RENT ($/SQM)

71
SECONDARY NET FACE RENT ($/SQM)

4.50-4.75
SUPER PRIME MARKET YIELD RANGE (%)

SYDNEY

121
PRIME NET FACE RENT ($/SQM)

105
SECONDARY NET FACE RENT ($/SQM)

4.50-4.75
SUPER PRIME MARKET YIELD RANGE (%)

BRISBANE

113
PRIME NET FACE RENT ($/SQM)

94
SECONDARY NET FACE RENT ($/SQM)

5.00-5.50
SUPER PRIME MARKET YIELD RANGE (%)

PERTH

89
PRIME NET FACE RENT ($/SQM)

69
SECONDARY NET FACE RENT ($/SQM)

5.50-6.00
SUPER PRIME MARKET YIELD RANGE (%)

ADELAIDE

98
PRIME NET FACE RENT ($/SQM)

70
SECONDARY NET FACE RENT ($/SQM)

5.50-6.00
SUPER PRIME MARKET YIELD RANGE (%)

A regional trend

In the Asia Pacific region, industrial and logistics is the most preferred sector for future investment, according to CBRE Research Asia Pacific Investor Intentions Survey for 2021. The survey found that 42% of investors are willing to pay above asking price of logistics.[19]

CBRE reports that investors in the APAC region retain a positive view towards logistics, with more buyers willing to bid above asking prices for this asset class. While cap rates are general unchanged in other sectors, cap rates for logistics assets continue to compress. Cap rates in Australia and New Zealand remain relatively high compared to Hong Kong, Taipei, Tokyo and Osaka.[20]

19 CBRE Research Asia Pacific Investor Intentions Survey 2021 https://www.cbre.com/research-and-reports/asia-pacific-investor-intentions-survey-2021

20 CBRE Asia Pacific Cap Rate Survey, March 2021 https://www.cbre.com.au/research-reports/Asia-Pacific-Cap-Rate-Survey-March-2021

INDICATIVE APAC CAP RATES AND OUTLOOK

Source: CBRE Asia Pacific Cap Rate Survey March 2021

COUNTRY	CITY	INSTITUTIONAL GRADE LOGISTICS (CITYWIDE)		
		SEP 2020	MARCH 2021	3 MONTHS OUTLOOK
Australia	Sydney	4.25 – 5.25	4.00 – 5.00	▼
	Melbourne	4.25 – 5.25	4.00 – 5.00	▼
	Brisbane	5.00– 5.50	4.50 – 5.50	▼
	Perth	5.50 – 6.50	5.25 – 6.25	▼
New Zealand	Auckland	4.50 – 5.25	4.00 – 5.00	▼
Greater China	Beijing	4.50 – 5.50	4.50 – 5.50	=
	Shanghai	4.50 – 5.50	4.50 – 5.25	▼
	Guangzhou	4.75 – 6.00	4.75 – 6.00	=
	Shenzhen	4.75 – 6.00	4.75 – 6.00	=
	Hong Kong SAR	3.50 – 4.50	3.00 – 4.00	=
	Taipei	3.50 – 4.00	3.50 – 4.00	=
Japan	Tokyo	3.50 – 4.00	3.50 – 4.00	▼
	Osaka	3.80 – 4.30	3.50 – 4.30	▼
Korea	Seoul	4.80 – 5.75	4.00 – 5.00	▼
Singapore	Singapore	5.50 – 6.25	5.50 – 6.25	=
India	Gurgaon	8.25 – 8.75	8.00 – 8.75	▼
	Mumbai	8.25 – 8.75	8.00 – 8.75	▼
	Bangalore	8.25 – 8.75	8.00 – 8.75	▼

SYDNEY

Sydney industrial leasing volumes in 2020 were 7% higher than the five-year average, according to Knight Frank. That's despite an initial dip in activity at the onset of the pandemic.

Sustained demand is driving new development. In 2020, around 688,000 sqm of new supply was delivered in Sydney.

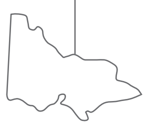
About 704,000 sqm of new supply is planned for 2021.

MELBOURNE

Compared to the office and retail markets, the pandemic didn't have a profound impact on the Melbourne industrial market. According to Knight Frank, take-up of vacant space through 2020 wasn't appreciably lower than recent years.

Melbourne's industrial market received a record 927,429 sqm of new supply in 2020, it's highest level in more than a decade.

Another record of more than 1 million sqm of new industrial stock is tipped to be completed in Melbourne during 2021.

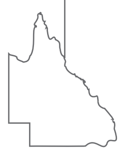


BRISBANE

After subdued activity for much of 2020, the Brisbane industrial market roared back to life in 4Q, according to Knight Frank.

Total takeup in 2020 was 430,208 sqm, down 23% on the prior year. While underlying demand from retail and related businesses was strong, border closures made it difficult to inspect properties and dampened activity. As restrictions eased, activity accelerated. More than a third of the takeup for 2020 was negotiated in 4Q.

This momentum has continued into 2021. Knight Frank says record construction in 2020 is expected to be exceeded this year.



Source: ABS

Office

One of the greatest disruptions to global office markets was observed in 2020. Australian net absorption reached a historic low for the year, while national vacancy surged to highs not experienced since the late 1990's, according to CBRE.[21]

Supported by the easing of COVID-19 restrictions, workplace occupancy has continued to improve since 2Q 2020, with premium grade office occupancy returning to pre-pandemic levels, according to CBRE's latest property management insights.[22]

IN 1Q, INVESTMENT ACTIVITY REBOUNDED BY

34%

In 1Q 2021, net face rents held steady across the board, except for Melbourne and Canberra. However, higher vacancy and still relatively soft tenant demand saw prime incentives continue to rise in most markets, particularly in Canberra and Melbourne.

As sentiment improved, there was an uptick in leasing activity, and sublease availability fell by 2% in the quarter. Prime yields remained relatively stable whilst secondary yields softened marginally.

Strong investor interest in commercial office assets was reflected in a big number of large-scale transactions by local and offshore investors. According to CBRE, investment activity rose by 34% in 1Q, returning to pre-COVID levels, with a total of $2.8 billion transactions across 26 assets.

21 CBRE Market Outlook 2021 Office https://www.cbre.com.au/research-reports/Australia-Office-Market-Outlook-2021

22 CBRE Australia Office MarketView 1Q 2021 https://www.cbre.com.au/research-reports/Australia-Office-MarketView-Q1-2021

SYDNEY CBD

Vacancy has risen from 5.6% in July 2020 to 8.6% in Jan 2021, according to Colliers.[23]

Over the long-term, Colliers expects a widening divergence between prime and secondary vacancy with a flight to quality that is more pronounced and prolonged than previous cycles.

"Occupiers will not only look to secure favourable lease terms, but also upgrade their premises to create an improved work environment and experience for employees to return to over the short-term and to attract and retain talent over the long-term," Colliers said in a research report.

Net face rents declined by 0.8% over 4Q 2020 in the prime grade market after a period of stabilisation through the first three quarters of 2020. Colliers forecasts average face rents to enter a deflationary cycle through 2021, predominantly impacting secondary assets, before a recovery in 2022.

MELBOURNE CBD

Vacancy in Melbourne CBD has increased from record lows of 3.2% in January 2020 to 8.2% in January 2021, largely driven by an increase in new supply. Colliers expects that vacancy will increase further in July 2021 as we expect sublease space to reach nearly 200,000 sqm in the first half of 2021. Incentives have also increased to between 35-40% and face rents are starting to come under some pressure due to the lack of demand.[24]

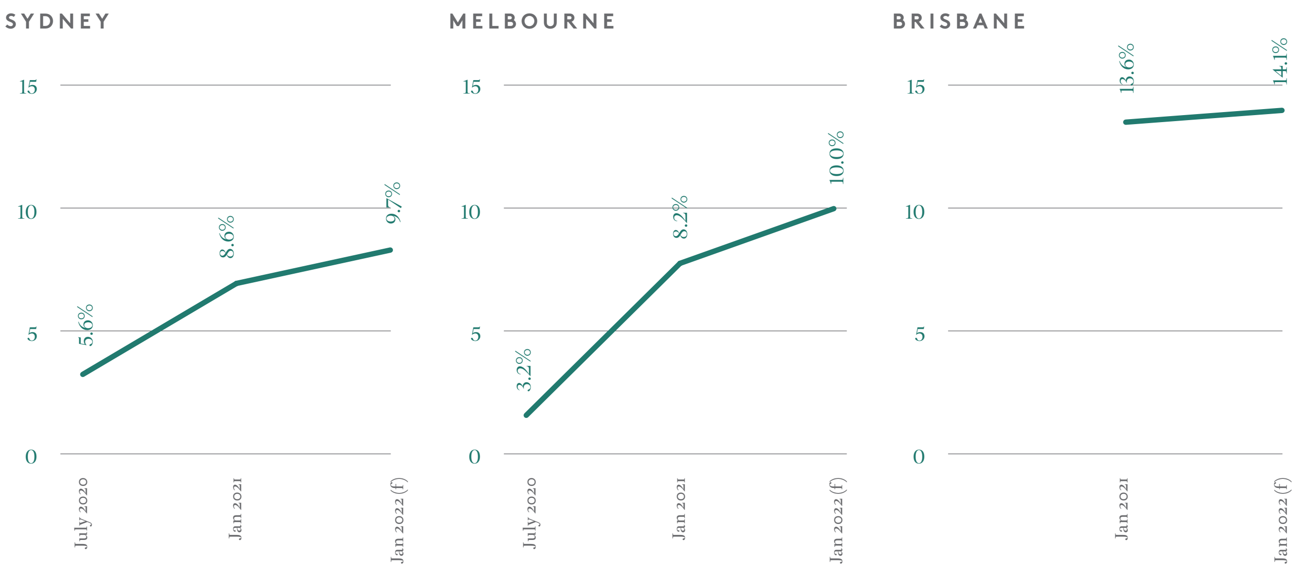
BRISBANE CBD

The Brisbane CBD leasing market showed resilience compared to other CBD markets in Australia during 2020. Market vacancy increased by about 15,940 sqm, equivalent to 0.7% of the CBD office stock, and reaching 13.6%, slightly above the 10-year average of 13.1%, according to Colliers. This compares to a vacancy increase across the Australia CBD markets of circa 365,590 sqm equivalent to 1.9% of Australia's CBD office stock.

23 Colliers, Research & Forecast Report, CBD Office, First Half 2021 https://www.colliers.com.au/en-au/research/office-cbd-rfr-h1-2021
24 Colliers, Research & Forecast Report, CBD Office, First Half 2021 https://www.colliers.com.au/en-au/research/office-cbd-rfr-h1-2021

TOTAL MARKET VACANCY RATE

Source: Colliers



Spotlight on residential's surprising resilience

Last year, when uncertainty about the impact of the COVID-19 pandemic was at its peak, several forecasters, including economists from some of the country's biggest banks, predicted falls in property values of as much as 10-20% over the next 12 months.[25 26]

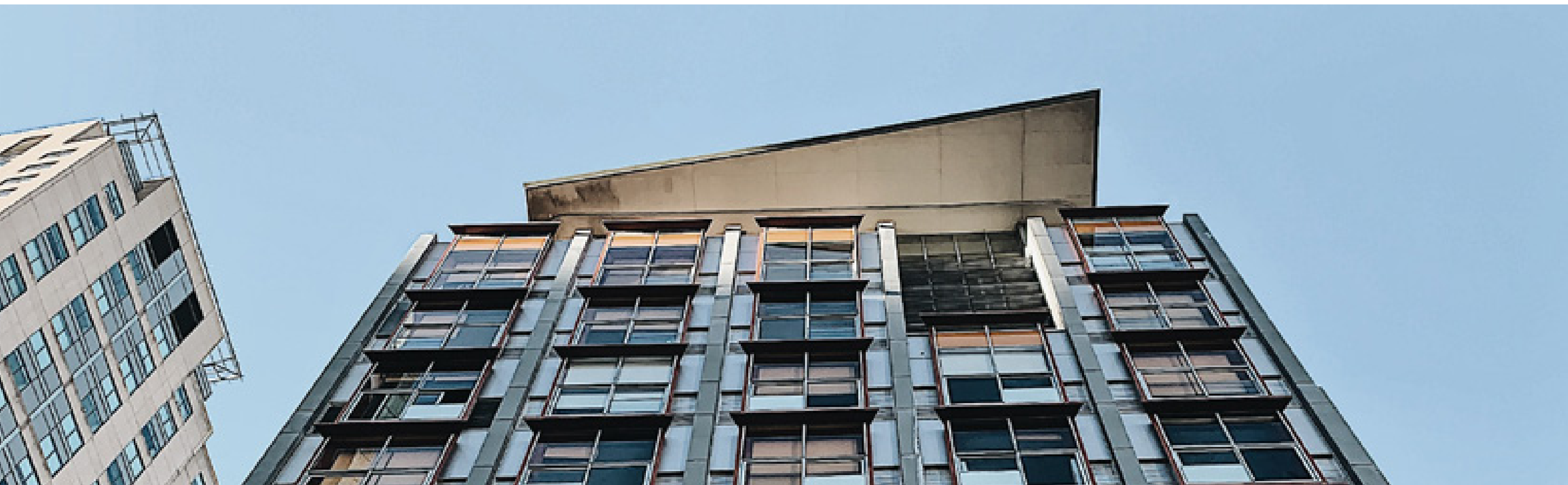
Worst-case scenarios suggested prices could fall as much as a third.[27] Reserve Bank of Australia (RBA) researchers also published stress tests measuring how sensitive indebted households would be to the shock of any sharp fall in house prices. They modelled a 40% fall in house prices, which the bank called "an extreme but plausible scenario".[28]

Now, a year into the pandemic, not only has that dramatic outcome been avoided, but we're seeing the reverse. Prices have risen more than 6.0% in the year to March and values in most capital cities are achieving record highs.[29]

More surprisingly, this growth is occurring while net migration has been decimated by Australia's pandemic related border restrictions.[30] This has resulted in a slowdown in the rate of population growth (traditionally seen as a proxy for underlying housing demand) to 0.9% in the year through September, from a pre-COVID rate of 1.4%.[31]

The strong market rebound is also occurring in an economy that, although recovering, is doing so unevenly. Industries based in the centre of capital cities, or that rely on foot traffic, mass gatherings, international students and tourism remain heavily impacted by the pandemic.[32]

25 Ted Tabet, "CBA Dials Back Price Fall Prediction", The Urban Developer, 9 September 2020 https://theurbandeveloper.com/articles/cba-dials-back-price-fall-prediction
26 Chris Rands, "Why Australian property prices could fall up to 20%" Livewire, 7 August 2020 https://www.livewiremarkets.com/wires/why-australian-property-prices-could-fall-up-to-20
27 Michael Janda, "CBA warns Australia risks 32 per cent house price crash in a 'prolonged downturn', flags $1.5 billion coronavirus-hit to bank", ABC News, 13 May 2020 https://www.abc.net.au/news/2020-05-13/coronavirus-commonwealth-bank-house-prices-economy-unemployment/12241338
28 Tawar Razaghi, "Property prices yet to see full scale of COVID-19 pandemic's impact: economists", Domain, 31 August, 2020 https://www.domain.com.au/news/property-prices-yet-to-see-full-scale-of-covid-19s-impact-economists-982528/
29 CoreLogic, Monthly Chart Pack, April 2021 https://www.corelogic.com.au/reports/housing-market-update
30 ABS, National, state and territory population, September 2020 https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/sep-2020
31 ABS, National, state and territory population, September 2020 www.abs.gov.au/statistics/people/population/national-state-and-territory-population/sep-2020
32 Daniel Ziffer, "JobKeeper supports nearly a million workers. It's over...so what happens now?", ABC News https://www.abc.net.au/news/2021-03-29/jobkeeper-ends-what-now-for-australian-businesses/100031668



What prevented the dire scenario?

Australian residential property prices declined initially due to COVID. Values fell by just 1.7% between March and October, before returning to a positive trajectory, despite Australia experiencing its worst economic downturn since the Great Depression.[33] There are several reasons why the fall in values was not more extreme, and why the recovery has been so rapid and strong, including:

1. The impact of falling migration is focused on the inner-city rental market in Sydney and Melbourne.

   To understand the impact of the fall in net overseas migration (NOM) on housing, CoreLogic analysed the composition of migrant flows, and where migration is geographically centered.[34] It found that temporary migrants comprise the large majority of NOM to Australia. CoreLogic says the large majority of temporary migrants rent rather than purchasing a home. Additionally, most permanent migrants tend to initially rent. This is why falling migration has been a major factor in driving down rents in Melbourne and Sydney.

   Last year 84% of all overseas migration flowed into the capital cities. Three quarters of those capital city migrants arrived in Sydney and Melbourne, according to CoreLogic. Within the cities, the largest number of overseas migrants are generally centred around the CBD, and precincts close to the CBD, where high density housing options are common, and to a lesser extent, middle ring suburbs close to educational precincts or transport hubs such as Parramatta in Sydney or Clayton in Melbourne.

2. Workers in the sectors worst hit by COVID are more likely to be renters – often in the inner city.

   These inner city market segments were also impacted by other factors beyond migration. Some of the worst hit parts of the employment market during the COVID-19 shutdown and recession were highly casualised industry sectors such as food, accommodation, arts and recreation workers. Workers in these segments are more likely to be renters than homeowners relative to other industries of employment. Additionally, fewer workers may be demanding rentals in the CBD's due to remote working arrangements.

   The flipside is that outside of Melbourne and Sydney, housing demand derived from NOM is less significant, and therefore the impact of falling migration is less significant.

3. Massive amounts of economic stimulus supported the economy.

   Fiscal stimulus including the federal government's $90 billion JobKeeper wage subsidy scheme helped keep the economy afloat as whole industries were forced to close to stop the spread of COVID-19. JobKeeper initially gave businesses $1,500 per fortnight per employee to help pay their wages. It helped to keep a connection between employers and employees, allowing a faster economic recovery when the pandemic was under control, and prevented a sharp rise in unemployment. At one point, almost a third of all Australian workers were on JobKeeper.[35]

4. Low interest rates and other central bank measures have supported the economy and helped drive mortgage rates to record lows.

   The RBA reduced the cash rate twice in March 2020, to 0.25%, and to 0.1% on 3 November 2020. This is boosting the cash flow of businesses and the household sector, and helping trade-exposed industries through the exchange rate.[36]

   Also in March 2020, the RBA announced a target for the yield on the three-year Australian Government bond of around 0.25% and reduced this target to around 0.1% on 3 November 2020. The central bank purchases bonds on the secondary market to help achieve this target.

   The central bank has also been keeping borrowing costs low through its bond repurchase program. The RBA announced in November that it would purchase bonds issued by the Australian Government and by the states and territories in the secondary market under a $100 billion bond purchase program. In February 2021, it announced that it would purchase an additional $100 billion of government bonds when the current bond purchase program is completed in April.

   In addition, it is providing a term funding facility (TFF) for the banking system, to support lending to businesses. The TFF was announced in March 2020, and an increase and extension of the facility was announced in September. Under the TFF, authorised deposit-taking institutions (ADIs) have access to funding from the RBA for three years at an interest rate substantially below their funding costs. In November, the interest rate on the TFF was reduced from 0.25% to 0.1% per cent.

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33 Eliza Owen, "Why didn't the Australian housing market crash?", CoreLogic https://www.corelogic.com.au/news/why-didnt-australian-housing-market-crash

34 Tim Lawless, "How will stalled net overseas migration impact housing demand?", CoreLogic https://www.corelogic.com.au/news/how-will-stalled-net-overseas-migration-impact-housing-demand

35 Daniel Ziffer, "JobKeeper supports nearly a million workers. It's over…so what happens now?", ABC News https://www.abc.net.au/news/2021-03-29/jobkeeper-ends-what-now-for-australian-businesses/100031668

36 RBA, Supporting the Economy and Financial System in Response to COVID-19 https://www.rba.gov.au/covid-19/

5. APRA adjusted bank capital expectations.

The Australian Prudential Regulator Authority (APRA) also introduced temporary changes to its expectations regarding bank capital ratios, to ensure the banks were well positioned to continue to provide credit to the economy in the challenging environment during the pandemic. Over the past decade, the Australian banking system has built up substantial capital buffers. The highest quality form of capital, Common Equity Tier 1 (CET1) capital, reached $235 billion at the end of 2019. As a result, banks were typically maintaining capital levels well above minimum regulatory requirements.[37]

In 2017, APRA set benchmark capital targets for banks to enable them to be regarded internationally as unquestionably strong (which was a recommendation of the 2014 Financial System Inquiry). These benchmarks are well above current minimum regulatory requirements. For the four major banks, for example, this benchmark equated to having a CET1 ratio of at least 10.5 per cent of risk-weighted assets. A lower benchmark applies for smaller banks. In comparison, the actual CET1 ratio of the banking system by the end of 2019 had reached 11.3 per cent.

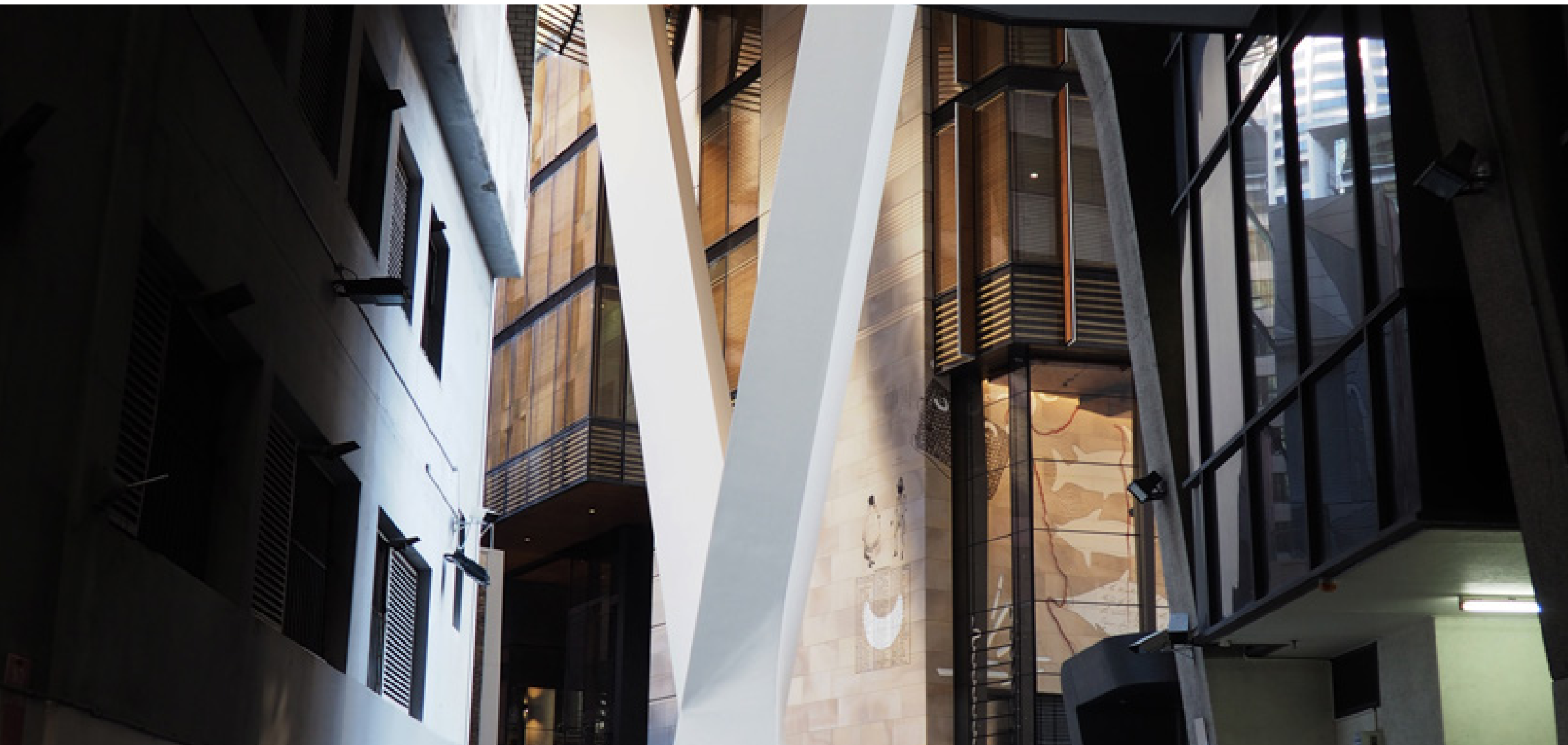
In March 2020 APRA advised all banks that, given the prevailing circumstances, it envisaged they might need to utilise some of their current large buffers to facilitate ongoing lending to the economy. Provided banks were able to demonstrate they could continue to meet their various minimum capital requirements, APRA wouldn't be concerned if they weren't meeting the additional benchmarks announced in 2017.

6. Mortgage freezes kept a lid on defaults.

High levels of regulator driven liquidity assisted in the banks' ability to offer six-month mortgage payment freezes, minimising defaults. There were very low levels of distress in the residential and commercial markets in 2020. In December, there were just five distressed residential listing out of hundreds of thousands. For the full year here were 71, even less than in 2019 when there were 98, according to REA. "The unusual nature of the recession being productivity driven, as opposed to finance, led, meant house prices across Australia didn't fall," said REA in its 2021 Property Outlook Report.[38]

37 APRA, media release, "APRA adjusts bank capital expectations", 19 March 2020 https://www.apra.gov.au/news-and-publications/apra-adjusts-bank-capital-expectations#:~:text=Over%20the%20past%20decade%2C%20the,at%20the%20end%20of%202019.&text=In%20comparison%2C%20the%20actual%20CET1,had%20reached%2011.3%20per%20cent.

38 REA Insights, Property Outlook Report 2021 https://www.realestate.com.au/insights/rea-insights-property-outlook-report-2021/



7. Supply is lagging demand.

   Despite steady population growth in Australia in recent years, home construction has been slowing. When COVID hit, forecasts were for as few as 110,000 homes to be delivered in 2020, less than half the near 230,000 built in 2016.[39]

   As the economy has recovered, the upswing in buyer demand has not been met with an equal rise in inventory, CoreLogic said in its Home Value Index report: "This has resulted in strong selling conditions, amidst a palpable sense of urgency amongst buyers, putting upwards pressure on housing prices."[40]

   The rise in valuations has been stronger in free standing houses than in units, where more supply has come online in recent years. Knight Frank reports the median house price across Australia rose by 5.8% in 2020 compared to a 0.9% rise in median apartment values.[41]

   A report from SQM Research revealed that higher demand in major Australian property markets than the rise in home listings during February, caused a notable decline in supply by 13.1% year-on-year.[42]

8. Incentives supported first home buyer demand.

   Many state incentives for first home buyers were expanded on[43], and the federal government introduced the First Home Buyer Deposit Scheme, which allows first home buyers to put down a deposit of just 5% and avoid having to pay the added impost of the insurance.[44]

9. Sydney prices are still not much above 2017 levels, but incomes have risen.

   While values have remained surprisingly buoyant during the pandemic and are now back on the rise after a slight downturn, it is easy to forget that this buoyancy followed a significant downturn in the market in recent years.

   Between September 2017 and June 2019, Australian residential property prices experienced their biggest fall in 40 years, following a period of exceptionally strong growth.[45] As discussed in our reports at the time, those value declines were largely driven by tightening in the availability of credit as the Australian Prudential Regulation Authority (APRA) had implemented measures to reduce the risks in the mortgage market, causing a fall in lending to investors.

   In the second half of 2019, as APRA began easing constraints on lending, the residential market was beginning to recover from the downturn, and then the pandemic struck in early 2020.

In an article examining the long-term property cycle, Christopher Joye of Coolabah Capital notes that in the 3.5 years since the peak of the last major housing boom, Sydney dwelling values have appreciated by just 1.1%. That equates to an annual rise of just 0.3% a year. At the same time, wages growth has been running at a much higher 2%[46]. The resultant higher income, along with ultra-low interests, is adding to the net purchasing power of Australian households.

Australians are wealthier than ever, and this has been reflected in strength in the prestige end of the housing market. Total household wealth hit a record high in the December $12.03 billion, driven by the rising value of deposits, superannuation balances, and residential assets, according to the Australian Bureau of Statistics.[47]

The REA Insights Property Outlook Reports that of the 30 suburbs with medians priced over $3 million, only five saw a price decline in 2020. More than half the suburbs on the list saw double digit price growth. And the number of $3 million plus suburbs doubled during the pandemic. REA predicts that the number of A$3 million suburbs will jump from 30 to 60 by the end of 2021.[48]

39 Tim Williams, "Australian public policy is inflating home prices, as usual", The Fifth Estate, 22 March 2021 https://thefifthestate.com.au/columns/spinifex/australian-public-policy-is-inflating-home-prices-as-usual/

40 CoreLogic, Hedonic Home Value Index, 1 April 2021 2021 https://www.corelogic.com.au/sites/default/files/2021-03/210401_CoreLogic_HVI.pdf

41 Knight Frank, Australian Residential Review 1Q 2021 https://www.knightfrank.com/research/report-library/australian-residential-review-q1-2021-7890.aspx

42 Martin Kelly, "Property demand swamps supply, drives up prices", Australian Financial Review, 2 March 2021 https://www.afr.com/property/residential/property-demand-swamps-supply-drives-up-prices-20210302-p5770d

43 Gerard Cockburn, First-home buyer grants expanded in NSW to assist building industry, NCA NewsWire/Gold Coast Bulletin https://www.goldcoastbulletin.com.au/breaking-news/firsthome-buyer-grants-expanded-in-nsw-to-assist-building-industry/news-story/11184b258dc734366590570946cbd320

44 John Collett, "First home buyers tap the bank of mum and dad", Brisbane Times, 20 April 2021 https://www.brisbanetimes.com.au/money/borrowing/first-home-buyers-tap-the-bank-of-mum-and-dad-20210415-p57jke.html

45 Shane Oliver, Head of Investment Strategy and Chief Economist, AMP Capital, Australian house prices back from the abyss. This article can be accessed at https://www.ampcapital.com/au/en/insights-hub/articles/2019/september/australian-house-prices-back-from-the-abyss

46 Christopher Joye, Why the house price boom is just getting started, AFR, 19 March 2021 https://www.afr.com/policy/economy/why-the-house-price-boom-is-just-getting-started-20210319-p57c9c

47 ABS, Media Release, "Strong growth in quarterly household wealth", 25 March 2021 https://www.abs.gov.au/media-centre/media-releases/strong-growth-quarterly-household-wealth

48 The REA Insights Property Outlook Report https://www.realestate.com.au/insights/rea-insights-property-outlook-report-2021/

Outlook

Australia's economy is expected to grow at its fastest pace this year since 2007[49] as the global economy gradually recovers – and there is room for more upside as borders potentially open further.

Continued economic growth combined with low mortgage rates will support the property market.

Diminishing supply pipeline supports residential market.

CoreLogic's national home value index recorded a 2.8% rise in March, the fastest rate of appreciation since October 1988, indicating the market is gaining momentum. Forward looking indicators are also positive. Commonwealth Bank's Household Spending Intentions (HIS) survey shows that home buying intentions rose further in March to the highest level since the start of the HIS in 2015. Both home loan applications and Google searches were up on the month and well up on February 2020 levels. "We continue to expect the home buying market to be a key source of support for the Australian economy in 2021 – driven largely by the very low level of interest rates," the report's authors said.[50]

Knight Frank says a diminishing pipeline of new projects over coming years is likely to keep vacancy at bay, adding this is likely to offset the fall in population growth given the temporary pause on migration.[51] CBRE expects the market to swing into a long-term under supply cycle from 2023 as demand strengthens but supply lags. It warns that an earlier than expected return of overseas migration would bring the undersupply forward, further fuelling prices.[52]

The outlook for migration remains uncertain and dependent on international borders re-opening and, potentially, travel agreements being negotiated between countries. Recently a travel bubble was put in place between New Zealand and Australia, allowing quarantine free travel between the two countries.[53]

49 https://www.reuters.com/world/asia-pacific/australias-covid-19-win-help-fuel-economic-growth-this-year-2021-04-20/
50 Commonwealth Bank of Australia, Household Spending Intentions Series, February 2021 https://www.commbank.com.au/business/latest/spending-intentions.html
51 Knight Frank, Australian Residential Review 1Q 2021 https://www.knightfrank.com/research/report-library/australian-residential-review-q1-2021-7890.aspx
52 CBRE, Market Outlook 2021 – Residential https://www.cbre.com.au/research-reports/australia-real-estate-market-outlook-2021/residential
53 Australian Government, Department of Home Affairs, New Zealand safe travel zone https://covid19.homeaffairs.gov.au/new-zealand-safe-travel-zone

Major banks forecasting strong residential price growth in 2021, 2022

ANZ economists recently predict house prices will soar 17% in 2021 across the capital cities[54], having scrapped an earlier prediction that prices would fall 10% due to COVID.[55] And, having a year ago predicted house prices would drop at least 10-12% and performed scenario modelling on a 30% fall, Commonwealth Bank of Australia now expects prices to rise by 10% in 2021.[56]

Westpac has forecast a 20% jump in house prices between now and 2023. "The bottom line is that Australia's housing upturn now has strong momentum that looks to be lifting further and will remain well supported by monetary conditions and an improving economic backdrop," Westpac economists Bill Evans and Matthew Hassan said.[57]

REA Insights says it's likely the outperformance of regional Australia will continue. While views per listing on realestate.com.au jumped 16% in capital cities during the second half of 2020, the increase in regional Australia was 44%. However with many people likely to be called back to the office soon, that will impact where people choose to live and work.[58]

Rental markets are likely to improve in 2021 as employment conditions improve, according to REA, adding that the return of on-campus learning for university students will also provide a boost, particularly once borders open again. Strong mining conditions and demand for beachside regional areas is expected to continue, supporting rents in these areas.

Industrial sector expected to remain elevated.

Kate Bailey, Head of Logistics and Retail Research, Australia, at CBRE, said the industrial and logistics sector in Australia remains well supported after the strong growth of 2020: "As e-commerce continues to grow, challenges around reverse logistics and delivery times will place pressure on occupiers to meet growing demand in a cost-effective way."[59]

Industrial and logistics assets comprised a record proportion (38.3%) of sales in 2020, and CBRE forecasts that momentum will continue through 2021 as more groups seek to reweight their portfolios to capitalize on increasing occupier demand: "The industrial and logistics sector is expected to remain elevated in 2021, with many investors seeking to reweight their portfolios to capitalize on this demand, while landlords are anticipating solid rent growth from an expanding occupier base."

Based on forecast e-commerce sales, CBRE estimates that an additional 350,000 sqm of new space will need to be developed each year. This will be comprised of traditional warehousing but also last mile hubs, repurposed retail facilities, and parcel lockers.

Office vacancy has further to rise but leading indicators improving.

Joyce Tiong, Head of Office Occupier Research, Australia, at CBRE said tenant demand is expected to remain soft in 2021 given the potential downside risks that may arise as stimulus measures such as JobKeeper, insolvency moratoriums, and eviction memorandums subside.[60]

"Although the question remains on what a hybrid/remote workforce will look like and what its impact to office demand may be, workplace occupancy will continue to be influenced by the containment of COVID-19 and the rollout of vaccination programs," Tiong said.

"Softer rental growth is anticipated in 2021 as a consequence of greater incentives on the back of weaker tenant demand. Subsequently, we expect occupiers to use this as fresh impetus to push for more favourable terms while simultaneously transitioning to more agile solutions and reducing their office footprints."

Although Australian occupiers have indicated space reductions will on average be less than the rest of the world, reductions are expected, nonetheless.

"The sentiment among executives, employees, and corporate real estate providers is that permanent changes in real estate use will emerge from the adaptation organisations and their workforce have had to make in response to the pandemic."

54 Elizabeth Redman, "House prices could rise 17 per cent this year, locking some first-home hopefuls out: ANZ", Domain, 24 March 2021 https://www.domain.com.au/news/house-prices-could-rise-17-per-cent-this-year-locking-some-first-home-hopefuls-out-anz-1038587/

55 The Weekly Source, "ANZ backtracks on 10% drop in house prices – forecasts 9% growth in 2021", https://www.theweeklysource.com.au/anz-backtracks-on-10-drop-in-house-prices-forecasts-9-growth-in-2021/

56 James Frost and James Eyers, "CBA, Westpac chiefs: house prices to rise 10% this year", AFR, 15 April 2021 https://www.afr.com/companies/financial-services/house-prices-to-rise-10-per-cent-this-year-cba-20210414-p57j97

57 Natalie Brown, "Westpac forecast 20% jump in Australian house prices", News.com.au, 22 February 2021 https://www.news.com.au/finance/economy/australian-economy/westpac-forecasts-20-per-cent-jump-in-australian-house-prices/news-story/433ab16b1cf953f872b2fac070a5033b

58 REA Insights, Property Outlook Report 2021 https://www.realestate.com.au/insights/rea-insights-property-outlook-report-2021/

59 CBRE Market Outlook 2021 Australia Industrial Logistics https://www.cbre.com.au/research-reports/Australia-Industrial--Logistics-Market-Outlook-2021

60 CBRE Market Outlook 2021 Office https://www.cbre.com.au/research-reports/Australia-Office-Market-Outlook-2021

CBRE expects CBD vacancies to increase further amid persistent economic headwinds and a push to a more hybrid or remote workplace before levelling out as the economy continues to recover and tenant demand revives.

CBRE notes Australian white-collar employment has recovered to pre pandemic levels and leading indicators point to a recover in office demand. The NAB Monthly Business Survey shows business conditions rose to a record high in March and business confidence is well above average.[61]

Risks still on the horizon

The outlook depends to some extent on the vaccine rollout continuing without major setbacks. Until the population is fully vaccinated, there remains the risk of outbreaks. While Australia is getting better at managing them, there remains the risk of an economic shutdown.

The phase out of JobKeeper in March could also put pressure on the economy. The scheme officially ended on March 28[62] and some businesses that have been artificially propped up by the subsidy may fail without it if their revenues have not recovered.

Another risk is that interest rates rise sooner than expected. While the RBA has indicated it's not in any hurry, rising bond yields indicate investors are increasingly worried about inflation with US President Joe Biden signing off on a US$1.9 trillion COVID relief bill in March.[63] The stimulus is driving the US dollar lower, putting upward pressure on the Australian dollar. A lower Australian dollar attracts inflationary pressure to Australia because businesses have to pay more for imported production inputs, and they often pass those higher costs onto customers by raising prices of their goods and services.That could increase pressure on the RBA to raise interest rates to contain inflation.

Regulators may seek to intervene in the residential market if becomes too hot. RBC said policy levers on the table for regulators include a limit on the percentage of high loan-to-value loans, a mandated percentage of lower loan-to-value loans, higher interest rate buffers imposed on borrowers, and greater scrutiny over borrowers' income and expenditure.[64]

However the RBA has indicated there is no need for intervention yet. RBA Governor Philip Lowe said in a speech to the National Press Club that it will be monitoring lending standards closely as housing prices rise: "We would be concerned if there were to be a deterioration in these standards, but there are few signs of this at the moment."[65]

Even if some macro prudential measures were introduced in 4Q and there was some easing in house price growth in 2Q post the end of the JobKeeper and the Homebuilder grant, nationwide house prices are likely to move higher for much of this year and next, according to RBC Capital Markets Chief Economist Su-Lin Ong.[66]

CoreLogic says tighter credit policies would have an immediate dampening impact on the market, adding that the timing and likelihood of any change in credit policies is highly uncertain and largely dependent on a material uplift in credit metrics such as debt to income ratios, loan to income ratios or high LVR lending. "According to APRA, although each of these metrics rose in the final quarter of 2020, lending standards remain healthy enough to keep any credit intervention at bay for now."

61 NAB, Monthly Business Survey: March 2021 https://business.nab.com.au/monthly-business-survey-march-2021-45724/
62 ATO, JobKeeper key dates https://www.ato.gov.au/general/jobkeeper-payment/jobkeeper-key-dates/#:~:text=28%20March%202021%20%E2%80%93%20the%20JobKeeper,business%20declaration%20in%20April%202021.
63 Jacob Pramuk, Biden signs $1.9 trillion COVID relief bill, clearing way for stimulus checks, vaccine aid, 11 March 2020 https://www.cnbc.com/2021/03/11/biden-1point9-trillion-covid-relief-package-thursday-afternoon.html
64 Tom Richardson, "RBA tipped to put brakes on house prices in 2021", Australian Financial Review, 22 March 2021
65 RBA Governor Philip Lowe, Address to National Press Club of Australia, 3 February 2021
66 Tom Richardson, "RBA tipped to put brakes on house prices in 2021", Australian Financial Review, 22 March 2021

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 centres 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.

MELBOURNE

Level 21, 90 Collins Street,
Melbourne VIC 3000
+61 3 9929 6400
enquiries@bannerassetmanagement.com

SYDNEY

Suite 7.05, Level 7, 1 Margaret Street,
Sydney NSW 2000
+61 2 9262 2422
enquiries@bannerassetmanagement.com