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Seeking to Look Beyond COVID-19

Over recent months, many businesses, individuals, families and communities have been in survival mode. As Australia gradually re-opens its economy, having largely suppressed the virus, what may be different is what we value. This could have significant impacts on our economy and its property markets.

Office Sector

Among the aspects of Australian life that many have learned to value are personal connections with family and friends. This could see some making permanent changes in their work/life balance.

Confined to home, with families often combining work from home and home schooling, many are now keen to return to the social experiences of their workplaces.

Others will prefer to remain at home, supported by employers who acknowledge they can trust employees, achieving greater productivity than in the office.

Physical distancing rules in office buildings in the Central Business Districts (CBDs) and congested public transport commutes, together with businesses failing or relocating, have contributed to some forecasts that CBD office values could fall by around 15%. However, Charter Hall has highlighted the likely reversal of the long-term trend of increased densities (to 15-16 m^2 per person), could offset to some extent the reduced demand for space (source: *The Australian*, 22 May 2020).

A middle way may be the emergence of suburban nodes, closer to home for many workers, but still offering benefits of workplace personal interaction and team working. This solution is sometimes referred to as the “hub and spoke” model.

A recent presentation by Andrew Quade of AMP Capital indicated his company had already seen increased enquiry for suburban business parks, especially near public transport and in buildings of up to three storeys. Lower costs than in the CBDs are an added attraction. He said there had also been enquiries for industrial premises with larger office components.

There appears to be a widely held business view, that in the absence of a vaccine, the way forward is about managing risk in a COVID-safe way. For some companies, this may involve an increase in short-term leases and more flexible options.

Office Sector……..Page 1
Industrial, Logistics & Retail Sectors…......Page 2
Gold Coast Activity……..….......................Page 3
HomeBuilder Stimulus.................................Page 4

Artist’s impression of completed houses fronting Lake Serenity in the Serenity 4212 master planned community at Helensvale (image courtesy of the Keylin Group)

Industrial, Logistics and Retail Sectors

The industrial and logistics sector, particularly prime assets with long weighted average lease expiries, has benefited from the expansion of ecommerce. The shift towards automation in warehouses will underwrite demand for new developments over the medium term.

The appetite for Australian industrial and logistics investments was highlighted by the recent announcement that Arrow Capital Partners is creating a new industrial fund. However, secondary industrial properties are more likely to see yields increase, with strength of tenant covenants now a major consideration.

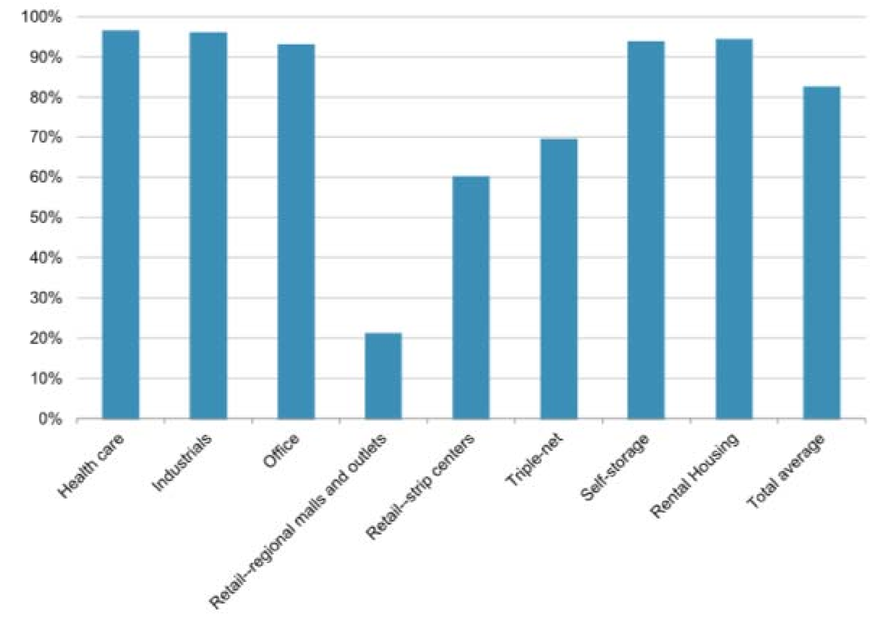
A revival of Australia's manufacturing industry is anticipated, supported by Government realisation that self-sufficiency in some goods, such as medical supplies, is critical. Despite this, it is not considered that Australia will turn its back on trade, a sector that has been the source of the nation's prosperity for over 200 years. The pursuit of free trade agreements with the United Kingdom and with the European Union signals this continued emphasis.

The nature of manufacturing is likely to differ from the large-scale factories that closed over recent decades. Featuring technologies such as 3D printing, new value-add manufacturing may be boutique operations. The Gold Coast Health and Knowledge Precinct is expected to benefit from the increased demand for health sector-related space.

While not directly representative of Australian conditions, Graph 1 shows the extent to which global real estate investment trusts (REITs) were able to collect rents in April 2020 (source: S& P Global Ratings & *The Urban Developer*, 16 June 2020).

The graph highlights the pain experienced by the retail sector. Discretionary retail and hospitality have been severely impacted by Governments' "stay at home" rules. Supermarkets and online retailers have done well, but clothing and footwear retailers may take longer to recover. Many shops, cafes and restaurants will not re-open. As an investment, the retail sector, already struggling before, now looks like a second-best choice for property investors.

Graph 1 - S & P Global Ratings REIT Average Rent Collected in April by Sector



Gold Coast Activity

The sectors most severely impacted by the restrictions associated with COVID-19 have been tourism (including aviation), arts and entertainment and universities. The Gold Coast's tourism industry has been particularly impacted, especially with the Queensland border still closed. According to Tourism Research Australia (TRA), in 2018/19, 9.3% of the state's employment and 7.7% of Gross State Product was attributable to tourism.

In 2017/18, tourism contributed 14.1% of the Gross Regional Product on the Gold Coast and accounted for 42,000 jobs (including 29,400 direct jobs). These jobs were primarily in hospitality and accommodation, but 16.7% were in the dominant retail industry (source: TRA).

These are the sectors most affected by the recession, both job losses and those receiving JobKeeper. While the Sydney and Melbourne CBDs (10,290 and 6,693 businesses respectively) had the highest numbers of businesses whose employees are receiving JobKeeper, within Queensland, Cairns (3,607 businesses) had the highest number, ahead of the Brisbane CBD (3,048 businesses). Six Gold Coast postcode areas accounted for 14,371 businesses on the scheme (source: *The Gold Coast Bulletin*, 11 June 2020).

The real estate and property industries have also been impacted, particularly those dealing with landlords and tenants, many of whom could not continue to pay rent (both commercial and residential). Within the residential sector, to date the impact on vacancies has been unevenly felt. According to SQM Research, in May 2020, the Main Gold Coast area had a vacancy of 5.0% (up from 2.0% in February), but Surfers Paradise had a 10% vacancy (up from 2.7%). Many residential areas had low vacancies, for example, Coomera/Pimpama 1.6%.

Construction activity has continued on many projects, and new work has commenced on the $1 billion upgrading of the M1 from Varsity Lakes to Tugun, as well as the Light Rail Stage 3a.

Alceon, the developer of the Brisbane Technology Park at Eight Mile Plains and BTP Northshore Hamilton in Brisbane, is close to completing the first stage of the 15,000 m^2 Acuity Business Park, opposite the train station at Robina. In early 2019, Metricon pre-committed to the three lower levels of the building with floor plates of over 1,000 m^2.

Acuity Business Park

Lifestyle Estate in Demand

The Serenity 4212 master planned estate at Helensvale in the northern Gold Coast, being developed by joint venture partners, the Keylin Group and Kinstone Developments, has an initial release of 110 waterfront and reserve frontage lots, with direct frontage to Lake Serenity (with pontoons) or to Coombabah Creek. Lots range in size from 500 to over 1,200 m^2. Since March 2020, the project has received over 1,300 enquiries, with 39 unconditional contracts, mainly by owner occupiers from the Gold Coast, Brisbane and overseas. Waterfront prices start at $675,000 (on average $1,200/m^2 of land). Townhouses, apartments, commercial/retail and retirement living options are proposed in future stages.

Shift to Larger Apartments

Even prior to COVID-19, there was a well-established shift from smaller apartments targeted to investors. Instead large apartments in prime locations, targeted to owner occupiers are now preferred. An example of this is the Spyre Group's Natura Burleigh. The trend also extends to larger houses, with bigger yards and more space to work from home. Fringe suburbs and regional areas are benefiting, as people realise technology enables them to work from home.

Population Growth a Key Driver
Population growth is one of the key drivers of demand for construction of new dwellings and commercial space. With the closing of Australia's borders in late March 2020, the outlook for demand fell sharply. In May 2020, the Federal Government indicated it anticipated a 30% decline in net overseas migration in 2019/20 (down from around 240,000 migrants in 2018/19), with an 85% fall in 2020/21 (to around 35,000 migrants).

AMP Capital has indicated that this would result in Australia's population growth falling to 0.7% (down from 1.5% in 2018/19). This would be the lowest level since 1917. It would imply an underlying demand for around 120,000 new dwellings over the next year, compared with some 200,000 new dwellings last year (source: Shane Oliver, 1 June 2020).

Recession Impacts
The impact on underlying demand is exacerbated by the recession, with the real unemployment rate, allowing for those who dropped out of the labour force, estimated at over 11% in May 2020 (source: Australian Bureau of Statistics). Currently JobKeeper, bank deferrals of home mortgage repayments, the moratorium on rental evictions and the reduction in the JobSeeker supplements are all expected to end in late September 2020. Unemployment and forced sales could rise further in coming months.

The **HomeBuilder Stimulus** is intended to respond to the anticipated collapse in the pipeline of building work later this year. The industry was already experiencing a downturn. ABS data shows private sector house commencements in the December Quarter 2019 were down 13.7% from the year before, with other residential commencements down 24.2%.

The Housing Industry Association (HIA) indicated private new home sales were down by 18.2% over the three months to May 2020, compared with the same period in 2019 (which was affected by the Federal Election). The HIA was estimating 500,000 job losses in coming months, before HomeBuilder.

Most commentators appear to be expecting buyers and developers of new housing estates to be the major beneficiaries. The threshold for a renovation to be eligible appears to be very high, especially in regional Australia. This includes in bushfire impacted areas, where rebuilding is occurring very slowly.

State Governments are announcing their own building and infrastructure initiatives, including funding social housing. Despite the stimulus measures Australia could see a 10% fall in house prices in 2020/21, mainly in southern capitals (source: *Australian Financial Review*, 6-7 June 2020). This could have the benefit of improved affordability for those able to participate in the market.

HomeBuilder Stimulus Parameters

- Grant of $25,000 to renovate an existing home or build a new home (from $150,000 to $750,000). Contracts signed by 31 December 2020. Construction to start in 3 months;
- Limited to individuals with a taxable income in 2018/19 up to $125,000 and for couples up to $200,000. Available to owner occupiers, not available to investors;
- Applies to new homes valued up to $750,000 and renovated homes up to $1.5 million;
- Administered by states and territories via a National Partnership Agreement;
- Available to existing home owners and for off-the-plan apartments. First home buyers may be eligible for additional state or territory grants and stamp duty concessions.