Market Commentary

Post COVID-19

By Scott Keck, Chairman, Charter Keck Cramer

19 May 2020
charterkc.com.au

CHARTER. KECK CRAMER

VALUATIONS

Although the impact of Covid-19 is dramatic, it has not yet manifested in indisputable evidence so far as the property market and values are concerned.

Nonetheless, the change in commercial, social and private occupancy, routines and behaviour, are igniting conversation about consequential trends in the medium to longer term. In this short commentary, we endeavour to summarise the influences that can be anticipated and suggest how property categories, may be affected.

Scott Keck
Chairman

E scott.keck@charterkc.com.au
T +61 (0) 3 8102 886
M +61 (0) 417 279 052

Australia's most trusted & innovative property group

Influences [Positive]

» Continued Asian economic strength throughout the region underpinning Australia's exports and ensuring a gradual but inevitable return to immigration and foreign students to Australia. Current tensions with China whilst of concern, will pass. There is an overriding, economic imperative to maintain bilateral trade and respectful relationship.

» Going into the crisis the government response was strong, quick and decisive. Upon reflection some may suggest it was more than necessary. Coming out of lock down community pressure will be overwhelming upon government to adopt a softer strategy opening up Australia 'internally' as quickly as possible to bolster domestic activity.

» For many reasons Australia will be viewed as a "safe haven". We are monitoring very strong enquiry from investors wanting to pursue real estate in all categories.

» Café society will return, but the recovery may be slow, particularly on the supply side.

» Nationally schools at all levels are returning to normality.

» Domestic interstate travel will be allowed within a few months and by mid 2021, international travel both inbound and outbound should be reviving, but with quarantine requirements and still hampered until a Covid-19 vaccine is available. Domestic tourism will improve strongly.

» Very significant acceptance of "work from home" remote IT technology. Profound ramifications.

» Unemployment and particularly under-employment will now be at higher levels and remain so for several years. The embracing of IT and eCommerce for remote working models means that many firms will emerge from Covid-19 as meaner and leaner. There is the probability that productivity, could improve per capita, dampening demand for re-employment.

» Home ownership both houses and apartments will still be keenly pursued supported by long term low interest rates. Short term declines in value could be 10 - 15% at urban fringe to less than 10% in inner urban sectors.

Influences [Negative]

» The simultaneous end of Job Keeper, Job Seeker and mortgage / lease deferments, in September will represent a real challenge if the economy hasn't revived sufficiently to give people financial ability to resume their commitments. Quite significant structural changes will be occurring in the economy yet to be reflected.

» Living with Covid-19 in the absence of a vaccine in the short term, and possibly in the much longer term, will mean the impact of effective social distancing in the work place, hospitality sector, public transport etc., will involve enormous change, compromise and reconfiguration of fit out.

» Changed retail shopping habits in consequence of the rise in the popularity of online shopping and eCommerce generally will have multiple impacts including challenges for retail investors. Australia has the highest per capita retail floor space globally after USA and Canada and is therefore significantly exposed to the changes in favour of online shopping.

» Lower personal expenditure during the lock-up period, and the need to accelerate savings for the future may dramatically change spending habits as society becomes more frugal, leading into a sustained downturn in consumerism.

» Downturn n population growth consequent upon reduced immigration through to mid 2022. Whilst this may result in a short term softening for housing and apartments, in Sydney and Melbourne, it may more likely result in a return to balance between supply and demand by 2023. The market was otherwise heading into under supply.

» The downturn in tourism, travel and foreign students has resulted in a sharp decline in demand for rental accommodation, exacerbated by a return of short stay Air B&B to the longer term rental supply. This increased vacancy rate has led to discounts in weekly rates as investors seek to maintain cashflow for their negatively geared investments. This should abate in the short to medium term out to 2 - 3 years, but the perception that it may last longer could impact on the confidence of intending investor / purchasers.

» Predictions about residential house price falls in value have been in some instances extreme and do not factor the underpinning supporting fundamentals as mortgage payments become similar to rental payments and the large pool of prospective purchasers previously unable to afford will jump in if values do decline to a perceived "buy trigger" level.

Consequential Influences / Trends (Positive)

» The industrial sector, including fulfillment centres, logistic accommodation, 3PL (third party logistics) and IT / data centres, is likely to benefit from a surge in demand, increased rentals and lower yields. Additionally, property investors, in particular domestic institutional investors, are likely to favour this sector in preference to the more general commercial and retail categories. The sector may also be favoured by a return to local manufacture and market-chain self-sufficiency.

» Retirement, aged care and health related facilities, notwithstanding some Covid-19 issues, nonetheless need to continue to respond to an aging demographic and can be anticipated to be proactive in overcoming recent industry criticisms.

» Federal and State Government capital programs not just infrastructure, but schools, and public buildings particularly in regional centres will receive more funding.

» Private sector regional development in Victoria at centres such as Geelong, Ballarat, Bendigo, Albury, Wodonga etc., can be expected in line with increased population favouring such locations for their lower residential entry value and "healthier" lifestyle.

» Build or Multi Family rental accommodation, may strengthen, notwithstanding a short term reduction in rental values, and an increase in vacancy rates. For many the pandemic will have reduced their eligibility for home ownership and there will also be a gradual return of population growth. The build to rent sector was already making gains in Australia and can be expected to continue evolving, seeking particularly, well located, sizeable but affordable sites.

» Domestic tourism and hospitality will likely benefit from increased demand, as acceptability of travelling overseas may still be adversely impacted longer term awaiting a Covid-19 vaccine, or treatment regime.

» Challenges in the retail sector highlight the need for many properties to adapt and repurpose to provide a wider range of community and other services. Properties that have that potential for further capital investment can be expected to hold their position and investment attraction.

» Smaller to medium size inner urban residential apartment developments focussed to owner occupiers and downsizers can be expected to remain in demand and viable as developments. To a degree, dependent on the value levels for established property to remain stable so that transition to apartments remains affordable. Generally, the outlook for inner urban established housing values is to remain reasonably stable. Predicted value falls relate to lower value urban fringe established housing.

» For medium scale, inner urban medium density apartment projects sales are slower but values are holding. Longer selling periods and higher margins for risk may impact site values but many developers are still interested in this sector.

Consequential Trends (Negative)

» The office sector may be vulnerable. Capitalisation rates or IRR will remain the same in line with long term prevailing low global interest rates, but the value adjustment will be with income, either deferred or lost or the lower levels at which rental rates may stabilise. The work from home model may reduce office demand, but for those businesses wishing all staff to return to work, their accommodation need will be greater due to spacing requirements and other Covid-19 protocols. There is a growing perception however that the commercial office sector may face increased prolonged vacancies and lower than past rental growth.

» Economic challenges will place significant downward pressure on business costs and overheads, with little relief in the foreseeable future. Opportunity for suburban office developments where rents are significantly less than CBD. Suburban offices also attractive in light of Covid-19 - lower density space and closer to home being less reliant on public transport.

» Major residential developments particularly high rise, may be viewed as more speculative, particularly as high concentration residential numbers at the one property have a higher risk of being hot spots for infection. Lower density developments are certainly being favoured.

» Land subdivision has been volatile in recent years, as it responds quickly to perceptions of population growth and demand. Expectedly however the lowering of population growth due to reduced immigration over the next period of up to two years, will soften demand for metropolitan fringe allotments and traditional house and land development activity will soften. First home buyer house and land packages will be directly effected by increased unemployment and low income growth.

» Retail properties which have little prospect for adaption or repurpose, will be subject to an acceleration of the challenges that were already emerging prior to the pandemic.