

Box C

Conditions in the Commercial Property Market

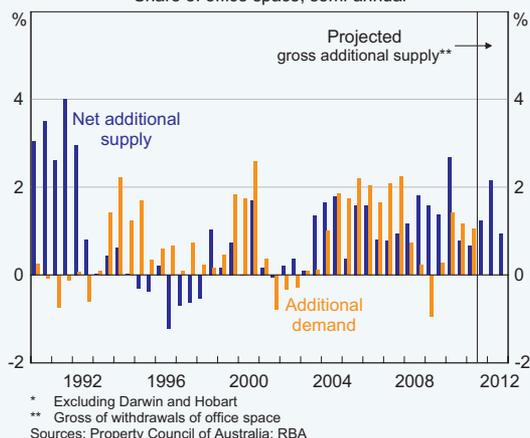
After a period of rising vacancy rates and falling property values and rents, conditions in the commercial property sector have improved somewhat over the past year. A further improvement is expected by most observers over the period ahead, with solid demand and only moderate additions to supply over the next few years leading to gradually declining vacancy rates and rising rents. Financing conditions, however, remain tight, albeit less so than in 2008 and 2009.

CBD Offices

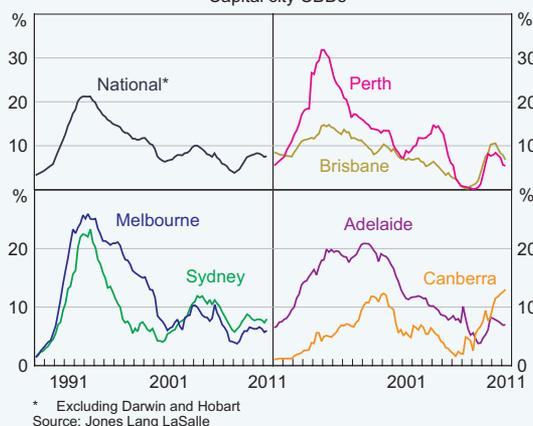
Conditions in the office market began to recover in 2010, following a downturn in 2008 and 2009 that saw higher vacancy rates and large falls in market rents and property values. During the downturn, firms' demand for additional office space weakened considerably, while the supply of office space continued to grow quite strongly, reflecting projects that had been planned, financed and commenced a few years earlier when conditions were more favourable (Graph C1). This combination of unexpectedly weak demand and strong supply saw the national vacancy rate for CBD offices increase from 4 per cent in late 2007 to 8 per cent by the end of 2009 (Graph C2). Demand recovered in 2010, although supply continued to grow faster in the first half of the year, pushing the national vacancy rate slightly higher, to peak at around 8½ per cent. Demand remained solid in the second half of 2010 while supply growth declined, causing vacancy rates to fall slightly.

This trend has continued, with the national CBD vacancy rate edging down to just over 7½ per cent in the June quarter 2011, slightly higher than its decade average. The largest falls in vacancy rates over the

Graph C1
Capital City CBD Offices*
Share of office space, semi-annual



Graph C2
Office Vacancy Rates
Capital city CBDs

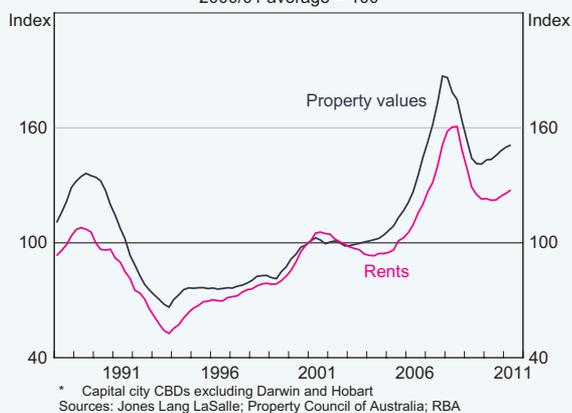


past year have been in Brisbane and Perth, though vacancy rates in these cities remain much higher than in 2007 when these markets were exceptionally tight. In fact, despite recent falls, the vacancy rate in Brisbane is still above its decade average, as is the

case in Canberra; vacancy rates in Perth, Adelaide, Melbourne and Sydney are below their respective decade averages. Conditions are weakest in Canberra, where the vacancy rate is 13 per cent, in part reflecting strong additions to office space in the first half of 2010. Outside of capital city CBDs the picture is mixed, with considerable spare capacity in certain areas such as the Gold Coast in Queensland and Chatswood in Sydney.

Rising vacancy rates over 2008 and 2009 saw market rents and property values fall significantly. Prime CBD office rents troughed in mid 2010 at around 25 per cent below their mid 2008 peak, with property values also falling by around 25 per cent from peak to trough (Graph C3). This downturn, while significant, was much shorter in duration and less severe than the downturn in the early 1990s, which saw the national CBD vacancy rate rise to over 20 per cent and prime CBD office values fall by around 50 per cent. In the past year, rents and property values have increased slightly, although they remain around 20 per cent lower than their recent peaks on a national basis, and are further below their peaks in Brisbane and Perth, where growth was exceptionally strong during 2006 and 2007.

Graph C3
Prime CBD Offices*
 2000/01 average = 100



Market rents are expected to gradually increase over the next few years, with market analysts generally anticipating solid growth in the demand for office space, including from expected employment growth in the financial and business services industries. At the same time, the supply of additional office space is likely to remain relatively modest for the next few years, having slowed considerably in the second half of last year, according to Property Council of Australia data (Graph C1). This period of modest supply reflects conditions in the aftermath of the 2008–2009 downturn, when rising vacancy rates, falling rents and very tight financing conditions saw fewer plans for new projects; the value of office building approvals fell sharply from mid 2008, and although approvals have picked up slightly since late 2009, they remain subdued. Based on the current pipeline of projects in the early stages of planning, supply is projected to grow at a faster pace by mid decade, although the extent and timing will depend on the outcomes of a number of proposed large developments. The Bank's liaison suggests that lenders' appetite for funding new office projects has improved a little over the past year, though funding conditions vary considerably across developers. Surveys also indicate that tighter pre-commitment requirements are contributing to funding constraints.

Industrial and Retail Property

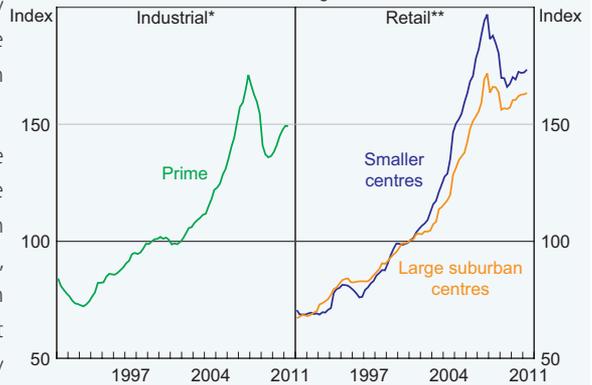
In the industrial market, rents for prime property (based on selected areas in four capital cities) troughed in the September quarter 2009 to be around 6 per cent lower than at their peak a year earlier. Property values fell more substantially, having fallen by around 20 per cent from their peak (Graph C4). As in the office market, the fall in industrial property prices over 2008 and 2009 was not as severe as in the early 1990s, when prime industrial property values fell by more than 25 per cent. Since

late 2009, prime rents and property values have increased by 4 per cent and around 10 per cent, respectively. In general, commercial property research firms' outlooks for industrial property are positive, reflecting expected solid demand and, in some areas, modest near-term growth in supply.

Property values for speciality retail stores in large suburban shopping centres are estimated to have fallen by around 9 per cent over the two years from their peak in late 2007. Smaller centres (for example, those without department stores) fared worse, with property values having fallen by around 15 per cent from their peak (Graph C4). Over this period, vacancy rates increased and growth in gross market rents slowed, with growth in rents slightly firmer in CBDs and larger suburban locations than in smaller neighbourhood centres.

More recently, gross rents for CBD retail properties were flat over the year to June, although there have been reports of solid growth in rents in certain premium locations. Property values in suburban centres have recovered somewhat from their lows, having increased by around 2 per cent over the past year. Overall, the outlook for retail property remains subdued reflecting modest growth in retail spending. ❖

Graph C4
Capital City Commercial Property Values
 2000/01 average = 100



* Excluding Canberra, Darwin, Hobart and Perth
 ** Excluding Darwin and Hobart; 'smaller centres' also excludes Canberra
 Sources: ABS; Jones Lang LaSalle; RBA

