CUSHMAN & WAKEFIELD

DATA INTO ACTION

AUSTRALIAN ECONOMIC UPDATE

BUDGET 2018/19

COMMERCIAL PROPERTY IMPLICATIONS

MAY 9, 2018

3 KEY TAKE AWAYS

1 **$25bn**
New infrastructure projects

2 **Up to $10**
A week tax cut for low to middle income earners

3 **3.00%**
GDP growth in 2018/19

WHAT HAPPENED?

Last night the Treasurer handed down the 2018/19 Federal Budget, while much has be written on the topic, this note will focus on the issues more relevant to commercial real estate (CRE).

While CRE is not specifically addressed in the Budget, the outcome is generally very positive for the sector.

The next federal election is potentially just 13 weeks away, so a goody giveaway could be expected and indeed the Government is promising tax cuts and a return to surplus in 2019/20. This has been achieved by extra revenue of around $35bn as a result of a stronger economic, profit and employment growth.

So gain, mainly for low to middle income Australia, with limited pain, mainly for those less likely to complain such a tobacco black marketers and tax minimising multinationals.

While some of the tax gains will start from 1 July 2018, the tax initiative is a seven year plan. A federal election is possible as soon as 4 August 2018 or as late as 18 May 2019 and with the Coalition trailing in the polls, there is no guarantee any of the longer-term initiatives will be implemented. The short-term initiatives are also unlikely to have an easy passage to legislation with the Coalition requiring crossbench support in the Senate. However, with limited pain in the Budget and potentially plenty of gain, politicians may be reluctant to get between the electorate and a tax cut.

FIGURE 1
Economic forecasts[1]

	2016/17	2017/18	2018/19	2019/20
Real GDP %	2.10 (1.75)	2.75 (2.75)	3.00 (3.00)	3.00
Nominal GDP %	5.90 (6.00)	4.25 (4.00)	3.75 (4.00)	4.75
Employment %	1.90 (1.00)	2.75 (1.50)	1.50 (1.50)	1.50
Unemployment rate %	5.60 (5.75)	5.50 (5.75)	5.25 (5.50)	5.25
Wage price index %	1.90 (2.00)	2.25 (2.50)	2.75 (3.00)	3.25
CPI %	1.90 (2.00)	2.00 (2.00)	2.25 (2.25)	2.50

1 Brackets are the last year's Budget forecasts. Percentage change on preceding year unless otherwise indicated. Employment and the wage price index are seasonally adjusted through the year growth to the June quarter. The unemployment rate is the rate for the June quarter. The consumer price index is through the year growth to the June quarter.
Source: Treasury

KEY POINTS:

The Government noted the Budget is about tax relief, business investment and "living within our means", which it hopes will lift consumer and business sentiment, as well as the Coalitions re-election chances.

Economic and wages growth are expected to pick up and along with solid employment growth should provide a boost for the commercial real estate sector.

There is expected to be limited direct impact on the office market though measures to encourage business investment should help maintain strong business conditions and tenant demand.

Tax cuts for low and middle income earners should assist with retail sales growth.

An ongoing commitment to infrastructure investment is positive for long-term economic growth and the industrial sector in particular.

Investment demand for Australian CRE is likely to remain strong, supported by positive economic growth and relatively low interest rates.

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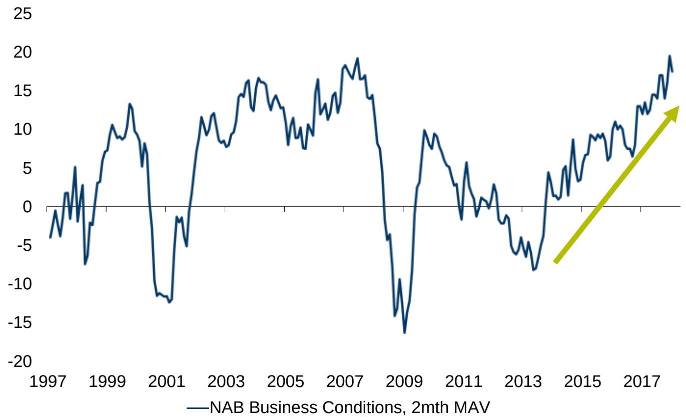
OFFICE

Not a great deal directly for the office sector from the Budget though the initiatives should be broadly supportive.

The projections for the economy are generally more positive for office tenant demand than in the 2017/18 Budget. While the growth projection remained unchanged with Real GDP growth of 2.75% in 2017/18 and 3% in 2018/19, the unemployment rate forecasts fall from 5.75% and 5.5% in 2017/18 and 2018/19 to 5.5% and 5.25% respectively. This is partly a result of stronger employment growth in 2017/18, which is now forecast at 2.75% rather than 1.50% as in the previous Budget.

Initiatives to boost business investment such as tax cuts for small and medium sized businesses (already legislated) should continue to provide a positive environment for businesses and flow on to relatively strong tenant demand. For example, the NAB Business Conditions Index in 2018 has been at or near record highs (Figure 2) helping the CBD vacancy rate in both Sydney and Melbourne to fall below 5%. The positive environment is not just in Sydney and Melbourne with vacancy also declining in the majority of office markets tracked by the PCA.

FIGURE 2
NAB Business Conditions



Source: NAB; Cushman & Wakefield

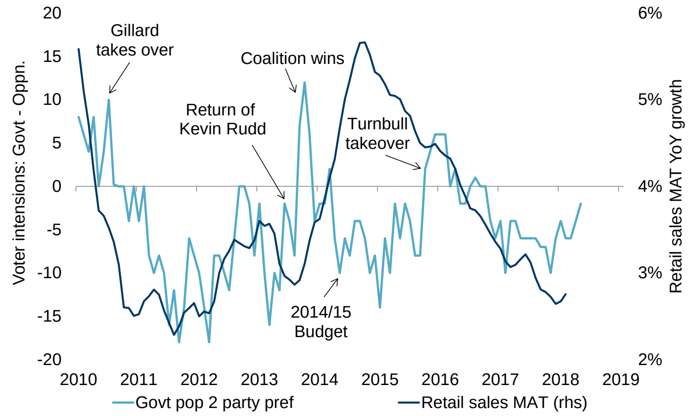
Business parks may benefit from initiatives to encourage investment in research, science and technology as well as medical research. This includes an additional $1.9 billion over 12 years for national research infrastructure and $1.3 billion to support Australia as a global health industry leader in medical technology, biotechnology and pharmaceuticals.

Strong infrastructure investment is flowing through to the broader economy. For example, engineering job advertisements in Brisbane are up 20% YoY.

Mining driven states should also benefit from a forecast return to positive growth for mining investment. Budget projections suggesting growth should rise to +3.5% in 2019/20 after averaging -14% over the previous three years. Mining investment is a significant driver of tenant demand in Perth and Brisbane prior to the GFC.

The Budget notes an ongoing initiative to create stronger multinational tax laws such as the Multinational Anti-Avoidance Law (MAAL) and the Diverted Profits Tax (DPT). When these were first introduced, it was thought they may discourage some investment in Australia by multinationals. But tenant demand from international companies has remained strong, particularly from technology companies. Additional action on multinational tax avoidance, such as moves to strengthen thin capitalisation rules and broadening the scope of the MAAL and the DPT, like the previous ones, also seem unlikely to discourage investment.

FIGURE 3
Government popularity and retail sales growth



Source: Newspoll; ABS; Cushman & Wakefield

RETAIL

Retail sales data for March, released yesterday, highlight that the retail environment is still soft with zero growth over the month. However the Budget should be quite positive for the sector.

While confidence is being sapped by weaker house prices, (this Budget had little to say on housing, suggesting a desire to let this political hot potato pass by), the government hopes it will build it's popularity. This also likely to be positive for consumer sentiment and retail spending (Figure 3).

The main positives are tax cuts for low to middle income earners, such as up to $530 a year for low to middle income earners ($1,060 for couples). Generally tax benefits for low to middle income earners are more likely to flow to consumption than those for higher income earners.

Extending the $20,000 instant asset write off provision is likely to also benefit retailers of items such as electronic goods, hardware and office supplies as small businesses make purchases before the end of financial year.

The proposed increase in the Medicare levy, from 2% to 2.5% in 2019 has been cancelled, which should be another positive for consumers.

INDUSTRIAL

In last year's Budget, the industrial sector was the big winner with major announcements such as $5.3bn for the Western Sydney Airport Corporation and $8.4bn for the Melbourne to Brisbane Inland Railway.

This year's Budget continues the strong focus on infrastructure with the ongoing $75bn 10-year infrastructure program and $24.5bn in funding for new major transport projects and initiatives.

This should continue to support industrial markets across the nation, for example the area around Badgerys Creek has benefited greatly from the new infrastructure.

New initiatives include:

- $5bn to build a Melbourne Airport Rail Link
- Roads of Strategic importance $3.5bn.
- $1bn Urban Congestion Fund.
- $250m Major Project Business Case Fund.

INVESTMENT DEMAND

Investment demand for commercial property in Australia has been very strong over the past few years. The Budget should continue to support this in several ways including:

- Providing an ongoing positive economic environment to support tenant demand across the three main CRE sectors;
- Creating further opportunities for investment around infrastructure, medical technology, biotechnology and pharmaceuticals;
- Whilst the low point for interest rates and bond yields appears to have passed for this cycle, returning the Budget to surplus in 2019/20 should help to reduce upward pressure on Australian rates and yields. Projections of an increase in the US deficit following tax reform passed in December 2017, helped push US bond yields above Australian yields for the first time in 20 years (Figure 4).

These factors suggest investment demand for Australian commercial property should stay strong from both domestic and international investors.

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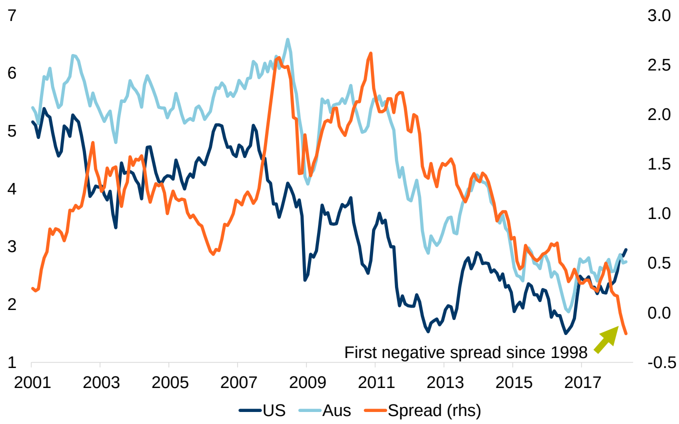
FIGURE 4
US and Australian 10 year bond yields, %



Source: St Louis Fed; RBA; Cushman & Wakefield

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