WHITE PAPER

2018 Market Sentiment Survey

The Urban Developer

Development Finance Partners

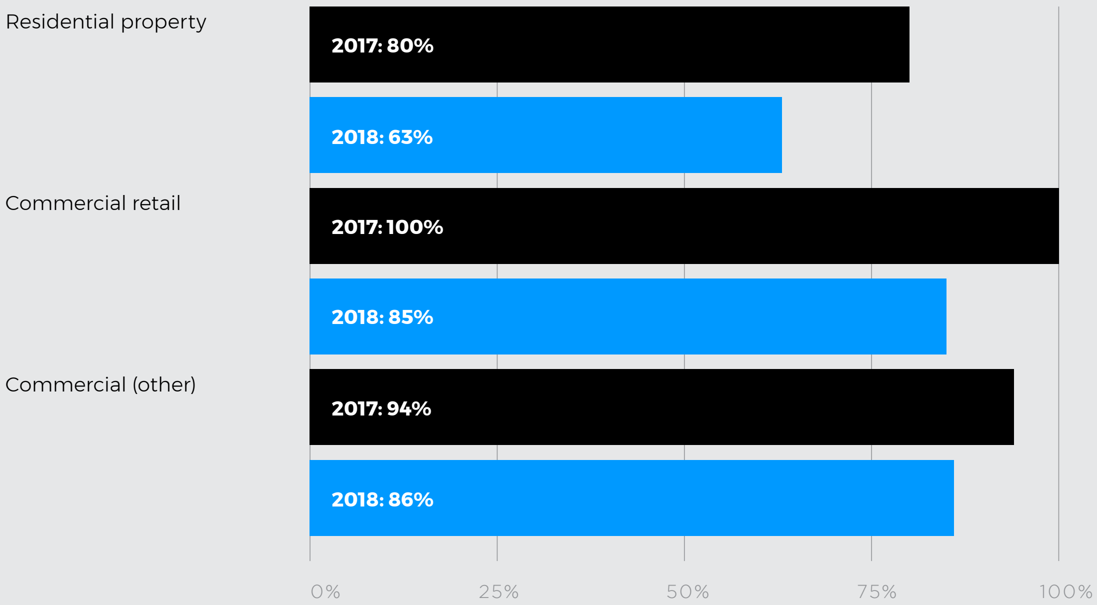
Turning plans into reality

Developers prove more pessimistic as funding difficulties take hold

Last year Development Finance Partners (DFP) undertook a Market Sentiment Survey of more than 150 developers, examining funding and other challenges they faced, with ground-breaking results.

This year the survey returns, showcasing how much optimism, of lack thereof, developers across the three spectrums of residential property, commercial (retail) and commercial (other) really have for the property market.

% OF OPTIMISTIC DEVELOPERS SEGMENT COMPARISON – NATIONAL LEVEL



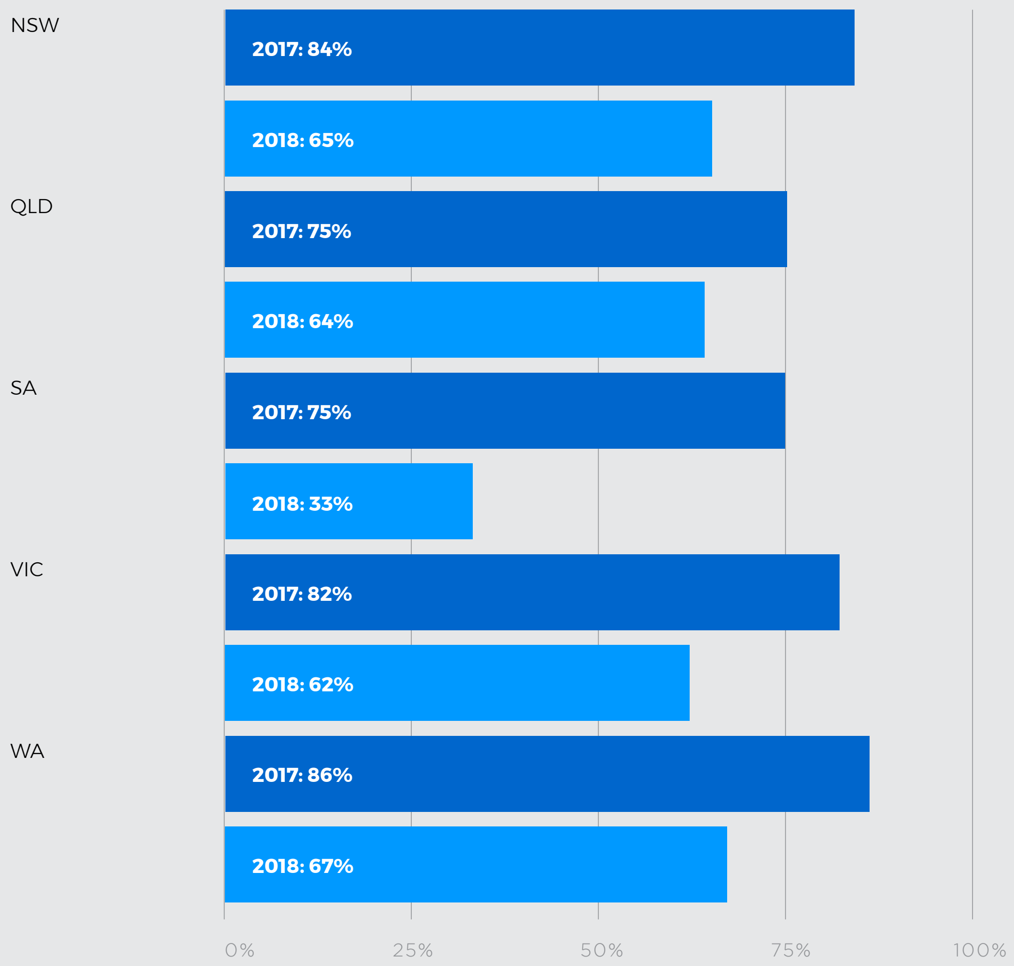
Optimism lowest for residential property sector

Overall, the optimism levels across all three segments decreased between 2017 and 2018.

The optimism level in the residential property sector was the lowest in 2017 and remains the lowest in 2018. However, this year the optimism level in that segment plummeted from 80 to 63 per cent, indicating major concerns among the responders.

While there has been a reduction in the optimism level across both commercial (retail) and commercial (other), this decrease is only attributed to changes in the optimism level for Queensland, as all other states and territories had very high levels.

% OF OPTIMISTIC DEVELOPERS IN RESIDENTIAL PROPERTY SEGMENT



RESIDENTIAL PROPERTY

Low developer optimism shows major funding worries

Residential property developers lost their enthusiasm for the property market with the survey showing the optimism level from 2017 to 2018 declined in all states and territories.

In fact, overall the optimism level of developers declined from 80 per cent in 2017 to 63 per cent in 2018, while in NSW it dropped from 84 per cent to 65 per cent and in Victoria 82 per cent to 62 per cent.

This year, the most optimistic developers in Australia were found in Tasmania with a whopping 100 per cent and, surprisingly given its flagging economy, in Western Australia with 67 per cent.

However, the survey showed Western Australia also had the highest pessimism level at 33 per cent.

The lowest optimism level was South Australia, which also suffers from a flattened economy, with 33 per cent.

By comparison, in 2017, the most optimistic developers were in Western Australia with 86 per cent and NSW just below with 84 per cent. The lowest optimism levels were in Queensland and South Australia, both with 75 per cent.

Last year's survey showed South Australia had the highest pessimism level at 25 per cent.

Doron Peleg, CEO of RiskWise Property Research, said lending restrictions, the findings of the Banking Royal Commission and an increased scrutiny of residential property loan applications had led to a significant reduction in investor activity and changed the market landscape and consumer sentiment. This had a direct flow-on effect on investor demand and consequently on developer sentiment.

As per Baxter Gamble, the Director of Development Finance Partners (DFP), there is definitely change in developer sentiment.

"In 2018, we've seen finance influences further frustrating the development sector as the retail banks push their property investor clientele with interest-only loans off their portfolio or subsequently have them convert to principal and interest.

"Many of these borrowers are unable to meet the cash flow requirements of that. This new approach will further dampen the market as it relates to investor purchases given their concerns about obtaining finance traditionally in an interest-only environment. Investors may panic, cut their losses and fire sale, which will lead to excess stock in the market reducing prices."

DWELLING COMMENCEMENTS

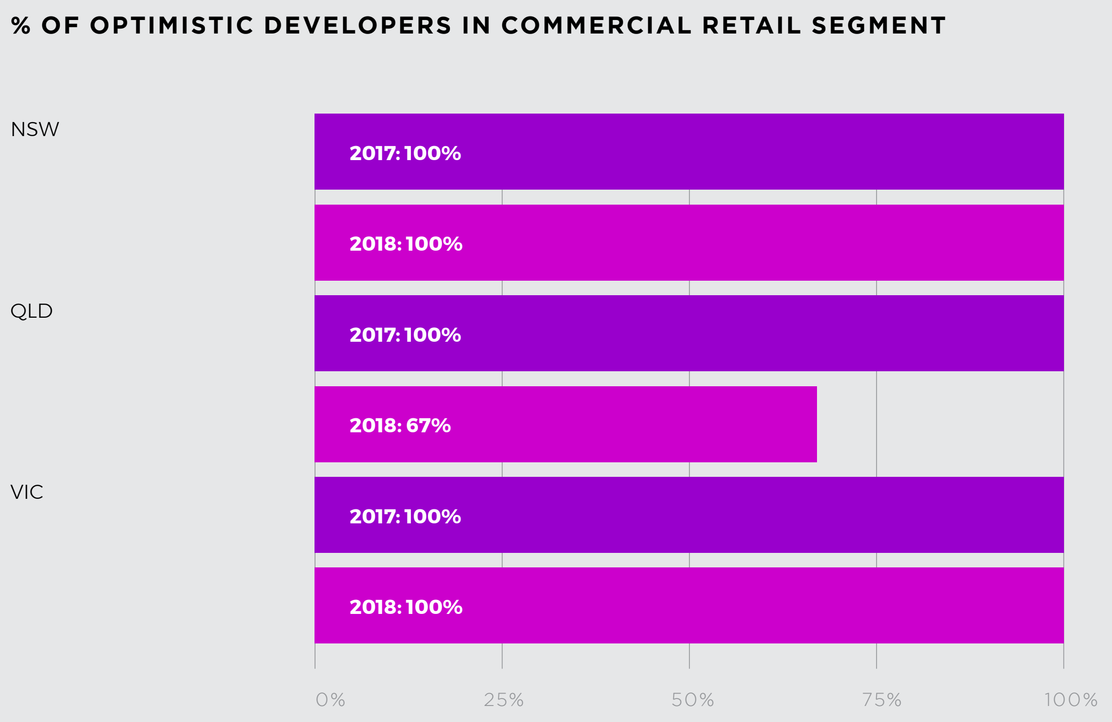
	NSW	VIC	QLD	SA	WA	TAS
April - June 2017	17,802	14,935	11,332	3,314	4,820	622
April - June 2018	17,301	17,205	10,439	3,659	4,539	732
Change	**-3%**	**15%**	**-8%**	**10%**	**-6%**	**18%**

Queensland dwelling commencements takes biggest fall

In addition, in some areas there was a reduction in dwelling commencements, the greatest of these witnessed in Queensland which fell 8 per cent between the Q2 of 2017 to Q2 of 2018.

On the other hand, strong optimism levels led to a significant increase of 18 per cent in dwelling commencements in Tasmania.

Mr Gamble said DFP was seeing greater disparity across regions driven by the fundamentals of supply and demand. For instance, the decline in dwelling commencement in Queensland directly relates to an oversupply vs an extended undersupply in Tasmania that is now flowing through into investment in that region.



COMMERCIAL RETAIL

Queensland the only state to see drop in enthusiasm

While the optimism of residential property developers may have dropped over the past 12 months, the news is much better for commercial retail developers with levels remaining constant in all states, except Queensland where a significant drop from 100 to 67 per cent was seen. The rest remained at 100 per cent.

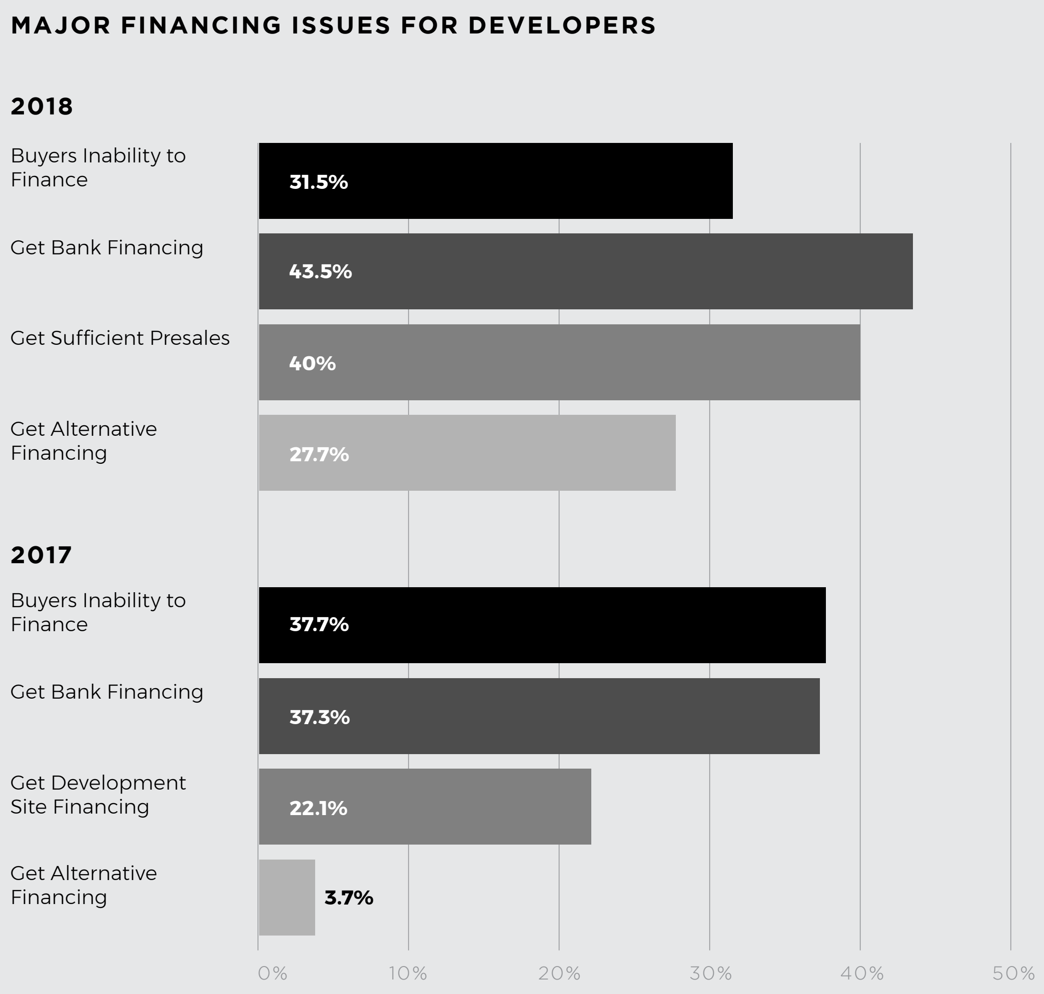
Overall in Australia, the optimism level of developers declined from 100 per cent to 85 per cent, due to the decrease in Queensland.

Mr Peleg said it was expected the optimism level for commercial (retail) would remain "very high" as the market was strong, particularly in Sydney and Melbourne, with very good economic activity and an increased demand for retail properties.

Mr Gamble said it was not surprising survey responders reported falling levels of optimism in the commercial segment.

"Poor fundamentals especially on the supply side in both the fringe and CBD markets continue to sustain historically high vacancy rates which is maintaining net effective rents at commercially unviable levels," he said.

"Accordingly to recently published data from Savills Research, the current net effective rent in fringe B Grade office market is $145psm. Unfortunately, it looks like the tenant market will persist in the short to medium term which will continue to dampen the enthusiasm and viability for new development in this sector for some time unless a very strong pre-commit can be achieved."



Finance the biggest hurdle for development

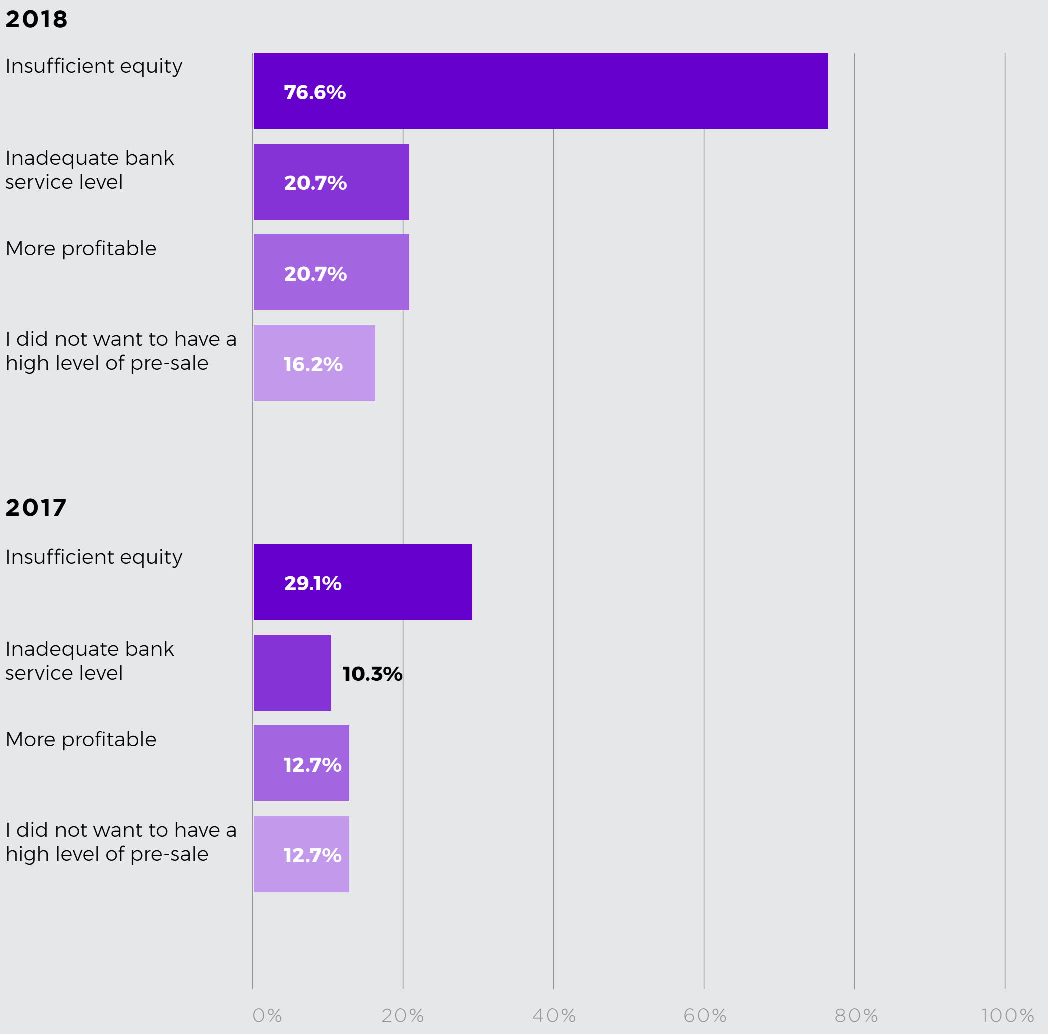
For 2017 and 2018, the common major issues for developers were shown to be bank financing and buyer inability to finance. The biggest change was the issue in obtaining alternative financing, only a minor issue in 2017 but a major one in 2018.

RiskWise's Doron Peleg said these results were unsurprising due to lending restrictions and more conservative lending standards in the residential property sector.

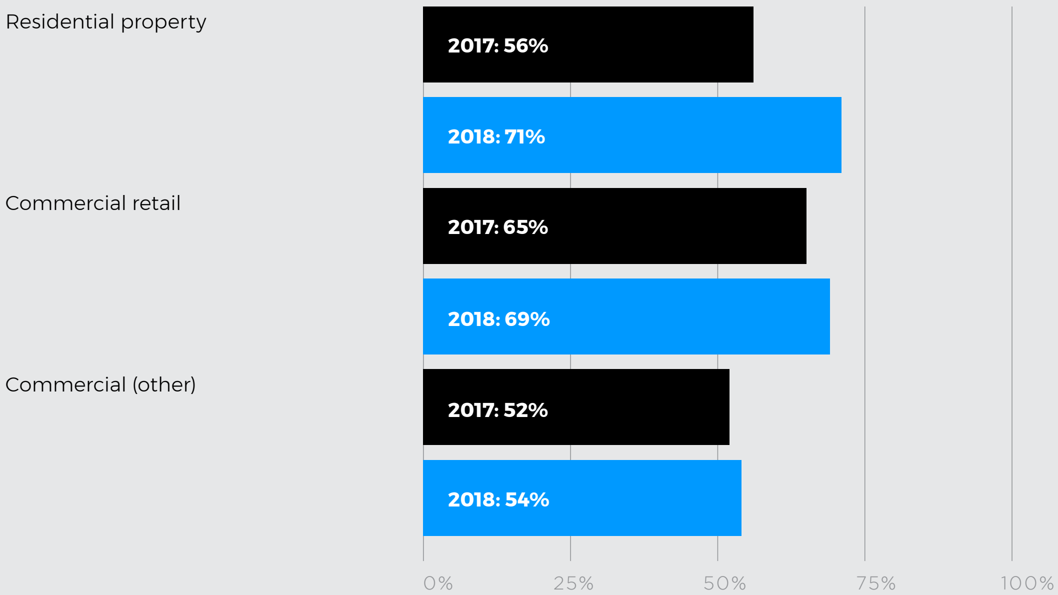
Growth in use of non-bank lenders

Between 2017 and 2018 there was a significant increase in the number of responders that mentioned an equity-related issue as the major reason for using a non-bank lender.

TOP 3 REASONS FOR USING NON-BANK LENDER



% OF RESPONDERS WHO USE NON-BANK LENDERS SEGMENT COMPARISON – NATIONAL LEVEL



The use of non-bank lenders across Australia varied depending on the type of developer and the state.

Overall, in 2018, 67 per cent of developers across the three property sectors investigated non-bank alternative finance options. This was an 11 per cent increase on 2017.

Refinancing residual stock not a common practice

The survey showed that in 2018, 85 per cent of developers did not refinance residual stock over any of the three property sectors.

The highest level of refinancing was 18 per cent in commercial (other) sector, followed by 15 per cent in residential property, and only 8 per cent in commercial retail.

The question of refinancing was not asked in the 2017 survey, so no comparison can be made.

Conclusion

The biggest factors affecting the change in sentiment from 2017 to 2018, have been the revisions in the banking sector and government policy to those buying investment properties. Changes to FIRB loans, the large retail banks moving from interest-only to principal and interest loans and Self-Managed Super Funds, as they relate to purchasing investment properties through these funds, have all impacted sale rates and subsequently a drop in confidence.

However, the market fundamentals of supply and demand still means there are opportunities for the sector. Developers will need to look more widely geographically for these opportunities or get more creative around the type of asset class they are developing, e.g. commercial, affordable housing.

What is interesting is that the trend to work with non-bank lenders will continue as developers realise that they will receive a higher return on equity by working with this sector of the market.

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