NAB RESIDENTIAL PROPERTY SURVEY Q3-2018

CURRENT MARKET SENTIMENT AMONG PROPERTY PROFESSIONALS DIPS TO A 7-YEAR LOW AND CONFIDENCE COLLAPSES AS WEAKENING HOUSE PRICES IN NSW & VIC WEIGH HEAVILY ON THE MARKET. ACCESSING CREDIT REMAINS A SIGNIFICANT IMPEDIMENT IN THE MARKET, BUT CONCERNS OVER INTEREST RATES NOW ALSO RISING.

National Australia Bank

NAB Behavioural & Industry Economics

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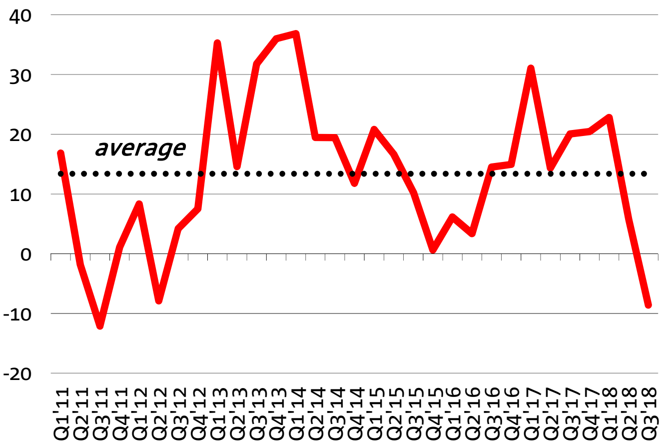
The NAB Residential Property Index fell sharply for the second straight quarter, down 15 to a 7-year low -9 points, and its first negative read since mid-2012. Sentiment was dragged lower by big falls in NSW and VIC, which offset gains in QLD (the only state reporting a positive result). Confidence has dipped to new lows, pulled down mainly by NSW and VIC where property professionals scaled back their outlook for prices, particularly in VIC where falls are now tipped to be much bigger. Capital growth is expected to be fastest in QLD and WA in the next 1-2 years. The outlook for rents is holding up, albeit a little softer. But as national house prices continue falling faster than rents, yields should improve. First home buyers remain key players in local housing markets, but their market share fell in Q3. Owner occupiers picked up the slack as tougher restrictions on investment lending saw the number of local investors in the market fall. The boom in Australian housing sales to foreign investors has also run its course, with their share of total sales falling to a 7-year low 8.1% in new markets and a survey low 4.1% in established markets. Accessing credit is impacting housing markets more now than for a number of years - and in all states - with the level of concern over interest rates now also rising. NAB's view is the orderly correction in house prices will continue over the next 18-24 months with Sydney falling around 10% peak to trough and Melbourne 8%. This reflects a bigger fall than previously expected but would still leave house prices well up on 2012 levels. Weakness in dwelling prices will continue to be driven by Sydney and Melbourne, particularly apartments, though it's likely Brisbane and Perth will also contribute. Overall, we see this as a healthy correction which will help offset some of the risk in the household sector against a backdrop of a relatively healthy economy and labour market. Our central scenario does not include a credit crunch event leading to disorderly falls in house prices.

VIEW FROM PROPERTY EXPERTS

NAB Index falls to its lowest level in 7 years

NAB RESIDENTIAL PROPERTY INDEX



RESIDENTIAL PROPERTY INDEX BY STATE

	Q2'18	Q3'18	Next 1yr	Next 2yrs
VIC	17	-7	-5	13
NSW	-12	-37	-25	-4
QLD	14	21	35	44
SA/NT	23	0	29	42
WA	-26	-14	36	64
AUST	6	-9	6	23

VIEW FROM NAB ECONOMICS

Further price falls in 2019 and into 2020 led by Sydney & Melbourne

NAB HEDONIC HOUSE PRICE FORECASTS (%)*

	2016	2017	2018f	2019f	2020f
Sydney	10.7	2.1	-5.7	-1.6	0.1
Melbourne	9.5	9.1	-5.9	-2.2	-0.6
Brisbane	2.7	3.1	0.2	0.0	0.0
Adelaide	3.8	3.3	0.9	1.7	1.7
Perth	-2.9	-2.6	-2.4	-0.2	0.0
Hobart	9.6	12.9	6.4	1.8	1.8
Cap City Avg	**7.3**	**4.0**	**-3.7**	**-1.0**	**0.0**

NAB HEDONIC UNIT PRICE FORECASTS (%)*

	2016	2017	2018f	2019f	2020f
Sydney	5.8	5.4	-3.6	-5.5	-0.9
Melbourne	4.7	8.4	-2.7	-3.4	-1.0
Brisbane	-3.0	-1.2	-0.5	-4.5	-2.2
Adelaide	0.6	0.5	1.2	0.5	0.5
Perth	-6.3	-0.9	-6.9	-2.3	-0.8
Hobart	6.4	9.1	5.9	1.2	1.2
Cap City Avg	**3.5**	**5.1**	**-3.0**	**-4.4**	**-1.0**

SOURCE: CoreLogic, NAB Economics

Date **October 2018**| **Author: NAB Behavioural & Industry Economics**

OVERALL MARKET SENTIMENT FALLS FURTHER IN Q3 2018

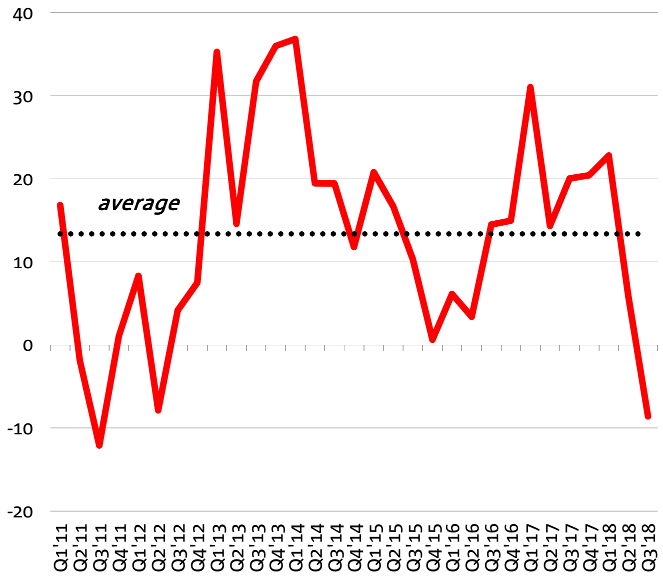
The NAB Residential Property Index - a measure of sentiment based on property professionals expectations for capital growth and rents - fell sharply for the second consecutive quarter in Q3, hitting a 7-year low.

Overall, the index fell 15 points to -9, its first negative read since mid-2012. Consequently, index has now also fallen well below its long-term average level (+13).

But the overall result hides some key differences by state. Sentiment fell heavily to a new survey low in NSW (down 25 to -37) and to a near 6-year low in VIC (down 24 to -7) as dwelling prices in Sydney and Melbourne fell. In SA/NT, the index also fell 23 to 0.

In contrast, sentiment improved in QLD (up 7 to +21) and it was the only state to record a positive reading. There was also a modest improvement in WA (up 12 to -14), but sentiment was still negative.

NAB RESIDENTIAL PROPERTY INDEX



RESIDENTIAL PROPERTY INDEX BY STATE

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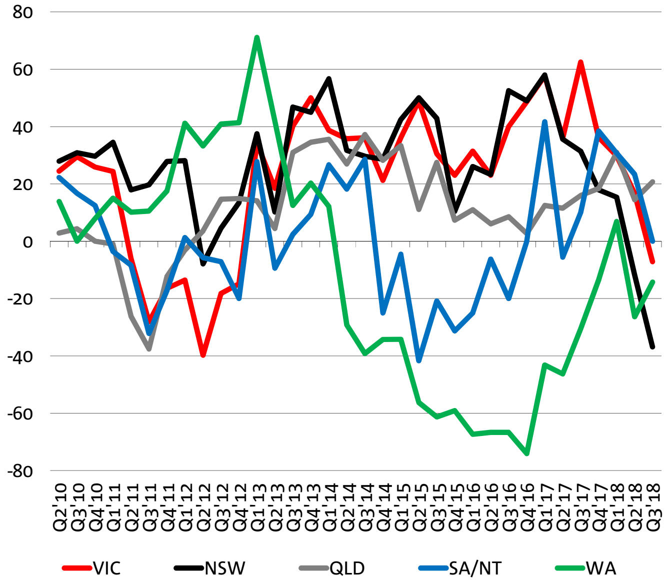
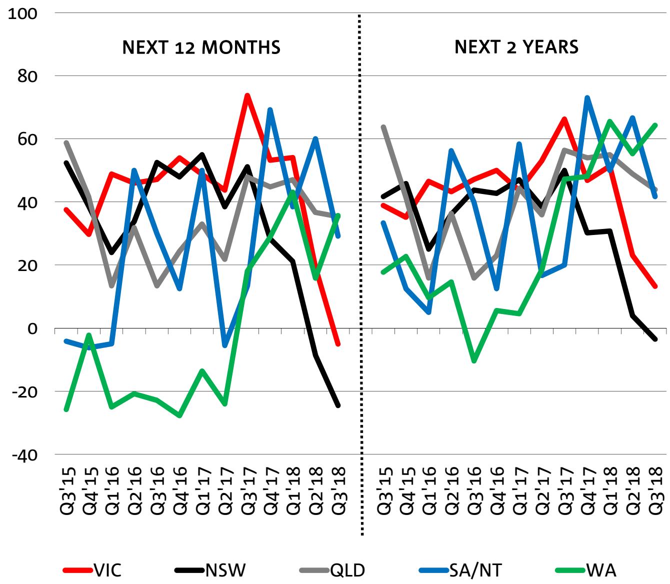
RESIDENTIAL PROPERTY INDEX: STATE

NAB Residential Property Index plummets in NSW (weakest overall), VIC & SA/NT. QLD now the only positive state…



Confidence levels also soften, particularly in NSW & VIC. WA & QLD leading the way forward…



Overall confidence (based on future expectations for house prices and rents) continued to soften in Q3, with NAB's Residential Property Index tipped to fall to +6 in the next year (+20 in the last survey) and +23 in two years' time (+32 in Q2). Consequently, confidence levels have fallen to new survey lows.

Confidence is being pulled down mainly by NSW and VIC where property professionals scaled back their outlook for house price growth further. In VIC, confidence levels for the next 12 months slipped 24 points to -5 - its lowest read since mid-2012. In NSW, confidence dipped further into negative territory to new Survey lows (down 16 to -25). As a result, property professionals in NSW and VIC remain the least confident in the country by some margin.

Confidence was also scaled back in SA/NT (down 31 to +29) but was still positive. Confidence levels in QLD were basically unchanged (down 2 to +35), but they picked up significantly in WA (up 20 to +36), driven mainly by an improved outlook for rents.

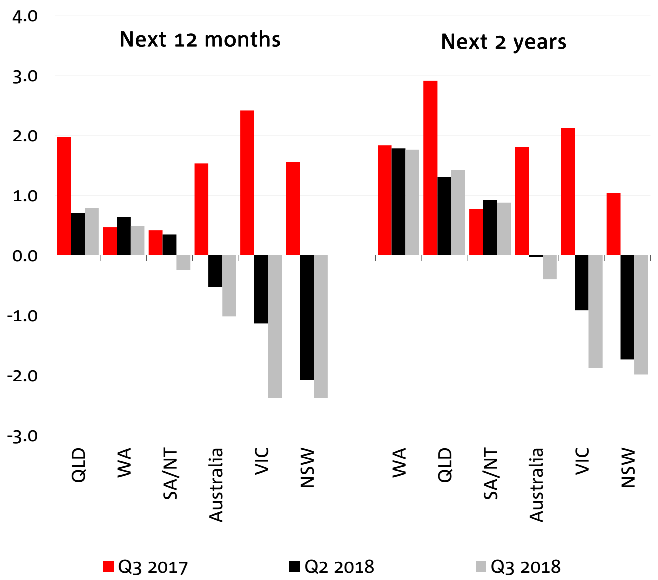
Longer-term confidence (2 years' time) fell in VIC (down 10 to +13) and was negative for the first time in NSW (down 8 to -4) as expectations for house price and rental growth weakened. Property professionals in SA/NT were less confident (down 25 to +42), with QLD also a touch weaker (down 5 to +44). But confidence in WA improved (up 9 to +64) and was the highest of all states.

SURVEY HOUSE PRICE EXPECTATIONS

Average survey expectations for national house prices for the next 12 months were cut notably in Q3, and are now tipped to fall -1.0% (-0.5% in Q2). This was largely due to big downward revisions in VIC where house prices are expected to fall by a much bigger -2.4% (-1.1% forecast in Q2) and also by -2.4% in NSW (-2.1% in Q2). The outlook for SA/NT was also little weaker at -0.3% (0.3% in Q2). QLD still leads the country for house price growth in the next 12 months - broadly unchanged at 0.8% (0.7% in Q2), ahead of WA also largely unchanged at 0.5% (0.6% in Q2).

SURVEY HOUSE PRICE FORECASTS

House price expectations for next 1-2 years cut further (and negative) in NSW & VIC...



Longer-term prospects are also negative, with the downturn in house prices expected to be sharper than previously anticipated. Overall, the average survey expectation has house prices falling -0.4% in 2 years' years' (flat in the last survey).

Prospects remain weakest according to property professionals in NSW and have been cut back further to -2.0% (-1.7% in Q2). But they are now only marginally weaker than in VIC where expectations were cut much more sharply to -1.9% (-0.9% in Q2).

WA is expected to lead country for house price growth in 2 years' time with expectations unchanged at 1.8%, followed by QLD at 1.4% (1.3% in Q2) and SA/NT at 0.9% (also unchanged).

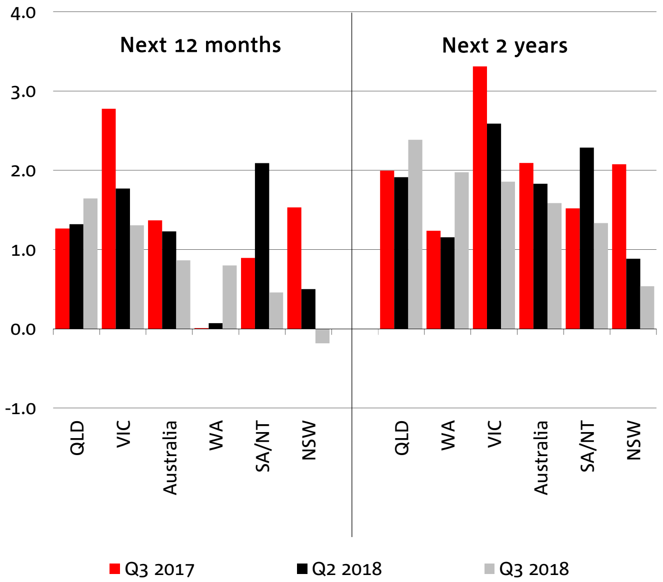
SURVEY RENTAL EXPECTATIONS

The outlook for rents is holding up better, albeit a little softer. Overall, the average survey expectation for rental growth in the next 12 months was shaved to 0.9% (1.2% in the last survey). But as national house are prices are expected to continue falling faster than rents, rental yields should also improve.

QLD is expected to lead the way for rents (1.6% vs. 1.3% previously), followed by VIC (1.3% vs. 1.8% vs. 1.1%) where rapid population growth and strong demand is still contributing to very low rates of residential vacancy. In NSW, property professionals were less bullish about rental growth and now see rents falling -0.2% (0.5% in Q2). The outlook for SA/NT was also scaled back to 0.5% (2.1% in Q2). But property professionals in WA were more bullish and now expect rents to grow 0.8% (0.1% in Q2).

SURVEY RENTAL GROWTH FORECASTS

Outlook for national rental softens, due to weaker outcomes in NSW, SA/NT & VIC...



The average survey outlook for national rental growth in 2 years' time was also cut back to 1.6% (1.8% in Q2). But this again masks some significant changes to the outlook across the states.

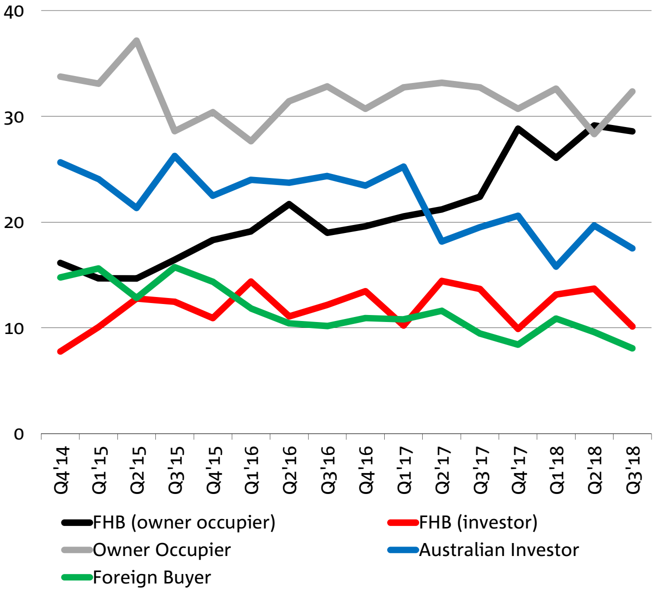
The outlook was strongest in QLD at 2.4% (1.9% in Q2), followed by WA at 2.0% (1.2% in Q2). They have also overtaken VIC as the best market for income returns in 2 years' time, with expectations in VIC cut back to a still solid 1.9% (2.6% in Q2). Income returns are expected to be lowest in NSW at just 0.5% (0.9% in Q2). Expectations in SA/NT were also trimmed to 1.3% (2.3% in Q2).

NEW DEVELOPMENTS

Owner occupiers accounted for almost 1 in 3 (32.4%) new property purchases in Q3, up from 28.3% in Q2. These buyers played a bigger role in all states except NSW and were most prevalent in SA/NT (40%) and WA (40%).

First home buyers (FHB) remain key players in new housing markets, but their overall market share declined in Q3. The share of FHB (owner occupiers) fell to 28.6% after reaching a survey high 29.1% in the previous quarter. The share of FHB investors also fell to 10.1% (13.7% Q2). In total, FHBs accounted for 38.7% of all new property sales, down from a survey high 42.9% in Q2 2018. FHBs were most prevalent in NSW and WA, with a market share of around 45%.

SHARE OF NEW PROPERTY SALES (%)

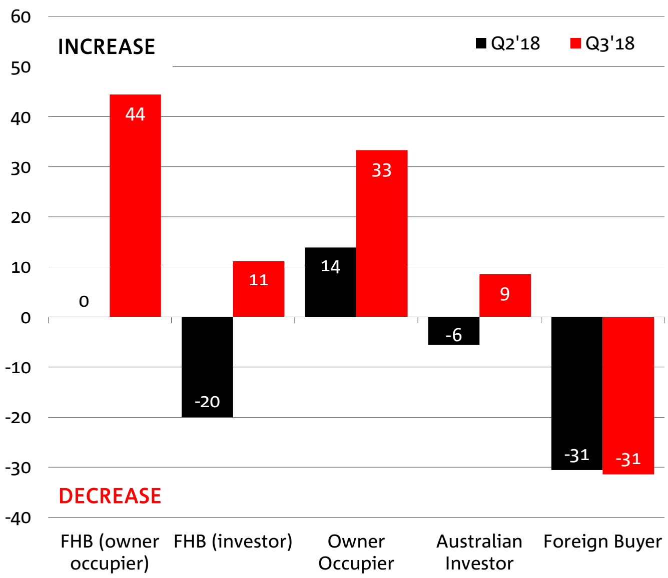


Tougher restrictions on housing investment lending saw the number of local investors in new property markets fall to 17.5% (19.7% in Q2). But this ranged from, 20.5% in VIC to just 10.7% in WA.

The share of foreign buyers in new property markets also continued to fall, hitting a 7-year low of 8.1% (9.6% in Q2). The share of foreign buyers in new Australian housing markets has now dropped well below survey average levels of 11%, and their share of new property sales has fallen to around half that seen at their peak in Q3 2014 (16.8%).

Foreign buyers were however, a little more active in the key markets of VIC, where their share increased to 13.0% (11.7% in Q2) and were unchanged broadly in NSW at 7.5% (7.4% in Q2). They were however far less active in QLD, with their share of sales dipping to a 4 year low of 6.2%, down from a 4½ year high of 22.8% in Q2.

COMPOSITION OF NEW PROPERTY BUYERS NEXT 12 MTHS (NET BALANCE)



Property professionals were asked whether they thought the share of new residential property buyers would increase or decrease in the next 12 months across each buyer segment.

In net terms, a large majority expected the share of FHB owner occupiers (+44%) and resident owner occupiers or 'upgraders' (+33%) to increase, A smaller number also expected investors - both FHBs (+14%) and local (+9%) to increase their market share. But a large number (-31%) still expect the share of foreign buyers to fall than increase.

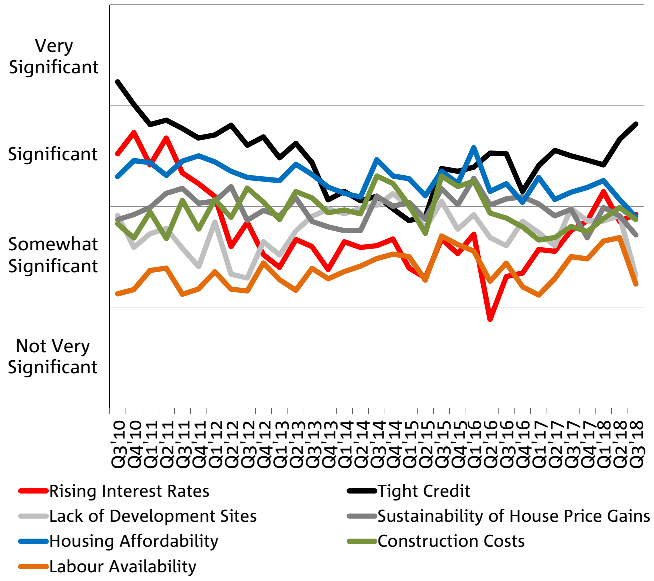
NEW HOUSING MARKET CONSTRAINTS

For the tenth consecutive quarter, property experts identified tight credit as the biggest constraint on new housing development in the country. Moreover, they said it was causing more concern than at any time since mid-2011. Clearly, intensified lending scrutiny by banks and APRA-inspired tighter credit policies has played a key role. Tight credit was also singled out as the biggest constraint for new housing development in all states - particularly in NSW where it was viewed as a 'very significant' constraint.

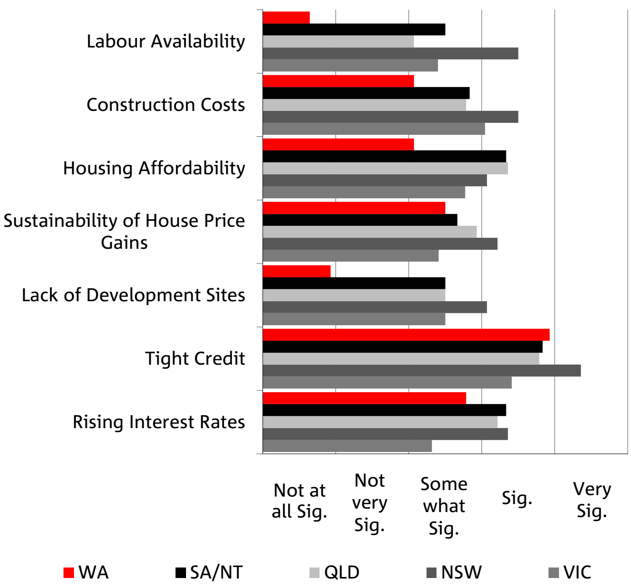
The overall level of concern over rising interest rates also grew. It was seen as being most problematic by property professionals in NSW and SA/NT and least problematic in VIC.

Property professionals overall were less concerned about all other factors, especially around lack of development sites and labour availability.

KEY CONSTRAINTS - OVERALL



KEY CONSTRAINTS - STATE

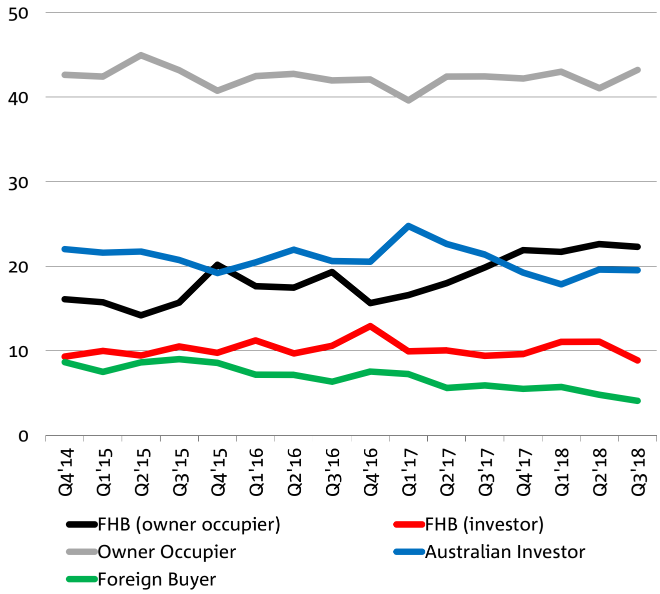


ESTABLISHED PROPERTY

Mirroring the trend in new property markets, the market share of owner occupiers or 'upgraders' in established housing markets also grew in Q3, reaching a 3-year high 43.2% (41.0% in Q2) - and continuing to account for the lion's share of buyers in this market. These buyers were most prevalent in WA (54.1%), SA/NT (48.3%) and QLD (45.3%) and least active in VIC (39.8%) and NSW (40.9%).

The share of FHBs buying for owner occupation was broadly unchanged at 22.3% (22.6% in Q2), but the market share of FHB (investors) fell to 8.9% (11.1% in Q2). In all, FHBs accounted for 31.2% of established property sales, down from a Survey high 33.7% in the previous quarter. Overall, FHBs were most prevalent in VIC (36.6%) and NSW (33.0%).

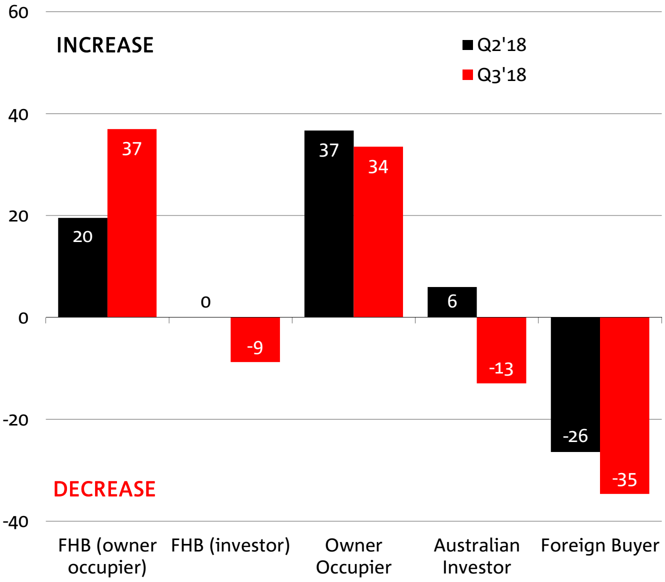
SHARE OF EST. PROPERTY SALES (%)



The share of local investors (net of FHBs) in established housing markets fell slightly to 19.5% in Q3 (19.6% in Q2). However, it is well down on levels seen in early-2017, when these buyers accounted for almost 1 in 4 (24.8%) of all sales. Despite falling house prices in key markets, curbs on investor lending and more cautious lending standards have also impacted this market.

The share of foreign buyers in established Australian housing markets fell to 4.1% of total sales (4.8% in Q2) - the lowest level since NAB began tracking this data in mid-2010. Moreover, foreign buyers were less active in all states. They were most active in VIC, but their market share of total sales fell to a near 6-year low 5.5% (6.2% in Q2). In NSW and QLD, they accounted for 4.5% (4.8% in Q2) and 3.0% (5.4%) of all sales respectively - their lowest level in 7 years.

COMPOSITION OF EST. PROPERTY BUYERS NEXT 12 MTHS (NET BALANCE)



On balance, a lot more property professionals (+37%) think the share of FHB (owner occupiers) and owner occupiers or 'upgraders' (34%) buying existing homes will increase in the next 12 months.

But noticeably more property professionals expect the share of foreign buyers to decrease relative to the previous quarter (-35% vs. -26% in Q2). More property professionals also believe the share of FHB investors (-9%) and local investors (-13%) will decrease in the next 12 months.

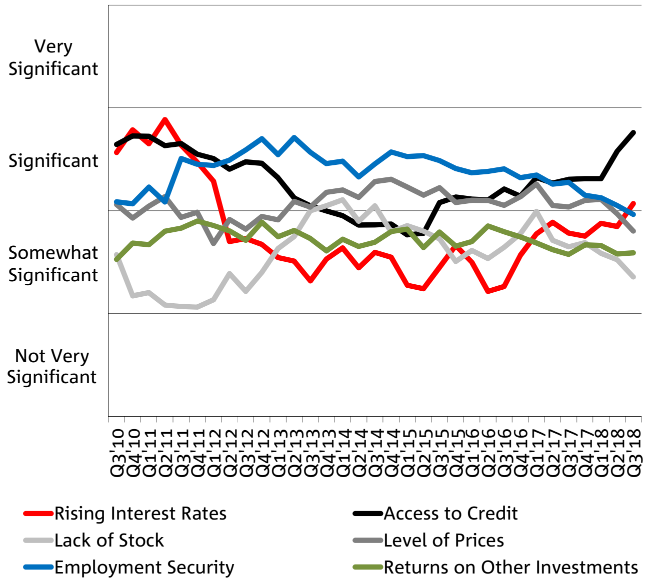
ESTABLISHED HOUSING MARKET CONSTRAINTS

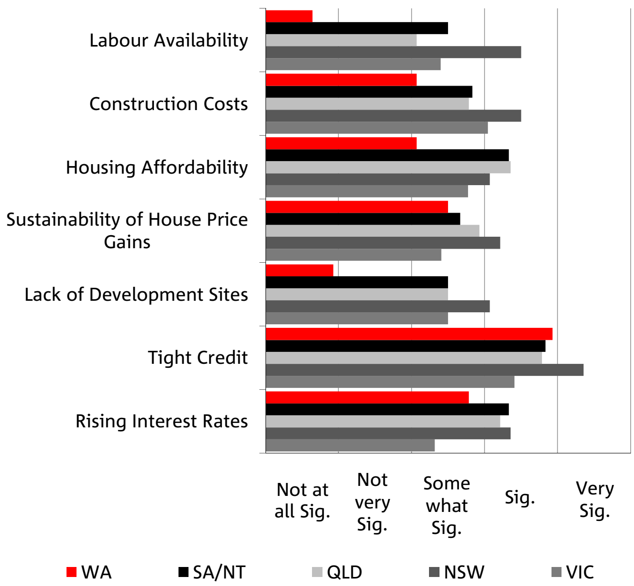
Access to credit remains the most 'significant' impediment for buyers of existing property according to surveyed property professionals. It was also seen as a much bigger issue than in the last survey and more so than at any time since the Survey began. Property experts in all states considered access to credit to be the most 'significant' issue in their state.

Rising interest rates replaced employment security as the second biggest issue for buyers of existing property in Australia - and in all states expect VIC (house price levels) and WA (employment security).

Heightened concern about interest rates is consistent with NAB's view of the market. We expect growth to remain above trend which should see the labour market tighten, wages growth lift and inflation more broadly begin to rise. As spare capacity is reduced, and inflationary pressures become more evident, the degree of accommodation in monetary policy will be gradually reduced, with the RBA starting a process of rates normalisation towards a more neutral setting.

KEY CONSTRAINTS - OVERALL & STATE



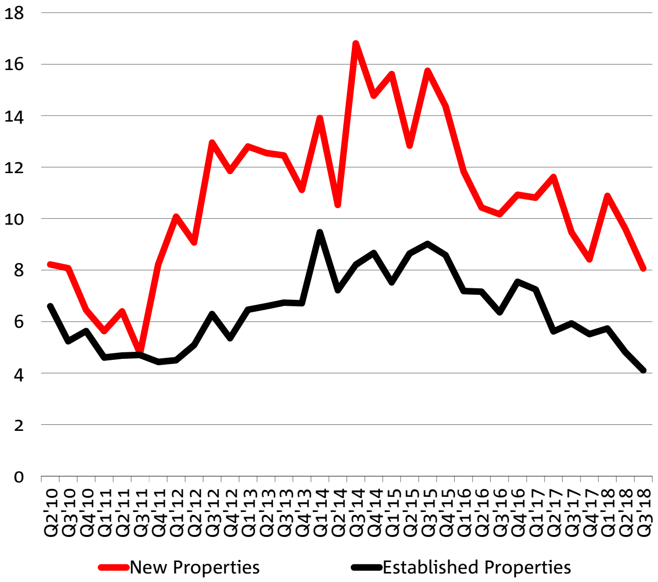


FOREIGN BUYERS

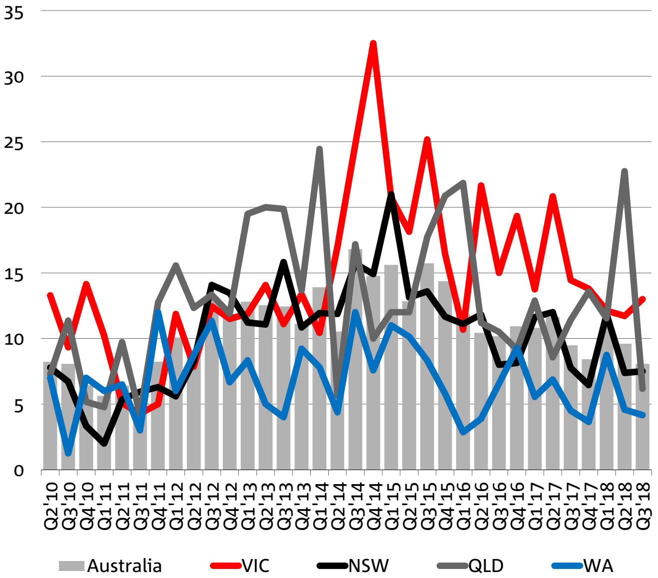
The boom in Australian real estate sales to foreign investors has run its course, with NAB's latest survey results continuing to highlight a decline in foreign buying activity resulting from policy changes in China on foreign investment outflows and tighter restrictions on foreign property buyers in Australia.

In Q3, there were fewer foreign buyers in the market for Australian property, with their market share falling to a 7-year low of 8.1% in new housing markets and a survey low 4.1% in established housing markets.

DEMAND FOR PROPERTY FROM FOREIGN BUYERS (% OF TOTAL)



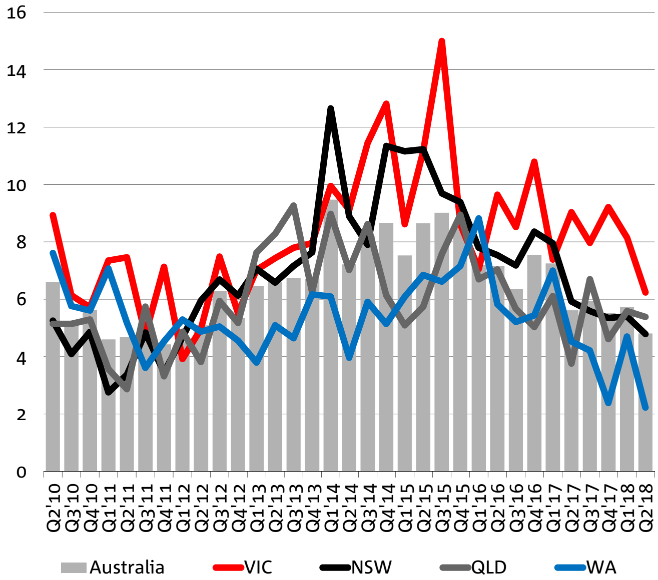
DEMAND FOR NEW PROPERTY FROM FOREIGN BUYERS (% OF TOTAL)



The share of sales to foreign buyers fell in all states except VIC where their share rose to 13.0% (11.7% in Q2), but still well below the record highs approaching 33% in late-2014. The share of foreign buyers in NSW was unchanged at 7.5% but also well down from a high of 21.0% in Q1 2015. The share of foreign buyers in QLD also fell to 6.2%, down from 22.8% in Q2, to its lowest level since mid-2014.

A similar trend is evident in established markets with the shares of sales to foreign buyers falling in all states. Property professionals in VIC reported the highest share of buyers in established housing markets at 5.5%, followed by NSW (4.5%), WA (3.7% and QLD (3.7%). Moreover, the share of foreign buyers has well fallen below survey average levels in all states.

DEMAND FOR ESTABLISHED PROPERTY FROM FOREIGN BUYERS (% OF TOTAL)



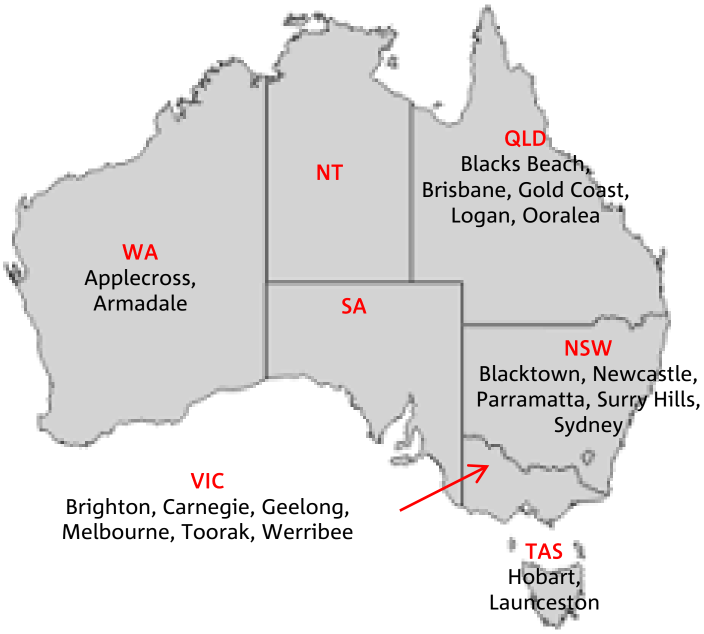
AVG SURVEY EXPECTATIONS: HOUSE PRICES (%)

	Q2'18	Q3'18	Next 1 year	Next 2 years
VIC	-0.6	-1.7	-2.4	-1.9
NSW	-1.4	-2.0	-2.4	-2.0
QLD	-0.1	0.1	0.8	1.4
SA/NT	0.1	-0.9	-0.3	0.9
WA	-0.1	-0.6	0.5	1.8
AUST	**-0.5**	**-1.1**	**-1.0**	**-0.4**

RENTS (%)

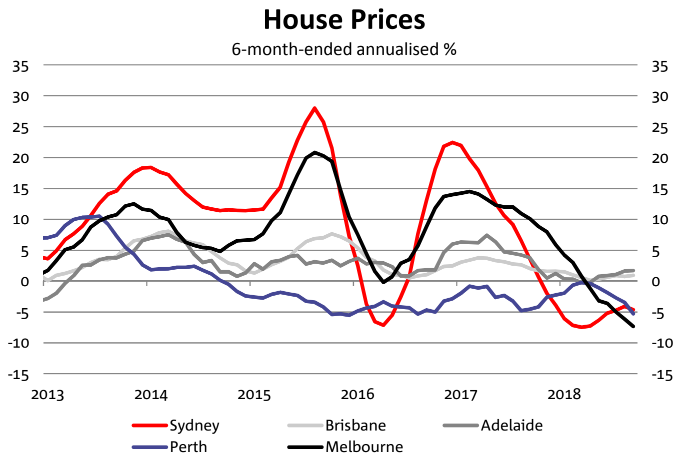
	Q2'18	Q3'18	Next 1 year	Next 2 years
VIC	0.9	0.8	1.3	1.9
NSW	-0.2	-0.8	-0.2	0.5
QLD	0.4	0.8	1.6	2.4
SA/NT	1.1	-0.1	0.5	1.3
WA	-0.8	-0.3	0.8	2.0
AUST	**0.4**	**0.2**	**0.9**	**1.6**

SUBURBS TIPPED TO ENJOY ABOVE AVERAGE GROWTH IN NEXT 12 MONTHS



continue to ease modestly and Adelaide to edge slightly higher. Hobart has performed strongly in 2018 to date and will likely end 2018 well up on 2017 and then increase a little further in 2019.

DWELLING PRICE GROWTH (6-MONTH ENDED ANNUALISED, %)



NAB'S VIEW OF HOUSE PRICES

Nationally, house prices have declined by 3.7% since their peak in late-2017.

The weakness in dwelling prices continues to be driven by weakness in the two largest markets - which also saw very large gains over the previous five years. Sydney prices are now 6.2% lower than their July peak, while Melbourne, which peaked in November, has fallen 4.4%. To date, the weakness has been concentrated in houses, with the declines in apartment prices less severe.

Perth has weakened again recently after showing some signs of stabilisation. The other capitals and regional prices have generally held up better over the past year.

Hobart continues to be the exception with prices up 9.3% over the year, though conditions appear to be moderating there too.

With the weaker than expected run of house price data and persistence of factors weighing on the established housing market, we have downgraded our outlook for house prices, now expecting a peak to trough decline of around 10% in Sydney and 8% in Melbourne.

We expect the weakness from here to be driven by the apartment market, though prices for houses will also decline a little. This would leave prices well above even three years ago.

We expect prices for houses in Brisbane to remain broadly flat over the next two years, Perth to

We expect in aggregate to see stronger declines in apartments in each of the next two years reflecting continued strong increases in supply in the Eastern states amidst some weakening in demand from investors and foreign buyers as well owner-occupiers.

Overall, we see this adjustment playing out in an orderly fashion - as it has done to date - with the correction serving to remove some of the risk which has built up in the household sector.

This adjustment is occurring against the back drop of a relatively strong economy and healthy labour market. Further, while there has been some tightening in credit conditions, we do not see a 'credit crunch' leading to generalised rapid price falls as the central scenario. Indeed, while investor credit growth has slowed notably, credit extended to owner-occupiers continues to rise at a relatively robust rate.

Rising interest rates are likely to weigh on house price growth further out, but will start from very low levels, occur gradually and be conditioned on stronger income and wage growth (which would serve to support house prices).

The economy grew at a relatively strong pace over the first half of 2018 and while we think growth will slow over the next two years, this should still be enough to see employment growth to outpace growth in the population and see further declines in the unemployment rate.

The tightening in the labour market should see a pick-up in wage growth as well as inflation more generally. This process is expected to be gradual (as it has been so far) which means we do not see any interest rate increases until mid-to-late 2019.

Any further tightening in lending standards as well as additional changes to government or prudential policy to address affordability or financial stability concerns, are likely to have an impact on these forecasts.

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Brisbane	2.7	3.1	0.2	0.0	0.0
Adelaide	3.8	3.3	0.9	1.7	1.7
Perth	-2.9	-2.6	-2.4	-0.2	0.0
Hobart	9.6	12.9	6.4	1.8	1.8
Cap City Avg	7.3	4.0	-3.7	-1.0	0.0

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Sydney	5.8	5.4	-3.6	-5.5	-0.9
Melbourne	4.7	8.4	-2.7	-3.4	-1.0
Brisbane	-3.0	-1.2	-0.5	-4.5	-2.2
Adelaide	0.6	0.5	1.2	0.5	0.5
Perth	-6.3	-0.9	-6.9	-2.3	-0.8
Hobart	6.4	9.1	5.9	1.2	1.2
Cap City Avg	3.5	5.1	-3.0	-4.4	-1.0

*Percentage changes represent through the year growth to Q4
SOURCE: CoreLogic, NAB Economics

ABOUT THE SURVEY

The NAB Quarterly Australian Residential Property Survey was first launched in Q1 2011.

The survey was expanded from NAB's Quarterly Australian Commercial Property Survey, which was launched in April 2010.

Given the large number of respondents who are also directly exposed to the residential market, NAB expanded the survey questionnaire to focus more extensively on the Australian residential market.

The large external panel of respondents consists of Real Estate Agents/Managers, Property Developers, Asset/Fund Managers and Owners/Investors.

Over 300 panellists participated in the Q3 2018 Survey.

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