CUSHMAN & WAKEFIELD

ECONOMIC UPDATE

BUDGET 2023/24

COMMERCIAL PROPERTY IMPLICATIONS

MAY 10, 2023

3 KEY TAKE AWAYS

1 **715,000** Net overseas migration in FY23&24

2 **2.75%** CPI by 2024/25

3 **4.5%** Peak unemployment

WHAT HAPPENED?

Last night the Treasurer handed down the 2023/24 Federal Budget. While much has been written on the topic, this paper will focus on the issues more relevant to commercial real estate (CRE). While CRE is not the specific target of support in the budget, several of the measures announced will impact the sector.

A lot of attention has been given to the budget forecast to return to surplus for the first time since fiscal year (FY) 2008 on the back of a historically strong labour market and windfall tax revenues from commodity prices.

However, the real economic impact of cyclical budget deficits and surpluses tends to be minimal over the medium term. Rather, the focus was on how the government would navigate the economic challenge of stubbornly high inflation and increasing cost of living in the short-term while laying the foundations for future growth.

As a result, many of the measures announced were targeted. These include a $14.6 billion cost-of-living relief package to assist lower-income households, $4.7 billion childcare subsidy, and tax incentives for the build-to-rent sector.

Migration was a pillar of the budget announcement, with the government forecasting net overseas migration to increase to 400,000 in the current FY and 315,000 in FY24 before returning to historical trends of 235,000. Although net overseas migration is generally a boon for CRE, a key challenge will be to provide appropriately located housing for these new migrants. This will require a targeted increase in the supply of housing, both of the right product and in the right locations.

FIGURE 1
Economic forecasts[1]

	2022/23	2023/24	2024/25	2025/26	2026/27
Real GDP %	3.25	1.5	2.25	2.75	2.75
Nominal GDP %	10.25	1.25	2.5	5.25	5.25
Employment %	2.5	1.0	1.0	1.75	1.75
Unemployment rate %	3.5	4.25	4.5	4.5	4.25
Wage price index %	4.0	4.0	3.25	3.25	3.5
CPI %	6.0	3.25	2.75	2.5	2.5

1 Real GDP and Nominal GDP are percentage change on preceding year. The consumer price index, employment, and the wage price index are through-the-year growth to the June quarter. The unemployment rate is the rate for the June quarter.
Source: Treasury

KEY POINTS:

The 2023/24 Budget is designed to invest in Australia's long-term growth potential while avoiding stoking further inflationary pressures. As a result, many of the measures announced were highly targeted.

The general growth outlook for the economy remains positive, though growth is expected to slow in the year ahead but start to return to longer term growth trends from 2024-2025.

Nevertheless, economic expansion and a resumption of real wage growth will provide ongoing support for the core CRE sectors of office, industrial and retail. The office and retail sectors in particular should also benefit from a resumption in overseas migration.

A robust medium term economic outlook for Australia will also provide some level of support for investment demand into Australian CRE as prices continue to adjust to higher financing costs.

This budget also provides targeted measures that will benefit other segments of CRE. The government announced tax benefits for the build-to-rent sector as well as increased childcare support payments.

The Budget aims to provide a path forward for the Australian economy. However, as a small open economy Australia is vulnerable to external shocks, which could cause the outlook to be revised.

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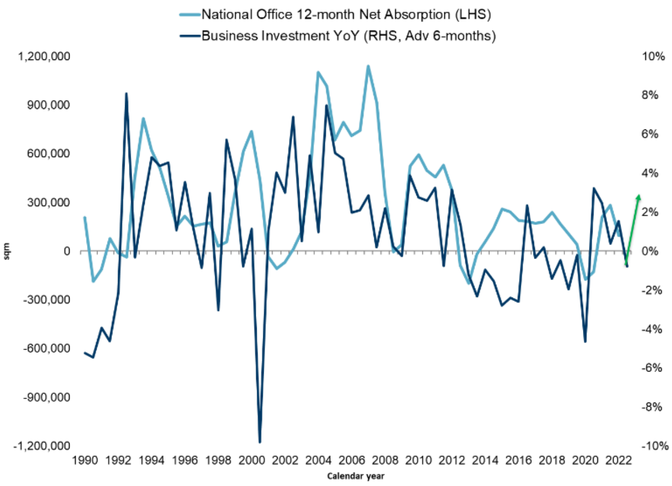
OFFICE

The economic outlook provided by the Treasury is broadly supportive of the office sector.

As shown in Figure 1, real GDP is set to slow in FY24 as the economy digests the impact of a rapid rise in interest rates. However, importantly growth is forecast to remain positive in the short-term before rebounding to long-term levels by FY26. Employment growth is set to rebound from FY25 as well, though at a slightly slower pace given the historically tight labour market and an unemployment rate at near 50-year lows.

Encouragingly the government forecasts robust growth in business investment over the next two years. Business investment is expected to be between 2%-3% over the next three years, driven primarily by non-mining investment. As can be seen in Figure 2, business investment tends to be a leading indicator for office net absorption in Australia. This projects well for tenant demand in the near term despite some challenging macroeconomic conditions.

FIGURE 2
Sydney CBD net absorption & business investment



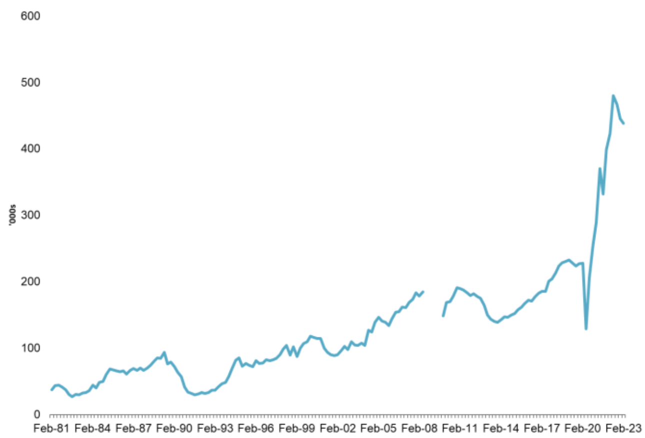
Source: ABS, DAE, PCA, Cushman & Wakefield

Growth in employment is expected to be constrained by a historically tight labour market. The outlook for the unemployment rate suggests that the government believes the economy will remain at or near full employment for the duration of the forecast horizon. Nevertheless, the increase in net overseas migration in FY23 and FY24 should help alleviate some staffing shortages, as job openings remain near record highs (Figure 3). Similarly, the government's decision to grant an additional two years of post-study work rights to international higher education graduates should also help to boost the labour force given the strong return of international students.

RETAIL

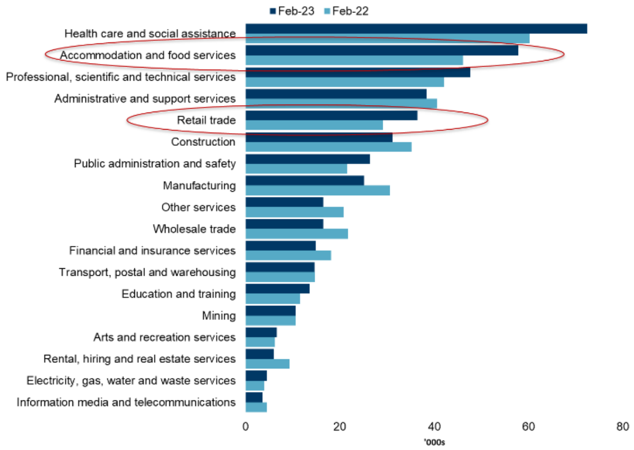
The retail sector should also benefit from the boost in migration given that retail and hospitality are two sectors most in need of workers (Figure 4). Although the government is re-instating the work hour cap for international student visa holders from July 1 2023, it will be increased from pre-pandemic levels by eight hours. This should help to ease staffing pressures on retail establishments and avoid decreasing trading hours due to a lack of staff.

FIGURE 3
Job openings



Source: ABS, Cushman & Wakefield

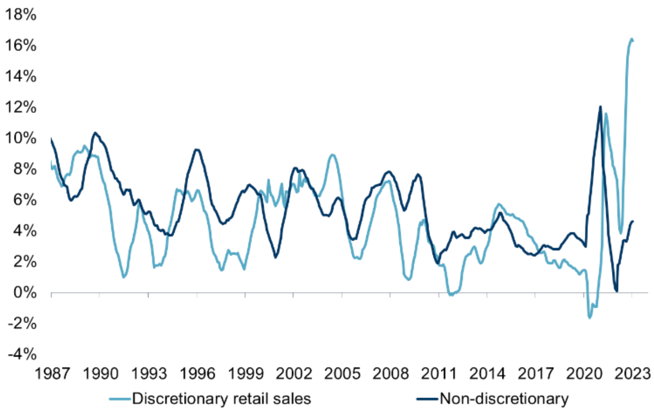
FIGURE 4
Job openings by sector



Source: ABS, Cushman & Wakefield

Negative real wage growth in FY22 and FY23 is likely to slow discretionary retail sales. This could be limited to a degree by the excess savings buffer built up during the COVID-19 pandemic when the household savings ratio hit an all-time high of 23.6%, though has since normalised and come down to 4.5% in the December 2022 quarter, as well as an increase in aggregate demand for goods and services that will be generated by rising migration. From FY24, above-trend real wage growth should be a tailwind for discretionary retail trade.

FIGURE 5
Discretionary and non-discretionary retail sales (YoY)



Source: ABS, Cushman & Wakefield

The government's announced $14.6 billion cost-of-living relief package targeting lower income households should provide a measure of support for non-discretionary retail sales until inflationary pressures subside.

INDUSTRIAL

Industrial has been the big CRE winner of the past few Budgets, primarily due to significant announcements surrounding infrastructure spending. The current government has taken a more cautious approach, announcing a national review of infrastructure projects while promising to keep the $120 billion rolling 10-year pipeline.

Support to small and medium sized businesses (SMEs) by a temporary increase in the instant asset write-off threshold to $20,000 and incentives to improve energy efficiency for SMEs should also benefit industrial property.

The government has also announced that it will extend the clean building managed investment trust (MIT) withholding tax concession to data centres and warehouses. This measure will extend eligibility for the concession to data centres and warehouses that meet the relevant energy efficiency standard from 1 July 2025.

BUILD-TO-RENT AND CHILDCARE

Build-to-rent (BtR) and childcare were two of the CRE sectors that benefited directly from policies announced in the budget.

For BtR, the government announced that it would increase the rate for the capital works tax deduction to 4% per year and reduce the final withholding tax rate for managed investment trusts (MIT) from 30% to 15%. The dwellings need to be held under single ownership for at least 10 years and landlords must offer a term of at least three years for each dwelling. The latter is a move that the property industry has long lobbied for as it brings the tax treatment of BtR assets in line with other classes of CRE. This measure is expected to support housing supply; the government expects the scheme will deliver 150,000 rental properties over 10 years. It will also create a more efficient BtR sector as offshore groups that operate in more established markets bring best practices to Australia.

The childcare sector will benefit from the announced $4.7 billion in subsidies from 1 July 2023. Families earning less than $80,000 per annum will see their subsidy climb to 90%, while those on more than $80,000 could see their subsidy increase by up to 20%. This likely means more demand for childcare services.

INVESTMENT DEMAND

Investment demand for CRE in Australia saw a strong recovery throughout the COVID-19 pandemic. Key reasons for robust demand include Australia's solid and stable economy combined with relatively high CRE yields compared to overseas CRE or fixed interest assets.

Although more recently uncertainty surrounding the future path of interest rates has hampered price discovering and weighed on demand, the government projects inflation to normalise by FY25. In addition, Australian economic growth is expected to outperform most developed market peers in the short term (Figure 6).

FIGURE 6

GDP Growth Projections (%, calendar year)

	2022	2023	2024	2025
Australia	3.6	1.75	1.5	2.75
China	3.0	5.75	4.5	4.5
Japan	1.0	1.25	0.75	1.0
USA	2.1	1.0	0.75	2.25
Euro area	3.5	0.5	1.0	1.75
UK	4.1	-0.5	0.5	2.25

Source: Treasury

A more hawkish monetary policy has pushed the Cash Rate and yields higher, both private forecasters and the market (as priced by ASX futures) see interest rates to be at or very near to their peaks. Although risks remain, Australia's generally supportive economic environment suggest quality Australian CRE assets should continue to attract both domestic and offshore investment demand.

CONCLUSION

The Federal Budget walks a fine line between investing in Australia's future economic growth while not stoking inflationary flames. Positive economic growth and a recovery in net overseas migration should provide ongoing support for Australian CRE.

However, with the exception of another black swan event, much of this outlook hinges on inflation falling back to within the Reserve Bank's target range in the next 24 months. This remains the key balancing act in the near term – supporting growth while tackling inflation.

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