



SIMON KNEEBONE

2021 - *Can we Expect the Unexpected again?*

15 February 2021

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For savvy investors, including property and mortgage investors, the new year traditionally starts with reading bold economic and property predictions by our favourite fund managers and economists trying to foresee “*what lies ahead for the coming year*”.

If 2020 taught us anything, it is to expect the unexpected. What I am 100% certain about is that 2021 will be a continuation of the emotional roller coaster ride that we all experienced in 2020. The only difference is that the unexpected is now the expected.

Mutating strains of Covid-19 rampaging through the globe alongside, the logistical issues inhibiting the efficient rollout of new vaccines, geo political instability and untraditional economic policies (QE and governments printing money) are just some of the examples of black swan events which lurk on the horizon in 2021.

It took me over a decade to truly appreciate and understand a quote from my old Economic Professor, “*economic forecasting is like trying to predict tomorrow’s weather whilst taking into account how people will collectively feel on that day*”. There is a big difference between economic forecasting and commentating, and those who are bold enough to forecast are sadly rarely right.

Despite the uncertainty, Australia continues to earn its title as the “The Lucky Country”, by being able to control the virus whilst remaining economically strong and stable as other nations lurch from crisis after crisis.

The IMF's latest predictions is that our economy will be powering towards 5.2% GDP growth this year and 4.1% GDP next year, much to the envy for the rest of the world. Despite what can be seen as one of the most significant trade wars in Australia's history, between us and China, our aggregate exports are steadily growing albeit predominately off the back of mining. Remarkably, there has been NO government support for continuing immigration during the pandemic, which traditionally is a significant economic driver. My mind truly boggles as to how this is playing out.

When it comes to the Australian property market, we need to remember it was less than 8 months ago that the general consensus of our most respected economists and property commentators was that property would fall in excess of 10%-20%, and some banks predicted declines of up to 30%. Today, RBA are saying that Houses could increase in value by up to 30% over the next three years. So much for expert economic commentators!



Despite the overall positive property euphoria, we must not become complacent with the apparent advent of continued unabated growth and unwittingly underestimate the “iceberg effect”. We still do not know what else could be lurking below the surface. No one can be quite sure of the quantum of Zombie companies still feeding off the Government's life support which is due to abruptly end in March. Moreover, once the bank moratorium is over, banks will surely begin recovering on delinquent loans. We are yet to see the full ramifications of both of these unfolding events.

We believe that the possible negative aspects of the above-mentioned events have been significantly mitigated due to the Government's generous support measures and swift actions enabling us to enjoy our current very favourable set of economic circumstances. Last week Prime Minister Scott Morrison, proudly announced that 90% of the jobs lost during the darkest hour of the pandemic have been clawed back thus allowing our free markets to take over with the economic recovery without further government support.

Interestingly, we are now experiencing a tsunami of capital flow through our financial markets.

Despite current rhetoric, as a commercial mortgage fund manager, we need to look much deeper than the high-level property headlines. For commercial mortgage funds managers to be successful in the long run, they need to be consistent and disciplined in their risk and credit assessment. This ensures maximisation of capital preservation can be maintained and our investors (including SMSF trustees) can rely upon the consistency of regular stable monthly income distributions.

The following are some of our market insights:



Regional Property

Despite a large spike in local migration from Sydney and Melbourne to regional areas, our view has not changed on the risk in lending in regional areas. Just as quickly as the prices and demand have gone up, they could easily revert back due to an exodus of people back to the metropolitan areas once the COVID-19 crisis abates and the physiological desire to work face-to-face rather than through Zoom may once again prevail.

The second reason is linked to regional areas having lower restrictions on creating new housing supply. In regional areas, undersupply of properties could turn to oversupply in a relatively short period of time as it does not have the same land constraints as the metro areas of Sydney, Melbourne and Brisbane.



Commercial Property

According to this week's data, the inner-city vacancy rates are 8.6%, which is essentially double the last quarter's figures with the delivery of further supply expected in 2021. This was not unexpected due to the additional restrictions on both businesses and landlords as well as the weakening, but still prevailing negative stigma of working in the city. To add insult to injury, many multi-national corporations have loosened up their work from home policies and are slowly giving up their commercial space in the city.

Despite this negative trend, we remain optimistic that this will reverse over time, however as it might take years, investors should be prudent on the gearing of investments secured against this asset class.



Houses versus Units

Most of the positive property headlines focus on houses prices rather than the entire residential property market, which prompts a question about the price trends for units? Corelogic recently published that the difference between house and unit prices has never been wider with this gap only continuing to expand.

In saying this there are a number of contributing factors to consider:

- Most units are concentrated in close proximity to the city and highly populated areas, which proved to be less desirable during COVID-19.
- Investors make up the largest segment of unit purchases as they favour apartments over houses, due to ease of management and cost. Property Investment activity is at one of the lowest levels for over 10 years.
- Due to Covid-19 we are short approximately 500,000 people who are normally short to medium term renters as a direct correlation to the lack of overseas students and tourists.

- Owner occupiers are the predominate buyers in the current market and their requirements are different to those of the investor buyers, that is, they want larger apartments. Due to the lack of supply for this specific product, owner-occupier buyers are turning to houses as an alternative.
- The Federal Government's current \$2billion Home Builder scheme is artificially increasing demand for houses through generous incentives on offer, the take up of which has far exceeded expectations.

Despite all the odds, including decreasing demand, unit prices remain resilient. We believe that unit prices, which normally lag behind house prices, will catch up in the long term and eventually the gap will shorten.

Mortgage Investment Opportunity

Msquared Capital has identified a number of emerging gaps in the commercial lending market which has enabled us to introduce our investors to these unique opportunities.

Business owners who have been temporally impacted by COVID-19 are now requiring commercial funding and banks have been slow to adapt and are still trying to wrap their heads around how to provide businesses with the right access to cashflow during COVID-19. These business operators typically have quality real estate to offer as security and this creates a specific opportunity for our investors right now.

With the RBA recently making a strong public commitment that interest rates will remain unchanged until 2024, both business and consumer confidence around obtaining appropriate finance is high. On the flip side, those investors who have historically relied upon bank term deposits to provide them with a good regular income stream are losing out with term deposit rates hovering around a meagre 0.75%pa..

Accordingly, it is a great time for those investors to look at alternate investments including an investment in a registered first mortgage loan to a small business borrower with target rates of return currently between 6.50%p.a. and 8.00% p.a.[1]

At Msquared Capital, we understand investor requirements and both our processes and platforms enables us to carefully choose the best possible options for our investors.

We believe that our investors deserve personalised service and expert assistance when contemplating a significant commercial mortgage investment.

That is why you can call me or my fellow joint managing director, Paul Myliotis, directly to find out more about what Msquared can offer you. Both Paul and I are happy to meet with you face to face at a time convenient to you. Our contact details are listed below.

[1] An investment in the Msquared Contributory Mortgage Income Fund it is not a bank deposit.

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