M3 PROPERTY

NEW SOUTH WALES MARKET SNAPSHOT

H2 2022

CONTENTS

INDUSTRIAL

“There were limited transactions of scale in the NSW Industrial sector over the second half of 2022. As such, the full extent of yield re-pricing is yet to be quantified. We anticipate yield softening to occur throughout 2023 and beyond, however, this is likely to be offset to some degree by strong rental growth, which is being driven by low vacancy and good levels of occupier and tenant demand."

JOEL DUCEY, DIRECTOR

CURRENT STATE OF PLAY

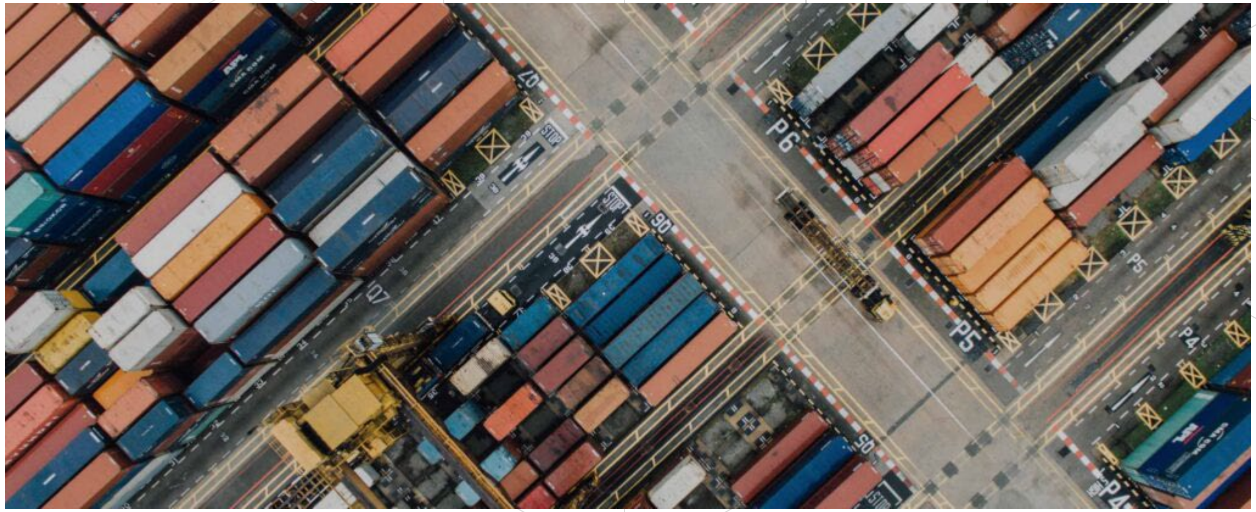
- There has been a continued strengthening in the leasing market and a renewed focus on rental levels from property owners now that market value growth via yield compression has slowed. This has resulted in strong growth in rentals, with prime rents growing by an estimated 22% over 2022.

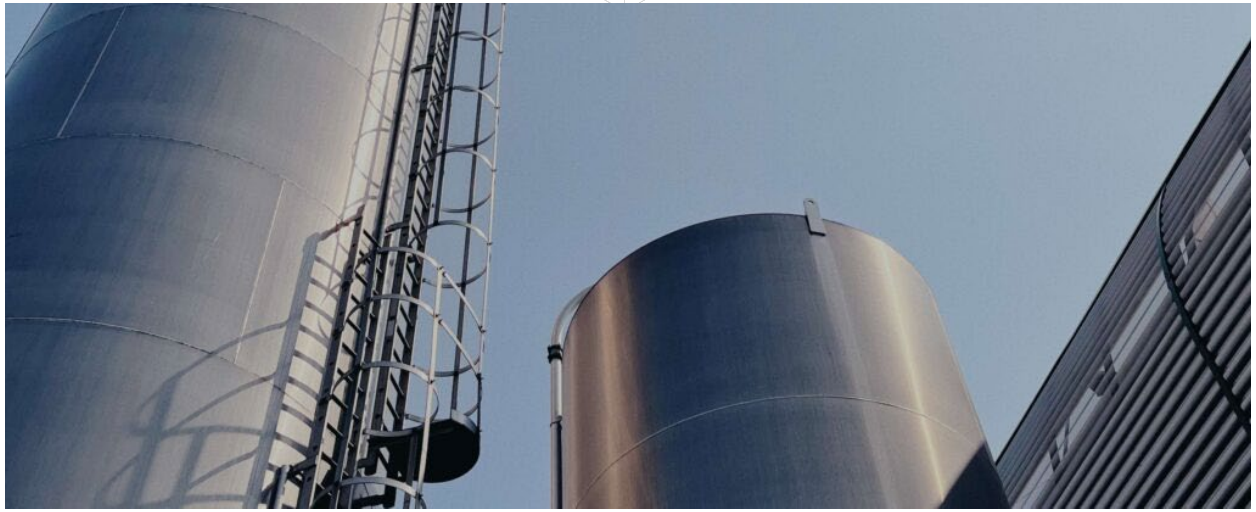
- Newer buildings in prime locations close to a major road or freight rail networks and designed to accommodate warehousing, distribution and logistics operations have seen more robust demand than the general market.

- Supply continues to be pre-commitment led; however, speculative development has increased. A substantial portion of building approvals over the year were for warehouses, reflecting continued demand for specific sub-sectors, including freight distribution services, temperature-controlled warehousing, and e-commerce.

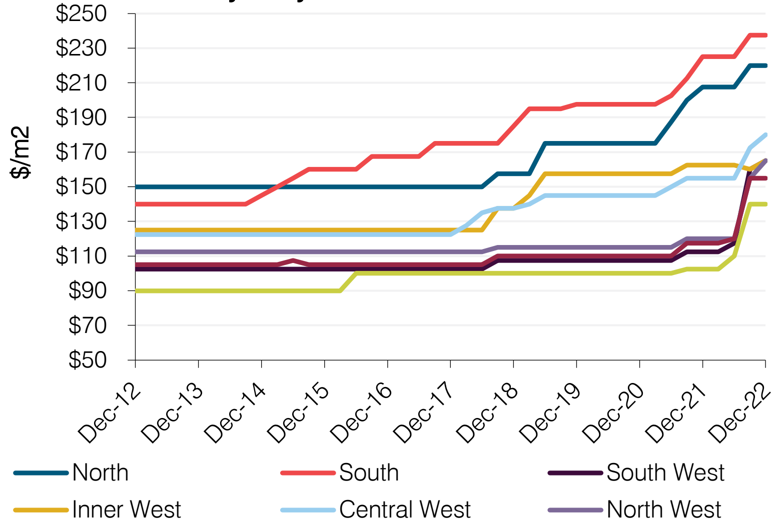
- The NSW Government's changes to the planning approval process will continue to assist new supply in moving through the planning system more quickly. The changes quicken the approval process for warehouses by lowering the State Significant Development threshold for warehouses from $50 million to $30 million and are in effect until May this year.

- Over the past few years, competition with other land uses in the southern and inner submarkets has reduced available industrial stock in these precincts and has led to an ongoing migration of activity into the western precincts, which have seen an increasing number of projects to accommodate displaced tenants.



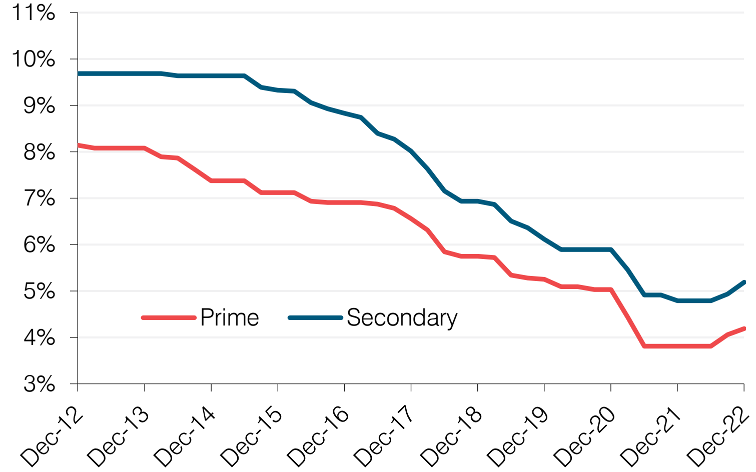


Sydney Prime Net Face Rents



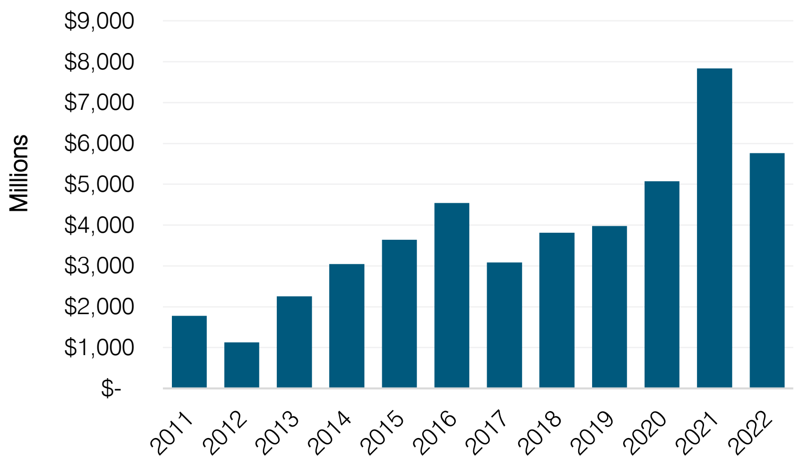
Source: M3 Property

Sydney Industrial Yields



Source: M3 Property

New South Wales Industrial Sales Volume



Source: Real Capital Analytics (RCA), M3 Property
Note: Sales over $5 million

RENTAL MARKET

- Prime net face rents ranged between $130 and $250 per square metre during the December 2022 quarter, with secondary net face rents ranging between $100 and $200 per square metre. The strongest growth in 2022 occurred in the South West, North West, and Outer South Precincts.

- Average incentives have declined to range between 5% and 10% for prime buildings and 8% and 15% for secondary buildings (with incentives higher than these ranges in the North).

YIELDS

- Prime yields ranged from 3.65% to 5.00% as of the December quarter 2022.

- Secondary yields ranged from 4.75% to 5.50% as of the December quarter 2022.

- Yields softened over the second half of 2022, following a long period of compression.

INVESTMENT MARKET

- According to RCA, there were 274 industrial sales over $5 million (totalling $7.3 billion) recorded during 2021 across the Sydney market. Sales activity decreased in 2022, with 207 sales recorded (totalling $5.4 billion).

- The industrial market consists of a broad purchaser profile, ranging from offshore institutions and REITs to local and offshore private investors or developers. Offshore groups and REITs were key buyers in 2022.

OPPORTUNITIES AND CHALLENGES

- There is an increasing shortage of developable industrial land in the inner Sydney submarkets, which is impacting location strategies of owner-occupiers and industrial developers. This scarcity of sites has resulted in upward pressure on land values. Zoning changes, competition from alternative land uses and robust industrial demand, particularly from retailers with the continued expansion of e-commerce, have driven a decrease in vacant land in the inner submarkets.

- As household discretionary incomes come under increased pressure over the coming year, we expect to see demand from retail groups moderate. However, supply chain disturbances will continue to encourage retailers to keep larger inventories.

- High inflation, rising interest rates, securing developable land at justifiable levels, and rising development costs will also continue to present as challenges in the market.

OUTLOOK

- There is a substantial pipeline of new speculative and pre-committed supply to come to the market in 2023. However, supply chain disruptions, higher construction costs and the rising cost of debt is expected to delay some projects in the short term.

- Occupier demand is expected to remain at strong levels over the coming six months with growth in e-commerce forecast to continue and drive demand for warehouse and logistics space, solid public sector investment and continued demand for advanced (particularly food) manufacturing.

- We expect that face rents will increase over the short term as leasing demand remains strong and the availability of leasing options declines.

- Land rates are expected to stabilise over the coming six to 12 months given high construction costs, continued supply chain issues and the potential easing of demand for investment stock. Over the medium-to long-term, the Outer West, South West, and Outer South West precincts are likely to see the highest levels of industrial development.

Property	Sale Date	Sale Price	Purchaser	GLA (m^2)	WALE (Income)	Initial Yield	GLA Analysis ($/$m^2$)
JalcoPortfolio, 6 Ash Road, Prestons; and 45 King Road, Hornsby	Nov-22	$38,000,000	Private	13,000	6.80	4.35%	$2,923
LEDA Holdings Portfolio, Eastern Creek, Smithfield & Mascot	Aug-22	$95,000,000	Pittwater Industrial	18,169	1.27	3.06%	$5,229

RETAIL

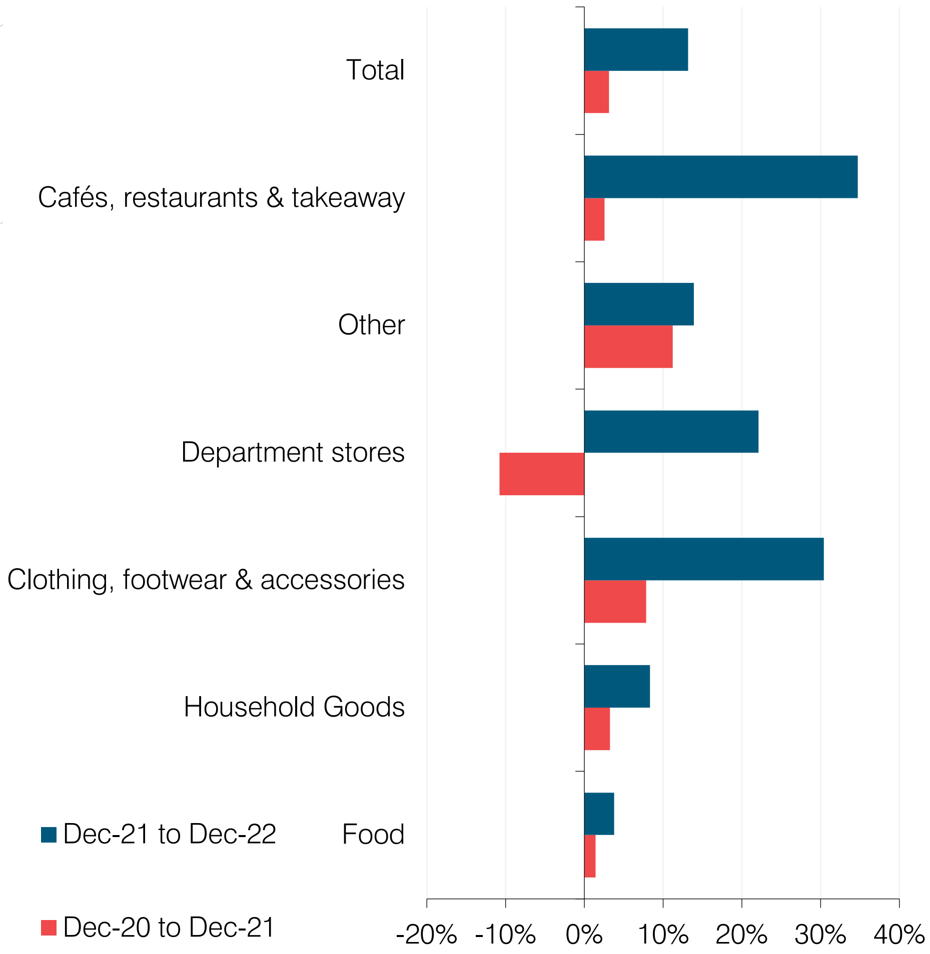
“There has been a lack of transactions in NSW during 2022, with continued economic market uncertainty following the RBA interest rate rises in early 2022. We are yet to identify the full extent of yield re-pricing in the retail market, however as we move into 2023, we expect sale activity to improve with purchaser and vendor expectations to be more aligned. Tenant demand has improved over the past six months, following the COVID-19 pandemic period and re-opening of international borders. Rental levels are expected to be reset by landlords to a more stabilised position, particularly in Sydney CBD.”

ANDREW CASH, ASSOCIATE DIRECTOR

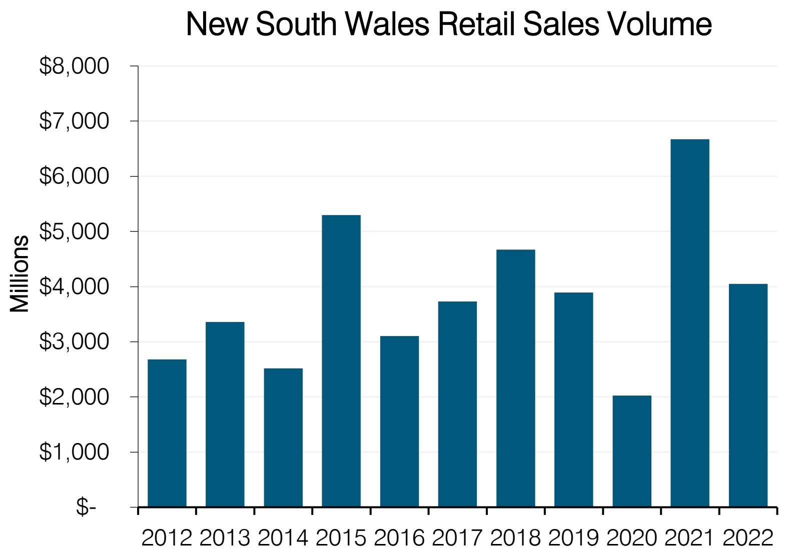
CURRENT STATE OF PLAY

- Total retail spending growth in New South Wales from the 2021 calendar year to the 2022 calendar year was 13.19%, up from 3.14% growth from 2020 to 2021. The strongest growth by retail category was recorded in Cafes, restaurants and takeaway (34.73%), coming off a low base from various periods of lockdown in 2020 and early 2021.
- Rental spreads (i.e. the difference between a tenants new rent and their prior rent) have materially improved over the last 12 months for AREIT shopping centre owners.
- According to the Westpac-Melbourne Institute, consumer sentiment is negative, having fallen considerably over the past year due to rising inflation and increasing pressures on the cost of living. Consumers are extremely pessimistic about making major purchases and about the short-term outlook for family finances and the economy.
- Growth in the online retail sector and the continuing expansion of online marketplaces has resulted in centre owners changing their tenancy mix. The pattern of rationalisation of fashion and growth of health and beauty, services, food-based retailing, and entertainment has been a trend over the past five years.
- There have been several retail developments completed in the Sydney CBD over recent years, including Brookfield Place, which was opened in 2021 and includes circa 6,000 square metres of prime retail space. Other new retail developments include the MLC podium redevelopment, the newly opened Quay Quarters Lane, and the Brookfield Place development at Wynyard. All of these new developments include significant food, beverage, and lifestyle offerings. The NSW Government is currently in the planning stage for the Central Station Precinct. The proposed development will include new retail and dining options.

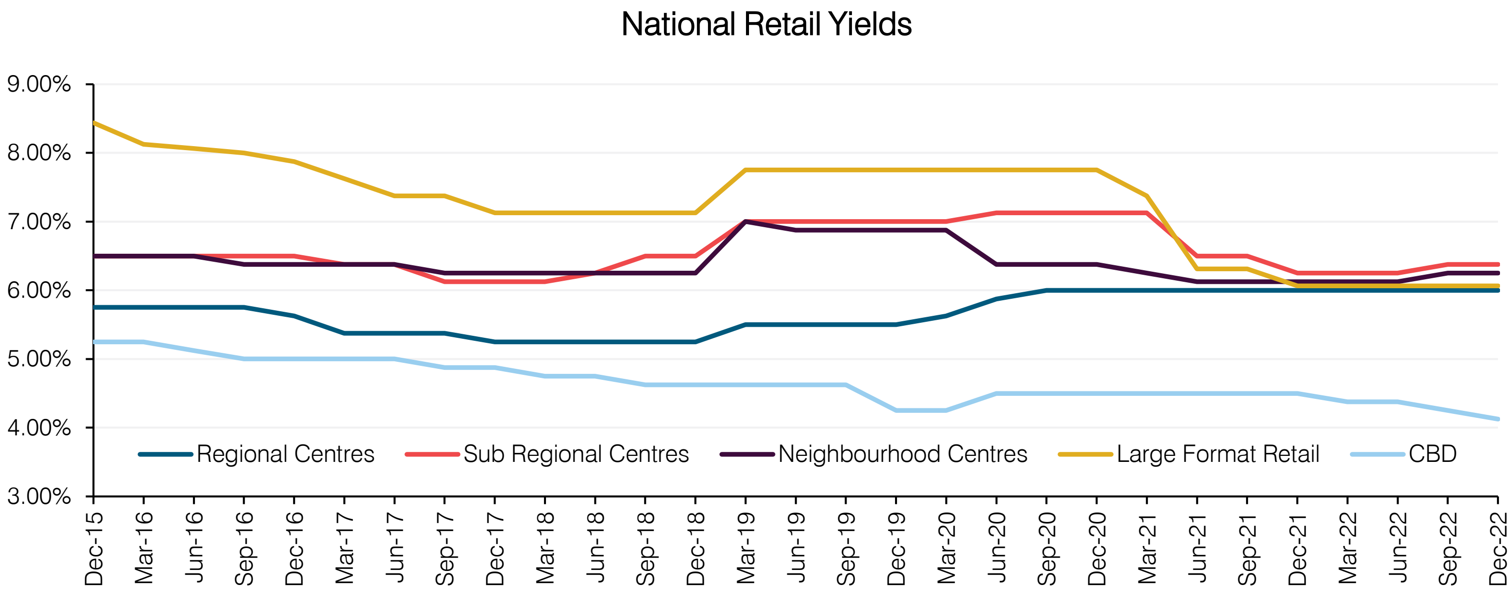
NSW MAT Growth by Retail Sector



Source: ABS, M3 Property



Source: Real Capital Analytics (RCA), M3 Property
Note: Sales over $5 million



Source: M3 Property

INVESTMENT MARKET

- Retail investment activity in New South Wales reached a record high in 2021 with $6.67 billion worth of sales. In 2022, whilst sales tracked at levels comparable to 2021 until September, activity declined in the final quarter of the year bringing the annual total down to a level comparable to prior to the pandemic.
- Private buyers were the most active buyer group during 2022, accounting for 36% of sales (by $ value). Offshore buyers were the next largest buyer group with 28% of sales.

TRANSACTIONS

- There were assets offered to the market and then withdrawn during 2022 with purchaser and vendor expectations not meeting in an uncertain economic environment.
- However, a number transactions were completed in late 2022 and further transactions are in the process of being completed in 2023 as vendor and purchaser expectations become more aligned.
- Transactions have reflected mixed results with some sales reflecting no yield softening and others indicating softening is occurring.

YIELDS

- Retail yields generally continue to look attractive relative to the alternative investment classes of office and industrial.
- Over 2022 and into 2023, transactions have been limited to below $300m. There has not been any recent evidence in New South Wales of transactions above that point.
- There has been limited stock of Bunnings Warehouses and Coles and Woolworths supermarkets offered to the market and as such, purchaser investment hurdles for these asset classes are yet to be strongly tested.

OPPORTUNITIES AND CHALLENGES

- Rental levels within shopping centres have largely been re-set over recent years, leading to more stable income profiles.
- Shopping centres sit on large tracts of land with flexible zoning provisions, allowing for a variety of mixed uses to be introduced, supporting the retail component and extracting further value for the owner. Many shopping centres are adding co-working tenants, childcare, serviced apartments and other non-traditional retail uses.
- The role of shopping centres in assisting with last mile logistics also provides opportunities.
- Under-performing anchor tenants are seen as a key income risk by potential purchasers, being mindful that while a vacant anchor tenancy can provide re-positioning opportunities, it creates income uncertainty and re-purposing is capital intensive.

OUTLOOK

- Tenant leasing demand has increased over the last six months, supporting improved leasing conditions.
- City centre visitation is expected to take some time to recover from COVID-19, given changes to white-collar working habits and the CBD’s high exposure to tourism and international students. However, we expect that visitation will improve given borders have re-opened and international arrivals are trending up.
- The higher inflationary and interest rate environment will impact the spending capability of consumers, and this is expected to flow through to weaker consumer spending on discretionary items over the medium-term.
- The demand for prime retail assets with a high proportion of non-discretionary retailers is forecast to continue. However, interest rate changes are expected to put upward pressure on investment yields for some property types going forward.

Property Address	Sale Date	Sale Price	Purchaser	GLAR (m^2)	WALE (Income)	Initial Yield	GLA Analysis ($/$m^2$)
Stanhope Village, NSW	Dec-22	$158,000,000	Revelop	19,454	2.80	5.70%	$8,122
Menai Marketplace, NSW	Nov-22	$150,000,000	HMC Capital	16,885	2.35	4.44%	$8,884
Homemaker Prospect, NSW	Nov-22	$78,900,000	Ashe Morgan	25,777	2.44	5.98%	$3,062

CBD OFFICE

"Rents at the prime end have been resilient with healthy face rent growth, albeit with heightened incentives. Whilst evidence is limited, values are gradually re-setting, reflecting the changing cost of capital and relativities to bond yields. The investment market is challenging with, in many cases, some distance between vendor and purchaser expectations. Purchasers are generally discounting uncertainty, fully accounting for downside risk in modelling. We are expecting a reduced level of transaction activity in the first half of 2023."

ANDREW DUGUID, MANAGING DIRECTOR

CURRENT STATE OF PLAY

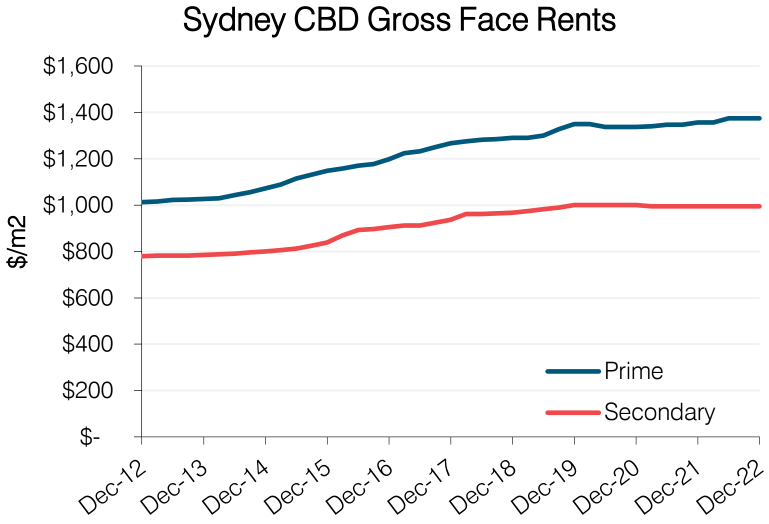
- According to the latest Property Council of Australia Office Market Report (OMR), the Sydney CBD Office market comprised 5,283,196 square metres of space as of January 2023.

- Over the twelve months to January 2023, the Sydney CBD vacancy rate increased from 9.3% to 11.3% as a result of net supply additions of circa 120,570 square metres. Whilst net absorption was positive during 2022 (3,702 square metres), it was well below the long-term average.

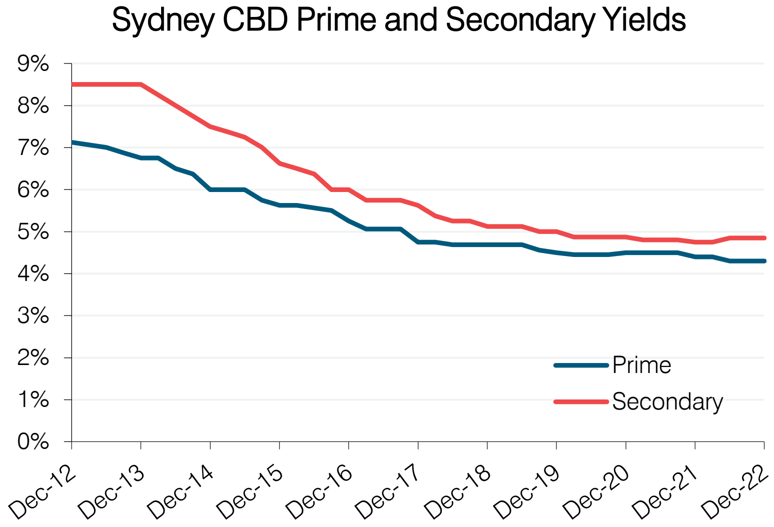
- Newer developed premium-grade assets are performing well, with a flight to quality occurring. During 2022, net absorption of premium-grade space was a strong 61,962 square metres, with all other grades of stock experiencing negative or negligent positive net absorption.

- According to the PCA, occupancy in the Sydney CBD remains below its pre-COVID-19 level at 59% in November 2022. However, while it has been an employees' market for the past three years and demand for workplace flexibility has increased, as this balance shifts, employers are more likely to encourage staff to engage in in-office activities.

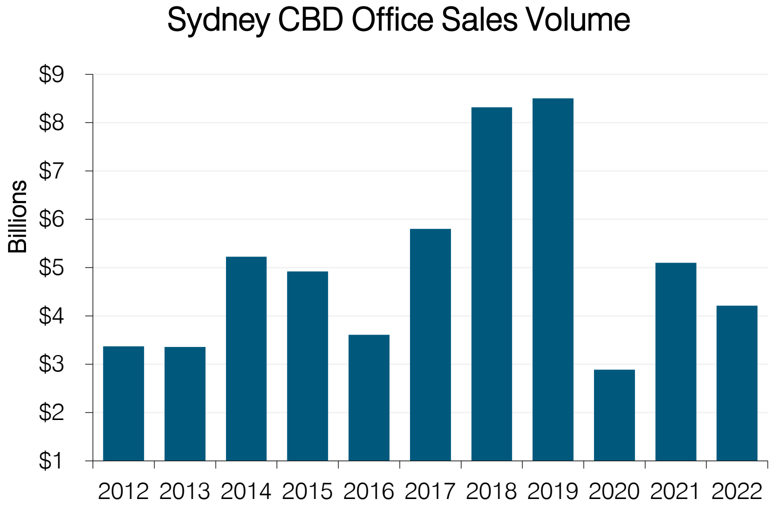
- Investor demand at previously compressed yields has reduced.



Source: M3 Property



Source: M3 Property



Source: Real Capital Analytics (RCA), M3 Property
Note: Sales over $5 million

RENTAL MARKET

- Prime gross face rents increased by circa 1.3% in 2022 to range between $1,000 and $1,750 per square metre during the December quarter.
- Secondary gross face rents were stable during the year, ranging between $840 and $1,150 per square metre.
- Prime and secondary gross incentives were stable during 2022, ranging between 30% and 37% for prime buildings and 29% and 37% for secondary buildings.

YIELDS

- Prime CBD yields ranged between 4.00% and 4.60% during the December 2022 quarter. Prime yields have been stable since the March quarter.
- Yields for secondary CBD office assets ranged between 4.40% and 5.30% during the December 2022 quarter. Secondary yields softened slightly in the June quarter and were stable during the second half of 2022.

INVESTMENT MARKET

- Transaction activity in the Sydney CBD market slowed considerably during 2020 before strengthening in 2021 to reach $5.01 billion of sales. An estimated $4.05 billion of properties transacted in 2022. Increased caution entered the market during the second half of the year, and this dampened investor demand.
- Offshore groups, particularly groups from the Asia Pacific region, have consistently been the most dominant purchaser group in the Sydney CBD office market over the past decade (based on total $ value of properties acquired).

OPPORTUNITIES AND CHALLENGES

- The Sydney Metro project will improve connectivity across Sydney. Occupier demand is likely to increase around new the Metro stations, which include Central Station, Pitt Street, Martin Place and Hunter Street.

- The high vacancy rate in the Sydney CBD market continues to make conditions favourable to occupiers. Occupiers are showing preference for high quality, newly constructed buildings, being critical of the level of amenity and end-of-trip facilities. Occupiers are also increasingly considering the building’s NABERS and WELL ratings.

- Office occupancy rates remain substantially lower than they were prior to the pandemic. In recognition of the changing work habits of employees (including more employees working from home), occupiers are seeking tenancies with numerous collaboration areas and breakout spaces as well as leases that allow for expansion and contraction of space during the lease term.

OUTLOOK

- Occupier demand has increased, and this will drive net absorption over the coming six months. The medium-term outlook for white-collar employment in Sydney is positive with BIS Oxford Economics forecasting an additional 88,000 persons to be employed in white collar employing industries in Sydney over the five years to June 2027.

- There is circa 250,000 square metres of supply under construction in the Sydney CBD market as well as a sizeable pipeline of mooted supply. The largest project expected to reach completion this year is the Parkline Place Pitt Street Metro Station development (circa 48,000 square metres). Completions over the first half of 2023 will be limited and we expect to see the vacancy rate decrease over this period.

- Gross face and effective rents are forecast to be largely stable over the first half of 2023. Rental growth is forecast to strengthen over coming years and with incentives forecast to trend downwards, effective rents are forecast to grow strongly over the 10-year horizon.

RESIDENTIAL

“Challenging market conditions continued in the second half of 2022 in the residential sector. Prices for residential dwellings continued to soften throughout the second half of 2022 however would appear to be stabilising. Higher funding and construction costs coupled with subdued levels of presales has resulted in new supply being constrained."

JARROD MORGAN, DIRECTOR

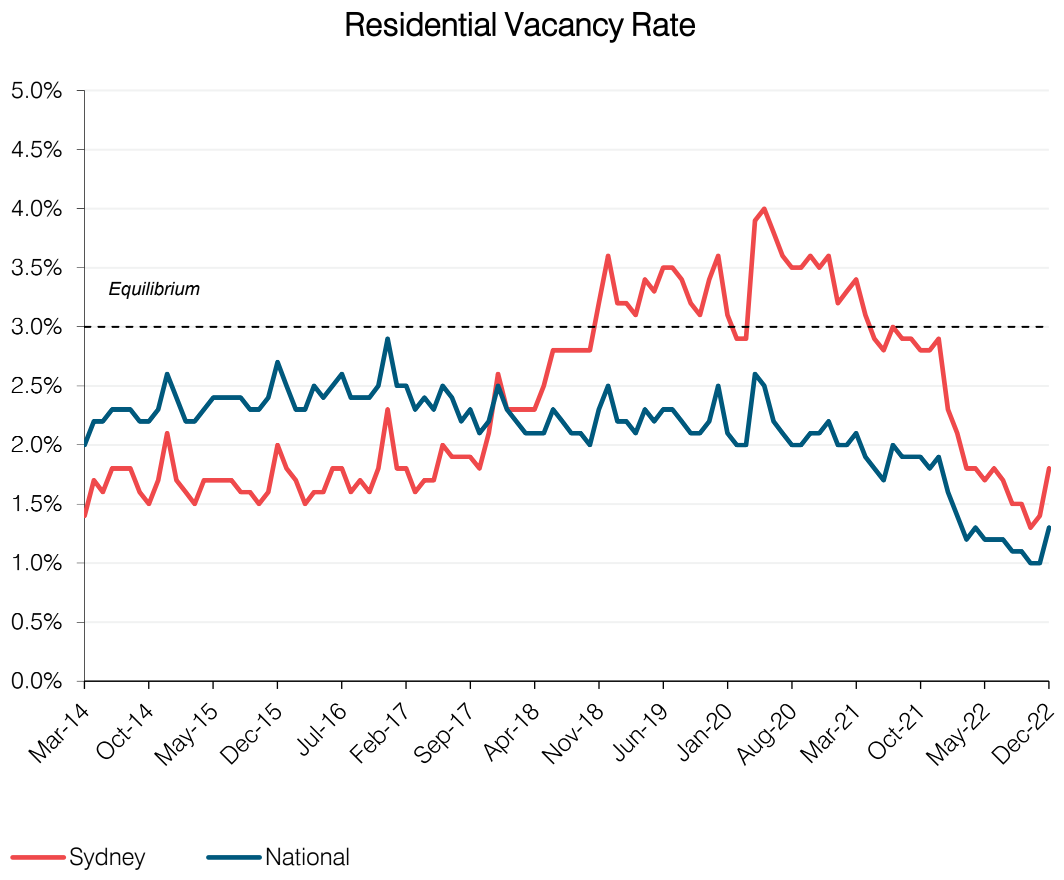
CURRENT STATE OF PLAY

- The dwelling price correction cycle is more advanced in Sydney than other capital cities. According to Domain, Sydney's median house price was $1,413,658 during the December 2022 quarter, decreasing 10.9% over the year. Unit prices decreased 6.5% during 2022 to be $748,422 during the December quarter.

- Vacancy across Sydney metropolitan residential market continues to be well below the benchmark equilibrium rate of 3.0%, indicating that the market is undersupplied. The tight vacancy rate is driving strong growth in rental rates.

- There were 53,293 dwellings approved in New South Wales during 2022, down 14.5% from 2021 approvals.

- The State Government has introduced the Shared Equity Home Buyer Helper, and First Home Buyer Choice, programs to improve the accessibility of home ownership in New South Wales. The Shared Equity Home Buyer Helper Program commenced on 23 January 2023, with 3,000 places available during the 2022-23 and 2023-24 financial years. The initiative is available for key worker first home buyers such as nurses, paramedics, police officers, teachers and early childhood educators, as well as single parents and individuals over 50 years. The program will see the government contributing up to 40% for a new home of 30% for existing home, with a deposit from eligible buyers of 2%. The First Home Buyer Choice came into effect in November 2022, with eligible first home buyers able to choose to forego upfront stamp duty and instead pay a smaller annual fee for properties purchased for up to $1.5 million.



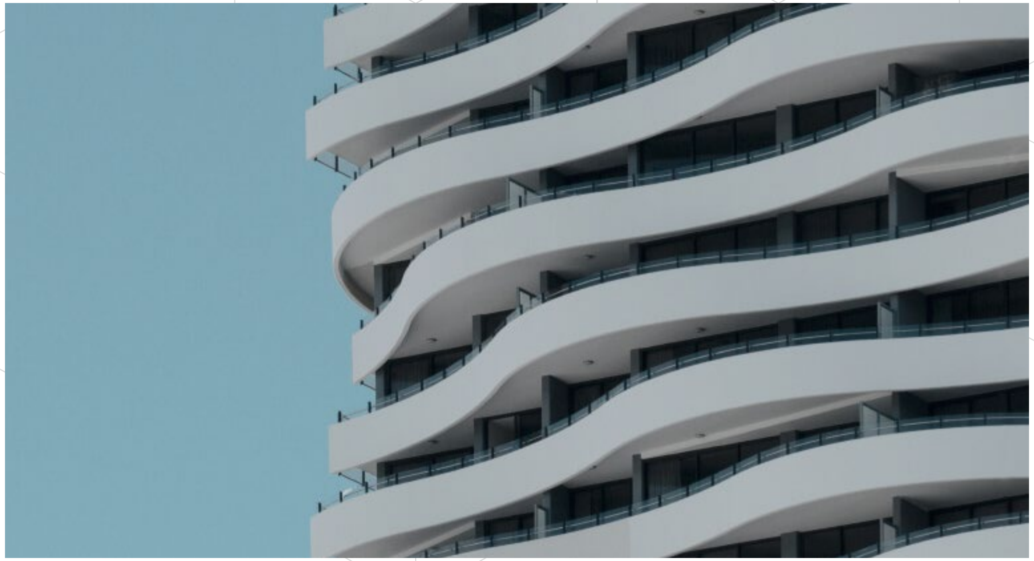
Source: M3 Property, SQM Vacancy

OPPORTUNITIES AND CHALLENGES

- Population growth has been subdued during the pandemic period. Growth is forecast to strengthen over the short-term with New South Wales expected to be a key beneficiary of growing overseas arrivals.

- Whilst tight vacancy rates across the city are expected to push rental rates up further (particularly in the context of rising demand from overseas arrivals), dwelling approvals are expected to face increased challenges in 2023 due to decreasing dwelling prices, construction cost blow-outs, and the prospect of lengthy project delays.

- Affordability constraints are expected to divert some buyer demand away from houses to the unit and townhouse market. We expect to see demand for owner-occupier, family suitable units and townhouses strengthen as a result. Furthermore, State Government initiatives such as the First Home Buyer Choice will likely stimulate stronger demand at the lower end of the market.



OUTLOOK

- The Sydney housing market remains extremely sensitive to interest rate rises and tighter lending conditions. BIS Oxford Economics are forecasting Sydney house prices to decline by 13.8% and unit prices to decline by 7.4% during the 2023 fiscal year.

- Median house rents are expected to increase strongly in 2023 as affordability constraints in the purchaser market and stronger population growth puts mounting pressure on the rental market. Unit rents are also expected to increase strongly, with demand from migrants and foreign students expected to strengthen.

CHILDCARE

“Throughout 2022 the childcare sector showed a high degree of resilience. We've seen a limited degree of yield softening in the face of increasing interest rates. Downward pressure on prices has been moderate. Investors have retained a good degree of confidence spurred on by continued government support for the sector."

JAMES RUBEN, DIRECTOR

CURRENT STATE OF PLAY

- The most recent data from the Department of Education showed 267,160 children in New South Wales used centre-based childcare services during the March quarter of 2022. The average number of hours spent at a centre-based childcare centre was 31.9 per child per week during the quarter.

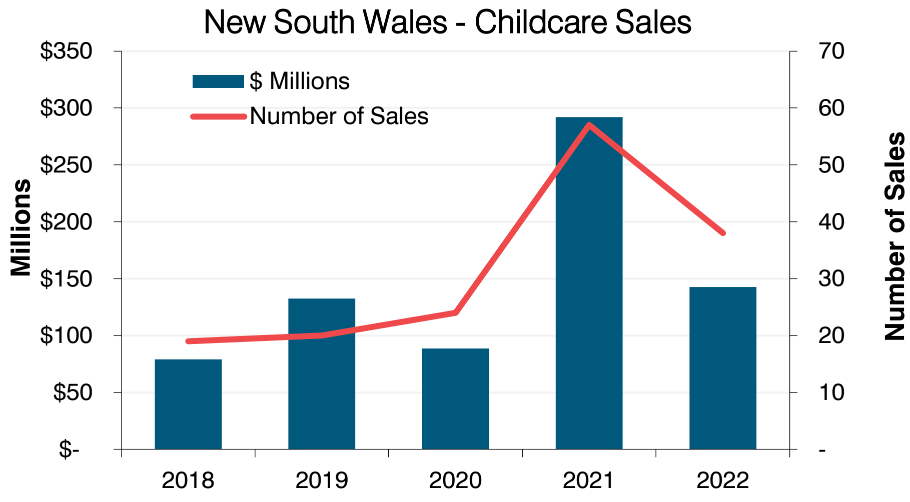
- There were an estimated 3,418 long day care centres, providing circa 196,595 childcare places in New South Wales as of February 2023 (Source: GapMaps).

- Ownership in the childcare market is becoming increasingly consolidated. During 2022, circa $143 million of childcare properties were transacted across New South Wales, decreasing from $292 million in 2021. Activity was tracking at 2021 levels until mid-year when demand started to soften due to the rising interest rate environment and increasing caution in the market.

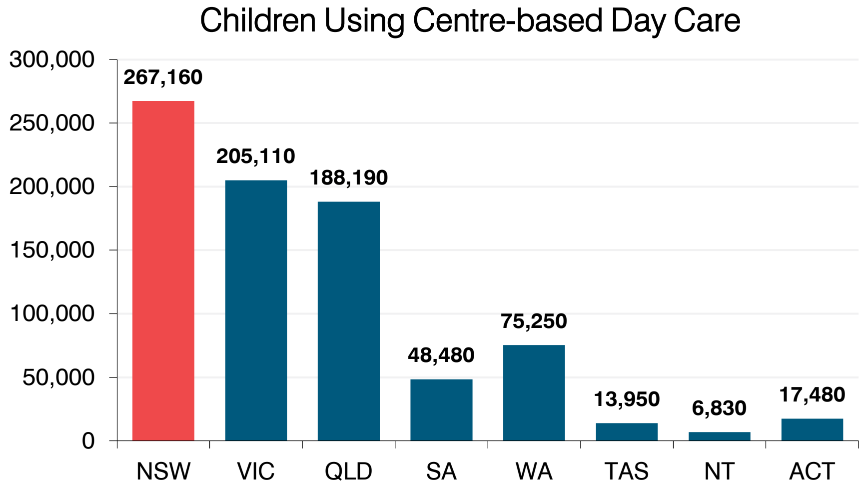
- Despite increased activity over recent years from offshore, listed and institutional groups, privates remained the largest buyer group in 2022, accounting for 80% of childcare sales (by $ value) across New South Wales.

- Yields for prime freehold interests are in the band of 4.50% to 5.50%.

- The State Government's $15.9 billion Early Years Commitment is a 10-year plan to transform early childhood education, child development and women's workforce participation in New South Wales. The package is forecast to improve the workforce participation gap between men and women by 14% by the end of the decade through making childcare more affordable and accessible. As part of the Commitment, $5 billion is being allocated to the Affordable Childcare Fund which will provide incentives to providers to enable them to extend their services to areas with supply shortages, improve the quality of existing services, and help attract and retain educators.



Source: Real Capital Analytics (RCA), M3 Property
Note: Sales over $1 million



Source: Australian Government Department of Education, M3 Property

OPPORTUNITIES AND CHALLENGES

- According to GapMaps, New South Wales's 0-5-year population is forecast to increase by an annualised 1.2% between 2022 and 2027. Combined with a forecast rise in labour force participation, demand for childcare services is expected to strengthen over the medium-term.

- There is a low level of childcare supply relative to potential demand in many locations across Greater Sydney. Areas with low supply to demand (typically more than five children per place – shown by the red and orange shading on the adjacent map) are generally suited to the development of further childcare places.

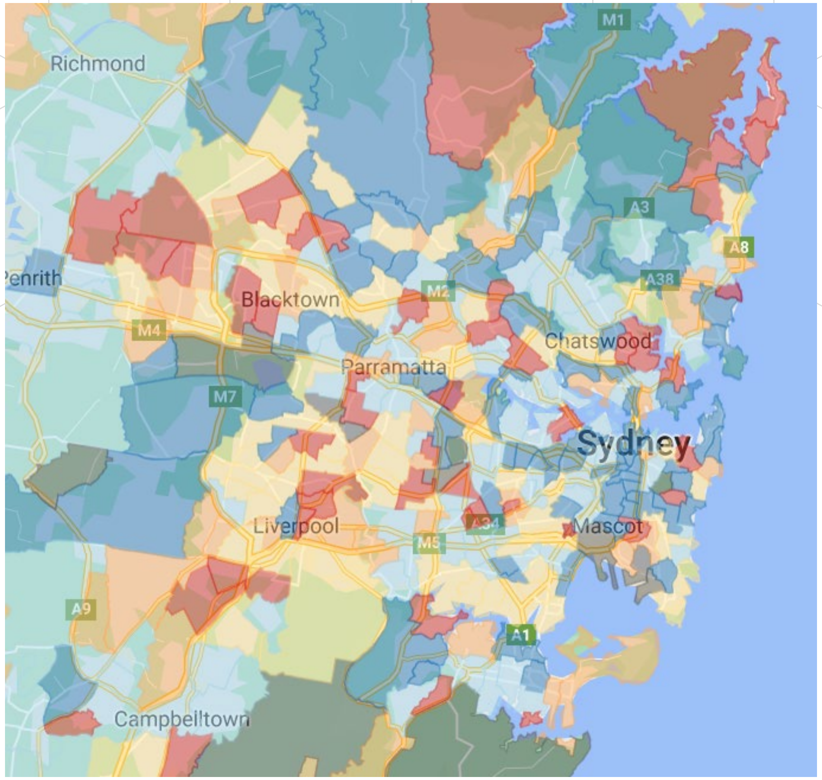
OUTLOOK

- Ownership of childcare centres is expected to become more consolidated as major institutional groups continue acquiring centres and portfolios of centres. We also expect to see further activity from private equity firms over the medium-term.

- We expect to see more existing centres undergoing refurbishments and upgrades going forward in order to compete for customers within the centre's catchment.

- The maximum subsidy amount will increase to 90% for one child and 95% for two children from 1 July 2023, making childcare more affordable. Furthermore, the household taxable income eligibility cap will increase to $530,000.

- Investment activity is expected to remain subdued, and yields are forecast to soften, during 2023.



Source: GapMaps

Supply and Demand
Childcare Ratio (0-5 yr Children / Places)

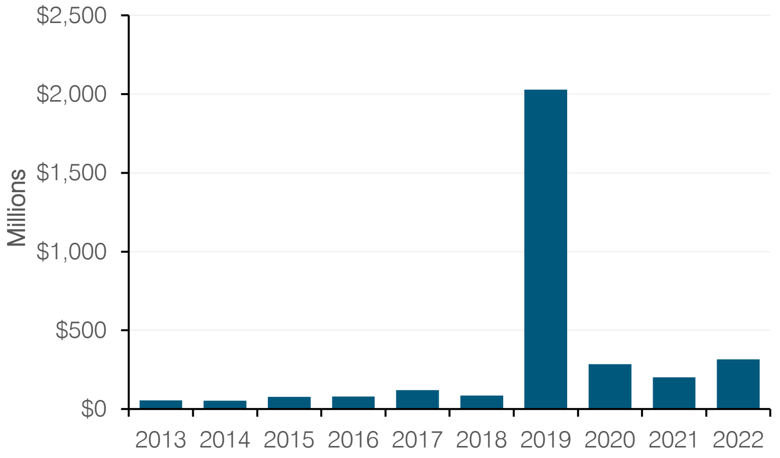
- > 6
- > 4
- > 3
- > 2
- > 0
- < 200 persons aged 0-5, no licensed places

MEDICAL INVESTMENT

“Whilst demand for prime healthcare assets remains unabated, the market has experienced reduced transaction activity as investor expectations are yet to re-balance. A softening of yields is to be expected, however a predominance of strong rental growth provides short- term defensiveness, especially assets providing CPI-backed reviews. As a continually expanding asset class, we foresee strong increases in operator and investor demand for long-play life sciences projects and partnerships alike."

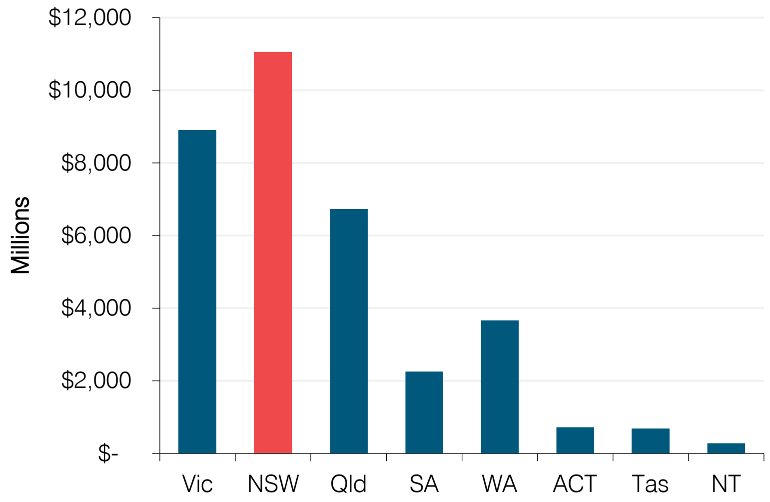
LAILA BURNET, DIRECTOR

NSW Medical Sales Volume



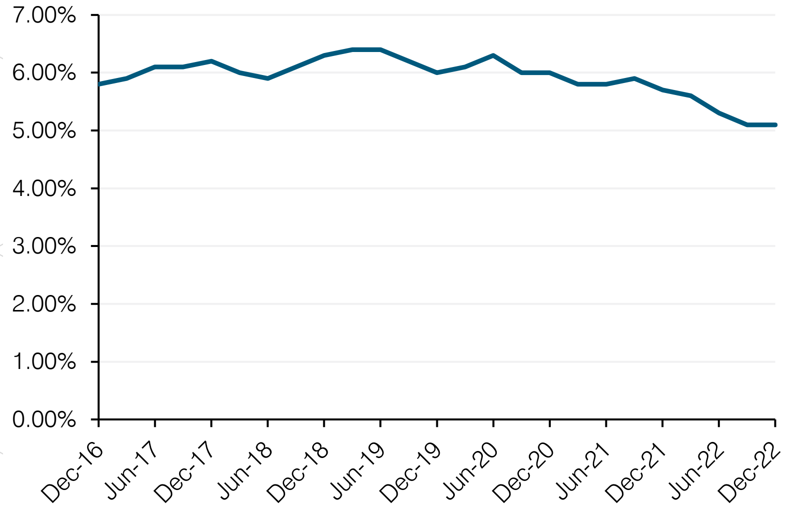
Source: Real Capital Analytics (RCA), M3 Property
Note: Sales over $1 million. Includes Medical and Hospital sales

Spending on Health



Source: GapMaps, M3 Property

Medical Property Yields



Source: Real Capital Analytics (RCA), M3 Property
Note: Sales over $1 million. Includes Medical sales only

INVESTMENT MARKET

- Medical investment activity in New South Wales reached a record high in 2019 with $2.03 billion worth of sales, boosted significantly by the Healthscope Hospital Portfolio sale.
- In 2022, sales tracked at higher levels than seen in 2020 and 2021 with $316.42 million of sales / 61 properties sold.
- Institutional investors, REITs, and private buyers have been the most active buyer groups over recent years.

TRANSACTIONS

- There were numerous healthcare portfolios offered to the market during 2022 with a significant variance in purchaser and vendor pricing expectations being a key driver in their withdrawal from the market.
- Transactions for several assets are expected to complete during the first half of 2023, which are anticipated to reflect a capitalisation rate softening for secondary healthcare assets with income risk associated with short WALE’s and below-average tenant covenant strengths.

YIELDS

- Yields have undergone a period of compression over recent years.
- Prime investment healthcare yields currently average between 4.50% and 5.00%.
- Yields for secondary assets are ranging between 5.50% and 6.50%.
- Yields are anticipated to soften during the first half of 2023.

OPPORTUNITIES AND CHALLENGES

- Rising interest rates has slowed investment activity in the healthcare market as expected. There is still strong demand from institutional grade investors, however, there is a lack of quality stock.
- Greater scrutiny is expected on healthcare providers by potential purchasers, particularly in secondary assets where there may be limited asset re-positioning opportunities, or it is capital intensive.
- Vendors looking to divest non-core assets are funds looking to pay off debt and fund their development pipeline.
- Life Science continues to emerge as a key sub-sector within the healthcare market as the appetite from institutional groups for these type of assets increases, specifically during 2022, with numerous transactions occurring in this sub-sector.

OUTLOOK

- The healthcare sector as an asset class will continue to grow to become a core asset class as it is supported by key market fundamentals, has significant investment growth opportunities and particularly as other core sectors face strong headwinds from rising inflation and the current interest rate environment.
- The sector will continue to benefit from strong investment interest as new and existing institutional capital is drawn to the asset class off the back of its key fundamentals; population growth, aging population demographics, government funding and private healthcare.
- It is expected that institutional investors will continue to work with healthcare providers and use their capital to expand and/or develop assets and establish broader healthcare precincts.

+61 2 8234 8100

L 39 / 25 Martin Place
Sydney NSW 2000

m3property.com.au
infonsw@m3property.com.au

M3

DISCLAIMER © M3 Property Australia Pty Ltd. Liability limited by a scheme approved under Professional Standards Legislation. This report is for information purposes only and has been derived, in part, from sources other than M3 Property and does not constitute advice. In passing on this information, M3 Property makes no representation that any information or assumption contained in this material is accurate or complete. To the extent that this material contains any statement as to the future, it is simply an estimate or opinion based on information available to M3 Property at that time and contains assumptions, which may be incorrect. M3 Property makes no representation that any such statements are, or will be, accurate. Any unauthorised use or redistribution of part, or all, of this report is prohibited.

M3
PROPERTY