M3 PROPERTY

NEW SOUTH WALES MARKET SNAPSHOT

OCTOBER 2023

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INDUSTRIAL

“Sale transaction volumes remain subdued, whilst yield repricing continues off the back of a rising interest rate environment and prevailing inflationary market conditions.

The full extent of yield softening is difficult to quantify at the current time and is somewhat case specific, however, appears to reflect a softening in the order of 50 to 75 basis points from the peak of the market in late 2021.

Strong leasing market conditions persist, being driven largely by a lack of and delay in supply, particularly within the Western Sydney Aerotropolis Precinct. Investors continue to favor assets with short term lease expiries, offering good reversionary potential."

JOEL DUCEY
DIRECTOR

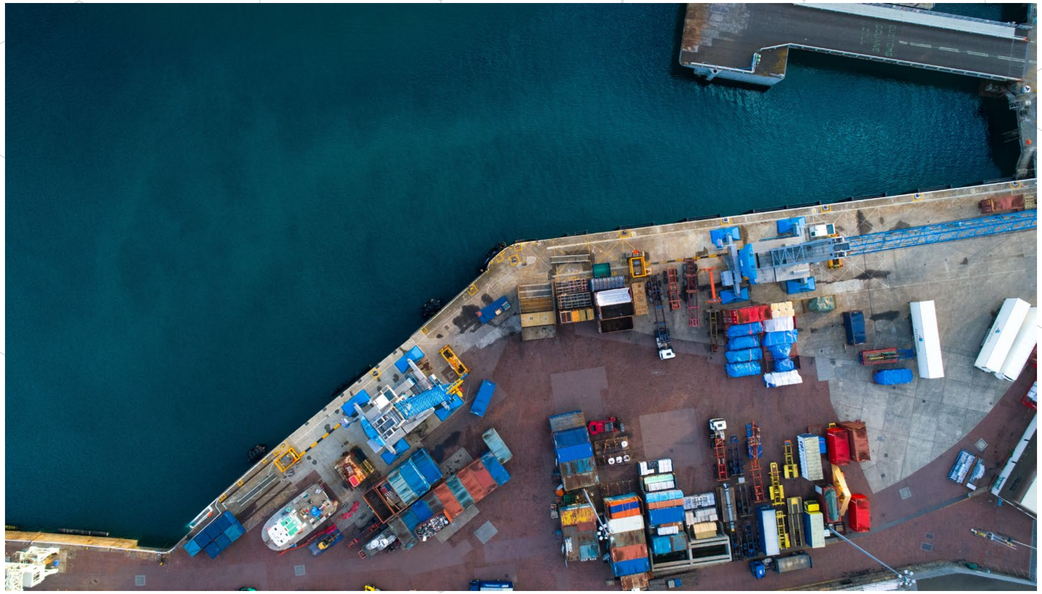
CURRENT STATE OF PLAY

- 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 rental growth over the preceding 24 months.

- 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.

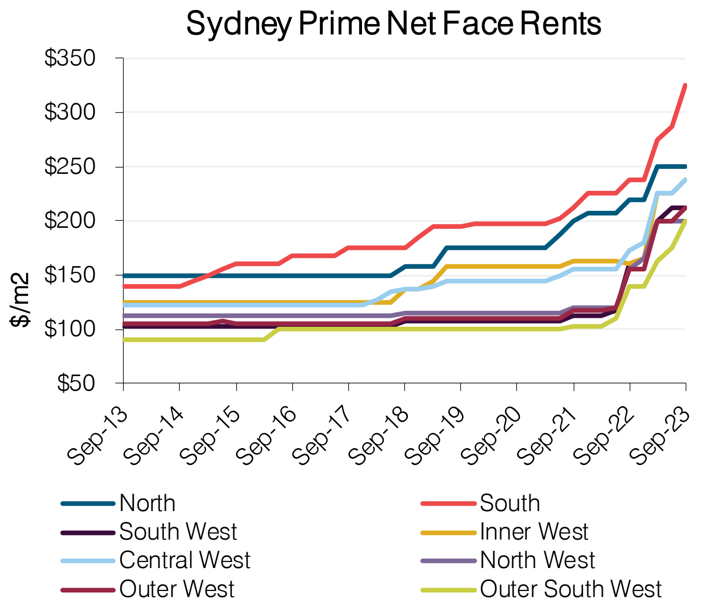
- Supply continues to be pre-commitment led; however, speculative development has increased. A substantial portion of building approvals over the year were for warehouses, reflecting continued demand for specific sub-sectors, including freight distribution services, temperature-controlled warehousing,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

- Over the past few years, competition with other land uses in the southern and inner submarkets has reduced available industrial stock in these precincts, which has led to the ongoing migration of activity into the western precincts and even further afield into the major regional centres. It has also led to the rising prominence of multi-level warehousing, particularly within the South Sydney sub-market.



RENTAL MARKET

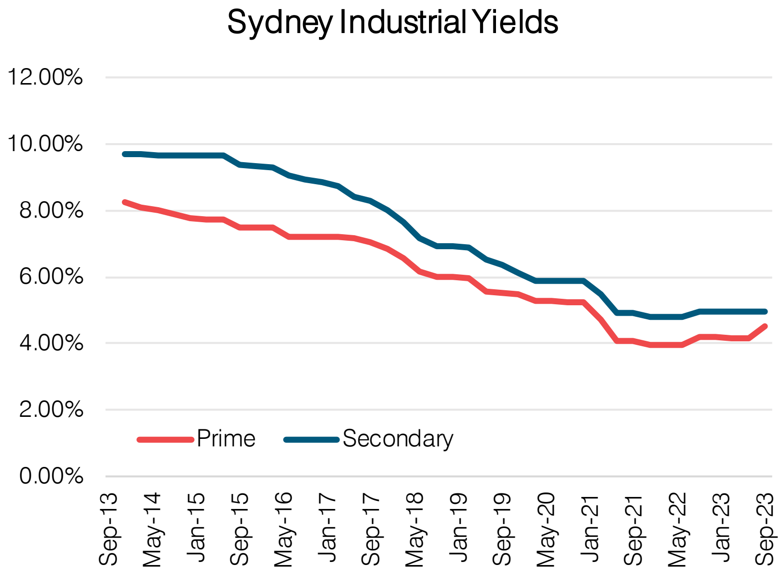
- Prime net face rents ranged between $175 and $350 per square metre during the September 2023 quarter, with secondary net face rents ranging between $110 and $220 per square metre. The strongest growth in the twelve months to 2023 occurred in the South West and North West Precincts.
- Average incentives have declined to range between 5% and 8.3% for prime buildings and 8% and 15% for secondary buildings.



Source: M3 Property

YIELDS

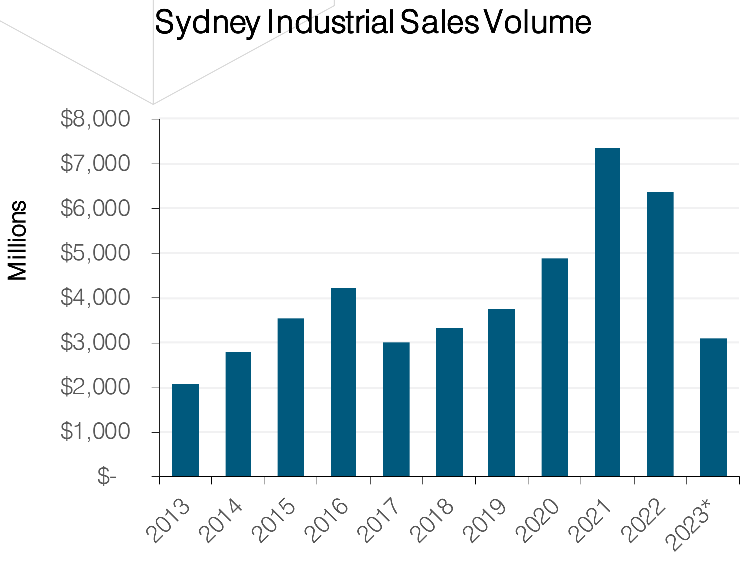
- Prime yields ranged from 4.00% to 5.00% as of the September 2023 quarter.
- Secondary yields ranged from 5.00% to 5.50% as of the September 2023 quarter.
- Yield repricing continues throughout 2023, following a long period of compression.



Source: M3 Property, RCA

INVESTMENT MARKET

- According to RCA, there have been 133 industrial sales over $5 million (totalling $3.1 billion) recorded across the Sydney market during the year to date. This compares with 266 sales recorded (totalling $6.4 billion) for the whole of 2022.
- 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 2023.



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

OPPORTUNITIES AND CHALLENGES

- There is an increasing shortage of developable industrial land in the inner Sydney submarkets, which is impacting the 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, including within the Western Sydney Aerotropolis Precinct.

- 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 due to high construction costs, increasing statutory holding costs, ongoing 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.

RETAIL

“There has been a low volume of retail transactions in New South Wales in 2023 to date, particularly for prime grade assets. Transactions that have occurred have provided guidance, as we begin to observe an upward trend in yields since the peak in early 2022.

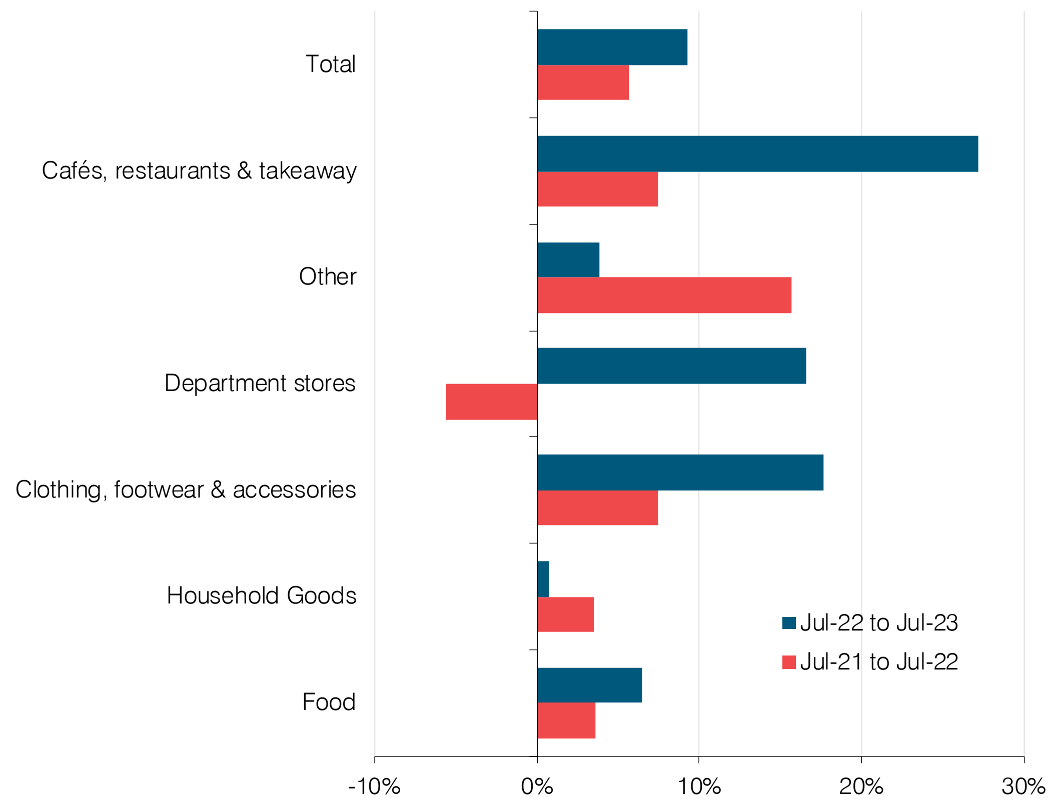
We are seeing moderate buyer interest, largely from local and off-shore private capital. Buyer activity for non-core secondary grade assets remains subdued, which is presenting higher-yielding opportunities.

It is expected that vendor and purchaser expectations will be more aligned once certainty returns to the market."

ANDREW CASH
ASSOCIATE DIRECTOR

CURRENT STATE OF PLAY

NSW MAT Growth by Retail Sector



Source: ABS, M3 Property

- Total retail spending in NSW for the 12 months ended July 2023 was 9.23%, up from 5.65% for the 12 months ended July 2022.
- The strongest growth by retail category was recorded in Cafes, restaurants and takeaway (27.18%), followed by Clothing, footwear & accessories (17.61%).
- 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. Alll 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.

OPPORTUNITIES AND CHALLENGES

- The current inflationary and macro-economic environment has presented a subdued level of sales activity, which has resulted in misaligned expectations between vendors and purchasers.
- Institutional owners have been offering non-core secondary grade assets to market to recycle their capital and rebalance their portfolios in the changing market.
- Non-core secondary-grade retail assets have been presented off-market, providing higher-yielding opportunities with short to long-term value-add propositions for active buyers.
- There are limited opportunities to acquire prime grade neighbourhood assets in NSW, with local and offshore investors at the forefront of these transactions.
- Development and/or value-add opportunities have become more capital intensive, off the back of rising construction costs and pressures in the labour market.

OUTLOOK

- We anticipate leasing demand to continue to improve in the Sydney CBD and metropolitan areas, contributing to further stability in rental levels in all retail sub-sectors.
- City centre visitation will continue to improve, with more white-collar workers adjusting to the return to office and increasing exposure to international tourists and students.
- The higher inflationary and interest rate environment will continue to impact the spending capability of consumers, and this is expected to contribute to weaker consumer spending on discretionary items over the medium-term.
- The demand for prime retail assets with a strong non-discretionary tenant profile and long-term WALE is likely to remain as a key focus for active buyers.
- It is likely we will witness some more misalignment in vendor and purchaser expectations across the sector until there is more stability and certainty in the market.

INVESTMENT MARKET

- Retail investment activity in New South Wales has slowed with $1.42 billion of properties transacting for the year to date. This compares with $3.6 billion for the whole of 2022.
- Private buyers were the most active buyer group during 2023, accounting for 78% of sales (by $ value). REITS were the next largest buyer group with 12% of sales.

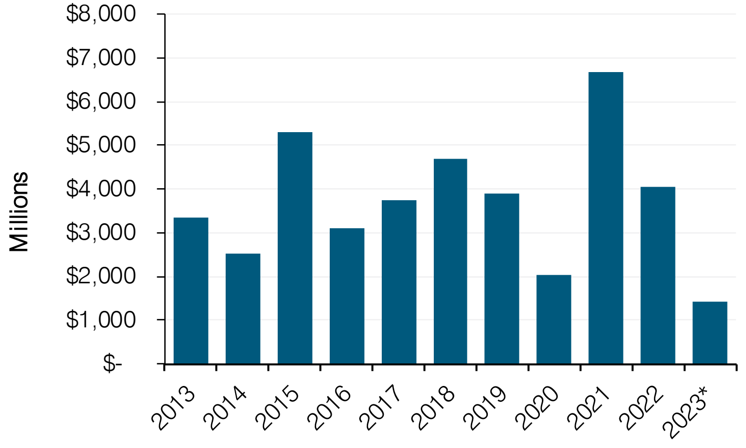
TRANSACTIONS

- There have been three transactions of more than $100 million in the year to date. The largest transaction was the sale of Stanhope Village in Blacktown for $158 million.
- Other transactions over $100 million were the sale of Menai Marketplace in Sutherland for $150 million and Deepwater Plaza on the Central Coast for $111 million.
- Transactions have reflected mixed results with some sales reflecting no yield softening and others indicating softening is occurring.

YIELDS

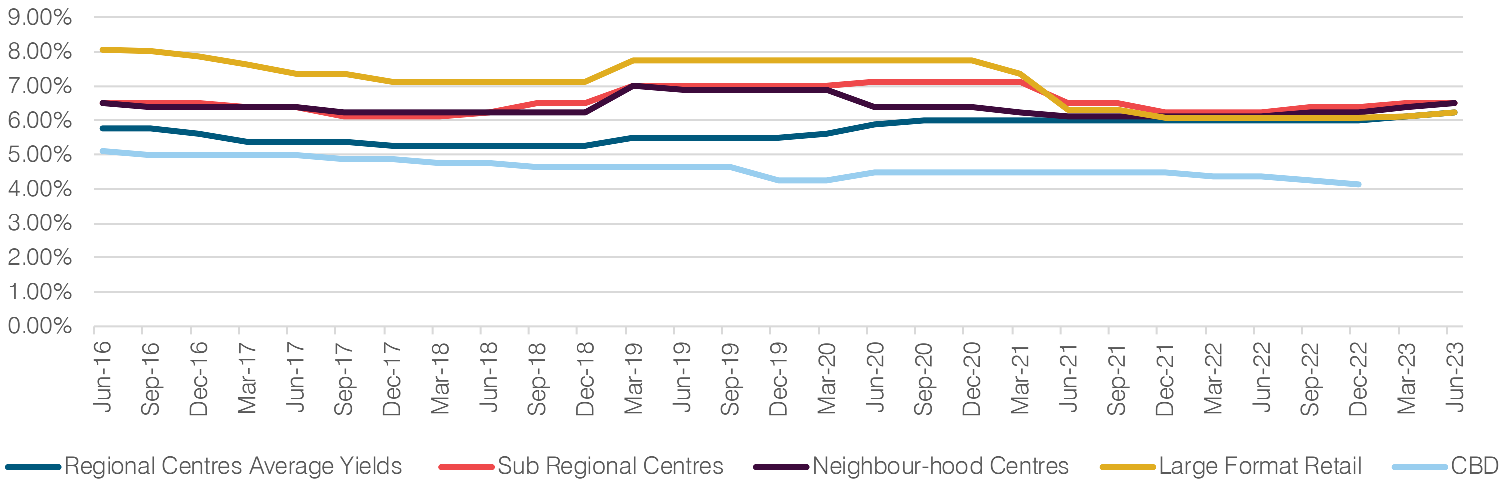
- Retail yields generally continue to look attractive relative to the alternative investment classes of office and industrial.
- Over 2022 and into 2023, transactions have been limited to below $300m. There has not been any recent evidence in New South Wales of transactions above that point.
- There 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.

New South Wales Retail Sales Volume



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

National Retail Yields



Source: M3 Property

CBD OFFICE

“There has been a thin volume of transactions in the Sydney CBD during 2023 to date. Those transactions that have been recorded have reflected material changes in value metrics from 2022. What's becoming apparent is an increasing spread in value metrics between prime and secondary, with the spread returning to historic norms.

Face rents have shown gradual improvements throughout 2023, supported by high incentives. Investors may return in larger numbers in 2024 as valuations adjust to market circumstances."

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 5,249,961 square metres of space as of July 2023.

- Over the twelve months to July 2023, the Sydney CBD vacancy rate increased from 10.1% to 11.5% as the addition of circa 544,000 square metres over the past four years has yet to be fully absorbed despite the withdrawal of circa 303,000 square metres over the same period.

- Net absorption was negative during the twelve months to July 2023 (-59,911sqm).

- Newer developed premium-grade assets are performing well, with a flight to quality occurring. During the twelve months to July 2023, net absorption of premium-grade and A-Grade space was a strong at a combined 30,873 square metres, with all other grades of stock experiencing negative net absorption.

- According to the PCA, occupancy in the Sydney CBD remains below its pre-COVID-19 level at 61% in February 2023. 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.

RENTAL MARKET

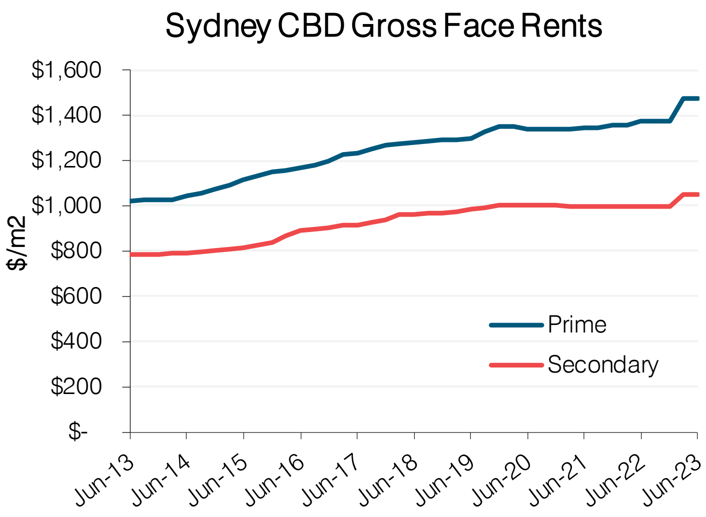
- Prime gross face rents increased by circa 7.27% in the twelve months to June 2023 to range between $1,100 and $1,850 per square metre.
- Secondary gross face rents increased by circa 5.5% during the year, ranging between $850 and $1,250 per square metre.
- Prime incentives increased by circa 2.9% in the twelve months to June 2023, ranging between 31% and 38%. Meanwhile, secondary incentives increased by circa 3.1%, ranging between 29% and 38%.

YIELDS

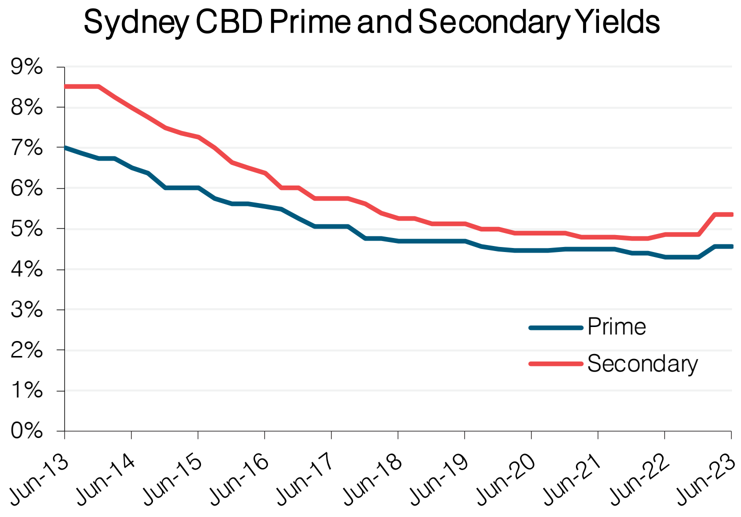
- Prime CBD yields ranged between 4.25% and 4.85% during the July 2023 quarter, softening slightly compared to the June 2022 quarter.
- Yields for secondary CBD office assets ranged between 4.90% and 5.80% during the July 2023 quarter. Secondary yields softened by 50bps compared to the June 2022 quarter.

INVESTMENT MARKET

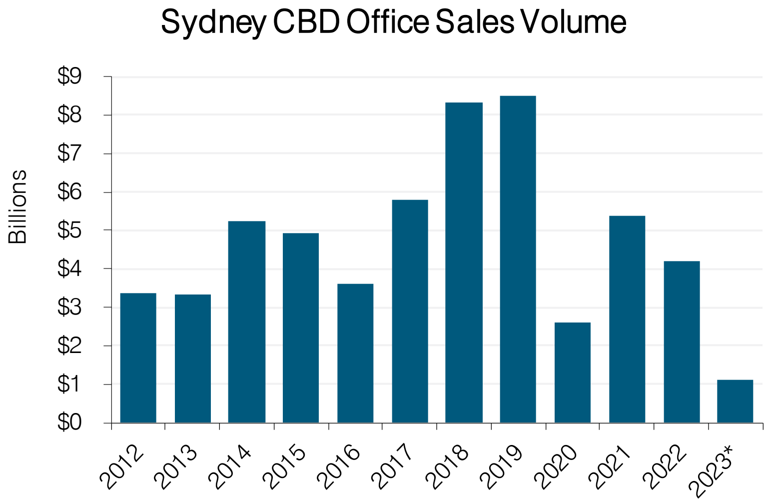
- Transaction activity in the Sydney CBD market has slowed considerably with an estimated $1.08 billion of properties transacting in the year to date for 2023. This compares with $4.21 billion for the whole of 2022. Increased caution entered the market during the second half of 2022, and this dampened 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).



Source: M3 Property



Source: M3 Property



Source: Real Capital Analytics (RCA), Cityscope, M3 Property

OPPORTUNITIES AND CHALLENGES

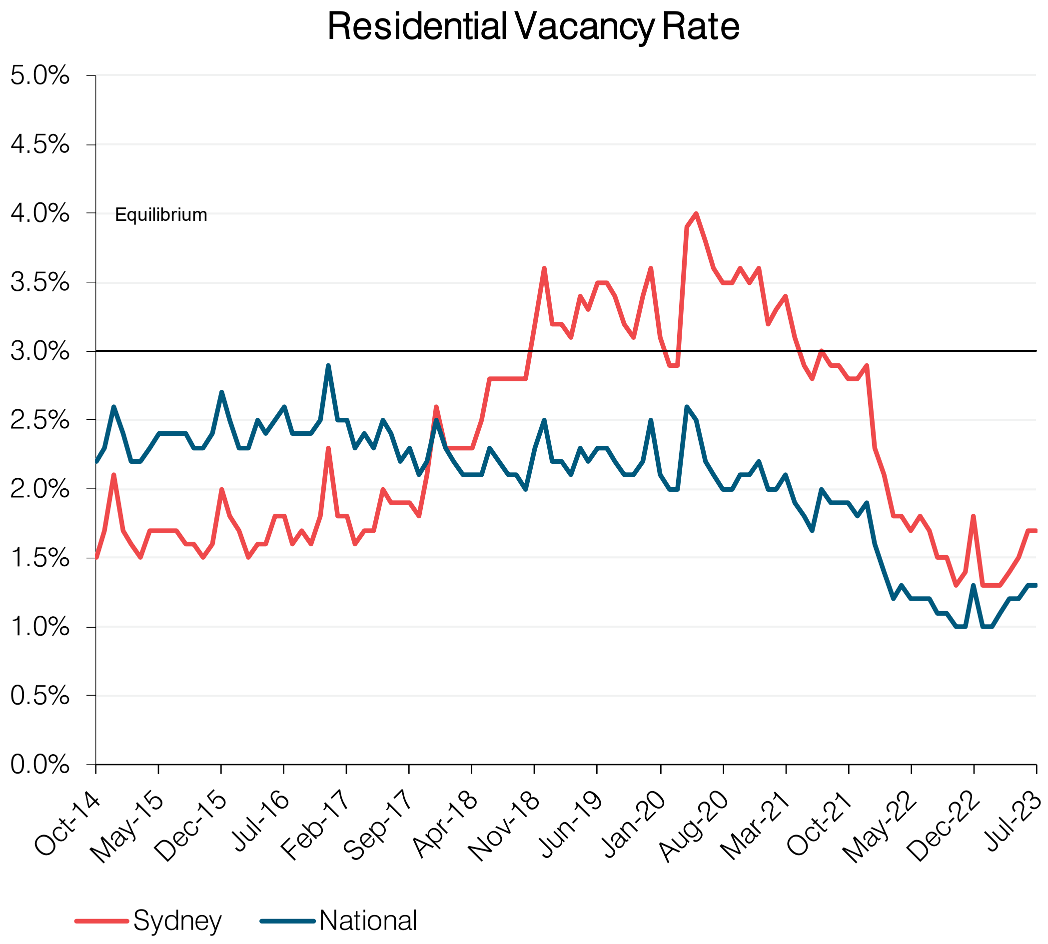
- The Sydney Metro project will improve connectivity across Sydney. Occupier demand is likely to increase around new the Metro stations, which include Central Station, Pitt Street, Martin Place and Hunter Street.
- The high vacancy rate in the Sydney CBD market continues to make conditions favourable to occupiers. Occupiers are showing preference for high quality, newly constructed buildings, being critical of the level of amenity. Occupiers are also increasingly considering the building's NABERS and WELL ratings.

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

RESIDENTIAL

CURRENT STATE OF PLAY



Source: M3 Property, SQM

- The Sydney property market has experienced eight consecutive months of growth as the market continues to recover from the most recent downturn. According to CoreLogic, Sydney's median house price was $1,381,045 at the start of October 2023, an annual increase of 8.1%. Unit prices increased 5.2% year on year to $828,919 by the start of October 2023.
- 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 50,893 dwellings approved in New South Wales in the twelve months to July 2023, down 4.61% year on year.
- 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.

“Market conditions in 2023 have stabilised, with price growth being witnessed in the residential sector.

The interest rate environment appears to have peaked, and construction costs have stabilised. We're now starting to see a better level of pre-sales being obtained."

JARROD MORGAN
DIRECTOR

OPPORTUNITIES AND CHALLENGES

- Population growth was 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.

- 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

- 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 have faced increased challenges in 2023 due to a fluctuation of dwelling prices, construction cost blow-outs, and the prospect of lengthy project delays. We expect prices to continue on an upward trajectory.

- 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.

SERVICE STATION

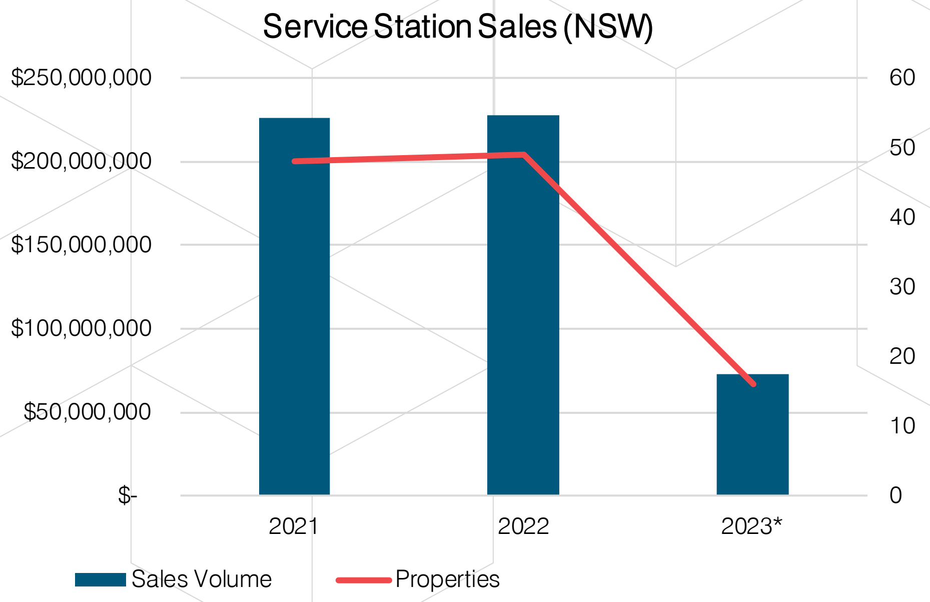
“Demand for fuel has largely recovered following COVID-19 lockdowns, and despite current elevated oil prices, margins for operators have seen a degree of improvement over the past 12 months. This has led to ongoing upward pressure on rents.

However, investors have become increasingly cautious following interest rate rises and the discussion of potential electric vehicle industry disruption. As a result, yields have softened over the first half of 2023, placing downward pressure on capital values."

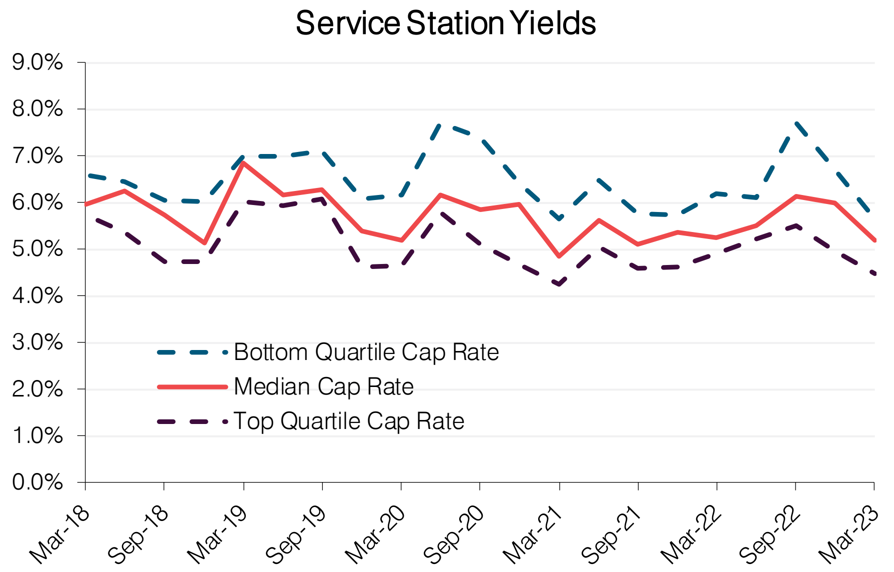
JAMES RUBEN
NATIONAL DIRECTOR

CURRENT STATE OF PLAY

- Activity has slowed in 2023 due to reduced investment demand. According to RCA, there have been just 16 transactions totalling $73m of service stations across NSW in the year to date. This compares with 49 transactions totalling $227.8m for the whole of 2022.
- Demand for highway service centres in strategic locations has been strong. These assets generally include a retail offering, with leases to high-quality national tenants.
- Institutional purchasers have had an increased presence over the past three years, typically through large-scale portfolio acquisitions. Whilst still actively buying, privates were **net** sellers of service stations between 2019 and 2023
- Ownership of service stations is expected to become more consolidated as major institutional groups continue acquiring individual properties and portfolios of service stations.
- An increase in demand arising from market consolidation by both the major and independent fuel networks has seen upward pressure placed on service station rental levels after a long downwards trend.
- Industry consolidation has been to the detriment of smaller independents and has significantly reduced their capacity to pay, effectively pricing them out of the upper end of the market and constraining prospects of rental growth for the lower end due to a reduced tenant pool.
- Service station yields have softened since the second quarter of 2022. Transaction activity has reduced over the past six months. Vendors are experiencing difficulty selling some assets due to reduced demand and a smaller buyer pool.



Source: M3 Property, RCA



Source: M3 Property, RCA

HEALTHCARE

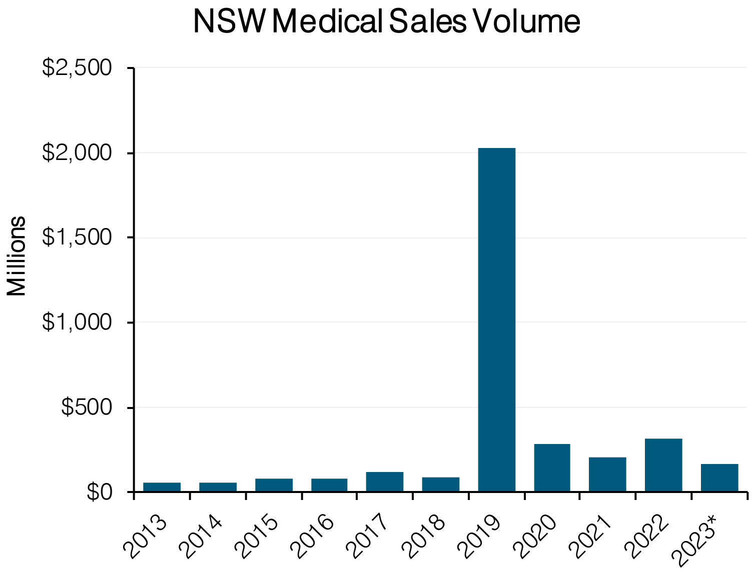
“The healthcare sector continues to see solid demand due to strong market fundamentals, including ongoing demand for healthcare services. Mental health has been a growth area, with significant investment into the sector to meet burgeoning demand.

In NSW there has been an increase in asset listings into the second half of 2023, with expectations of market-setting transactions to occur.

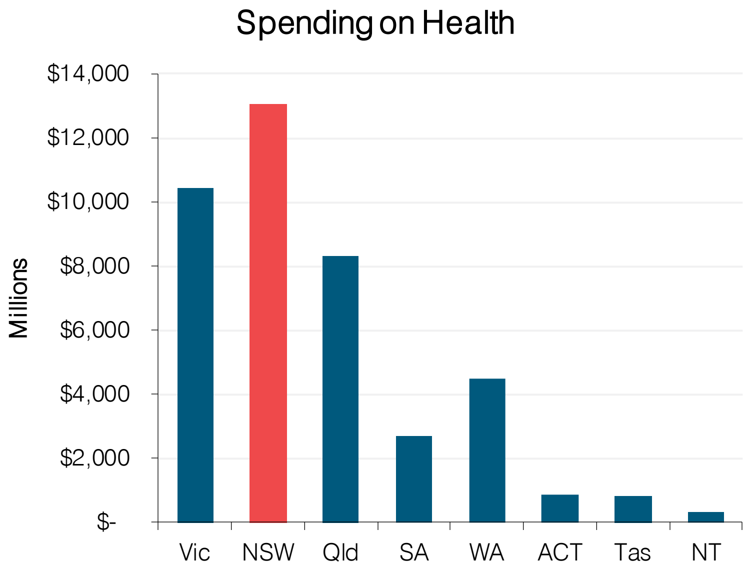
Investor expectations are yet to re-balance as a result of changing market conditions. However, brownfield development activity continues to provide future market opportunities.

We anticipate the sector will continue to see high levels of demand for prime assets that have strategic market positioning."

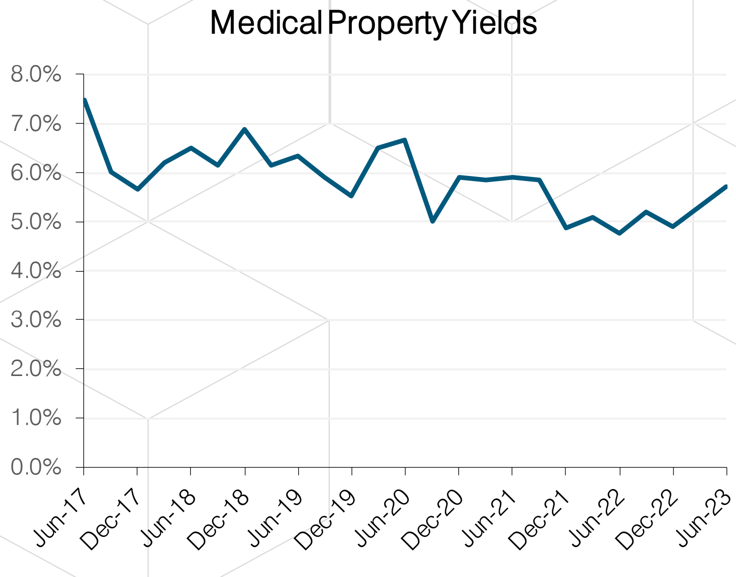
LAILA BURNET
NATIONAL DIRECTOR



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



Source: GapMaps, M3 Property



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

INVESTMENT MARKET

- There have been 41 medical and hospital properties with a total value of $163.8 million transacted across NSW in the year to date. This compares with 61 transactions at a total value of $316.4 million for the whole of 2022.

- 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 have been completed during the first half of 2023, which has reflected 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.

- Core 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 second 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.
- Mental health and well-being is becoming an emerging health issue, with 43.7% of people aged between 16 and 85 experiencing a form of mental disorder in their life and 21.4% of people experiencing a mental disorder for at least 12 months.
- Demand for medical services by a growing and ageing population is expected to continue increasing. Unhealthy lifestyles, obesity rates and increasing focus on wellbeing and mental health continue to drive demand for medical services and medical suites and centres.
- 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.
- Investment demand for high quality medical assets will remain strong over the medium-term, despite interest rate pressures coming into play. The healthcare market is still highly fragmented and there are significant opportunities for consolidation.

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