m3property Update

Qld Service Stations Market Update

May 2018

Key Points

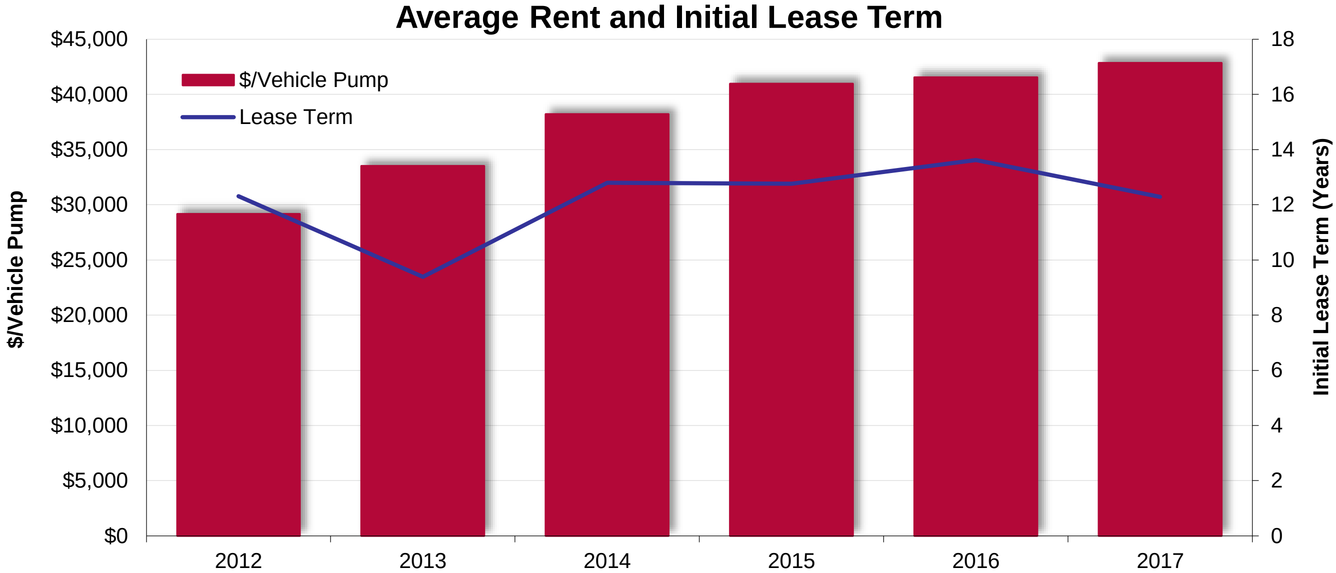
- Owners and fuel companies are vastly improving the retail and convenience offerings at service station sites.
- Queensland rents have shown substantial growth over the past five years. However, rental growth has started to slow.
- Yields have undergone significant compression over the past five years. This has been alongside strong investment demand, including demand from newly created service station REITs.
- Whilst there has been a growing movement towards electric vehicle ownership globally, in Australia, this movement is still in its early days.
- There is a considerable amount of new supply proposed for South East Queensland.

Rental Market

A key drawcard of service stations as an investment property are their long lease-terms and strong covenants. Leases also generally provide for fixed rental increases. During 2017, the median rent for service stations in Queensland was $42,190 per vehicle pump. There has been substantial rental growth during the past five years (46.9% between 2012 and 2017), with most of the growth occurring between 2012 and 2015. Whilst growth was still evident in 2016 and 2017, the rate of growth was less significant. Anecdotal evidence suggests this is partly because the major operators are currently resisting higher rental rates at market reviews and for new leases.

A decline in the average length of the initial lease term was evident during 2017. During 2017, the average lease term was 12.3 years, down from 13.6 years in 2016. The decline in the average lease term has been the result of two key factors. Firstly, International Financial Reporting Standards now require nearly all rental obligations to be listed as a liability on the tenant's balance sheet, with reference to an estimate of the lease term (including options when the lessee is reasonably certain to exercise the option to extend the lease), from 1 January 2019. The introduction of this requirement has resulted in tenants requesting shorter lease terms than traditionally seen in this industry. Secondly, there is a level of uncertainty surrounding the future market share of hybrid and electric vehicles in Australia. This uncertainty appears to be reducing some tenants' inclination to accept longer lease terms due to concerns pertaining to consumer demand for fossil-fuel powered vehicles over the long-term.

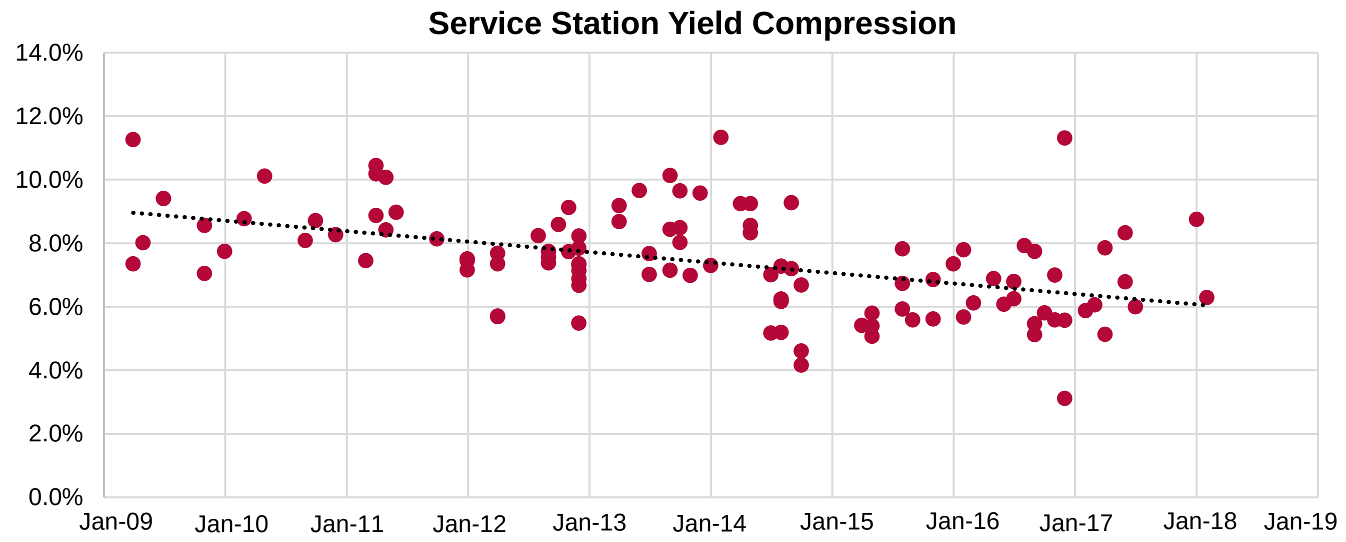
Average Rent and Initial Lease Term



Source: m3property

There has been a strong interest in service stations as an investment asset during the past five years. Similar to other investment classes, sales activity has been strong and yields have undergone significant compression during this period. Whilst previously, private investors were the core buyers of service stations; recently, demand has increased from self-managed superannuation funds, offshore buyers and REITs.

During 2017, equated market yields averaged 6.58% and sales rates averaged $2,097 per square metre of site area for service station sales in Queensland. Yields stabilised during 2017, as a result of numerous factors including the shortening of lease terms, long-term uncertainty regarding the viability of the sector and stronger investment demand for other asset classes, such as healthcare. The following chart shows average equated market yields and the yield trend for service station investments across Queensland.



Source: **m3**property

Sale Analysis
Valued by m3property (Qld)

United Petroleum, 1786 Sandgate Road, Virginia, Brisbane, Qld

The property is located within the established suburb of Virginia, approximately 11 kilometres north of the Brisbane CBD and 1.8 kilometres north of Virginia Railway Station.

The property is improved with a United Petroleum branded service station with a 387 square metre convenience shop. There is a ten lane petrol forecourt containing five pump islands, each with multi-fuel dispensers. Ancillary improvements include air and water points, electronic pylon signage, on-site car parking, loading bay, concrete sealed driveways and basic landscaping.

The property was sold prior to auction and purchased by a local private investor. The property is currently leased to United Petroleum. The lease was structured on a net basis whereby all outgoings are recoverable from the Lessee, including Land Tax. The lease includes annual fixed rent increases of 3.5%.

Sale Price	$6,000,000	**Sale Date**	July 2017
Vendor	Private	**Purchaser**	Private
Site Area	2,714m²	**Net Passing Income**	$360,000 p.a.
Remaining Lease Term	20.0 years	**$/m² Site Area**	$2,211
Initial Yield	6.00%	**Equated Market Yield**	6.00%

There are two major REITs which operate in the service station market, being Viva Energy REIT and Convenience Retail REIT. The key portfolio metrics of these REITs are shown below. Both Viva Energy REIT and Convenience Retail REIT have highlighted in their most recent investor presentations the importance of convenience retailing and amenities at service station sites over the long-term. Service stations are increasingly being positioned to offer services (such as postal, click-and-collect and laundry) and dining options. Owners are taking these measures to ensure the relevance of service stations over the long-term as growth in the uptake of electric vehicles strengthens.

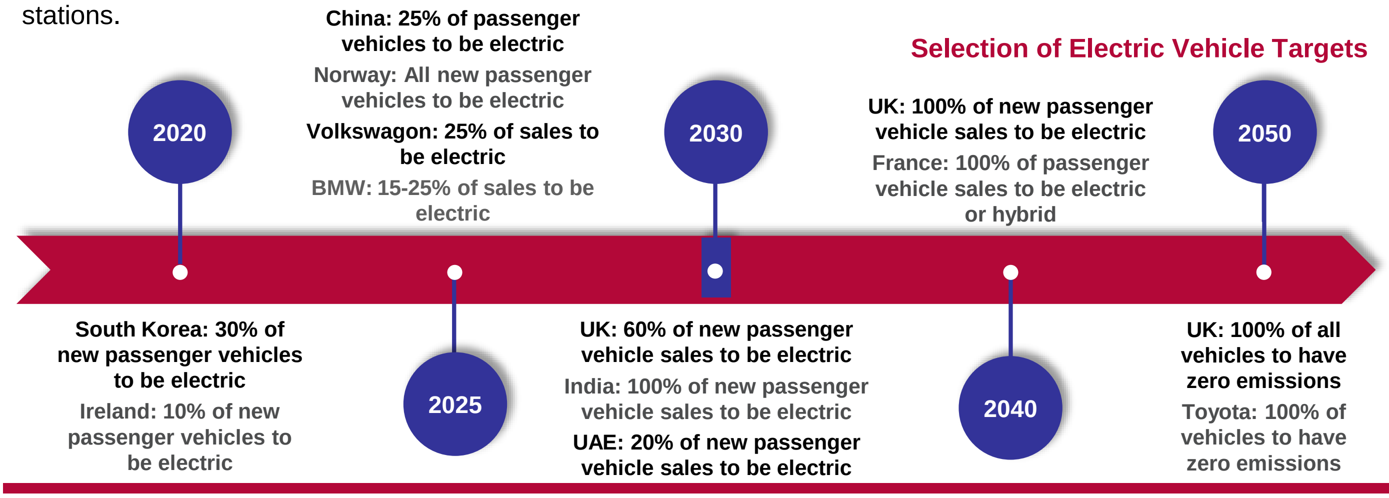
Convenience Retail REIT (as at 31 March 2018)	
Number of Properties	69 (circa-75% in Qld)
Total Value	$334.8 million
WALE by Income	12.8 years
Weighted Avg. Capitalisation Rate	7.1%
Major Tenant/s	Puma, Woolworths, 7-Eleven

Viva Energy REIT (as at 31 December 2017)	
Number of Properties	438 (circa-20% in Qld)
Total Value	$2.28 billion
WALE by Income	13.7 years
Weighted Avg. Capitalisation Rate	5.8%
Major Tenant/s	Viva Energy

Electric Vehicles and Industry Disruption

Australia is behind most developed nations in the uptake of electric vehicles. Countries including Britain, France, China and India have all introduced regulations and strategies to increase the proportion of electric vehicles on the road. In Australia, the key factors preventing consumers from purchasing these vehicles at present appear to be the upfront cost and concerns over charging infrastructure. According to the Electric Vehicle Council, electric vehicles typically carry a cost premium of $8,000 to $12,000 over petrol vehicles. However, the sale of electric vehicles is expected to grow substantially over the medium- to long-term as a result of increased government and industry-body investment and regulation as well as a decline in the cost of production of these vehicles. According to Bloomberg New Energy Finance, the upfront cost of electric vehicles is expected to fall to a point in which it is equivalent to the cost of traditional fossil fuelled vehicles in five to six years. This is likely to result in a rapid uptake of these vehicles.

In terms of Government policies, earlier this year, the Greens party announced a policy to ban the sale of new petrol and diesel cars by 2030 and to make the price of electric cars more affordable. The proposed policy has five core elements, being: to set emissions standards for new cars to be in-line with American and European regulations; set mandatory targets for electric vehicles; eliminate tariffs, stamp duty and GST on new electric car sales (as well as three years of free registration); increase the luxury car tax; and increase funding for charging stations. The State Government of Queensland has announced its intention to invest in electric vehicle technology. The Queensland Government currently offers electric vehicle owners a discount on vehicle stamp duty and annual registration fees. It has also installed electric vehicle charging stations at 17 locations in Queensland that allow for travel between the Gold Coast and Cairns and Brisbane and Toowoomba using an electric vehicle, with charging being free in the initial phase. Other industry bodies such as NRMA have also announced their intention to establish networks of charging stations.



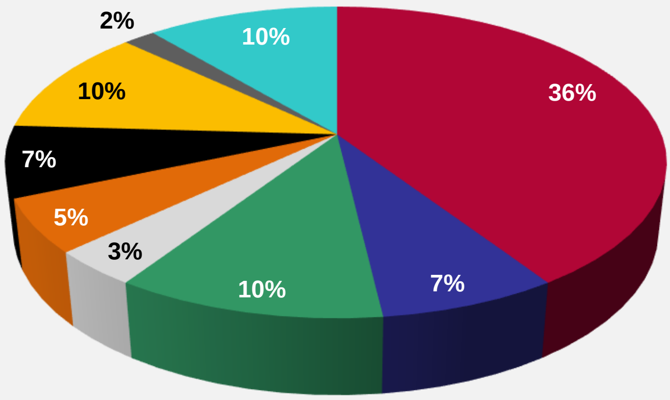
Focus Point: New Supply in South East Queensland

There has been a large number of new service stations proposed to be developed across South East Queensland (SEQ) during recent years. This has been a function of developers looking to capitalise on strong investment demand for end product – i.e. developers know they can lease and sell modern service stations. By location, areas experiencing strong population growth, such as the Moreton Bay Region and northern parts of the Gold Coast, are seeing an influx of new service stations being developed. By occupier, 7-Eleven has been the most active occupier in the market during 2017 and into 2018.

7-Eleven has been expanding rapidly in the fuel retailing market. An estimated 36% of new service stations completed in 2017 and 2018 to date, as well as those under construction, are occupied by 7-Eleven. According to IBISWorld, the group experienced growth of 13.9% in revenue generated from service station sales during the 2017 financial year. Following 7-Eleven, the next most active operators in the market at present are Caltex, Coles Express and United (each accounting for an estimated 10% of new supply completed and under construction). 7-Eleven also accounts for the largest proportion of new stores proposed for development across SEQ.

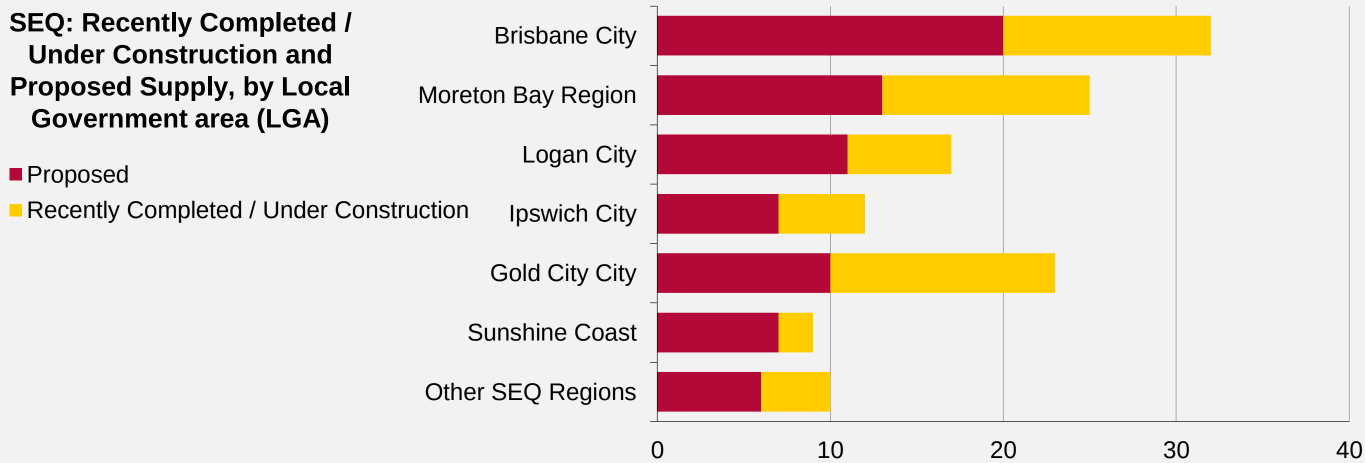
In terms of existing service station sites, BP and Caltex have been actively redeveloping and improving their existing stores across SEQ. Caltex has been rolling out its 'The Foodary' stores at a number of sites.

SEQ: Recently Completed / Under Construction Supply, by Operator



There are an estimated 55 new service stations completed, or currently under construction (and scheduled for completion this year), across SEQ since the start of 2017. The Brisbane City, Moreton Bay Region and Gold Coast City LGAs have seen the largest proportions of new supply developed. In emerging locations that are seeing strong population growth (such as the Moreton Bay Region), new service station supply is increasingly being incorporated as part of multi-use developments that include retail, medical centres, self storage or child care centres. The Brisbane City, Moreton Bay Region, Gold Coast City and Logan City LGAs account for the largest amounts of new supply proposed for development (but not yet under construction). We estimate there to be circa-75 new service stations proposed for development (but not yet under construction) across SEQ.

SEQ: Recently Completed / Under Construction and Proposed Supply, by Local Government area (LGA)



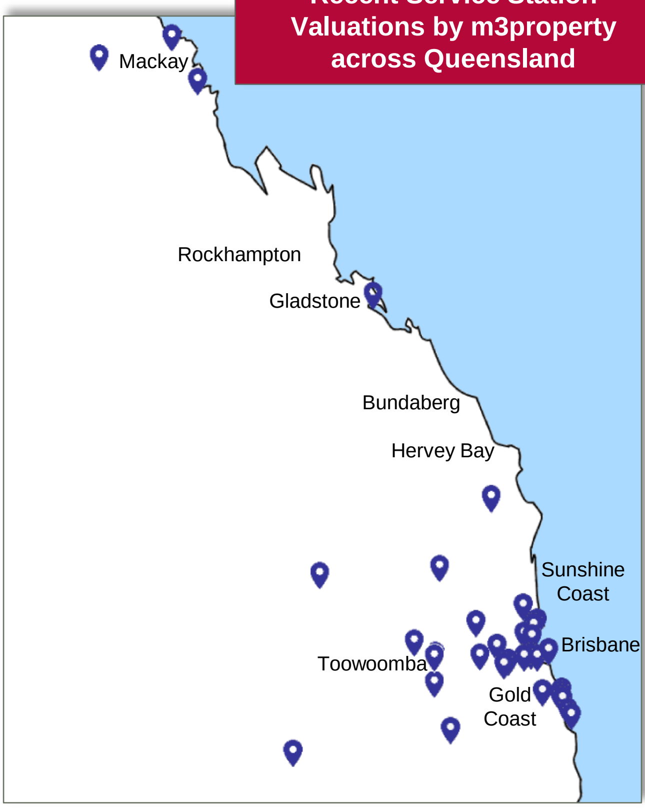
Source: Various, including Cordell Connect and IBISWorld

Industry Outlook

According to IBISWorld, fuel retailers will carry a medium to high risk during the 2019 financial year. The primary negative factors are the world price of oil and strong competition. The industry is reported to have limited scope for growth in consumer demand for fuel. Congestion and the cost of fuel are likely to increasingly encourage consumers to choose fuel-saving transport alternatives such as hybrid or electric cars as well as use public transport. Whilst electric vehicles only currently account for a small proportion of passenger vehicle sales, due to numerous factors, we expect that growth will accelerate substantially over the coming decade. The repurposing of some existing service station sites to cater for growth in electric car ownership will be required over the medium- to long-term.

Looking specifically at SEQ, improvements in public transport infrastructure are expected to increasingly encourage consumers to use public transport over driving. The Cross River Rail (early works), Brisbane Metro (fully funded) and the North Coast Connect Fast Rail Project (early investigation), as well as the completed Redcliffe Rail Corridor, all have the potential to reduce consumer reliance on private vehicles in South East Queensland over the medium- to long-term.

We have some concern for the amount of new supply that is proposed to be developed across SEQ. However, a good deal of the supply is positioned in areas forecast to experience strong population growth over the medium- to long-term. Furthermore, service station developers are more frequently incorporating retail and convenience offerings at sites in order to attract increased patronage, and we expect this to continue.



Recent Service Station Valuations by m3property across Queensland

In the rental market, average initial lease terms are expected to continue to trend downwards due to the introduction of the new International Financial Reporting Standards on leases (which come into effect on 1 January 2019). Rents are expected to be relatively stable during the remainder of 2018.

In the investment market, the major REITs are expected to remain active in the service station sector during 2018. Whilst growth in hybrid and electric vehicles poses a threat for service stations over the long-term, the major players are already adapting their sites to focus on the convenience offering that service stations can provide. We expect this trend will continue. We also expect there to be growth in the number of service station sites that are developed with electric vehicle charging stations.

A potential risk for investors is the possibility of future road upgrades which impact on traffic flow past service station sites. In areas experiencing strong population growth, it is reasonable to expect that road upgrades will form part of the medium- to long-term plans for the area. This potentially presents a risk for service station investments in some locations.

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