M3 PROPERTY

SPECIALIST
INDEPENDENT
VALUATION

VICTORIAN MARKET SNAPSHOT H1 2024

AUGUST 2024

CONTENTS

CHILDCARE

HEALTHCARE

INDUSTRIAL

OFFICE

RESIDENTIAL DEVELOPMENT

RETAIL

SERVICE STATIONS

M3

VICTORIAN MARKET SNAPSHOT H1 2024

Investor sentiment in Victoria continues to be challenged by increasing State property taxes, particularly with the introduction of the Commercial and Industrial Property Tax, a relatively slower recovery of the CBD market and lagging State economic growth. During H1 2024, some sub-markets were subdued, with low levels of transactional activity whilst other sub-markets have seen a higher level of transactions. We expect to see more broad market improvement in 2025 as interest rates stabilise and greater confidence returns.

In our latest Victorian Market Snapshot – H1 2024, representatives from our valuation sectors share their insights into the year to date as well as opportunities and challenges for the year ahead.

CHILDCARE

M3

HARRY DEHNE
Senior Valuer | Specialised Assets

"The Victorian childcare market has performed well over the first half of 2024, with a number of strong sales throughout metropolitan Melbourne. Investor interest has predominantly stemmed from private investors, with a trend towards funds / AREITs selling down their childcare assets and private investors looking to add quality assets to their portfolios.

There is a flight to quality, with secondary assets achieving less interest and softer yields.

We are seeing a reduction in new supply coming to the market due to the high-inflationary environment over the previous three years. Combined with the national Child Care Subsidy (CCS) rolled out on 1 July 2023, this has resulted in strong rental growth across both metropolitan and regional markets.

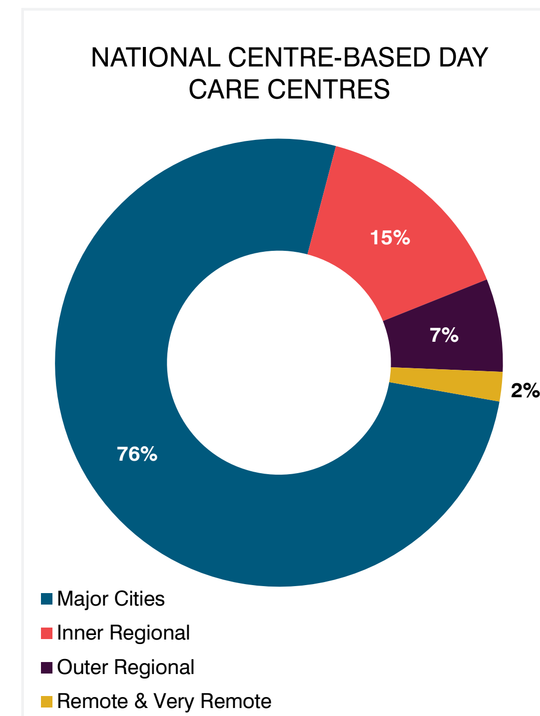
We anticipate new supply to remain low, market rental growth to continue, and a similar level of investment activity over the back end of 2024."

“WE ANTICIPATE NEW SUPPLY TO REMAIN LOW, MARKET RENTAL GROWTH TO CONTINUE, AND A SIMILAR LEVEL OF INVESTMENT ACTIVITY OVER THE BACK END OF 2024.”

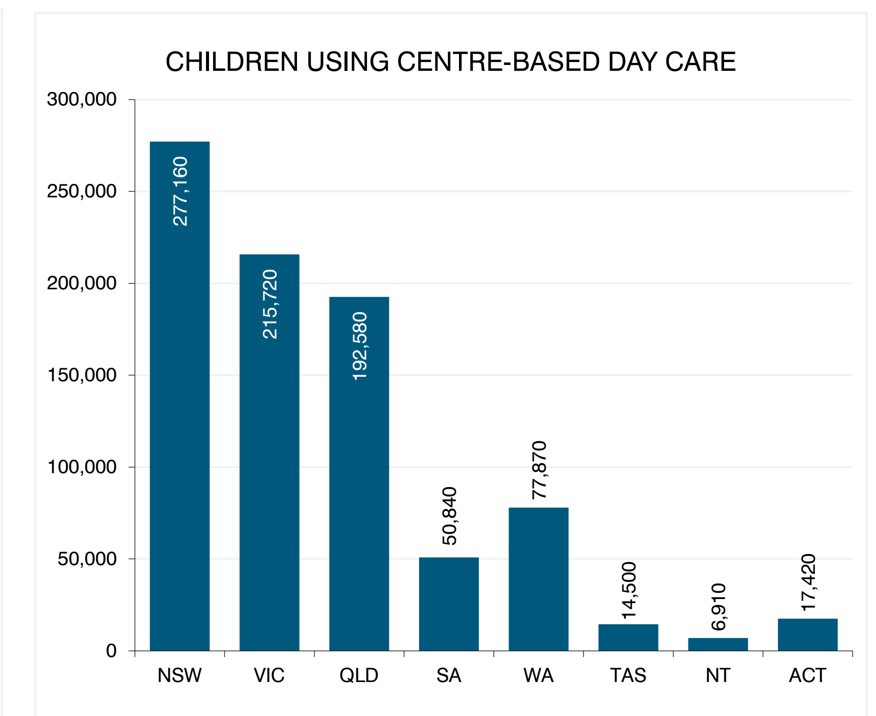
- HARRY DEHNE

CURRENT STATE OF PLAY

- The Childcare Inquiry Report by ACCC released in January 2024 highlights the strong growth of Childcare fees across all services since the introduction of CCS. The ACCC recommends a new approach by the Federal government rather than the current “one size fit all” regulations in order to deliver the desired objective for both communities and governments.
- Since 1 July 2023, families earning up to $530,000 have been eligible to receive the Childcare Subsidy, with the maximum subsidy increasing to 90% for families earning up to $80,000. The subsidy will decline by 1% for each additional $5,000 in income the family earns. Under the new subsidy, families with more than one child in childcare can also receive a higher subsidy for the additional children if their family income is less than $356,756 per annum.



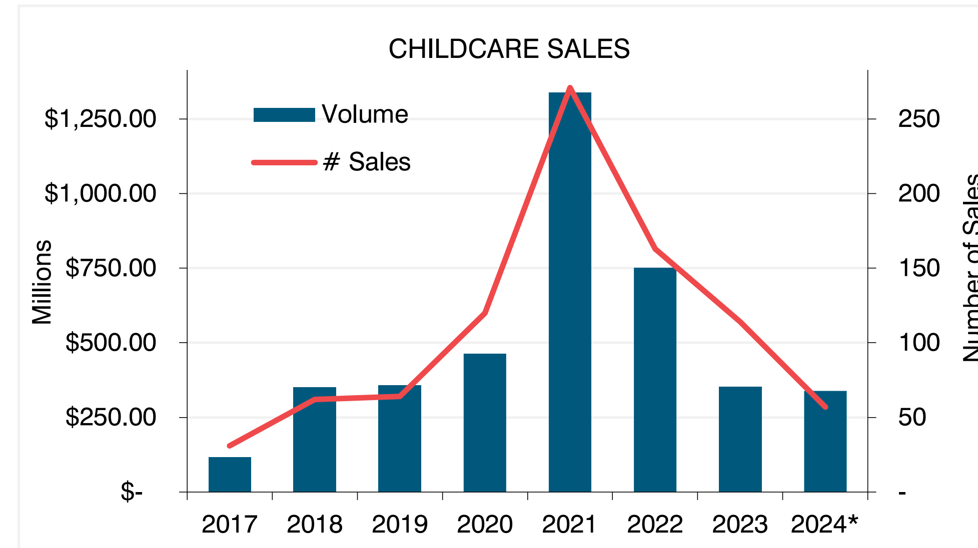
Source: Dept of Education, GapMaps, M3 Property



Source: Dept of Education, GapMaps, M3 Property

INVESTMENT MARKET

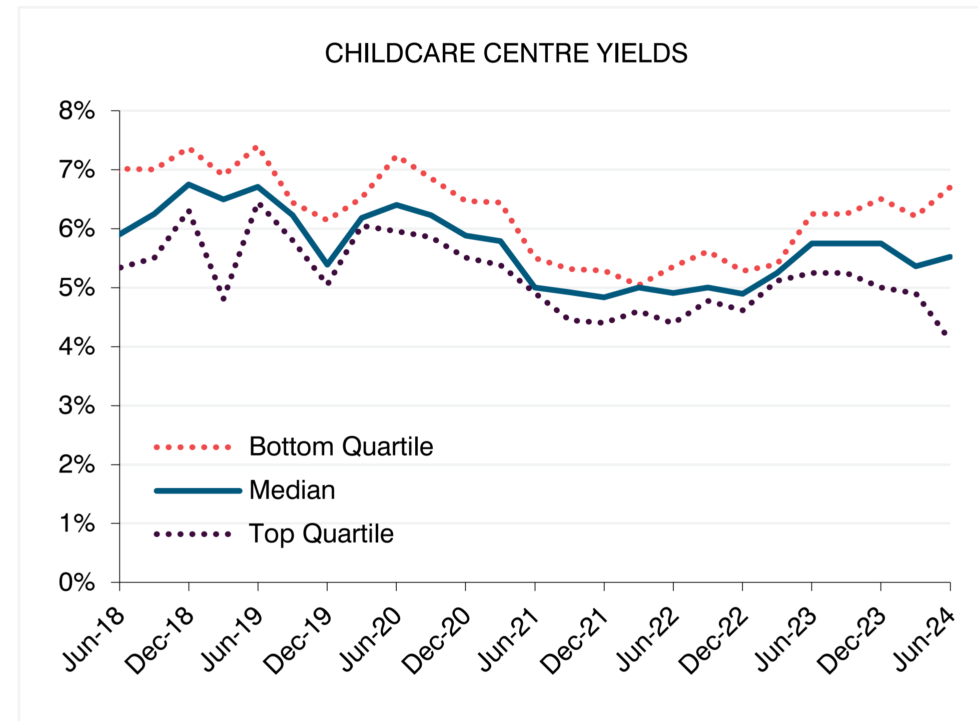
- Childcare centre values are dependent on location, supply/demand, competition, centre size and tenant covenant.
- The childcare investment market showed a high level of resilience during the COVID-19 pandemic. Childcare investment activity reached a record high in 2021, with $1.34 billion of sales (271 properties) recorded nationally. Activity slowed significantly in 2023, with $351 million of childcare sales recorded (114 properties) during the year.
- Activity has picked up in 2024, with a total of $338.7 million transacted across 58 sales so far.



Source: Real Capital Analytics (RCA), M3 Property

YIELDS

- Yields for prime freehold interests are in the band of 4.10% to 6.70%. Yields tightened over recent years until 2022. Demand for well-placed centres is still competitive, however other market factors like strong rental growth and investor appetite have pushed yields upwards.
- In the current economic environment, the focus of investors has been heightened to the strength of the tenant lease covenant and centres with known established operators often achieve premium market rates, however for sites which do not meet these investment standards, investors are using their buying power to negotiate purchaser-favourable pricing.
- Childcare investors include small and medium-sized operators, and small-scale passive investors along with large investment trusts and owners.



Source: M3 Property

OPPORTUNITIES AND CHALLENGES

- New supply has pushed occupancy rates down to relatively low levels in some metropolitan markets.
- New childcare centres are increasingly being included in new office buildings and business hubs to cater for demand from office workers.
- The sector continues to face labour shortages which have resulted in some childcare centres having to put a cap on enrolments, despite being licensed for a higher number of children. The 2023-24 Federal Budget included a $1.6 billion investment into the early childhood education workforce, including funding for professional development and training programs. Increased funding will help address workforce shortages in the sector.

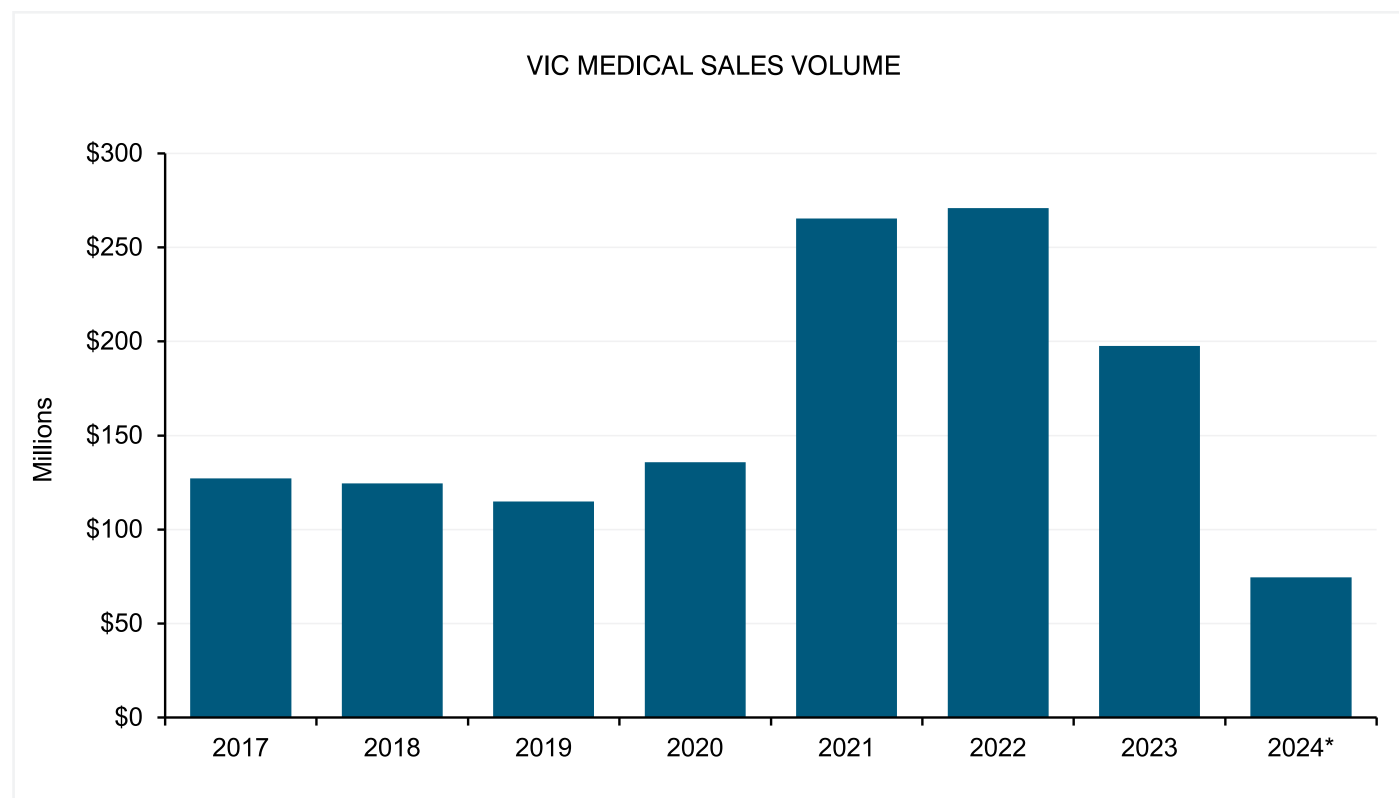
OUTLOOK

- Over the medium-term, the number of children aged 0 to 5 years is forecast to increase most strongly in Queensland, followed by Victoria and West Australia, with lower but still strong growth expected in all other states and territories. Furthermore, labour force participation rates are forecast to trend upwards in most states and territories over the medium- to longer-term and this is expected to contribute to a continued increase in the average number of hours children attend childcare per week. These factors will drive demand for childcare and the development of new childcare centres in some areas.
- There is strong bipartisan government support for the childcare sector that will see continued funding to the sector towards childcare subsidiary for family households. As a result, the average daily rate per child across all states has grown by $10-$20 per day, a large increase in discretionary spending for most family households.
- Private investors have been the major purchaser over the last 12 months, as major institutional groups continue to sell down their childcare portfolios. We anticipate this trend to continue.
- We expect to see more existing centres undergoing refurbishments and upgrades going forward in order to compete for customers within the centre's catchment.

HEALTHCARE

SIMON HICKIN
Director | Health, Aged Care & Seniors Living

> “The healthcare sector in Victoria continues to maintain its investment appeal in the face of elevated interest rates, supported by good quality assets, strong fundamentals and continued demand.
>
> The Federal Government has launched a review into the private hospital sector, due to recent concerns voiced by the industry over financial viability concerns being faced by some operators.
>
> We’ve seen a softening in yields over the past six months, with mixed results for sales overall. Activity in the higher value institutional-grade assets appear to have been affected to a greater extent by market conditions. Assuming interest rates start to decrease moving into 2025, we anticipate greater activity to return to the market.”



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

INVESTMENT MARKET

- According to RCA, sales volume of healthcare properties in Victoria for 2023 was $197.5 million from 74 transactions. This figure does not include the five Victorian assets sold as part of the Healthscope Hospital Portfolio.
- There have been 17 transactions valued at $74.7 million so far in 2024.
- Institutional investors, REITs, and private buyers have been the most active buyer groups over recent years.

YIELDS

- Yields are now averaging around 5.0% for prime medical centre assets and 7.50% for secondary medical assets (predominantly regionally located older facilities).
- Yields for private hospitals generally range between 4.75% and 6.00% for prime assets and 6.25% and 7.50% for secondary assets.
- Average cap rates have softened by around 50bps to 100bpts in the twelve months to June 2024 with secondary assets softening to a greater extent.

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.

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.

INDUSTRIAL

PATRICK CURRAN
Director | Industrial

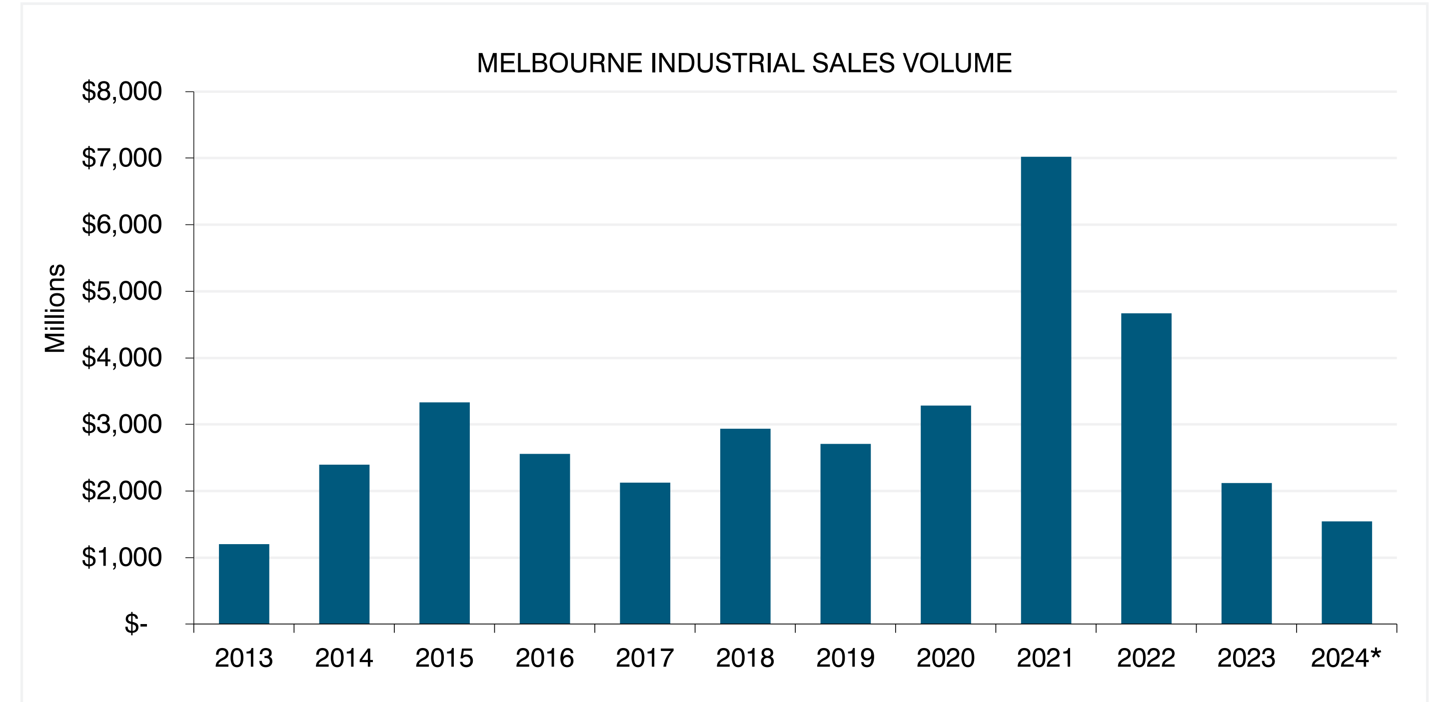
> "In the face of high interest rates, a slowing economy and low consumer confidence, Melbourne's industrial market has remained resilient over the first half of 2024. Although there has been a material decrease in the quantum of transactions and some yield expansion has occurred, this has been largely offset by rental growth. This has preserved capital values, to a large extent.
>
> Land transactions have continued to sporadically occur at rates that show limited evidence of a contracting market.
>
> Institutional and other large market participants continue to hold a buoyant outlook for the sector. This, paired with sound macro- economic fundamentals, will assist to underpin demand going forward."

CURRENT STATE OF PLAY

- High net worth individuals are becoming more active in the $10 to $30 million investment market as Real Estate Investment Trusts continue to sit out the market due to their increasing cost of capital.
- Market yields have softened in the last 12 months and are expected to continue softening under current interest rate pressure.
- The market participation of the institutional class has remained subdued for H1 2024 as a 'wait and see' approach has been adopted regarding interest rates and ongoing inflation.
- Demand for zoned land remains strong, however given increases in interest rates and therefore holding costs, the market for unzoned land awaiting Precinct Structure Plan approval has softened.
- Improved infrastructure, land affordability relative to Sydney, a reduction of available sites in inner precincts, and ongoing residential development has seen an increasing prevalence of industrial land being marketed in outer areas of Melbourne.

“LAND TRANSACTIONS HAVE CONTINUED TO SPORADICALLY OCCUR AT RATES THAT SHOW LIMITED EVIDENCE OF A CONTRACTING MARKET.”

- PATRICK CURRAN



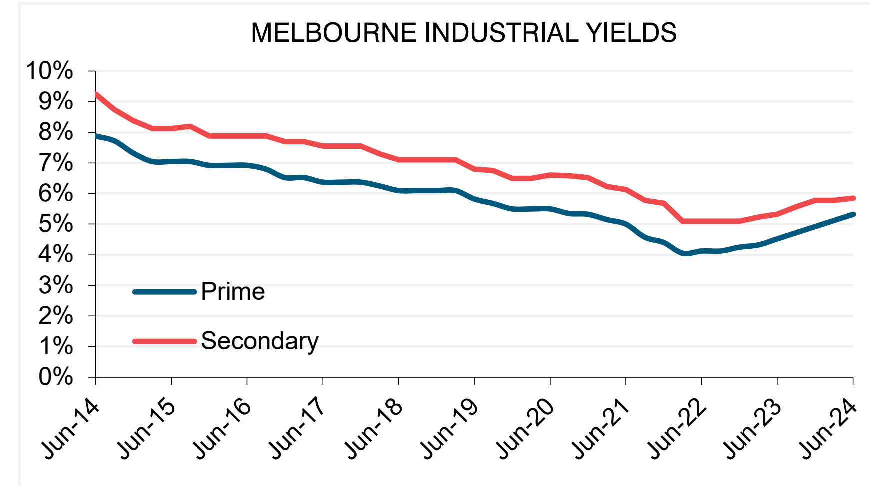
Source: Real Capital Analytics (RCA), M3 Property
Note: sales over $5 million

INVESTMENT MARKET

- According to RCA, there have been 78 industrial sales totalling $1.54 billion recorded across the Melbourne market to the end of H1 2024.
- The largest sale during H1 2024 was the sale of the Metcash Victoria Mega Distribution Centre in Truganina for $216.8 million. The property was purchased by Barings and Rest Super as part of a 12-property portfolio that was acquired from Goodman Group for a total of $780 million. The Metcash Victoria Mega Distribution Centre is currently under construction and will be the largest wholesale distribution centre in Australia with a total of 115,000 sqm of space spanning 700 metres in length.
- Offshore investors and Private Buyers continue to be the largest buyers of industrial property in Melbourne in 2024.
- The market participation of the institutional class has remained subdued for H1 2024 as a ‘wait and see’ approach has been adopted regarding interest rates and ongoing inflation.

YIELDS

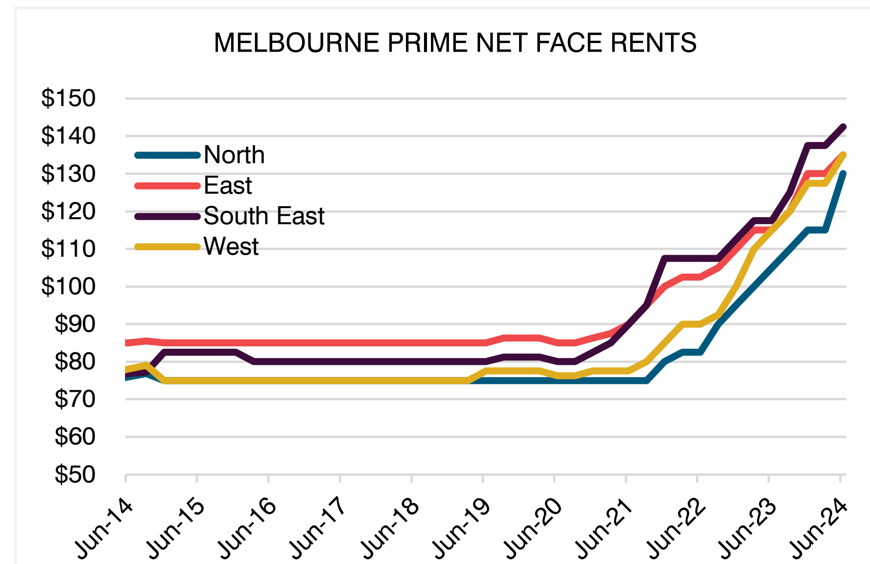
- Prime assets are currently trading at yields between 5.00% and 6.00%. Secondary assets are trading between 5.75% and 6.75%.
- Prime yields softened by circa 50 basis points while secondary yields softened by circa 65 basis points in the twelve months to end of H1 2024.
- In the decade prior to 2021, healthy investor appetite and the spread between property yields and interest rates exerted significant downward pressure on yields. However, economic uncertainty has seen yields soften over the past two years.



Source: M3 Property

RENTAL MARKET

- Rental growth for prime assets remains strong while growth in secondary assets has been more subdued, with vacancy rates still sitting at historic lows. While economic growth continues, the supply/demand imbalance is likely to continue to support rental growth – however increased occupancy costs, including much higher land tax outgoings, bring some doubt to the capacity for tenants to pay increased rentals.
- There has been a renewed focus on rental levels from property owners over the past year. Precincts where built form supply shortages are evident have seen the strongest growth in rents.
- Prime rents increased by circa 19.9% in the twelve months to end of H1 2024, with growth seen across all precincts. Secondary rents experienced a slight increase in the twelve months to end of H1 2024 of 2.8% compared to H1 2023.
- Incentives have broadly remained steady for prime and secondary buildings over the twelve months to end of H1 2024 at around 10%-15% and 5%-10% respectively. However recent transactions indicate these may be increasing.



Source: M3 Property

OPPORTUNITIES AND CHALLENGES

- Despite concerns in the investment market due to inflationary pressures, recent transactions show land values continue to increase. The market sees a persistent shortage of well-located industrial zoned land in the major markets of the southeast and western precincts.
- In the institutional space, purchasers have had to reprice due to the increasing cost of capital, however, vendors have not yet adjusted to the new pricing levels. This has led to a significant fall in transaction levels. During 2024, the expectation is that more property in the $30 million-plus price point will come to the market and a reevaluation of market yields is likely to occur.
- Construction cost growth appears to have moderated. Cost certainty should help to increase supply; however, this will always be limited by a shortage of zoned land.
- Continuing high interest rates and the ability to purchase land at levels which make development feasible present an ongoing challenge to the market.

OUTLOOK

- Occupier demand is expected to remain at strong levels over the coming months with growth in e-commerce and solid public sector investment forecast to continue driving demand for warehouse and advanced (particularly food) manufacturing space.
- However, with household discretionary spending being curtailed, we expect to see logistics demand from retail groups cool in the near term. Supply chain disturbance risk however, will continue to encourage retailers to maintain larger inventories.
- We expect face rental growth for prime and secondary accommodation will continue in the short term but effective rents could be tempered by incentive increases.

CBD OFFICE

GARY LONGDEN
Director | Office

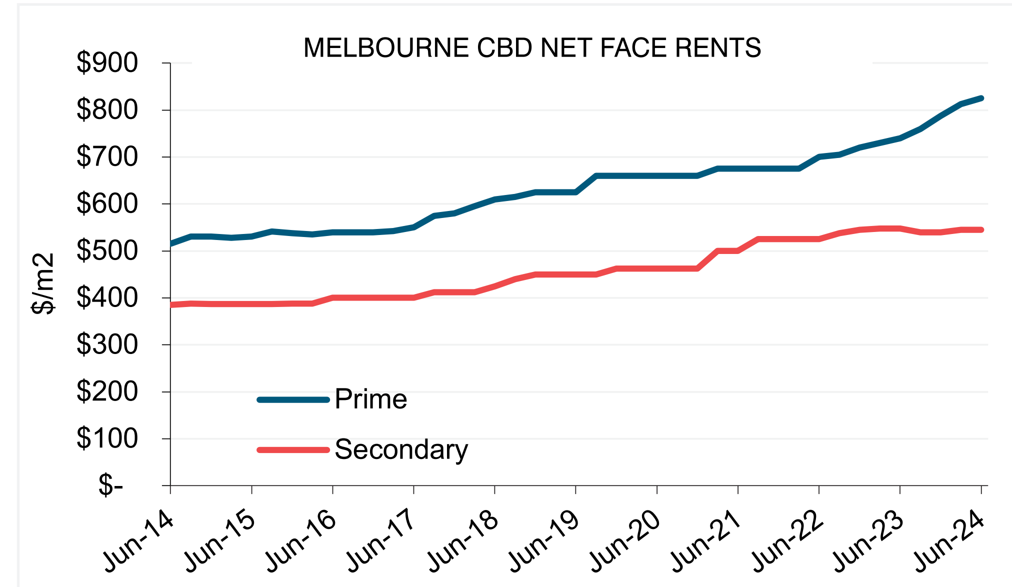
> “Investors in the Melbourne CBD office market are at “risk off” stage where office assets with short WALEs and/or high levels of vacancy are currently either being discounted in the marketplace or not transacting at all. Yields for high-quality properties are recording less decompression, whilst high-risk properties, including B-grade assets, are showing yields above 7%.
>
> Face rents are forecast to rise modestly over the remainder of 2024 whilst incentives are forecast to increase further before stabilising and reducing in FY2026 and 2027. Effective rental growth is expected to strengthen as incentives reduce in the second half of the decade.”

CURRENT STATE OF PLAY

- According to the Property Council of Australia (PCA), there was 5,237,846 square metres of office space in the Melbourne CBD as of July 2024; an increase of 130,608 square metres from July 2023. The Western Core remains the largest precinct, accounting for 33.32% of total CBD stock, followed by Docklands (23.7%).
- The total vacancy rate for Melbourne’s CBD office market increased from 14.9% in July 2023 to 18% in July 2024, with increases experienced in both the prime and secondary markets. Vacancy has increased due to both new supply added to the market, as well as negative / subdued net absorption, over the past four years.
- Over the past five years, there has been an average of 83,556 square metres of new supply added to the market every six months. Accounting for withdrawals, net supply additions averaged 55,839 square metres every six months.
- There is currently circa 287,680 square metres of stock under construction in the CBD and an additional 111,435 square metres undergoing site works. Adding DA approved and submitted developments, the total supply pipeline for the Melbourne CBD is circa 786,468 square metres, however, not all projects that are approved will proceed to development.
- Investor demand at previously compressed yields has significantly reduced. Currently vendors are reluctant to reduce asking prices and selling periods are extended.

RENTAL MARKET

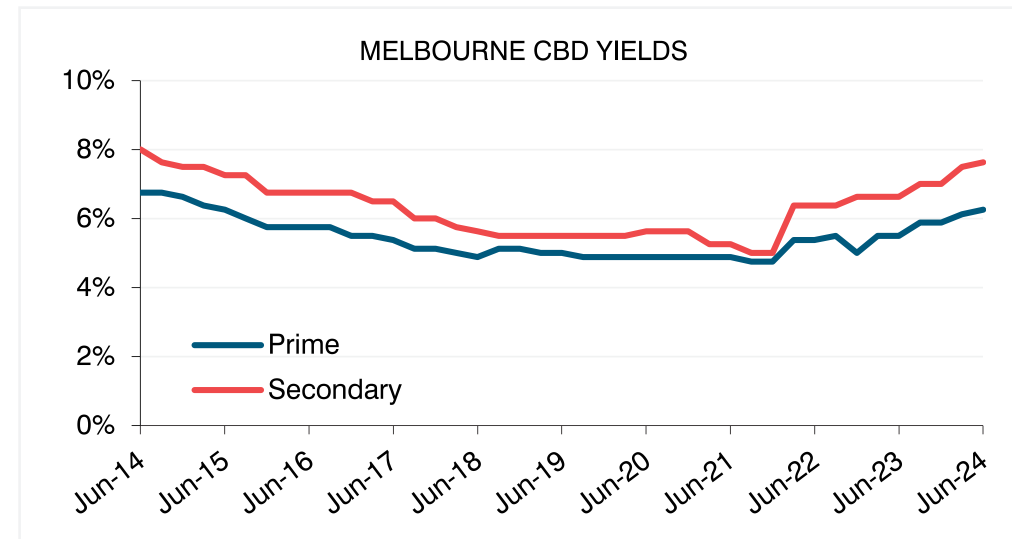
- Prime net face rents increased by 11.49% over the year to the end of H2 2024 to range between $675 and $950 per square metre. Prime incentives ranged between 37% and 43% at the end of H1 2024. Incentives bottom line have increased over the year, resulting in net effective rentals increasing by 8.3% over the year.
- Secondary net face rents ranged between $490 and $600 per square metre at the end of H1 2024, decreasing slightly by 0.5% over the year. Secondary incentives generally range between 35% and 42.5%, tightening the bottom line which resulted in a 2.45% decrease in secondary net effective rent.



Source: M3 Property

YIELDS

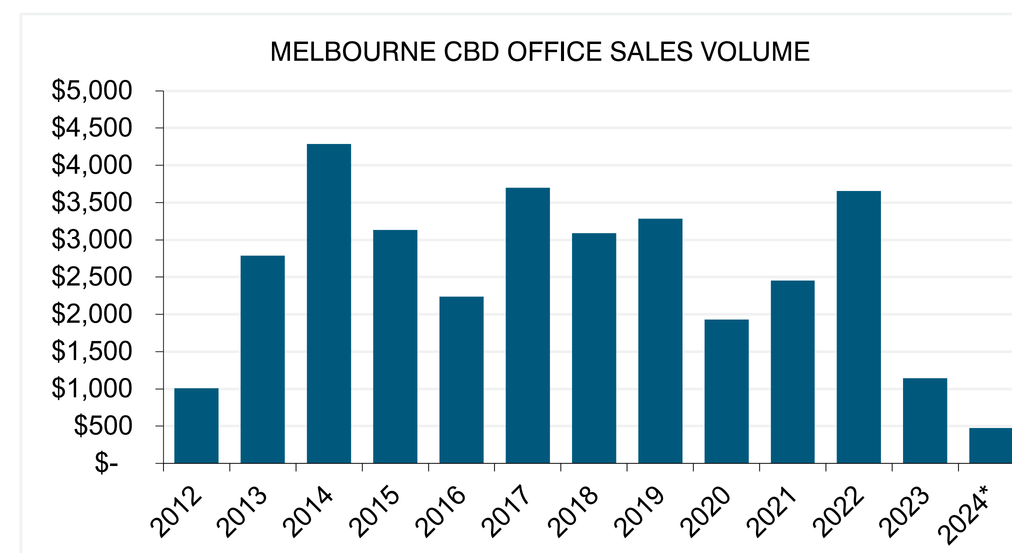
- At the end of H1 2024, yields ranged between 5.50% and 7.00% for prime buildings and 7.25% and 8.00% for secondary buildings.
- Prime and secondary yields have continued to soften over H1 2024. Prime yields are estimated to have softened by circa 75 basis points, and secondary yields by circa 100 basis points, over the twelve months to the end of H1 2024.



Source: M3 Property

INVESTMENT MARKET

- Sales activity in the Melbourne CBD office market averaged $2.49 billion per annum over the five years to the end of 2023.
- According to RCA, there have been 8 sales totalling $476.6 million recorded in the Melbourne CBD Office market to the end of H1 2024. Sales volumes for H1 2024 are slightly higher than the 8 sales totalling $415.1 million recorded for H1 2023.
- Institutional buyers have been the largest buyers of office property in Melbourne in 2024, accounting for 28% of the transactions.



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

OPPORTUNITIES AND CHALLENGES

- The high vacancy rate in the Melbourne 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, Green Star 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.
- The Victorian Government's Commercial and Industrial Property Tax was introduced in July 2024 and is creating a degree of uncertainty. The CIPT progressively abolishes stamp duty on commercial and industrial properties and replaces it with the Commercial and Industrial Property Tax which will apply ten years after the settlement date at the rate of 1% per annum of the site value. The CIPT has been greeted with caution by the industry with investors adopting a wait and see approach.

OUTLOOK

- There is circa 287,680 square metres of supply under construction in the Melbourne CBD. The increased cost of construction as well as rising interest rates have potential to push some development timeframes out.
- The medium-term outlook for white-collar employment in Melbourne is positive, with BIS Oxford Economics forecasting an additional 128,030 persons to be employed in white collar employing industries in Melbourne from 2024 to 2028. Occupier demand in the CBD market is expected to strengthen over this period.
- Prime face rents are forecast to rise modestly over the second half of 2024, whilst incentives are forecast to increase further before stabilising and reducing in FY2026 and 2027. Effective rental growth is expected to strengthen as incentives reduce in the second half of the decade.

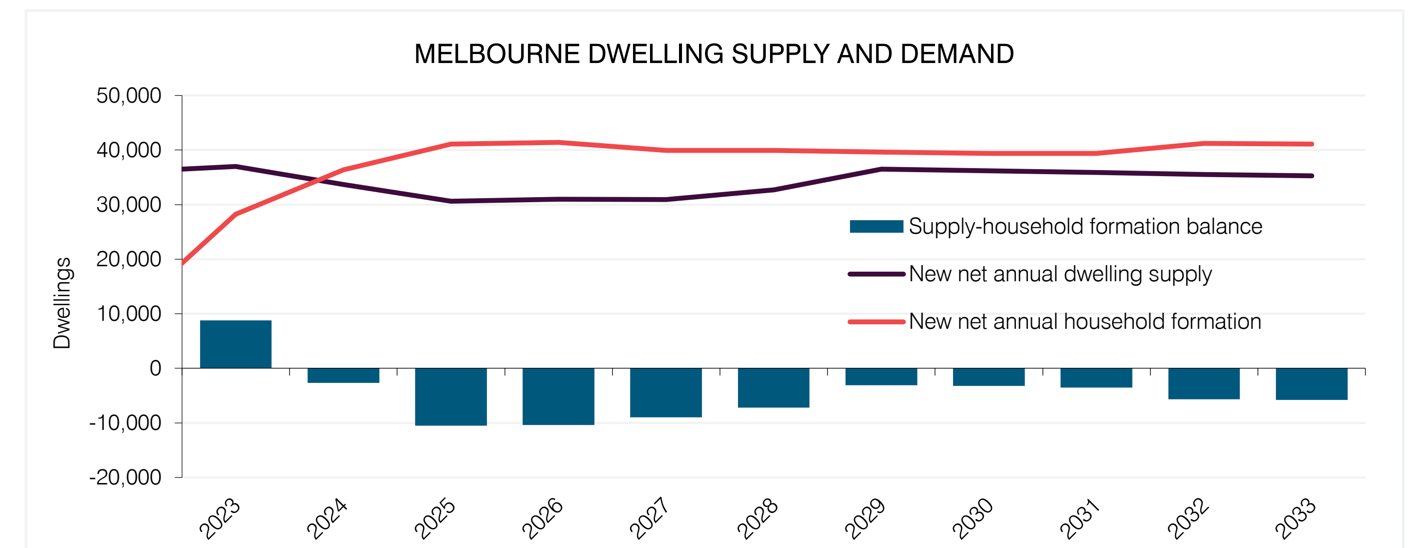
RESIDENTIAL DEVELOPMENT

LUANA KENNY
Managing Director

"The delivery of projects in the apartment and townhouse sector continues to be below market average, as meeting required market returns remains a challenge. Whilst we are starting to see stabilisation in construction costs, we need to see price growth in revenues for feasibilities to improve. We expect prices to increase in these markets in 2025, with population a major driving factor, through 2026 and 2027.

The residential lot market remains subdued. However a lack of zoned land supply in growth areas will see this market improve through the latter half of 2025 as demand starts to outstrip supply, putting pressure on prices and delivery of lots to the market.

Looking forward, whilst the market will continue to face challenges for the remaining 2024, it is expected to improve in 2025, with the residential land market anticipated to take longer with increased sale rates and some growth in lot prices in the latter part of 2025."



Source: NHFIC, M3 Property

M3

CURRENT STATE OF PLAY

- Low vacancy rates and limited supply coming to the market is continuing to put pressure on rental rates, with the vacancy rate reducing from its peak in December 2020 of 4.7% down to 1.3% in May 2024.
- The market has experienced a modest recovery from the most recent downturn, with house prices returning a positive annual growth of 2.8% and unit prices returning positive annual growth of 1.7% in the twelve months to June 2024.
- The overall economic fundamentals will continue to underpin a recovery of the market following the rapid increase of the cash rate from May 2022.
- There were 51,924 dwelling approvals in the twelve months to April 2024, down 8.21% on the 56,570 dwelling approvals in the twelve months to April 2023. Approval rates for new dwellings are currently below the 10-year average.
- Housing Australia is forecasting net dwelling completions in Victoria to total 33,700 for 2024 (compared to 37,000 in 2023) before trending further downwards between 2025 and 2027. Supply completions are likely to continue being impacted by the supply of fully serviced land, elevated construction costs, and low revenue growth.
- However, as population growth returns to pre pandemic levels, with a growth of 2.78% over the 12 months to December 2023 and expected to increase by an average of 1.4% per annum over the next five years, this will put pressure on the market, resulting in an undersupply from 2024, with the market expected to remain undersupplied for the next ten years.
- In September 2023, the State government released the Victoria's Housing Statement, which sets an ambitious target of 800,000 new dwellings over 10 years to address the housing shortage and affordability issues that are being faced by Victoria.

Source: SQM, M3 Property
*Note: The market equilibrium vacancy rate is considered to be 3.0%. Vacancy rates higher than this typically represent an oversupplied rental market whilst lower vacancy rates typically represent an undersupplied market.

OPPORTUNITIES AND CHALLENGES

- The growth corridors of Melbourne face significant headwinds relating to unlocking planning controls and approval of new Precinct Structure Plans (PSPs) and planning permits. Excessive time delays in the planning process due to constraints relating to flora and fauna, and approval of Cultural Heritage Management Plans, have in part contributed to a drag in the approval of proposed PSP's and issuance of planning permits impacting on development within growth areas. The announcement by the State Government to focus resources on greater development in established infill locations will see further delays in approving PSP's and impact bringing supply to the market in these areas.
- Planning continues to be a challenge with ongoing permit approval delays, uncertainties in existing areas around development guidelines, and government and local authority intervention delaying development.
- The 2024 State Budget allocated $700 million to expand the Victorian Homebuyer Fund, which helps first time buyers purchase properties up to a value of $700,000 in regional Victoria or $950,000 in Metro Melbourne. However, it also announced that the scheme will end once the Federal Government's Help to Buy scheme is established.
- The State government has recently introduced further property taxes, increasing the cost of developing and delivering new home supply to the market. The introduction and increase of taxes is disadvantaging Victoria in attracting investment into the property market and delivering the housing supply required to meet affordable housing opportunities and keep demand with increasing population growth.

OUTLOOK

- Population growth has rebounded which will assist the continuing residential market recovery during 2024, with the market expected to see some price growth during 2024, albeit not at the same levels that was experienced through 2021/2022. The Melbourne market recovery to date has been more modest compared to other states, with median house prices forecast to remain stable for the second half of 2024. Oxford Economics Australia is forecasting a marginal increase of 1.6% for CY2024. Longer term it is expected that house prices will increase by 8.3% per annum by 2026.
- Increasing overseas and domestic migration rates will place upward pressure on housing demand, further supporting an increase to unit and housing prices. It will also support the demand for CBD and inner-city apartment developments, which has faced challenges since early 2020.

RETAIL

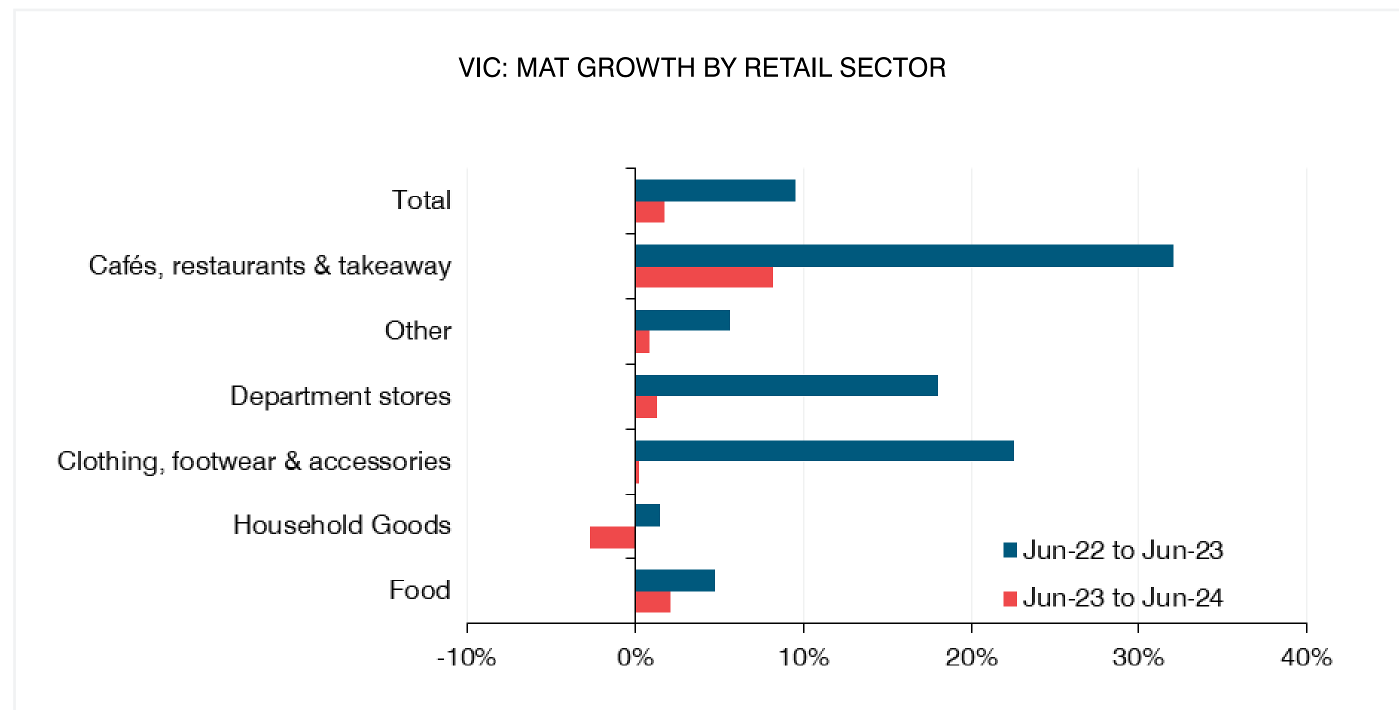
SHAUN O'SULLIVAN
Director | Retail

"Over the first half of 2024 we have witnessed renewed interest in retail assets across all retail sub-categories in the Victorian market. In particular we have seen fund managers and syndicators continue to chase sub-regional and regional centres, attracted by the higher yields offered by these assets. We have also seen the re-emergence of institutions / AREITs as buyers, with a number of groups acquiring or being in the process of acquiring centres, signalling an improved sentiment in the sector.

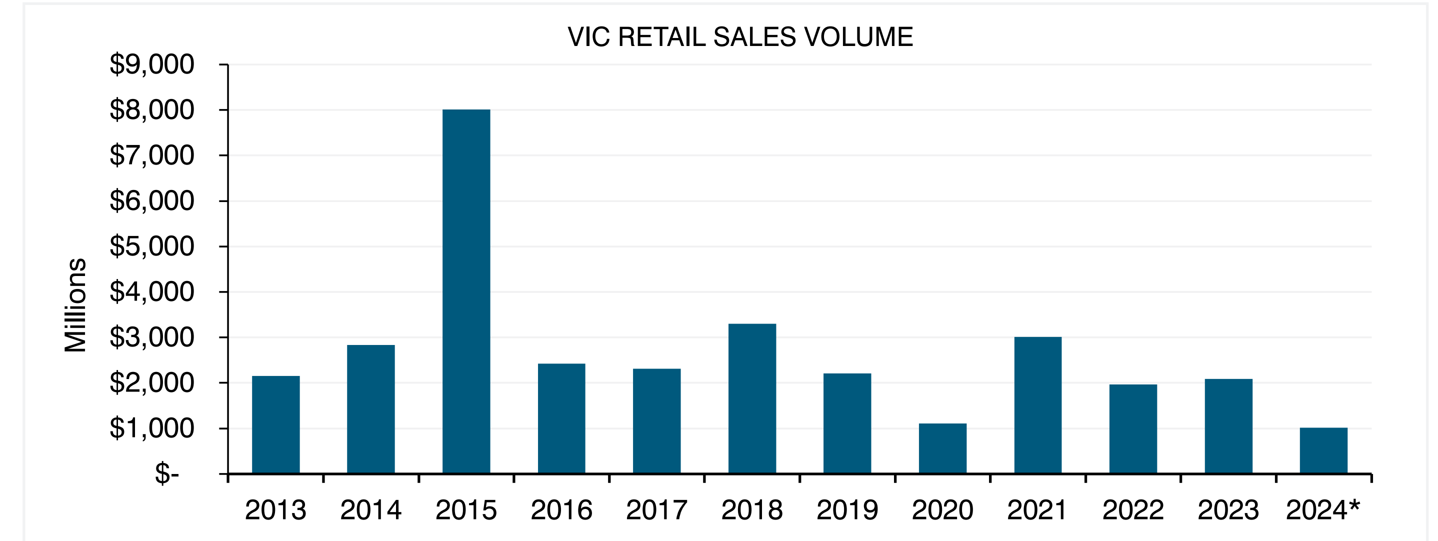
There are various interests in regional shopping centres currently exchanging, reflecting activity in this asset class that was not present during 2023. This has, in part, been the result of vendors being more willing to meet the market on pricing. Transactions are expected to continue to occur during the remainder of 2024 as owners re-weight their portfolios and recycle capital."

CURRENT STATE OF PLAY

- Total retail spending growth in Victoria for the 12 months ended June 2024 was 1.72%, significantly down from 9.53% growth for the 12 months ended June 2023.
- The strongest growth by retail category was recorded in cafes, restaurants and takeaway (8.22%), followed by food (2.13%).
- 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.
- 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.
- Spending on high-end, discretionary items such as luxury retail and restaurants has been less impacted by the cost-of-living crisis.



Source: ABS, M3 Property



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

TRANSACTIONS

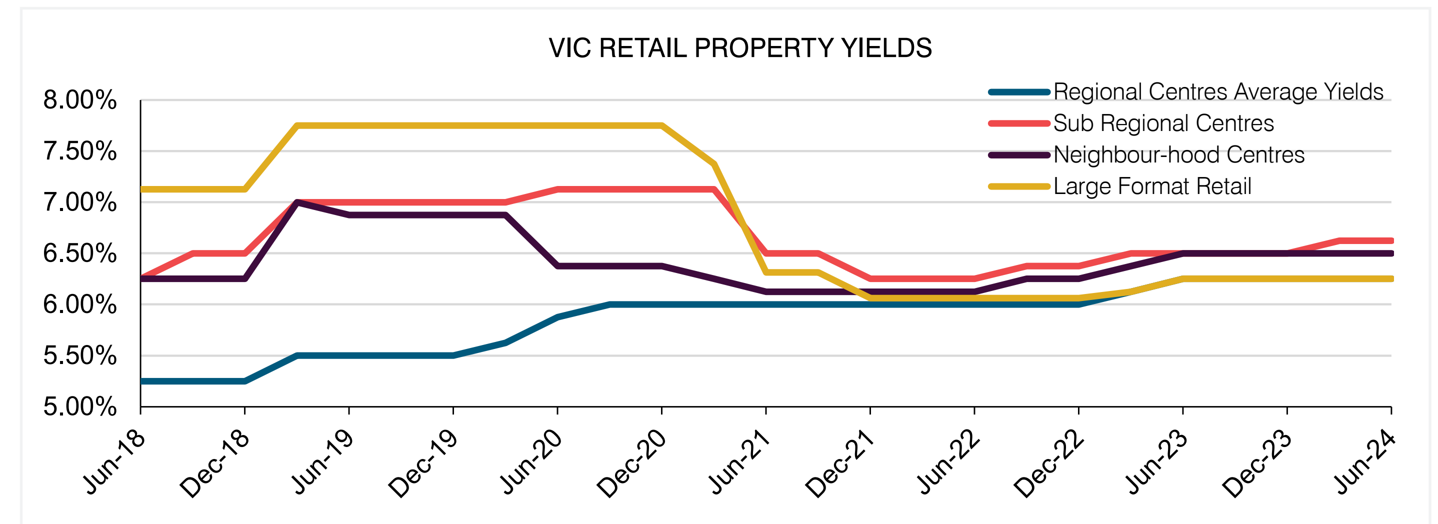
- There has been a slowing of the market as the value of transactions completed in H1 2024 is lower than the value recorded for H1 2023.
- The largest sale during H1 2024 was the sale of the Rosebud Plaza, a Sub-Regional Shopping centre for $134.25 million. The property was purchased from Charter Hall by Arcadia.
- Transactions have broadly reflected yield softening for assets above $20 million, although there are exceptions.

INVESTMENT MARKET

- According to RCA, there have been 32 retail sales totalling $682 million recorded across the Victorian market to the end of H1 2024. Sales volumes for H1 2024 are significantly lower than the 44 sales totalling $1.43 billion recorded for H1 2023.
- Of the 32 retail sales, it is noted that $256 million of the H1 2024 total of $682 million relates to BWP Trust acquiring four retail assets by purchasing all the shares in the Newmark Trust (the retail assets acquired as a result of this acquisition were the Chadstone Lifestyle Centre, Retail Centre and two Bunnings sales).
- A further $150 million of the H1 2024 total relates to the purchase of inner city and CBD retail properties.
- Private buyers and REITs have been the largest buyer groups in 2024, accounting for 33.9% and 34.8% of sales respectively.

“OVER THE FIRST HALF OF 2024 WE HAVE WITNESSED RENEWED INTEREST IN RETAIL ASSETS ACROSS ALL RETAIL SUB-CATEGORIES IN THE VICTORIAN MARKET.”

- SHAUN O’SULLIVAN



Source: M3 Property, RCA

YIELDS

- Retail yields generally continue to look attractive relative to the alternative investment classes of office and industrial.
- Prime yields for CBD retail properties generally ranged from 1.50% to 4.75% during the March quarter 2024. Secondary yields ranged between 3.50% and 6.50%.

OPPORTUNITIES AND CHALLENGES

- Rental levels within shopping centres have largely been reset 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

- Consumer confidence will be closely monitored over the next six months to measure the impact of the increased cost of living and increased interest rates on consumer spending and turnover of retail tenants.
- With interest rates stabilising, purchasers have become more active in considering assets offered for sale.

SERVICE STATIONS

JAMES RUBEN
National Director | Specialised Assets

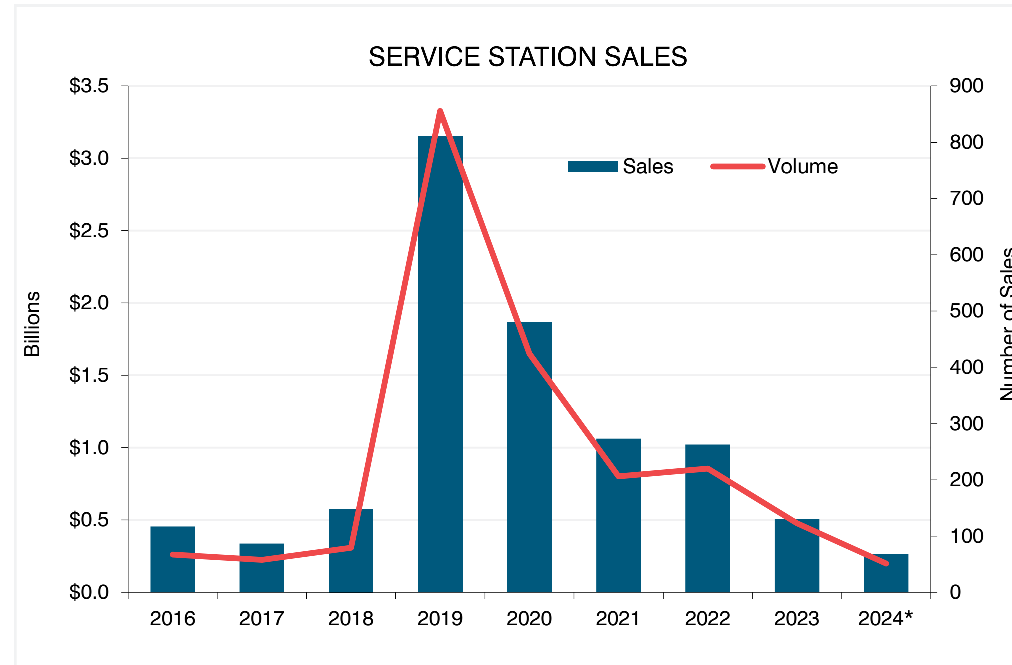
> "The Victorian service station market has seen a degree of fragmentation. Prime assets such as highway service centres with strong lease covenants have retained their investment appeal, however several transactions in the first half of 2024 have showed moderate yield softening. At the same time, secondary assets in more regional locations with less desirable leasing covenants are experiencing resistance from investors, resulting in substantially softer yields."

CURRENT STATE OF PLAY

- The total value of service station transactions is up nationally for the first half of H1 2024 compared with H1 2023, but slightly down for Victoria. However, the price per transaction has increased significantly in Victoria compared to twelve months ago.
- 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.
- 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.

INVESTMENT MARKET

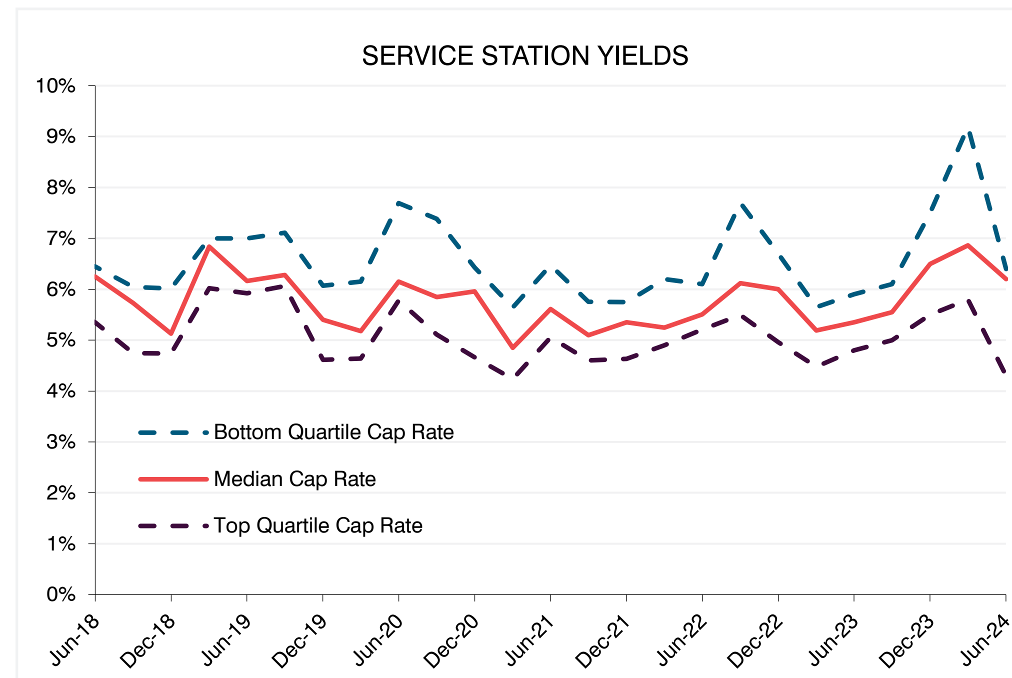
- According to RCA, there have been 51 sales of service stations totalling $265.6 million across Australia to the end of H1 2024. The total sales amount for H1 2024 is higher than the 55 sales totalling $259.4 million recorded across Australia for H1 2023.
- Of the 51 national sales, there were just 6 sales totalling $55.2 million in Victoria to the end of H1 2024. This compares with 15 sales totalling $58.1 million for H1 2023,
- The price per transaction is higher for H1 2024 at $9,200,000 per transaction compared with $3,870,168 for H1 2023.
- Total value of service station investments are up nationally for the first half of 2024 compared with H1 2023. However, sales remain subdued compared to the peak of the market around 2019/20 and are also below the volumes achieved in 2021/22.



Source: M3 Property, RCA

YIELDS

- A surge in investment activity in the last quarter has provided solid evidence of yield softening in the sector, which has been more pronounced for secondary assets.
- Regional locations generally have softer yields than metropolitan locations, with the spread between metropolitan and regional yields widening over recent years.



Source: M3 Property, RCA

OPPORTUNITIES AND CHALLENGES

- Service stations have evolved to focus more on the sale of convenience and grocery items, which has boosted profit margins, with non-fuel products accounting for 15.0% of industry revenue.
- Operating conditions have been volatile over recent years, largely due to global oil price fluctuations and pandemic-related travel disruptions.
- Actual profits can vary considerably between retailers, with some service station sites making substantial profits and others making little depending on their operational model.
- Strong competition in the industry makes it difficult for new entrants in the market – which are also faced with large initial capital outlays, heavy regulatory constraints and gaining environmental approvals.

OUTLOOK

- We expect that the yield differential between prime and secondary service station investments will become more defined over the medium-term as investors look to acquire service stations that have a wider convenience and services offering and / or an alternative use.
- Assets with future development opportunities are keenly sought after, particularly sites with surplus land in strong growth corridors.

KEY CONTACTS

LUANA KENNY
Managing Director
luana.kenny@m3property.com.au

GARY LONGDEN
Director | Office
gary.longden@m3property.com.au

HARRY DEHNE
Senior Valuer | Specialised Assets
harry.dehne@m3property.com.au

JAMES RUBEN
Director | Specialised Assets
james.ruben@m3property.com.au

JONATHON CLOSE
Director | Office
jonathon.close@m3property.com.au

PATRICK CURRAN
Director | Industrial
patrick.curran@m3property.com.au

SHAUN O'SULLIVAN
Director | Retail
shaun.osullivan@m3property.com.au

SIMON HICKIN
Director | Healthcare
simon.hickin@m3property.com.au

m3property.com.au

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.