SPECIALIST
INDEPENDENT
VALUATION

NEW SOUTH WALES MARKET SNAPSHOT H2 2023

FEBRUARY 2024

CONTENTS

NEW SOUTH WALES MARKET SNAPSHOT H2 2023

The New South Wales property market is experiencing an improvement in confidence and transaction volumes as interest rates and bond yields stabilise, in the context of a more positive inflation outlook. In most sectors, limited transactions over 2023 highlight the disconnect between buyer and seller pricing expectations. However, this pricing gap should decrease given the adjustment of asset values over the second half of 2023. It is expected that we will see an increase in transaction activity over 2024 across sectors as cap rates settle and as the market has greater visibility into peak interest rates.

In our latest New South Wales Market Snapshot for H2 2023, representatives from each of our valuation sectors share their insights into the past six months as well as opportunities and challenges for the year ahead.

HEALTHCARE

MITCH ENRIGHT

Director | Health, Aged Care & Seniors Living

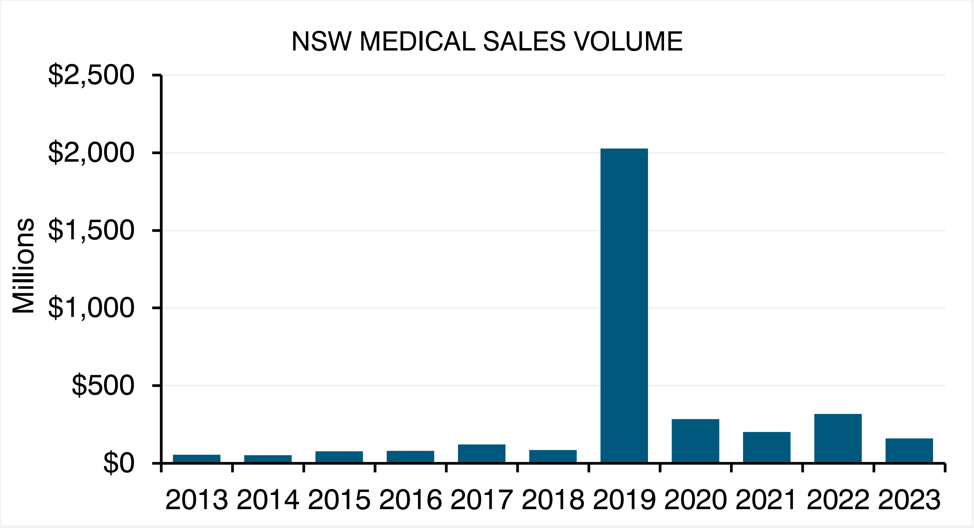
"With a much more positive inflation outlook coupled with strong underlying fundamentals, the healthcare sector could see an increase in market transactions for healthcare-related assets during 2024 - particularly within the sub-$30 million bracket - as private investors see opportunity to enter the sector. This has been evident in NSW already in 2024, with the transaction of a primary healthcare asset to a private investor for $20 million.

Limited transactions over 2023 highlight the disconnect between buyer and seller pricing expectations. However, this pricing gap should decrease given the reduction in healthcare asset values over the second half of 2023.

A continued focus on responsible investment and ESG from investment/fund managers will also see ongoing demand in the sector as it continues to grow and emerge as a core asset class.''

INVESTMENT MARKET

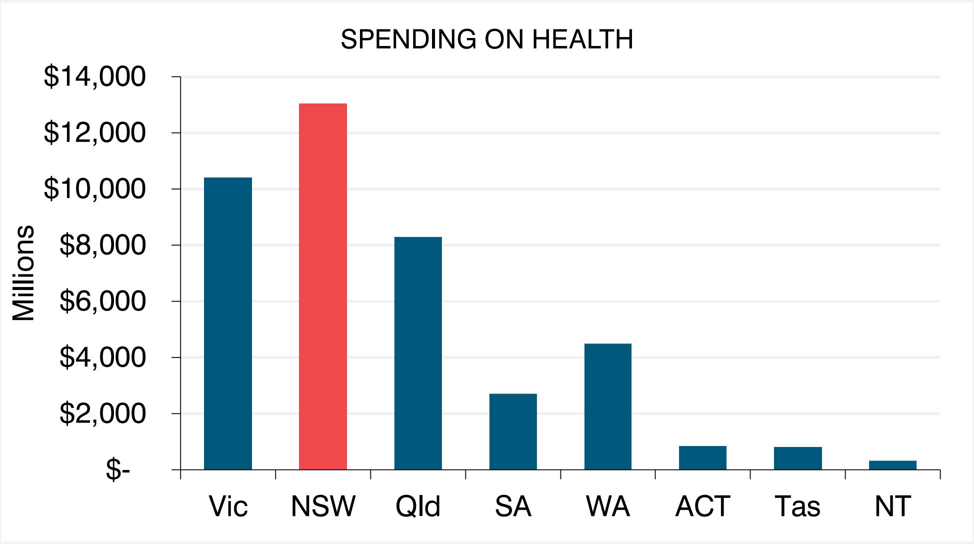
- There were 46 medical and hospital properties with a total value of $159.2 million transacted across NSW in 2023. This compares with 61 transactions at a total value of $316.4 million for the whole of 2022.
- The NSW figure for 2023 does not include the three NSW properties sold within the Healthscope Hospital Portfolio.
- Institutional investors and private buyers have been the most active buyer groups over recent years.



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

TRANSACTIONS

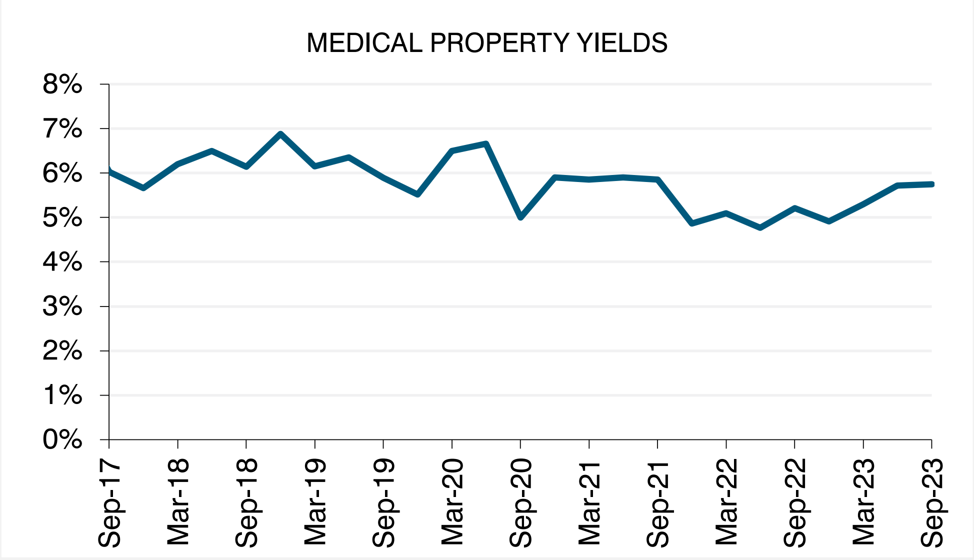
- Healthcare sales during 2023 were boosted by the sale of the Healthscope Hospital Portfolio. This sale included three assets in NSW: Nepean Private Hospital, Sydney Southwest Private Hospital and Campbelltown Private Hospital.
- The sale of the Healthscope Hospital Portfolio aside, sales transactions have been more subdued during 2023 compared to past years.



Source: GapMaps, M3 Property

YIELDS

- Yields have undergone a period of compression over recent years, dropping as low as 4% for prime medical yields.
- However, yields have since eased and are expected to soften further in 2024.
- Yields are now averaging around 5.25% for prime medical assets and 7.50% for secondary medical assets (predominantly regionally located).



Source: M3 Property

OPPORTUNITIES AND CHALLENGES

- Inflation appears to have peaked and further interest rate rises look unlikely. The Australian economy still faces uncertainty and volatility. This could favour the Healthcare sector due to its strong underlying fundamentals reducing income and tenancy risk.
- 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.
- In 2024, the sector will benefit from added investment interest from private capital as the asset class is becomes more ‘affordable’ 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.

HOTELS AND ACCOMMODATION

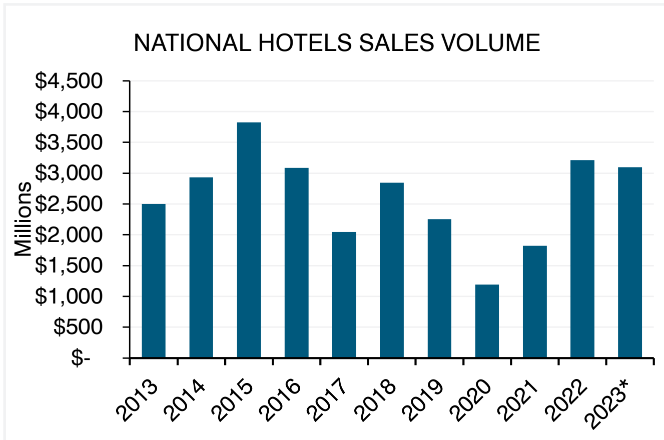
> "Since the end of border closures and COVID-19 lockdowns, although there has been continued upward movement on room rates and occupancies, this has been counterbalanced to some degree by rising operational costs for operators. Yields have continued to remain stable. Overall, there has been modest capital value growth in the hotels sector, which we expect to continue looking forward.
>
> In the current financing and development environment, the delivery of new hotels has been challenging and is likely to remain so in the short to medium-term."

JAMES RUBEN

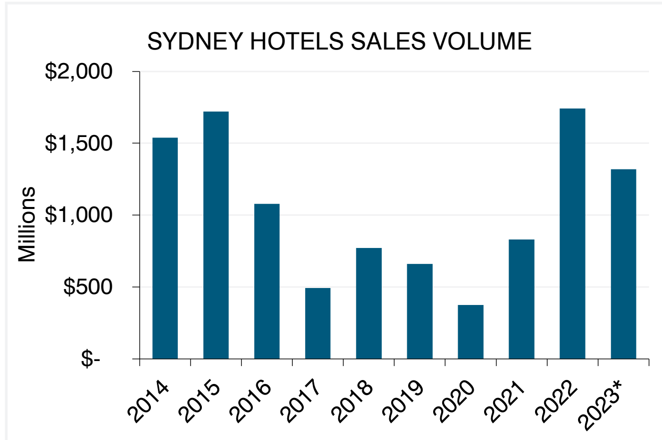
National Director | Specialised Assets

TRANSACTIONS

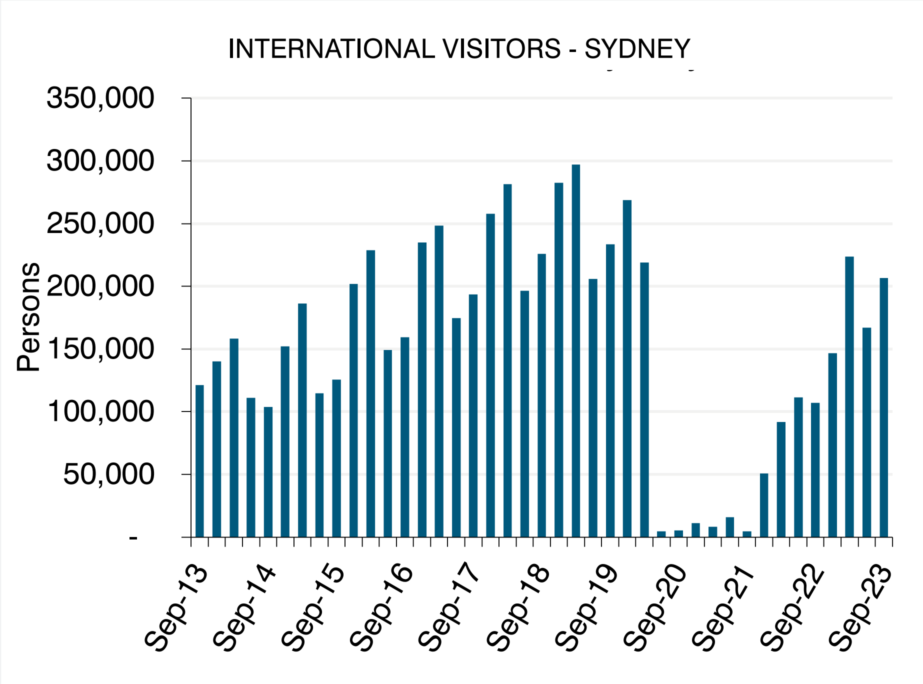
- Nationwide there were the same number of hotel transactions in 2023 as there were in 2022. According to RCA, there were 84 transactions of hotel assets totalling $3.09 billion nationwide in 2023. This compares with 84 transactions for a slightly higher total of $3.21 billion for 2022.
- Activity in Sydney was lower in 2023 due to reduced investment demand. According to RCA, there were 12 transactions totalling $1.12 billion of hotel assets across Sydney. This compares with 21 transactions totalling $1.7 billion for 2022, which was a record.
- Offshore groups (predominantly from the Asia Pacific region) are typically the largest buyers of accommodation properties in New South Wales. However, for 2023, private investors formed the largest group of buyers at 61.9% followed by offshore groups at 8.8%.



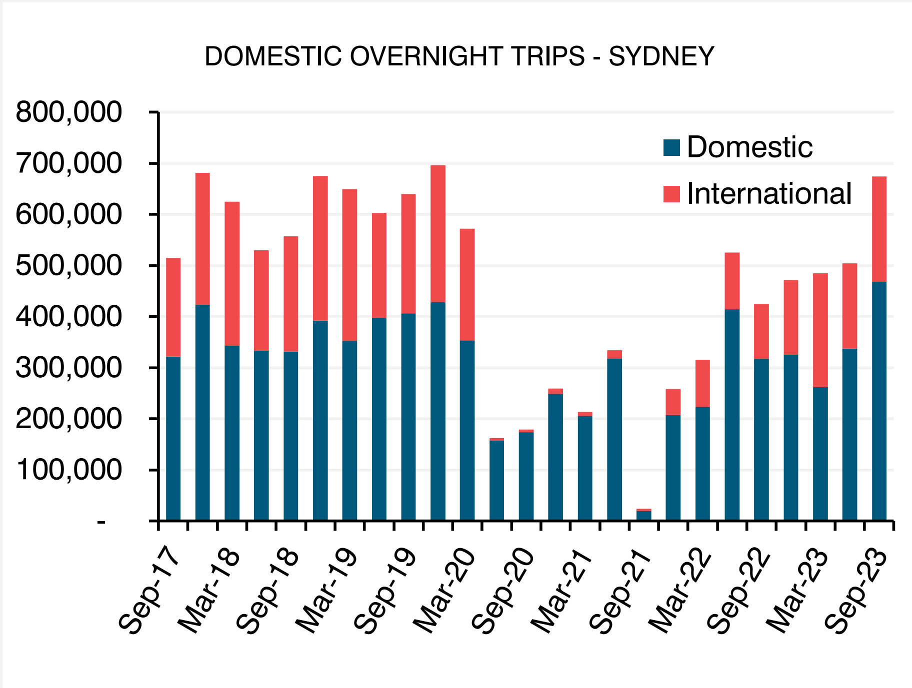
Source: Real Capital Analytics (RCA), M3 Property



Source: Real Capital Analytics (RCA), M3 Property



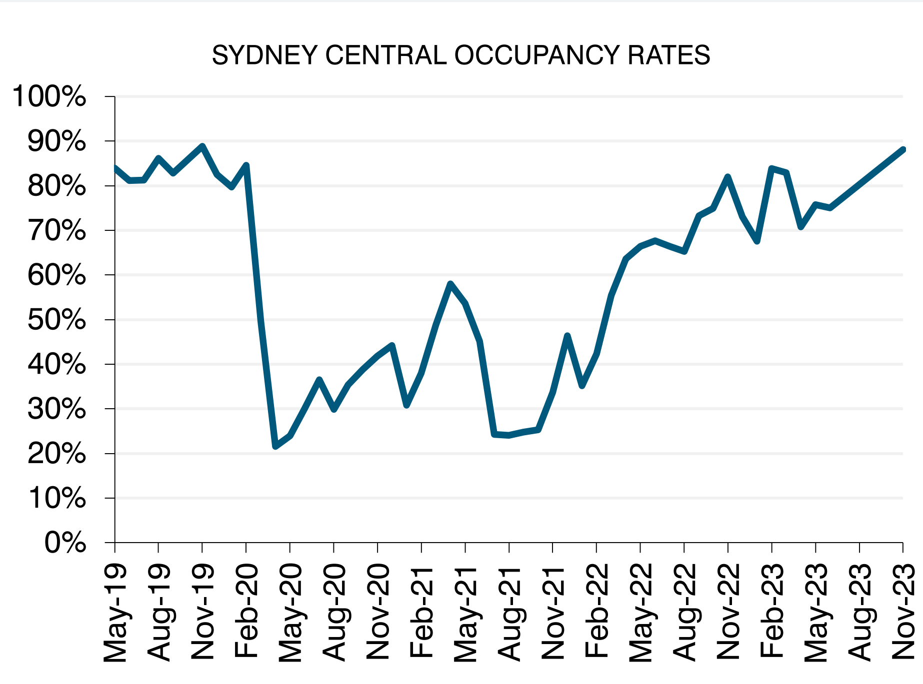
Source: TRA, M3 Property



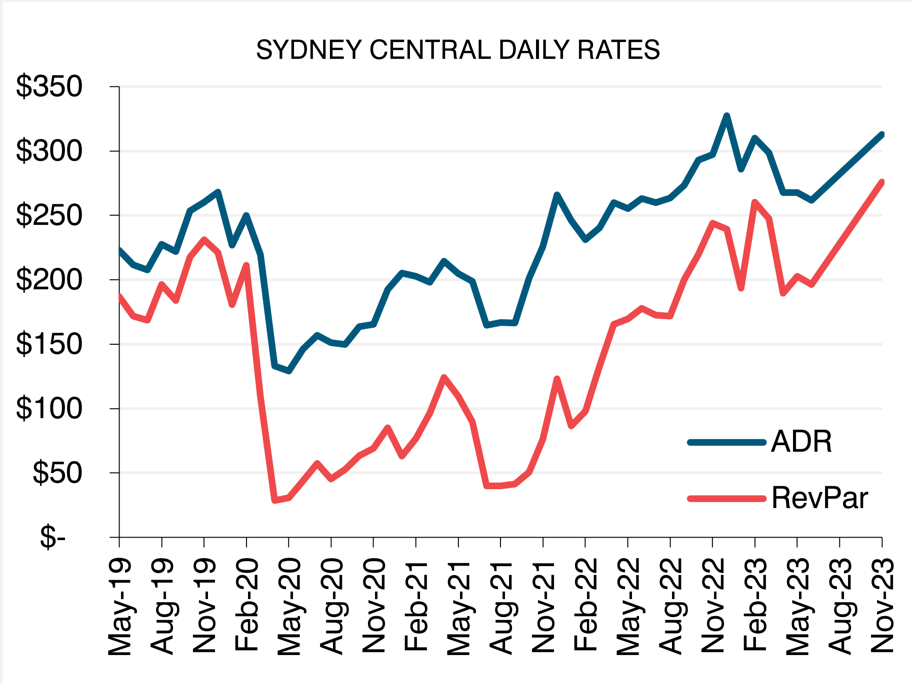
Source: TRA, M3 Property

CURRENT STATE OF PLAY

- Occupancy rates per room have largely recovered to pre-pandemic levels, with the Sydney market recording 88% occupancy rates in November 2023.
- Revenue per available room has recovered to pre-pandemic levels which is a result of significant ADR growth. ADR growth has been influenced by a number of factors including strong inflation with operators passing on increases in outgoings; an increased quality of stock driving premium rates; and evolving travel trends increasing demand.
- International visitor rates to the Sydney market remain below pre-pandemic levels but are showing significant year-on-year gains.
- Inter-state visitor rates to the Sydney market have returned to pre-pandemic levels.



Source: STR, M3 Property



Source: STR, M3 Property

OPPORTUNITIES AND CHALLENGES

- Construction costs continue to place pressure on new hotel development, however, conversion and refurbishment/ repositioning opportunities exist within the market to repurpose alternate use properties or older/tired accommodation assets.
- Evolving consumer expectations and travel trends around sustainability and social governance will continue to influence both consumer decision making and investment.
- Demand for good quality, sustainable assets is expected to grow, together with consumer demand for higher quality accommodation products and services.
- Evolving technology continues to improve efficiency in hotel management, with potential to reduce staffing levels and improve margins.
- New trends such as leisure travel, digital nomadism, eco-tourism, wellness tourism and boutique product positioning are all contributing to the transforming market.

INDUSTRIAL

"Sale transactions remain subdued overall, albeit volumes have generally increased over the past three to six months. Transaction volumes are expected to increase once the market has greater visibility in respect of the peak of interest rates.

Yield repricing continues off the back of a rising interest rate environment and prevailing inflationary market conditions, with a typical softening in the order of 100-125 basis points from the peak of the market in late 2021.

Strong leasing market conditions with atypical low vacancy rates have been exhibited over the past six months, with rental growth anticipated to continue, however at a more moderate pace. Investors continue to favour assets with short-term lease expiries, offering good reversionary potential."

JOEL DUCEY

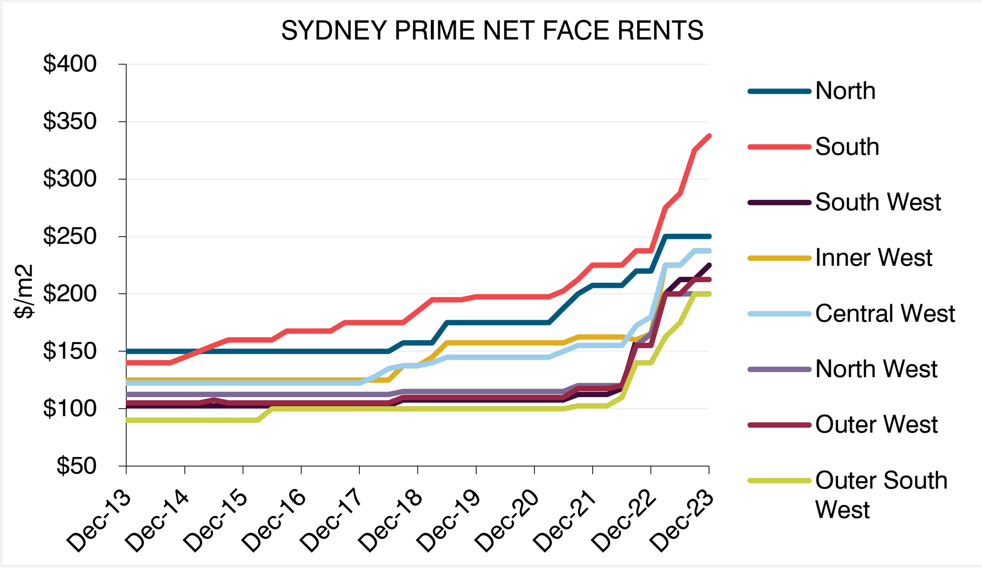
Director | Industrial

CURRENT STATE OF PLAY

- Newer buildings in prime locations close to a major road or freight rail network 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 markets owing to growing affordability concerns, traffic congestion and lack of development land in Sydney (outside of Western Sydney Aerotropolis). It has also led to the rising prominence of multi-level warehousing, particularly within the inner south Sydney sub-market.

RENTAL MARKET

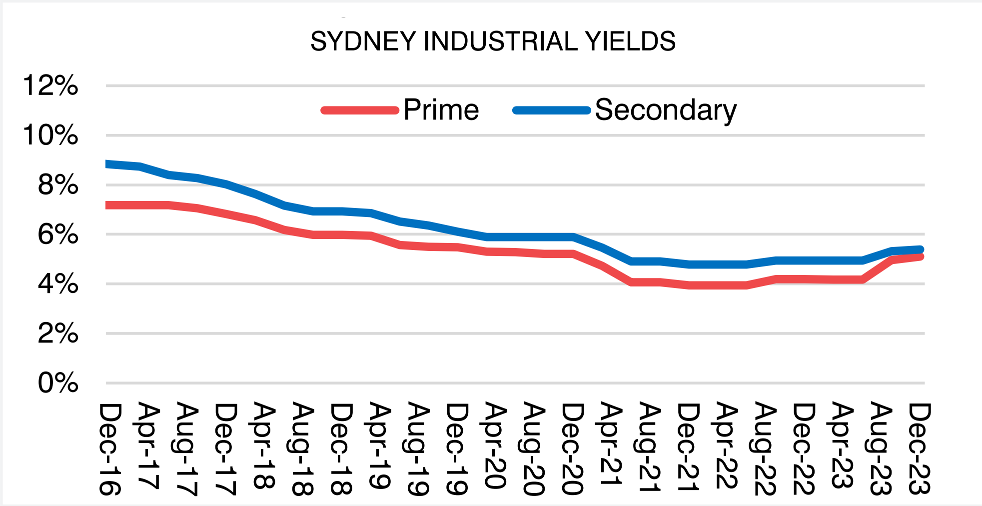
- Prime net face rents ranged between $175 and $375 per square metre at the end of 2023, with secondary net face rents ranging between $120 and $235 per square metre.
- There has been a continued strengthening in the leasing market and a renewed focus on rental levels from property owners over the past year, resulting in strong growth in rentals.



Source: M3 Property

YIELDS

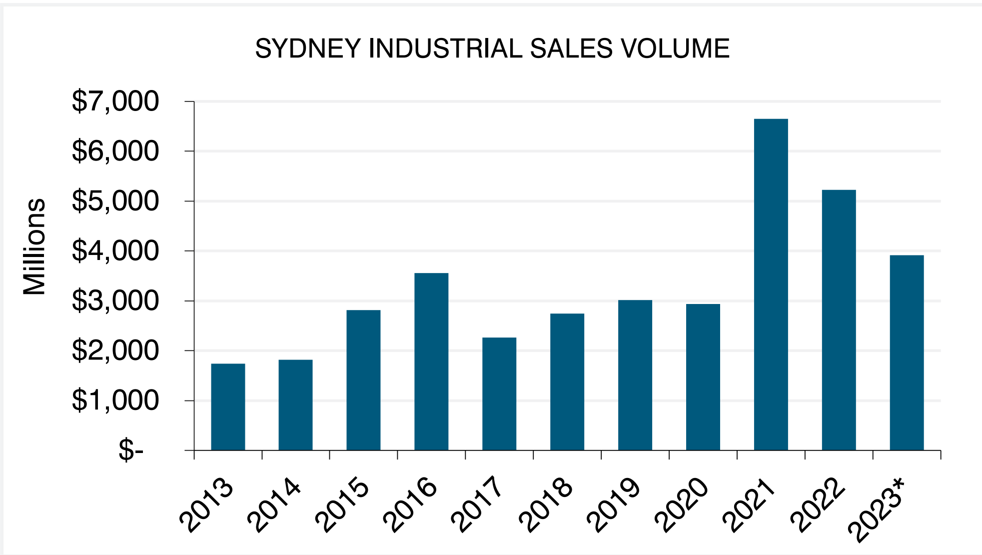
- During 2023, prime yields softened by 60 bps to an average of 5.1%, while secondary yields softened by 50bps to 5.39% in the December 2023 quarter.
- Investment demand has been softening since the peak of the market in 2021, with lower levels of demand persisting to date.
- Incentive levels declined slightly throughout 2023, with prime incentives ranging from 5% - 10% while secondary incentives range between 8% - 15%.



Source: Real Capital Analytics (RCA), M3 Property

INVESTMENT MARKET

- According to RCA, there were 103 industrial sales over $10 million (totalling $3.9 billion) recorded across the Sydney market in 2023. This compares with 151 sales recorded (totalling $5.2 billion) for the whole of 2022.
- Offshore groups and private investors have been the key buyers in 2023.
- Changes to the monetary policy have resulted in an easing in investor demand as market participants consider the impact of a rising interest rate environment on yields and internal return hurdles.



Source: Real Capital Analytics (RCA), M3 Property

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.
- 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 2024. However, supply chain disruptions, higher construction costs and the rising cost of debt is expected to delay some projects in the short term, including the Western Sydney Aerotropolis Precinct.
- Occupier demand is expected to remain at strong levels in 2024, with growth in e-commerce forecast to continue to drive demand for warehouse and logistics space, solid public sector investment and continued demand for advanced (particularly food) manufacturing.
- Rental growth is anticipated to continue, however at a more moderate pace.
- Land rates are expected to remain at current levels due to high construction costs, increasing statutory holding costs, and the continued easing of demand for investment stock. Over the medium to long term, the Outer Western Sydney and major regional sub-markets are likely to see the highest levels of industrial development.

CBD OFFICE

ANDREW DUGUID
Managing Director

> "Office vacancy continues to rise in the CBD and core metropolitan markets, largely due to softer macro demand and negative net absorption. The leasing market does however remain active, particularly for smaller tenants.
>
> Demand has focused on the CBD Core and preferred market precincts, and in buildings with strong active management. Vacancy data is skewed in areas by a range of buildings set for medium-term redevelopment available on a restricted basis. Face rents grew throughout 2023, supported by cyclical high incentives.
>
> Transaction activity has been limited. Offerings have generally been met with moderate levels of demand with syndicators and offshore investors being most active. AREITS have been net sellers, manicuring portfolios and preserving or recycling capital into development projects.
>
> The yield decompression cycle continues and investor confidence and transaction volumes are likely to improve as interest rates and bond yields stabilise. We expect greater transaction activity and to see cap rates settle over 2024."

CURRENT STATE OF PLAY

- According to the latest Property Council of Australia Office Market Report (OMR), the Sydney CBD Office market comprised 5,219,293 square metres of space as of January 2024.
- Over the twelve months to January 2024, the Sydney CBD vacancy rate decreased slightly from 11.5% to 10.8%.
- Net absorption across all grades was negative during the twelve months to January 2024 (-104,801 sqm).
- Newer developed premium-grade assets are performing well, with a flight to quality occurring.

RENTAL MARKET

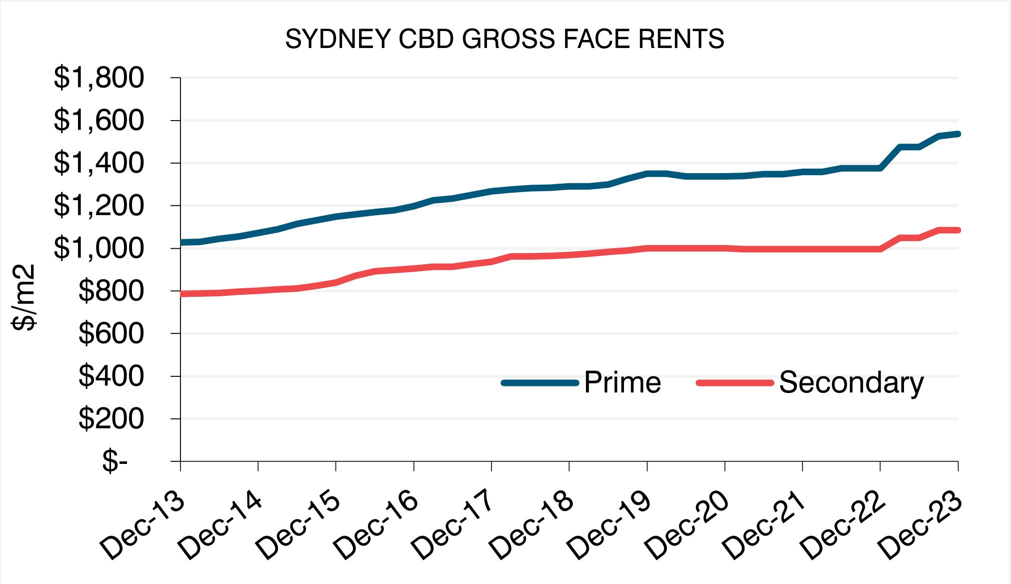
- Sydney CBD Prime gross face rents increased by circa 11.81% in the twelve months to December 2023 to range between $1,150 and $1, 925 per square metre.
- Sydney CBD Secondary gross face rents increased by circa 9% during the year, ranging between $870 and $1,300 per square metre in December 2023.
- CBD Prime incentives increased by circa 1.5% in the twelve months to December 2023, ranging between 32% and 38.5%. Similarly, secondary incentives increased by circa 1.5%, ranging between 30% and 38%.

YIELDS

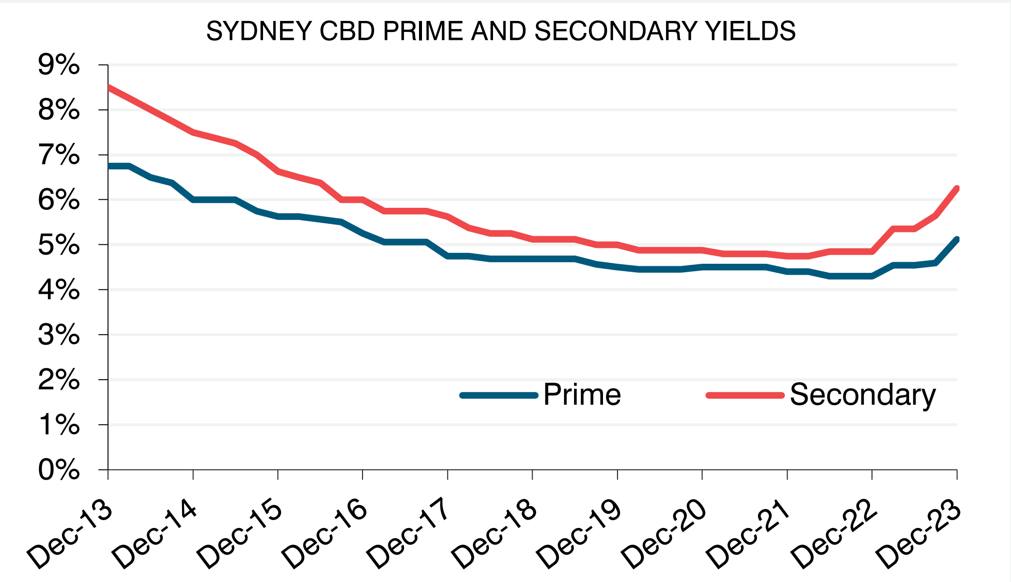
- Prime CBD yields ranged between 4.75% and 5.50% during the December 2023 quarter, softening by 75 bps compared to the December 2022 quarter.
- Yields for secondary CBD office assets ranged between 5.50% and 7.00% during the December 2023 quarter. Secondary yields softened by 90bps compared to the December 2022 quarter.

INVESTMENT MARKET

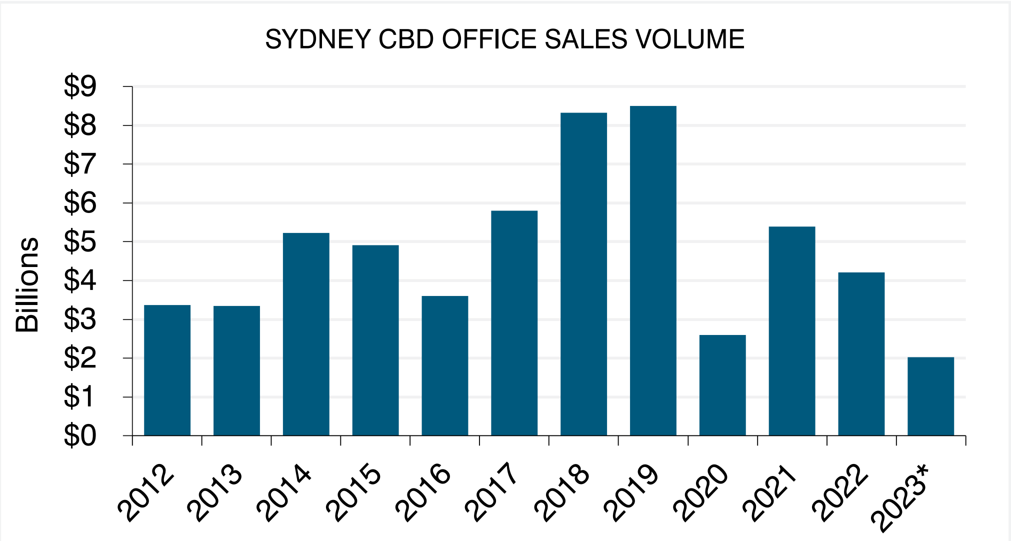
- Transaction activity in the Sydney CBD market has slowed considerably with an estimated $2.02 billion of properties transacting in 2023. This compares with $4.21 billion for the whole of 2022. Increased caution entered the market during the second half of 2022, and this dampened investor demand.
- 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), M3 Property

OPPORTUNITIES AND CHALLENGES

- The Sydney Metro project will improve connectivity across Sydney. Occupier demand is likely to increase around the new 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 in the early part of 2024 is the Metro Martin North Tower Metro Station development (circa 63,000 square metres).
- Gross face rents increased by an average of 5.91% over the year to December 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 DEVELOPMENT

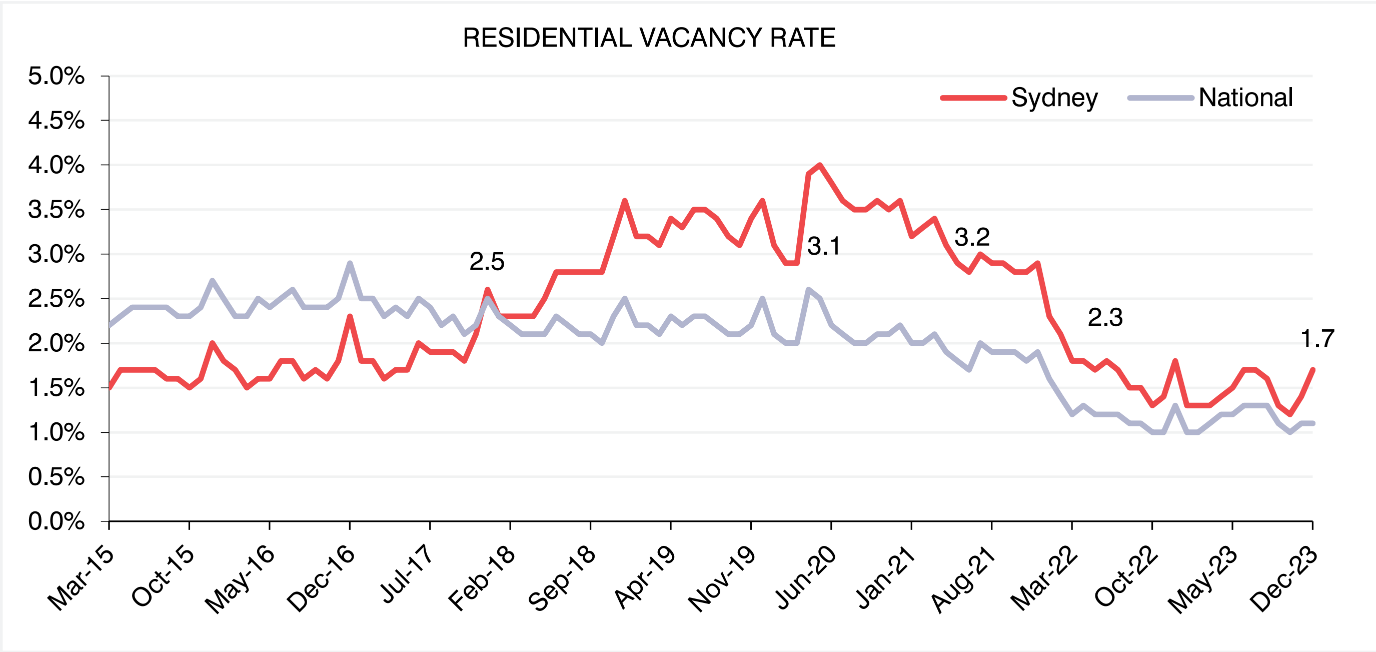
"In the second half of 2023, we saw market conditions stabilise and started to see price growth in the residential sector.

Early market indicators in 2024 are positive, with continued market optimism. The interest rate environment appears to have peaked and construction costs have stabilised. We're continuing to see a better level of pre-sales being obtained."

JARROD MORGAN
Director | Residential Development

CURRENT STATE OF PLAY

- According to CoreLogic, Sydney's median house price was $1,400,630 at the start of 2024, an annual increase of 14.66%. Unit prices increased 8% year on year to reach $834,578 by January 2024.
- 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 46,491 dwellings approved in New South Wales in the twelve months to November 2023, down 12.62% year on year.
- There has been a stronger than expected recovery in residential markets following a downturn during the later part of 2022. The Sydney market recovery slowed in the last quarter of 2023 and house prices are forecast to stabilise through to the end of FY2024.



Source: M3 Property, SQM

WE EXPECT PRICES TO CONTINUE IN AN UPWARD TRAJECTORY.

OPPORTUNITIES AND CHALLENGES

- Population growth has increased exponentially compared to the subdued level 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 in an upward trajectory.
- Median house rents are expected to increase strongly in 2024 as continuing 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.

RETAIL

ANDREW CASH

Associate Director | Retail

“Transaction volumes and sales activity for retail assets in New South Wales increased in the second half of 2023, albeit remaining low in comparison with previous years following the broader market trend.

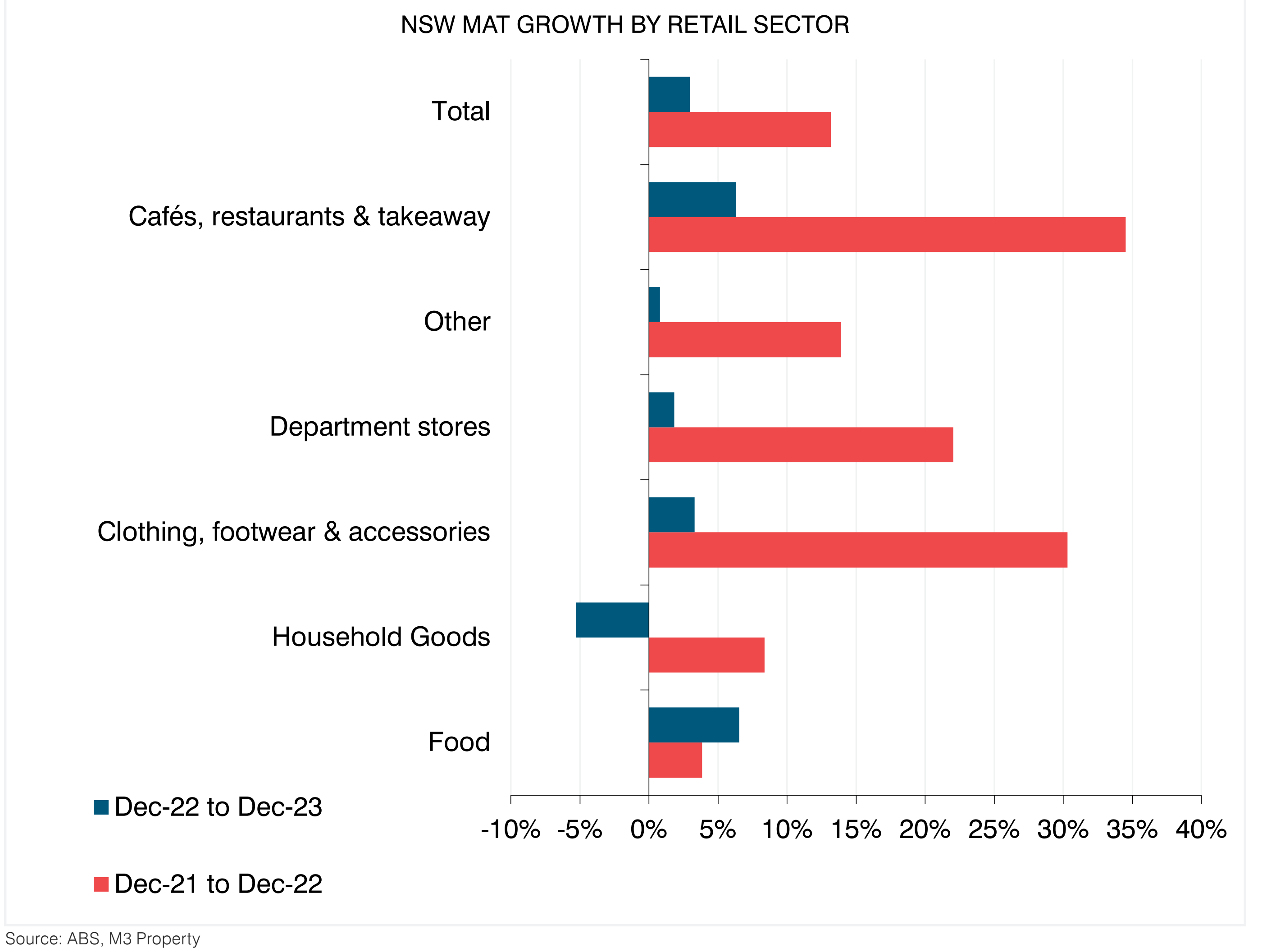
Several transactions that have occurred are yet to be finalised and are due to settle in early 2024. These transactions are likely to provide the market with guidance on market level property yields and to instill confidence for buyers in 2024.

In the second half of 2023, buyer demand was dominated by local and offshore private capital, followed by syndicate/fund groups who accounted for a large weighting of transactions in the retail sector. Institutional groups were the primary sellers, disposing of non-core assets in their portfolios as they recycle capital and continue to observe the broader market conditions.

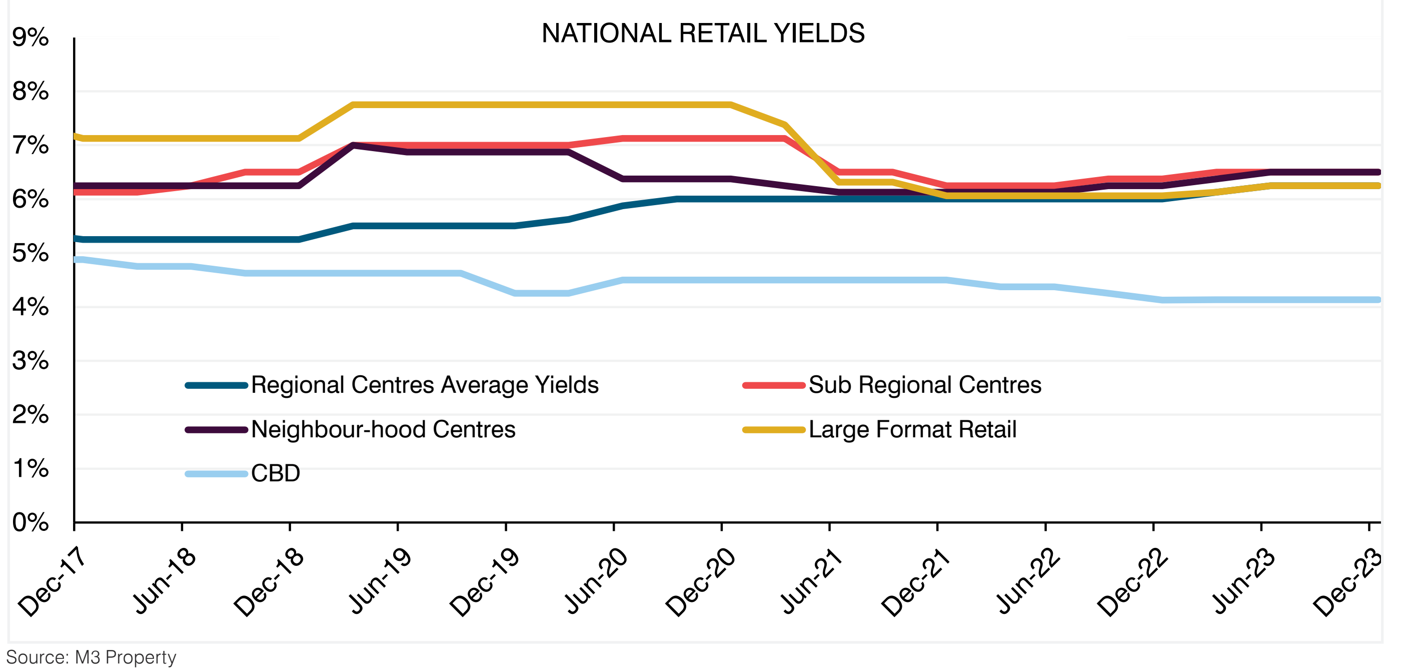
Investors will remain focused on retail assets offering long-term secure income streams to quality tenants, coupled with good income growth.”

CURRENT STATE OF PLAY

- Total retail spending in NSW for the 12 months ended November 2023 increased by 1.24%, which is a significant drop from the 8.85% recorded for the 12 months ended November 2022.
- The strongest growth by retail category was recorded in Cafes, restaurants and takeaway (9.02%), followed by Food (7.03%).
- Rental spreads (i.e. the difference between a tenant's 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.



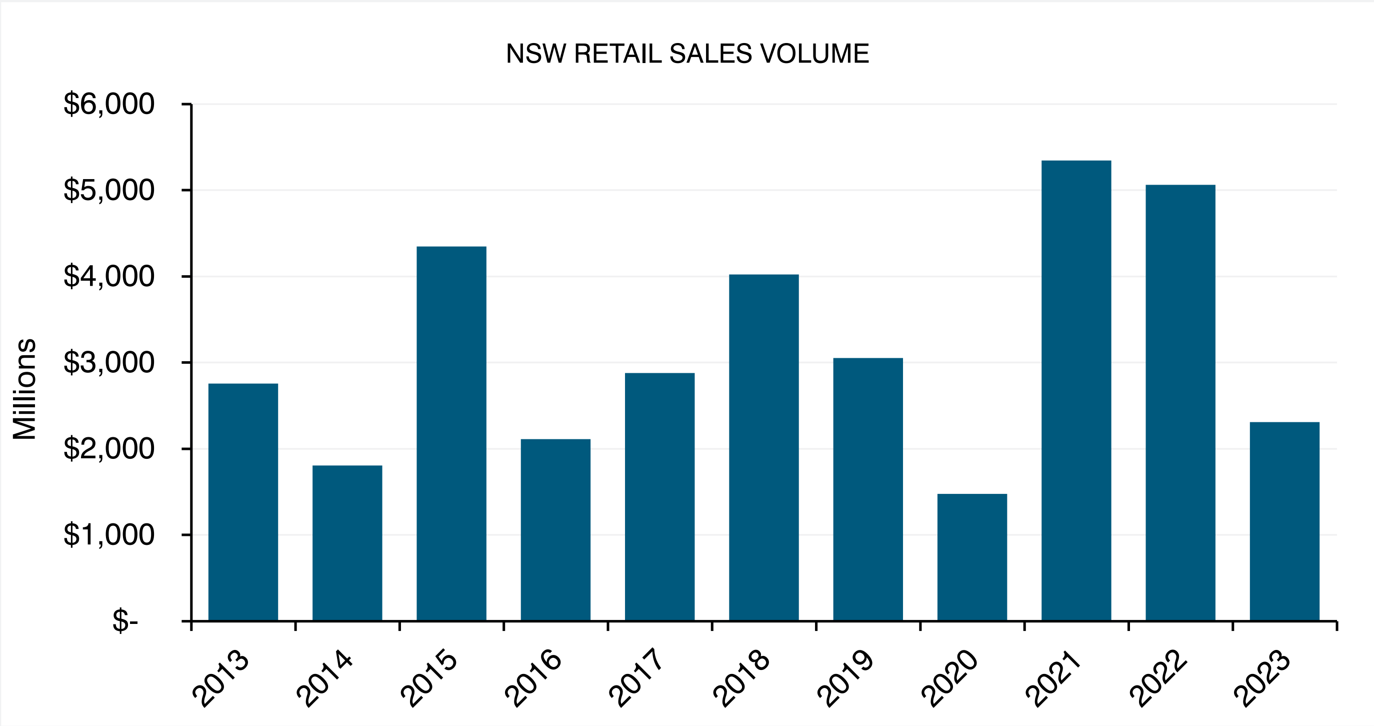
Source: ABS, M3 Property



Source: M3 Property

YIELDS

- Retail yields has been performing similarly to the alternative investment classes of office and industrial.
- There is a softening in Sydney prime yields in the last 12 months, with large format retail centers averaging at 6.13% in December 2023, a 63 bps increase from December 2022 quarter. Prime CBD and Strip are averaging at 4.63% in December 2023, a 13 bps increase from December 2022.
- Yields for prime neighbourhood centres have softened by 25 bps to 5.75% in the year to December 2023, while yields for prime sub regional centres softened by 38 bps to 6.25% in the year to December 2023.



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

INVESTMENT MARKET

- Retail investment activity in New South Wales has slowed with $2.3 billion of properties transacting for the year 2023. This compares with $5.06 billion for the whole of 2022.
- Although there are more Retail transactions in 2023 compared to 2022 (90 transactions in 2023 as compared to 64 in 2022), price per transaction has dropped significantly.
- Private buyers were the most active buyer group in 2023, accounting for 47.9% of sales (by $ value). Offshore and Institutional buyers were the next largest buyer groups taking up circa 20% of sales each.

TRANSACTIONS

- There were 6 transactions of more than $100 million in 2024.
- The largest transaction was the sale of a 49% stake in Chatswood Chase in Chatswood. Vicinity Centres had originally sold the 49% stake to GIC back in 2017 and have now acquired it back for $307 million giving Vicinity full ownership of the centre.
- Other noteworthy transactions over $150 million were the sale of Menai Marketplace in Sutherland for $150 million and Stanhope Village in Stanhope Gardens for $158 million.

OPPORTUNITIES AND CHALLENGES

- Coles and Woolworths continue to acquire sites to capture market share and develop new neighborhood centres to put to market.
- Sales activity is likely to be challenged until there is stability and certainty in the economic and inflationary environment.
- Rising statutory and operating outgoings for retail assets may cause impact to the net return for owners.
- Institutional owners continue to offer non-core secondary grade assets to market to recycle their capital and rebalance their portfolios to pay down redemptions or fund development pipelines.
- Non-core secondary-grade retail assets have been challenged, providing higher-yielding opportunities for active buyers.
- Retail assets with development and/or value-add opportunities are likely to be challenged with added risk and uncertainty in the construction markets, albeit those groups with strong leasing and repositioning capabilities could see benefit.

OUTLOOK

- Local and offshore private capital are likely to continue challenging other buyer groups to capitalise on quality retail assets, particularly up to $100 million.
- Investors will remain focused on assets offering long-term secure income streams to quality tenants, coupled with good income growth.
- The market is likely to witness further cost-of-living pressures impacting revenues of some retail categories.
- New tenants are likely to demand more favourable terms and higher incentives to account for rising fit out costs and cost of living pressures.
- The market will continue to closely observe broader economic market trends and transactions will be key to seeking certainty on appropriate market investment returns.
- If we see stability and certainty return to the market in 2024, it is likely we will witness more alignment in vendor and purchaser expectations and transactions across the sector.

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