Banner

The Quarterly

Property Report
June 2023

Investment. Knowledge. Growth.

Contents

Introduction

Welcome to the Q2 2023 edition of Banner Asset Management's Quarterly Property Report.

A combination of cyclical and structural factors drove the performance of the local real estate market in the three months to June 30 as it adjusted to economic conditions and the lingering consequences of the pandemic.

Residential property continued to rebound in the face of rising interest rates, primarily as a result of continued supply issues and resurgent migration. The pace of the gains, however, began to slow in June – perhaps as a sign that rate hikes had quelled buyer confidence.

In commercial real estate, Australia's industrial and logistics property remains a standout with the lowest national vacancy rate in the world. The outlook for the sector remains generally favourable as vacancy rates are expected to remain low for the foreseeable future.

The local office market is facing similar headwinds to other countries but prime space continues to provide relatively solid results. The Brisbane CBD market, in particular, remains a standout performer in terms of rental growth.

In our Spotlight section, we take a look at the future of petrol stations as a result of the uptick in local electric vehicle (EV) sales. The available evidence suggests the full transition to EVs will likely take 30 years or so – and that petrol stations consequently continue to be a viable property investment. Petrol station owners are also diversifying their operations beyond fuel to include services such as food and convenience shopping, in a move which will complement their potential adoption of EV recharging facilities.

We hope you find these insights useful.

Economic Update

Overview

Australia's economic growth continues to moderate with the latest official figures showing gross domestic product (GDP) grew by 0.2% in the three months through March, and 2.3% compared to the same time last year [1].

It was the sixth straight quarter of economic growth but also the weakest quarterly growth since the COVID-19 Delta lockdowns in the September quarter of 2021, according to the Australian Bureau of Statistics (ABS).

Domestic demand was the primary contributor to GDP growth, while net trade detracted from growth (as imports rose more relative to exports).

The Reserve Bank of Australia (RBA) paused interest rate hikes at its April meeting but immediately recommenced raising rates in its two subsequent monthly meetings, pushing the official cash rate to 4.1%.

The central bank then paused rate hikes again in the first week of July, with RBA Governor Philip Lowe noting the "4 percentage point increase in official rates since May last year was working to create a more sustainable balance between supply and demand in the economy and will continue to do so".[2]

However, he also indicated the RBA was prepared to resume rate increases if economic conditions warranted it and reiterated the board's priority was to return inflation to target within a "reasonable timeframe".

"Some further tightening of monetary policy may be required to ensure inflation returns to target in a reasonable timeframe, but that will depend on how the economy and inflation evolve," Lowe said in a statement accompanying the July decision to pause rates.

Monthly data shows headline inflation rose 5.6% in the 12 months to May, which was the smallest increase since April last year. While prices kept rising for most goods and services, the increases were smaller than those recorded in preceding months, according to the ABS.[3]

Governor Lowe also noted in his statement that wages growth had picked up in response to a continued tight labour market and high inflation.

"The board remains alert to the risk that expectations of ongoing high inflation will contribute to larger increases in both prices and wages, especially given the limited spare capacity in the economy and the still very low rate of unemployment," he said.

The RBA's expectation is the economy will grow as inflation returns to the 2-3% target range, but Lowe again said the "path to achieving this balance is a narrow one" – in a mantra the central bank has adopted for some time now.

GDP rose by 0.2% in the March quarter.

The unemployment rate remained low at 3.5% in June.

The RBA lifted interest rates twice in the June quarter to 4.1%.

Australia's population growth accelerated to 1.9% in the year to December 2022.

Source: Australian Bureau of Statistics, Reserve Bank of Australia

1 ABS (2023, 7 June), 12 things that happened in the Australian economy during the March quarter | Australian Bureau of Statistics (abs.gov.au) [Press release]

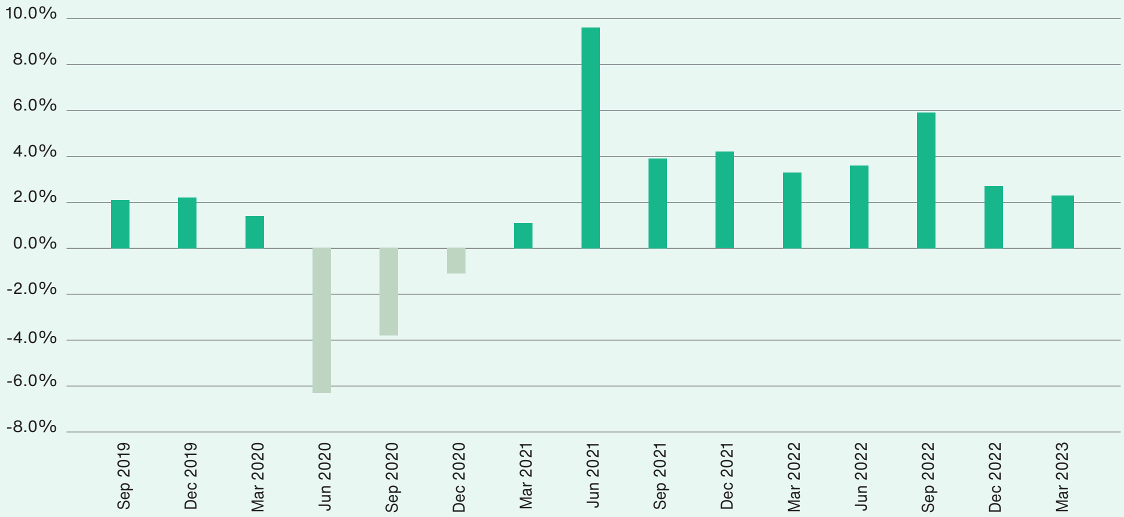
2 RBA (2023, 4 July), Statement by Philip Lowe, Governor: Monetary Policy Decision | Media Releases | RBA

3 ABS (2023, June 28), Monthly CPI indicator annual rise of 5.6% in May 2023 | Australian Bureau of Statistics (abs.gov.au) [Press release]

The numbers

Annual GDP growth moderates

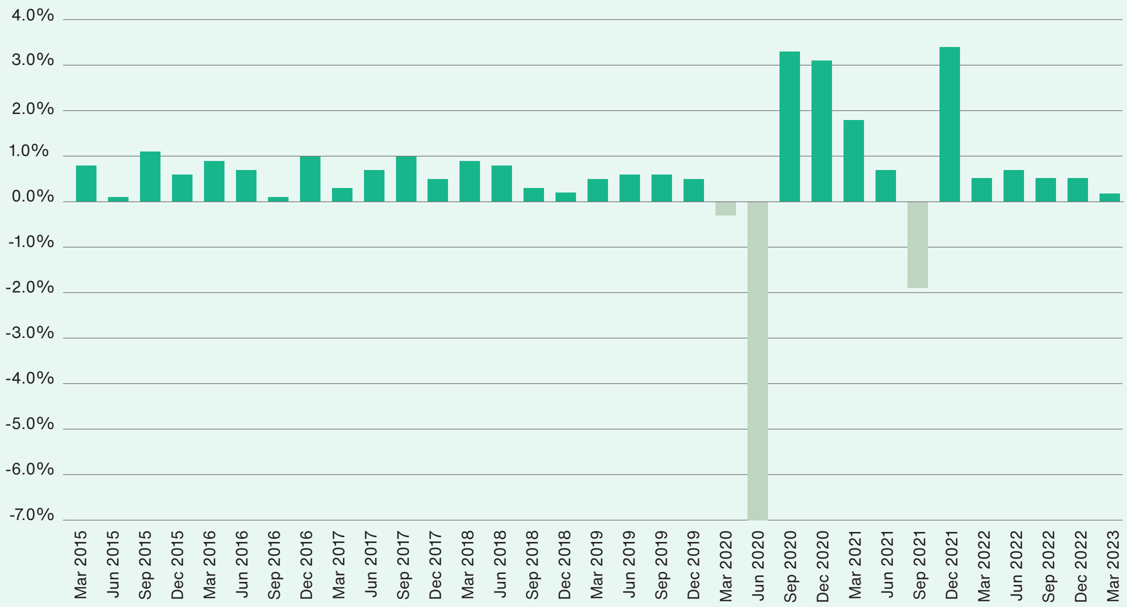
Source: ABS



2.3%
Decrease
of 0.4%

Quarterly GDP growth continues to ease

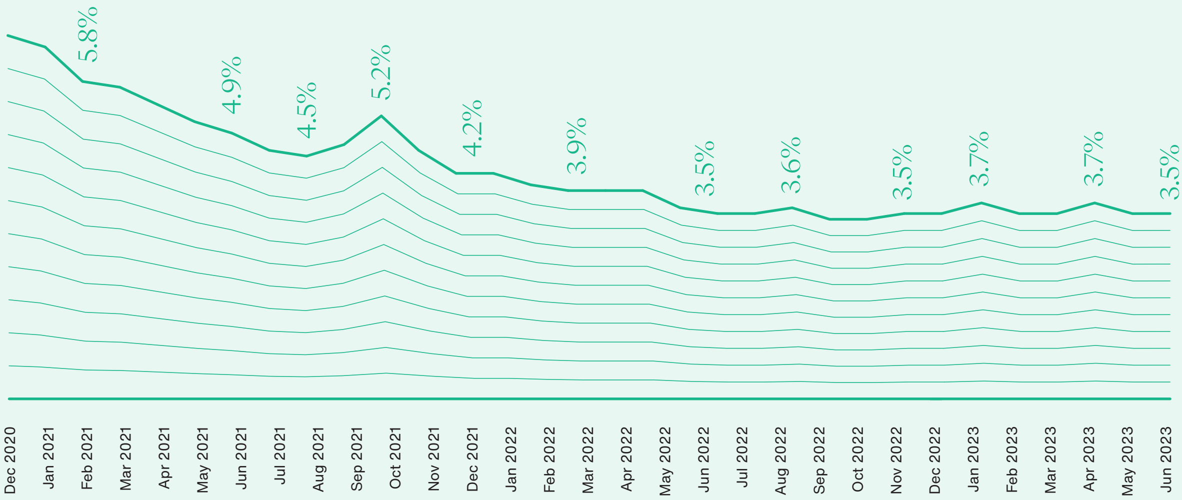
Source: ABS



0.2%
Decrease
of 0.4%

Unemployment rate steadies

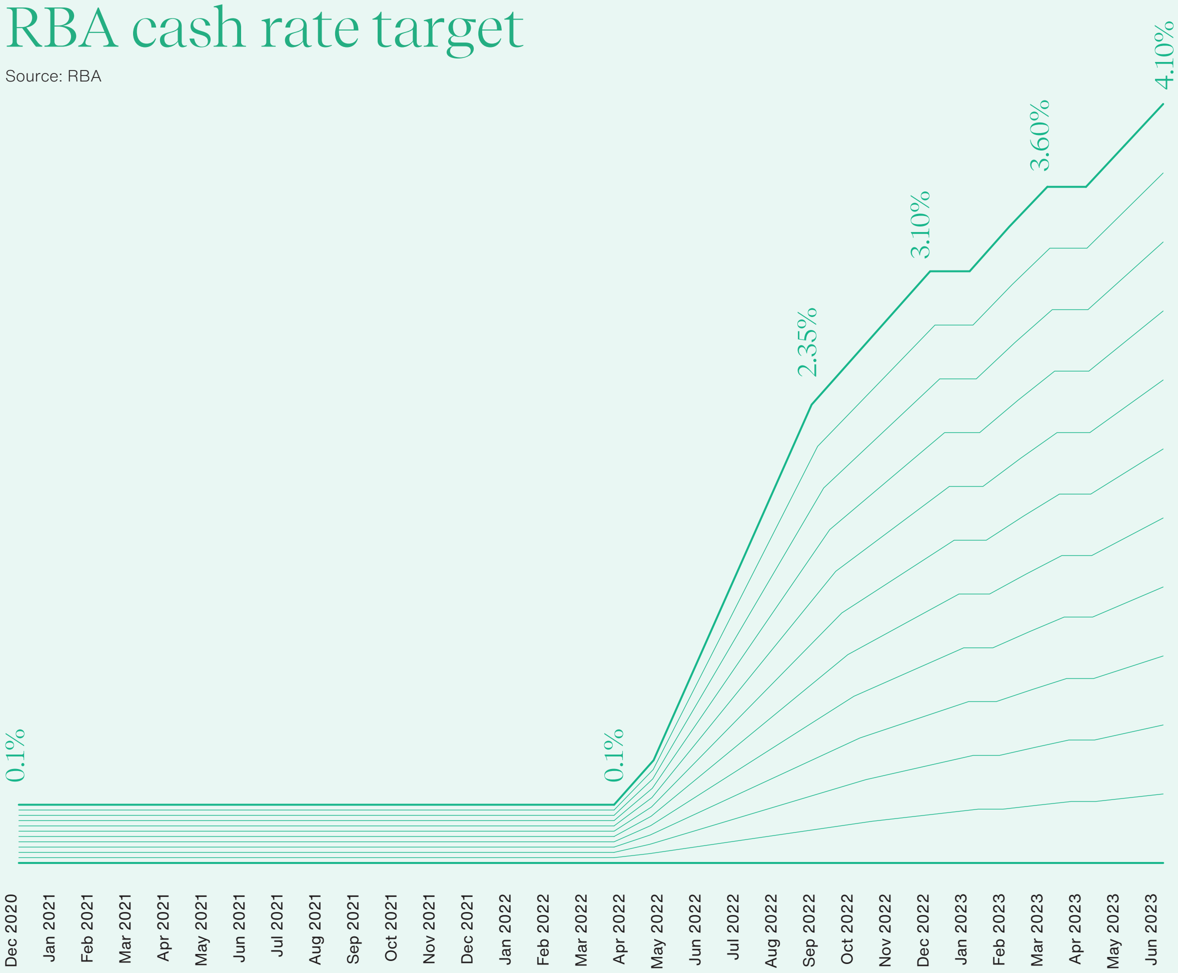
Source: ABS



3.5%
No change from May

RBA cash rate target

Source: RBA

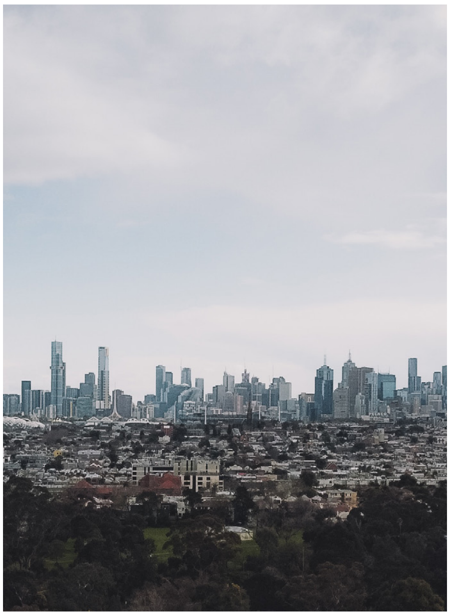


4.1%
Increase of 0.25%

Residential

Performance

Hans Wibawa, Investment Analyst



Low supply and post pandemic migration helped push national housing prices up by 2.8% in the June quarter, led by the Sydney and Brisbane markets.

It was the highest quarterly rise since January last year, according to CoreLogic, though national prices remain 6% below the previous high recorded in April 2022[4].

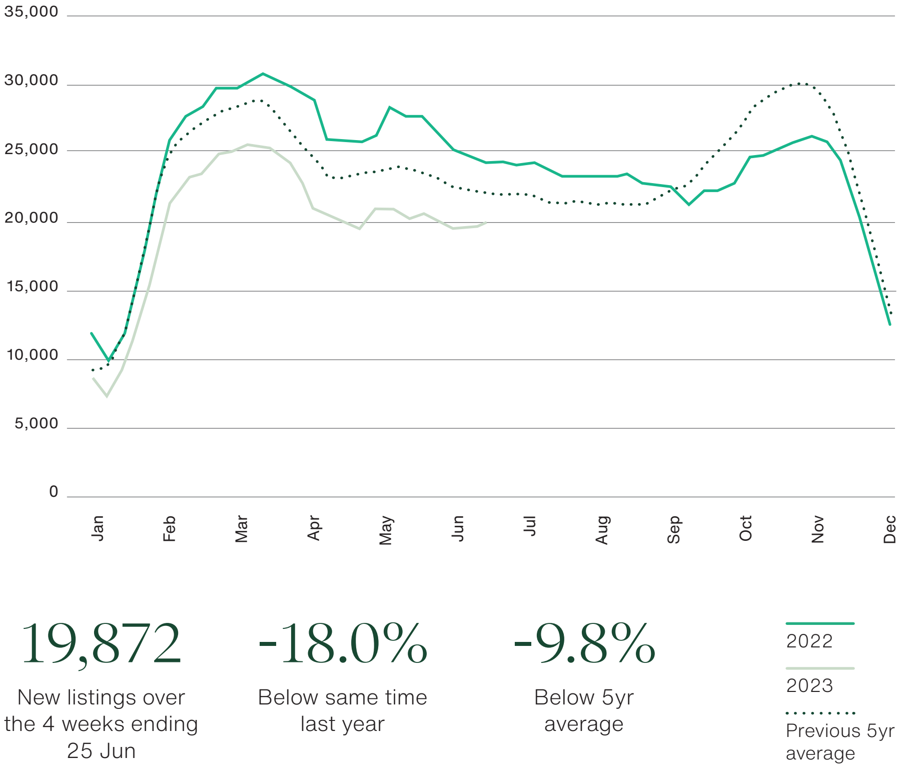
The ongoing lack of supply has created an environment favouring sellers, with capital city listings in the four weeks ending June 25 almost 20% lower than the same period last year[5].

The overall pace of capital gains eased in the month of June, perhaps as a sign that sentiment was falling as interest rates bite.

Darwin was the only capital not to record a gain in the quarter, while regional housing values grew at a slower pace than major cities[6].

New listings, rolling 28-day count, combined capitals

Source: Corelogic



19,872 New listings over the 4 weeks ending 25 Jun

-18.0% Below same time last year

-9.8% Below 5yr average

4 CoreLogic (July 3, 2023), Hedonic Home Value Index
5 ibid
6 ibid

Supply issues

In May, over 15,000 total dwellings were approved, a 20.6% increase from April but still 9.8% down on an annual basis[7]. National Australia Bank's Chief Executive Officer, Ross McEwan, called for urgent action to accelerate housing supply in an appearance before the House of Representatives Standing Committee on Economics in early July.

He stated there is a "chronic undersupply of housing" and that "fast-tracking planning permissions and development would be the single most effective way" to reduce pressure[8].

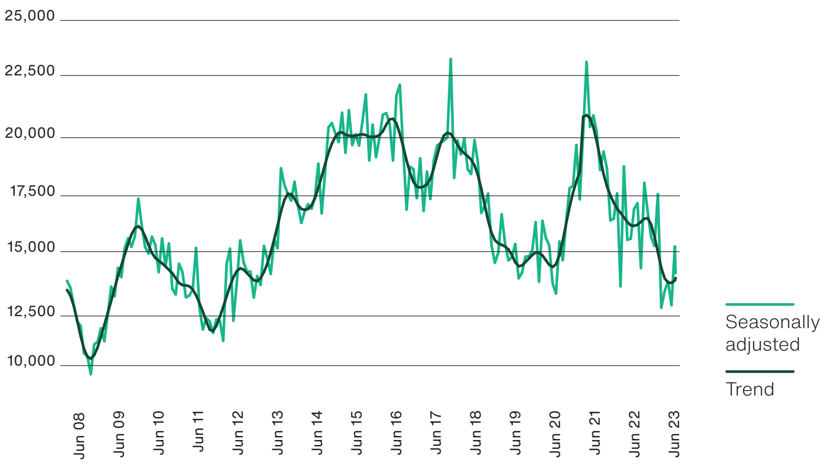
A forecast increase in Australia's net overseas migration to 400,000 this financial year – 27% above the previous record set in 2008 – will create even more demand for housing.

That demand will initially be felt in the rental market but ultimately extend to owner-occupied property as permanent migrants purchase their own homes, according to CoreLogic.

Overall, the National Housing Finance and Investment Corporation expects the gap between supply and household formation to burgeon out to -106,300 dwellings between 2023-2027 as a result of rising material costs and supply chain issues[9].

Dwelling units approved (a)

Sources: RBA



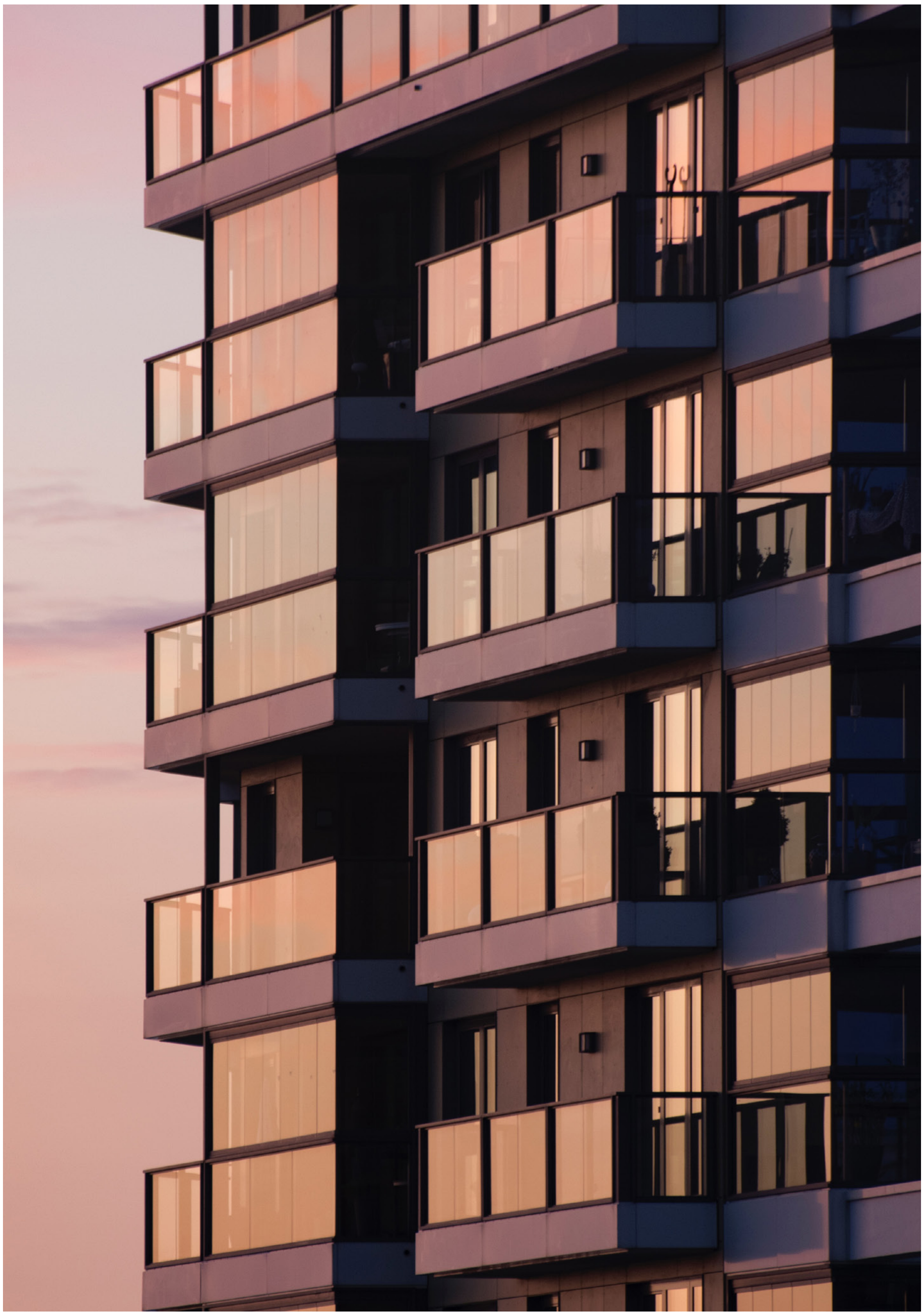
7 ABS, (May 2023), Building Approvals Australia – May 2023

8 Australian Financial Review, (12 July, 2023), NAB boss delivers urgent housing supply warning

9 NHFIC, (3, April 2023), State of the Nation's Housing Report 2022-23

Rental market eases

There are early signs annual growth in rent is easing across the combined capitals but it remains high versus previous years, reaching well into double digits for units in major cities and hovering around 10% for houses.



Increased migration was a major factor in annual rent appreciation for units, which reached as much as 18.8% in Sydney in the year to June 30. Perth clocked up the biggest annual increase in rents for houses (13.1%) and Melbourne followed with a 10.6% gain[10].

Rental vacancy rates across the combined capital are also rising (to 1.1% on June 30) but, nonetheless, remain well below the decade average of 2.8%[11].

CoreLogic argues an increase in the size of the average household in response to rising costs means rental appreciation will moderate further over time.

10 CoreLogic (July 3, 2023), Hedonic Home Value Index,

11 ibid

Market snapshot

National	Melbourne	Sydney	Brisbane
Capital City Dwelling Prices	**Dwelling Prices**	**Dwelling Prices**	**Dwelling Prices**
+3.3% On quarter	+1.8% On quarter	+4.9% On quarter	+3.0% On quarter
-4.8% On year	+5.7% On year	-5.1% On year	-8.2% On year
-18.0% Capital city sales volumes: on year	+12.6% Rents: on year	+12.9% Rents: on year	+10.3% Rents: on year
+11.5% Capital city rents: on year	1.3% Vacancy in June	1.7% Vacancy in June	1.0% Vacancy in June
3.6% Capital city gross rental yield	1.2% Up from 1.2% in May	1.5% Up from 1.5% in May	1.0% Steady from 1.0% in May

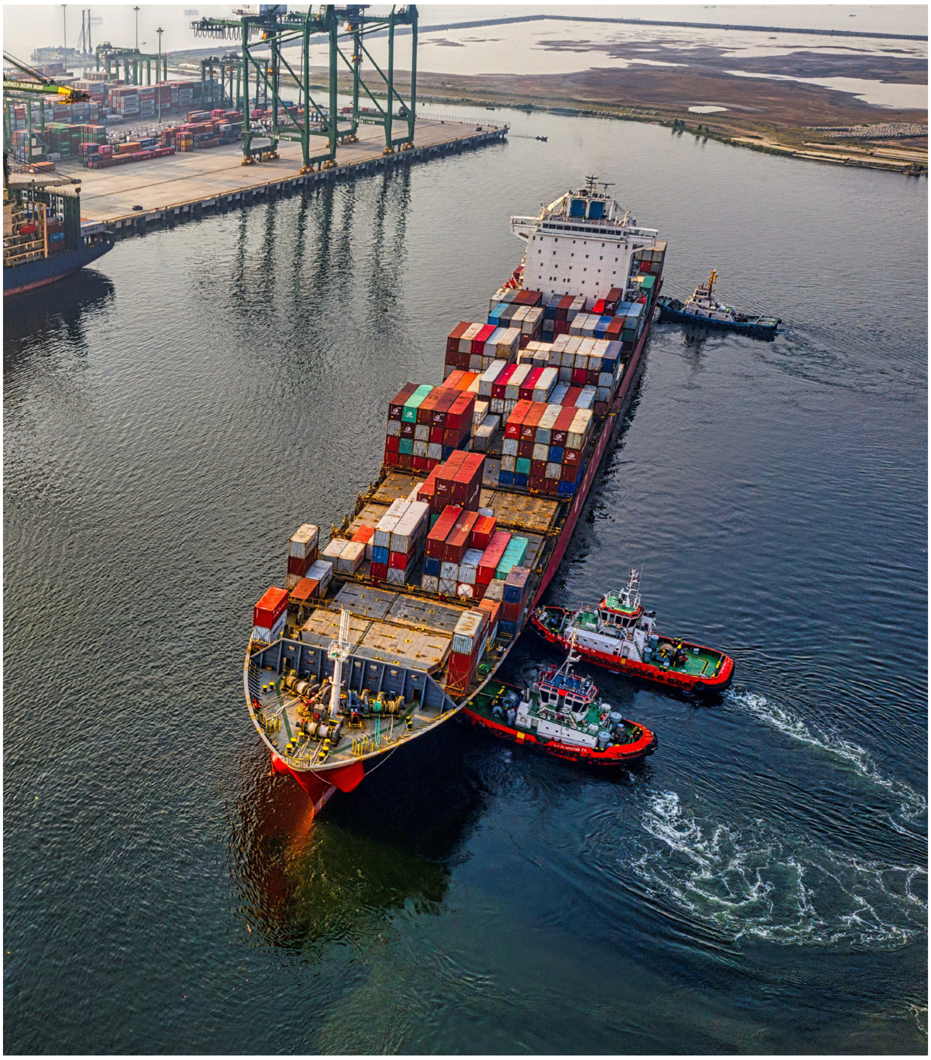
Source: Corelogic, SQM Research residential vacancy rates

Industrial & Logistics

Key Insights

Industrial and logistics property has been the standout segment of commercial property since the onset of the COVID pandemic.

With most markets around the country recording severe supply shortages for warehouse and industrial premises, vacancy rates continue to reflect extremely tight leasing conditions. According to CBRE, Australia's industrial and logistics sector has the lowest national vacancy rate in the world, while Sydney's vacancy rate, at 0.2% for the first half of 2023, is the lowest of any city worldwide[12].



12 CBRE Research, (July 2023) Australia Industrial and Logistics Vacancy 1H23

Signs of easing vacancy rates

Persistent undersupply is likely to keep vacancy rates at very low levels for the rest of the year, but there are early signs that rental markets may be beginning to relax. JLL reports some companies have started subleasing warehouse space that now are surplus to their requirements as supply chains return to normal following disruptions due to pandemic restrictions[13].

Leasing inquiry levels have also returned to normal after reaching record highs in 2021 and 2022, according to Colliers, although it notes that an extra 2.9 million square metres of vacant space would be needed before market rental growth was affected[14].

As the market stands, rents have risen 5.3% over the second quarter of 2023, and 40% over the past 18 months, according to Colliers research reported in the *Australian Financial Review*[15].

With rents rising and vacancy rates tight, capital values for prime industrial property increased 3.6% nationally over the second quarter to $3420 per square metre, while yields rose 18 basis points to 5.27%, the *Australian Financial Review* reports[16].

As in previous quarters, most stock under construction is pre-committed, meaning supply shortages are unlikely to abate for many months to come.

Vacancy rates 1H 2023

National	Melbourne	Sydney	Brisbane
0.6%	1.1%	0.2%	0.6%

Source: CBRE

Super prime net face rental growth 2Q23

Melbourne*	Sydney*	Brisbane**
7.6%	5.4%	18.5%

Prime net face rental growth year-on-year to 2Q23)

* Source: CBRE
** Source: Cushman & Wakefield

13 JLL, (June 22,2023), Warehouse subleases give hope to hamstrung tenants

14 Property Australia, (July 12, 2023), Industrial values continue to rise

15 Larry Schlesinger, Australian Financial Review, (July 3, 2023), Industrial property up 4pc in three months on the back of rental surge

16 ibid

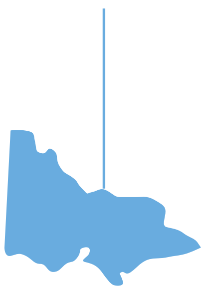
Market Overview

Melbourne

Consistent with previous quarters, Melbourne vacancy rates remain at a record low of 1.1% and rents continue to rise, particularly for prime grade properties. According to CBRE, average super prime rents increased by 7.6% in the second quarter, while prime and secondary rents increased by 6.2% and 5.6%, respectively[17].

Almost 87,500 square metres of floorspace was added to the market in the second quarter. Over the full calendar year, Melbourne is expected to gain almost 900,000 square metres of industrial space, but 78% of this space is already pre-committed[18], so it is unlikely there will be a significant impact on vacancy rates.

"Melbourne's vacancy rates remain at a historic low of 1.1%, leading to rising rents, especially for prime grade properties. Second quarter data indicates a 7.6% increase in average super prime rents, while prime and secondary rents rose by 6.2% and 5.6% respectively."



Sydney

Average vacancy rates in Sydney, at just 0.2%, are the lowest of any city worldwide[19]. The chronic supply shortages are constraining activity in the market and fuelling rental growth.

The development pipeline in Sydney is 143% larger than the long run average, which should ease the pressure over the quarters to come, but like elsewhere most of the supply due for completion in 2023 is pre-committed[20].

Sydney super prime rents increased by 5.4% and prime rents rose by 5.9% in the quarter[21].

"Sydney boasts the world's lowest average vacancy rates at a mere 0.2%. Severe supply shortages are constraining the market and driving rental growth. Super prime rents in Sydney increased by 5.4%, while prime rents saw a 5.9% rise in the last quarter."

Brisbane

In Brisbane, 36% of the 705,000 square metres of new floorspace expected to be added over the year was completed in the second quarter, a 31% increase on the previous quarter's levels. However, as in other cities, supply shortages persist, with 90% of the supply pre-committed[22].

Vacancy rates in Brisbane remain at record lows: 0.6% for the first half. As in other cities, tight supply has driven rental growth higher. Prime net face rents increased by 7.7% in the city's North over the quarter, by 4.4% in the Australia Trade Coast precinct, and 4.1% in the Outer South[23].

With additional supply due for completion over the coming quarters, vacancy rates and rents may stabilise in the near term, but Brisbane's long-term growth prospects are expected to hold demand above historic levels.

"Vacancy rates in Brisbane's first half were at a record low of 0.6%, driving rental growth. Prime net face rents saw notable increases, with 7.7% in the city's North, 4.4% in the Australia Trade Coast precinct, and 4.1% in the Outer South."

17 CBRE Research, (July 10, 2023), Figures Melbourne Industrial and Logistics 2Q23
18 ibid

19 CBRE Research, (July 10, 2023), Figures Sydney Industrial and Logistics 2Q23
20 ibid
21 ibid

22 CBRE Research, (July 10, 2023), Figures Brisbane Industrial and Logistics 2Q23
23 ibid

Office

Headwinds persist

Andrew Turner, Founder and CEO

Australia's office market is facing similar headwinds to other countries but prime space continues to provide relatively solid results.

According to a CBRE report released in May, national prime market net absorption is only slightly below its 20-year average of around 143,100 square metres [24].

A relatively wide dispersion between cities is evident as a result of key drivers of activity. Brisbane has proved a standout in terms of rental growth as supply struggles to match its expanding population and employment growth. Meanwhile, Melbourne is forecast by Colliers to record growth in underlying demand in the near term.[25]

A key question for the sector is the extent to which assets may be revalued as a result of factors such as rising interest rates and entrenched working-from-home practices. Office values in unlisted property funds fell by over 5% in the June quarter, according to MSCI Real Assets,[26] and major superannuation funds are also reported to have written down their office exposures in recent months.

As a result, market commentators will be keeping a watchful eye on the office sector as the rest of 2023 plays out.

24 CBRE (2023, May 28), Australian Office Market Q1 2023 | CBRE Australia
25 Colliers (June 2023), Insights & Outlook: Offices
26 AFR, (2023, July 13), "Office values slump 5pc for unlisted funds in June: MSCI"

Overview

Melbourne CBD

A flight to quality continues to be reflected in positive net absorption rate for prime office space as employers seek to woo staff in a tight labour market, according to Cushman and Wakefield[27].

Prime net effective rents are $395 per square metre per annum, representing a year-on-year decline of 3.7%.[28]

Colliers has identified the Victorian capital as among the international cities likely to experience growth in underlying demand for offices moving forward – a view based on factors such as percentage changes in capital values over the past 12 months, prospects for further change and the city's long-term economic outlook[29].

"Melbourne may see further capital value adjustments as yields move out, but the rental outlook is optimistic and the long-term economic growth story is very positive," the Colliers team noted[30].

Sydney CBD

Overall vacancies remain elevated but tenant demand for prime space is strong as the flight to quality evident since COVID-19 continues to play out.

According to CBRE, rental growth has accelerated across the CBD with the average prime net face rental rate ending the second quarter at $1,078 per square metre – an increase of 6.2% year on year[31]. Elsewhere, rental rates were mixed. Areas close to the CBD such as North Sydney and the city fringe recorded strong growth, but other areas had only mild increases or even contractions[32].

New supply of CBD office space is expected to be limited for the remainder of 2023. Cushman and Wakefield reports that around 70,000 square metres of refurbished office space will become available –with 80% coming online in the second half of the year[33].

Brisbane CBD

Rental growth in the Queensland capital has been strong across property grades as a lack of supply and rising inflation combined to push up gross face rents in the first half of the year. Indeed, Savills has singled out Brisbane as a market which has experienced a particularly strong increase in demand for office space as a result of both employment growth and net interstate migration[34]. Population inflow from other states reached the highest annual level in more than a decade in September last year[35].

The fact that no additions to supply are planned for 2023 means positive net absorption is likely to continue into the latter half of 2024.

Prime gross effective rents are $485 per square metre per annum, a year-on-year increase of 10.2% – and continued pressure on rents is likely until new supply is complete.[36]

13.8%

Vacancy rate
for Melbourne CBD

Source: Cushman & Wakefield

11.3%

Vacancy rate
for Sydney CBD

Source: Cushman & Wakefield

12.9%

Vacancy rate
for Brisbane CBD

Source: Cushman & Wakefield

27 Cushman & Wakefield (2023, June 29), Q2 2023 Melbourne CBD Office Report
28 ibid
29 Colliers (June 2023), Insights & Outlook: Offices
30 ibid
31 CBRE (2023, July 10), Sydney Office Rental Rate and Incentives Snapshot 2Q 2023
32 ibid
33 Cushman & Wakefield (2023, June 29), Q2 2023 Sydney CBD Office Report
34 Savills (2023, May), Office Briefing
35 Knight Frank (2023, May), Brisbane CBD Office Market Report
36 Cushman & Wakefield, (2023, June 29), Q2 2023 Brisbane CBD Office Report

Spotlight

EV growth: The challenges and opportunities for investors

Nick Lakin, Chief Lending Officer

Demand for electric vehicles (EVs) has experienced an uptick in Australia, with sales up by 86% in 2022 compared with 2021, according to data from the Electric Vehicle Council[37].

37 Electric Vehicle Council (February 7, 2023), Australian Electric Vehicle Recap 2022

The Australian Government is now backing the sector, allocating $7.4 million over four years in its May budget to support the introduction of fuel efficiency standards aimed at encouraging the uptake of EVs[38]. This follows the launch of a national EV strategy in April.

The transition away from fossil fuel powered vehicles will have an impact on traditional petrol stations in the long term. But as the Electric Vehicle Council notes, Australia's adoption of EVs is still making slow progress, accounting for less than 0.5% of Australia's passenger and light commercial vehicle fleet.

Limited supply of EVs in Australia, along with a lack of charging infrastructure, and general rises in energy prices mean it will be many years before fossil fuel vehicles are phased out entirely.

During the transition period – likely for the next 30 years or so – petrol stations will continue to be a viable investment.

Indeed, Ray White Commercial notes that the appetite for service station assets – particularly among private investors – has increased since 2011[39].

In 2022, Ray White Commercial recorded over $1 billion worth of petrol station transactions across Australia, up 52% on the previous year's result. Average yields on petrol stations rose in 2022 to 5.9%, from 4.4% for metropolitan assets and 5.1% for regional assets in the previous year[40].

38 Australian Financial Review (May 9, 2023), "The 20 budget measures you might have missed"

39 Ray White (January 9, 2023), Service Station sales up despite threat of EVs

40 ibid

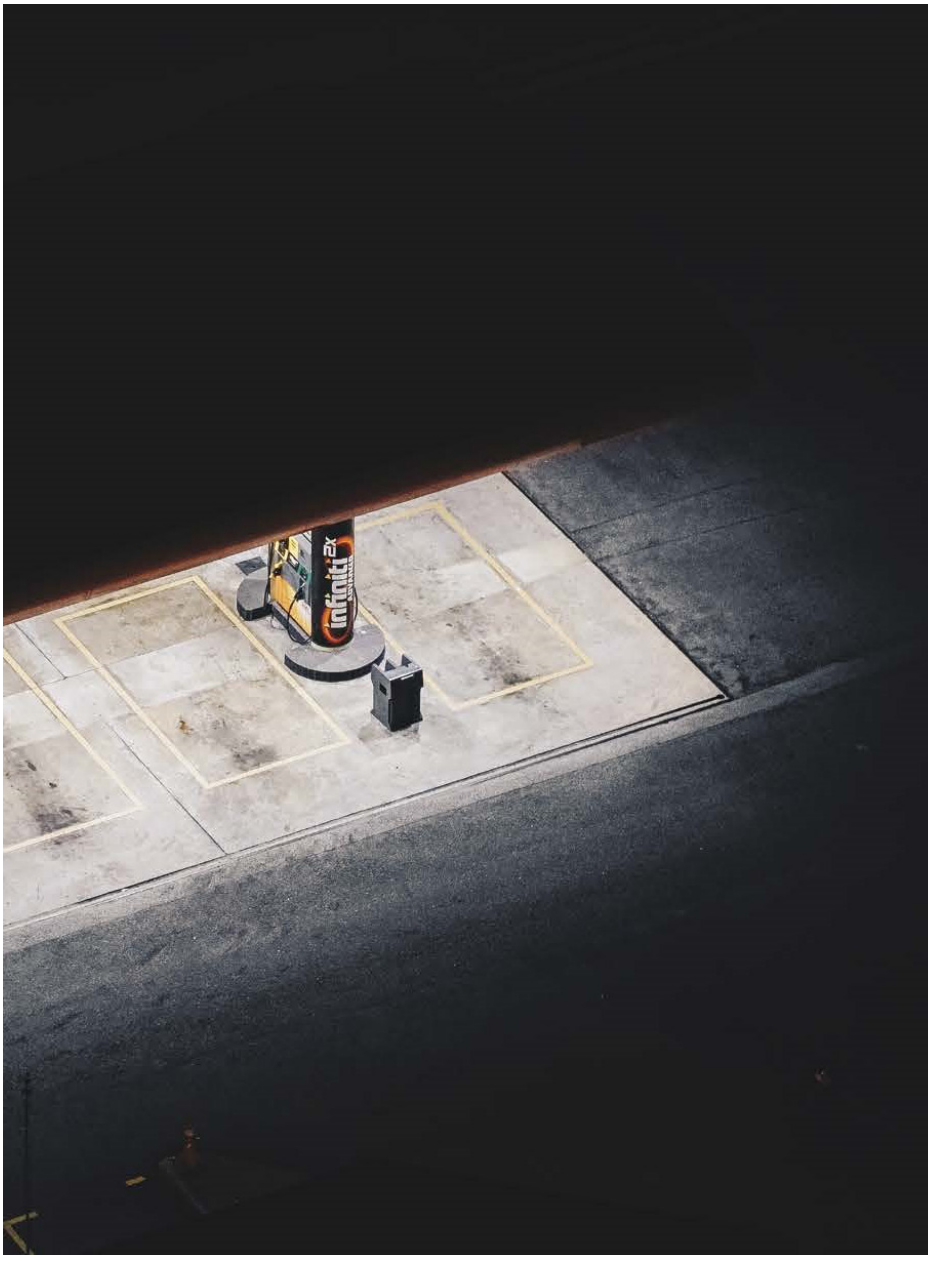
Performance drivers

Petrol station property offers investors stable income secured by long-term leases to national and multi-national tenants.

For example, Banner's recently completed 7-Eleven service station and convenience store in Southside in the Gympie region of Queensland is currently leased to 7-Eleven for an initial 12-year term with further extension options.

The Banner Service Station & Convenience Store Property Fund targets average lease terms of at least 10 years, to mostly national tenants. Tenant businesses across the portfolio include brands that are household names such as United Energy, Ampol, Hungry Jack's, Red Rooster and Starbucks, as well as 7-Eleven.

Another attraction to service station properties is that they are highly and professionally maintained, largely at tenants' costs. Leases typically include recoveries of on-costs, reducing the potential cost burden on investors.



The road ahead

Converting petrol stations to electric chargers is a complex process but the long timeframe for transition gives tenants and property owners ample time to adapt or consider their options.

While fuel is the primary product sold at petrol stations, most of these outlets have already diversified their focus, incorporating food and convenience offerings. Fast-food, convenience retail and petrol stations have overlapping demands when it comes to location, requiring high-traffic sites in densely populated areas, Burgess Rawson notes[41].

The outlook for convenience and fast-food retail is strong. While retail sales have been weak over the past year amid cost-of-living pressures, food retailing has recorded monthly rises in 16 out of the 18 months to May 2023, with turnover at cafes, restaurants and takeaway food services at record levels, Australian Bureau of Statistics figures show[42].

In the longer term, property owners may choose to convert their petrol station sites to EV charging stations. These investors will find convenience food, retail, and entertainment options remain in high demand due to the length of time that it takes to recharge an EV, Ray White predicts.

And for investors who choose not to convert their petrol station properties, the assets' locations – typically at major intersections and on main roads in densely populated areas – offer valuable redevelopment potential.

41 Burgess Rawson (April 2023) Convenience Retail: Industry Insights Report" (CR-Industry-Insights-Report-April-2023-LR.pdf (burgessrawson.com.au).
42 Australian Bureau of Statistics (June 29, 2023) "Retail turnover boosted by sales events" [Press Release]

Outlook

Curbing inflation

The RBA has indicated it expects Australia's economic growth to be subdued over the "next couple of years" and that it will take time for inflation to return to target.

The uncertain environment means the outlook for residential property remains unclear, despite the recent rebound in prices.

The potential for still more rate hikes suggests the recovery in national dwelling values may at least slow as borrowers are forced to reel in their budgets, according to CoreLogic[43].

This may prove particularly true as more people reach the so-called fixed rate cliff – at which point their previous cheap home loans will expire and they will have to remortgage at much higher interest rates. A potential increase in listings in the traditional spring selling season could also impact property values, though the anticipated record migration and small pipeline of approved housing supply will likely continue to buoy prices.[44]

Undersupply issues are also impacting the industrial and logistics property sector, where vacancy rates are at record lows, and among the tightest in the world. Demand is showing early signs of softening with subleasing on the rise, but at nowhere near the levels needed to balance the market. Most of the new stock under construction is already pre-committed, so shortages will persist for some time to come, maintaining pressure on rents and keeping vacancy rates very low.

The outlook for office property is perhaps most unclear as the sector continues to adjust to the cyclical and structural dynamics that have impacted it so far in 2023. In such an environment, prime assets are likely to continue to outperform other property grades in the flight to quality that has prevailed since the onset for COVID-19. This is part of a global trend in which Cushman & Wakefield notes that the risk of office obsolescence, or at least the need to reposition assets, is rising.[45]

43 CoreLogic (July 3, 2023), Hedonic Home Value Index
44 CoreLogic (July 3, 2023), Hedonic Home Value Index
45 Cushman & Wakefield, (Retrieved July 24, 2023), Rethinking the office sector: Optimising your asset for a new era

Our clear vision for success

We provide an opportunity for investors to gain exposure to the real estate debt market through lending to established and proven developers for development projects, or for strategic acquisition of sites earmarked for development in the future.

10 Years

Banner has been managing funds for investors for over 10 years.

$5 Billion

Managing over 10 funds, single asset or pooled, over $5b in projects financed with consistent performance.

A consistent and rigorous approach

At Banner Asset Management we provide opportunities to invest in secured debt products and other property through funds alongside project partners.

We invest in developments with a proven use, evidenced either by presales or lease agreements, as well as strong fundamentals, including proximity to population growth and the likelihood of resilient demand.

In the residential space, our focus is on medium density development (apartments and town-houses) in the bigger population centres of Sydney, Melbourne, and Southeast Queensland, which provide greater liquidity and depth than other markets in Australia. This includes mixed-use residential projects that incorporate uses such as office space or retail. We also invest in non-discretionary retail and the industrial sectors, as growth in e-commerce drives demand for warehousing and logistics.

Banner

Investment. Knowledge. Growth.

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