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Shoalhaven

Commercial Property Market Insights 2024

Harrison Fulton AAPI CPV

Certified Practising Valuer

Welcome to the Shoalhaven NSW commercial property market insight for Financial Year 2023 - 2024. Explore insights crafted by your local expert property valuer, Harrison Fulton, to gain a clear understanding of the current property market.

Due to a relatively thinly traded office sector, which is generally considered synonymous with retail assets, for the purposes of this insight we have merged office assets within the commercial category.

Depending on Shoalhaven market activity this will be a publication released on a biannual or annual basis to keep the local market participants and professional community informed of market performance.

In brief, the commercial property market throughout the FY23/24 has been a year of recalibration post an Australia-wide property boom across all sectors. Each of the various asset sectors' performance has differed as we faced multiple interest rate rises aimed at sticky inflation levels, resulting in a decrease in overall business activity and property transaction volumes during this period.

The industrial property market performed the strongest of the sectors amid these economic headwinds. The commercial sector continues to experience an evolving market sentiment being most affected by changing social norms in relation to hybrid WFH (working from home) trends and the rise of online shopping and consumer behaviour.

The development sector has multiple challenges, being primarily labour cost increases, materials shortages and the rising cost of debt. The development sector is highly sensitive to imputed cost and revenue variables which have had a magnified effect on site values and development feasibilities.

The cost of capital has greatly interfered with debt serviceability across all of the property sectors which has in broad terms, decreased demand for new acquisitions and also provided motivation to dispose of assets at attractive value levels.

The buyer profile through FY23/24 is commonly described as the 'bargain hunter' looking for softened pricing opportunities to capitalise on the current state of the market.

On the other hand, asset owners have the consensus of 'deal or no deal', indicating affordability of assets is still present and owners are determined to ride out the storm.

This indicates that the current cost of debt has not intimidated asset owners and the market has remained resilient amidst tightening debt serviceability lending ratios and a heightened interest rate climate.

Noting also that interest rates have remained steady since November 2023 with the cash rate moving from 4.10% to 4.35%.

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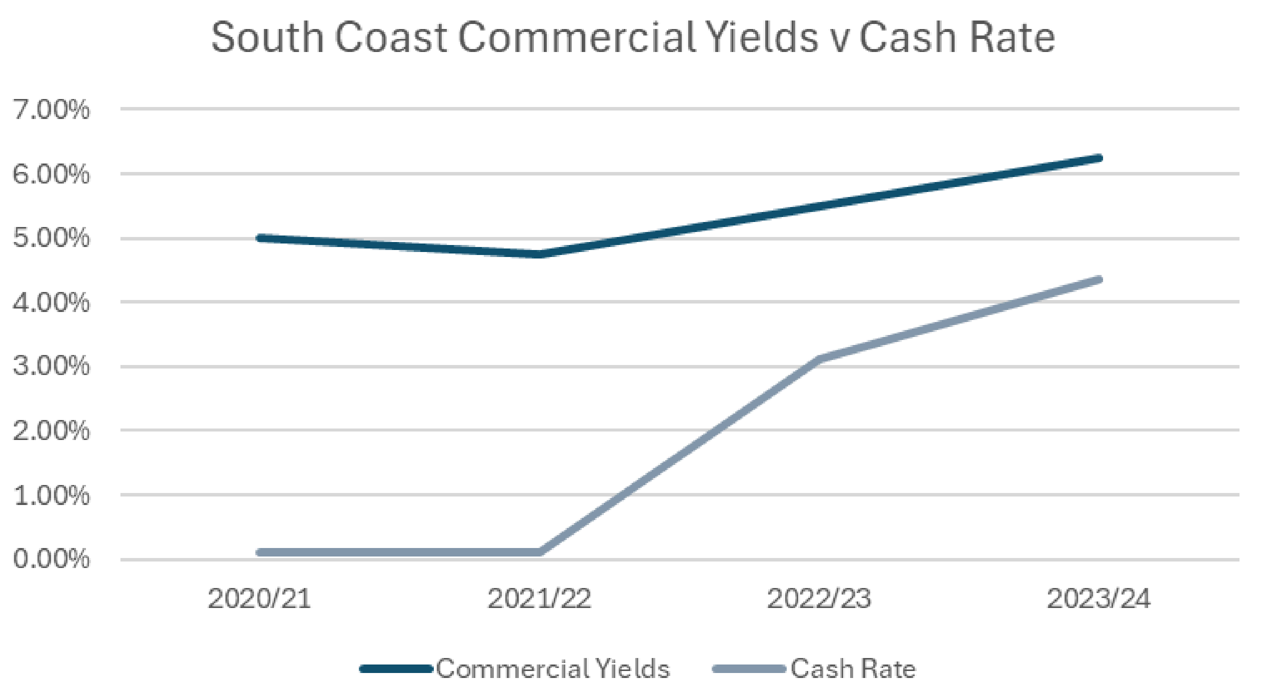
Commercial

The commercial property sector throughout the South Coast has shown signs of resilience due to the tightly held market behaviour which has masked yield softening.

This is also evident in the drastic drop in transaction volumes, which according to our records have dropped approximately 70% since the 2021/22 record low interest rate environment had its effect on market participant behaviour.

This is telling of the impact cost of capital has on the region’s commercial sector, coupled with inflationary pressures on building outgoings and decreased discretionary spending.



Multi-tenanted assets within this region are predominantly owned and purchased by private investors and self-managed superannuation funds. These landlords are typically interested in rental returns and the potential for capital growth.

Over the last 6-12 months, these investors have priced higher yields into their purchases to factor in the heightened interest rate environment and rising building outgoings which directly impact their debt serviceability.

Our observations indicate gross rental structures have also had a large part to play in this. Rising building insurance premiums, land tax and council rates have eroded net operating incomes across the board.

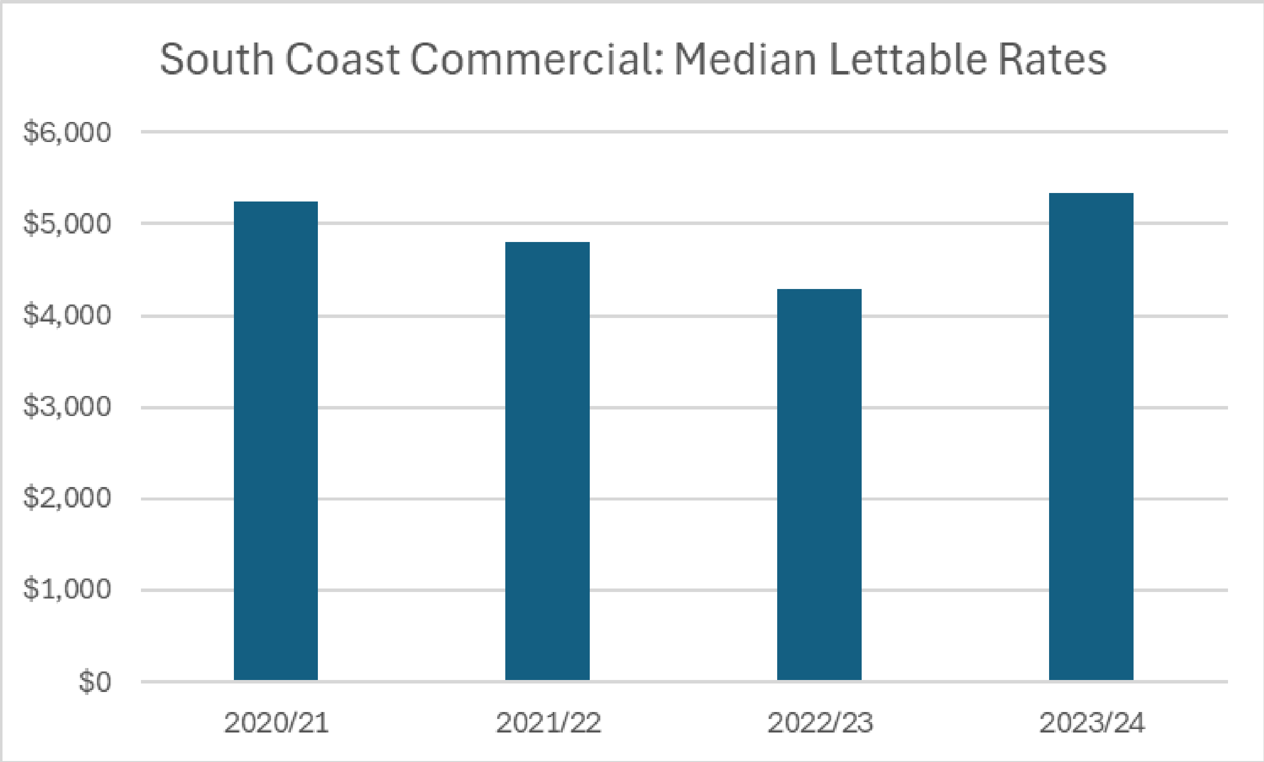
Albeit landlords which have mechanised rental reviews in alignment with movements in CPI, based on discussions with landlords and agents, somewhat offset the rising outgoings' impact on their net incomes.

Such reduced gearing ability has influenced the majority of landlords' transactional decision-making, when either selling, divesting or refinancing to purchase an additional property for their portfolio; instead many investors are waiting, with a view to ride out the storm.

Information gathered from discussions with local market participants and agents suggest this decision to hold and wait is driven by a positive outlook for the sector which has relatively masked the softening of the market, potentially due to transactions where yields have increased but not yet transacted.

Investment properties have experienced longer marketing periods, which while extending timelines, offers opportunities for buyers to secure valuable assets at competitive prices. This situation reflects a healthy negotiation environment, allowing for favourable outcomes for buyers.

The presence of delistings in the market indicates a strategic patience among investors, primarily due to prioritising capital value preservation of what they purchased assets for during the low interest rate environment of previous years. Discussions with agents and landlords reveal that current conditions are creating opportunities for investors to acquire properties at attractive rates, leading to a more balanced market dynamic.



The single tenancy strata or freehold assets are dominated by owner occupiers which typically translate into the firmest analysed net market yields and strong lettable area rates, as owner occupiers typically factor in internal financial agreements which translates into increased motivation to pay more than an investor. These properties have been performing relatively well despite the current market challenges, especially those properties with excellent exposure and strategic positionings within popular township areas such as Mollymook, Ulladulla, Milton, Berry and Huskisson.

Commercial properties with a clear development reversion still trade well and are also tightly held, however the outlook on any future development has petered in recent times, namely with heightened construction costs and long approval times diminishing perceived terminal development value. However the option of any future development to an investor still typically influences lower yields and higher building value rates.

The working from home dynamic has been a large driver in the subdued performance and rental growth, especially coupled with decreases in discretionary spending. This has decreased spending in main townships at local businesses across the region, affecting retail business performance directly. This leaves landlords prioritising tenant security rather than aggressively pushing for rental growth.

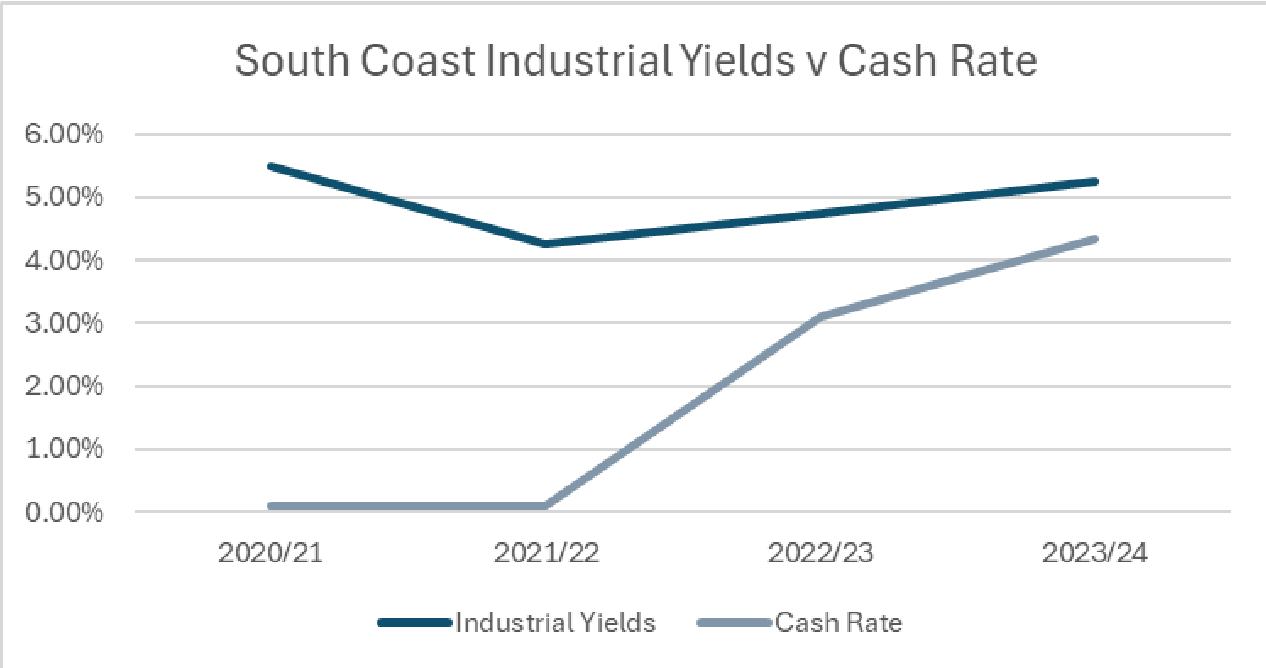
Whilst there are difficulties in the market, there are also just as many opportunities to capitalise on a softened environment for astute investors, being wise in pricing, and conducting good asset management and value-creation practices to preserve value.

Industrial

The south coast industrial market has remained stable in recent months from January 2024, however also slightly subdued from previous years due to the RBA's increases in interest rates which have been on hold for several months.

Industrial has been the star performing sector amidst market woes, proving the most resilient against rising outgoings, online shopping, and working from home trends.

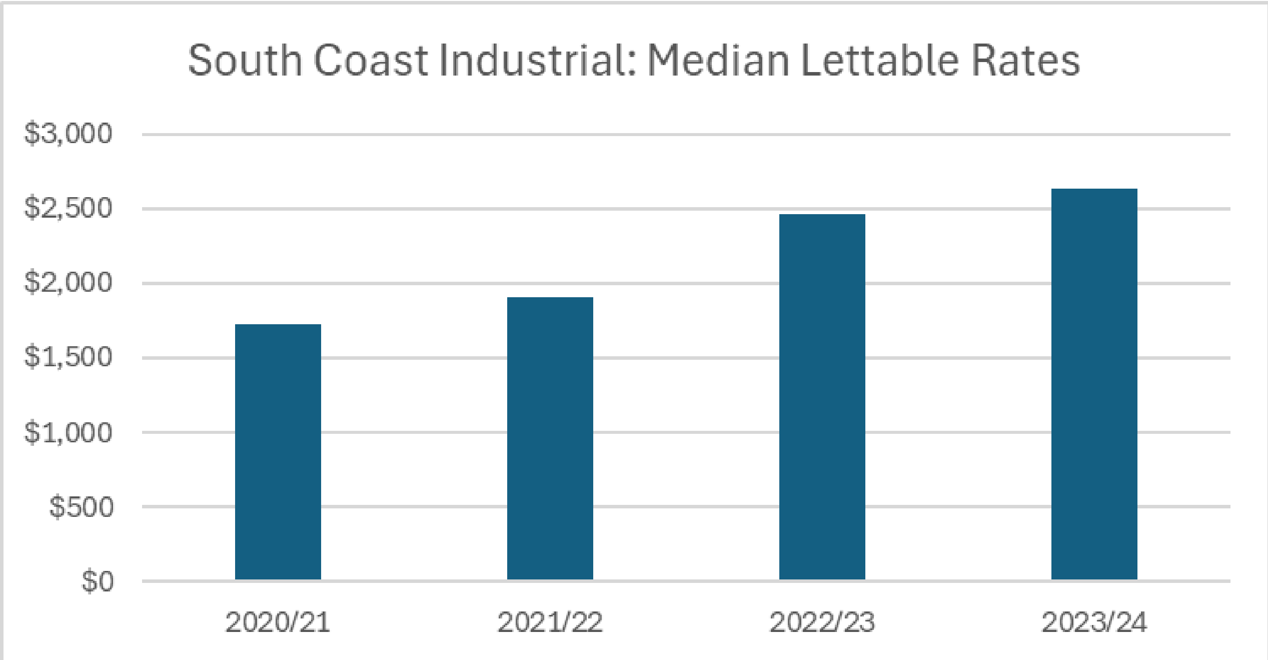
As the demand for e-commerce has increased, the logistics sector has grown simultaneously to meet the demands of storage, transportation and last mile delivery needs. This has naturally translated into strong demand for industrial and warehousing assets, coupled with a lack of supply which has resulted in elevated demand through recent years.



Inflationary pressures on outgoings, especially insurance and statutory items have had a softer impact on industrial owners across the board. This is partly due to the strong presence of owner occupiers, and secondly, industrial markets have net leases in place which recover most of the building outgoings from the tenant. These two factors coupled with a firm/low yield environment has protected capital value levels across the industrial market.

Tenant rental affordability is up for question, with a sharp increase in building insurance and council rates, commonly recoverable, putting pressure on tenants throughout the sector, potentially influencing an increase in gross rental structures particularly for sub 100 sqm industrial assets.

Rental prices in the industrial sector are remaining strong on the south coast for prime locations particularly for property fronting the Princes Highway and other main arterial roads, which include large yard space and also ample onsite parking provisions. The industrial property market within the region is displaying its resilience due to the nature of the market being tightly held and dominated by owner occupiers.



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There is a shortage of industrial property supply which also aids in underpinning the market's strong performance. New land releases are few and far between, however as new developments reach the market, they show generally strong numbers.

There are large council-owned englobo industrial parcels in the Ulladulla region, which had been considered for subdivision and sale to the open market in circa 2017, however, this was not deemed viable at the time.

In recent times, economic sustainability of the Shoalhaven council has brought these same parcels into consideration again, though this is still in the early stages of investigation and consultation. The majority of the industrial product throughout the south coast region is older and lower clearance and there is a clear demand for modern high bay facilities.

Discussions with local business owners who utilise industrial property for their operations – or need to, have expressed this need for new facilities/supply. This limited supply pipeline has bolstered demand and thus been a driving force for maintained asset value levels and strong yields.

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Formal Qualifications

- Associate of the Australian Property Institute
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- Certified Practising Valuer
- Bachelor of Business Property

Industry Experience

Harrison's professional experience includes commercial, industrial, retail and residential property and development site valuations through New South Wales, for the purposes of mortgage security, financial reporting, rental assessment and advice including acquisition and disposal, strategic advice, feasibility and negotiation purposes.

Harrison specialises in and services the NSW Shoalhaven and surrounding commercial property market, providing advice on a variety of asset classes and service types.

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