WESTERN SYDNEY INSIGHTS

NSW Block of Units

ISSUE 3 RWC WESTERN SYDNEY JUN 2024

Executive Summary

The block of unit market has transitioned into one of the most *attractive* asset classes in the current marketplace.

This has been aided by the growing sophistication surrounding the "build to rent" concept and heightened interest from institutional and offshore investors, resulting in the unassuming "in one line" unit block, its robust returns and promising potential undeniable. The disparity between the demand for and supply of residential housing has ensured values of residential properties have grown, vacancies decline and rental growth commonplace, a trend that is not anticipated to abate in the short term.

Residential vacancy rates continue at historically low levels throughout New South Wales, with the middle and outer rings experiencing the greatest impact due to their strong population base and relative affordability. This compression in vacancy has resulted in significant rental growth, a phenomenon that is also evident in the size of assets in demand, with bedsit rents recording the most rapid growth, followed by 2-bedroom units that cater to families priced out of the rental house market.

These impressive rental returns have brought the block of unit market to the forefront of investors' attention, with a larger pool of buyers seeking to capitalise. Encouragingly, some owners are divesting their generational assets at a time when discounting on a per-unit basis has lessened.

So far this year, there has been a flurry of investment opportunities, with approximately $165 million in transactions recorded. Robust activity in the inner and eastern suburbs has contributed to an uptick in average sale prices. Despite increasing financing costs, investment yields have experienced minimal upward movement, with the range of rates tightening and averages only marginally increasing.

The attraction of investment not only stems from rental growth, but also from future opportunities. Given the high cost of construction, the existing built form presents an attractive investment, as the replacement values continue to increase with high construction and labour costs. The potential for future subdivision or development, in conjunction with the strong gains observed in the broader residential market, remains a key consideration for investors.

If you'd like to discuss this report in more for learn more about the Block of Units market, we would be delighted to engage in a conversation with you.

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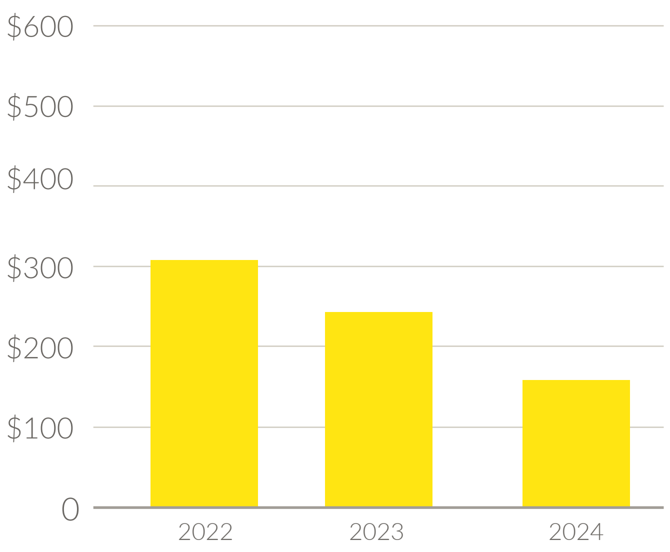
Block of Units
Key Statistics

TOTAL SALES TRANSACTIONS

$ MILLIONS



SALES TRANSACTIONS

2022	$307.1M
2023	$239.1M
2024	$164.9M *TO 1 JUNE 2024

AVERAGE TRANSACTION SIZE: $6.6M

GROSS YIELD RANGE: 2.8% - 7.0%

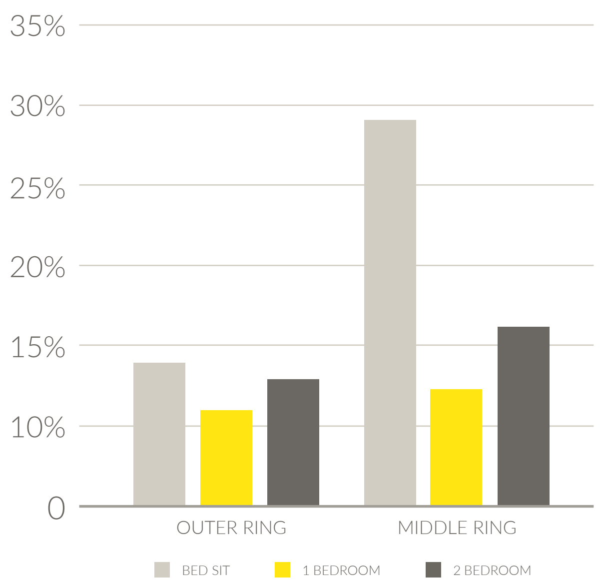
SOURCE: REINSW (APRIL 2024)

1.5% SYDNEY TOTAL VACANCY	**1.5%** MIDDLE RING VACANCY	**1.3%** OUTER RING VACANCY

SOURCE: REINSW (APRIL 2024)

% ANNUAL GROWTH IN AVERAGE UNIT RENTS

% ANNUAL GROWTH



% ANNUAL GROWTH IN AVERAGE OUTER RING UNIT RENTS

(3 YEAR ANNUAL AVERAGE)

BED SIT	14.3% (11.1%)
1 BEDROOM	11.1% (9.4%)
2 BEDROOM	13.2% (11.1%)

SOURCE: FACS INSIGHTS (MARCH 2024)

% ANNUAL GROWTH IN AVERAGE MIDDLE RING UNIT RENTS

(3 YEAR ANNUAL AVERAGE)

BED SIT	28.6% 18.4%)
1 BEDROOM	12.7% (15.9%)
2 BEDROOM	16.7% (17.9%)

SOURCE: FACS INSIGHTS (MARCH 2024)

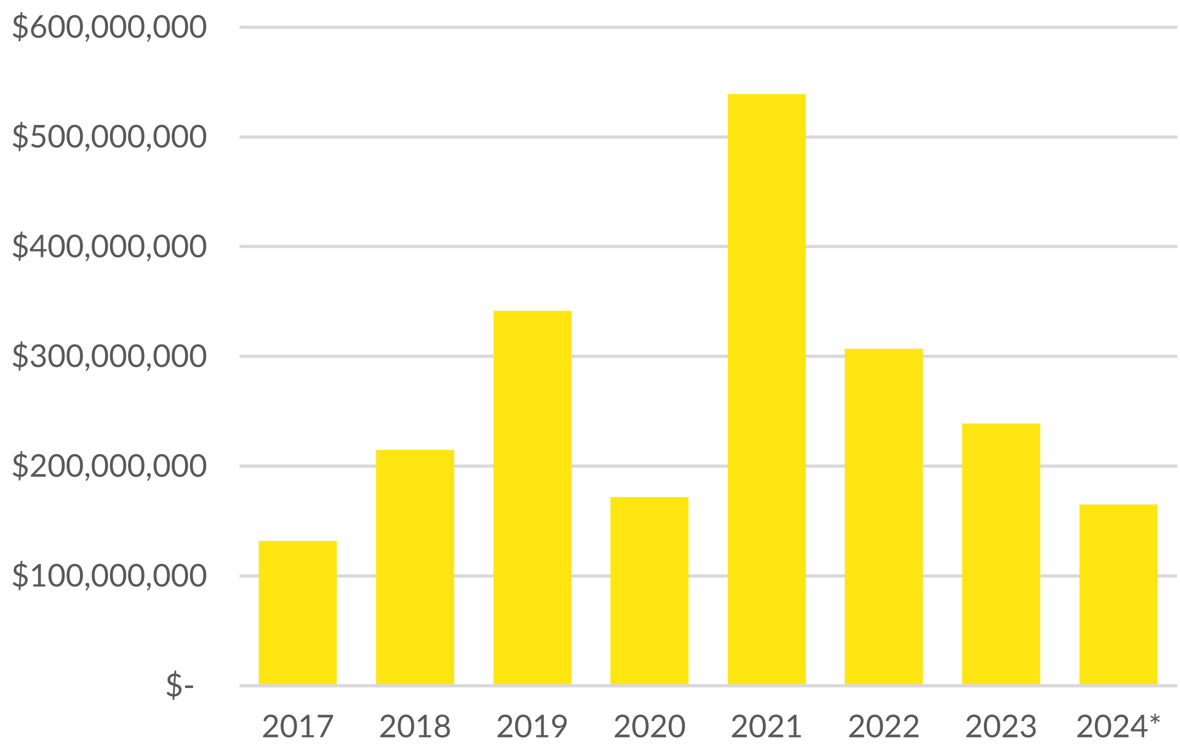
6.4% - 6.6%
INVESTMENT INTEREST (ONLY) RATES

SOURCE: RBA (MARCH 2024)

Transaction activity has started the year *strong.*

Block of unit assets are now in the limelight, resulting in an uptick in investment demand, with many long-term owners looking to capitalise on the changing attitudes toward the asset class.

NSW BLOCK OF UNIT TRANSACTIONS



SOURCE: RWCWS *2024 REPORTED TO 1 JUNE

THE RISE OF THE BLOCK OF UNIT MARKET

The block of unit market has risen in popularity over the last few years. However, with assets tightly held, investment volumes had continued to move downward since the peak of the market in 2021. Encouragingly, the rising profile of the block of unit segment has seen a shift in attitudes towards this investment type, reducing the discounting typically associated with these assets when considering value on a per-unit basis.

The change in sentiment has been aided by the ongoing pressures on the housing market across NSW, notably in Western Sydney, where housing supply additions have not kept up with the rapid growth in population.

This has caused:

- A significant uplift in median prices for both the house and unit market, rising to new long-term highs.
- In addition, low vacancy has resulted in strong rental gains, shining the spotlight on residential as a robust asset class garnering quality return.

VENDOR ACTIVITY AND TRANSACTION LEVELS

Some vendors are taking advantage of this changing fortune, which has resulted in close to $165 million transacting in the first five months of the year. Representing 25 reported sales, the average transaction level has risen to $6.6 million, indicative of the strong level of activity in the inner Sydney and eastern suburbs market, highlighting an average unit price of $800,000. This uptick, compared to 2023 results of $682,000, is indicative of not only a change in transactions by location (including limited regional transactions) but also the elevated prices achieved across Sydney.

OPPORTUNITIES FOR INCREASED CAPITAL RETURNS

The opportunity to strata subdivide and add value is a major attraction of this asset class. Many longer-term private buyers enjoy the growing income and prospect of capital returns linked to the residential market. In the current environment, the high cost of replacement is making established dwellings such as these even more attractive.

This mismatch in housing supply and demand has spurred on "build to rent" projects in Australia, an asset class popular in Europe, UK together with multi-family homes in Asia. The block of unit market is the precursor to these emerging market segments, offering tenants long-term leasing certainty and owners a regular, stable income stream while captialising on underlying growth in residential housing.

Residential vacancy rates *remain low.*

The Australian housing market, particularly in NSW and Western Sydney, is under significant pressure due to rapid population growth outpacing the supply of new homes. This has led to prolonged low vacancy rates, impacting the block of unit market.

The Australian housing sector is facing ongoing pressure, with the issue becoming more severe in NSW due to significant population growth.

During the 2022/23 financial year, NSW's population increased by
174,100 people

The completion of new housing has not been sufficient to meet the growing demand

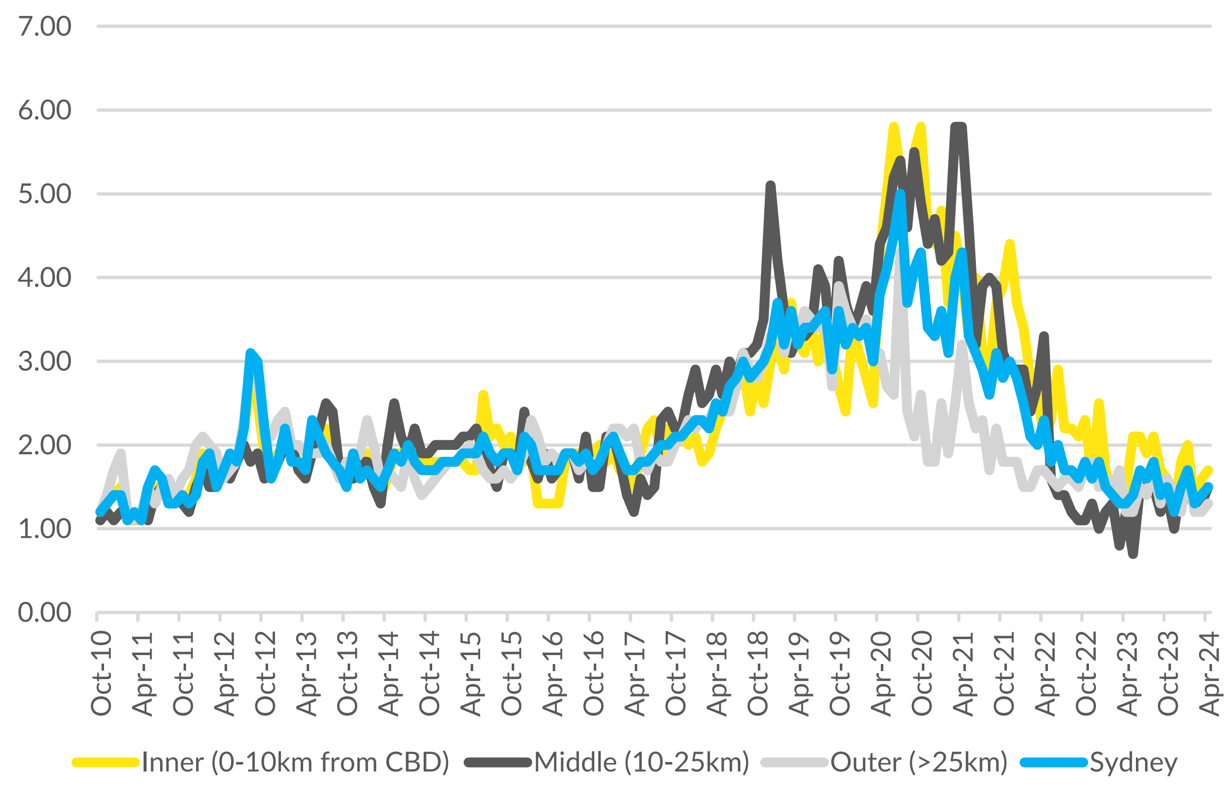
WESTERN SYDNEY'S CHALLENGES

The Western Sydney region is expected to face the most significant challenges, as it is **projected to accommodate an average of 53,340 new residents annually from 2024 to 2041.** This influx of new people will require approximately 24,178 new homes each year, placing immense strain on the housing market and leading to substantial increases in rents and record low vacancy rates.

VACANCY RATES IN SYDNEY

In April 2024, the Real Estate Institute of New South Wales (REINSW) reported the vacancy rate of Sydney's outer ring at 1.3%. Over the past two years, vacancies have consistently remained low, averaging 1.5% following a significant drop from the high levels seen during the COVID-19 pandemic in 2020 and 2021. For middle Sydney, the current vacancy rate stands at 1.5%, while over the last two years, the average vacancy rate has sat at 1.3%.

SYDNEY RESIDENTIAL VACANY RATES (%)



SOURCE: REINSW

FACTORS AFFECTING HOUSING SUPPLY

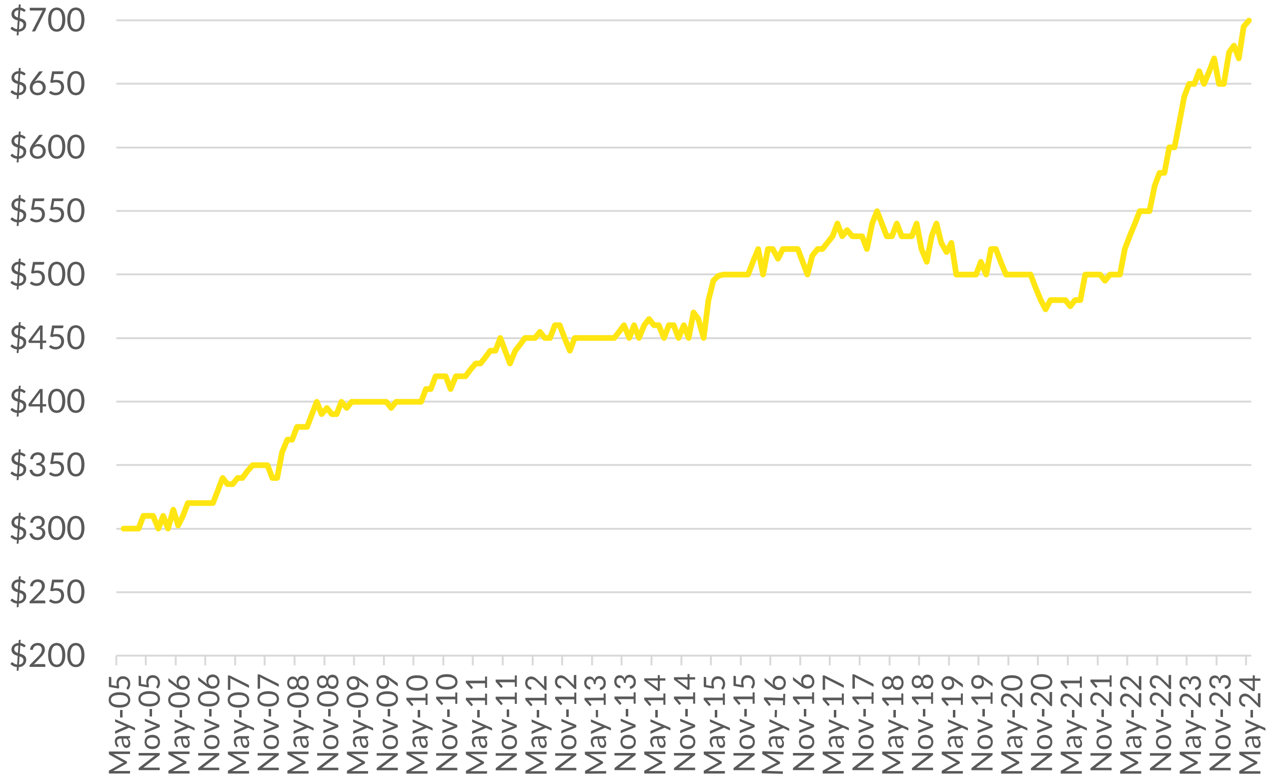
The elevated construction costs and lengthy approval processes are expected to slow down the addition of new homes needed to meet the growing demand, potentially leading to further increases in rental prices. Some markets may experience an increase in household size, with a greater emergence of multi-generational housing to aid in alleviating the rising cost of housing.

Any investment opportunities tied to these ongoing strong and secure returns will be advantageous for investors, resulting in the continued purchasing of assets, near individual market value or at competitive yields with future capital growth potential in mind.

Residential rents continue to *surge.*

Sydney's median unit rents have skyrocketed to an all-time high, driven by unprecedented average annual growth that far outpaces historical trends. This exacerbates affordability concerns amidst a persistent housing shortage and ongoing population growth.

GREATER SYDNEY RENTS, UNITS, $/WEEK



SOURCE: CORE LOGIC

Sydney's median unit rental prices have experienced a remarkable surge, moving in the opposite direction of the vacancy rate. **As of May 2024, the median weekly rent for units in Greater Sydney reached an all-time high of $700.**

GROWTH AND COMPETITIVE RETURNS

This growth has been unprecedented and particularly pronounced over the past three years, with the median rents increasing by $225/week or 47.4% from $475 in May 2021.

The average annual rental growth during this period stands at an impressive **15.8%,** making residential investments returns more competitive than many other asset classes.

This is without considering the capital appreciation which has been experienced, especially over the last 12 months following the price corrections that occurred due to interest rate increases in 2022.

HISTORICAL TRENDS IN RENTAL GROWTH

The recent gains in residential rents, however, are not in line with historical trends.

Over the past decade, average unit rents in Sydney have grown at a rate of **5.2% per annum.**

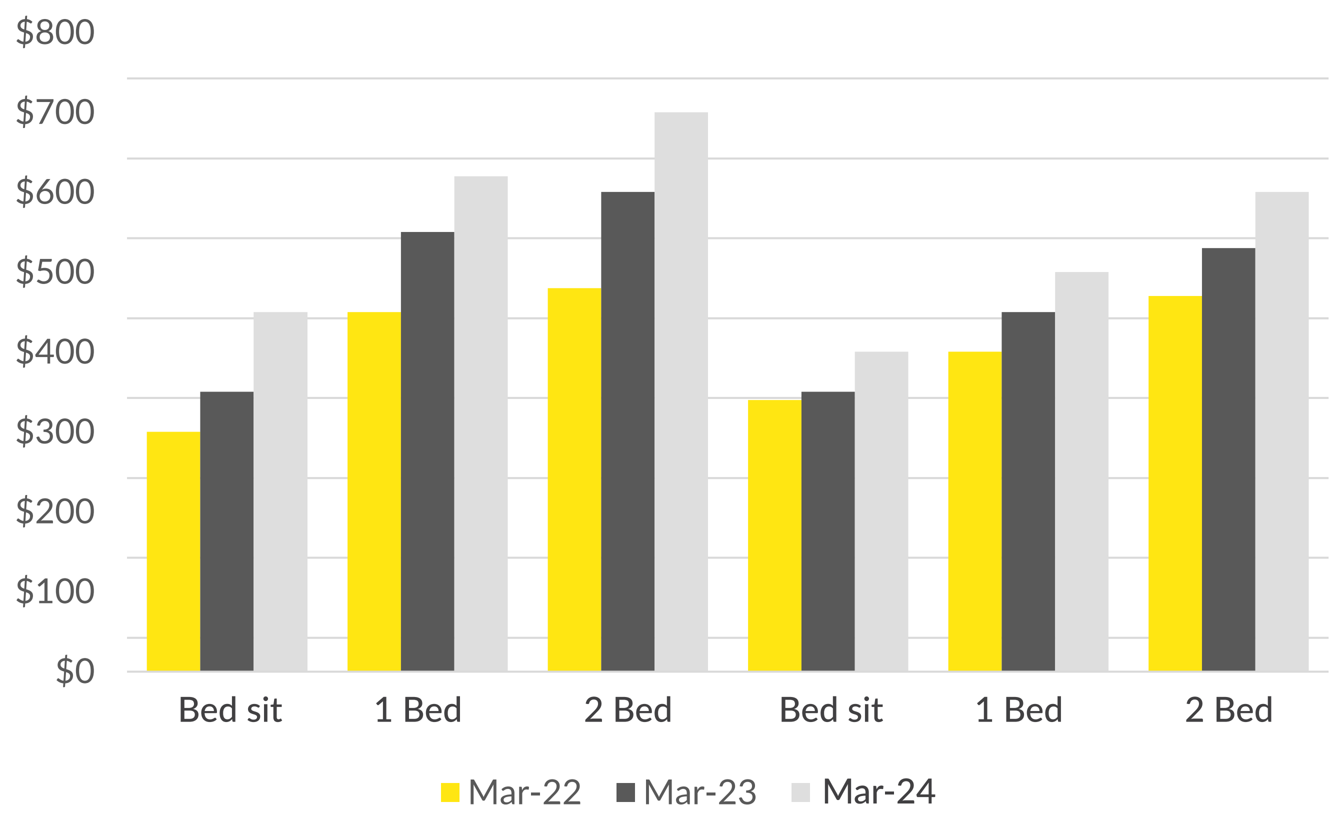
Yet, when considering the ten years prior to the commencement of this significant growth in 2021, the annual improvement was a lesser 1.2%.

OUTLOOK AND AFFORDABILITY CONCERNS

Despite the current high rental prices and growing affordability concerns, the underlying shortage of housing stock and the slow pace of new additions to the market, coupled with expectations of continued population growth, are likely to sustain the pressure on an already strained rental market in the foreseeable future.

The greatest rental growth has been seen in *bedsit* and *two-bedroom* unit offerings.

GREATER SYDNEY MEDIAN UNIT RENTS BY SIZE AND RING, $/WEEK



SOURCE: FACS INSIGHTS

In the face of Sydney's tight rental market, bedsits and two-bedroom options have outperformed, offsetting growth in financing costs for many buyers.

OUTPERFORMANCE OF MIDDLE RING UNITS

Amidst the tight vacancy environment and ongoing rental squeeze across Sydney, units in the middle ring have outperformed over the past two years. The growing demand for affordable housing has increased the appeal of smaller accommodation options, including boarding houses. With a limited supply of bedsit options in the middle ring, this segment has experienced the most substantial growth, increasing by 50% over the past two years, resulting in weekly rents of $450. Considering affordability, the outer ring has also seen growth for these smaller offerings, now averaging $400/week, although growth over this two-year period has been more limited at 17.7%.

As families find themselves priced out of the rental house market, the 2 bedroom unit sector has experienced a similar surges in average rents. The middle ring now commands rents of $700/week, representing a 45.8% increase over two years. Many occupiers have shifted their focus towards the outer ring, where weekly rents sit at $600/week based on recent bond lodgments, a 27.7% growth over the same time frame.

Although trailing behind bedsit and 2 bedroom options, 1 bedroom unit accommodation have still garnered outstanding growth results. The middle and outer rings have recorded 37.8% and 25.0% increases, respectively, compared to the March 2022 period.

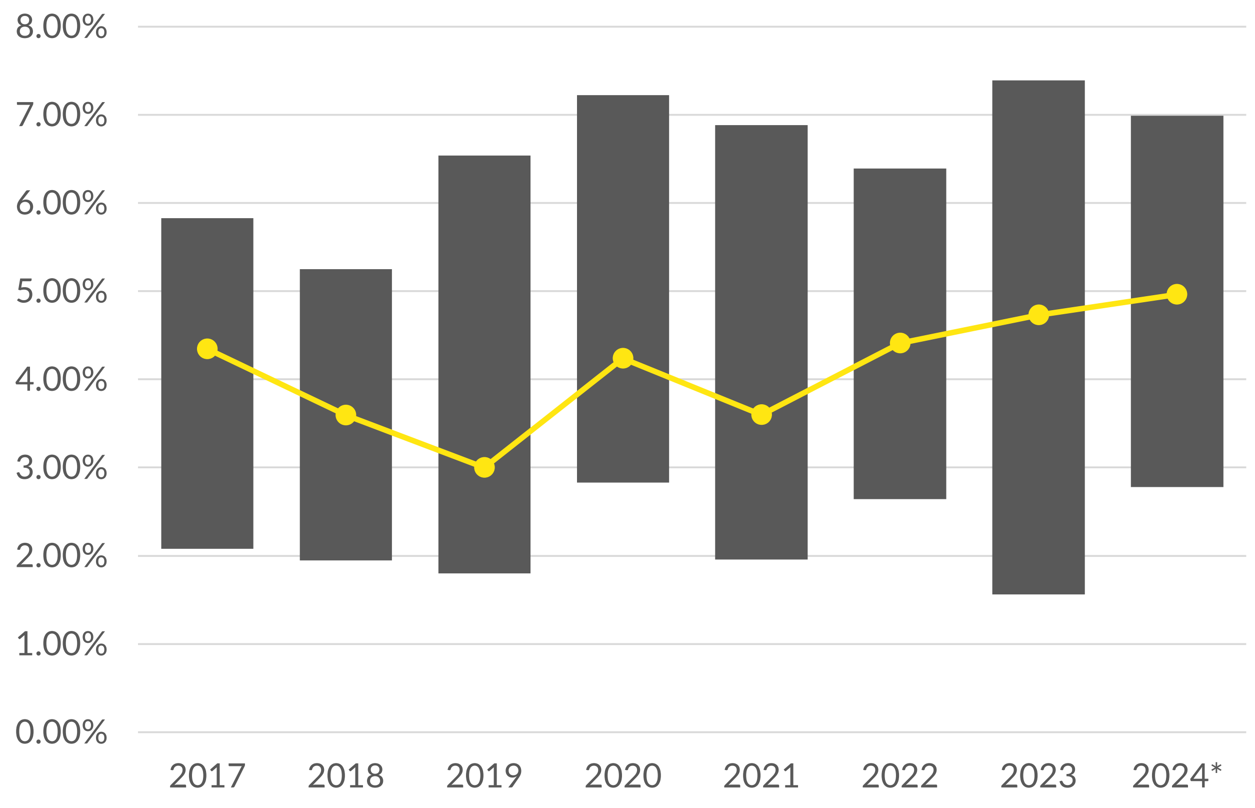
UNCERTAIN INTEREST RATE OUTLOOK

Block of unit assets have demonstrated up to 50% income growth across both the outer and middle rings in just a two-year period. Despite these gains, the cost of finance has increased, although it remains achievable for many buyers given the current interest-only investment loans now averaging between 6.4% and 6.6%, according to the Reserve Bank of Australia (RBA). Expectations surrounding interest rate reductions have quietened more recently due to inflation not moving down as quickly as anticipated. This may result in interest rates remaining at their current level or moving upwards this year, depending on economic pressures.

Investment yields *buck* commercial trends.

Relative stability in investment yields for blocks of units has been spurred on by savvy investors looking not only at income returns but also at the future potential of assets.

GREATER SYDNEY MEDIAN UNIT RENTS BY SIZE AND RING, $/WEEK



*RWCWS *2024 REPORTED TO 1 JUNE*

STABLE INVESTMENT YIELDS FOR BLOCK OF UNITS

Despite the rising cost and increased difficulty in obtaining finance, investment yields for blocks of units have shown limited change, particularly when considering other commercial property investment opportunities.

Investment yields for transactions this year have averaged **4.96%**

Within the broad range of **2.78% to 6.99%**

FACTORS INFLUENCING YIELD RANGE

The range in yields (which has narrowed) is based on risk factors such as the type of asset (eg boarding house), size, age, unit mix, condition as well as location. Savvy investors are also looking beyond the immediate returns and considering the future potential of their investments, such as the possibility of reconfiguring the property, renovating, strata subdividing, or even exploring air rights redevelopment in the future.

INCREASED OPPORTUNITIES FOR THE SECTOR

Interestingly, there's been a slight increase in investment opportunities this year, especially when it comes to long-term, family-held properties in Sydney. However, many owners remain reluctant to part with these assets, as they provide a growing income stream and the opportunity to pass on wealth or housing opportunities to future generations.

On the development side, there's been a rise in boarding house development sites and newly completed projects entering the market. Developers are looking to capitalize on the "build to rent" trend and address the growing demand for affordable housing, which has been exacerbated by the population growth in NSW. However, the high cost of construction and ongoing labour issues can make these development opportunities challenging to "stack up," even with the higher rents they can command.

Conclusion

The block of unit market is poised to maintain its position as one of the most sought-after "commercial" property investments this year, continuing to capitalise on improvements in residential rents and overall capital value appreciation. The fundamental drivers of population growth and limited new housing supply across the country, particularly in western Sydney, will ensure that demand for occupancy remains elevated, keeping investment yields competitive. While this asset class is of interest across the private market, it is a less sophisticated alternative to the rapidly growing "build to rent" concept, which has emerged in response to the housing crisis.

The level of listing activity in this space in 2024 has been surprising, given that these assets have historically been tightly held. Total transaction volumes for the year are expected to surpass 2023 levels, with greater metropolitan asset sales likely to improve, however the demand for regional assets may slow.

Continued gains in rents may dissipate in inner and middle markets, making way for more substantial increases in the outer ring in response to affordability concerns. The ongoing pressure on rents will persist until the mismatch between supply and demand is resolved, which is expected to be a medium to long-term timeframe. With limited vacancies and the development of new stock remaining costly, consistent, quality returns will continue to be attractive to investors.

Investment yields are anticipated to remain within a narrow range and will represent value for buyers who are not solely focused on short-term rental returns but have longer-term plans for redevelopment, subdivision, and other strategies. The strong growth in bedsit rent aligns with the growing attractiveness of boarding house assets, which offer a higher yield range given the increased risk. If competition remains fierce, we could see more buyers move up the risk curve and invest in these assets.

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OUR OFFICE

With a strong foundation of experience and expertise, we bring a winning combination of dynamism and operational rigour to the commercial agency space.

Our People are *Your Advantage.*

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Who we are,
what we do,
why we do it

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