



AUSTRALIAN CAPITALISATION RATES

A closer look at trends in Australian real assets

INTRODUCTION

Australian farmland values have appreciated each year for the seven years through 2020 and increased at a compound annual growth rate of 7.6% over the twenty years ending 2020.¹ Bar an exceptional change in circumstances, 2021 (analysis herein largely focuses on trends through early 2021) will stretch the streak to eight years and likely deliver an annual growth rate above the twenty-year average.

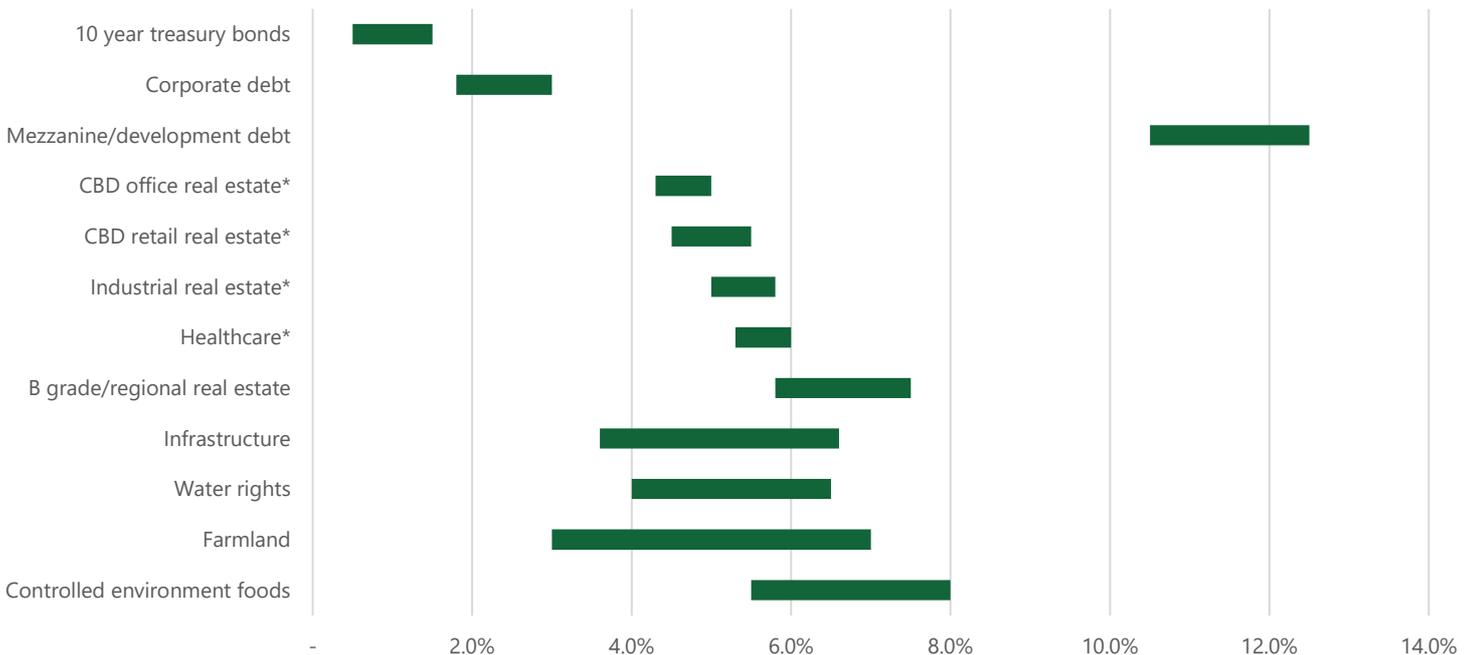
This paper summarises key conclusions of recent internal analysis of real asset capitalisation rate trends completed by the Riparian team. For the purposes of this paper, the cap rate is defined as:²

$$cap\ rate = \frac{Pretax\ funds\ from\ operations}{market\ value\ of\ assets}$$

2021 CAPITALISATION RATE RANGES

Over the past decade, real assets investors have seen a steady decline in cap rates. Farmland and agriculture-related infrastructure (including Controlled Environment Food production assets such as glasshouses) have not been immune to this trend; however, analysis suggests that the cap rate spreads to treasury bond yields have remained relatively consistent over the period. Furthermore, analysis indicates that select water entitlements have not witnessed the same level of cap rate compression seen in other agricultural sector assets.

2021 capitalisation rate ranges



*Prime real estate only

Source: Colliers International, CBRE and RCP analysis

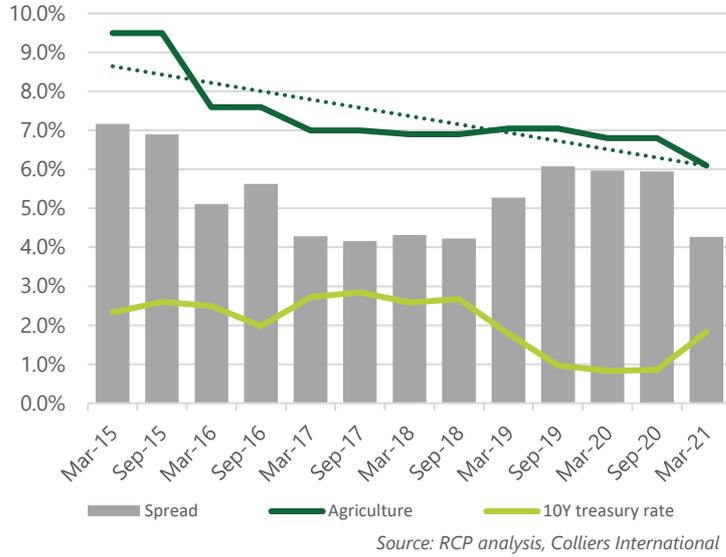
CAPITALISATION RATE TRENDS

Farmland

Within the farmland sector, lease rates can fall within a wide range depending on the type of the asset. Horticultural assets tend to fall at the higher end of the range,³ with dryland grain and cattle operations operating at the lower end.

Over the last decade, the average cap rate has steadily declined, however the spread to the 10Y treasury rate has generally remained constant, typically fluctuating between 4% and 6%.

Australian farmland average cap rates

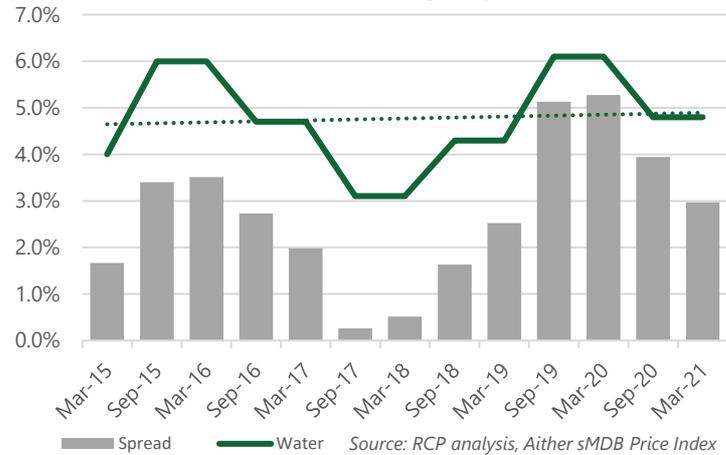


Lease rates experienced further compression in 2021 with lessors under pressure following increasing land values.

Water entitlements

While values of water entitlements have increased over the period (particularly since 2013), the earnings generated from selling water allocated to entitlement holders (entitlement earnings) at the prevailing market rate at the time of receiving allocations has also increased. Riparian analysis indicates yields from March 2015 – March 2021 averaged 4.8%.⁴ Furthermore, lease rates since 2015 through early 2021 remained relatively constant as a percentage of entitlement values.⁵

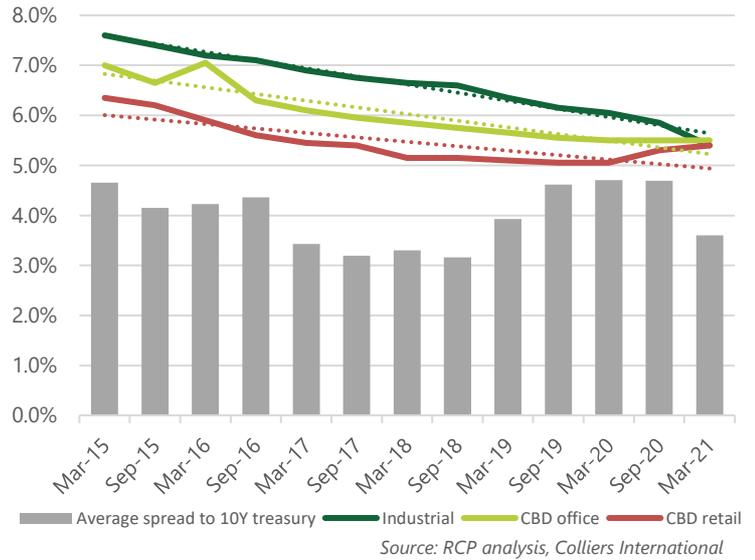
Australian water entitlements average cap rates



Real estate

Consistent with farmland, cap rates in the real estate sector have also declined over the last decade. The spread to treasury yields has remained more consistent in the range of 3.2% to 4.7%.

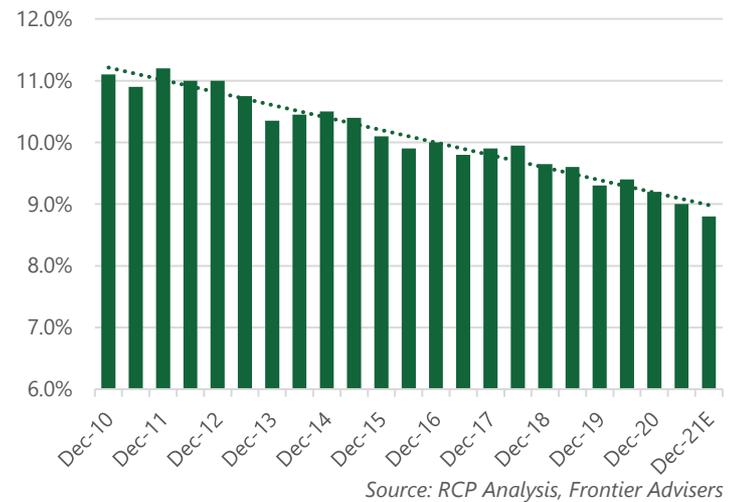
Australian real estate cap rates



Infrastructure

Cap rates are less commonly associated with infrastructure assets, with manager's generally using discount rates to determine the viability of a particular investment. Like other real asset sectors, infrastructure assets have seen a declining average discount rate since 2010.

Average Australian infrastructure equity discount rates



Frontier Advisers noted in their June 2021 update report, that while discount rates have declined over the past 10 years, this has largely been due to the declining risk-free rate. The average risk premium for assets in 2020 was broadly in-line with the historical average.⁶

CONCLUSION

The Australian farmland market cycle through 2021 has strengthened and cap rates have contracted, a trend that is consistent with other Australian real assets.

Controlled environment facilities such as glasshouses continue to display competitive cap rates against other real property assets.

Interestingly, water entitlement earnings as a percentage of entitlement values have remained relatively constant.



NOTES

1. *Rural Bank, 2021, Australian Farmland Values 2021, Adelaide and Bendigo Bank Ltd, Bendigo. Past performance is not indicative of future results which may vary.*
2. *EBITDA has been used as a proxy for pre-tax funds from operations where the information is unavailable, particularly with regards to the prospective infrastructure transactions.*
3. *An FTI Consulting review of commercial lease agreements within the horticultural sector suggests that a lease rate of 6.0% to 7.5% is reasonable and in line with 2021 market rates. Past performance is not indicative of future results which may vary.*
4. *Riparian analysis of publicly available water trade data and Aither sMDB Water Entitlement Index. Past performance is not indicative of future results which may vary.*
5. *Riparian analysis indicates leasing of water entitlements in the sMDB has become increasingly common since 2014. Past performance is not indicative of future results which may vary.*
6. *Frontier's RADIUS system showed an average risk-free rate used in valuations of 2.6% vs government 10-year bond yields below 2.0%.*

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“Riparian zone” refers to a broad zone spanning from the riverbank to the floodplains; it occasionally includes hill slopes that may influence the stream ecosystem.

Oxford Dictionary 2018

