RESEARCH

MAY 2014

SYDNEY INDUSTRIAL

Market Overview

HIGHLIGHTS

- Further yield compression is being recorded in the investment market with strong levels of capital inflow looking for exposure to the sector. Average prime yields range between 7.75% and 8.50% (based on a five year WALE), however modern assets with long lease durations would trade below this range.
- After tracking at the bottom of the cycle for around three years, the value of medium and large sized land parcels have started appreciating. Driving the growth is competition for a limited amount of developable land parcels for sale, with demand stemming from both owner occupiers and developers looking to restock depleted inventory levels.
- Industrial tenant demand has been relatively modest over the past 12 months and as a result rents have remained largely unchanged. The exception has been the South, where prime rents increased 3.5% in the year to April 2014. However, led by the lift in housing construction and retail spending, the macro drivers for the NSW industrial market are starting to provide the basis for an improvement in tenant demand, although this is yet to materialise in leasing deal activity.

INDUSTRIAL OVERVIEW

Table 1
Sydney Industrial Market Indicators April 2014

Precinct	Avg Prime Rent		Avg Secondary Rent		Avg Core Market Yields		Avg Land Value			
					Prime	Secondary	<5,000m²		1 - 5 ha	
	$/m² net	(%p.a)	$/m² net	(%p.a)	%	%	$/m²	(%p.a)	$/m²	(%p.a)
Outer West	104	-0.2%	93	-0.2%	7.75 - 8.25	8.50 - 9.50	352	0.6%	285	14.0%
Inner/Central West	118	0.0%	102	0.6%	7.75 - 8.25	8.75 - 9.50	509	0.0%	309	4.2%
South West	95	0.0%	82	0.0%	8.00 - 8.50	9.00 - 9.75	310	1.3%	227	5.6%
North	159	0.2%	134	0.1%	8.25 - 9.00	9.00 - 9.75	595	2.6%	475	2.2%
South	147	3.5%	124	0.0%	7.25 - 7.75	8.00 - 8.75	1,175	10.6%	900	10.8%
Sydney Average	**124**	**0.7%**	**107**	**0.1%**	**7.75 - 8.50**	**8.75 - 9.50**	**390***	**0.6%***	**274***	**7.9%***

Source: Knight Frank *Average Outer West, Inner/Central West and South West
Prime: Asset with modern design, good condition & utility with an office component 10-30%. Located in an established industrial precinct with good access.
Secondary: Asset with an older design, in reasonable/poor condition, inferior to prime stock, with an office component between 10%-20%.
Core Market Yield: The percentage return/yield analysed when the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for property specific issues (ie rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

Economic Snapshot

After tracking below the national rate for a number of years, the outlook for the NSW state economy is starting to look more positive, with growth in 2014 forecast to be in line with Australian GDP. Underpinning this outlook is the cyclical upturn in housing construction, which appears to becoming more firmly entrenched. While partly interest rate driven, rising activity is being boosted by considerable demand for residential development opportunities in inner city apartment markets from offshore investors. As a result, there appears to be a particularly strong response from the unit part of the market (as opposed to houses). As at February, NSW dwelling approvals were up 38.7% yoy. According to Deloitte Access Economics, housing investment in NSW is expected to average 12.3% growth over 2014 and 2015.

The low interest rate environment appears to be gaining further traction with retail sales, which have been trending higher since the mid-2013. Annual state retail sales growth to March measured 8.6% seasonally adjusted. Although an on-going recovery in consumer spending through 2014 is anticipated, it is unlikely that the current growth rate will be sustained in the short term, given some moderation in confidence levels. This is having a positive impact on trade data with Port Botany reporting total container trade for March 2014 was 15.6% higher compared to the same month last year.

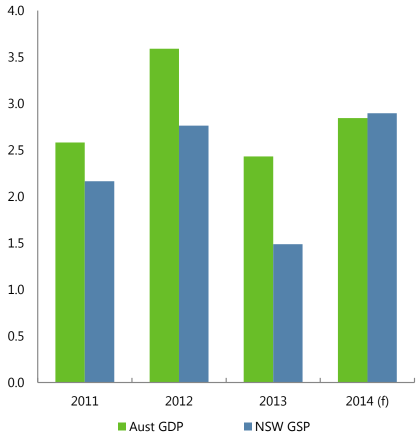
Infrastructure

At both a Federal and State level, there is considerable focus being placed on infrastructure projects across Sydney. Major rail and road projects include:

- South West Rail Link – an 11.4km rail line from Leppington to Glenfield. Services commencing 2015.
- North West Rail Link – a 23km twin track railway between Epping and Rouse Hill. Completion due 2019.
- WestConnex - a 33km motorway including a widening of the M4, a duplication of the M5 East and new sections of motorway to provide a connection between the two roadways. Three staged completion between 2019 and 2023.
- NorthConnex – a twin tunnel motorway linking the M1 Pacific Motorway at Wahroonga to the Hills M2 Motorway at West Pennant Hills. Completion scheduled for 2019.

The Government has also announced that the site for Western Sydney's new airport will be Badgerys Creek. Although completion will not occur for another 10 years, construction is expected to commence by 2016. The project will incorporate a number of road upgrades to improve accessibility to the M7 and M4 motorways. While these projects will assist the gradual migration of many industrial users west, there nevertheless remains a number of user groups in the air and shipping industries that still require premises in close proximity to the existing airport and Port Botany (amongst a diminishing land supply).

Figure 1
Economic Growth
NSW vs Australia – 2011 to 2014



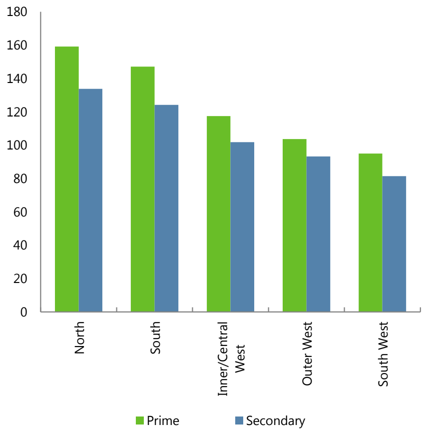
Source: Deloitte Access Economics

Industrial Overview

Although leasing absorption data indicates relatively modest levels of tenant demand, enquiry levels are starting to show more positive signs. Demand from logistics and storage users has been relatively consistent and continues to drive the bulk of demand. However the early stage of the residential construction cycle upswing is starting to supplement tenant demand. Aside from the South region, rents have remained broadly flat. However with supply remaining below the 10 year average, there is some potential for improvement should current enquiry translate into a more enduring pick-up in demand.

The sales market is currently being boosted by strong inflows of capital with a broad range of investors seeking increased exposure to the sector. Although yield and WALE are key attractions, there is a growing volume of secondary sales being transacted given limited opportunities in the prime market. This has underpinned yield firming across both the prime and secondary grades.

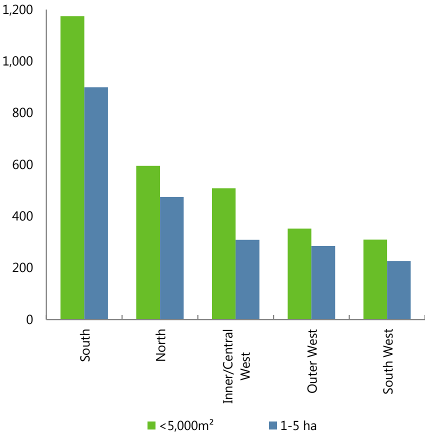
Figure 2
Sydney Industrial Rents
$/m^2 net rent by precinct – April 2014



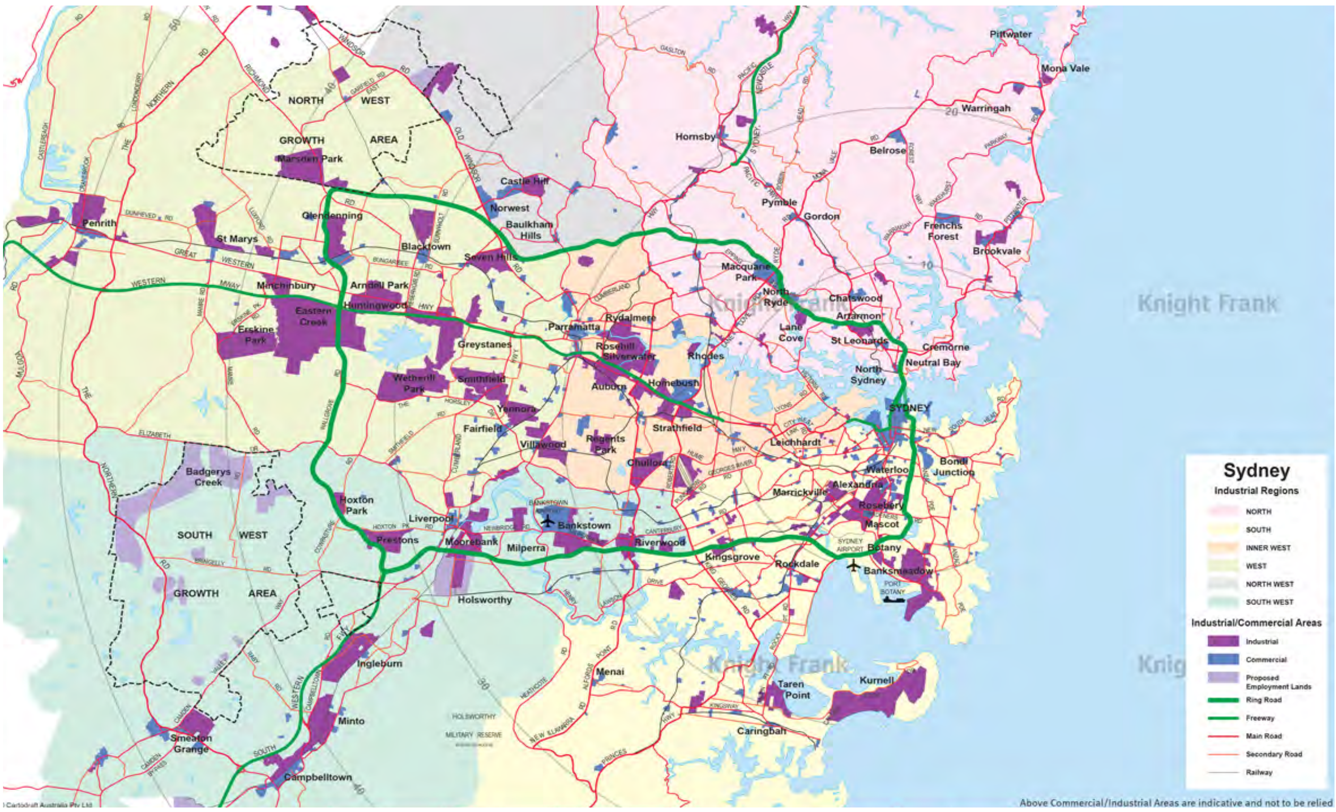
Source: Knight Frank

Land sales over the past few years have been notably subdued. However with developers' inventory levels becoming relatively depleted, the early stages of land value appreciation are emerging. This is being driven by a number of developers and owner occupiers currently looking for land opportunities. This increase is being experienced in both medium (2-5ha) and large (10ha+) sized land parcels where institutional demand is present.

Figure 3
Sydney Industrial Land Values
Average value serviced lots by precinct ($/m^2) – April 2014



Source: Knight Frank



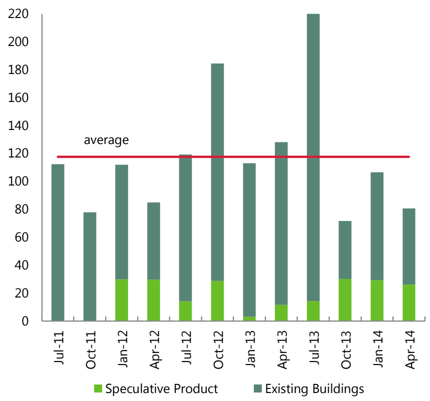
OCCUPIER DEMAND & RENTS

In the year to April, gross take up (excl. D&C's) for lease deals in excess of 5,000m² amounted to 479,599m². Although this represents a 12% decline compared to the previous corresponding period, there has been a notable increase in the uptake of prime stock. Since mid-2013 gross take-up of prime grade stock has measured 174,692m² compared to 84,331m² for secondary. Coupled with pre-lease activity, which is not included in these absorption figures, prime demand is substantially outpacing that for secondary. This had not been the case in the preceding 12 months, when a number of tenants behaved cautiously and utilised cheaper secondary options with shorter lease terms.

Although pre-lease demand over the past few years has stemmed from businesses focussing on supply chain efficiencies and operating costs, there are signs of the improving NSW economy starting to stimulate tenant demand. Currently, this is stemming from the upturn in the residential sector, where a number of sub-5,000m² construction related tenants are starting to make enquires and premises related decisions. Nevertheless, logistics remains the predominant source of pre-lease demand. This includes pre-lease demand for sub-10,000m² buildings able to facilitate B-Double semi-trailers. This is driving demand for facilities with larger land components compared to the majority of existing facilities available for lease.

With take up volumes yet to display a meaningful pick-up, rental growth has been relatively static over the past 12 months. However the exception has been the South region, where annual prime rental growth on a net basis has measured 3.5%. This growth has been a combination of relatively robust tenant demand, but also the downward pressure on supply stemming from industrial rezoning to residential. Rezoning has, in many cases, changed the highest and best use to residential and mixed uses with demand for such opportunities substantial at present. Incentives, although slightly down on the cyclical high recorded in 2009, have remained broadly stable over the past 30 months and average 11% for prime assets. However tenants are very particular with their requirements and as result incentives can be lower for well configured, highly functional assets.

Figure 4
Sydney Industrial Take-up
'000m² Est Take-up buildings 5,000m² + (excl D&C)



Source: Knight Frank

Table 2
Major Industrial Leasing Transactions Sydney Region

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Lease type	Tenant	Date
Templar Rd, Erskine Park	OW	U/D	32,000	15	Pre-com	TNT	P/C
Templar Rd, Erskine Park	OW	U/D	20,500	20	Pre-com	RMM	P/C
Quarry at Greystanes	OW	U/D	7,900	U/D	Pre-com	Supply Network	P/C
Quarry at Greystanes	OW	U/D	15,710	6	Speculative	The Consortium Centre	Feb-14
81-85 Roberts Rd, Chullora	OW	100	1,189	3	New	International Formwork	Feb-14
75 Owen St, Glendenning	OW	~105	4,600	5	New	Hyne & Son Pty Ltd	Dec-13
Bungarribee Industrial Estate, Huntingwood	OW	117.5	8,140	10	Speculative	Beaumont Tiles	Jan-14
48 Airds Rd, Minto	SW	84g	10,393	5	New	Sebel Furniture	Jan-14
66-68 Jedda Rd, Prestons	SW	115	5,355	5	New	Western Pet Foods	Jan-14
62 Marigold St, Revesby	SW	88	4,613	5	New	Australian Ports (NSW) Logistics	Jan-14
22-24 Beaumont Rd, Mount Kuringgai	N	133	3,130	5	New	Baden P Morris	Jan-14
25 Frenchs Forest Rd, Frenchs Forest	N	210g	2,634	3	New	DJO Global Pty Ltd	Jan-14
68 Waterloo Rd, Macquarie Park	N	295 140	1,532 (O) 723 (W)	5	New	Pitney Bowes	Mar-14
34 Rosebery Ave, Rosebery	S	145	4,100	7	New	Emotrans	Jan-14
73 Beauchamp Rd, Matraville	S	145	1,293	7	New	Ferag Australia	Feb-14

Source: Knight Frank g refers gross U/D refers undisclosed OW Outer West SW South West ICW Inner Central West N North S South

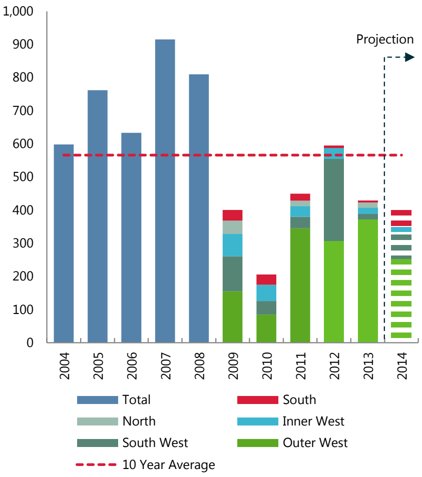
DEVELOPMENT & LAND VALUES

Gross supply of industrial projects (in excess of 5,000m²) is forecast to measure 412,015m² in 2014. Although relatively in line with last year, this amount of supply is 29% below the 10 year average and continues a period of relatively low development levels. The majority of new supply is located in the Outer West region, which accounts for 61.2% of the 2014 forecast total and includes the six largest projects. A significant proportion of these 2014 projects stem from the logistics sector with pre-lease facilities to tenants such as Toll (53,305m²), DHL (31,745m²) and Kuehne + Nagel (20,500m²).

Figure 5

Sydney Industrial Development

Annual Gross Supply* ('000 m²)



Source: Cordell Connect/Knight Frank

* includes developments with industrial floor area >5,000m² and excludes deferred/abandoned projects

After a lack of new supply in 2013, the South West region is set to see an increased volume of new completions in 2014. Major projects include the Grace Records Management facility at Campbelltown (17,700m²) and the new Breville facility at Minto (14,900m²). Supply is also forecast to increase in the South region, with Goodman completing two pre-leased facilities (Veolia 5,000m² and Visa Global Logistics 6,500m²) and a 5,375m² speculative facility. The major extensions to Australia Post's parcel facilities at Alexandria will also complete in 2014.

With land inventory levels now more depleted, there has been a reduction in the amount of speculative activity in the market. There was 95,361m² of unleased speculative stock in the market 12 months ago, (both completed and under construction), however as at April 2014, that amount had declined to 31,536m². While some projects are earmarked to imminently progress, in most cases an adjoining anchor tenant will be necessary prior to commencement.

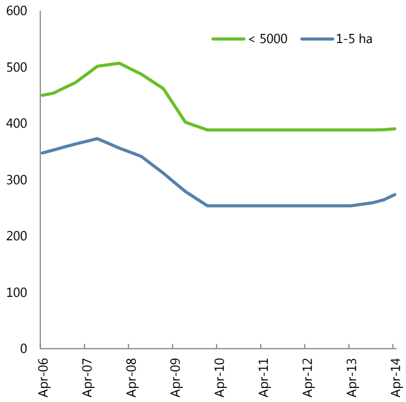
Despite growing interest from developers, the lack of appropriately zoned parcels of land available for sale is currently stifling land sales volumes. At the larger end of the market, transactions have been limited to Mirvac's $55 million acquisition of 21.9ha at 60 Wallgrove Road, Eastern Creek. It is understood a number of other institutional buyers were interested in the site. CIP have also been able to secure land, acquiring a 7.8ha englobo parcel of land in Cambelltown for $6.5 million. Some of the smaller land sales have included 21 Lamb Street, Glendenning, where Earthworks acquired 10,150m² for $1.695 million to develop a new facility for owner occupation.

Competition for land parcels greater than 2ha is being driven by institutional developers with some owner occupiers also active. This demand has seen land values in Greater Western Sydney for 1-5ha parcels increase by 7.8% over the past 12 months, with similar growth recorded for large lot sizes above 10ha. The South has experienced even stronger growth of 10.8% for 1-5ha lots given rezoning pressures upon site availability.

Figure 6

Sydney Industrial Land Values*

Avg. value serviced lots ($/m²)



Source: Knight Frank

* Average Outer West, Inner/Central West and South West

Table 3

Major Land / Development Sales Activity Sydney Region

Address	Region	Price ($ m)	Area (m²)	$/m² of site area	Vendor	Purchaser	Date
Lot 2 Lamb St, Glendenning	OW	4.98	19,900	250	Private	Private	Mar-14
21 Lamb St, Glendenning	OW	1.695	10,150	167*	RTA	Earthworks	Mar-14
52 Quarry Rd, Erskine Park	OW	4.24	19,700	215	CSR	Fife	Dec-13
60 Wallgrove Road, Eastern Creek	OW	55.00	219,000	251	Private	Mirvac Group	Dec-13
6 Hepher Road, Campbelltown	SW	6.50	78,000	83	Aveo Group	CIP Commercial	Nov-13
111 Quarry Rd, Erskine Park	OW	10.66	50,700	210	CSR	Murray Goulburn	Jun-13

Source: Knight Frank * unserviced rate and included some land to be utilised in proposed road widening

OW Outer West SW South West ICW Inner Central West N North S South

SALES & INVESTMENT YIELDS

The last 12 months has seen a substantial increase in industrial sales volumes with a broad range of investors actively looking for acquisition opportunities in the market. Institutional investors continue to be attracted to the sector given relatively high yields compared with other investment classes and the longer leases available on prime assets. However with fewer owners looking to divest, particularly given the yield compression currently being recorded, opportunities to invest in the prime market are relatively limited at present. While this has seen a continuation of the prime yield compression that commenced in 2012, it has also seen a number of investors actively moving up the risk curve and acquiring secondary assets with shorter lease profiles.

Sales in 2013 totalled $1,660 million ($10m+) with AREITs and unlisted wholesale funds notably acquisitive and seeking opportunities to increase their exposure to the sector. Active AREITs have included Stockland (40-88 Forrester Rd, St Marys, $72.85m), Australian Industrial REIT (29 Glendenning Rd, Glendenning, $29.50m and 74-94 Newton Rd, Wetherill Park, $22.0m) and GPT (38 Pine Rd, Fairfield, $43.60m) amongst others. There remains considerable interest from offshore buyers, however the lack of well leased, prime assets available for sale has constrained purchasing activity. Offshore capital inflow therefore continues predominantly comprise wholesale development JV's.

Private investors have been accounting for approximately half of the $10m+ sales with a large number of sub-$20 million purchases being finalised. Demand for assets of sub-$20 million have also been supplemented by a steady flow of owner occupier demand. Although mostly sub-$10 million, there have been some larger sales including 29 Penelope Cresent, Arndell Park, which sold to Jaybro in December for $12.35 million.

The strong inflow of investment capital is anticipated to sustain buoyant sales levels over the course of 2014. A number of assets are currently in final negotiations, as detailed in Table 5. It is estimated that these sales will total approximately $95 million to $105 million.

Based on a five year WALE, average prime yields across Sydney are estimated to range between 7.75% and 8.50%. This range

Table 4
Major Improved Sales Activity Sydney Region

Address	Region	Price ($ m)	Bld Area (m^2)	Core Mkt Yield (%)	WALE (yrs)	Vendor	Purchaser	Date
405-407 Victoria St, Wetherill Park	OW	12.75	12,323	9.28	5.9	Sumy (Tesrol)	Altis Prop. Partners	Apr-14
28-54 Percival Rd, Smithfield	OW	19.20	26,084	10.50	2.7	Cromwell Prop. Group	GM Properties	Dec-13
29 Penelope Cres, Arndell Park	OW	12.35	9,396	VP*	VP	Private	Jaybro	Dec-13
40-88 Forrester Rd, St Marys	OW	72.85	60,239	7.95	5.3	Goodman (GAIF)	Stockland	Nov-13
29 Glendenning Rd, Glendenning	OW	29.50	21,874	7.93	15	Green's General Food (S&L)	Australian Industrial REIT	Nov-13
38 Pine Rd, Fairfield	OW	43.60	33,198	8.70#	2.5	Kingsmede	GPT	Oct-13
74-94 Newton Rd, Wetherill Park	OW	22.00	17,044	9.53	2.8	Australia Post/ Challenger Life»	Australian Industrial REIT	Oct-13
114 Kurranjong Ave & 9 Coventry Pl, Mt Druitt	OW	16.75	18,137	9.48	0.9	Australian Unity	Altis Prop. Partners	Oct-13
350 Edgar St, Condell Park	SW	22.80	22,243	9.50	3.7	AMP	Ambot Pty Ltd	Dec-13
52-88 Lisbon St, Fairfield	SW	65.00	59,828	8.46	2.1	Balmainˇ	Aviva Investors	Nov-13
34 Airds Rd, Minto	SW	25.88	24,095	7.75†	-	Altis Prop. Partners	Interface Aust Holdings	Nov-13
102 Bonds Rd, Riverwood	SW	11.70	3,487	12.82ɫ	0.6	AMP	Private	Nov-13
8-12 Wiggs Rd, Riverwood	SW	9.70	8,899	VP‡	VP	Hills Industries	Private	Oct-13
42 Birnie Ave, Lidcombe	ICW	12.20	8,069	VP‡	VP	Private	Private	Apr-14
118 Bourke Rd, Alexandria	S	19.00	10,214	~7.50	4.0	AMP	Private	Mar-14
Sydney Corporate Park, 180 Bourke Rd, Alexandria	S	343.00	117,000	~7.00	~3.0	Rathdrum Properties	Goodman (GAIF)	Dec-13
73 Beauchamp Rd, Banksmeadow	S	11.80	6,636	7.71	2.6	Kingsmede	Tipalea Partners	Dec-13

Source: Knight Frank # excluding surplus land » tenants in common * purchased for owner occupation ‡ purchased for part owner occupation
ɫ initial yield † transfer based on lease mechanism between parties ˇ representing the vendor
OW Outer West SW South West ICW Inner Central West N North S South

represents firming of approximately 50bps through the cycle thus far and now sees prime yields trading in line with their 10 year average. Market sentiment suggests firming in excess of this amount and with capital inflows likely to remain strong, further compression is anticipated during 2014. Across the regions, the South has led the firming cycle for prime assets, with approximately 75bps of tightening recorded since 2010. Compression in the other regions has been less pronounced, ranging between 30bps and 50bps.

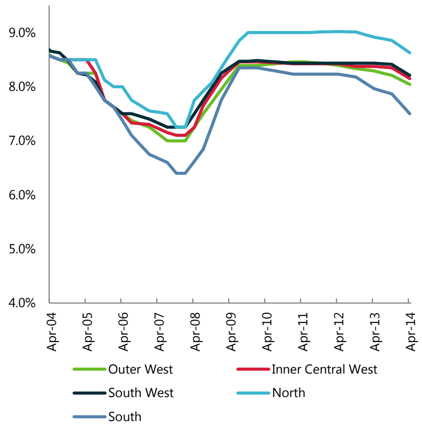
However it is noted that these parametres are based on a five year WALE. For assets with longer lease profiles of between 10 and 15 years, compression has been greater. It is envisaged that should such as asset come to market, it would trade below the aforementioned average range. Conversely, yield firming has been less pronounced for assets with one or two year WALEs.

Yield firming for secondary grade assets has become more entrenched over the past two quarters after been largely confined to upper secondary assets for most of 2013. Average secondary yields range between 8.75% and 9.50% and continue to reflect a positive spread of circa 20bps compared to the 10 year average.

Figure 7

Average Prime Core Market Yields

Sydney Industrial Regions



Source: Knight Frank

OUTLOOK

The improving outlook for the NSW economy, in particular both housing construction and retail expenditure, is providing a sound basis for more positive levels of tenant demand over the coming year. Further support is anticipated to come from the Australian dollar that has been holding its ground above US$0.90 to the benefit of import volumes. NSW Ports data for Port Botany indicates that FY2014 total container trade to March is up by 4.1% compared to the same period last year with full import containers being the main source of growth. Deloitte Access Economics is forecasting CY 2014 imports in NSW to record growth of 2.6%.

Below trend industrial supply in 2014, coupled with stronger leasing uptake of prime buildings, is providing scope for some downward pressure on prime vacancy should signs of improving tenant demand gain further traction. However, it is anticipated that some of the increase in prime vacant stock that was recorded over the past 12 months will need to be absorbed before any material rental growth starts to emerge.

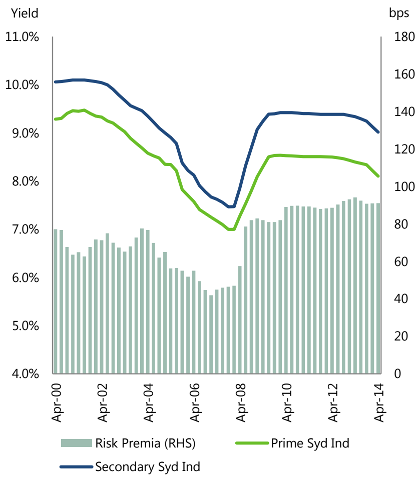
As developers look to facilitate tenant demand for specialised assets from companies addressing supply chain efficiencies, there is expected to be increasing competition for land opportunities when they arise. Land values should continue to benefit from this competition as institutions rebuild land inventory levels and owner occupiers look for new premises.

Supported by the considerable depth of buyers in the market, sales volumes are anticipated to remain firm. However with very limited prime opportunities available in the market, is likely that sales over the next 12 months will be characterised by a high concentration of secondary assets. Secondary demand is also expected to be supported by the relative value between the different grades. Despite the onset secondary market firming, the yield spread between prime and secondary assets continues to remain at historically elevated levels, currently measuring 91bps (refer Figure 8).

Figure 8

Sydney Industrial Core Market Yields

Prime vs Secondary – 2000 to 2014



Source: Knight Frank

Table 5

Major Industrial Assets Under Final Negotiations* – Sydney region

Address	Region	Area (m²)	Vendor
42 Airds Rd, Minto	SW	10,711	Hyperion Property
386 Woodpark Rd, Smithfield	OW	53,400#	Insurance Australia
46 Carrington Rd, Castle Hill	NW	16,276	Amway
Confidential	S & OW	U/D	AREIT (Conf)
133 Vanessa St, Kingsgrove	S	8,419	UniSuper

Source: Knight Frank * excludes off market transactions # denotes site area

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