RESEARCH

SYDNEY INDUSTRIAL

MARKET OVERVIEW MAY 2015

HIGHLIGHTS

Leasing conditions have improved over the past six months with retail and housing sector tailwinds resulting in increased leasing absorption and an outlook for tightening vacancy levels.

Land values have appreciated over the past year driven by scarcity of large, serviced land parcels as well as owner occupier and private developer interest in the small and medium end of the market.

Further yield firming has been recorded given elevated sales activity and low cost of debt. A depreciating AUD and portfolio sales activity are expected to sustain transaction volumes in 2015.

KEY FINDINGS

Gross supply (5,000m²+) forecast to measure 408,215m², 28% below the 10 year average.

Annual land value growth of 10.9% for medium 1ha to 5ha parcels and 4.1% for small sub-5,000m² lots in Western Sydney.

Prime net face rents in Sydney increased 2.4% in the 12 months to April.

Average prime yields have compressed 100bps through the cycle thus far, firming 45bps below the 10 year average.

NICK HOSKINS
Director - NSW Research

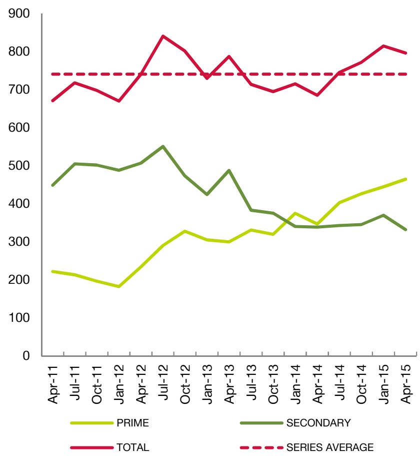
VACANCY SNAPSHOT

The three months to April 2015 saw the first decline in vacant stock levels since the beginning of 2014, with available space reducing to 796,156m² in the quarter. Underpinning the fall was a further increases in the volume of gross take-up, which measured 165,941m² during the quarter, marking the third consecutive quarter of above average gross take-up.

Amongst the regions, the Outer West comprises the largest volume of vacant space, however following strong demand from relocating tenants and tenants looking for efficiencies derived from new facilities located at key transport nodes, vacancy levels have now been trending lower over the past two years. Although the South region has recorded a rise over the past year, the bulk of this has stemmed from tenant displacements due to building sales for change of use purposes with the residual vacant space generally available on a short-term basis prior to redevelopment. As such, underlying tenancy options are more scarce than the headline figure suggests.

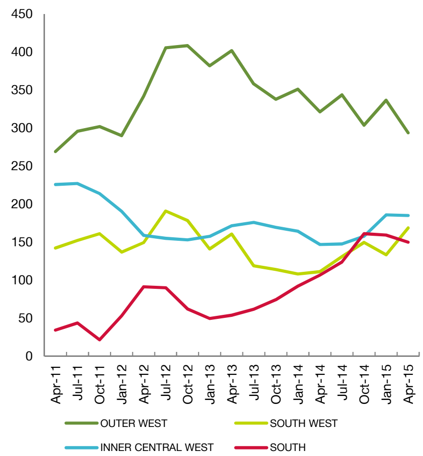
The amount of vacant stock is anticipated to fall further in the current quarter. This reflects the improving leasing demand in the market with a number of vacancies under offer to lease, as well as several options under offer for purchase by owner occupiers and developers. However, the reduction in vacancy is expected to be exaggerated due to hail damage sustained by a number of buildings in late April that has resulted in at least 70,000m² of vacant space in the Outer West being leased by effected occupiers, albeit mostly on a short term basis of 12 to 15 months.

FIGURE 1
Sydney Industrial Market
'000m² available space by quality



Source: Knight Frank

FIGURE 2
Location of Vacant Stock
'000m² available space by region



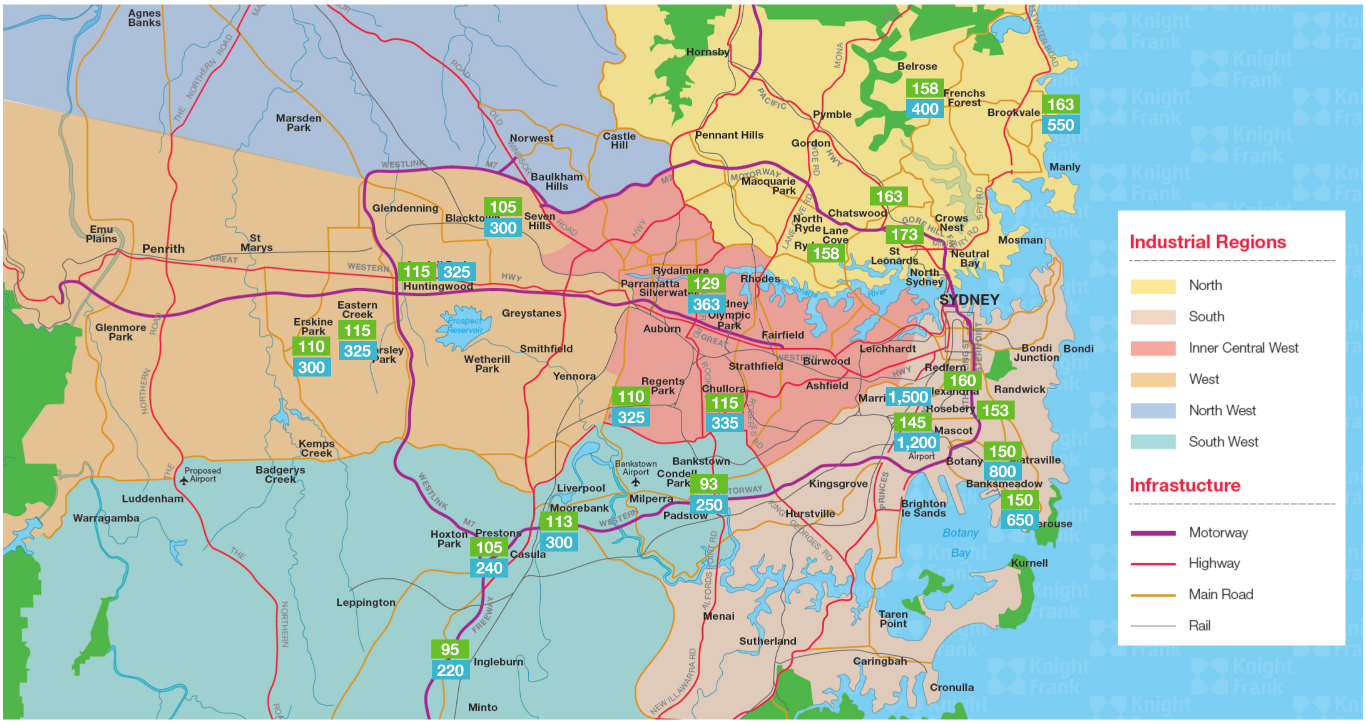
Source: Knight Frank

TABLE 1
Sydney Industrial Market Indicators as at April 2015

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields		Avg Land Values <5,000m²		Avg Land Values 1 - 5 ha	
	$/m² net	(%p.a)	$/m²	(%p.a)	Prime	Secondary	$/m²	(%p.a)	$/m²	(%p.a)
Outer West	107	2.2%	93	0.0%	7.00 - 8.00	8.00 - 8.75	370	4.4%	315	13.5%
Inner/Central West	121	2.7%	103	1.2%	7.25 - 8.00	8.25 - 9.00	541	4.7%	346	12.1%
South West	98	2.6%	82	0.0%	7.25 - 8.00	8.25 - 9.25	325	3.3%	240	6.9%
North	163	2.1%	135	0.9%	8.00 - 8.75	8.75 - 9.25	620	4.6%	500	3.6%
South	151	2.5%	126	1.3%	6.50 - 7.25	7.50 - 8.25	1,263	12.8%	975	13.0%
Sydney Average	**128**	**2.4%**	**108**	**0.7%**	**7.00 - 8.00**	**8.25 - 9.00**	**412***	**4.1%***	**300***	**10.9%***

Source: Knight Frank *Average Outer West, Inner Central West and South West

INDUSTRIAL PRECINCTS—SYDNEY



Prime Industrial Net Face Rent ($/m²)

Industrial Land Value based on medium sized lot 1-5ha ($/m²)

Source: Knight Frank

MAJOR INDUSTRIAL SUPPLY

Gross industrial supply (5,000m²+) in Sydney is expected to total 408,215m² in 2015. Although this volume is 28% below the 10 year average, it is relatively inline with the post-GFC average (since 2009) of 419,442m².

Supply remains largely concentrated in the Outer West, where 74% of the 2015 forecast total is located. This supply is largely focused within Eastern Creek (major 2015 completions including Techtronic Industries 41,200m², Fisher & Paykel plus adjoining spec 23,012m²) and Erskine Park (major completions including Rand Transport 23,940m², RRM 20,500m²).

However land availability in addition to road upgrades is seeing a number of large projects completing in other precincts. At Sydney Business Park at Marsden Park, the 29,075m² Lindt factory is due to complete mid-year, while the Swire Cold Storage facility is scheduled to complete in 2016. Major 2015 supply completions in South West include pre-leased facilities to GMK Logistics (15,034m² at Narellan), Quantium Solutions (7,465m² at Minto) and Inghams Enterprises (13,917m² at Prestons).

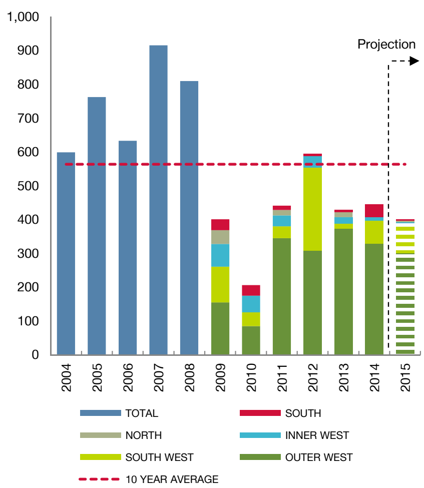
Speculative supply is on track to total 102,011m² in 2015. This has been relatively well received by the market with 56% of this being leased as at the end of the first quarter. The bulk of these projects are located in Eastern Creek and Huntingwood. These precincts are close to fully developed, which has allowed developers to progress speculative buildings with limited competition from pre-lease options within those particular markets, while also allowing developers to control the design of the facility. As a result, many of these developments comprise stand-alone buildings as opposed to the previous few years where the majority of speculative projects have comprised space adjoining an anchor tenant in the same building.

Although pre-lease volumes at this stage indicate a likely continuation of current supply volumes in 2016, the rail terminal and warehousing development by QUBE Logistics at Moorebank has the potential to materially boost supply. Although still in the early planning stage, the project will provide up to 300,000m² of warehouse distribution facilities to be constructed in three stages with timing dependent on market demand.

FIGURE 3

Sydney Industrial Development

Annual Gross Supply ('000 m², bldgs >5,000m²)



Source: Knight Frank

DEVELOPMENT & LAND VALUES

Land Sales

Although supply volumes are yet to revert to pre-GFC levels, the last 18 months has seen an increase in transaction activity for land parcels. Combined with a relative lack of large land opportunities for sale, this has resulted in the land value appreciation that commenced in 2014 continuing over the past six months. Although the land shortage in the South and Inner Central West regions stems from constrained land supply as well as strong competition from mixed use developers on the back of rezoning, there is a large amount of zoned land in the Western Sydney area. However, the bulk of this land is unserviced with only a limited amount of serviced greenfield sites officially on the market.

Institutional developers looking to build exposure to the sector have been looking to secure sufficient land inventory for the medium term, particularly given development immediately post-GFC was largely undertaken from existing land holdings. This has resulted in a number of 10ha+ sales with examples over the past year including Altis (50ha at Erskine Park, Dec 14), DEXUS (26.1ha at Greystanes, June 14) and Stockland (11.5ha at Warwick Farm, Feb 2015 and 28.0ha at Ingleburn, June 2014).

For small and medium parcels (sub-5,000m² and 1ha to 5ha respectively), there is a steady flow of buyer enquiry from both owner occupiers and private developers. Low interest rates have been a key contributor to the demand from owner occupiers, with the low cost of capital favouring development instead of renting in many instances. In a demonstration of this depth, eight parcels ranging in size from 1,600m² to 3,900m² at Cox Place, Glendenning went to auction in May. All parcels sold at rates of between \$380/m² to \$430/m² with buyers consisting of a mix of private investors and owner occupiers.

Although sale evidence has shown some variability in land rates, it is estimated that over the past 12 months, average land values in Western Sydney have increased by an average of 4.1% for small sub-5,000m² parcels and by 10.9% for medium 1ha to 5ha parcels. Despite this growth, values still remain approximately 15% to 20% below the last cyclical peak in late 2007. At a precinct level, some of the recent growth has stemmed from improved road access into areas such as Erskine Park and Wetherill Park, which has seen some moderation in the value differential between a number of Outer West precincts. In the Inner Central West, there has been a lack of land sales to test values in the region. However, with properties selling above replacement cost coupled with competition from developers seeking urban renewal opportunities, it is estimated that land rates have appreciated broadly in line with Western Sydney average growth.

D&C Activity

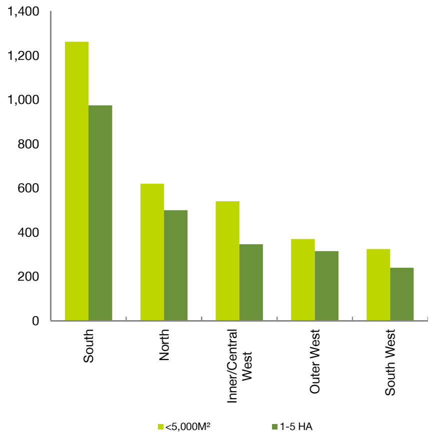
There remains a steady flow of pre-lease deals being recorded in the market with enquiry levels improving during the early months of 2015. This has been most notable in the sub-5,000m² part of the market where a number of smaller users have outgrown existing facilities. While this is partly an indicator of organic growth, it has also been a likely result of accumulated demand from a number of businesses delaying new premises decisions during the past few years due to subdued confidence levels.

Large pre-lease activity continues to be driven by the logistics sector with recent deals including DHL pre-leasing two facilities totaling 58,090m² at Oakdale Industrial Estate, Eastern Creek as well as major logistics company committing to a new pre-lease facility at Banksmeadow. Both developments are anticipated to complete in the first half of 2016. There has also been evidence of demand from industries benefitting from the upturn in the housing development cycle with examples including Fisher & Paykel (household goods) and Techtronic Industries (power tools for users in the construction industry). Such demand has also fed into spec leasing with an example being Hitachi leasing 20,000m² in Huntingwood.

FIGURE 4

Sydney Industrial Land Values

Average value serviced lots by region as at April 2015 (\$/m²)



Source: Knight Frank

TABLE 2

Recent Land/Development Sales Activity Sydney

Address	Region	Price \$ mil	Area m²	\$/m² of site area	Vendor	Purchaser	Sale Date
Mamre Rd, Erskine Park	OW	80.00	500,000	c.160	Private	Altis Property Partners	Dec-14
Richmond Rd, Marsden Park	OW	c.20.00	70,170	c.285	Marsden Park Dev.	Swire Cold Storage	Aug-14
52 Quarry Rd, Erskine Park	OW	5.45	19,700	277	Fife Capital	Aust. Industrial REIT	Aug-14
Nancy Ellis Leebold Dr, Bankstown	SW	4.50	36,000	125	Korda Mentha	Landcross Projects Pty	Mar-15
Gov. Macquarie Drv, Warwick Farm	SW	17.20	115,000	150	Australian Turf Club	Stockland	Feb-15
4 Austool Pl, Ingleburn	SW	2.15	7,794	275	Blight Investments	DNG Constructions	Dec-14
Corish Circle, Banksmeadow	S	c.25.00	19,130	c.1,307	Orica	Woolworths	Feb-15

Source: Knight Frank   OW Outer West   SW South West   ICW Inner Central West   N North   S South

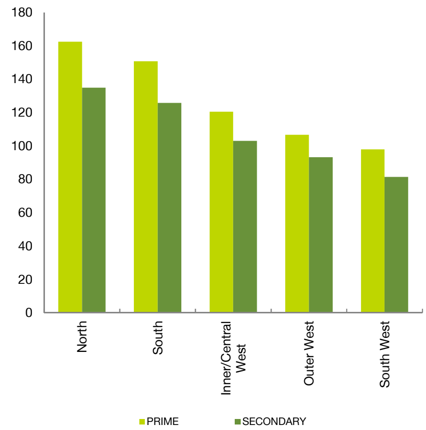
OCCUPIER DEMAND & RENTS

There has been a measured improvement in leasing activity of existing buildings, with gross take-up figures steadily increasing since the beginning of 2014. Gross absorption (excl D&C's) in the 12 months to April 2015 measured 577,453m², which was 12.8% above average. Demand is notably stronger for prime assets, which have accounted for 57% of gross take-up. Including pre-lease demand, prime absorption accounts for closer to 75% of total new leasing activity.

The bulk of new activity has stemmed from tenant migration to outer ring locations with the Outer West region accounting for 54.2% of gross take-up over the past year. Nevertheless, there is evidence of relatively firm demand within inner and middle ring markets for areas between 1,000m² and 3,000m² with vacancies of this size recording faster letting up periods. This has been particularly the case in the Inner Central West, where a number of leases have been signed by groups requiring distribution of goods to metro areas or perceived access to staff.

These factors have resulted in annual average growth in prime net face rents moving to a post-GFC high of 2.4% as at April. Growth is softer in the secondary market with net face rents increasing an average of 0.7% during the same period. However, the regions to record growth in the secondary market were the South and Inner Central West regions, where rezoning and change of use impacts are flowing through to tighter leasing markets and subsequent pressure on rental rates.

FIGURE 5
Sydney Industrial Rents
Net rent by region as at April 2015 ($/m²)



Source: Knight Frank

TABLE 3
Recent Leasing Activity Sydney

Address	Region	Net Rent $/m²	Area	Term (yrs)	Lease Type	Tenant	Date
13-21 South St, Rydalmere	ICW	100n	2,763	5	New	Camfil Australia	Aug-15
13-21 South St, Rydalmere	ICW	100n	2,114	5	New	IDT	May-15
16 Fariola St, Silverwater	ICW	135n	2,075	3	New	Pan Asia Aluminium	May-15
6 Hope St, Ermington	ICW	115n	5,635	10	New	IGT	Jan-15
Oakdale Central, Horseley Park	OW	Conf.	58,090*	Conf.	Pre-com	DHL	P/C
11-13 Gibbons Rd, Baulkham Hills	OW	Conf.	8,800	15	Pre-com	Toshiba International Corporation	P/C
Kangaroo Av, Eastern Creek	OW	Conf.	13,400	10	Pre-com	Fisher & Paykel	P/C
Quarry at Greystanes	OW	Conf.	12,506	Conf.	Pre-com	Yusen Logistics	Jan-15
57-65 Templar Rd, Erskine Park	OW	110n	5,466	6	New	Icehouse Logistics	May-15
24 Cox Pl, Glendenning	OW	95g	3,500	5	New	By Design	Apr-15
31-39 Sturt St, Smithfield	OW	74n	4,991	5	New	Homemirus	Mar-15
29a Davis Rd, Wetherill Park	OW	75n	9,825	12	New	A&J Packaging	Feb-15
21-25 Interchange Dr, Eastern Creek	OW	100n	14,800	15	Speculative	Provet	Jan-15
66 Glendenning Rd, Glendenning	OW	90n	16,461	5	Renewal	McAlpine Hussman	Nov-14
7 Eucalyptus Pl, Eastern Creek	OW	115n	15,925	7	Speculative	FDM Logistics	Nov-14
86 Rodeo Rd, Narellan	SW	105.5g	15,034	10	Pre-com	GMK Logistics	P/C
361 Milperra Rd, Bankstown	SW	50n	6,585^	3	New	Taren Point Auto Traders	Feb-15
30-50 Yarrawa St, Prestons	SW	139n	45,571	15	New	Mainfreight	Jan-15
361 Milperra Rd, Bankstown	SW	80n	3,767	5	New	Hopper Transport	Oct-14
35 Bryant St, Padstow	SW	103g	17,949	10	New	A.H. Beard	Oct-14
26 Cranbrook St, Botany	S	135g	965	5	New	Megadeck	May-15
55 Doody St, Alexandria	S	210g	2,271	5	New	National Bowling & Recreational	Apr-15
1-11 Allen St, Waterloo	S	140g	1,174	2	New	Lend Lease	Apr-15
116 Rothschild Ave, Rosebery	S	145n	1,560	3	New	CSR	Mar-15

Source: Knight Frank g refers gross n refers net Conf. refers confidential * across two buildings P/C refers practical completion ^ refers site area
OW Outer West ICW Inner Central West SW South West N North S South

INVESTMENT ACTIVITY & YIELDS

Sydney industrial sales activity continues to demonstrate heightened levels of transactions with demand stemming from a broad range of buyer groups. Sales volumes by value ($10m+) measured $1.8 billion in 2014, which although relatively inline with the volume recorded in the previous year, was 55% above the five year average. (Note. 2014 sales volume data excludes Sydney assets included in the $2.6bn Frasers takeover of Australand). Factors supporting activity continue to be the low cost of debt, while, notwithstanding some recent resilience, the general depreciation of the AUD over the past 12 months has been supportive of offshore demand.

Given the strong demand by institutional funds to build scale in the sector, approximately a third of the 2014 Sydney volume comprised portfolio assets that were generally sold as national portfolios. Late 2014 examples included the Altis and Valad portfolio sales to Mirvac and a combination of M&G Real Estate and Propertylink respectively as well as Charter Hall acquiring a number of Inghams facilities on sale and leasebacks. Portfolio activity will continue to drive volumes in 2015. In February, Cache Logistics Trust (Singaporean REIT) acquired 127 Orchard Rd, Chester Hill for $37million from McPhee Distribution Services as part of a three asset portfolio. Forthcoming sales are expected to include current national portfolio offerings from both GIC as well as US listed REIT, Equity Commonwealth (currently in DD).

Aside from portfolios, stand alone prime investment opportunities remain relatively limited. Institutions, who account for the bulk of new supply, have shown a tendency to retain ownership of completed projects, either on balance sheet or within wholesale JVs. This has made it difficult for offshore groups to find direct opportunities, despite a number of pension funds keen to source long duration assets to effectively manage long term liability streams. While there has been an increasing amount of direct investments by offshore groups as opposed to wholesale joint ventures, there has been strong competition from local funds for any opportunities.

There has been a steady stream of asset sales in the $15 million to $40 million range. A number of local, unlisted funds have been active in this space, with a willingness to look at value add opportunities, particularly where active leasing management expertise can be utilised. Owner occupier demand has

TABLE 4

Recent Improved Sales Activity Sydney

Address	Region	Price $ mil	Bldg Area (m²)	Passing Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
127 Orchard Rd, Chester Hill#	ICW	37.00	25,830	7.03	10.0	McPhee Dist. Services (S&L)	Cache Logistics	Feb-15
44 Biloela St, Villawood	ICW	19.50	15,845	c.8.5	U/D	Realgrace Pty Ltd	Altis Property Partners	Oct-14
2 Lincoln St, Lane Cove	N	16.87	9,438	9.72	3.8	Centuria Property	Private	Mar-15
7 Gundah Rd, Mt Kuring-gai	N	55.00	41,880	8.4	2.5	Indust. Parks of Aust.	Propertylink	Dec-14
300 Victoria St, Wetherill Park	OW	33.00	39,845	10.6	3.0	GWA (S&L)	Charter Hall (CPIF)	Mar-15
66 Glendenning Rd, Glendenning	OW	19.17	16,461	7.73	c4.7	DEXUS››	Investec	Mar-15
165 Newton Rd, Wetherill Park	OW	18.50	12,529	7.86	11.3	Valad Property Group	Investec	Dec-14
133-145 Lenore Dr, Erskine Pk#	OW	79.53	44,702	5.9	14.1	Washington H Soul	Logos Property‡	Nov-14
9-10 John Morphett Pl, Ersk. Pk#	OW	61.71	37,160	6.75	11.2	Valad Property Group	Property Link†	Aug-14
5-9 Bridges Rd, Moorebank	SW	25.00	20,000	N/A	c.0.6	Joyce Corporation	Private Developer	Mar-15
5 Inglis Rd, Ingleburn	SW	22.35	18,400	U/D	0.5	Private	Altis Property Partners	Dec-14
20 Williamson Rd, Ingleburn	SW	13.20	11,283	c.8.6	c.6.0	Manora Property	Lester Group	Dec-14
6 Benson Rd, Ingleburn#	SW	15.90	7,700	Conf.	20.0	Inghams (S&L)	Charter Hall (DIF 2)	Nov-14
36-48 Bernera Rd, Prestons	SW	70.00	22,100	6.62	13.6	Vaughan	Logos Property‡	Oct-14
230 Hoxton Park Rd, Prestons	SW	9.00	6,533	7.62	6.9	Jlab Investments	Treviso	Sep-14
19 Military Rd, Matraville	S	13.00	c.2,700^	10.0	U/D	Indigenous Business Australia	EG Funds Management (Core Plus Fund)	Mar-15
2 Simblist Road, Port Botany	S	45.50	39,996	13.5	18.0	NSW Ports	Altis Property Partners	Mar-15
Lakes Business Park, Botany	S	153.50	43,617*	N/A	3.2	LPB Holdings	DEXUS	Dec-14
2-8 Baker St, Botany	S	20.30	9,550	7.6	c1.5	Private	Stockland	Dec-14
300 Coward St, Mascot	S	22.50	10,420	6.4	8.0	Bricktop	Private	Oct-14

Source: Knight Frank U/D refers undisclosed # acquired as part of a portfolio † on behalf of M&G Real Estate ‡ on behalf of Kumpulan Wang Persaraan (KWAP) ›› obo private client mandate S&L refers sale and leaseback * 30,379m² office and 13,238m² industrial ^1.3ha site OW Outer West SW South West ICW Inner Central West N North S South been particularly strong for buildings of between 5,000m² and 10,000m². The South West has recorded a number of such sales, a trend that has resulted in such sales accounting for almost half of gross take-up in calendar year 2014.

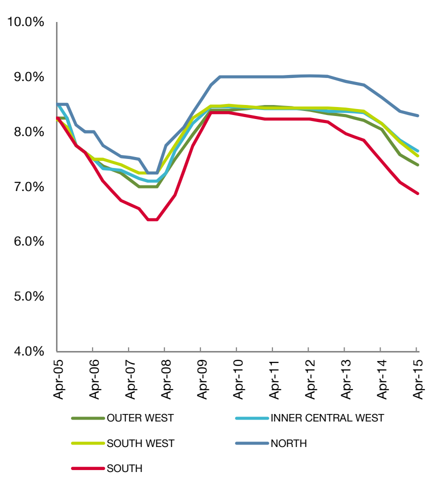
Based on a five year WALE, average Sydney prime yields are estimated to range between 7.00% and 8.00%. This range represents approximately 100bps of compression through the cycle thus far and has resulted in in prime yields being 45bps tighter than the 10 year average. However, newly constructed assets with 10+ year WALEs are trading at a significant premium to this range. For instance the last quarter of 2014 saw asset sales such as 133 Lenore Drive, Erskine Park (14.1 year WALE, 5.9% passing yield) and 36 Bernera Road, Prestons (13.6 year WALE, 6.6% passing yield). The current offering of the Coles Distribution facility with a 19 year WALE is anticipated to crystalise further tightening for super prime assets to sub-6%. Given the strong demand for such assets, yields for super prime assets are also estimated to have firmed in excess of the 100bps recorded in the broader market as evidenced by similar transactions during 2011/2012 reflected yields within a 7.5% to 8.0% range.

Demand from both investors looking for value add opportunities as well as interest rate sensitive owner occupiers has resulted in further compression amongst the secondary grade assets.

FIGURE 6

Average Core Market Prime Yields

Sydney Industrial Regions



Source: Knight Frank

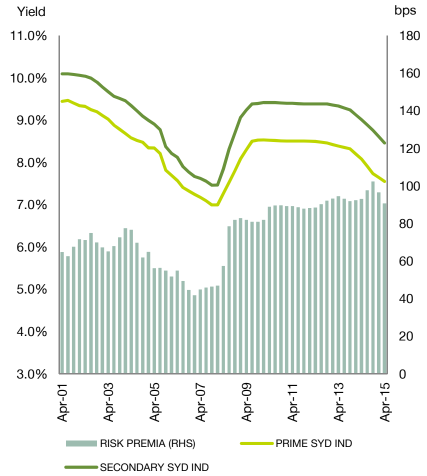
Average secondary yields range from between 8.00% and 9.00%. In terms of the risk premium compared to prime, the spread has held at a relatively high level of circa 90bps for the best part of five years. Secondary asset sales based on alternate use potential have traded at substantial premiums to metrics based on an ongoing industrial use, particularly given a number of developers taking on a higher degree of planning risk. The bulk of such sales have occurred in suburbs in the South region undergoing urban renewal including Waterloo and Mascot, as well as the Inner Central West.

Whilst capital costs and bond yields have had a positive impact on pricing, there is the potential for a rise in bond rates to constrain the extent of cap rate firming over the medium term, particularly in light of 10-year bond yields increasing circa 50bps between the end of March to mid-May. However, as at April, the spread between Sydney prime industrial yields and the 10-year bond rate measured 519bps, which is well above the 10-year average of 326bps. This relative pricing metric implies a degree of cushion for industrial yields given bond rates still remain very low in the context of the historical average.

FIGURE 7

Sydney Industrial Core Market Yields

Prime vs Secondary and spread



Source: Knight Frank

Outlook

- While the national economy is demonstrating mixed performances by geography, conditions in NSW are expected to remain supportive for industrial tenant demand. Retail sales continue to grow above the national average, business conditions as at April were the highest amongst the mainland states and the sharp lift in housing activity is expected to see elevated construction persist into the medium term. Plans by the State Government to reallocate $20 billion to infrastructure projects will also be a positive.
- Coupled with below average construction levels and expectations of vacant stock levels to reduce in coming quarters, these factors provide scope for the current rate of moderate prime rental growth to be sustained over the remainder of 2015. There is potential for outperformance in supply constrained markets, such as the South region, particularly given the impact from alternate use re-zoning.
- Although undeveloped, serviced land is sufficient to meet new build requirements for the next few years, demand for land is expected to remain firm as developers will look to secure positions in englobo land in the growing Western Sydney market.
- The lower end of yield ranges is expected to be tested by a number of assets currently on the market, with expectations of some further firming in yields to be crystallised. However, notwithstanding the significant depth of capital looking for opportunities, the recent rally in global bond yields may provide a headwind to the extent of further compression.

Definitions:

Core Market Yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).

Super Prime Grade: Brand new asset with 15+ year WALE and high covenant strength.

Prime Grade: Asset with modern design, good condition & utility with an office component 10-30%. Located in an established industrial precinct with good access.

Secondary Grade: Asset with an older design, in reasonable/poor condition, inferior to prime stock, with an office component between 10-20%.

Vacancy Methodology:

This analysis collects and tabulates data detailing vacancies (5,000m²+) within industrial properties across all of the Sydney Industrial Property Market. The buildings are categorised into 1) Existing Buildings – existing buildings for lease. 2) Speculative Buildings – buildings for lease which have been speculatively constructed and although have reached practical completion, still remain vacant. 3) Spec. Under Construction – buildings for lease which are being speculatively constructed and will be available for occupation within 12 months.

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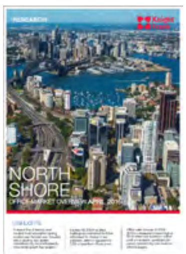

North Shore Office Market Overview April 2015

Chinese Outward Investment Globally and into Australia

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