RESEARCH

SYDNEY

INDUSTRIAL MARKET BRIEF NOVEMBER 2016

Key Facts

Prime net face rents have increased by 3.2% over the past 12 months, the highest level of growth in a decade.

Up to 541,927m^2 of new industrial space, mostly pre-committed, is being completed across Sydney in 2016, up 18% YoY.

Speculative developments are achieving favourable leasing results, with more than 70% being leased prior to or at completion.

Further capitalisation rate compression for quality assets was recorded on the back of positive leasing fundamentals.

ALEX PHAM

Senior Research Manager

Follow at @KnightFrankAu

3PL groups, e-commerce and consumer goods retailers continue to be the primary drivers of industrial space demand in Sydney. High quality industrial assets remain attractive to investors on the back of positive fundamentals.

Occupier Demand & Rents

The NSW economy remains in good shape in 2016, with the State economic growth being supported by strong population growth, positive retail trade, record dwelling starts and low unemployment. The State economy has outperformed its long-term trend over the past year, growing at 3.5% pa in real terms. In addition, significant infrastructure investment and upgrades to road networks have been the key catalysts driving growth in the industrial sector.

3PL groups, e-commerce and consumer goods retailers are the primary drivers of demand for industrial space in Sydney over the past 12 months. Up to 113,129m^2 of industrial space (ex. D&C) has been absorbed in the three months to October 2016, with prime space accounting for 67% of this total gross take-up over the period. By precinct, the Outer West has the strongest level of demand, driven by the availability of new space, and tenant migration from the other precincts. Demand in the Outer West accounted for more than half (54.4%) of the total gross absorption over the quarter to October 2016.

Prime net face rents have increased by 3.2% over the past 12 months, the strongest growth rate in a decade. In the secondary market, net face rents have risen by 3.6% in the year to October 2016. It is worth noting the divergence of rental growth rates across different precincts in Sydney (Table 1). This is a reflection of the different local market conditions and supply/demand dynamics.

The rapid depletion of industrial stock, particularly secondary stock, in the South region saw prime and secondary net face rents in the precinct rising by 8.2% (\$166/m^2) and 11.4% (\$147/m^2) in the 12 months to October 2016 respectively. In the Outer West, the strong demand for modern and well-located industrial spaces has seen prime rents achieving stronger growth than secondary rents. The average prime net face rent in the Outer West has escalated by 3.1% over the past 12 months to reach \$111/m^2, whilst secondary rents has risen by only 0.7% to around \$95/m^2. Elsewhere, net face rents remained relatively steady over the past 12 months.

Development & Land Values

Industrial development activity continues to expand across Sydney with up to 541,927m^2 of new industrial space, most of which has been pre-committed, expected to be completed in 2016. This represents an increase of 18% over 2015. Nevertheless, the current level of supply is still substantially below pre-GFC levels of circa 700,000m^2 a year (Figure 1).

By precinct, the Outer West accounts for the majority of new completions in 2016. Up to 342,233m^2 of new stock (63% of the total) this year is located in the Outer West region, followed by 84,000m^2 in the South West and 79,685m^2 in the South region. Development in the South region is concentrated primarily in the area surrounding Port Botany, where Goodman is completing a facility at 2-28 McPherson Street, Banksmeadow pre-leased to Toll Holdings (16,000m^2).

Speculative developments are achieving favourable leasing results, with Knight Frank's analysis showing more than 70% of speculative developments having been leased prior to or at completion over the last two years. We understand that deals on the two speculative facilities of Mirvac (60 Wallgrove Road, Eastern Creek) and Stockland (35 Stennett Road, Ingleburn) are imminent as at November 2016.

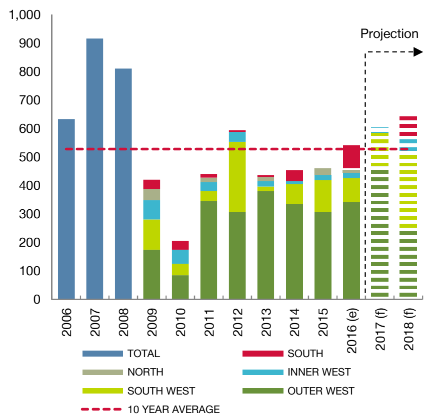
Recent pre-leases include furniture retailers; Nick Scali and Fantastic Furniture, committing to 12,000m^2 and 10,310m^2 warehouses at Frasers' Horsley Drive Business Park in Wetherill Park. Following these pre-lease successes, Frasers have commenced the speculative development of two more buildings of 7,250m^2 and 7,915m^2 at the back of the two recently pre-leased buildings.

As at November 2016, there is 28,973m^2 of un-committed speculative industrial buildings. These include the remaining space at Stockland's 35 Stennett Road, Ingleburn (15,738m^2—completed), 145 Lenore Drive, Erskine Park (7,540m^2—U/C) and 415 Pembroke Road, Minto (5,695m^2—U/C).

On the back of a strong development market amid declining land stock, industrial land values have risen strongly over the past 12 months (Table 1). As at October 2016, development site values in the Western Sydney region averaged around \$478/m^2 for small-sized lots (<5,000m^2), representing an increase of 8.3% YoY. Medium-sized lots (1-5 hectares) are expected to trade at around \$367/m^2, up 7.3% from a year ago.

Frasers Property was one of the most active institutional land buyers in the past quarter acquiring two sites for a total consideration of over \$100 million (Table 3). Another institutional acquisition was Logos' purchase of 21 hectares at Marsden Park for \$40 million (\$190/m^2).

FIGURE 1
Sydney Industrial Development
Annual Gross Supply ('000 m², bldgs >5,000m²)

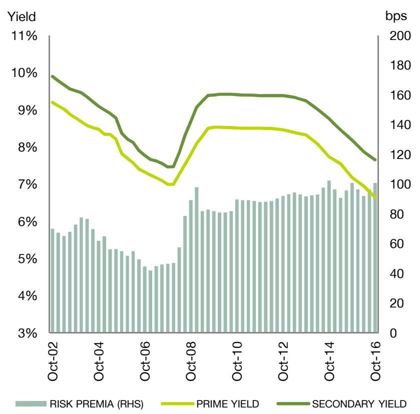


Source: Knight Frank Research

FIGURE 2
Sydney Industrial Land Values*
Avg. Value Serviced Lots (\$/m²)

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

FIGURE 3
Sydney Industrial Core Market Yields
Prime vs Secondary



Source: Knight Frank Research

TABLE 1
Sydney Industrial Market Indicators as at October 2016

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	111	3.1	95	0.7	5.75 - 6.75	7.00 - 8.00	483	16.0	400	15.9
Inner/Central West	123	0.5	105	0.0	6.25 - 7.25	7.25 - 8.25	573	1.1	410	4.1
South West	103	1.9	84	3.1	6.75 - 7.25	7.50 - 8.50	377	7.7	290	1.8
North	166	2.3	139	2.8	6.50 - 7.50	7.75 - 8.75	725	12.4	555	5.7
South	166	8.2	147	11.4	5.50 - 6.25	6.25 - 7.00	1,625	18.2	1,225	19.5
Sydney Average	**134**	**3.2**	**114**	**3.6**	**6.15 - 7.00**	**7.15 - 8.10**	**478***	**8.3***	**367***	**7.3***

Source: Knight Frank Research

† reflects average rents for existing buildings. Pre-lease rents average above these indicative rates.
* Average Outer West, Inner/Central West and South West
^ Core yields assume five year WALE.

Sales & Investment Activity

Investor demand remains strong but volumes have somewhat moderated in 2016 due to the lack of quality stock on the market. Circa $2.02 billion worth of industrial properties (over $5 million) have traded in Sydney over the 12 months to November 2016, down 22% YoY.

Year-to-date investment activity in NSW has been dominated by major portfolio transactions (Table 3). Two portfolio deals that have been completed earlier the year are the Altis Portfolio sold to Mapletree for $85 million at a combined passing yield of 7.4% and the JP Morgan portfolio acquired by AMP Capital for $250 million at a blended yield of 6.5%.

Following the sale of their portfolio to Mapletree, Altis has subsequently purchased a national portfolio comprising of 14 assets across three states (NSW, Vic and Qld) on a sale and lease back agreement at a combined initial yield of 8.76% and a WALE of 4.6 years. In NSW, there are two assets in Sydney (15-21 Britton St, Smithfield and 63 Britton St, Smithfield) and one in the Hunter Region (11-21 Gardiner Street, Rutherford).

Blackstone is reportedly in negotiation to acquire a second national portfolio from Goodman, after the first portfolio acquisition (none of the assets were in NSW) earlier in the year for $640 million. The second portfolio, once completed, could be worth more than $650 million and see Blackstone taking control of 21 industrial properties across Australia, one of which is located in NSW.

As at October 2016, prime industrial assets in Sydney (based on 5 year WALE) are trading on average core market yields of between 6.15% and 7.00% (Table 1). Prime facilities with over 10 year WALEs may trade at sub-6% core market yields. In the secondary market, average core market yields are ranging from 7.15% to 8.10%, with the prime-secondary yield spreads standing at around 100bps.

TABLE 2

Recent Leasing Activity Sydney

Address	Region	Net Rent	Area	Term (yrs)	Tenant	Date
Pre-lease						
Horsley Drive Business Park	OW	U/D	12,700	10	Nick Scali	P/C
Horsley Drive Business Park	OW	U/D	10,310	U/D	Fantastic Furniture	P/C
38-42 Cosgrove Rd, Enfield	SW	c.135	13,500	10	U/D«	P/C
Horsley Drive Business Park	OW	115	5,855	12	Survitec	P/C
Existing Leases						
141 Newton Rd, Wetherill Park	OW	110	11,817	7	AUSREO	Nov-16
122 Hassall St, Wetherill Park	OW	122g	1,380	5	Let's Play Games	Oct-16
Horsley Drive Business Park	OW	111	8,478	10	Phoenix Transport	Oct-16
22 Myrtle St, Marrickville	ICW	117g	1,753	3	ERTH Visual &	Oct-16
Abbott Industrial Estate	ICW	93	5,314	7	85 Degrees Coffee	Sep-16
80 Cope St, Waterloo	S	99	1,013	2	Bravofoods	Sep-16
106 Derby St, Silverwater	ICW	110	2,560	5	PTC	Sep-16
40 Marigold St, Revesby	SW	110	4,323	5	Verosol Australia	Aug-16
76 Heathcote Rd, Moorebank	SW	120g	2,700	5	Grosvenor	Aug-16

TABLE 3

Recent Land/Development Major Sales Activity Sydney

Address	Region	Price ($ mil)	Area (ha.)	$/m² of Area	Vendor	Purchaser	Sale Date
15 Muir Rd, Chullora≠	ICW	65.0	15.19	428÷	SUEZ	Frasers Property	Oct-16
Hanson Wallgrove Quarry, Eastern	OW	35.8	10.00	358	Heidelberg Cement	Frasers Property	Oct-16
Marsden Park site	OW	40.0	21.00	190	Private	Logos	Sep-16

Recent Improved Major Sales Activity Sydney

Address	Region	Price $ mil	Bldg Area (m²)	Passing Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
15-21 Britton St, Smithfield±	OW	19.00	12,223	6.23	U/D	Private	Altis	Nov-16
63 Britton St, Smithfield±	OW	10.75	8,100	10.59	U/D	Private	Altis	Nov-16
1 Clyde St, Silverwater	ICW	11.35	5,201	7.20	<1.00	CREI Industrial	Tennyson	Nov-16
2-34 Davidson St, Greenacre	ICW	35.00	18,114	VP Sale	NA	AMP Capital	Abacus/GAW	Oct-16
1 Huntingwood Dr, Huntingwood	OW	31.50	21,376	VP Sale	NA	Sharp	GPT	Oct-16
91 Kurrajong Ave, Mount Druitt	OW	15.50	16,179	U/D	<1.00	Fred's Holdings	LEDA	Oct-16
62-64 O'Riordan St, Alexandria	S	14.50	3,938	3.90	1.10	Propertycorp	Private	Oct-16
7 Steel St, Blacktown	OW	16.05	9,180	8.10	c.5.0	Bidvest Group	Western Chill	Sep-16
JP Morgan Portfolio*	W & SW	250.00	147,496	6.50	6.75	JP Morgan	AMP Capital	Jun-16
Altis Portfolio#	W	85.00	51,612	7.40	5.80	Altis	Mapletree	May-16

Source: Knight Frank Research «leased to an undisclosed storage business
± Sold as part of an off-market national portfolio of 14 properties across three states (NSW, Vic, Qld) from two private investors to Altis for a total price of $89 million.
≠ Site comprises six hectares of developable land and an investment component on the adjoining 9.19 hectare parcel leased to SUEZ ÷ Blended rate.
* Assets (all in NSW) include; 52 Huntingwood Drive, Huntingwood, 32 Sargents Road, Minchinbury, 64 Biloela Street, Villawood, 52 Lisbon Street, Fairfield,104 Vanessa Street, Kingsgrove and 32 Bessemer Street, Blacktown.
# Assets (all in NSW) include; 114 Kurrajong Avenue, Mount Druitt, 53 Britton Street, Smithfield, 405-407 Victoria Street, Wetherill Park, 3 Distillers Place, Huntingwood
OW Outer West SW South West ICW Inner Central West N North S South g refers gross U/D refers undisclosed

Outlook

The NSW economy is expected to maintain above-trend economic growth over the next two years, boosted by a solid pipeline of infrastructure development projects by the NSW State government. The positive macro economic backdrop coupled with solid growth in e-commerce and retail trade will support demand for industrial and logistics space across Sydney. In addition, the industrial market is poised to benefit from the rapid expansion of international retailers, such as; ALDI and Costco, and the anticipated arrival of Kaufland (ALDI's arch rival in Europe) and Amazon Fresh. These dynamics would further boost demand for modern and strategically located logistics facilities.

On the supply side, new development is projected to increase over the next two years on the back of a strong pre-commitment market and solid leasing requirements for larger space in excess of 10,000m^2. The majority of this supply pipeline is in the Outer West, where serviced land is still available, albeit reducing quickly.

Overall, it is expected that rental growth should track slightly above the CPI rate of around 2.5% to 3.5% per annum over the next two years. However, rental growth should vary greatly across precincts, with local supply and demand dynamics playing a significant role in determining this growth. Specifically, rental growth in the South region will continue to outstrip other markets due the continued depletion of industrial stock.

Investor demand is expected to be maintained as the quest for income stability continues. Prime assets with 5 year WALEs are expected to trade at around 6.0% to 7.0% yields but those with 10+ year WALE are likely to continue to attract yields of circa 6.0% and below.

Definitions:
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 with the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for specific issues (ie rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives etc).

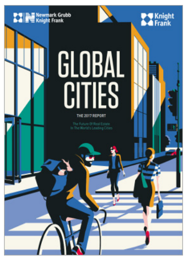
Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Sydney Industrial Vacancy Analysis October 2016

Australian Residential Review November 2016

Melbourne Industrial Market Brief November 2016



Global Cities The 2017 Report

Knight Frank Research Reports are available at **KnightFrank.com.au/Research**

RESEARCH & CONSULTING
Alex Pham
Senior Research Manager
+61 2 9036 6631
Alex.Pham@au.knightfrank.com

Matt Whitby
Group Director
Head of Research & Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

INDUSTRIAL
Tim Armstrong
Head of Industrial, NSW
+61 2 9761 1871
Tim.Armstrong@au.knightfrank.com

David Morris
Managing Director - Sydney West
+61 2 9761 1818
David.Morris@au.knightfrank.com

Matthew Lee
Director, Industrial
+61 2 9761 1874
Matthew.Lee@au.knightfrank.com

Alex Jaafar
Director - South West
+61 2 9733 0186
Alex.Jaafar@au.knightfrank.com

Terry Hassan
Director - South West
+61 2 9733 0187
Terry.Hassan@au.knightfrank.com

Peta Antoniou
Director - Head of South Sydney
+61 2 9036 6749
Peta.Antoniou@au.knightfrank.com

James Reeves
Director - South Sydney Industrial
+61 2 9036 6789
James.Reeves@au.knightfrank.com

VALUATIONS
Lachlan Graham
Divisional Director
+61 2 9028 1132
Lachlan.Graham@au.knightfrank.com

James Cox
Associate Director
+61 2 9036 6781
James.Cox@au.knightfrank.com

Knight Frank
Newmark Knight Frank Global