RESEARCH

SYDNEY
INDUSTRIAL MARKET BRIEF MAY 2017

Key Facts

Increased tenant demand and limited vacancy resulted in **Sydney's average prime net face rents rising by 3.8%** over the past 12 months.

Gross absorption of industrial space measured 176,378m² in Q1 2017, 18.5% above the series average.

Average industrial land values (ex. North and South regions) have risen by 18.8% and 22.7% for small and medium sized lots respectively over the past year.

Investment volumes over the 12 months to Q1 2017 reached $2.7 billion, a 13% increase from a year ago.

ALEX PHAM
Senior Research Manager

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Increased infrastructure investment and the rise of online retailing are driving positive tenant demand across Sydney while investment activity is elevated on the back of improved leasing conditions and rising effective rents.

Occupier Demand & Rents

Sydney's industrial sector is in the midst of a growth spurt underpinned by increased infrastructure investment and rising merchandise trade volumes. The Federal Government has recently announced an $18 billion infrastructure development package for NSW over the next seven years, with major investments including $3.5 billion for the Western Sydney Airport and $3.6 billion for the Western Sydney Infrastructure Plan. This is in addition to the record $73.3 billion infrastructure program to be funded by the State Government over the next four years.

In addition to infrastructure development, the rise of online retailing has further boosted demand for warehousing, transport and logistics facilities across the State. Estimates by NAB show Australian online retail sales reached $22.23 billion in the 12 months to March 2017, up by 9.0% YoY. This sees many major retailers embracing the 'bricks & clicks' business model, driving demand for distribution centres capable of delivering goods directly to households in a short timeframe. Recent examples include Hello Fresh (9,500m² in Greystanes) and The Iconic (19,100m² in Yennora) while Amazon (100,000m² in Horsley Park) is expected to be operational this year.

Gross absorption of industrial space (excluding D&C) across Sydney totalled 176,378m² in the first quarter of 2017, 18.5% above the series average. The strong demand has occurred more evenly across the board this quarter, with prime absorption representing 59% of the total take up in comparison to the previous quarter which saw prime stock account for 88% of the total absorption level.

By precinct, the Outer West continued to outperform other regions, accounting for almost half of the gross absorption over the quarter, reflecting the ongoing geographical shift of tenant activity within Sydney. Availability of new stock and improved infrastructure were the key catalysts for tenants to migrate to the Outer West region. This was followed by the South West, representing 19% of the total take up and the South and Inner West both accounting for 16% of the total. Positive tenant demand and low speculative supply have resulted in Sydney's vacancy falling to its lowest level on record of 401,690m², 21% lower than the previous quarter.

On the back of lower vacancy levels, average prime net face rents across Sydney increased by 3.8% YoY to $136/m² as at April 2017. This is the strongest level of rental growth over the past decade. A similar level of growth was recorded for secondary rents, which rose to $116/m² by April 2017. By precinct, the strongest rental uplift occurred in the South region, with prime and secondary net face rents rising by 8.9% ($169/m²) and 10.9% ($149/m²) respectively over the past 12 months. The ongoing erosion of industrial space in the South continues to drive tenant demand to other markets. As a result, prime net face rents in the Outer West and Inner/Central West have risen by 2.6% to $112/m² and 2.0% to $126/m² respectively last year.

Development & Land Values

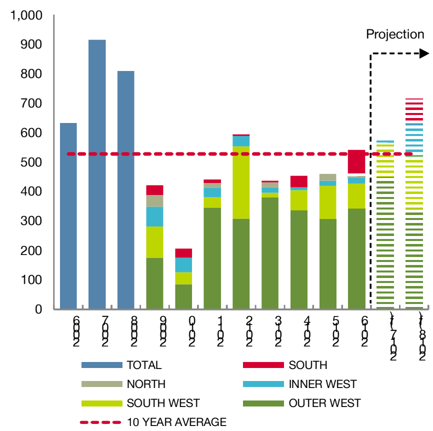
The low interest rate environment, declining vacancies and positive rental growth are creating optimum conditions for new industrial development. A total of 541,972m² of new supply was completed across Sydney in 2016, up 17.6% from a year earlier. This is the strongest level of supply in the past four years, but still lower than the pre-GFC levels. Despite the increase in gross supply, only 26% was speculatively developed. Of these speculative developments, more than 70% were leased prior to or at practical completion, highlighting the strong tenant preference for prime and new industrial facilities.

The bulk of gross supply over the past 12 months occurred in the Outer West with 324,233m² of new industrial floor space added to the market (63% of total supply). This was followed by the South West and South with 84,310m² and 79,685m² delivered respectively.

The buoyant development market is putting upward pressure on industrial land prices across Sydney. With supply being severely restricted, and a significant amount of industrial land being converted to residential, the South region saw the biggest increase in land values, with prices for small (<5,000m²) and medium lots (1-5ha) rising by 63.6% and 56.1% YoY to average $2,250/m² and $1,600/m² respectively as at April 2017. However, land availability in the South region is extremely scarce with only Botany having a small amount of undeveloped land.

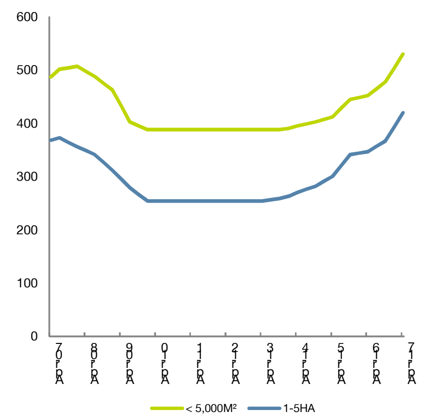
Industrial land prices have also risen strongly across the Outer West, Inner/Central West and South West regions. The average values for small and medium lots across these markets have increased by 18.8% and 22.7% respectively over the 12 months to April 2017. The

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



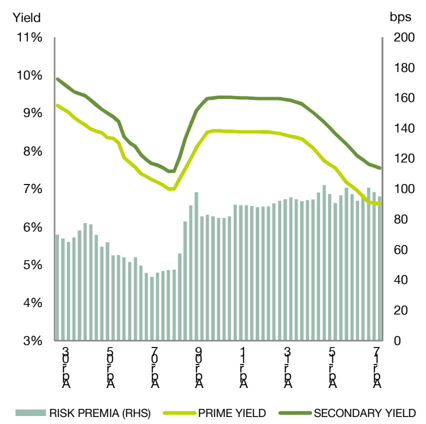
Source: Knight Frank Research

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 April 2017

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	112	2.6%	96	0.7%	5.75 - 6.50	7.00 - 7.75	500	20.0%	420	20.0%
Inner/Central West	126	2.0%	106	0.6%	6.00 - 7.25	7.25 - 8.25	613	8.2%	450	11.1%
South West	103	0.5%	86	1.8%	6.50 - 7.25	7.25 - 8.25	477	28.2%	390	36.8%
North	172	3.3%	145	4.8%	6.50 - 8.00	7.75 - 9.00	750	16.3%	565	7.6%
South	169	8.9%	149	10.9%	5.50 - 6.25	6.25 - 7.00	2,250	63.6%	1,600	56.1%
Sydney Average	**136**	**3.8%**	**116**	**3.8%**	**6.00 - 7.00**	**7.00 - 8.00**	**530***	**18.8%***	**420***	**22.7%***

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
^ Based on five year WALEs

intensified competition for industrial sites between developers and owner occupiers has resulted in price growth in excess of 30% in the South West, while the Outer West region saw an increase of 20% last year. As at April 2017, land values for small and medium sized lots in the Outer West averaged $500/m² and $420/m² respectively.

According to Knight Frank's analysis, the total amount of zoned and serviced industrial land across the Western Sydney Employment Area (WSEA) was 126.7 hectares as at January 2016. Based on the historical average take-up rate of 55 hectares per annum, the current serviced industrial land bank is equivalent to only 2.3 years of development. This will put a cap on future supply and maintain upward pressure on land values going forward.

Sales & Investment Activity

Investor demand for industrial assets across Sydney has picked up strongly with the total investment volume over the year to Q1 2017 rising by 13% YoY to reach $2.7 billion. With Sydney's prime office and retail properties being traded at sub-5% yields, industrial property is still presenting a more attractive yield proposition. Prime industrial properties (based on 5 year WALEs) are currently traded at 6.0% to 7.0% core market yields. In the secondary market, core market yields currently range between 7.0% and 8.0%.

The largest single deal in Q1 2017 was Woolworths Distribution Centre at 69 Sargents Road, Minchinbury sold by Lendlease to Logos for $161 million. The core market yield of 7.98% reflects the leasehold ownership. A freehold property of similar calibre could be traded at a sub -7% yield in the current market. This is evidenced by the sale of 1 Culverston and 1 Hunstmore Road for $27.7 million late last year at a core market yield of 6.73% and the recent Leda Portfolio sale for $71 million at a 6.79% blended yield.

TABLE 2

Recent Leasing Activity Sydney

Address	Region	Net Rent $/m²	Area	Term (yrs)	Tenant	Date
New Builds						
290 Kurrajong Ave, Prestons	SW	113	10,300	7	BAM Wine	D&C
Calibre, Eastern Creek	OW	120	19,000	4	CEVA Logistics	Spec.
Crossroads Centre, Casula	SW	108	12,500	10	Cosentino	D&C
Unit E Quarry West, Greystanes	OW	150	9,500	7	Hello Fresh	D&C
89 Quarry Rd, Erskine Park	OW	115	11,500	11	PACT	Spec.
35 Stennett Rd, Ingleburn	OW	100	15,000	7	Next Logistics	Spec.
Existing Leases						
1 Buru Wargun Dr, Greystanes	OW	115	4,355	10	Patrons Wines	May-17
1 Huntingwood Dr, Huntingwood	OW	110	21,366	U/D	IVE Group	Apr-17
15-23 Quarry Rd, Erskine Park	OW	118	9,256	7	Packcentre	Apr-17
350 Parramatta Rd, Homebush	ICW	135	6,347	10	NEP Australia	Dec-16
160 Bourke Rd, Alexandria	S	165#	5,800	7	Mercedes Benz	Nov-16
205-231 Fairfield Rd, Yennora	OW	108	19,100	7	Iconic	Nov-16

TABLE 3

Recent Land/Development Major Sales Activity Sydney

Address	Region	Price ($ mil)	Area (m²)	$/m² of Area	Vendor	Purchaser	Sale Date
457-463 Victoria Street, Wetherill Park	OW	10.3	35,100	293	FD Properties	Private	Dec-16
Lot D 31 Bay Road, Taren Point	S	24.3	31,800	764	Leda Holdings	ARV	Apr-17
36 Huntingwood Drive, Huntingwood	OW	29.7	56,600	525	Beiersdorf	Charter Hall	Feb-17

Recent Improved Major Sales Activity Sydney

Address	Region	Price $ mil	Bldg Area (m²)	Passing Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
Sydney Six Portfolio«	Various	71.0	45,850	6.79	1.8	Simonson Properties	Leda Holdings	May-17
Primo Industrial Portfolio»	Various	179.4	U/D	6.50	10.5	Lederer	Charter Hall	May-17
60 Marple Avenue, Villawood	SW	20.0	18,529	8.50	U/D	360 Capital	Private	Jan-17
69 Sargents Road, Minchinbury±	OW	161.0	88,555	7.98<	4.4	Lendlease	Logos	Jan-17
3 George Young Street, Auburn	ICW	10.3	5,000	6.50	6.1	Private	PrimeWest	Jan-17
1 Culverston Road, Minto	SW	27.7	15,519	6.73<	10.6	Private	Charter Hall	Dec-16
Suez Industrial Portfolio^	Various	65.9	23,931	6.00	15.0	Suez	Charter Hall	Dec-16
79-99 St Hilliers Road, Auburn	ICW	65.0	26,000	4.90	U/D	Dexus	China Lesso Group	Dec-16
55 Kent Road, Mascot	S	30.0	7,321	5.10	2.4	Private	Bayswater Car	Nov-16

Source: Knight Frank Research OW Outer West SW South West ICW Inner Central West N North S South
g refers gross U/D refers undisclosed P/C refers pre-commitment # Gross rent is $210/m²
« Assets include: 160-162 Newton Road, Wetherill Park, 8 Hexham Place, Wetherill Park, 488-490 Victoria Street, Wetherill Park, 484-486 Victoria Street, Wetherill Park, 87-91 Victoria Street, Smithfield, 6 Shale Place, Eastern Creek.
» 10 assets across NSW and Vic
± Leasehold property < Core market yield
^ 10 properties located across QLD, NSW, WA and Vic

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Outlook

The NSW economy is expected to retain its position as an economic powerhouse of Australia over the next 12 months, with the State GDP growth forecast to be above trend at 3.0%—3.25% this year. Buoyant business investment, merchandise trade and construction activity will be the main drivers of growth, while unemployment is expected track below the national average.

This strong economic foundation combined with the rise in e-commerce and logistics will translate to improved industrial tenant demand over the next 12 months. Moreover, the arrivals of global retailers such as Amazon, Lidl and Decathlon, will further strengthen demand for well-located warehouses, cold storage and logistics facilities in Sydney. The positive outlook is extended over the medium-term, in line with the massive infrastructure projects across the State over the coming years.

Against this backdrop, Sydney's average industrial rental growth is expected to trend above 3.5% over the next two years, although there will be significant variation across the regions. Strong rental growth is expected to be sustained in the South region due to the lack of new supply and declining stock base. Other markets however, will see relatively moderate face rental growth of between 2.5-3.5%.

Industrial property continues to offer attractive value proposition to investors, with yields trading at 100-200bps higher than the other commercial property asset classes. Combined with the restricted trading stock, this will see the pressure on capitalisation rates be maintained over the next 12 months. Prime industrial assets with 5 year WALE are expected to trade at circa 6.0%-6.5% yield whilst sub-6.0% yields are anticipated for well-positioned properties with 10-year+ WALEs and strong lease covenants.

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).

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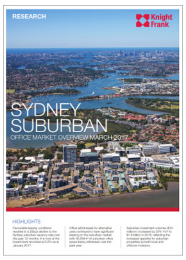

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RESEARCH & CONSULTING

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

Marco Mascitelli
Research Analyst
+61 2 9036 6656
Marco.Mascitelli@au.knightfrank.com

INDUSTRIAL

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

NATIONAL

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

Greg Russell
Head of Industrial Investments, Australia
+61 7 3246 8804
Greg.Russell@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

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Newmark Knight Frank Global