RESEARCH

SYDNEY

INDUSTRIAL MARKET BRIEF **NOVEMBER 2017**

Positive tenant demand for logistics and warehousing facilities has led to strong rental growth across the Sydney industrial market. In conjunction with limited availability, this has resulted in further industrial yield compression.

Key Facts

Gross absorption totalled 679,132m² across Sydney in the 12 months to October 2017, with strong demand stemming from logistics and eCommerce companies.

Average prime and secondary net face rents have risen by 5.9% and 9.4% YoY, the highest growth levels since we began monitoring in January 2007.

Land values across Outer West, Inner Central West and South West have risen by circa 50% over the year to October 2017.

Prime and secondary industrial assets are being traded at 5.00-7.50% and 5.25-8.00% respectively.

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Occupier Demand & Rents

The rise of online retailing continues to underpin demand for warehousing, transport and logistics facilities across Metropolitan Sydney. Australian online retail sales have increased by 10.3% to $23.3 billion over the year to August 2017. This has translated to demand for e-fulfilment and last-mile delivery centres located in close proximity to urban centres and transport nodes. These trends are expected to accelerate following the arrival of Amazon, which is forecast to boost the Australian online retail turnover by up to 14% p.a, according to Citibank's estimates.

Major infrastructure projects are full steam ahead across Sydney with the M4 Widening and the King Georges Road Interchange Upgrade completed as at October 2018. These are part of the larger WestConnex project due for completion in 2023. Additionally, the NorthConnex tunnelling work has passed the halfway point. The project, to be completed in 2019, will see 5,000 trucks taken off Pennant Hill Road and the connectivity between the Northern and Outer West industrial precincts improved significantly. The Draft Western Sydney District Plan 2036 has recently been released for public comment. Of note is the potential for a rail link between the future Western Sydney Airport and the Outer West industrial precincts of St Marys and Marsden Park, as well as another connection through Eastern Creek and Parramatta. These projects will have a massive impact on Sydney's industrial supply and demand over the next decade.

Gross absorption of industrial space (excluding D&C projects) across Sydney totalled 679,132m² in the 12 months to October 2017, with strong demand from logistics and eCommerce companies. Recent examples include Dutt Transport leasing 4,077m² at 149 McCredie Street, Smithfield and GraysOnline taking up 9,733m² at 376 Newbridge Road, Moorebank. Additionally, Visa Global Logistics has pre-committed to 6,000m² at Erskine Park Logistics Estate. The site will be developed by LOGOS Property with completion expected in mid-2018.

By precinct, the Outer West and South West precincts have received the strongest levels of demand, accounting for 45.1% and 44.3% respectively of the total space absorption over the three months to October 2017. They are followed by the Inner West precinct representing 10.3% of the total demand.

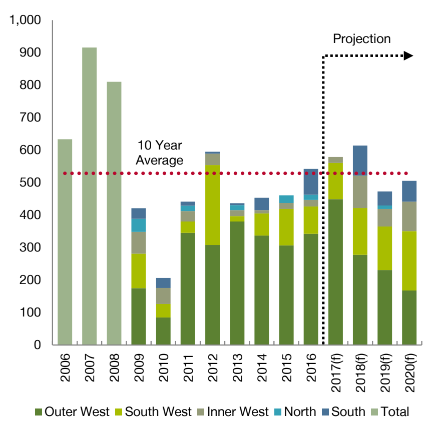
On the back of the strong leasing market, overall rents have risen across the board, although the levels of increase vary by precinct. The overall prime net face rent has risen by 5.9% YoY to $142/m² as at October 2017. This is the highest level of rental growth since Knight Frank began to track the series in January 2007. Stronger rental growth was recorded for secondary rents, jumping by 9.4% over the past 12 months to $125/m². These increases have been driven largely by rental uplifts in the South and South West regions due to the lack of new supply and increased stock withdrawal. Prime and secondary average rents in the South region have increased by 6.8% YoY to $177/m² and 18.2% YoY to $173/m² respectively. The corresponding growth rates in the South West precinct are 10.2% ($113/m²) and 19.0% ($100/m²). Strong rental growth has also been observed across the North region, which also experienced competitive pressure from urban regeneration. Prime and secondary rents in the North region have risen by 7.0% and 4.8% in the year to $178/m² and $145/m² respectively.

With relatively more moderate growth, prime rents in the Outer West and Inner Central West precincts have registered increases of 3.3% and 2.0% YoY respectively, whilst secondary rents were up by 1.6% and 3.6% YoY. The average prime and secondary rents in the Outer West currently are $115/m² and $97/m² and those in the Inner Central West are $126/m² and $109/m² as at October 2017. It's noted, however, notwithstanding the strong rental growth for existing stock, pre-lease and pre-commitment rents have remained relatively stable over the past six months with typical incentives of seven months rent-free on a five-year lease (12%).

Development & Land Values

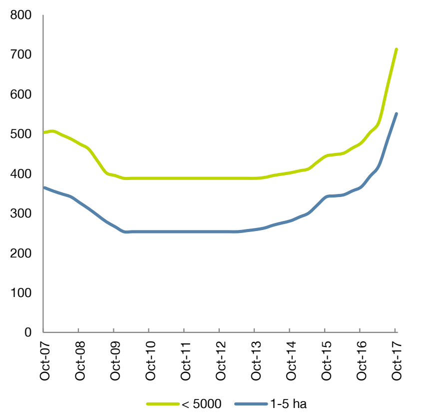
Sydney's industrial land values continue to escalate as demand for development sites intensifies across all markets. Urban regeneration in the South region continued to be the main catalyst for significant land value uplifts, measuring 61.5% and 38.8% YoY for small (2-5,000m²) and medium sites (1-5ha) respectively. By the same token, the Northern suburbs saw land prices jump by 25.5% and 32.4% YoY for small and medium land parcels respectively. Across the Western industrial precincts, serviced land availability is diminishing as developers step up the pace of development on the back of a strong

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



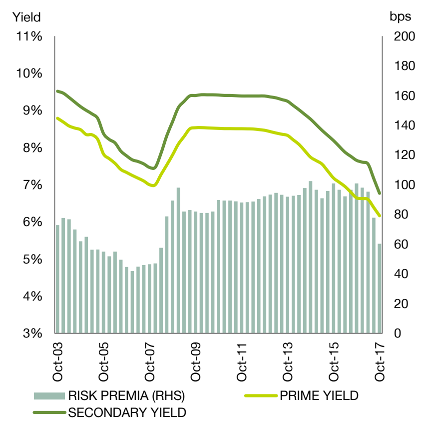
Source: Knight Frank Research

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 2017

Precinct	Avg Prime Rent†		Avg Secondary Rent		Core Market Yields^		Avg Land Values <5,000m²		1 - 5 ha	
	$/m² net	(%p.a)	$/m²	(%p.a)	Prime	Secondary	$/m²	(%p.a)	$/m²	(%p.a)
Outer West	115	3.3	97	1.6	5.50 - 6.50	6.75 - 7.50	683	41.4	550	37.5
Inner/Central West	126	2.0	109	3.6	5.50 - 7.00	6.50 - 7.50	838	46.3	581	41.8
South West	113	10.2	100	19.0	5.50 - 6.25	5.75 - 6.75	620	64.5	522	80.0
North	178	7.0	145	4.8	6.00 - 7.50	6.75 - 8.00	910	25.5	735	32.4
South	177	6.8	173	18.2	5.00 - 5.50	5.25 - 6.00	2,625	61.5	1,700	38.8
Sydney Average	**142**	**5.9**	**125**	**9.4**	**5.00 - 7.50**	**5.25 - 8.00**	**714***	**50.7***	**551***	**53.1***

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

leasing market. The blended land rates across Outer West, Inner Central West and South West have risen by circa 50% on average for both small and medium lots over the year to October 2017.

Following the surge in development activity, new supply is expected to increase over the next 12 months. Knight Frank estimates that up to 578,480m^2 of new stock will be delivered this year, an increase of 6.7%. Despite the majority of this new supply having been pre-committed, there are a number of major speculative developments approaching completion over the next six months. Notable developments include; Stockland's Coopers Paddock Warwick Farm (17,005m^2), Mirvac's Calibre Estate, Eastern Creek (20,000m^2) and Dexus' Quarry Industrial Estate, Greystanes (37,000m^2). These will likely result in a rise in vacancy levels and a divergence in rental levels between pre-lease offers and existing stock.

Sales & Investment Activity

Following a record year of investment activity in 2016, the lack of available stock on the market has been a major constraint for investors since the beginning of this year. A total of $1.0 billion worth of industrial assets have been traded in Sydney over the first three quarters of 2017, down 76% YoY.

The largest single transaction in the last quarter was the acquisition by EG of the former Roche facilities at 100 South Creek Rd, Cromer for $55 million. The property has an NLA of 25,999m^2 and 7.5ha of land. The sale represents a rate of $2,115/m^2 of NLA and a repositioning play for EG given Roche has vacated the site to relocate to the CBD. Another highlight deal this year was the Primo Industrial Portfolio secured by Charter Hall Group for $179.4 million. The national portfolio comprises 10 industrial properties with three of them in Sydney. The sale reflects an average initial yield of 6.5% and a 10.5 year WALE.

TABLE 2

Recent Leasing Activity Sydney

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Date
New Builds						
1 Millner Ave, Kemps Creek	OW	110	18,000	15.0	Iron Mountain	Aug-17
1 Millner Ave, Kemps Creek	OW	115	14,917	10.0	Briggs & Sratton	Aug-17
23 Hollinsworth Rd, Marsden Park	OW	95	12,000	7.0	eStore Logistics	Aug-17
Horsley Dr B Park, Wetherill Park	OW	110	8,009	7.0	Royal Comfort	Aug-17
200 G Mac Dr, Coopers Paddock	SW	110	33,278	10.0	Daikin	Jul-17
Horsley Dr B Park, Wetherill Park	OW	105	26,055	7.0	Vivin Imports	Jul-17
60 Wallgrove Rd, Eastern Creek	OW	117	17,065	10.0	Miele	Jul-17
Existing Leases						
2-34 Davidson Rd, Chullora	ICW	125	10,169	5.0	Shiro Australia	Sep-17
1A Raffles Gld, Eastern Creek	OW	123	8,439	5.0	Cleanaway	Sep-17
45 Britton St, Smithfield	OW	115	17,073	3.5	Snack Brands	Jul-17
5-7 Murtha Pl, Arndell Park	OW	95	12,480	8.0	Focus on	Jul-17
8 Penelope Cres, Arndell Park	OW	97.5	11,420	10.0	YHI Tyres	Jul-17

TABLE 3

Recent Land/Development Major Sales Activity Sydney

Address	Region	Price ($ mil)	Area (m²)	$/m² of Area	Vendor	Purchaser	Sale Date
1 Rexroth Pl, Huntingwood	OW	2.7	4,073	651	Private	Private	Sep-17
4 Ash Rd, Prestons	SW	8.8	16,100	547	Private	Private	Aug-17
Lot 102 John Hines Ave, Minchinbury	OW	4.1	7,080	579	Private	Private	Jul-17

TABLE 4

Recent Improved Major Sales Activity Sydney

Address	Region	Price $ mil	Bldg Area (m²)	Passing Yield (%)	WALE (years)	Vendor	Purchaser	Sale Date
100 S Creek Rd, Cromer	N	55.00	25,999	VP	VP	Roche	EG Funds Mgmt	Sep-17
5 Williamson Rd, Ingleburn	SW	24.75	20,000	n/a	n/a	Jobema Investments	Leda Holdings	Sep-17
12a Rodborough Rd, Frenchs Forest	N	20.80	7,490	7.69	n/a	Stewart Investments	Propertylink Group	Sep-17
150-156 McCredie Rd, Smithfield	OW	23.00	20,236	VP	VP	Propertylink	Hong Australia	Aug-17
40 Holbeche Rd, Arndell Park	OW	12.35	20,500	n/a	n/a	Cavadale	Acco Brands	Aug-17
91 Mars Rd, Lane Cove West	N	24.00	6,794	n/a	n/a	Balcro	Private	Jul-17
7-9 Orion Rd, Lane Cove West	N	18.20	5,802	5.50	n/a	Desane Properties	Lane Cove Inv.	Jul-17
37-41 Day St, Lansvale	SW	16.20	15,141	n/a	n/a	Landsdowne	SIVAS Property	Jul-17
219-231 Botany Rd, Waterloo*	S	40.00	5,481	n/a	n/a	Maville Group	Landmark Group	Jun-17
Primo Industrial Portfolio	Various	179.40	n/a	6.50	10.5	Lederer Group	Charter Hall	May-17

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
*Purchased for residential conversion

Outlook

The Sydney industrial market is expected to benefit from accelerated growth in online retailing and a solid State economy. According to IBIS, online retail sales are anticipated to grow at an annualised rate of 9.4% over the next five years, further boosted by the arrival of global eCommerce giants such as Amazon and Alibaba. The supermarket sector is also buoyed for growth by the latest entrance of Germany's Kaufland, which is actively looking for warehouse-style sites across the country. These dynamics will ensure solid demand in both the leasing and capital markets over the coming years.

Looking forward, Sydney's average industrial rental growth is expected to be maintained at above 4.0% over the next two years, although conditions will vary across regions. The South, South West and North regions will continue to experience upward rental pressure and falling incentives due to declining stock level and limited new supply.

The Outer West, however, is expected to have moderate gross face rental growth of between 2.5—3.5% to accommodate the potential increase in new developments and industrial space availability. However, the strong tenant demand from logistics and retail occupiers is expected to maintain solid absorption levels over the next 12 months. We anticipate the majority of the speculative builds to be committed prior to or at completion.

With Sydney's prime office and retail assets being traded well below a 5.00% yield, the industrial sector remains an attractive value proposition for investors. Prime industrial yields for assets with a 5 year WALE are ranging between 5.00% and 7.00%. Secondary industrial properties are expected to trade at 5.25—8.00%, with the South market being at the low end of the spectrum. However, the strong capital flow and demand for small-ticket assets are expected to lead to a narrower yield gap between prime and secondary assets.

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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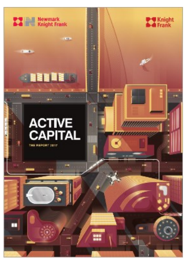

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