RESEARCH

FEBRUARY 2014

SYDNEY INDUSTRIAL

Vacancy Analysis

HIGHLIGHTS

- The steady downward trend in vacant stock levels since mid-2012 has started to moderate. Vacant stock (5,000m²+) as at January 2014 measured 662,661m², which is largely unchanged from the previous quarter.
- After decelerating in mid-2013, gross take-up (excl. D&Cs) stabilised in the fourth quarter, measuring 93,054m², although this is still 22% below the average level since the series began in 2011. Approximately 35,000m² of vacant stock is also currently under offer.
- The relatively firmer tenant demand for prime grade facilities is becoming evident in the take-up data with 72% of gross absorption in the second half of 2013 consisting of prime grade stock (six months gross take-up of 118,578m² prime vs 46,245m² for secondary). This trend has also seen an improvement in the rate of speculative projects achieving successful leasing outcomes.

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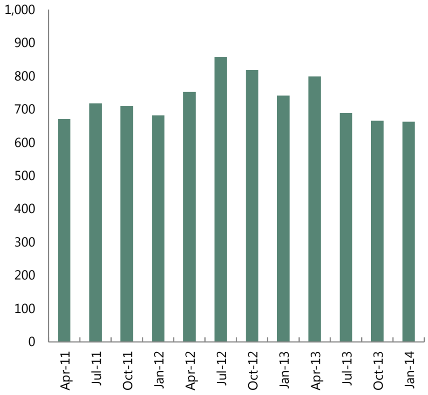
Table 1
Sydney Industrial Available Space 5,000m²+ as at January 2014

Precinct	Available Space (m²)	No. of Buildings	Av Asking Rent $/m² net	Change Past Qtr (m²)	Change Past Year (m²)	Building Quality Prime %	Building Quality Secondary %
Outer West	305,256	25	99	-9,554	-88,344	31.6	68.4
South West	101,486	14	99	-5,881	-39,360	60.5	39.5
Inner West	164,112	16	112	-5,095	6,716	56.8	43.2
South	91,807	11	145	17,786	42,630	77.8	22.2
Sydney Total	**662,661**	**66**	**110**	**-2,744**	**-78,358**	**48.6**	**51.4**

Source: Knight Frank
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%.

Vacant stock levels in the Sydney market were largely unchanged over the final quarter of 2013, recording a relatively immaterial 2,744m² decline. Vacant stock (+5,000m²) now measures 662,661m² and reflects a 25% contraction since the peak recorded in July 2012. However the rate of decline has moderated since the middle of 2013 and is reflective of below average gross take up (excl. D&Cs).

Figure 1
Sydney Industrial Market
'000m² available space



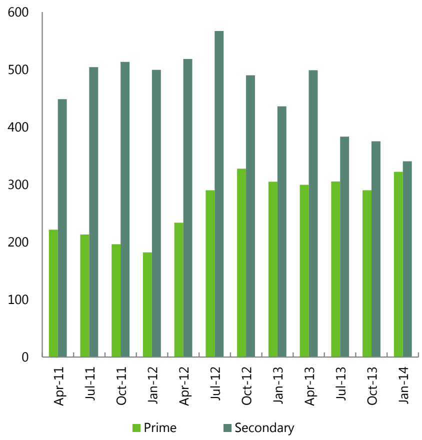
Source: Knight Frank

Despite modest leasing activity at the end of 2013, total vacant stock levels have been well contained courtesy of a lack of new vacancies entering to the market. Over the second half of 2013, the rate of new vacancies tracked at only 67% of the average rate since the series began in 2011. A key reason is the relatively benign supply level with 2013 supply been 30% below the 10 year average. An additional factor keeping the vacant stock figure in check has been several vacancies selling to owner occupiers.

Quality of Stock

As at January 2014 prime vacancies totalled 322,359m² compared with 340,302m² for secondary. The proportion of total vacancies made up of prime stock is now at its highest level since the series began (refer Figure 2). It is noted, however, that the prime figure does include some older buildings in the South market that have been considered prime due to clearance and functional attributes. Although the majority of tenant enquiry is for prime, there remains firm competition, notably in the Outer West, from the pre-lease market where net rents range from $110/m² to $120/m².

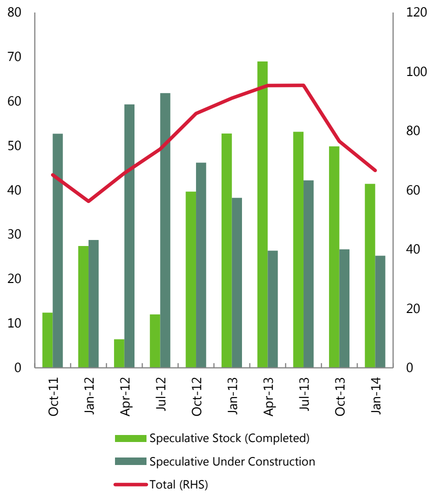
Figure 2
Sydney Industrial Available Space
'000m² by grade - April 2011 to January 2014



Source: Knight Frank

Speculative stock available for lease (including both under construction and completed) measures 66,637m². This reflects a 30% drop over the past six months and is the lowest amount since the beginning of 2012. In the short term, available speculative stock is expected to fall further with slightly in excess of 20,000m² currently under offer. However this will likely be offset by several new projects anticipated to imminently commence.

Figure 3
Speculative Stock
'000m² - October 2011 to January 2014

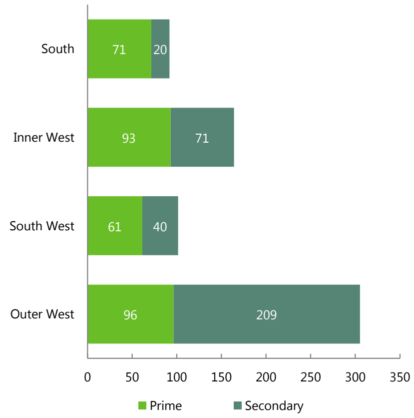


Source: Knight Frank

Distribution by Precinct

The majority of vacant stock is located in the Outer West, which accounts for 46% of the total Sydney figure. Larger options are more limited in the South and South West, which contribute only 14% and 15% respectively of the total figure.

Figure 4
January 2014 Available Space
'000m² by quality & precinct

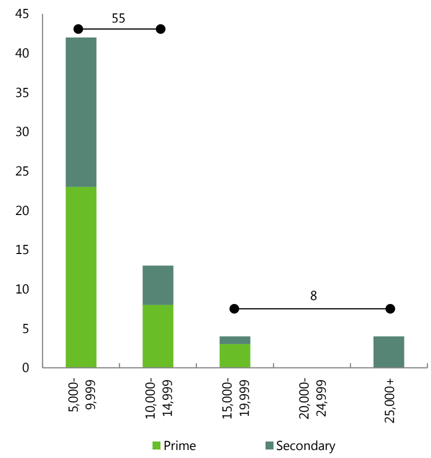


Source: Knight Frank

Size & Type of Stock

On the back of some backfill options entering the vacancy count, three prime vacant buildings now exist in excess of 15,000m². Five secondary options of this size currently exist. There is a greater availability of options for tenants at the smaller end of the market with 55 options smaller than 15,000m² (of which 31 are prime).

Figure 5
January 2014 Available Space
No of buildings by size of building m² and quality



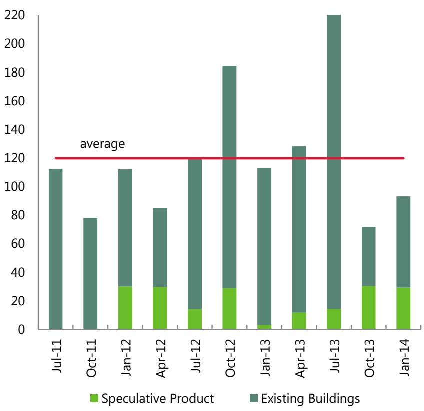
Source: Knight Frank

Building Take-up

After the decline in leasing activity during the third quarter of 2013, the final quarter experienced a degree of stabilisation. During the quarter, 11 leases greater than 5,000m² (excl. D&C's) were recorded covering an area of 93,054m². Nevertheless, this is still below the average gross take-up level and indicates that the post-election boost did not eventuate as many had anticipated.

The bulk of gross absorption in the second half of 2013 consisted of prime grade stock (six months gross take-up of 118,578m² prime vs 46,245m² for secondary). Coupled with activity in the pre-lease market, which are not included in these absorption figures, there appears to be relatively firmer demand for prime assets. 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 periods.

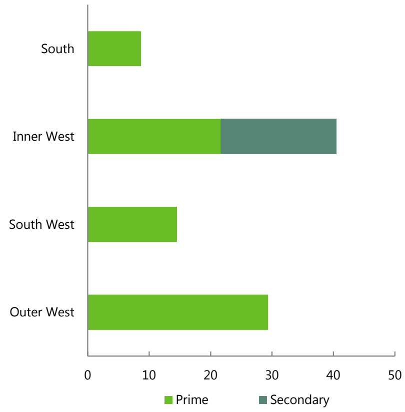
Figure 6
Sydney Industrial Take-up
'000m² Est Take-up buildings 5,000m² + (excl D&C)



Source: Knight Frank

An encouraging leasing aspect has been the improvement in speculative stock absorption (refer Figure 6). Late 2012 and the first half of 2013 saw very subdued levels of speculative absorption, however the last two quarters have seen this reverse. The first quarter of 2014 is expected to post another strong result given several speculative options currently under offer.

Figure 7
Sydney Industrial Take-up 3 months to January 2014
'000m² Est take-up buildings 5,000m² + (excl D&C)



Source: Knight Frank

Summary

Despite several backfill options entering the market and relatively modest leasing conditions, a lack of new supply has enabled vacant stock levels to be well contained in the Sydney market. While enquiry levels suggest a degree of improvement, there remains a lack of urgency from tenants to finalise premises related decisions. Although not covered within the data of this report, anecdotal feedback from agents indicates that leasing activity appears relatively firmer for sub 2,000m² options.

At a macro level, a number of key drivers are starting to lay an improved basis for users of industrial space and therefore tenant demand. Historically low interest rates are feeding into the housing market, where Sydney house prices have risen around 15% over the past 12 months. The subsequent wealth effect has historically been a precursor to an improving retail environment. Trend dwelling approvals as at December were tracking at 30.4% annual growth, which is a positive forward looking indicator to stronger construction levels. According to Deloitte Access Economics, housing investment is expected to average 12.3% growth over 2014 and 2015. This will be further supported by the ramping up of state government infrastructure expenditure in the medium term.

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Methodology:
This analysis collects and tabulates data detailing vacancies within industrial properties across all of the Sydney Industrial Property Market. The analysis only includes building vacancies which meet the following criteria. 1. The sample data includes buildings with a minimum floor area of 5,000m². 2. Buildings are categorized into the below three types of leasing options. A) Existing Buildings – existing buildings for lease. B) Speculative Buildings – buildings for lease which have been speculatively constructed and although have reached practical completion, still remain vacant. C) Spec. Under *Construction* – buildings for lease which are being speculatively constructed and will be available for occupation within 12 months.

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