

# PERTH

## INDUSTRIAL MARKET BRIEF MAY 2015

### Key Facts

**Vacancy levels continued to rise**, recording a 62% increase over the year to April 2015.

**Industrial rents continued to decline**, with prime grade rents averaging \$100/m<sup>2</sup> as of April 2015.

**Eleven transactions in excess of \$10 million were recorded over the 12 months to May 2015**, with a total value of \$251.99 million.

**Core market prime yields firmed by 25 basis points over the past six months**, now ranging from 7.50% to 8.00% across the market.



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Sales transactions reflect increasing investment demand for sale and leaseback deals. However, prime investment opportunities are limited with fewer owners looking to divest as prime yields are expected to compress in the short term.

The relatively low market confidence in Western Australia continues to be a factor impacting the local industrial market. The price of iron ore has fallen more than 60% since last year caused by excess supply and cooling demand from China, pushing the price of iron ore to a record low of \$US46.70 during early April 2015. However, the price has recovered to \$US63 a tonne at the end of May following the announcement that two of the world's biggest producers, BHP Billiton and Vale, were considering a reduction in output to rebalance the global supply glut. In the broader economy, the historical low interest rate environment is boosting housing construction and helping to alleviate the risks surrounding the rebalancing of the economy.

### Development & Land Activity

A steady flow of pre-commitment deals has kept some deal flow occurring in the industrial land market, albeit activity has been broadly soft. The D&C development at

1290 Abernethy Road, Hazelmere was progressively completed in 2014. The 20 hectare site located in the eastern suburbs was fully leased to major tenants which includes Chevron, Reject Shop, Office Max, AHG, Wridgways and Khumo Tyres. Additionally, Whytes Specialised Equipment and Comfort Plus have both secured leases in Hazelmere over 5,000m<sup>2</sup> respectively.

Further development within the Jandakot Airport precinct is expected to continue due to the availability of land. Notable tenants such as Super A-Mart (23,500m<sup>2</sup>), K-Mart (41,700m<sup>2</sup>), Reece (26,500m<sup>2</sup>) and Aqua Techniques Pool Company (10,000m<sup>2</sup>) will be anchoring large spaces within the area, further enhancing the area as a pre-lease location.

A lack of land sales evidence has made it hard to accurately benchmark current rates, however at least notionally, land values at the smaller end of the market (< 5,000m<sup>2</sup>) have fallen over the past six months. This is partly attributed to weaker owner occupier demand and a function of lower rents. Land

values will remain under downward pressure over the short to medium term.

The Western Australian government hopes to foster the growth of the eastern suburbs of Perth with the construction of two mega-projects worth \$3 billion which will serve to better integrate the eastern suburbs with the rest of Perth's economy, putting it within easy reach of the CBD and the city's industrial zones.

The \$2 billion Forrestfield Airport Link will see the construction of an underground tunnel between Bayswater and Forrestfield which will significantly improve traffic to and from Perth Airport, while the \$1 billion Gateway WA will create landmark road infrastructure around the Perth Airport and the freight and industrial hubs of Kewdale and Forrestfield.

## Occupier Demand & Rents

Perth's industrial sector continued to be affected by the escalating levels of vacant space in the market. The level of available industrial space (+2,000m<sup>2</sup>) continued to rise over the past quarter to sit at 453,593m<sup>2</sup> as at April 2015 (428,210m<sup>2</sup> in January 2015). This is a record high since the series began in April 2012 and sits 73% above the historical average level as well as 62% higher than the vacancy 12 months ago of 280,851m<sup>2</sup>.

Over the quarter to April 2015, prime space increased by 4% while secondary space increased by double the rate at 8% which saw an increasing number of older style secondary grade properties added to the market. This confirms the

trend of tenants migrating from secondary to prime grade buildings, taking advantage of the soft market for an upgrade and to reset their rents. This has also contributed to the relatively weaker performance of secondary market rental levels.

The stubbornly high vacancy levels are providing challenges to landlords to sustain current levels of competition to secure tenants leading to heavy discounting of rental levels coupled with increasing incentives (up to circa 10%). Over the year to April 2015, average prime market rents have fallen by 9.6% across the Perth region to be \$100/m<sup>2</sup> net. The secondary market has also shown softening of 10.0% over the past year to be \$81/m<sup>2</sup> net across the precincts.

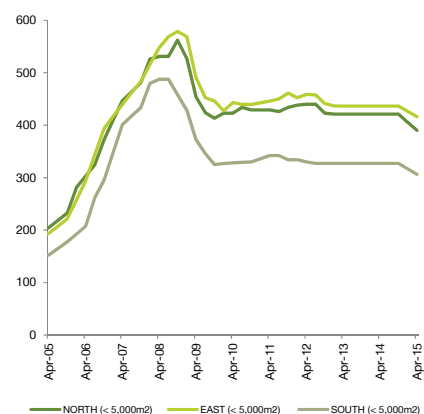
Gross take-up (excl. D&C's) totalling 45,291m<sup>2</sup> was recorded during the quarter to April 2015 reflecting a 42% decline in absorption levels compared to the previous quarter. Notably, there was an increasing trend of sublease space absorption recording circa 34% of the total take-up space during the quarter to April 2015. This trend is expected to intensify as sublease properties continue to offer highly competitive rents and incentives in order to replace tenants.

Demand continues to stem from medium sized (3,000m<sup>2</sup> - 6,000m<sup>2</sup>) tenants such as Kansai Foods Ltd (3,400m<sup>2</sup>), Mirebu Investments Pty Ltd (3,892m<sup>2</sup>), Recall (5,636m<sup>2</sup>) and Winning Appliances Pty Ltd (3,000m<sup>2</sup>). Demand from large tenants (10,000m<sup>2</sup>+) remains limited.

FIGURE 1

### Land Value by Size and Region

\$/m<sup>2</sup> average land value (2005–2015)

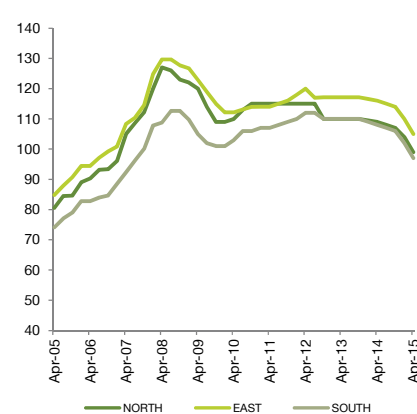


Source: Knight Frank

FIGURE 2

### Perth Region Prime Rents

\$/m<sup>2</sup> average net rent (2005–2015)



Source: Knight Frank

TABLE 1

### Perth Industrial Market Indicators as at May 2015

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields (%)		Avg Land Values			
	\$/m <sup>2</sup> net	(%p.a)	\$/m <sup>2</sup> net	(%p.a)	Prime	Secondary	< 5,000m <sup>2</sup>	(%p.a)	1–5 ha	(%p.a)
North	99	-9.2	79	-10.2	7.50 – 8.00	8.50 – 10.00	390*	-7.4	237	-6.0
South	97	-10.2	78	-10.3	7.50 – 8.00	8.50 – 10.00	306	-6.3	227	-5.4
East	105	-9.5	85	-9.6	7.50 – 8.00	8.50 – 10.00	416	-4.6	293	-3.3
<b>Perth Average</b>	<b>100</b>	<b>-9.6</b>	<b>81</b>	<b>-10.0</b>	<b>7.50 – 8.00</b>	<b>8.50 – 10.00</b>	<b>371</b>	<b>-6.1</b>	<b>252</b>	<b>-4.8</b>

\*Average excludes Osborne Park land values

Source: Knight Frank

TABLE 2

## Recent Leasing Activity Perth

Address	Region	Net Rent \$/m <sup>2</sup>	Area	Term (yrs)	Tenant	Date
Site 506, Pilatus Road, Jandakot	South	131	9,903	undis.	Schlumberger	undis.
165 Kewdale Road, Kewdale	East	81	3,400	10+3+3	Kansai Foods Ltd	Feb-15
407 Victoria Road, Malaga*	North	54	3,892	2.8	Mirebu Investments Pty Ltd	Nov-14
5 Abbott Road, Perth Airport	East	125	5,636	undis.	Recall	Oct-14
6 Gauge Circuit, Canning Vale*	South	94	3,000	3+3	Winning Appliances Pty Ltd	Oct-14
17 Casella Place, Kewdale	East	124	5,231	7	TEK Ocean Energy Services	Aug-14

Source: Knight Frank \* Sub-lease undis. Undisclosed

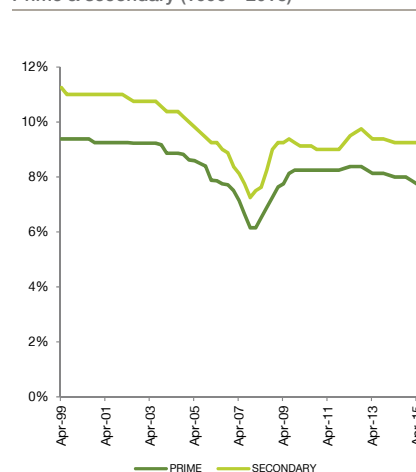
expected to compress, opportunities to invest in the prime market are relatively limited at present.

The average prime core market yield is currently 7.75% (in a range of 7.50% - 8.00%), a reduction of 25 basis points over the past six months. This has occurred as a result of increasing investment interest in prime assets, particularly for investors seeking a core, passive income stream under current market conditions. The average secondary core market yields have remained stable over the past six months at 9.25% (in a range of 8.50% - 10.00%).

FIGURE 3

## Average Core Market Yields

Prime & secondary (1999–2015)



Source: Knight Frank

## Sales &amp; Investment Activity

Sales activity marginally improved in the Perth industrial market over the 12 months to May 2015. A total of \$251.99 million across eleven transactions was recorded in the market, for sales over \$10 million. This was 6.8% higher than the \$235.90 million recorded across the same number of transactions in the previous 12 month period. Private investors and owner occupiers remain the most active purchasers in the market.

Recent sale transactions reflect a

growing sale and leaseback trend emerging in the WA market evident from deals such as 239 Planet St, Welshpool and 44-50 Great Eastern Highway, South Guildford which were both sold with a 12-year leaseback. This emphasises that there is still solid investment demand for prime assets which are leased to reputable tenant on a long lease in a core location.

Lower interest rates combined with a sustained demand for industrial property will likely see prime core market yields tighten further. Therefore, with fewer owners looking to divest as yields are

TABLE 3

## Recent Land/Development Sales Activity Perth

Address	Region	Price \$ mil	Area m <sup>2</sup>	\$/m <sup>2</sup> of site area	Zoning	Vendor	Purchaser	Sale Date
Lot 123 Bushland Ridge, Bibra Lake	South	2.40	8,270	290	Industrial	Private	Private	May-15
49-51 Hensbrook Loop, Forrestdale	East	1.95	9,311	209	Gen. Ind.	Tenista Pty Ltd	Ach Industrial Land	Feb-15
4 Brant Road, Kelmscott	East	0.76	2,021	374	Gen. Ind.	Martin Metals Recycling	Valdrew Nominees	Oct-14

## Recent Improved Sales Activity Perth

Address	Region	Price \$ mil	Bldg Area m <sup>2</sup>	Passing Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
44-50 Great Eastern Highway, South Guildford <sup>^</sup>	East	6.50	3,005	8.20	12	Tutt Bryant Equipment	Primewest	Feb-15
239 Planet St, Welshpool <sup>^</sup>	East	29.87	17,530	8.00	12	RCR Tomlinson	Charter Hall	Dec-14
74 McCoy Street, Myaree	South	11.50	3,970	7.50	6.4	McCoy Street Perth	Motema Investments	Nov-14
5-13 Wood St, Bassendean	East	10.88	10,857	8.50	10	UGL Rail Services	GDI DPT~	Sep-14

Gen. Ind. General Industrial <sup>^</sup> Sale and leaseback deal ~ to be part of GDI No.38 Diversified Property Trust (DPT)

Source: Knight Frank

## Outlook

The vacancy in Perth's industrial market is expected to continue to rise as additional backfill space enters the market. It is expected that over the next two years more quality space will become available to the market as manufacturers downsize and more consolidation into purpose built premises occurs. This may limit the feasibility of pre-construct developments, as existing stock will provide a wide range of competitively priced options.

With the lack of expansionary measures being implemented by WA businesses, any material increases in absorption is unlikely. Any pre-lease activity would result in increased levels of backfill space becoming available.

Escalating vacancy levels have also added further downward pressure on

prime and secondary grade rents, as tenants are spoilt for choice while seeking to upgrade their accommodation. This trend is likely to remain unchanged in the near term.

Nevertheless, business activity has begun to shift away from mining towards other industries, including retail and construction. This is evident from the rapid expansion of Aldi supermarkets which is scheduled to open 20 stores in WA between June to December 2016 upon completion of its distribution centre at Jandakot Airport. Similarly, IKEA has reportedly purchased a parcel of industrial land bound by Sainsbury Road and Carrington Street in O'Connor. Improvement in labour market conditions within the retail and construction sectors is expected to have positive flow on effects through to Perth's industrial market.

### 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%.

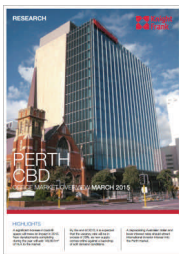
**Core Market Yield:** The percentage return/yield analysed with the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for property specific issues (ie rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies,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

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