

PERTH

INDUSTRIAL MARKET BRIEF JUNE 2016

Key Facts

Vacancy levels continued to rise, recording a 42% increase over the year to April 2016.

Industrial rents continued to decline, with prime grade rents averaging \$90/m² as at April 2016, a fall of 10.8% over the past year.

74 transactions exceeding \$1 million were recorded in the 12 months to April 2016

Core market prime yields firmed by 17 basis points over the past six months, now ranging from 7.00% to 8.25% across the market.



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The Perth market continued to experience an increase in vacant industrial properties and is heavily dominated by secondary grade stock, now accounting for 76% of the total vacancy, an increase of 22% since January 2016.

Economic Snapshot

Low market confidence in Western Australia continues to be a factor impacting the local industrial market. The ongoing affects of the mining industry directly impact the industrial sector. The price of iron ore fell over 70% in 2015 to a record low of \$US30 a tonne but has since lifted to US\$55 a tonne as at late May 2016. This was caused by an excess of supply and cooling demand from China putting pressure on the iron ore price.

The Perth industrial market has a high correlation with the resources sector where companies are currently staying put or moving into smaller space triggering downward pressure on rental rates and increases in vacancy. Nevertheless, an 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 over the coming year.

Development & Land Activity

The current level of vacant industrial space available in the market is affecting the feasibility of new developments. A steady flow of pre-commitment deals has kept some deal flow occurring in the industrial land market, albeit activity has been broadly soft. In the last 12 months, significant developments accounted for approximately 200,000m² of newly developed pre-lease space added to the overall industrial stock. Speculative development has been limited, especially in the less established regions. The opportunity to refurbish or reposition older-style facilities to cater for tenant demand is evident where there is current demand is for modern facilities.

The 2015-16 State Budget mentions ongoing investment for infrastructure and it is expected that \$2.5 billion will be set aside in the short term lifting to a total of \$9.8

billion in 2018-19. This includes funding for key road and rail projects such as Forrestfield Airport link, Perth Freight Link, NorthLink WA and Gateway WA.

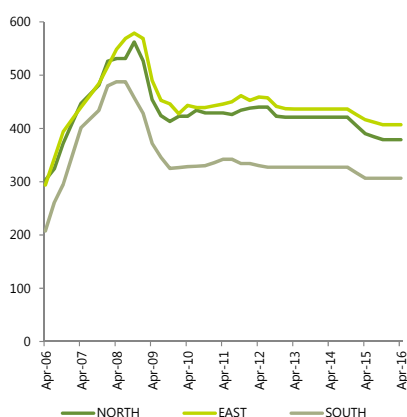
The \$2 billion Forrestfield Airport Link includes the construction of an underground tunnel between Bayswater and Forrestfield which will significantly improve traffic to and from Perth Airport.

The \$1 billion Gateway WA project will create landmark road infrastructure around the Perth Airport and the freight and industrial hubs of Kewdale and Forrestfield. The Gateway WA project is arguably the state's most important transport interchange. It allows road, rail and air services to interconnect and will drive change and improvement in the areas of focus for infrastructure moving forward.

FIGURE 1

Land Value by Region

\$/m² average land value (2006—2016) <5,000m²



Source: Knight Frank Research

TABLE 2

Recent Industrial Leasing Activity Perth

Address	Region	Net Rent \$/m ²	Area	Term (yrs)	Tenant	Date
32 Forsyth Street, O'Connor	South	105	3,790	5	Fremantle Freight Pty Ltd	Feb-16
463 Bushmead Road, Hazelmere	East	122	3,747	5	TL Engineering Pty Ltd	Nov-15
12 Thorpe Close, Welshpool	East	124	2,442	na	Capital Smart	Nov-15
Lot 6 Leath Road, Naval Base	South	87	22,130*	7	Steel Mains Pty Ltd	Oct-15
310 Treasure Road, Welshpool	East	85	11,348	3	AAAC Towing	Oct-15
54 Miguel Road, Bibra Lake	South	92	22,358*	12	CTI Freight Systems	Oct-15

Source: Knight Frank Research

* Sale & Leaseback

Occupier Demand & Rents

Perth's industrial sector has continued to be affected with escalating levels of vacant space in the market. The total available industrial space (>2,000m²) continued to rise over the past quarter, up 16%, to 647,746m² as at April 2016. This is a record high since the series began in April 2012 and is 98% above the long term average as well as 42% higher than the total vacancy 12 months ago of 457,169m².

Over the quarter to April 2016, vacant prime space increased nominally while vacant secondary space increased by 22% 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 for landlords to sustain current levels of competition to secure tenants leading to heavy discounting of rental levels coupled with increasing incentives now above 10%. Over the year to April 2016, average prime market rents have fallen by 10.8% across the Perth region to \$90/m² net. The secondary market has also shown softening of 21.1% over the past year to \$64/m² net across the precincts.

Gross take-up (excl. D&C's) totalling 45,181m² was recoded during the quarter to April 2016 reflecting a 26% decline in absorption levels compared to the previous quarter. There continues to be a demand for sublease space in the market as these properties offer competitive rents and incentives in order to replace tenants.

TABLE 1

Perth Industrial Market Indicators as at April 2016

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields (%)		Avg Land Values			
	\$/m ² net	(%p.a)	\$/m ² net	(%p.a)	Prime	Secondary	< 5,000m ²		1—5 ha	
							\$/m ²	(%p.a)	\$/m ²	(%p.a)
North	91	-12.9	63	-19.3	6.75 – 7.75	8.50 – 10.00	390*	-7.4	237	-6.0
South	86	-11.8	63	-20.2	6.75 – 8.50	8.50 – 10.00	306	-6.3	227	-5.4
East	91	-7.6	65	-23.6	7.25 – 8.50	8.50 – 10.00	416	-4.6	293	-3.3
Perth Average	90	-10.8	64	-21.1	7.00 – 8.25	8.50 – 10.00	371	-6.1	252	-4.8

Source: Knight Frank Research

*Average excludes Osborne Park land values

The Perth industrial market vacancy has risen, due partially to approximately 200,000m² of newly developed pre-lease space, as backfill space comes online. In the Jandakot industrial area alone a 42,000m² warehouse was pre-leased to K-Mart, Reece took 26,000m² and Super Amart and Oceaneering Australia both took 25,000m² and 9,000m² respectively. Similarly Hazelmere added 40,000m² for CEVA Logistics, 24,000m² was pre-leased to Mainfreight Transport, Austrans Container Service took 28,000m² and Wridgeways acquired 10,000m². Moving forward this will continue to impact the level of backfill space where tenants relocate into new industrial space.

FIGURE 2

Perth Region Prime Rents

\$/m² average net rent (2006–2016)



Source: Knight Frank Research

Investment Activity & Yields

Sales activity marginally improved in the Perth industrial market over the 12 months to April 2016. A total of \$715 million across 74 transactions was recorded in the market, for sales over \$1 million. The sales activity at the top end of the market has increased in recent years with 2016 recording the highest volume of sales in a decade. 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. This is evident from deals such as Charter Hall's purchase of the Stockyards Industrial Estate on Bushmead Road, Hazelmere from Goodman Group for \$240 million, on an initial yield of 6.94%. The property was sold in December 2015 fully leased at the time to Linfox, Coca-Cola, Toll IPEC and MTU. This emphasises that there is still investment demand for prime assets which are leased to reputable tenants on a long lease term.

Sirona Capital plans to develop a total of 150 hectares of land as part of the Northern Gateway industrial park development. In March 2016, BP signed a multi-million dollar agreement as one of the first investors in the new industrial

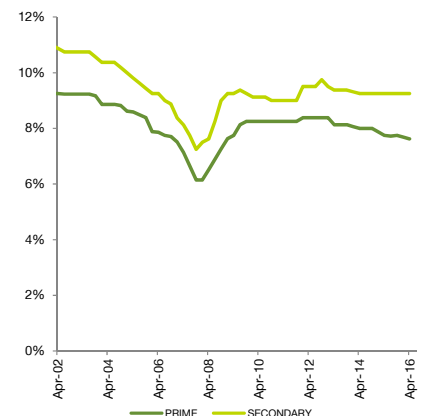
area located north-east of Perth. BP has secured a 2.5 hectare site in Muchea for a new service station and truck stop expected to be open by 2019.

The average prime core market yield is currently 7.58% (a range of 7.00% - 8.25%), a reduction of 17 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. Average secondary core market yields have remained stable over the past six months at 9.25% (a range of 8.50% - 10.00%).

FIGURE 3

Average Core Market Yields

Prime & Secondary (2002-2016)



Source: Knight Frank Research

TABLE 3

Recent Land/Development Sales Activity Perth

Address	Region	Price \$ mil	Area m ² ('000)	\$/m ² of site	Zoning	Vendor	Purchaser	Sale Date
Lot 153 Talbot Road, Hazelmere	East	17.5	69.0	253.6	Gen. Ind.	Perpetual Corp. Trust	LOGOS Property	Nov-15
Lot 152 Talbot Road, Hazelmere	East	12.0	60.3	199.0	Gen. Ind.	Perpetual Corp. Trust	LOGOS Property	Oct-15
Lot 11 Talbot Road, Hazelmere	East	19.3	76.8	251.3	Gen. Ind.	Perpetual Corp. Trust	LOGOS Property	Sep-15

Recent Improved Sales Activity Perth

Address	Region	Price \$ mil	Bldg Area m ²	Passing Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
15 Ashby Close, Forrestfield	East	18.95	11,058	7.81	8.0	Dazzlemore Pty Ltd	Perdaman Industries	May-16
215-217 Bannister Road, Canning Vale^	South	9.50	6,547	n/a	n/a	Fairbury Pty Ltd	Lanaba Pty Ltd	Jan-16
300 Collier Road, Bassendean^	East	5.50	5,514	9.00	1.0	Undis.	Undis.	Dec-15

Source: Knight Frank Research

Gen. Ind. General Industrial

^Owner Occupier

Undisc. Undisclosed



Outlook

The Perth industrial market has recorded consecutive lifts in vacancy. The market vacancy is expected to continue to rise as additional backfill space enters the market following a relatively large pre-lease pipeline. The next two years will more than likely see an increased demand for quality prime grade space as conditions allow a move into quality space as a more viable option for businesses. There may be a fall in pre-construct developments as existing stock will provide competitive pricing options for interested parties. 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 short 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.

The Perth industrial market has a high correlation with the resources sector where companies are currently sitting idle or downsizing, triggering downward pressure on rental rates. Nevertheless, an 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 over the remainder of the year.

Definitions:

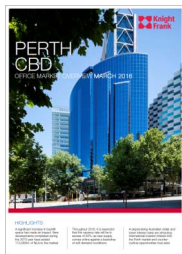
Prime: Asset with modern design, good condition & utility with an office component 10-30%. Located in an established industrial precinct with good access.

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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