PUSHING THE BUTTON

SPECULATIVE DEVELOPMENT ON THE RISE

INDUSTRIAL DEVELOPMENT TRENDS EASTERN SEABOARD

RESEARCH | INSIGHT JULY 2019

OVERVIEW

> **"Logistics is high on the radar of institutions, who appear to be actively increasing their exposure to the industrial / logistics asset class over retail."**

Industrial development activity on the Eastern Seaboard is rising, with the pace of growth accelerating in Sydney and Melbourne on the back of an upturn in speculative (spec) development projects.

This report briefly reviews some of the development trends emerging on the Eastern Seaboard and takes a look at the key factors likely to drive the market moving forward.

SPECULATIVE INDUSTRIAL DEVELOPMENT BOOM

It is estimated that 422,000 sqm of spec stock was completed across Sydney, Melbourne and Brisbane in 2018, which is largely considered to be a record high for the sector, especially in Sydney, where spec completions are currently 238% above the annual average.

Spec volumes in 2019 look to far exceed 2018, with almost 560,000 sqm of spec projects underway or proposed to be completed. While Sydney is expected to see similar volumes of spec completions in 2019, it is Melbourne that is likely to reach record levels this year. Driven largely by demand for Melbourne's western corridor, where the greatest capacity for expansion exists, the volume of spec projects for 2019 is expected to be more than double what was delivered in 2018.

E-COMMERCE BUOYS WAREHOUSE DEMAND

Logistics continues to benefit from ongoing technology and e-commerce demand shifts, for example same day delivery has already transformed into same hour delivery in some countries. Distributors, logistics operators and retailers are increasingly seeking out supply-chain efficiencies to meet the demands of e-commerce. Not surprisingly, take-up trends suggest that demand is being driven by transport / logistics and retail growth, as well as some light manufacturing, notably from companies making products that support logistics and retail. This demand has buoyed developer confidence, and development activity is rising, with spec opportunities at the forefront in Melbourne and Sydney.

In contrast to Melbourne and Sydney, spec development activity in Brisbane appeared to peak around 2015/16. Take-up times are improving, and new spec projects are being considered on the back of tenant pre-commitments which underwrites development risk.

NEARLY 50% OF SPEC LEASED PRIOR TO PC

Early in this cycle, especially for Melbourne and Sydney, the level of demand was so high that in some cases, developers were unable to keep up. This has buoyed confidence to build speculatively in those markets, as reflected in the short take-up periods on spec development.

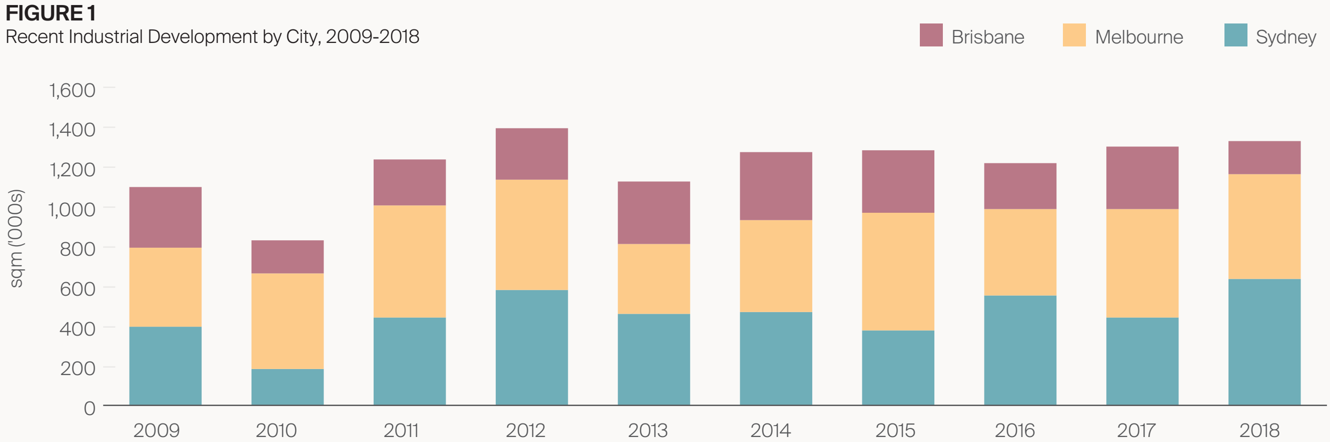
In Sydney, the average time on the market is one month, with the majority of spec being leased before completion. In Melbourne, spec builds average two months on the market following completion and in Brisbane, it is four months.

CASE REMAINS STRONG FOR FURTHER SPEC

The short leasing periods on spec space suggests that there does not yet appear to be an oversupply in Melbourne and Sydney, possibly because existing prime stock in key transport nodes is in such short supply.

The rise of e-commerce and the ongoing evolution of the supply-chain is driving changes in the sector. By improving local supply-chains for last-mile delivery and creating hubs to meet the demand for industrial and logistics space, development is playing an integral role in this evolution.

FIGURE 1
Recent Industrial Development by City, 2009-2018



Source: Knight Frank Research / Cordell

RISING ALLOCATIONS

Logistic type assets are high on the radar of institutional investors, who appear to be actively increasing their exposure to the industrial / logistics asset class, potentially diversifying away from retail. This trend seems closely linked to the rapid growth in the online environment as changes to the development landscape become more pronounced.

Underpinned by improved infrastructure, and strong macroeconomic fundamentals, as well as growth in the e-commerce / online retail segment, the Eastern Seaboard markets present significant development upside in both the pre-lease and spec development markets.

Institutional owners appear especially active on this front, with those fundamentals mentioned underpinning long-term confidence in the sector and possibly the search for higher yielding assets.

INSTITUTIONS GROW FUTURE PIPELINE

There has been a significant amount of institutional capital acquiring development land throughout the last 12-18 months, mostly in Sydney and Melbourne, including the acquisition of a 41.3 ha site in Dandenong South by Frasers Property Australia for c$80 million, reflecting a rate of nearly $200 / sqm. This is also a similar rate to the price paid by ISPT for 30 ha in Altona North. In Sydney, Logos Property, which has been expanding their footprint in Australia since 2015, recently acquired Toll's 15.3 ha Villawood site. The acquisition includes a partial leaseback to Toll, with Logos to redevelop the remaining 11.3 ha into a $200 million logistics and intermodal hub. In April 2018, Boral sold their 12.89 ha Prospect Masonry site in Greystanes to ISPT for c$60 million, reflecting a rate of $532 /sqm and Frasers' acquired CSR's 10 ha site in Horsley Park for $575 / sqm.

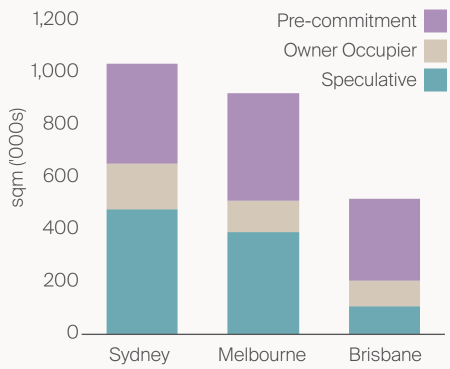
Other major industrial owners who have been active include Dexus, Stockland, Mirvac and GPT, all of whom are targeting an increase in allocation to industrial through their development pipeline.

The level of activity against the backdrop of high demand has contributed to rapid appreciation of land values over the last three years. While some of these owners are still holding developable land that they acquired previously, which in some cases was 10+ years ago, the tailwind from e-commerce growth seems to be creating enough demand to sustain the take-up momentum we are seeing from transport/ logistics, retail and light manufacturing.

KEY FINDINGS

1) **Spec development in Sydney reached a decade-high in 2018**, with total completions, including pre-commitments, almost 200,000 sqm above the historic average.
2) **Spec development is gathering momentum in Melbourne, with completions in 2019 forecast to be more than double what was delivered last year.** More than half of the upcoming spec stock due in Melbourne's West is already under offer.
3) **Brisbane spec development is expected to rise as vacancy hits six year lows.** Supply will remain dominated by the South and Trade Coast precincts.
4) **1.49 million sqm of new industrial stock has been completed in Sydney, Melbourne and Brisbane since 2018.** Almost 87% of this was added to Sydney and Melbourne's industrial precincts.
5) **Circa 988,239 sqm is under construction or proposed to be completed on the Eastern Seaboard over the remainder of 2019.** Almost half is being built speculatively.
6) **Development activity is increasingly becoming institutional-led**, with most developers heavily weighted towards the Eastern Seaboard markets.

FIGURE 2
Recent Industrial Development by Commitment Type, 2018-2019(f)



Source: Knight Frank Research

FIGURE 3
Average Months to Lease Spec Space 2017-2019

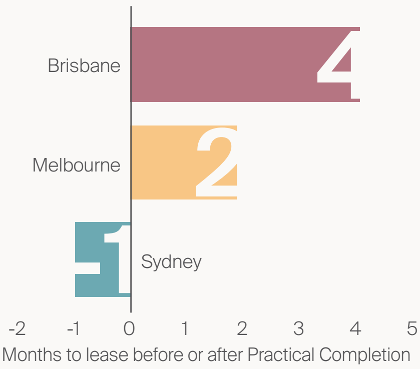
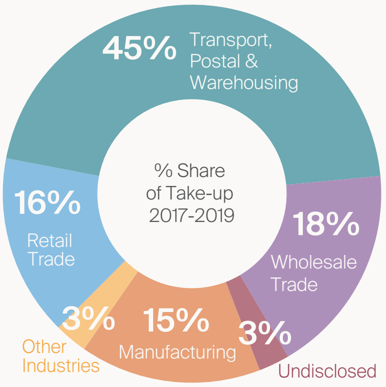


FIGURE 4
Recent Industrial Lease Activity by Industry Sector



SYDNEY

“High tenant demand has resulted in short take-up periods on speculative development projects, typically before or upon practical completion.”

DEVELOPMENT REACHES HISTORIC HIGH

Sydney’s industrial market has undergone significant expansion over the last decade, underpinned by new development in Sydney’s west. While some of the development has been influenced by infrastructure and the State’s employment land strategy, which released and rezoned land for employment use to create growth centres, it has also been demand led on the back of rising freight volumes and the need for greater efficiencies in the supply-chain.

4.58 million sqm in new industrial space has been added to the market since 2009, with stock levels growing on average 5.4% per annum between 2009 and 2018. The pipeline of new stock topped out at 640,000 sqm in 2018, a record high for the decade. Development volumes in 2018 were also about 183,000 sqm above average annual development trends.

WEST HAS LION SHARE

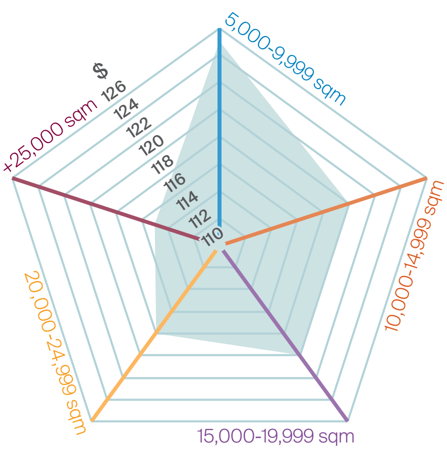
Almost 90% of last year’s pipeline was delivered in the Outer West and South West by institutional owners, underpinned by pre-commitment demand and an upswing in confidence levels to build speculatively on land they have been banking. However, amidst a backdrop of high tenant demand and constraints surrounding the supply of newly zoned industrial land, there has been significant upward pressure on land values over the last three years.

SPEC DEVELOPMENT GAINS MOMENTUM

Between 2013 and 2017, spec projects averaged around 20% of total development, compared to 66% in the pre-lease segment. On the back of the rezoning and supply of employment lands, the spec market began gaining momentum in 2016, led by institutional developers in Western Sydney. In 2018, spec projects accounted for 40% of total new development (c258,500 sqm), a decade-high for the sector.

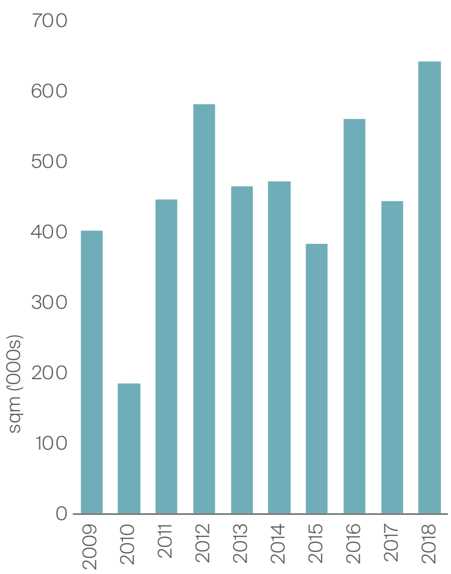
The widening of the M2 and M5 motorways, as well as the WestConnex project, has positioned areas in the west with direct access to Sydney’s port and airports, making them an attractive and efficient transport node for companies to locate, supporting above-average leasing demand.

FIGURE 5
Sydney Spec Build Average Rent $/sqm Asking Rent By Size Bracket, 2017- 2018



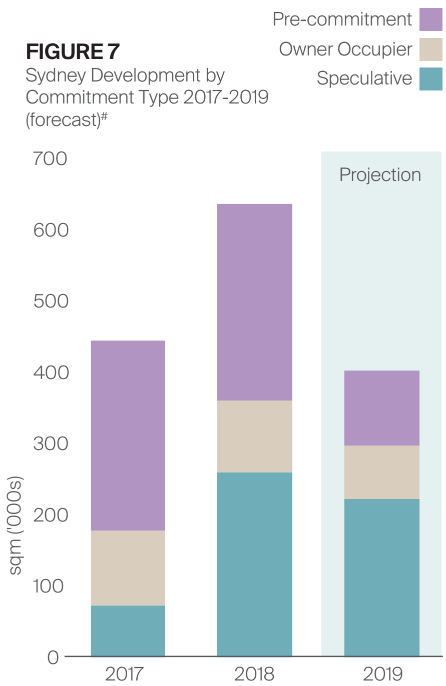
Source: Knight Frank Research

FIGURE 6
Sydney Historical Industrial Development Completed by Year, 2009-2018



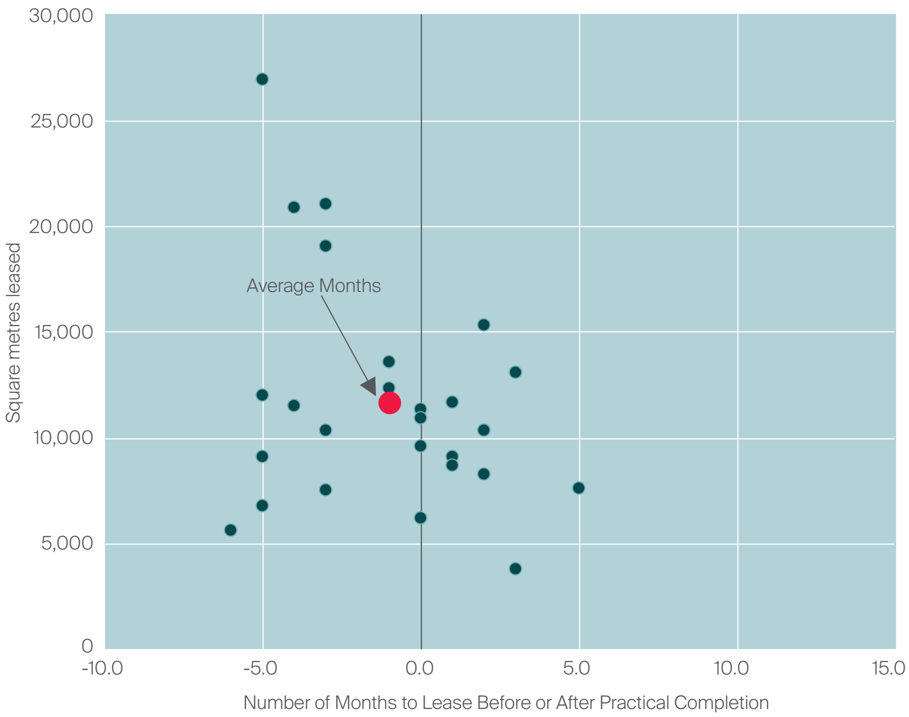
Source: Knight Frank Research

FIGURE 7
Sydney Development by Commitment Type 2017-2019 (forecast)#



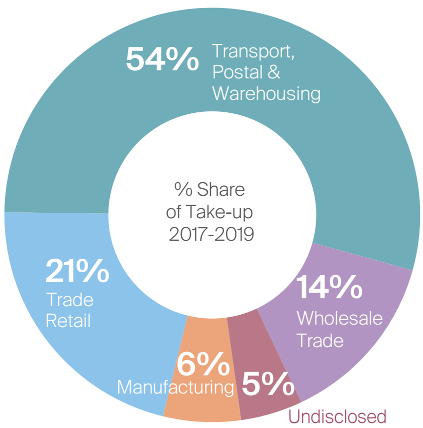
#2019 data includes forecast completed, under construction and proposed
Source: Knight Frank Research / Cordell

FIGURE 8
Sydney Speculative Development—months to take-up from practical completion 2017-2019, by size



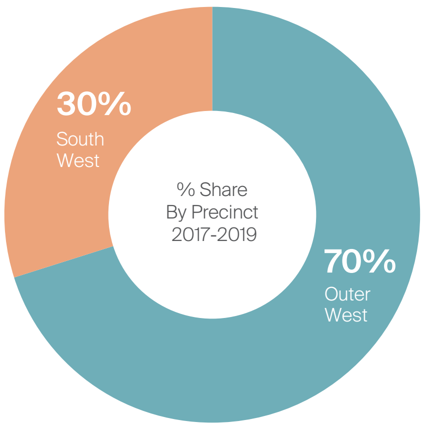
Source: Knight Frank Research

FIGURE 9
Sydney Spec Take-up by Sector



Source: Knight Frank Research

FIGURE 10
Sydney Spec Build by Precinct



Source: Knight Frank Research

MORE THAN 50% OF SPEC STOCK LEASED BEFORE COMPLETION

New technology and continued growth in the e-commerce sector has fuelled demand for warehousing and logistics facilities from new entrants, as well as demand from businesses undergoing expansion or seeking to upgrade warehouse facilities to improve supply-chain efficiencies. This has placed pressure on the availability of land in certain areas, particularly the traditional South West and Inner West, and contributed to the recent capital growth of land.

Broadly speaking, developers have been targeting locations in key logistics nodes in the Outer West and South West with demand from logistics and retail users driving recent take-up trends, particularly in the spec segment due to their increased focus on transportation costs and improving delivery frequencies.

Demand for newly developed stock is evident from the low leasing periods seen since 2017, with more than 50% of the spec-built properties being leased prior to completion.

LOGISTICS & RETAIL DEMAND DRIVES LEASING TAKE-UP

More than half of the spec-built facilities between 2017 and 2019 were leased by Transport & Logistics (Warehousing & Distribution) users (54.1%), while Retail and Wholesale Trade tenants accounted for 25% of spec leasing volumes. 15% of spec buildings were leased by Manufacturing tenants.

This demand has resulted in short take-up periods on spec development, typically before or upon practical completion (PC). Over the 2017-2019 period, 51.7% of buildings constructed on a spec-basis were leased within six months of PC being reached. Another 10.3% were leased on PC date and 34.5% were leased within the first three months following PC. 3.4% were leased between three and six-months following PC.

Speculative Development
Compass Logistics Estate
Eastern Creek, New South Wales

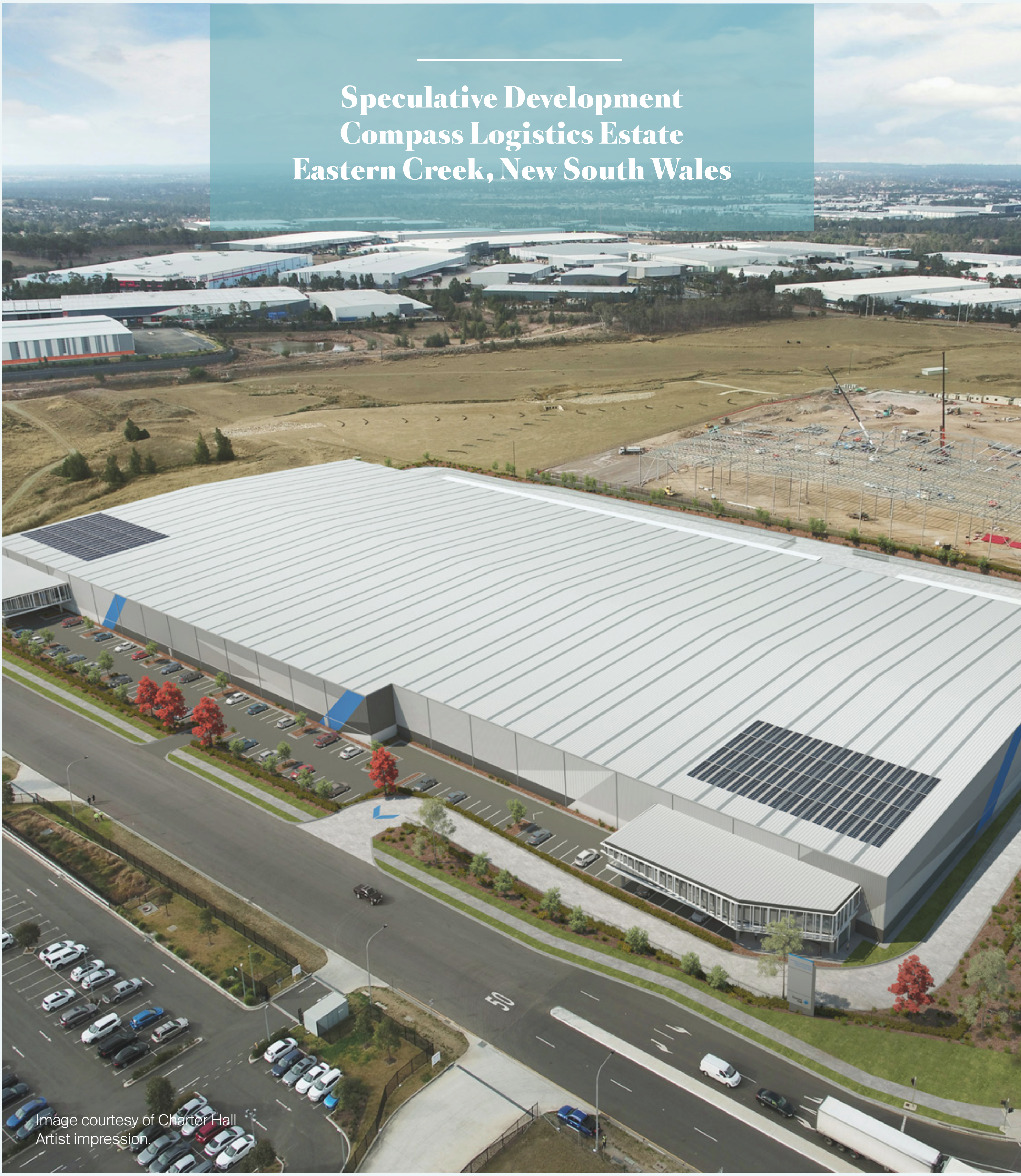
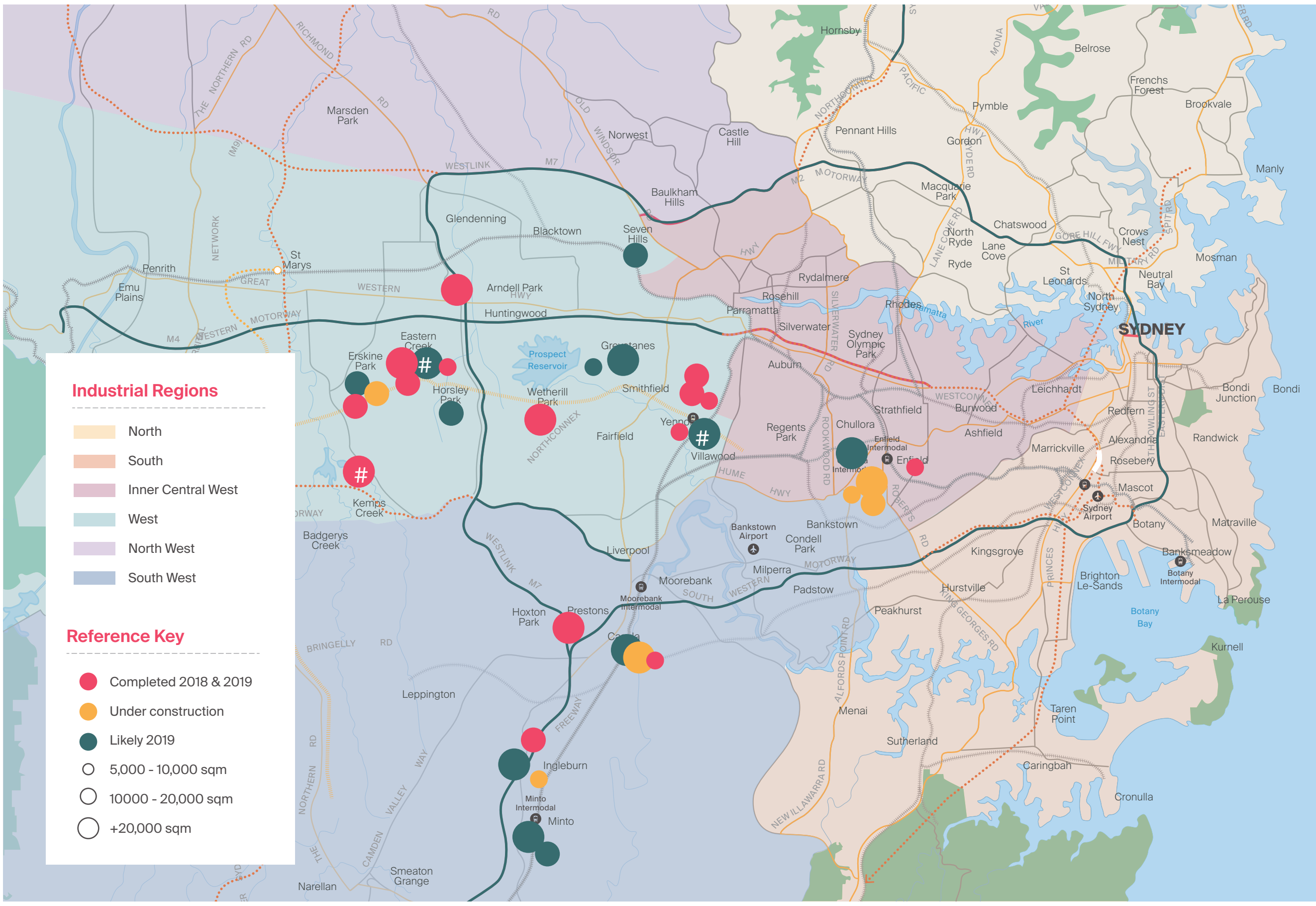


Image courtesy of Charter Hall
Artist impression.

SYDNEY (CONTINUED)

FIGURE 11

Sydney Recent Industrial Spec Build by Precinct 2017-2019



Source: Knight Frank Research # Multiple sites have been developed on a spec basis.

TABLE 1

RECENT LEASING ACTIVITY OF SPECULATIVE DEVELOPMENTS — SYDNEY

Address	Net Rent ($/sqm)	Area (sqm)	Term (yrs)	Tenant	Date	Months from PC
2-6 Dolerite Way, Greystanes	135	13,700	10	Beaumont Tiles	Jan-19	-3
50 Wallgrove Road, Eastern Creek	U/D	30,100	8	ACR Supply Partners	Jan-19	0
Calibre Estate, 60 Wallgrove Road, Eastern Creek	125	21,676	5.1	ACFS Port Logistics	Dec-18	-5
Eastern Creek Business Park, Stage 5, Honeycomb Drive, Eastern Creek	120	13,050	12	LJM	Sep-18	-3
1B Huntingwood Drive, Huntingwood	125	11,276	5	Cahill Transport	Aug-18	0
Calibre Estate, 60 Wallgrove Road, Eastern Creek	120	21,101	7	Pet Circle	Feb-18	-3

Source: Knight Frank Research U/D refers undisclosed. PC refers Practical Completion.

MELBOURNE

> **142,334 sqm of spec development is due to land in the West in 2019, which is approaching double what was recorded in 2018 (87,390 sqm) & 2017 (85,262 sqm).**

NEW DEVELOPMENT CONTINUES TO SURGE

Throughout the last five years, it is estimated that more than 2.56 million sqm of new industrial space has been added to Melbourne's industrial precincts, with underlying tenant demand squeezing vacancy rates and providing the impetus for new projects and appetite to land bank for future demand.

The West precinct has traditionally been the largest industrial precinct in the state and the most active, accounting for almost half of the new stock coming online in the last five years, however the South-East has also become increasingly active on the development front.

SPECULATIVE DEVELOPMENT NOW ON THE RADAR

Demand for prime grade industrial remains very high and to a large extent, unsatisfied, particularly in the West and South-East corridors as reflected in the increasing pressure on land and rental values.

While the development of new facilities across Melbourne has previously been dominated by pre-commitment leasing activity, there has been a notable upswing in spec development activity recently and in some areas, demand is outstripping supply.

E-COMMERCE AND TIGHT SUPPLY CREATE DEMAND FOR SPEC

An increase in imports on the back of e-commerce demand is helping to buoy demand for warehousing and logistics facilities (with particular emphasis on automation). Low vacancy in many of the areas, particularly the West and South-East, has been recognised by developers, who, despite rising land values, are now backing spec development with a higher level of confidence due to the resilient outlook on leasing demand.

That confidence is also feeding into future supply plans with many institutional owners opting to land bank recently acquired industrial sites.

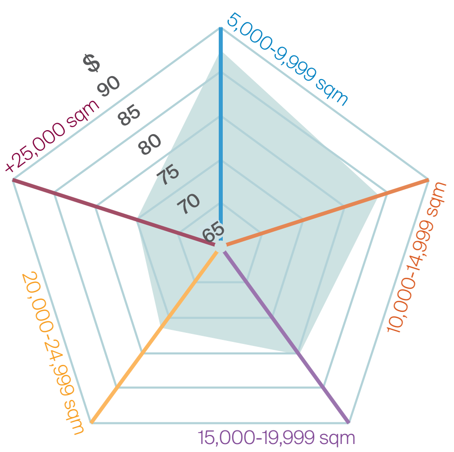
SPEC DEVELOPMENT PIPELINE DOUBLES

Although REITs and private developers are focused on building future developable land supplies through acquisitions, there remains a clear focus on current spec demand for construction-ready, modern and efficient facilities, particularly from the transport and logistics sector. This sentiment has solidified the near-term outlook for spec supply, with the volume of new spec development anticipated to reach 280,000 sqm in 2019, more than double what was recorded in 2018 (110,500 sqm).

SPEC GATHERS STEAM IN MELBOURNE'S WEST

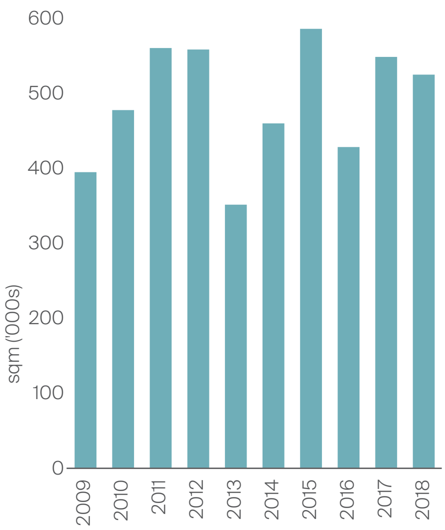
Much of the spec development activity underway has been driven by the West precinct, arguably where a greater number of developable sites exists. In 2019, it is estimated that 142,334 sqm of spec development is due be completed - this is approaching double what was recorded in 2018 (87,390 sqm) and 2017 (85,262 sqm).

FIGURE 12
Melbourne Spec Build Average Rent $/sqm Asking Rent By Size Bracket, 2017- 2018



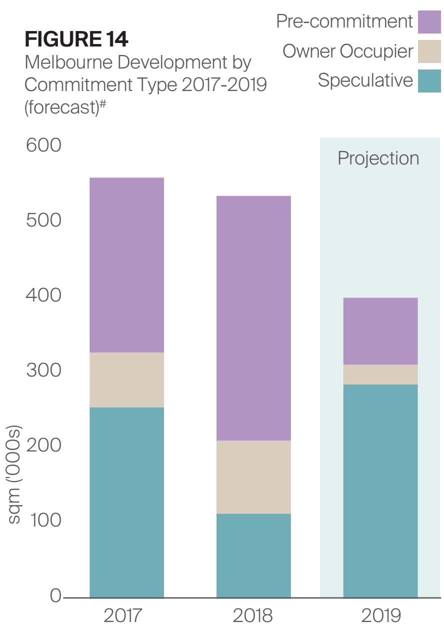
Source: Knight Frank Research

FIGURE 13
Melbourne Historical Industrial Development Completed by Year, 2009-2018



Source: Knight Frank Research

FIGURE 14
Melbourne Development by Commitment Type 2017-2019 (forecast)#



#2019 data includes forecast completed, under construction and proposed
Source: Knight Frank Research / Cordell

Just over half of Melbourne's industrial spec development pipeline for 2019 is concentrated in the West (51%), with the second largest share of spec activity originating from the South East (32%). The North is expected to account for around 18% of spec projects in 2019.

While the 88,464 sqm of spec due to come online in the South East during 2019 is up on the 11,593 sqm recorded in 2018, the figure is still below the 2017 level of 110,451 sqm.

SHORT TAKE-UP TIME REFLECTS HIGH DEMAND

On average it takes two months for Melbourne spec developments to be taken-up post practical completion.

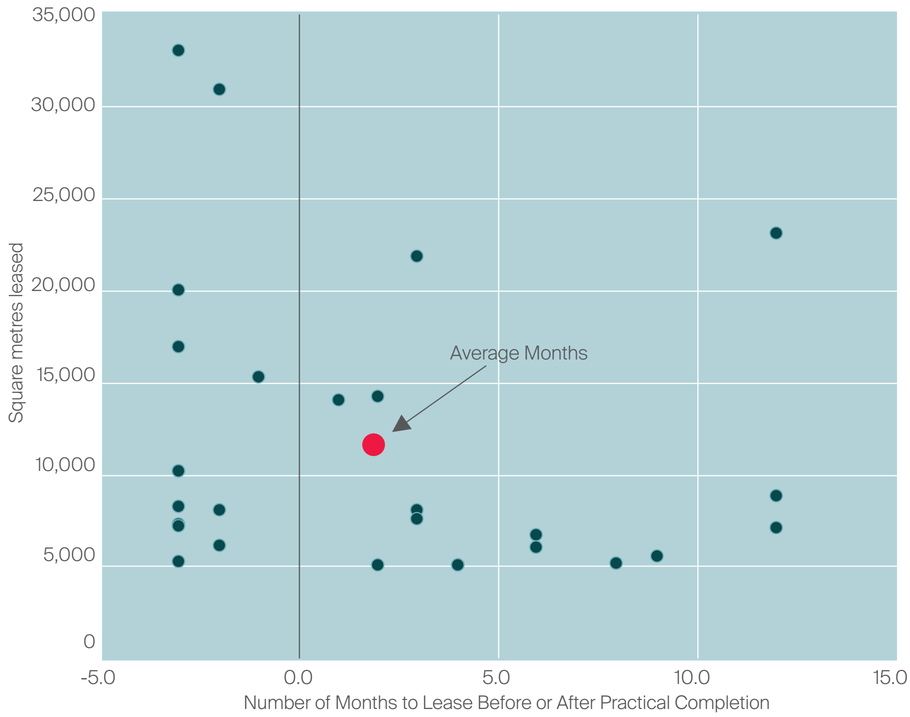
While take-up time in Melbourne is slightly longer than in Sydney, which averages one-month pre-practical completion, this can be attributed to there being more space available in Melbourne which allows prospective tenants more time to inspect properties to ensure the layout meets their needs.

HALF OF THE WEST'S UPCOMING SPEC ALREADY UNDER OFFER

Over the 2017-2019 period, 46.4% of buildings constructed on a spec-basis were leased during the three months prior to PC. As such, now is seen to be a good time to spec build in Melbourne as it is felt the demand is there to absorb any such new developments.

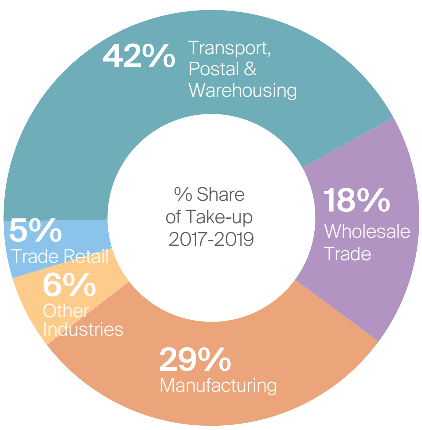
The increase in spec activity in the West started in earnest in late 2018 and has carried over into 2019, with much of the new stock due to be completed in Q3 2019. We understand that more than half of the spec space coming online in Melbourne's West is already under offer, indicative of the level of demand in the market and the 'flight to quality' trend towards higher-grade facilities.

FIGURE 15
Melbourne Speculative Development—months to take-up from practical completion 2017-2019, by size



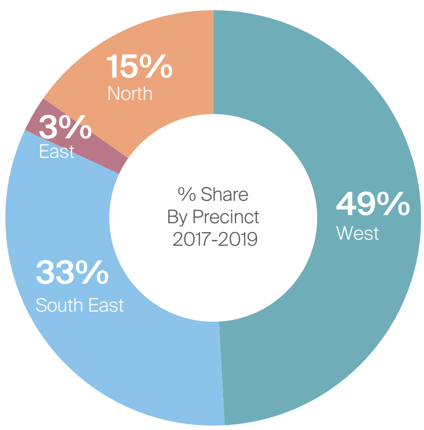
Source: Knight Frank Research

FIGURE 16
Melbourne Spec Take-up by Sector



Source: Knight Frank Research

FIGURE 17
Melbourne Spec Build by Precinct

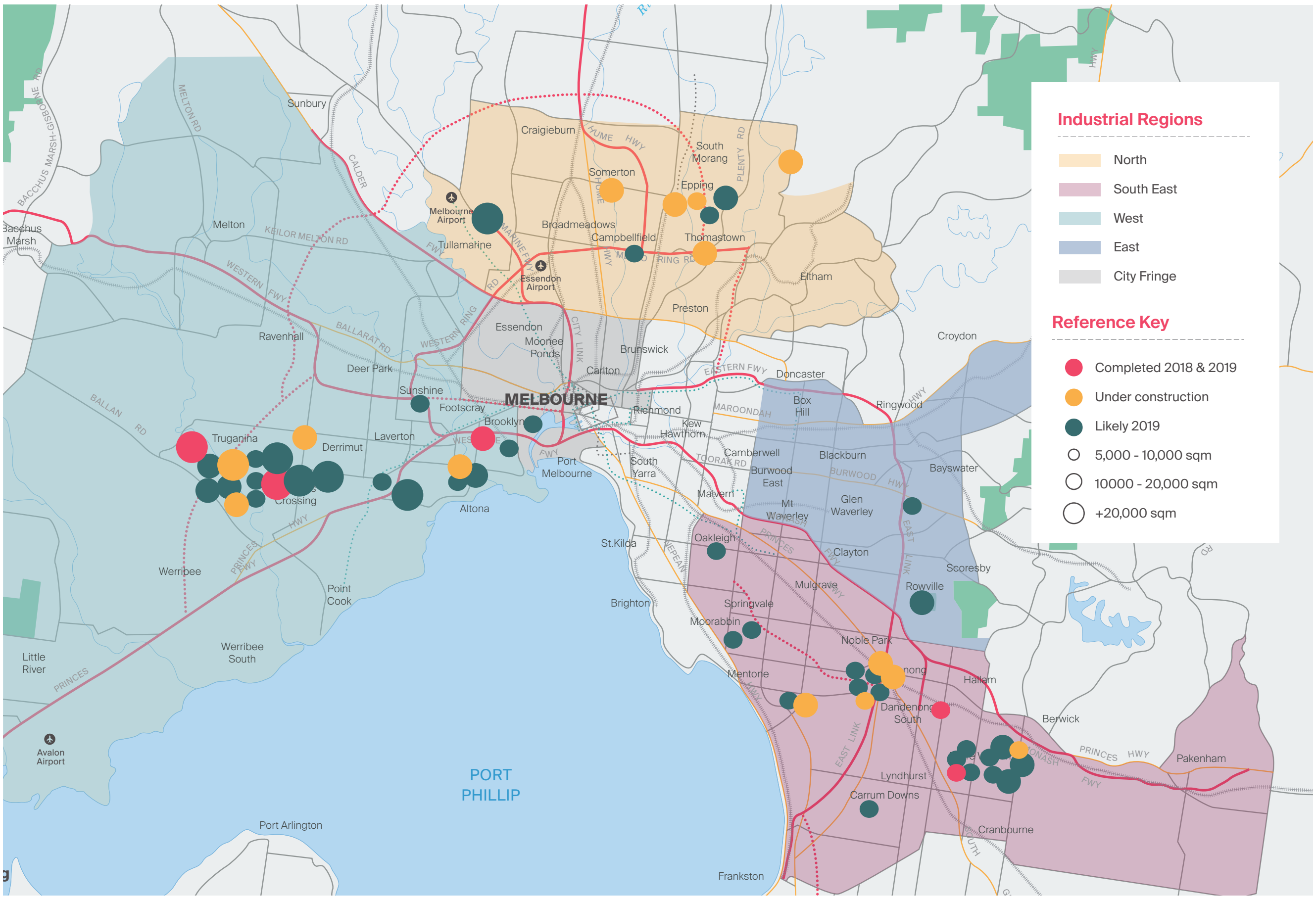


Source: Knight Frank Research

Image courtesy of Goodman
Development currently under construction.

FIGURE 18

Melbourne Recent Industrial Spec Build by Precinct 2017-2019



Source: Knight Frank Research

TABLE 2

RECENT LEASING ACTIVITY OF SPECULATIVE DEVELOPMENTS — MELBOURNE

Address	Net Rent ($/sqm)	Area (sqm)	Term (yrs)	Tenant	Date	Months from PC
Spec 1 & 2 Canterbury Rd, Braeside	$75*	14,144	6	IVE Group	Q1-19	2
33 Archer Rd, Truganina	$73	15,227	5	CTI Logistics	Q1-18	1
93 - 103 Pacific Dr, Keysborough	$85	8,745	5	IHS GLOBAL	Q1-18	U/D
W/H B - Spec 6 - Atlantic Dr, Keysborough	$90	7,357	5	GH Cabinets/Pazstone	Q1-18	6
930 - 940 Taylors Rd, Dandenong South	$85	6,651	5	Bolt Group	Q1-18	4
67 Scanlon Dr, Epping	$86	6,070	10	Diseb Food Group	Q4-18	0

*Source: Knight Frank Research U/D refers undisclosed PC refers Practical Completion *Estimated*

BRISBANE

> While the availability of speculative space is at its lowest level in four years, the timing of speculative starts is largely expected to remain tied to pre-commitments on an adjoining site.

SPEC CONSTRUCTION SET TO INCREASE

Spec development is expected to increase across Brisbane as vacancy hits a six-year low. Lower construction and improved tenant take-up are combining to reduce vacancy and create the environment for rental growth.

SUPPLY HAS BEEN LOW

As shown in Figure 20, construction levels for Brisbane have been modest since 2016. Throughout 2017 and 2018, new supply accounted for 481,993 sqm, with 25% of this (119,689 sqm) speculatively developed space.

Spec development peaked in 2015 with 95,905 sqm delivered, however lower demand conditions resulted in an overhang of spec space (Figure 19) in Brisbane which has only recently begun to unwind.

Spec development in 2019 will remain in line with the past three years, with 55,000 sqm forecast to be delivered. New supply will remain dominated by the South and Trade Coast precincts, where land estates and institutional development activity is most prevalent, due to the strong transport links in these locations.

The second half of 2019 is expected to see greater spec project commencements, but only two are likely to be completed this year, with the remainder delivering H1 2020.

AVAILABLE SPEC SPACE LOWEST IN FOUR YEARS

After reaching a high of 109,420 sqm in the October 2016 survey, the amount of available vacant spec space has been on a recovering trend. The April 2019 result of 49,398 sqm is a four-year low and reflective of the greatly improved vacancy conditions across the wider market, which is at a six-year low. The absorption of spec space has been driven by the market preference for good quality, high clearance warehouse space with flexible loading facilities and good road access.

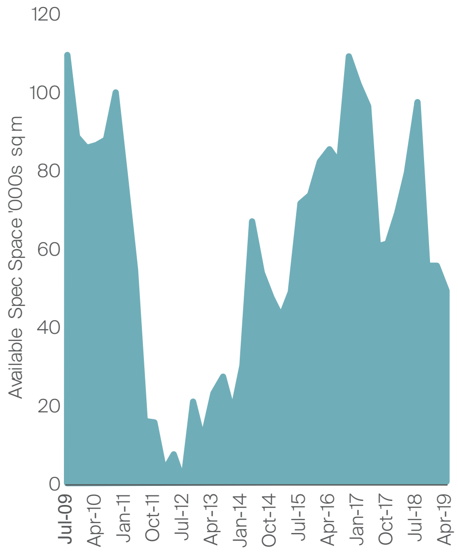
RENTAL PREMIUM BUT SHORTER LEASE TERMS

The average face rents achieved for speculatively developed assets since 2017 is $113/sqm net, ranging from $100–$120/sqm for tenancies 5,000sqm+.

This represents a circa 3% premium to the average prime market levels over the same period.

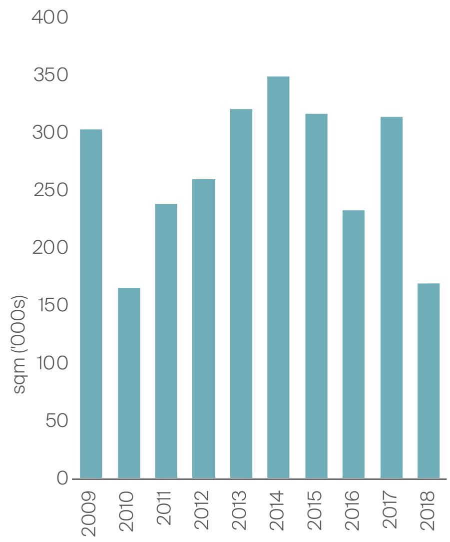
Lease terms achieved have varied with the generally expected 5-7 year terms joined by a number of shorter term deals undertaken during H2 2018. CEVA (1 year), DHL (1.5 years), Amart (8 months) and Boeing (3.5 years) were all spec deals done on terms traditionally considered shorter than ideal. However, the strategy to take cashflow appears to have been sound with CEVA signing to extend their tenure by a further year and the Amart space reportedly leased with no downtime to Keppel Logistics on a 5 year deal for $115/sqm.

FIGURE 19
Brisbane Available Speculative Space 2009-2019



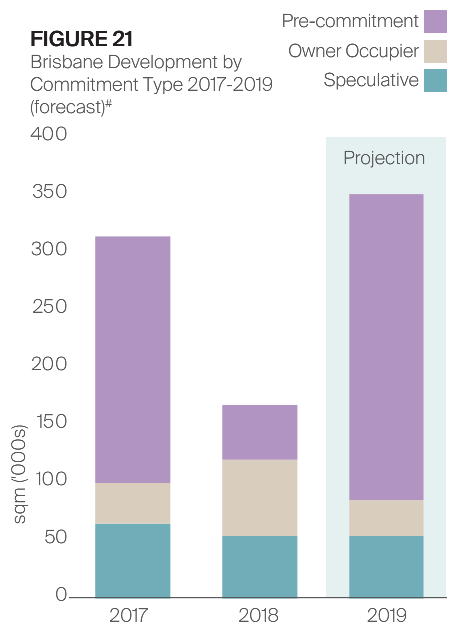
Source: Knight Frank Research

FIGURE 20
Brisbane Historical Industrial Development Completed by Year, 2009-2018



Source: Knight Frank Research

FIGURE 21
Brisbane Development by Commitment Type 2017-2019 (forecast)#



#2019 data includes forecast completed, under construction and proposed
Source: Knight Frank Research / Cordell

TIME ON THE MARKET HAS FALLEN

The average time on the market for spec space constructed over 2017-2019 was four months for the Brisbane market.

This is a significant improvement from the 9.3 months period seen between completion and take-up for spec assets constructed in 2015 and 2016, when leasing conditions were tougher. The current stock of completed and available spec space has been available for an average of 4.75 months, ranging from four months to seven months, with one of these understood to have HOA signed.

SPEC TO ACCELERATE

There are only four completed spec developments available, ranging from 2,800 sqm–17,880 sqm in the market at the time of this report, plus a further two in the early stages of construction. With the largest of these available spec tenancies understood to have achieved HOA, the stock of spec space, particularly for larger tenants, is set to diminish further in the short term.

Vacancy analysis shows there were only eight prime options of 10,000 sqm+ as at the April 2019 survey across the whole of Brisbane. This shows how quickly the level of choice for larger prime spaces can diminish in Brisbane. This is also reflected by the greater level of pre-commitment activity for 2019 (264,600 sqm) and expected in 2020 (138,260 sqm).

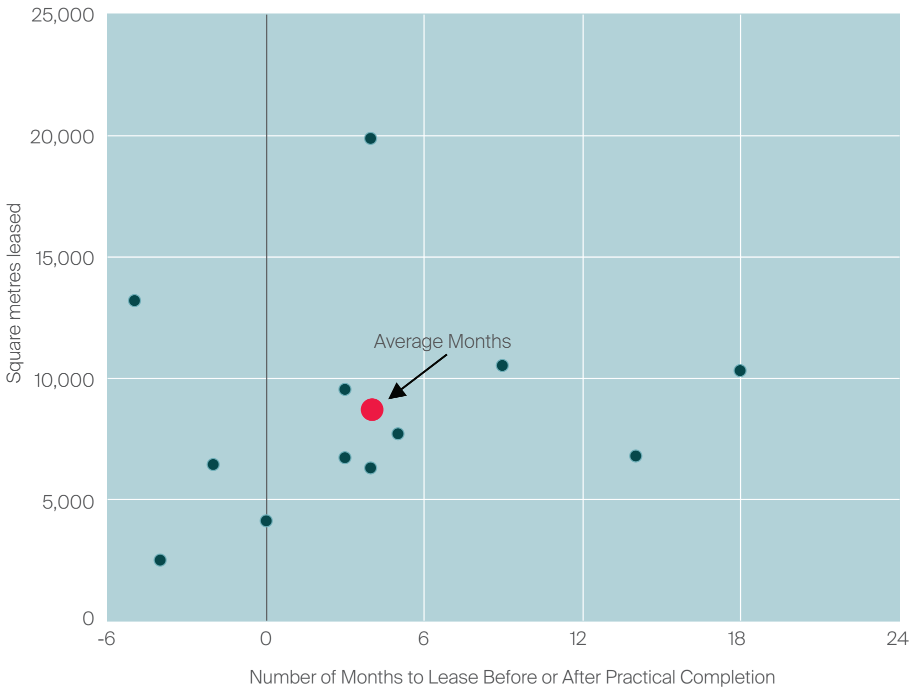
INSTO'S TO DOMINATE

More tenants in the market (recently dominated by 3PL, consumer goods, food production and packaging users) are requiring a higher standard of warehouse design to incorporate greater automation and supply-chain efficiency. In most cases these occupiers are willing to pay more for new or prime space.

Spec supply is expected to remain dominated by the institutional funds. Spec development will likely progress in tandem with the construction of a pre-committed adjacent facility to maximise the addition of assets into the funds' pipeline with a mitigated risk profile.

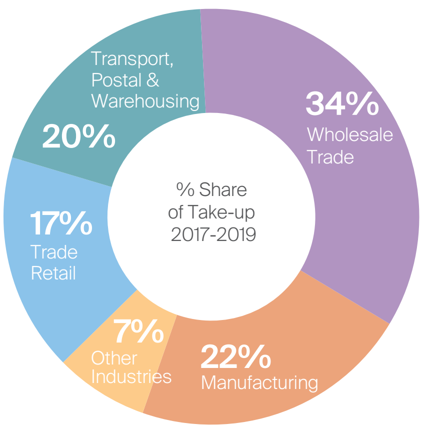
Although slated spec developments can be deferred or quickly converted into pre-committed construction, Knight Frank's analysis shows circa 110,000 sqm as likely spec delivery during 2020, twice the level of 2019.

FIGURE 22
Brisbane Speculative Development—months to take-up from practical completion 2017-2019, by size



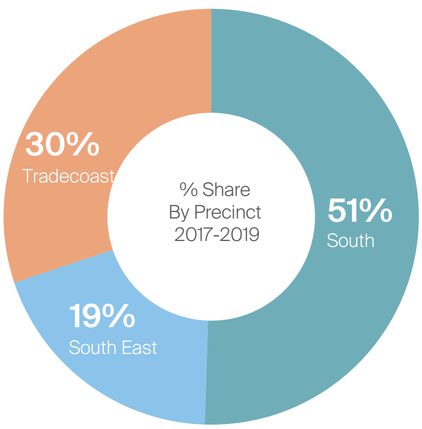
Source: Knight Frank Research

FIGURE 23
Brisbane Spec Take-up by Sector

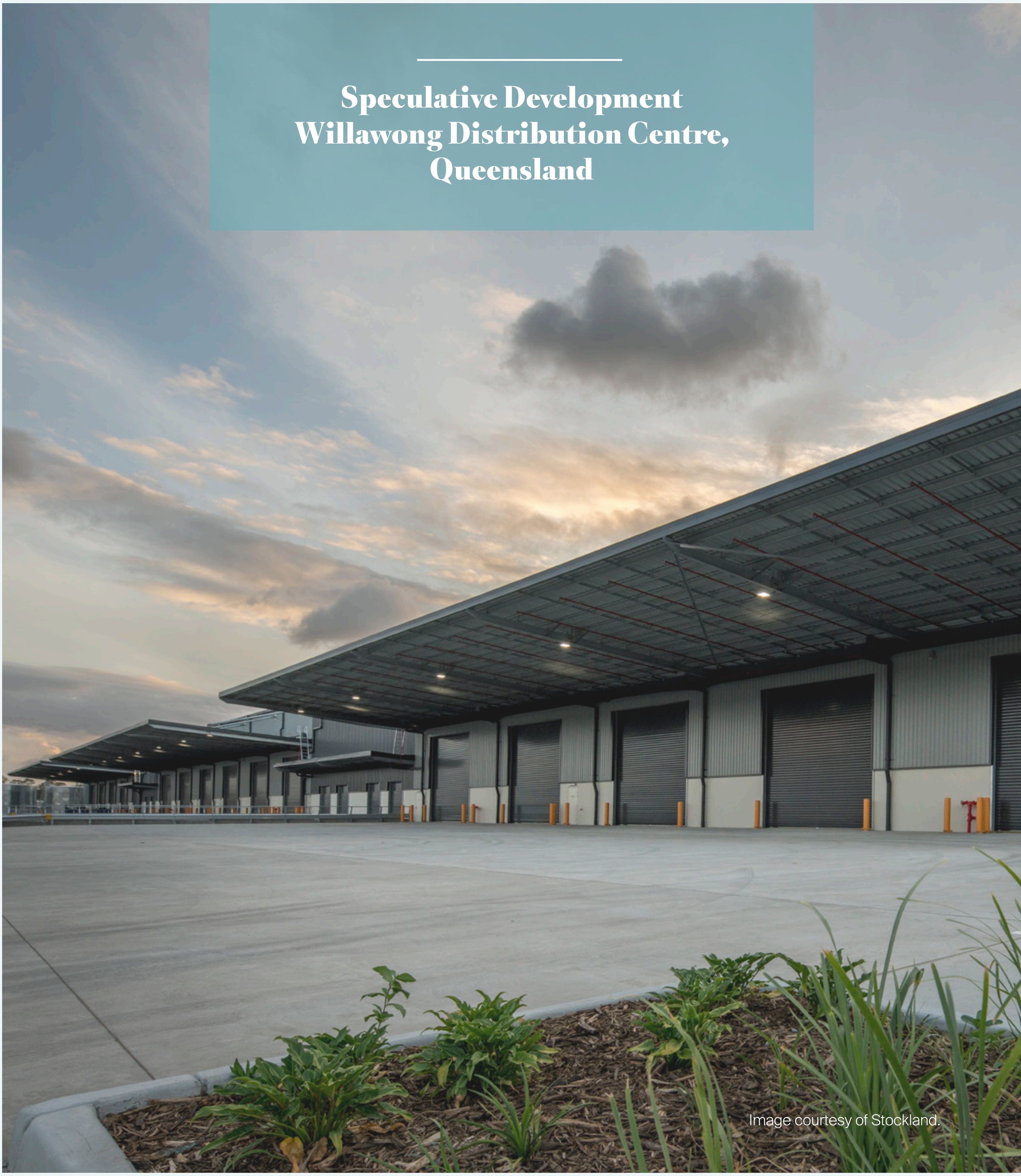


Source: Knight Frank Research

FIGURE 24
Brisbane Spec Build by Precinct



Source: Knight Frank Research

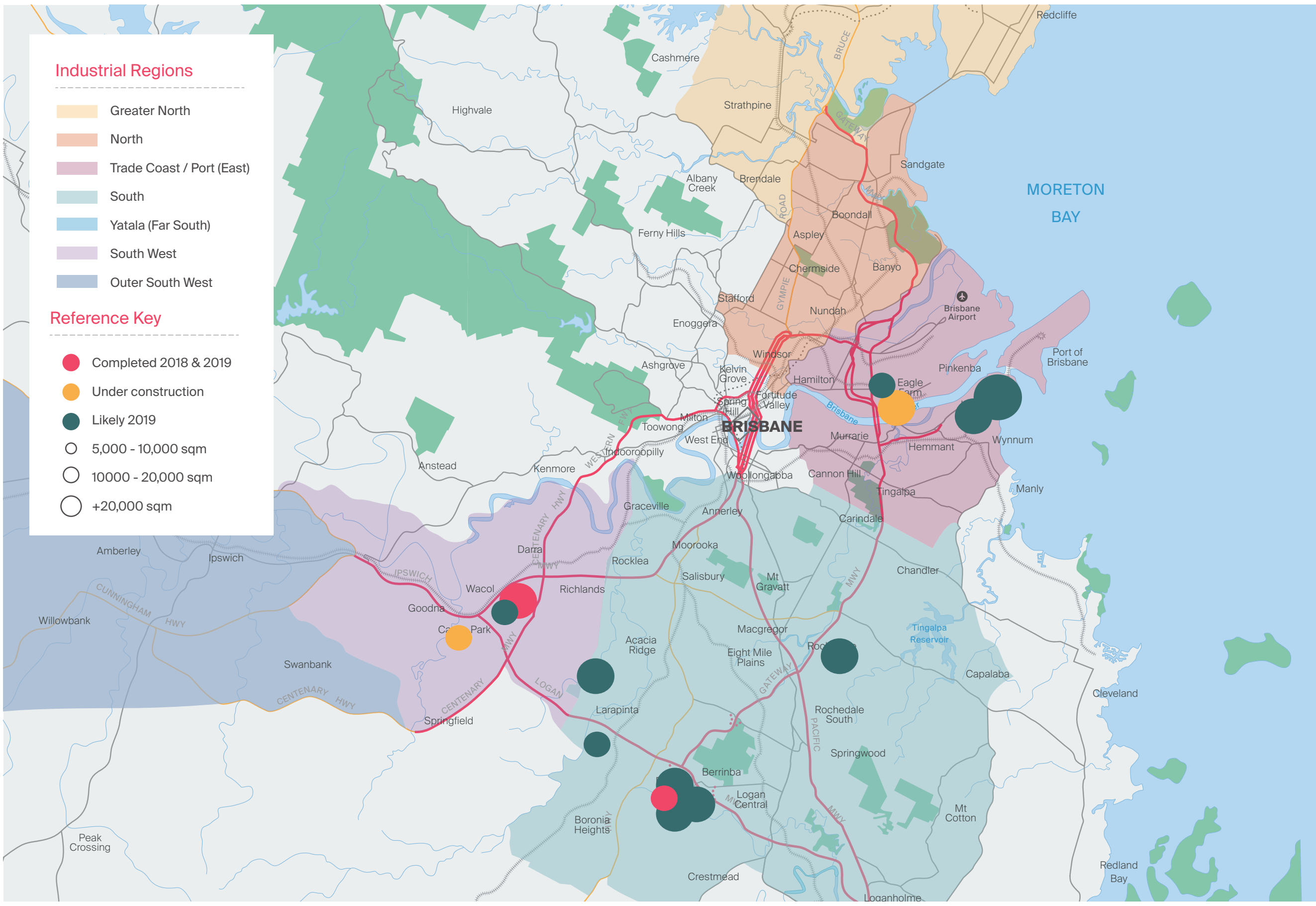


Speculative Development Willawong Distribution Centre, Queensland

Image courtesy of Stockland.

FIGURE 25

Brisbane Recent Industrial Spec Build by Precinct 2017-2019



Source: Knight Frank Research

TABLE 3

RECENT LEASING ACTIVITY OF SPECULATIVE DEVELOPMENTS — BRISBANE

Address	Net Rent ($/sqm)	Area (sqm)	Term (yrs)	Tenant	Date	Months from PC
Gooderham St, Willawong	113	c6,900	5	Apergy	Apr 19	3
26 Action St, Wacol	110	6,735	3.5	Boeing	Oct 18	14
47 Logistics Pl, Larapinta	115	7,670	1.5	DHL	Oct 18	5
Huntress St, Berrinba (Ten A)	105	10,455	5	GMK Logistics	Sep 18	24
28 Brickworks Dr, Rochedale	105	10,475	8 mths	Amart	Sep 18	9
29 Forest Way, Berrinba (Ten B)	100	10,294	1	CEVA	Aug 18	18
Bld 4, Drive Industrial Estate, Richlands	98	14,670	6	Winc	Jul 18	31
Bld 2, Drive Industrial Estate, Richlands	U/D	6,800	5	Steinhoff	Apr 18	28
103 Wayne Goss Dr, Berrinba	110	6,290	5	PACCAR	Oct 17	4

Source: Knight Frank Research U/D refers undisclosed PC refers Practical Completion

OUTLOOK

> **"The increasing need for more sophisticated product types and efficient supply-chain networks, may see a rise in the demand for warehouse and distribution facilities in infill locations in Melbourne and Sydney."**

While the commentary regarding e-commerce demand and supply-chain efficiencies is not new, the rise in institutional allocations to industrial real estate assets through development is becoming increasingly topical.

Investment in industrial land has been very strong recently, with several Australian and offshore REITs purchasing large-scale land banks in Sydney and Melbourne as they look to boost asset allocation to the sector over time and stabilise their returns through the development of logistic and industrial assets in those markets over the next three to five years.

REITS TO REMAIN FOCUSED ON LAND

REITs are expected to continue to focus on developable land supplies, competing for any significant land bank opportunities in Sydney and Melbourne in transport corridors, such as Western Sydney and Western Melbourne, placing continued, albeit more modest pressure on land value growth in those markets especially.

PIPELINE TO REMAIN ELEVATED

There has already been a notable upswing in the volume of new industrial development projects in the Eastern Seaboard markets over the last 18 months, with Sydney and Melbourne at the forefront, and this trend is expected to continue in the near-term on the back of REITs actively targeting expansion in the sector.

The volume of speculative development has been rising and in areas where spec activity in previous cycles had elevated vacancy rates, strong demand is now shortening take-up periods, usually before or upon practical completion. Institutional owners have recognised the upside of this and are growing increasingly confident in investing in spec projects.

On that note, demand for new development on both on a pre-lease and spec-basis is expected to remain elevated. Melbourne is likely to exceed Sydney's spec pipeline this year, driven largely by the West where to some extent the greatest capacity for expansion exists.

We understand that more than half of the spec space coming online in Melbourne is already under offer, indicative of the level of demand in the market and the 'flight to quality' trend towards higher-grade facilities. In Brisbane, landlords are beginning to see improvements in leasing demand, however the timing of spec projects is likely to remain closely linked to pre-commitment in the short-term to help mitigate risk.

ADAPTING BUILDING SPECIFICATIONS

E-commerce trends and technology changes, along with supply-chain fulfillment demands is flowing through to warehouse design. While some of these changes are still in their infancy, expect to see greater emphasis on building design and consumer focused urban-spoke logistic models moving forward. However, with landlords less likely to see the payback on investment in technology on short-term lease exposure, this trend is more likely to be led by pre-commitment demand than spec.

RISING DEMAND FOR INFILL LOCATIONS

Ongoing growth in the online retail environment is likely to continue driving demand for logistics assets and the growing populations in the Eastern Seaboard markets will help to sustain strong occupier demand from transport / logistics, manufacturing and retail. The increasing need for more sophisticated product types and efficient supply-chain networks, as well as consumer demand, may see a rise in the demand for warehouse and distribution facilities in infill locations in Melbourne and Sydney. Amazon wants to make one-day delivery the default for its Prime-Now subscribers and Google's drone company Wing launched their project phase in Australia recently, suggesting that improvements to supply-chain efficiencies to the last-mile will remain at the vanguard of the logistics sector in the immediate term.

Image courtesy of Stockland.

DEFINITIONS

Speculative (Spec) Development:
A development that commences with no tenant pre-commitment.

Pre-commitment (or pre-lease):
A commitment/lease with a tenant for a new development prior to any construction commencing.

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 (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).

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