Knight Frank

SYDNEY INDUSTRIAL

MARKET OVERVIEW JULY 2019

CHANGING PREFERENCES FUELS INVESTMENT VOLUMES

HIGHLIGHTS

Strong capital inflows in the first half of 2019 have elevated investment volumes to $1.16 billion, almost 70% of 2018 volumes.

2019 leasing take-up volumes are running above average, buoyed by pre-commitment and speculative leasing demand on the back of logistics and e-commerce industry growth.

By the end of 2019, c679,000 sq m of new supply is expected to enter the market, with over half of this new supply stemming from speculative developments.

MARKET DRIVERS

Population Growth
Aust: 1.6% NSW 1.6%
Dec 2018 (YoY)

Economic Growth
Aust: 2.8% NSW: 2.6%
FY2018 FY2018

Retail Trade
Aust: 2.7% NSW: 1.0%
May 19 (YoY, trend)

Exports
Aust: 19.2% NSW: 13.8%
May 19 (YoY)

Sydney Supply (sq m)
459,280 679,395
10 Yr Avg v 2019 (Gross)

ECONOMY & DEMAND

With a record pipeline of new development, surging investment and leasing take-up volumes, 2019 is shaping up to be above-trend, as investors respond to logistics and e-commerce industry growth.

Positive economic outlook

Following the first of two rate cuts since 2016, borrowing rates for businesses and households are at historically low levels. A lower AUD has improved competitiveness for domestic manufacturers and employment growth is around double its long-run average. Backed by above-trend population growth and workforce participation rates, economic growth in 2018-19 is forecast to be 2.75%.

Although the cycle of residential construction activity appears to have abated, record infrastructure spending together with strong warehouse demand, primarily from logistics and retail, is continuing to stimulate private investment in the sector, helping to offset the impact of the decline in residential development.

Development at record high

Industrial development is at record highs, led by speculative (spec) projects, with many owners securing tenants prior to completion. Growth in e-commerce is also playing a critical role in investment decision making, with institutional capital actively increasing their exposure to the sector through acquisition of existing but strategically located assets and development land at record prices.

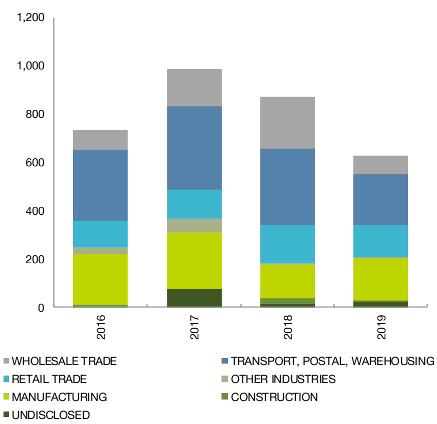
Leasing activity on track for strong finish

Buoyed by pre-commitment and spec leasing demand, take-up volumes for 2019 have already reached 620,000 sq m. This contrasts with c420,000 sq m at the same time last year. Demand is being driven by transport / logistics and e-commerce, as well as light manufacturing.

Pre-commitment lease activity is running above its annual average, while spec projects are forecast to account for over half of new development this year—double its five-year average.

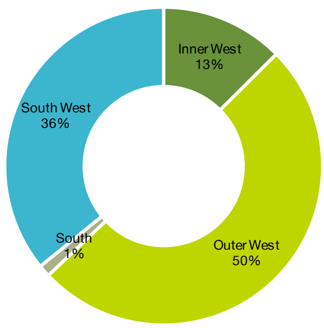
There is real demand for new industrial product with growing emphasis on building design and warehouse specifications, such as automation being incorporated—mostly in the pre-lease segment. For example, Coles has recently committed to lease a c66,067 sq m automated ambient distribution centre in Kemps Creek and at the end of last year, chip company, Snack Brands, pre-committed to lease a purpose -built 30,255 sq m facility with a 35-metre high-bay section and automated warehousing and distribution system.

FIGURE 1
Sydney Industrial Lease Activity
'000sq m, by Business Sector



Source: Knight Frank Research

FIGURE 2
Sydney Industrial Lease Deals
By Region, 2018-2019YTD



Source: Knight Frank Research

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VACANCY & RENTS

Vacancy remains well below historical average

Ongoing demand from logistics, particularly 3PLs and retail trade sectors, continues to be a catalyst for below-average availability levels. As at July 2019 vacant stock totalled 420,960 sq m, 28% below the historical average. Prime stock continues to dominate the level of available space, accounting for 87% of total stock. As a proportion, this is up from 67% from July 2017.

Vacancy levels are concentrated in the Outer West precinct, accounting for 60% of total vacant stock, followed by the Inner West (19%), South West (18%) and South Sydney (3%). The largest proportion of vacant stock in the Outer West can be attributed to the concentration of new gross supply in the precinct, with 64% or one million square metres being added to the market since 2017.

Robust level of development activity continues

New industrial supply topped out at almost 685,000 sq m in 2018, a decade-high for the sector. 2019 is set to continue this trend, with a robust level of development activity underway. By the end of 2019, c679,000 sq m of new supply is expected to enter the market. Fuelling developer confidence is the appetite coming from distributors, logistics operators and retailers seeking new supply-chain efficiencies to meet consumer and e-commerce demands.

More than half of new supply in 2019 is spec, which has come on the back of expansion of e-commerce trade.

Pre-commitment demand continues to bolsters activity

The pre-commitment market remains a key driver of new supply in Sydney, with more than 670,000 sq m of the pipeline stemming from this demand since the start of 2018. In regards to industry, wholesale trade (34%) and logistics operators (31%) have accounted for majority of pre-commitment deals. This contrasts with spec developments where logistics operators account for over 50% - a trend which suggests that e-commerce occupiers are undergoing rapid expansion.

Fast migration to newer facilities that incorporate the building specifications needed improve the supply-chain mean spec projects are increasingly well-positioned to cater for this demand.

Rents, Incentives & Outlook*

Prime	$152/sq m 5.1% YoY 9.6% incentive	↗
Secondary	$130/sq m 4.3% YoY 9.7% incentive	↗

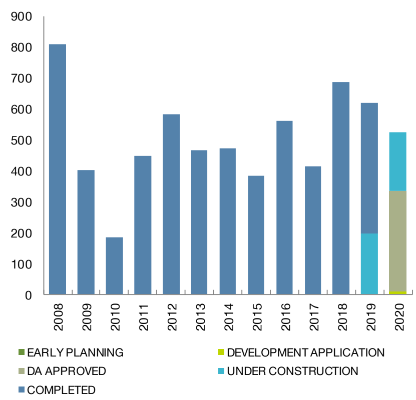
Source: Knight Frank Research
*Prices reflect an average across all precincts

Positive rental growth

On the back of the demand from occupiers and changing end-user requirements in regards to warehouse design, rents have risen across the board. Overall, prime net face rents have risen by 5.1% YoY to $152/sq m as at July 2019, above the 10 year average of 1.6%. Secondary market rents have risen by 4.3% YoY to average $130/ sq m.

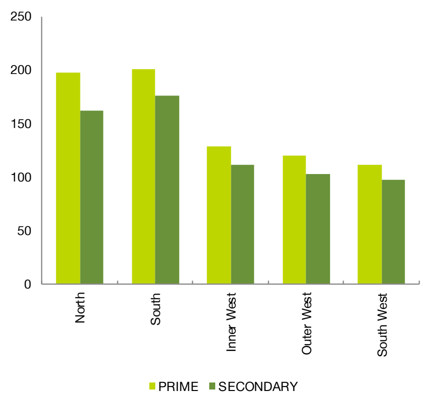
Above-trend development activity has also spurred on rental growth with tenants willing to pay a premium for the best stock. Knight Frank Research anticipates steady rental growth to continue on the back of strong tenant demand and the healthy pipeline of supply into 2020.

FIGURE 4
Sydney Industrial Development
Annual Gross Supply ('000 sq m, bldgs >5,000 sq m)



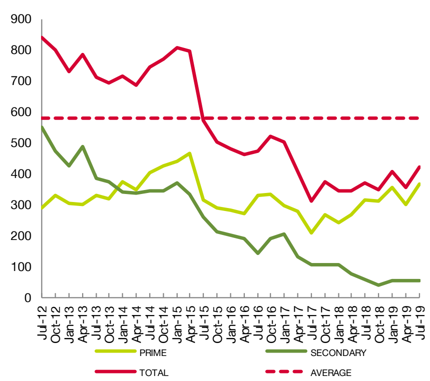
Source: Knight Frank Research/Cordell Connect

FIGURE 5
Sydney Industrial Rents by Precinct
$/sq m net rents, Prime and Secondary



Source: Knight Frank Research

FIGURE 3
Sydney Industrial Vacancy
'000 sq m prime vs secondary available space



Source: Knight Frank Research

TABLE 1
Recent Leasing Activity Sydney

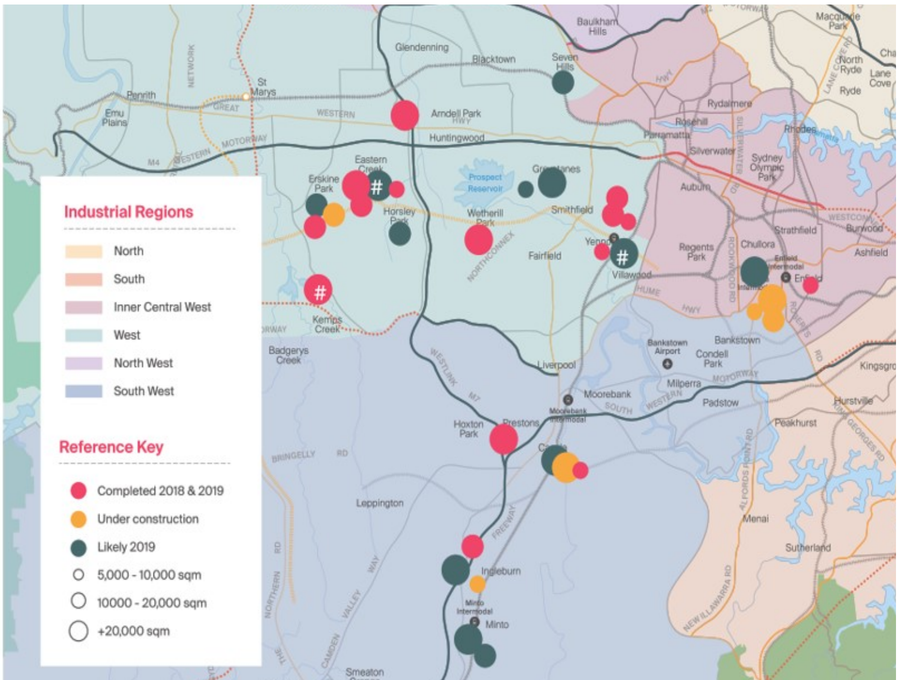
Address	Net Rent	Area (sq m)	Term (yrs)	Tenant	Date Reported
Pre Lease					
34 Yarrunga Street, Prestons	U/D	27,000	15	Intertrading Aust.	May-19
WH1, 386-400 Woodpark Road, Smithfield	U/D	8,020	10	Auto Parts Group	May-19
Bringelly Business Hub	U/D	7,763	12	CEA Group	Feb-19
Existing & Speculative Leases					
Bld 2A, Ingleburn Logistics Estate*	105	10,400	8	BGC	May-19
Bld G1, Regents Park, Industrial Estate	112	17,634	1.5	Lion Beer	Mar-19
2 Tyrone Place, Erskine Park	122.5	21,142	5	Linfox	Jun-19

Source: Knight Frank Research *Speculative lease deal U/D Undisclosed

DEVELOPMENT & LAND VALUES

FIGURE 6

Sydney Recent Industrial Spec Build by Precinct 2017-2019



#multiple sites have been developed on a spec-basis

Source: Knight Frank Research

Land Values & Outlook*

<5,000sqm	$1,374sq m 7.3% YoY	↑
1-5ha	$1,067/sq m 10.7% YoY	↑

Source: Knight Frank Research
*Prices reflect an average across all precincts

Land price growth

The record levels of industrial land value growth experienced between 2016-2018, which saw consistent high double-digit growth across all precincts, has begun to ease as average YoY growth rates drop to single digits. There have still been a number of significant land transactions over the past 12 months, with record prices being achieved that reflect a blended growth rate of between 92-95% on the prices achieved three years ago.

Over the 12 months to July 2019, average industrial land values across Sydney (all precincts blended) have increased 7.3% and 10.7% for small (2,000-5,000 sq m - $1,374/sq m) and medium sized sites (1-5ha - $1,076/sq m) respectively.

Generally, YoY growth has been driven by the North, South and Inner West precincts as parcels of developable land are becoming increasingly scarce and developers seek to landbank these sites for future development.

Land price growth has been the most prominent in South Sydney, increasing by 13.6% and 21.3% YoY for small (2,000-5,000 sq m) and medium sites (1-5ha) respectively.

Spec a developers delight

There has been sharp increase in new industrial development activity recently, underpinned by pre-commitment and spec leasing demand. Owners appear to be focused on delivering new industrial product, with spec projects at the forefront, particularly in the Outer West and South West markets.

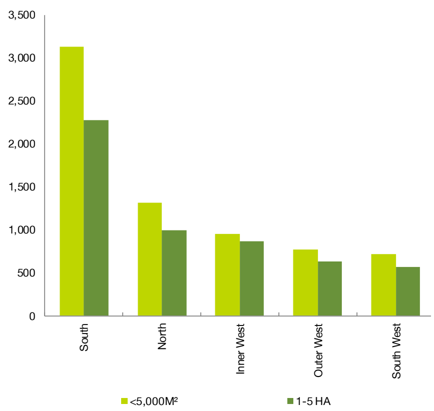
Historically new industrial development in Sydney has been fuelled by the pre-commitment market. Between 2013-2017, 66% of new supply was on the back of pre-commitments and only 20% stemmed from spec developments. Fast forward to 2018-2019 and spec developments account for almost half of all new supply. The average leasing period of around one month prior to completion for spec developments in Sydney suggests that there is strong demand for this type of product.

Institutional investors appear to be actively growing their exposure to logistic -type assets through land acquisition and development. Rapid growth of online retail trade, in conjunction with mounting consumer pressure on logistics providers for services such as same day delivery, is helping to reshape the landscape.

FIGURE 7

Sydney Industrial Land Values

By Precinct ($/m²)



Source: Knight Frank Research

TABLE 2

Land/Development Sales Activity Sydney

Address	Region	Price $ mil	Area Ha	$/m² of site area	Purchaser	Sale Date
25 Holbeche Road, Arndell Park	OW	15.1	2.37	637	APPF*	Jul-19
Lot 107 Clunies Ross Street, Greystanes	OW	24.5	5.08	482	Aliro/ISPT	Jul-19
Manchester Road, Auburn	IW	94.2	14.0	673	Mirvac	Jun-19
Kiora Road, Yennora	OW	49.0	8.8	557	U/D	Mar-19
Turner Road, Gregory Hills	SW	47.1	13.09	360	Stockland	Jan-19

Source: Knight Frank Research * Australian Prime Property Fund (Lendlease Industrial Fund)

INVESTMENT ACTIVITY & YIELDS

Activity Signals Big Demand

On the back of ESR closing its all-cash takeover of PropertyLink assets and GPT's recent acquisition of a five property portfolio, investment volumes in the first seven months of 2019 have reached $1.16 billion, almost 70% of 2018 volumes.

While it has been mostly institutions trading assets to boost their asset allocation to logistics, several large private/ owner occupiers have divested assets, creating further opportunity for active capital to increase their market share.

Yields still compressing

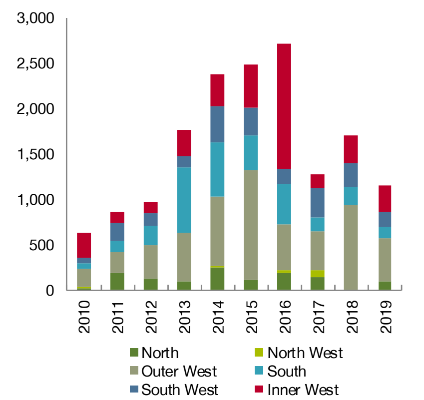
Average Sydney prime yields currently range between 4.50% and 6.75%, reflecting a 30bps of compression over the past 12 months. While the yield compression cycle has been running for some time, there are signs that the rate of compression is beginning to slow, with average compression over the quarter only 8bps.

Most institutions have been upfront about new allocation targets in the sector and this appears to be driving much of the activity of late in both the acquisition of existing assets and of land suitable for industrial development. This will be increasingly topical and likely fuel competition and potentially further prime yield compression moving forward, particularly given the outlook for capital growth in the sector.

FIGURE 8

Sydney Industrial Sales by Region

$10mill+, 12 months to July 2019



Source: Knight Frank Research

Insto's underpin activity

In March 2019, Swiss Re, via AMP Capital, acquired Greenlit Brands' (formerly Steinhoff) distribution centre in Eastern Creek for $90.5 million, on a core market yield of 4.93%. The 36,404 sq m facility, located at 1 Eucalyptus Place, formed part of the Greenlit portfolio that was offered to the market in 2018, however was sold individually on a leaseback arrangement to Best & Less (a subsidiary of Greenlit Brands).

GPT continues to fulfil their strategy to grow their position in the logistics sector through acquisition and development, picking up a three-property portfolio from AMP Capital for $105 million (Villawood, Kingsgrove, Blacktown) and two logistics properties in Erskine Park from a local private for $107 million. Combined, the transaction represents blended passing yield of 5.4%.

Current Yields & Outlook*

Prime	4.50% - 6.75% -30bps YoY	⇩
Secondary	4.75% - 7.25% -36bps YoY	⇩

Source: Knight Frank Research

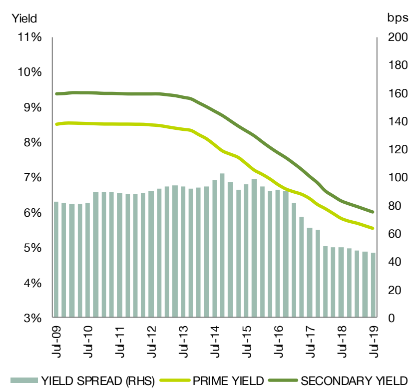
*Prices reflect an average across all precincts

Logos Property has acquired a 15.3-hectare infill site in Villawood from Toll Group with a partial leaseback to Toll over a portion of the site. Logos plans to undertake upgrade works to Toll's existing facilities and has announced plans to redevelop the remaining 11.3 hectares into a logistics and intermodal site on a spec basis.

FIGURE 9

Sydney Industrial Core Market Yields

Prime vs Secondary



Source: Knight Frank Research

TABLE 3

Industrial Sales Activity Sydney

Address	Region	Price $ mil	Bldg Area m²	Core Mkt Yield (%)	Vendor	Purchaser	Sale Date
AMP Capital Three Property Portfolio (Villawood, Blacktown, Kingsgrove)	Various	105.0	U/D	5.57	AMP Capital	GPT	May-19
Portfolio (57-87 and 89-99 Lockwood Road, Erskine Park)	OW	107	U/D	U/D	Fitzpatrick Investments	GPT	May-19
8 Williamson Road, Ingleburn	SW	66.3	34,000	6.07^	CSR Ltd	Fife Capital	Mar-19
1 Eucalyptus Place, Eastern Creek	OW	90.5	36,404	4.93	Eipross Pty Ltd	AMP Capital (Swiss Re)	Mar-19
13 Ferndell Street, South Granville	IW	24.25	15,302	6.37	Centuria	Pipeclay Lawson	Jan-19

Source: Knight Frank Research OW Outer West SW South West IW Inner West N North S South
g refers gross U/D refers undisclosed P/C refers pre-commitment ^ Passing yield

PRECINCT HIGHLIGHTS

Outer West

Vacancy

Prime:	216,696 sq m
Secondary:	34,076 sq m

Land

<5,000 sqm:	$767/sq m
1-5 ha:	$635/sq m

Rents

Prime:	$121/sq m
Secondary:	$103/sq m

Yields

Prime:	5.00% - 6.00%
Secondary:	5.25% - 6.50%

- Outer West vacancy currently represents 60% of total market vacancy.
- Spec stock either completed or due for completion in 2019 totals over 218,000 sq m, this represents 66% of all spec developments.
- Steady prime rental growth of 4.3% over the past 12 months and 2.5% for secondary stock.
- Prime yields have firmed by 23bps over 12 months to average 5.42%.

Address:	1 Eucalyptus Place, Eastern Creek
Price:	$90.5 million
Sale Date:	Feb-19
Vendor:	Epiross Pty Ltd
Purchaser:	AMP Capital
Initial Yield:	4.93%
Comment:	Premium grade 36,404 sq m, warehouse. Sold on 10 year leaseback to Epiross Pty Ltd.

South West

Vacancy

Prime:	70,249 sq m
Secondary:	4,500 sq m

Land

<5,000 sqm:	$720/sq m
1-5 ha:	$570/sq m

Rents

Prime:	$111/sq m
Secondary:	$98/sq m

Yields

Prime:	5.00% - 6.00%
Secondary:	5.75% - 6.50%

- Vacancy has declined by 29% in the 12 months to July 2019.
- By the end of 2019 over 150,000 sq m of new supply will be added to the South West precinct.
- Charter Hall's spec development, stage 2 at 290 Kurrajong Road, is due for completion in Q4 2019 and will add 27,500 sq m.
- Healthy investment volumes have been recorded thus far for 2019 with transactions totalling $163.3 million.

Address:	8 Williamson Road, Ingleburn
Price:	66.3 million
Sale Date:	Mar-19
Vendor:	CSR Ltd
Purchaser:	FIFE Capital
Initial Yield:	6.07%*
Comment:	Warehouse of 34,00 sq m leased to Viridian Glass until 2028. *Initial yield excludes surplus land.

Inner West

Vacancy

Prime:	63,964 sq m
Secondary:	15,973 sq m

Land

<5,000 sqm:	$950/sq m
1-5 ha:	$863/sq m

Rents:

Prime:	$129/sq m
Secondary:	$111/sq m

Yields:

Prime:	5.00% - 6.25%
Secondary:	5.75% - 6.50%

- Vacancy levels are 43% below the historical average; highlighting the strong demand for the precinct.
- Lease deals struck this year total over 79,000 sq m.
- Following demand for prime core assets in the precinct, the yield compression cycle has continued.
- Yields have compressed 33bps over past 12 months to average 5.68%.

Address:	Manchester Road, Auburn
Price:	$94.2 million
Sale Date:	Jun-19
Vendor:	Payce
Purchaser:	Mirvac
Land rate	$673/ sq m
Comment:	14Ha future industrial estate. Largest industrial land sale for the year.

South

Vacancy

Prime:	15,502 sq m
Secondary:	0 sq m
<5,000 sqm:	$3,125/sq m
1-5 ha:	$2,275/sq m
Prime:	$201/sq m
Secondary:	$176/sq m
Prime:	4.50% - 5.00%
Secondary:	5.00% - 5.50%

- South Sydney remains tightly held with vacancy well below historical levels.
- Limited availability has driven rental growth by 8.2% over the last 12 months.
- With parcels of developable land becoming more scarce land prices have increased by 13.6% and 21.3% YoY for small (2,000-5,000 sq m) and medium sites (1-5ha) respectively.

Address:	28B McPherson Street, Banksmeadow
Price:	$60.2 million
Sale Date:	Nov-18
Vendor:	Private
Purchaser:	Charter Hall REIT
Yield:	4.44%
Comment:	Sold with a 14.3 Year WALE to Federal Government (AFP).

North

Vacancy

Prime:	
Secondary:	N/A

Land

<5,000 sqm:	$1,310/sq m
1-5 ha:	$990/sq m

Rents:

Prime:	$198/sq m
Secondary:	$162/sq m

Yields:

Prime:	5.00% - 6.75%
Secondary:	5.50% - 7.25%

- Rental growth of 5.1% and 7.3% was recorded in the prime and secondary markets respectively.
- The precinct is tightly held, with the only major transaction activity coming on the back of the ESR all cash takeover of the PropertyLink portfolio. Part of the takeover included 16 & 22 Rodborough Road, Frenches Forest, along with 7-15 Gundah Road, Mt Kuring-Gai.

Definitions:
Prime: Asset with modern design, good condition & utility with an office component 10-20%. 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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