RESEARCH

Key Facts

Sydney Industrial available space (5,000m²+) declined by 2.2% in the April quarter to 796,156m².

The majority of vacancies comprise prime stock (58.3%). Secondary vacancies are now at their lowest point since the series began.

Gross take-up in the April quarter amounted to 165,941m², the highest result since the July quarter in 2013.

The steady upward trend in leasing deal volumes has continued with the third consecutive quarter of take-up (excl. D&C’s) above the series average. This is resulting in some stabilisation in vacant stock levels after the increase in 2014.

The first quarter of 2015 saw the continuation of steady improvement in leasing volumes being recorded in the Sydney market. Gross absorption (excl D&C’s) for the three months measured 165,941m², which was the third consecutive quarter of above average gross take-up. As a result, vacant stock fell for the first time in 12 months, with available space declining to 796,156m² in the three months to April.

The Outer West recorded the largest decline in available space during the quarter, declining by 42,709m². This was followed by the South region, which reduced by 9,452m², however a number of buildings currently under offer indicates further falls will be recorded in the coming quarter. The volume of imminent/forthcoming vacancies currently being tracked has also fallen, which provides scope for available space to fall again in the second quarter.

Despite the presence of a number of headwinds to the broader economy, the pick-up in leasing volumes is consistent with a number of positive macro drivers supporting industrial demand at a state level. As at February, NSW retail sales and dwelling approvals posted year-on-year growth of 5.6% and 33.9% respectively with both figures outpacing the national average. These conditions are being reflected in business surveys with business conditions in NSW the highest amongst the mainland states.

Nevertheless, it is noted that the headline take-up figures likely overstate the improvement in underlying organic demand to a degree due to a number of leasing deals stemming from larger institutional owners moving tenants amongst portfolio assets. Anecdotal feedback from agents also indicates demand above 5,000m² still remains patchy whereas demand is more consistent for small and medium sized facilities, where the bulk of enquiries currently exist.

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Quality of Stock

The divergent trend being exhibited by prime and secondary vacant stock levels over the past three years continued in the first quarter with prime vacancies recording another rise, while secondary vacancies declined to their lowest level since the time series began in 2011. The proportion of total vacancies constituting prime stock now measures 58.3%, which is a series high.

While this trend is at odds with dynamics in the leasing market, where approximately 60% of leasing deals have comprised prime stock in the past year, it largely reflects the impact of supply. New supply in 2014 added to the Sydney market (5,000m²+) measured 420,572m², which although being 25% below the 10 year average, has still been sufficient to result in a number of A-grade backfill vacancies that organic demand has not been able to absorb.

The amount of speculative stock available for lease declined in the quarter to 58,348m², of which 26,740m² is still under construction. The majority of 5,000m²+ speculative projects are being developed by larger institutions. Although the leasing of such product has been relatively successful, with almost 100,000m² of speculative stock absorbed in the past 12 months, it is noted that a number of leases have stemmed from the shuffling of tenants between portfolio assets of the developer. This trend reflects the drive for consolidation and operational efficiencies that come with the benefits of new facilities in prime locations.

Distribution by Precinct

The only region to record a decline in vacancy over the past 12 months has been the Outer West. This region currently has 293,552m² of vacancies across 23 different buildings, which has resulted in vacancies being 11.8% below the series average. This average size of vacancies measures 12,763m², which is 39.6% larger than the Sydney ex. Outer West average of 9,138m². Of all the larger, 10,000m²+ vacancies throughout Sydney, half are located within the Outer West.

Although the South region has experienced a rise in vacant stock since 2013 following a number of backfill options entering the market and the relocation of tenants from buildings that

### TABLE 1

<table>
<thead>
<tr>
<th>Precinct</th>
<th>Available Space m²</th>
<th>No. of Buildings</th>
<th>Av Asking Rent $/m² net</th>
<th>Change Past Qtr Qm²</th>
<th>Change Past Year m²</th>
<th>Building Quality</th>
<th>Building Quality Secondary %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outer West</td>
<td>293,552</td>
<td>23</td>
<td>107</td>
<td>-42,709</td>
<td>-27,586</td>
<td>Prime %</td>
<td>62.0 [Prime %] 38.0 [Secondary %]</td>
</tr>
<tr>
<td>South West</td>
<td>168,363</td>
<td>21</td>
<td>98</td>
<td>35,222</td>
<td>57,401</td>
<td>Prime %</td>
<td>56.6 [Prime %] 43.4 [Secondary %]</td>
</tr>
<tr>
<td>Inner Central West</td>
<td>184,713</td>
<td>20</td>
<td>117</td>
<td>-957</td>
<td>38,105</td>
<td>Prime %</td>
<td>53.7 [Prime %] 46.3 [Secondary %]</td>
</tr>
<tr>
<td>South</td>
<td>149,529</td>
<td>14</td>
<td>146</td>
<td>-9,452</td>
<td>43,131</td>
<td>Prime %</td>
<td>58.7 [Prime %] 41.3 [Secondary %]</td>
</tr>
<tr>
<td>Total</td>
<td>796,156</td>
<td>78</td>
<td>114</td>
<td>-17,895</td>
<td>111,052</td>
<td>Prime %</td>
<td>58.3 [Prime %] 41.7 [Secondary %]</td>
</tr>
</tbody>
</table>

Source: Knight Frank
record a rise in vacancies in the first quarter with an increase of 35,222m² in available space. However, despite this, quarterly gross take-up has been above average since the middle of 2014 and suggests vacancies should stabilise over the next six months. The region has also been a large beneficiary of low interest rates supporting vacant possession sales to owner occupiers, a trend that is expected to continue.

Tenant migration continues to impact the Inner Central West with vacant stock increasing 38,105m² over the past 12 months to 184,713m². Vacant stock is tending to have relatively long leasing down-time periods with the majority of owners in the region focussed on renewing leasing for existing tenants. However, Industrial rezoning to residential within Inner Sydney industrial markets has helped alleviate the overall impact of modest leasing demand on vacancy levels.

Building Take-up
Gross take-up in the quarter to April amounted to 165,941m², which continued the improvement in leasing volumes over the past 18 months. The structural trend of tenant migration to outer ring locations is being reflected by gross take-up trends amongst the regions with the Outer West region accounting for 54.2% of gross take-up (excl D&C’s) over the past year. While additional deal activity in the region has also been achieved in the pre-lease market, it is noted that limited land supply is expected to start seeing some of the pre-lease demand move into the North West and South West regions in the short to medium term.

Outlook
With factors such as housing construction and the progression of a number of infrastructure/transport projects set to support industrial demand in 2015, the momentum in leasing activity is anticipated to be sustained in coming quarters. Coupled with a number options currently under offer, vacant stock is expected to reduce again in the next quarter, notwithstanding the impact of some potential speculative projects that may be progressed.
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