RESEARCH

SYDNEY
INDUSTRIAL VACANCY OCTOBER 2016

Key Facts

Sydney industrial available space (5,000m^2+) increased by 13.2% in the quarter to October to 540,960m^2.

Gross take-up measured 113,129m^2 during the quarter to October, 21% below the longer term average.

Speculative developments continue to achieve positive leasing results upon or prior to completion, with demand deriving from 3PL, food supply and e-commerce firms.

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Sydney industrial vacancy continued to rise in the three months to October 2016, instigated by a combination of factors including below average take-up and increased backfill vacant space as the next supply cycle commences.

The NSW economy remained Australia's economic powerhouse in 2016. State economic growth has been underpinned by strong population growth, positive retail trade, record dwelling starts and low unemployment. The Gross State Product (GSP) is forecast to grow above the long-run trend rate at circa 3.0% in 2017. However, the State economy is expected to face some short-term challenges with respect to the slowdown in housing construction activity, which has been one of the primary contributors to growth, and the tightening of lending standards.

On the back of these uncertainties and following a sustained period of constrained supply, Sydney industrial vacancy levels have increased in the recent quarter as the market enters the next supply cycle. In the three months to October 2016, the total industrial vacant space (+5,000m^2) across Sydney increased by 13.2% to 540,960m^2. The current vacancy level, however, remains slightly more than 20% below the long-term average of 678,822m^2.

The continued push towards greater operational efficiency is leading to a shift in tenant preferences towards well-located, more modern facilities that offer greater flexibility. In particular, the Outer West, where the bulk of new supply concentrates, sees the strongest level of demand.

Third-party logistics (3PL), food supply and e-commerce firms have been the primary drivers of pent-up demand for speculative construction, particularly for larger buildings which offer more flexible floorspace. Over the past three months, the gross absorption across Sydney totalled 113,129m^2, 15% of which was demand for speculative spaces (up from 11% in the prior quarter).

Despite some short-term downsides, the medium-term outlook for Sydney industrial market remains positive. Demand is expected to strengthen in light of the commencement of major infrastructure projects across Metropolitan Sydney over the coming months. The overall vacancy, however, is expected to increase on the back of increased backfill vacant space.

Quality of Stock

Vacant prime space (5,000m²+) increased by 5.2% over the quarter to 349,530m² (primarily backfill space) as at October 2016. Vacant prime space now represents almost 65% of the total available space across Sydney, reflecting the ongoing trend of cost-conscious tenants favouring secondary over prime premises since the beginning of 2016.

In the secondary market, after dipping to the lowest vacancy level (since the beginning of our series) in July 2016, secondary vacancy has picked up in the three months to October 2016. Rising from a low base, the available amount of secondary space rose by 31.7% over the quarter to reach 191,430m² as at October 2016. However, on a year-over-year basis, secondary vacancy remains 9.8% lower than a year ago.

Despite the relatively high level of availability in the prime market, the average time on the market for prime stock (7.1 months) is 15% lower than that for secondary stock (8.4 months). This is further evidenced by a number of premium speculative developments achieving strong leasing results upon practical completion (PC), such as; DEXUS' E3 Quarry project at Greystanes leased to Hello Fresh (9,500m²) and Frasers' Horsley Dr Business Park project at Wetherill Park leased to Phoenix Transport (8,440m²).

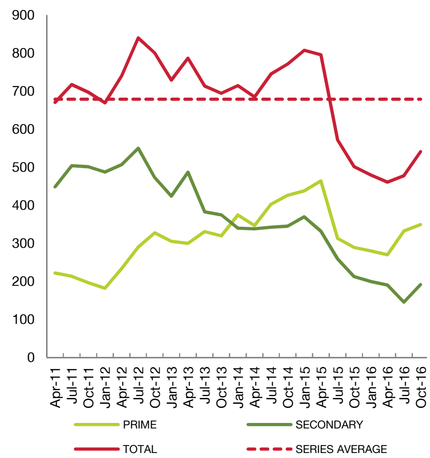
As at October 2016, there is 61,005m² of speculative stock currently vacant or seeking commitment, down 7.2% over the quarter. These include the two major projects of Stockland and Mirvac at 35 Stennett Rd, Ingleburn (28,800m²—completed) and 60 Wallgrove Rd, Eastern Creek (18,970m²—U/C) respectively, plus two smaller developments at 145 Lenore Dr, Erskine Park (7,540m²—U/C), 415 Pembroke Rd, Minto (5,695m²—U/C).

Distribution by Precinct

Vacancy has increased across all precincts with the exception of the South region, due to the ongoing conversion of industrial stock to alternative uses. Accordingly, industrial vacancy in the South fell by 41.2% to 31,257m² in the past quarter. This is the lowest level of vacancy in the South in five years.

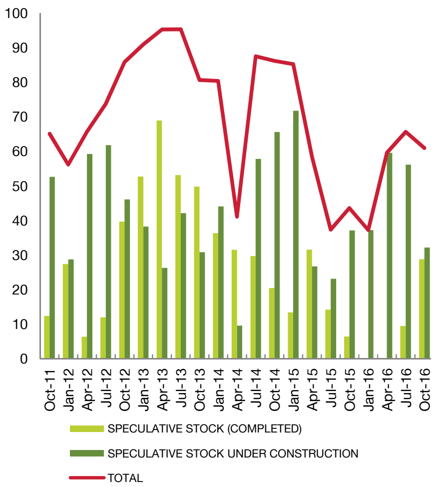
The Outer West experiences the strongest level of vacancy with 244,840m² of vacant stock (primarily secondary) as at October 2016. This represents an increase of 32.6% over the quarter. Significant vacant spaces of above 10,000m² over this period include the ex Hyundai Mobis facility at 495 Victoria St, Wetherill Park (14,081m²), ex Axima space (moving to Charter Hall's 17 Long St) at 17 Jumal Pl, Smithfield (13,444m²), 12,700m² sub-lease space at 67-71 Templar Rd, Erskine Park,

FIGURE 1
Sydney Industrial Market
'000m² available space by quality



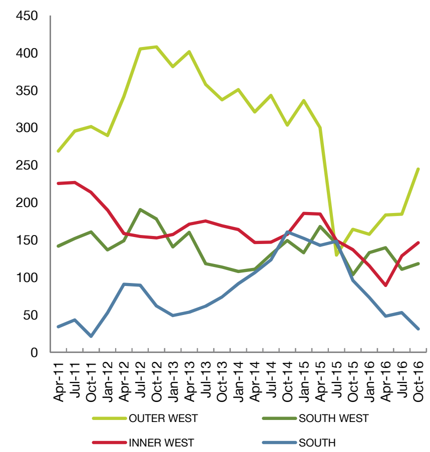
Source: Knight Frank Research

FIGURE 2
Speculative Stock
'000m² - October 2011 to October 2016



Source: Knight Frank Research

FIGURE 3
Location of Vacant Stock
'000m² available space by region



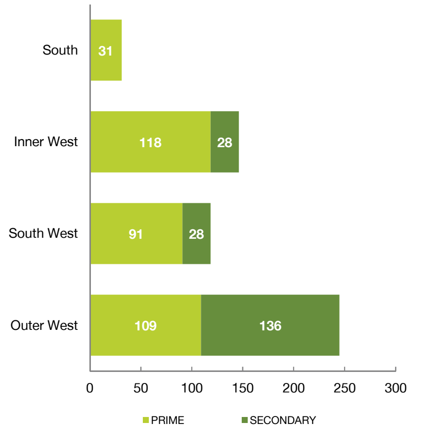
Source: Knight Frank Research

TABLE 1
Sydney Industrial Available Space 5,000m²+ as at October 2016

Precinct	Available Space m²	No. of Buildings	Av Asking Rent $/m² net	Change Past Qtr (m²)	Change Past Year (m²)	Building Quality Prime %	Building Quality Secondary %
Outer West	244,840	21	106	1,226	54,642	45	55
South West	118,522	11	106	-28,760	-34,028	77	23
Inner Central West	146,341	15	111	39,630	-20,408	81	19
South	31,257	4	163	4,961	-95,055	100	0
Total	**540,960**	**51**	**112**	**17,057**	**-94,849**	**65**	**35**

Source: Knight Frank Research

FIGURE 4
October 2016 Available Space
'000m² est. by area and quality



Source: Knight Frank Research

the ex Tyremax space at 8 Penelope Cres, Arndell Park (11,420m^2) and the 10,221m^2 vacancy at Goodman's 209 Walters Rd, Arndell Park.

The amount of vacant space in the Inner Central West increased by 13.5% to 146,341m^2 in the three months to October 2016. 45,460m^2 of new vacant stock has been added to the precinct, deriving entirely from backfill space. The major vacant space over this period was the 12,718m^2 backfill at 4-8 Ferndell St, South Granville.

The South West recorded 118,522m^2 of vacant stock across 12 buildings, 78% of which is from prime vacant space. A major new vacancy this quarter was 10,401m^2 at 6 Farrow Rd, Campbelltown.

Building Take-up

The gross absorption (excl D&C's) has moderated in the three months to October 2016, following a strong period of demand in the July quarter. The total gross take-up declined by 53% to 113,129m^2 as at October 2016, relatively 21% below the long-term average. Prime space accounted for 67% of the total gross take-up over the period. Absorption of speculative spaces measured 17,940m^2 over the quarter, representing 15.8% of the total gross take-up,

By precinct, the Outer West continues to see the strongest level of demand driven by the availability of new space and the strong tenant migration from the other precincts. Demand in the Outer West accounted for more than half (54.4%) of the total gross absorption over the quarter to October 2016 (or 61,547m^2). Major leases in the past quarter include a 12,775m^2 new lease at 5-7 Murtha Street, Arndell Park and a 10,000m^2 deal at 36 Huntingwood Dr, Huntingwood.

In the South region, 26,979m^2 of industrial space has been absorbed over the last three months. The largest leasing deal over the quarter was a 13,500m^2 lease at Goodman's 149 Mitchell Road, Alexandria.

Elsewhere, positive leasing figures were also recorded over the quarter for the Inner West and the South West of 15,893m^2 and 8,710m^2 respectively.

Size & Type of Stock

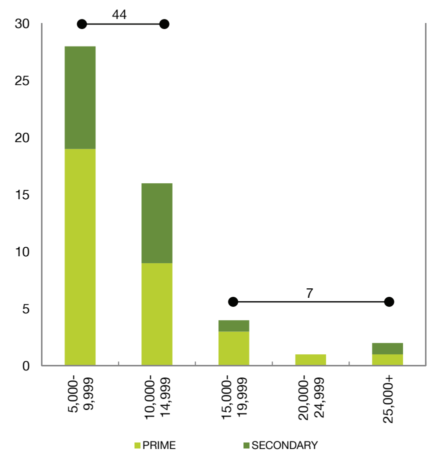
Over the three months to October 2016, the number of vacant industrial buildings increased from 45 to 51 buildings. By size, 55% (28 options) of the total number of vacancies are for sub-10,000m^2 spaces. Available options between 10,000m^2 and 15,000m^2 are across 16 buildings, whilst there are seven vacant buildings of above 15,000m^2, five of which are prime buildings.

Outlook

Whilst leasing conditions are expected to pick up on the back of improved demand from 3PL, food supply and e-commerce firms, the overall vacancy is forecast to continue to trend upward over the next 12 months. A number of factors are contributing to the upward pressure on vacancy over the coming months. The recent collapse of Masters Home Improvement is expected to result in 50,474m^2 of vacancy at their distribution centre at Hoxton Park.

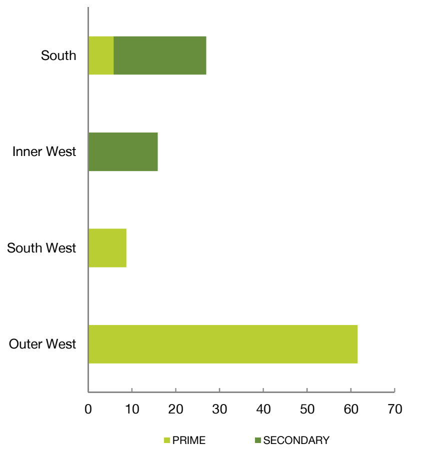
In addition, the completion of a number of speculative developments will result in some backfill supply as a result of tenant migration. Upcoming new developments will include two GPT projects at Eastern Creek Dr, Eastern Creek (26,850m^2) and 18-24 Abbott Rd, Seven Hills (18,000m^2) as well as two buildings Frasers are constructing at Horsley Park (7,915m^2 and 7,250m^2 respectively) on the back of two recent pre-commitments by Nick Scalli and Fantastic Furniture.

FIGURE 5
October 2016 Available Space
No. of buildings by size and quality



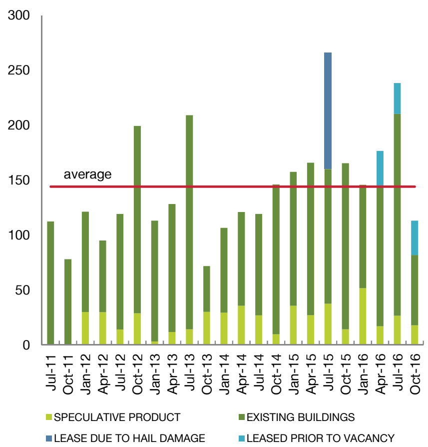
Source: Knight Frank Research

FIGURE 6
Take-up 3 months to October 2016
'000m² est. take-up buildings (excl. D&C)



Source: Knight Frank Research

FIGURE 7
Sydney Industrial Take-up
'000m² take-up buildings 5,000m²+ (excl. D&C)



Source: Knight Frank Research

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Methodology:
This analysis collects and tabulates data detailing vacancies within industrial properties across all of the Sydney Industrial Property Market. The analysis only includes building vacancies which meet the following criteria. 1. The sample data includes buildings with a minimum floor area of 5,000m². 2. Buildings are categorized into the below three types of leasing options. A) Existing Buildings – existing buildings for lease. B) Speculative Buildings – buildings for lease which have been speculatively constructed and although have reached practical completion, still remain vacant. C) Spec. Under Construction – buildings for lease which are being speculatively constructed and will be available for occupation within 12 months.

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