RESEARCH

Knight Frank

PERTH INDUSTRIAL

MARKET OVERVIEW JULY 2018

HIGHLIGHTS

Recent announcements pertaining to resource sector projects and Government expenditure will be hoped to provide a stimulus to the local economy and boost demand for industrial property.

Occupancy and rental rates remain stubbornly low. However, both appear to have stabilised at their current levels, and sentiment in the market has improved over the first half of the year.

Investment demand remains strong from east coast based trusts and funds in particular, driving further yield compression in transactions observed over the past 12 months.

MARKET DRIVERS

Population Growth
Aust: 1.6% WA: 0.8%
CY2017 ABS

Total Employment
Aust: 2.5% WA: 1.5%
Yoy May 18 ABS

Retail Trade
Aust: 2.7% WA: 0.1%
Yoy Apr 18 ABS

Building Activity
Aust: 3.7% WA:-11.6%
CY2017 ABS

Commodity Prices

	Unit Price	Yoy Δ
Iron Ore#	$65.11 per DMT (62%)	13%
LNG#	$9.30 per MMBu	66%
Gold^	$1,670/oz	1%

expressed in USD
^ expressed in AUD

Mineral Exploration
Aust: 23% WA: 19.5%
CY2017 ABS

Mining Capital Expenditure
Aust: -8.6% WA: -16.7%
Yoy Mar 18 ABS

NICHOLAS LOCKE
Research Analyst—Western Australia

ECONOMY & DEMAND

Following a period of reduced mining and related sector investment, a swathe of recently announced projects are hoped to provide a necessary boost to the Western Australian economy, and improve demand for industrial property.

Capital expenditure to return

Over the past 12 months, improving commodity prices have driven growth in metals & mining equities by some 30%, whilst mineral exploration is estimated to have increased by 24.4% for the year to March 2018 according to the ABS.

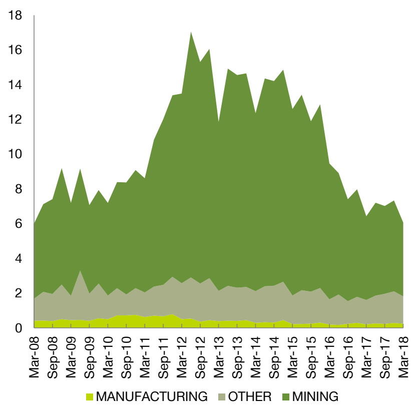
Whilst this has not yet translated to a material increase in capital expenditure in Western Australia, announcements over the first half of 2018 indicate an increase in investment should be expected over coming years into a combination of building new mines, and upgrades to existing mines reaching the end of their life cycle.

In addition to private sector investment, Federal funding contributions have recently been announced for a range of road and rail projects.

This pipeline of expenditure will be to the benefit of contractors and suppliers and increase their requirement for industrial facilities, having a positive impact on demand for space.

More broadly, increased investment will be to the benefit of the greater economy, spurring other drivers to industrial demand such as retail trade (including e-commerce) and residential construction.

FIGURE 1
WA Private Capital Expenditure
$ billion by quarter



Source: Knight Frank Research / ABS

TABLE 1
Major Government and Private Sector Projects Western Australia

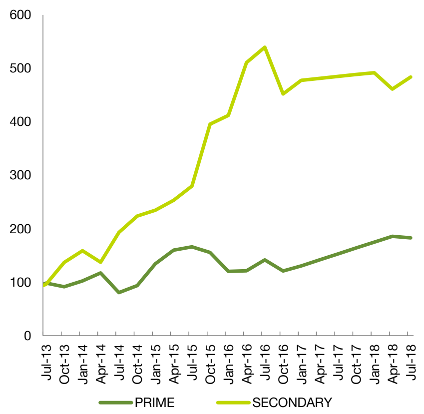
Project	Current Status	Cost#
Northlink WA G	U/C with estimated completion 2019	$1.02 bn
Forrestfield-Airport Rail Link G	U/C with estimated completion 2020	$1.86 bn
METRONET passenger rail projects G	Planning underway for four main projects, estimated to commence 2019.	$2.50 bn
Greenbushes lithium mine plus Kwinana & Kemerton processing plant expansions	Kwinana processing plant upgrade works underway, with final approvals for other expansions due 2018.	$2.00 bn
South Flank iron ore mine (BHP, Mitsui, Itochu)	First construction contracts awarded.	$4.50 bn
Eliwana iron ore mine (FMG)	Approved. Construction due to commence in 2019 and mine operational 2020.	$1.70 bn
Koodaideri iron ore mine (Rio Tinto)	Awaiting final investment decision. Construction estimated to commence 2019.	$3.00 bn
Gorgon LNG Stage 2 (Chevron JV)	Further subsea infrastructure investment confirmed.	$5.10 bn
Pluto LNG expansion (Woodside)	Forecast capital cost to expand onshore and offshore capacity. Final decision likely 2020.	$11.00 bn

Source: Knight Frank Research # estimate G federal/state government

VACANCY & RENTS

Available space remaining stubbornly high

FIGURE 2
Perth Industrial Vacancy
'000m² prime versus secondary available space



Source: Knight Frank Research

Vacancy data collected for the July 2018 quarter reveals total available industrial space of approximately 659,000 sqm across 142 buildings; a modest increase of around 20,000 sqm in comparison to April 2018 figures.

Further findings reveal:

- the number of listings remains reasonably static at an average of 145 per quarter over 2 years, and between 141 and 149 in 2018;
- average days listed increasing from 444 in January, to 482 in July; and
- average space increasing from 4,423 sqm in January, to 4,639 sqm in July.

This provides confirmation to a trend whereby on average the take-up of space has not quite kept pace with the space brought to market in new listings, and turnover of space has been for smaller and more recent listings.

Some specific larger secondary properties are particularly struggling, with those listed for over two years comprising 26% (or 171,000 sqm) of total availability, averaging 6,572 sqm across 36 properties. The balance of vacant buildings average 4,203 sqm in size in comparison.

Rents stabilising on average but performance is varying across markets

On average, face rents remain in slight decline, however it should be noted that this is dependent on the sub-market in question with regards to the type of facility and its quality, size, configuration, and location.

For example, there is currently a lack of supply for high quality workshops. Tenants with specific requirements do not have the ability to relocate in order to secure better terms. Conversely, the true decline of rents in larger secondary warehouse facilities is difficult to measure, as there is a lack of tenants with such requirements.

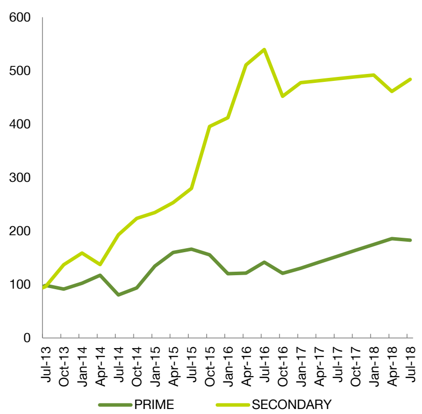
Rents, Incentives & Outlook

Prime	$81/sqm -4.4% yoy 10.7% incentive
Secondary	$64/sqm -1.1% yoy 10.7% incentive

The key driver to the decline in rents for prime facilities is the motivation in securing a high quality new or sitting tenant. A reduced rental rate is preferable to extended void periods and leasing campaigns, and keeps the preferred tenants within the landlords' control.

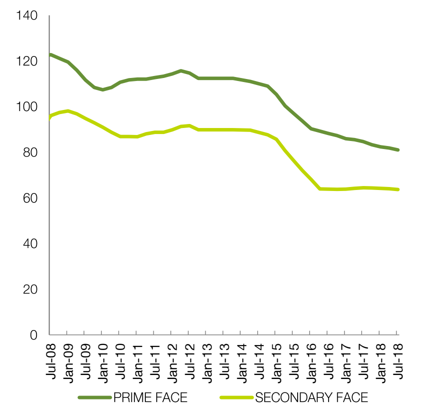
Prominent local private owners have held land within core locations for long periods of time and are not as highly leveraged, allowing them to compete with institutions at these reduced levels.

FIGURE 3
Perth Industrial Vacancy
Number of buildings by size and grade



Source: Knight Frank Research

FIGURE 4
Perth Industrial Rents
$/sqm prime versus secondary net face rents



Source: Knight Frank Research

TABLE 2
Recent Leasing Activity Perth

Address	Corridor	Area	Tenant	Date
6 Enterprise Court, Canning Vale	South	3,314	Auzparts	Jul 18
841 Abernethy Road, Forrestfield	East	14,379	CTI Logistics	Jun 18
38B Bannister Road, Canning Vale	South	5,947	KTI Logistics	Jun 18
41 Hope Valley Road, Naval Base	South	3,300	Government	Jun 18
535-537 Abernethy Road, Kewdale	East	6,278	Australia Post	May 18

Source: Knight Frank Research

DEVELOPMENT & LAND VALUES

Land Values & Outlook

<5,000sqm	$324/sqm -6.1% yoy	
1-5ha	$219/sqm -7.1% yoy	

Strength from proximity to core precincts

The take-up of larger sized lots within the eastern corridor has continued, with recent 2-4 ha sales within Forrestfield and Kenwick selling in the range of $175-$200/sqm to local developers. These establishing areas, in addition to High Wycombe and Hazelmere, benefit from good transport access, and proximity to the established core Kewdale/Welshpool precinct.

Despite elevated building vacancy, the lack of supply for quality stock for logistics companies in particular has allowed for some design-and-construct activity. However, lower rents achieved for such developments have been a constraint on land values.

Infill developments supplying smaller lots to the market throughout Canning Vale, Bassendean, and Gnangara have sold well and are reducing in supply within their current stages, with limited further releases to come. Land values within these areas have declined with the overall market, but are performing comparatively better.

Peripheral weakness

For all sizes of lots in outer precincts such as Neerabup, Forrestdale, and Hope Valley, demand remains weak despite a lower price point.

Additional transport costs incurred by operating from these locations is considered to be a strong factor in their performance, and future growth may rely on expansion of the surrounding urban population and demand for associated services required.

These precincts have been master-planned with longer term horizons.

INVESTMENT ACTIVITY & YIELDS

Strong demand and limited high quality opportunities driving yield compression

Investment demand has remained strong across all price points into the first half of 2018, particularly for modern facilities subject to strong lease terms.

Limited investment transactions have occurred due to a lack of availability, with the Perth industrial market being dominated by several large private developers that are generally reluctant to sell due to high capital gains tax, transaction costs, and limited alternative investment options.

Notwithstanding the above, private investor or developer vendors comprise 46% of the $305 million of transactions for properties over $5 million in the past 12 months, due in part to the strong compression in yields that has emerged.

Solid fundamentals drawing east coast interest

Higher value industrial assets put to the market are experiencing strong enquiry from east coast-based syndicators and trusts.

Yields are still considered favourable, and the resetting and stabilisation of rents and incentives over the past 18 months provides sound investment fundamentals, in addition to speculation of an improving broader economy that may drive future rental growth.

With positive signs for the Western Australian economy, it is likely that yields will experience further tightening.

Current Yields & Outlook

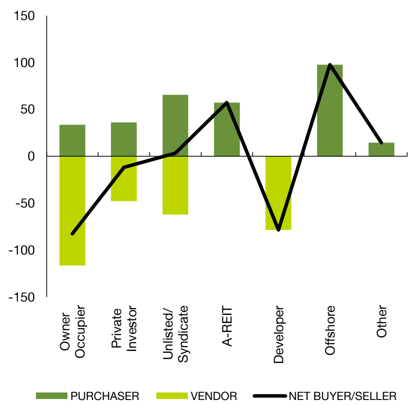
Prime	6.98% - 7.42% -30bps 12mths	↓
Secondary	7.35% - 8.57% -66bps 12 mths	↘

Properties at lower price points have equally experienced yield compression, with increased investment demand from self-managed superannuation funds.

FIGURE 5

Perth Vendor/Purchaser

$ million sales, $5 million+ 12 mths to July 2018

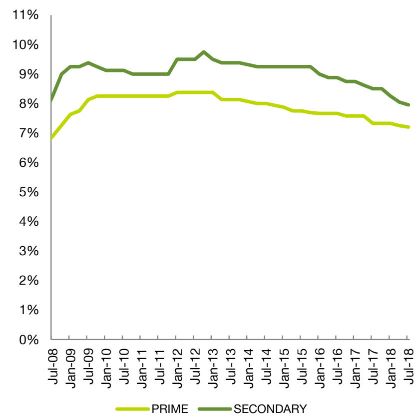


Source: Knight Frank Research

FIGURE 6

Perth Region Average Yields

Prime v secondary core market (2007—2018)



Source: Knight Frank Research

TABLE 3

Recent Investment Sales Activity Perth

Address	Corridor	Price $ mil	Bldg Area m²	Core Mkt Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
100 Chisholm Crescent Kewdale	East	14.50	8425	7.00^	8.0	Unlisted Syndicate / Fund	City of Subiaco	Jun 18
15 Ashby Close, Forrestfield	East	20.50	9,266	5.88	6.1	Locally-based Private Investor	Locally-based Unlisted Syndicate / Fund	Apr 18
5 Ryelane Street, Maddington	East	5.15	3,454	7.00	8.2	Locally-based Private Investor	Locally-based Private Investor	Mar 18
15 Modal Crescent, Canning Vale#+	South	13.20	9,619	7.10	12.0	Owner Occupier	Locally-based Unlisted Syndicate / Fund	Sep 17
13 Modal Crescent, Canning Vale	South	10.20	5,477	7.00	3.2	Locally-based Unlisted Syndicate / Fund	Nationally-based Unlisted Syndicate / Fund	Aug 17
92 Robinson Avenue, Belmont	East	11.20	7,124	7.45	3.9	Locally-based Unlisted Syndicate / Fund	A-REIT	Aug 17
23 Destiny Way, Wangara+	North	15.10	4,032	6.28	7.0	Locally-based Private Investor / Developer	Locally-based Unlisted Syndicate / Fund	Aug 17
Lots 6 & 7 Hugh Edwards Drive, Perth Airport	East	46.00	31,896	7.25	6.4	Locally-based Private Investor / Developer	A-REIT	Jul 17

Source: Knight Frank Research # vendor leaseback ^ passing yield + part of portfolio sale

PRECINCT HIGHLIGHTS

Northern Corridor

Vacancy

Prime:	17,543 sqm
Secondary:	60,082 sqm

Land

<5,000 sqm:	$361/sqm
1-5 ha:	$217/sqm

Rents:

Prime:	$88/sqm
Secondary:	$68/sqm

Yields:

Prime:	6.96% - 7.46%
Secondary:	7.35% - 8.50%

- The best performing precinct by virtue of a higher proportion of modern stock, and well-located core precincts servicing strong residential catchments.
- The previous success of smaller unit developments has lead to an undersupply of prime premises above 2,000 square metres.
- Occupancy and rental levels have arrested their decline and stabilised at higher levels in comparison to other precincts.

"An undersupply of prime facilities larger than 2,000 square metres, along with a lack of demand for more common smaller premises, is creating the unconventional situation of higher rental levels being achieved for larger premises in the northern corridor"

Sam Hammond
Sales & Leasing Executive WA

Case Study

Address:	42 Truganina Road, Malaga
Price:	$4.20 million
Sale Date:	March 2018
Purchaser:	Owner occupier
GLA:	3,059 sqm
Rate:	$1,373/sqm
Comment:	Corner site improved with clear span workshops, and concrete laydown areas.

Southern Corridor

Vacancy

Prime:	102,977 sqm
Secondary:	210,836 sqm

Land

<5,000 sqm:	$272/sqm
1-5 ha:	$204/sqm

Rents:

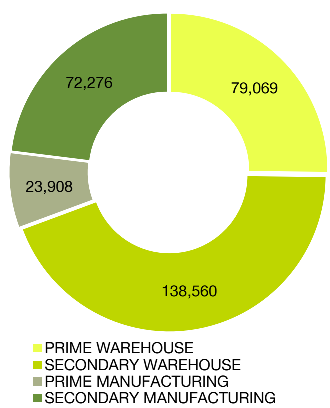
Prime:	$79/sqm
Secondary:	$59/sqm

Yields:

Prime:	5.75% - 6.25%
Secondary:	6.45% - 8.00%

- Total available space in the southern corridor of 313,813 sqm comprises 48% of the total market.
- Turnover of stock is also slow, with each listing averaging 592 days on the market.
- Secondary warehouse facilities dominate the market, with many no longer considered to be "fit for use" for many occupiers, or located at the periphery of the precinct where higher transport costs are incurred.

FIGURE 7
Southern Vacancy Composition
sqm m by building type and grade



Source: Knight Frank Research

Eastern Corridor

Vacancy

Prime:	62,309 sqm
Secondary:	212,772 sqm

Land

<5,000 sqm:	$339/sqm
1-5 ha:	$235/sqm

Rents:

Prime:	$77/sqm
Secondary:	$64/sqm

Yields:

Prime:	6.89% - 7.39%
Secondary:	7.31% - 8.53%

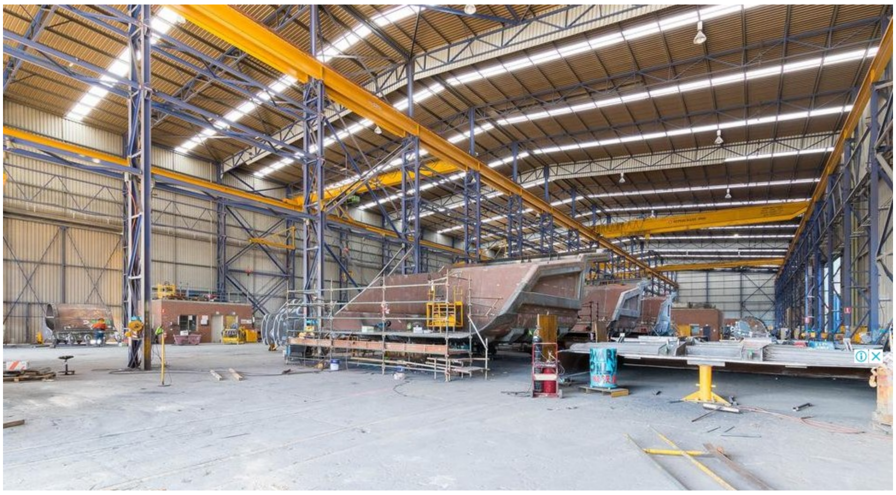
- Preferred location for many occupiers, however comprises a high proportion of secondary stock, impacting upon rental levels.
- Larger landholdings in developing precincts such as Hazelmere, Forrestfield/High Wycombe and Kenwick/Maddington have held up in value in comparison to fringe northern and southern locations.
- Commands the tightest yields due to strong locational attributes and high quality tenants.

"An improvement in market confidence, take-up, and anticipated sustained demand for prime facilities larger than 2,000 square metres will soon place upward pressure on rents for better quality stock"

Jarrad Grierson
Partner—Head of Industrial WA

Case Study

Address:	100 Chisholm Crescent, Kewdale
Price:	$14.50 million
Sale Date:	July 2018
Vendor:	Private Investor
Purchaser:	City of Subiaco
Yield:	6.99%
Comment:	Significant manufacturing improvements subject to long term lease.



RESEARCH

Nicholas Locke
Research Analyst, WA
+61 8 9225 2429
Nicholas.Locke@au.knightfrank.com

Ben Burston
Partner,
Head of Research & Consulting
+61 2 9036 6756
Ben.Burston@au.knightfrank.com

INDUSTRIAL

Jarrad Grierson
Partner, Head of Division—Industrial
+61 8 9225 2411
Jarrad.Grierson@au.knightfrank.com

Scott Bailey
Associate Director
+61 8 9225 2421
Scott.Bailey@au.knightfrank.com

Geoff Thomson
Associate Director
+61 8 9225 2436
Geoff.Thomson@au.knightfrank.com

Sam Hammond
Sales & Leasing Executive
+61 8 9225 2471
Sam.Hammond@au.knightfrank.com

VALUATIONS

David Lang
Director
+61 8 9225 2525
David.Lang@au.knightfrank.com

Definitions:
Core Market Yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).
Prime Grade: Asset with modern design, good condition & utility.
Secondary Grade: Asset with an older design or less functional design, in reasonable/poor condition, and inferior to prime stock.
WALE: Weighted Average Lease Expiry

Vacancy Methodology:
This analysis collects and tabulates data detailing vacancies (2,000m²+) within industrial precincts across the Perth Metropolitan Area.

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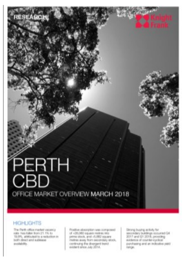

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