Sydney rental growth continues to moderate and yields stabilise

1.1%	▼ c.87,000 sqm	▲ c.124,000 sqm	▶ 5.3%
NSW annual population growth FY24-33[1]	New industrial supply 1Q24	Gross take-up 1Q24	Super prime midpoint yield

Note: Arrows indicate change from previous quarter.

Key Points

- Gross take-up over the quarter increased significantly compared to 4Q23, totalling circa 124,000 sqm over 1Q24. The Transport, Postal & Warehousing dominated total floorspace leased (55%).
- Average vacancy remains low at 0.5% (as at 2H23).
- Development supply was subdued this quarter, with 87,000 sqm in new floorspace added.
- Positive rental growth continues although at a slowing pace. Super prime net face rents recorded an average y-o-y growth rate of 14%.
- Average land values for all lot sizes have decreased with ‘infill’ precincts showing the most resilience.
- A total of AUD 260 million of investment sales has been recorded in 1Q24, across 11 transactions (for sales ≥ AUD 5 million).
- Super prime and prime midpoint yields have remained stable at 5.33% and 5.50%, respectively.

1. Deloitte Access Economics.
Source: CBRE Research Q1 2024

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Demand

Leasing activity sees uplift over 1Q24

Gross take-up doubled in 1Q24 compared to the previous quarter (c.62,000 sqm in 4Q23), totalling c.124,000 sqm. The increase in take-up comes off the back of a slow end to 2023 leasing volumes coupled with a pickup in pre-lease deals.

Notable lease transactions in 1Q24:

- A pre-lease by CTDI in Sydney's Outer North West
- A pre-lease by DB Schenker in the Outer North West
- A pre-lease by Bisley Workwear in the Outer North West

Pre-lease transactions made-up just over 70% of total floorspace leased over the quarter - this compares to 44% in CY2023. We expect the share of pre-lease transactions to remain relatively elevated throughout 2024 due to the wave of new development supply entering the market over 2024 and 2025.

We forecast that take-up levels over CY2024 will surpass the 10-year annual average of c.920,000 sqm as occupiers have more choice in the market due to the wave of new supply and sub-lease space available.

The concentration of lease transactions over the quarter occurred within the Outer North West precinct, accounting for 64% of total take-up (by floorspace), followed by the Outer South West (25%).

The wave of new supply expected has provided tenants with optionality, with some opting to look outwards for cheaper rents or increased functionality and scale. There was only one sub-lease transaction greater than 5,000 sqm over the quarter.

Transport, Postal and Warehousing dominates leasing over the quarter

Occupiers within the Transport, Postal and Warehousing sector dominated lease activity over the quarter - accounting for 55% of the total floorspace leased. Manufacturing occupiers accounted for 24% of floorspace take-up.

FIGURE 1: Sydney gross take-up 2014-2024YTD, by precinct

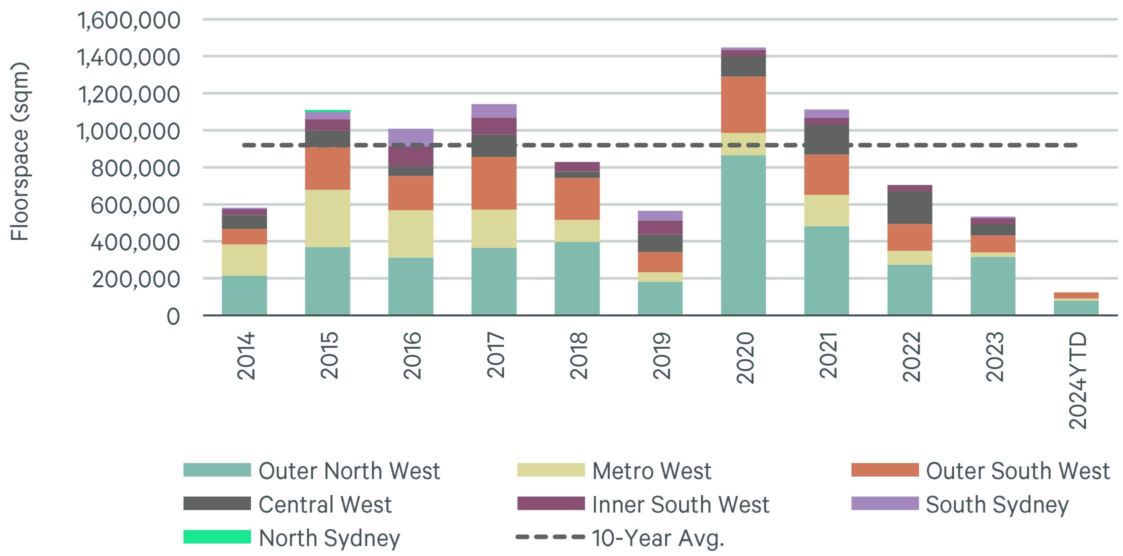
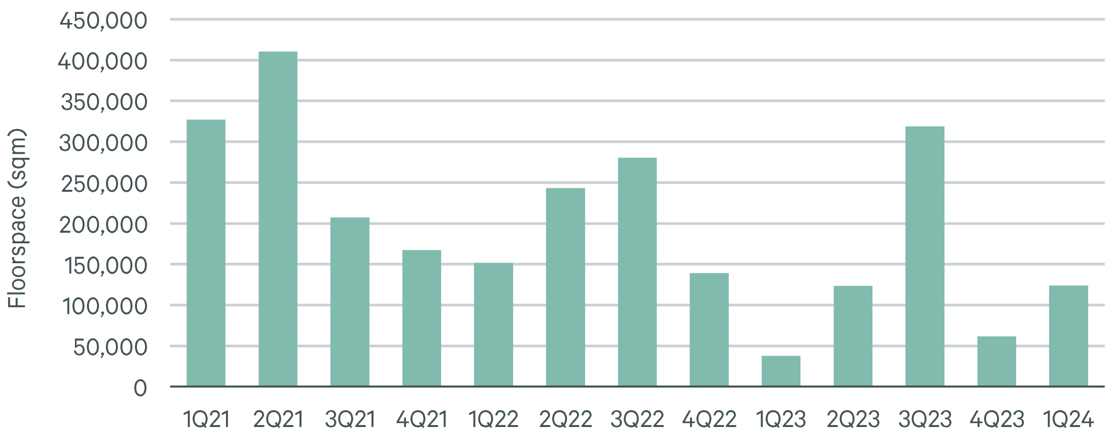


FIGURE 2: Sydney quarterly gross take-up, 1Q21-1Q24



To note: Reflects leasing transactions >5,000 sqm.
Source: CBRE Research Q1 2024

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Supply

Almost half of 2024 and 2025 supply pipeline is pre-committed

New floorspace added to the market over the quarter totalled only c.87,000 sqm, which is significantly below the 2023 quarterly average of c.252,000 sqm. We forecast the bulk of new supply for the 2024 pipeline to be delivered in 3Q24.

Major projects that reached practical completion in 1Q24 included Winnings Appliances Warehouse on the Aspect Industrial Estate, 804-882 Mamre Road (66,600 sqm) and 1 Nancy Ellis Leebold Drive, Bankstown Airport (8,807 sqm).

The CY2024 supply pipeline is expected to total c.1,144,000 sqm, which is double the long-run average (566,000 sqm). Currently, c.957,000 sqm (or c.84% of CY2024 supply) is under construction.

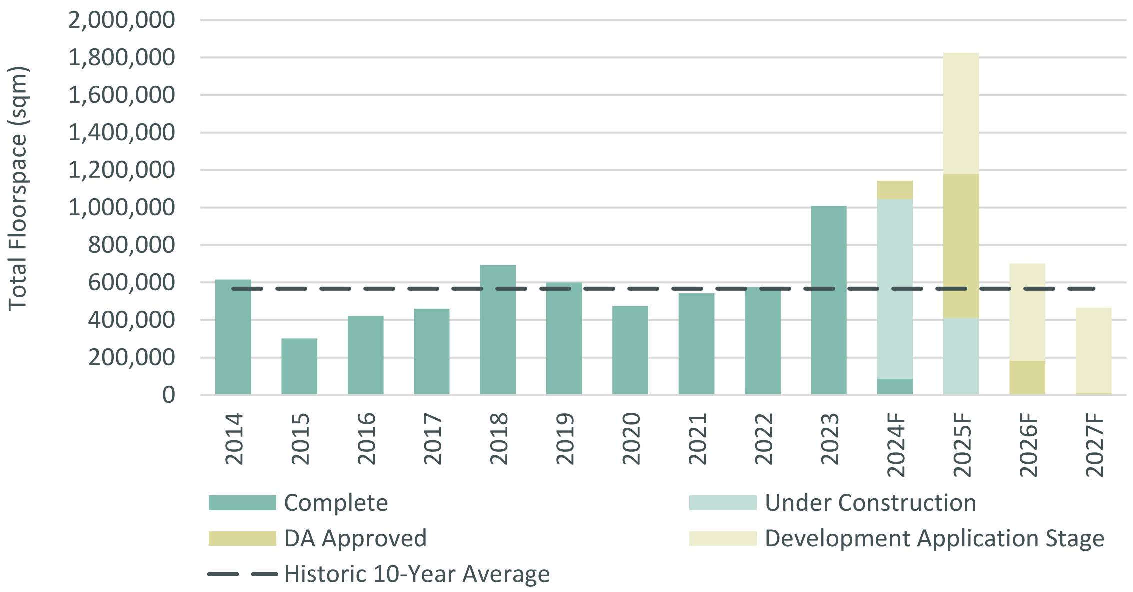
Around c.290,000 sqm of space is expected to be added to the market next quarter. Major projects to complete next quarter include:

- Connect Estate, 2 Christina Road, Villawood (c.69,150 sqm)
- The Yards, Warehouse 13, Kemps Creek (c.31,680 sqm)
- The Yards, Warehouse 2, Kemps Creek (c.30,320 sqm).

The pre-commitment level for the 2024 pipeline is strong with around two-thirds of the new supply committed. The 2025 pipeline is expected to reach a record high of c. 1.8 million sqm, however it is important to note that c.76% of this is still in DA stage. Despite the total supply in 2025 expected to reach double the long-run average, as at 1Q24 the pre-commitment rate stands at just over 30%.

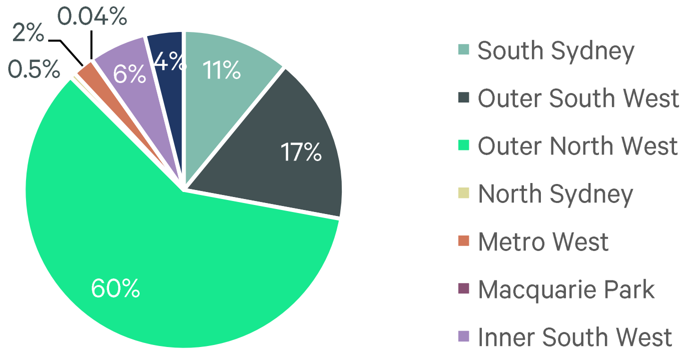
The Outer North West precinct is forecast to account for 60% of all new developments between 2024 and 2026.

FIGURE 3: Sydney development supply pipeline 2014-2027F



To note: Reflects new projects >5,000 sqm.
Source: CBRE Research Q1 2024

FIGURE 4: Development supply 2024F-2026F floorspace share, by precinct



To note: Reflects new projects >5,000 sqm.
Source: CBRE Research Q1 2024

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Leasing Market

Rental growth continues to moderate over the quarter

Sydney average super prime and prime rents increased by 1.6% and 1.5% (q-o-q), respectively. This shows that growth has continued, albeit at a decreasing rate. In the Outer South West precinct super prime rents recorded the strongest growth over the quarter of 4.4% (q-o-q). This precinct has recently attracted greater demand from occupiers located within Inner Sydney precincts that are in search for relatively lower rents with respect to infill rental levels.

The Sydney vacancy rate of 0.5% (as at 2H23) continues to support positive rental growth as occupiers have minimal options to attain the floorspace and fit out that suits their needs. New developments continue to be readily absorbed by tenants looking for scale and functionality. Average secondary face rents recorded marginal negative growth of -0.2%, highlighting the occupier shift to more modern warehouses, especially as new developments come closer to P.C.

Sydney net effective rents decreased marginally across all asset grades as incentives increased over 1Q24. Average super prime, prime and secondary grade incentives increased by 2% and now average 12%, 14% and 14%, respectively. There are signs of some pressure on landlords, both institutional and private, to attract and secure occupiers as greater optionality is present in the market. We expect incentive levels to further rise over 2024 across all asset grades as greater space options become available - both new floorspace as well as sub-lease space.

Despite the expectation that vacancy levels will rise throughout the year, thus leading to marginal rent growth for the balance of 2024, strong pre-lease rates are expected to keep vacancy levels at sub-4% for the Sydney market in 2024.

On a year-on-year basis, Sydney super prime average net face rents increased by 14%. Prime and secondary rents grew by 7% and 2%, respectively.

Source: CBRE Research Q1 2024

FIGURE 5: Average Sydney Net Face Rent Growth y-o-y, by Asset Grade (2014-2024)

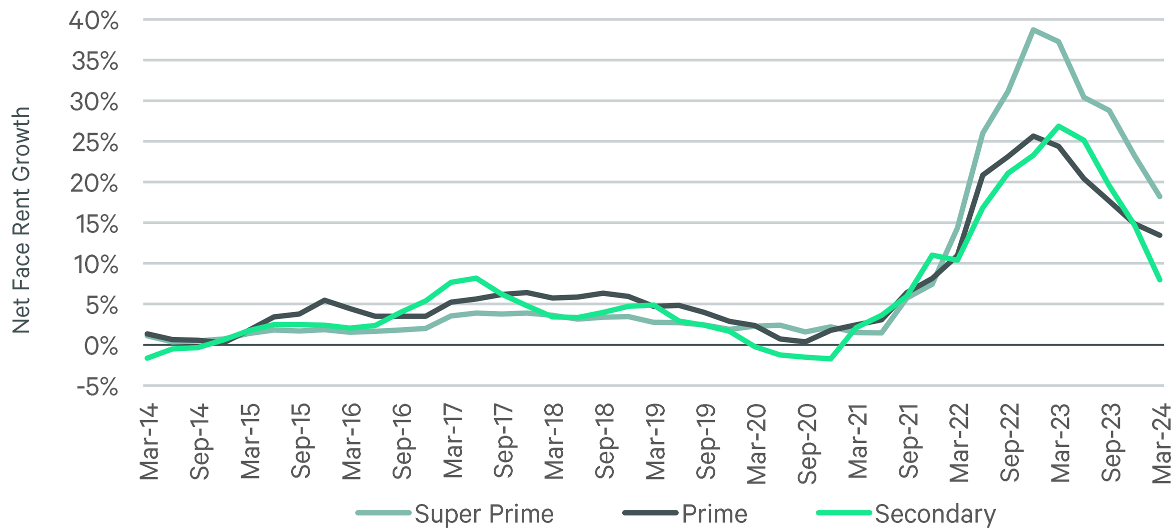
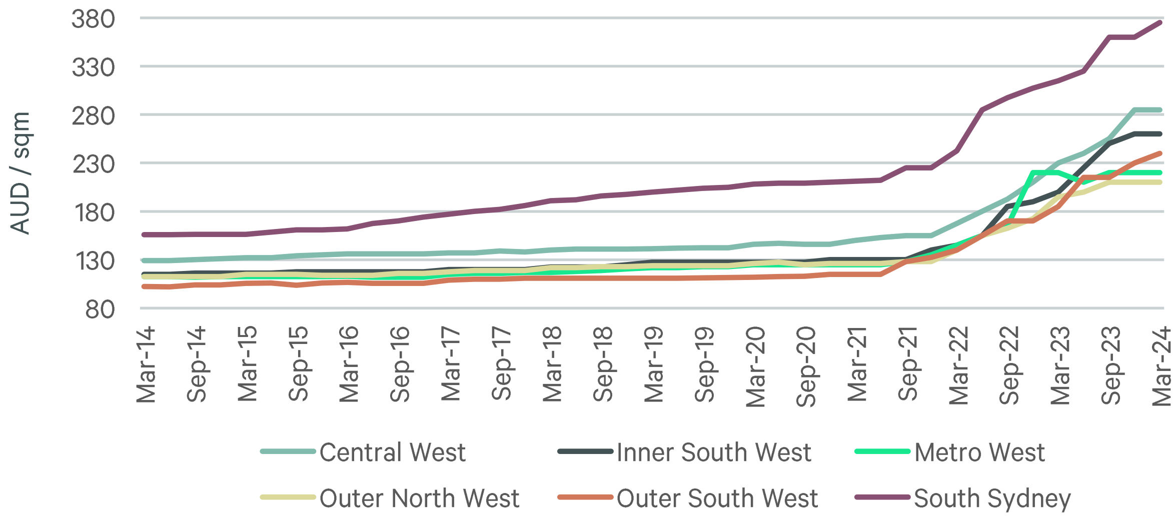


FIGURE 6: Average Super Prime Net Face Rents, by Precinct (2014-2024)



Source: CBRE Research Q1 2024

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Land Values

Land values decline over the quarter despite resilience from 'infill' precincts

Demand for all lot sizes of industrial zoned land in Sydney decreased on a y-o-y basis. Average land values for 3-5 ha lots decreased by -2.2% (y-o-y). Over the quarter, a marginal decline in land values for 1.6 ha and 0.25 ha lot sizes was also recorded of -2.1% and -1.8%, respectively. Whilst the cost of capital remains high and institutions remain uncertain about the timing of an interest rate reversal, investment feasibility in land is expected to remain muted.

Land values over 1Q24 also decreased across the board and recorded movements of -2.4%, -1.7% and -1.8% for 0.25 ha, 1.6 ha and 3-5 ha lots, respectively. This decline reflects the slowdown in developer interest to build on new parcels of land - a result of impeding high construction costs and increasing land taxes. Signs of a reversal from peak land values was confirmed last quarter with persistently high interest rates creating inertia for protentional investors.

The Outer North West precinct recorded the only positive quarterly growth of 2.1% for larger 3-5 ha lots. The Precinct has the largest amount of undeveloped land supply (2,054 ha) is Sydney, however only 10% of this is serviced. Land values in the Outer North West currently average AUD1,325 per sqm for 1.6 ha lots, which is 39% below the Sydney average. Due to the relatively more affordable land rates in this precinct, coupled with the higher share of developed stock (mass of industrial activity), there has historically been greater land sales. This is validated by the ISPT and UniSuper JV landmark acquisition of the 280 ha Burra Park Development Site in Badgerys Creek for AUD 860 million, which transacted over the quarter.

Average land values in South Sydney, North Sydney and the Metro West proved to be the most resilient over 1Q24, as land values across all lot sizes remained stable. These inner precincts are the most land constrained precincts in Sydney, which supports stability in pricing due to scarcity. The "infill" status and proximity to the CBD and Kingsford Smith Airport continues to support medium-term land value appreciation for inner precincts such as North and South Sydney. Currently, land values in these precincts are more than double the average land values of Outer Western precincts.

Source: CBRE Research Q1 2024

FIGURE 7: Average Land Values (0.25 ha lots), by precinct (1Q23 vs. 1Q24)

FIGURE 8: Average Land Values (1.6 ha lots), by precinct (1Q23 vs. 1Q24)

Source: CBRE Research Q1 2024

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Investment Market

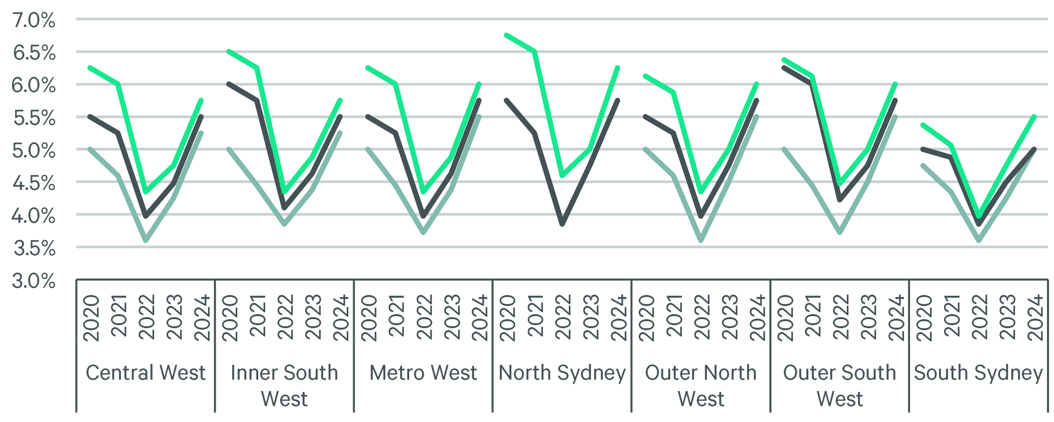
Investment sales volume slowed in 1Q24

A total of AUD 260 million of investment sales for income-producing assets was recorded in 1Q24 across 11 transactions (for sales ≥ AUD 5 million). The largest investment transaction was 77 Governor Macquarie Drive, Chipping Norton, acquired by Partners Group and Realterm Global JV for AUD 62 million. Other notable transactions include 488-494 Victoria Street, Wetherill Park acquired for AUD 45 million and 33A Shaddock Avenue, Villawood, for AUD 27.5 million.

Total investment sales activity was significantly lower in 1Q24 (65% below) compared to the 2023 quarterly average of AUD 741 million. However, we expect to see greater investment sale activity over 2H23 as interest rate cuts commence and the cost of debt becomes cheaper.

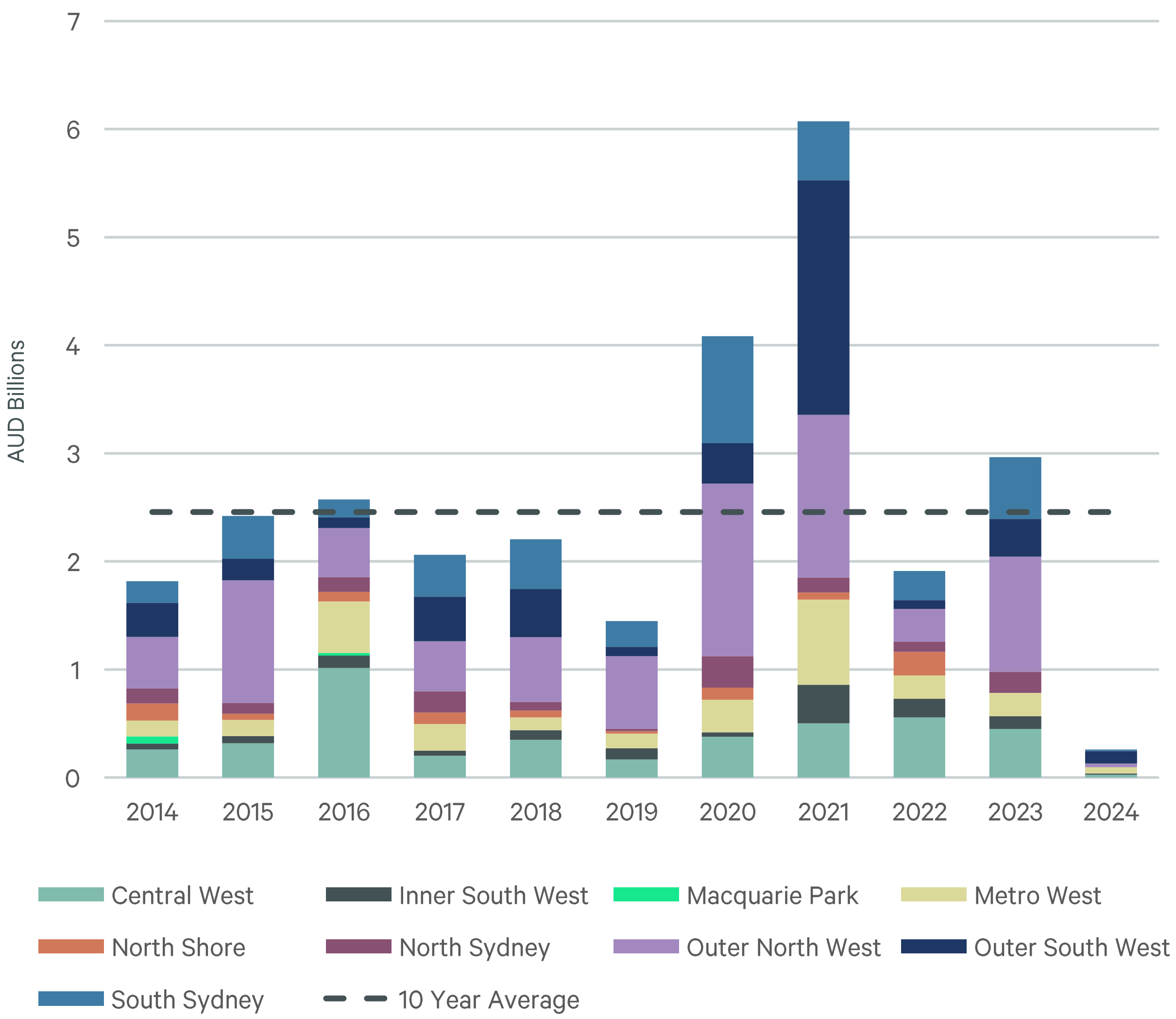
The expectation that further rental growth will eventuate in the market over the next 12 months is an attractive thematic for investors looking to deploy capital in the Australian market. Although we expect yields may further expand over the next 3-6 months by up to 25bps, yields are already showing signs of stabilising. Midpoint yields over the quarter remained stable across all asset grades. Super prime and prime grade asset midpoint yields currently sit at 5.33% and 5.50%, respectively.

FIGURE 9: Midpoint Yields 1Q20-1Q24, by Precinct



Source: CBRE Research Q1 2024

FIGURE 10: Sydney Industrial Investment Sales (greater than AUD 5 million)



To note: Does not include land/development sales.
Source: CBRE Research Q1 2024.

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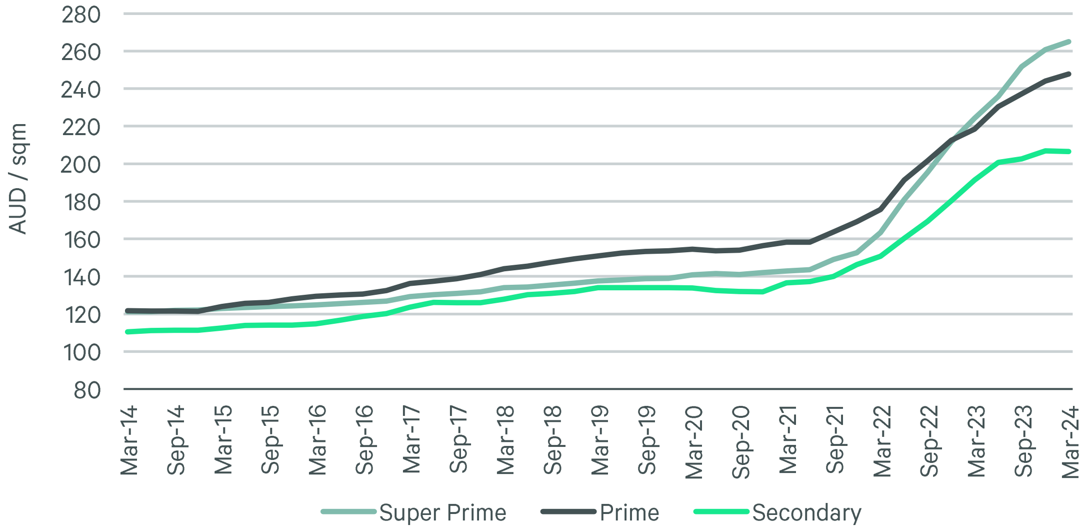
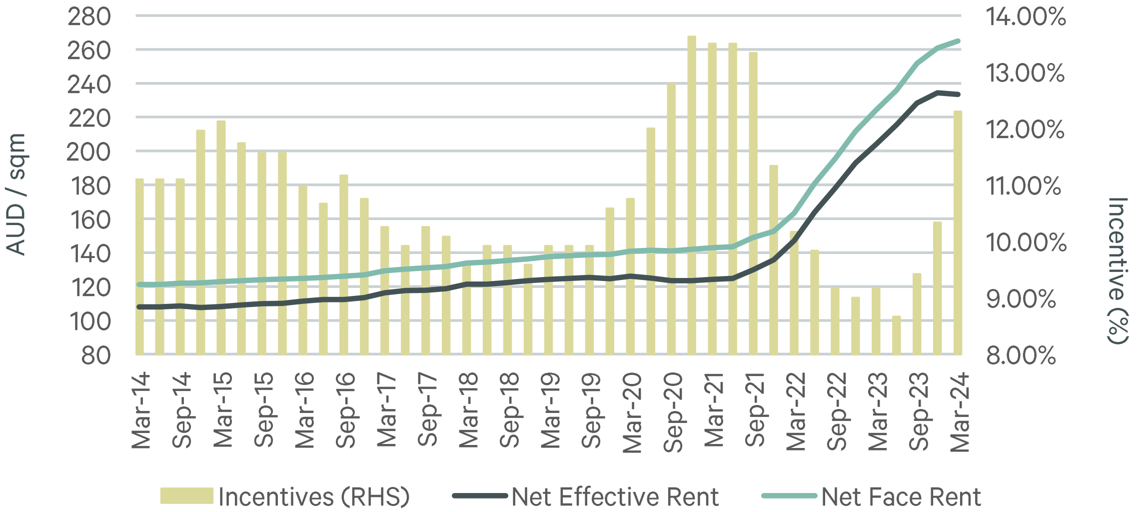
FIGURE 11: Average Sydney Net Face Rents, by Asset Grade (2014-2024)



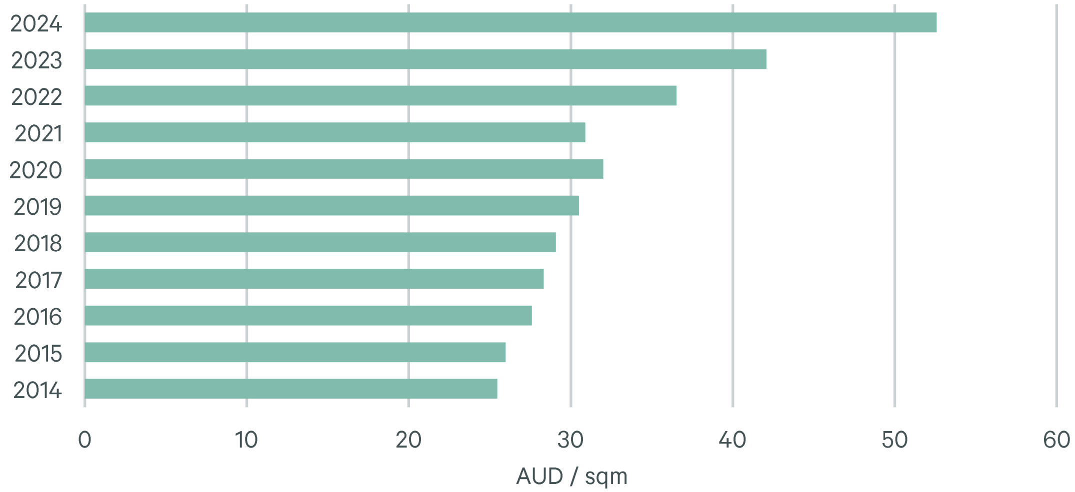
Source: CBRE Research Q1 2024

FIGURE 13: Average Sydney Super Prime Rents and Incentives (2014-2024)



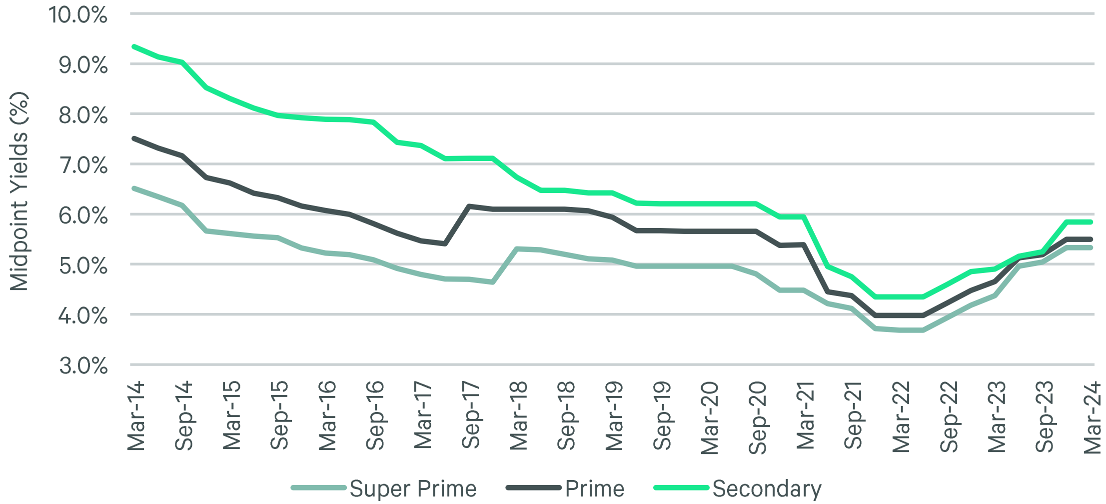
Source: CBRE Research Q1 2024

FIGURE 12: Average Sydney Historical Outgoings, 2014-2024 (excludes Strata and Hi-Tech)



Source: CBRE Research Q1 2024

FIGURE 14: Midpoint Sydney Yields, by asset grade (2014-2024)



Source: CBRE Research Q1 2024

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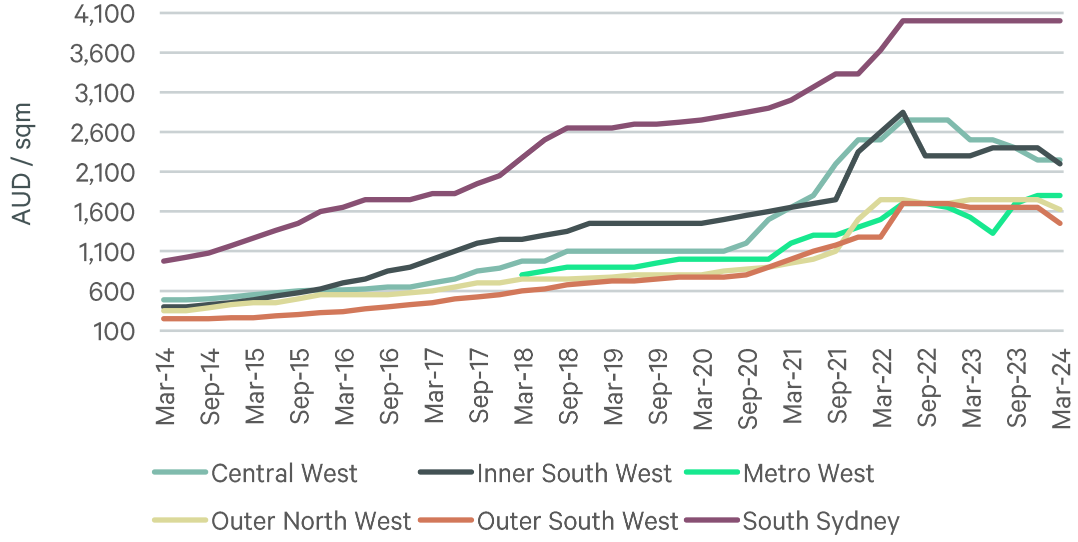
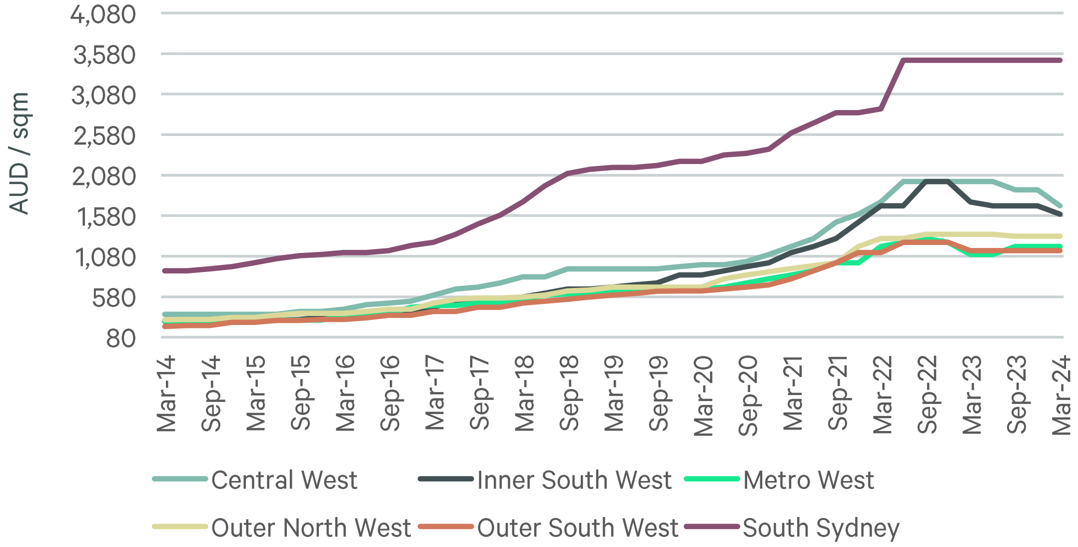
FIGURE 15: Average Land Values (0.25 ha lots), by Precinct (2014-2024)



Source: CBRE Research Q1 2024

FIGURE 16: Average Land Values (1.6 ha lots), by Precinct (2014-2024)



Source: CBRE Research Q1 2024

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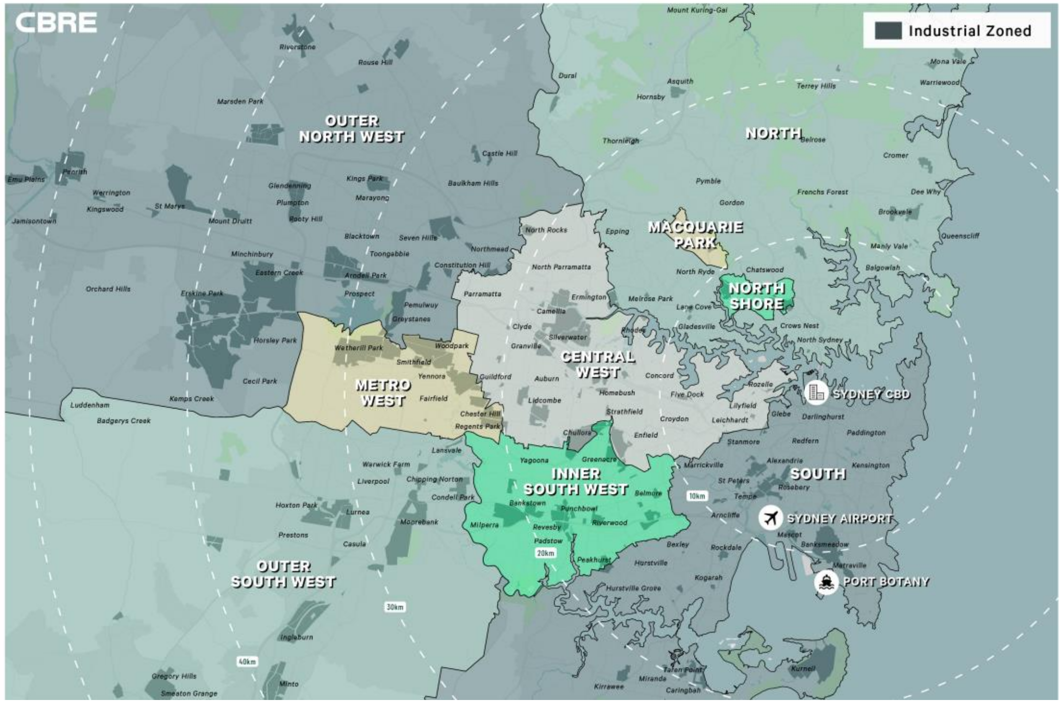
Market Area Overview



Definitions

Super Prime:
Less than 6 years old, height clearance between 13.7m and 14.6m. Buildings showcasing design excellence with combination of ESFR sprinklers and docks / on-grade doors, as well as strong truck articulation for loading/unloading.

Prime:
Generally, between 6 and 15 years old, height clearance over 10m and up to 13.7m.

Secondary:
Buildings that are older style but still very functional, height clearance in the ranges of 8-11m, Over 15 years old.

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