Sydney rental growth continues at a decreasing rate

1.3%	◀ ▶ c.308,000 sqm	▼ c.62,000 sqm	▲ 5.33%
NSW annual population growth FY23-27[1]	New industrial supply 4Q23	Gross take-up 4Q23	Super prime midpoint yield

Note: Arrows indicate change from previous quarter.

Key Points

- Gross take-up over the quarter has decreased significantly compared to 3Q23, totalling circa 62,000 sqm over 4Q23. The Retail Trade sector dominated total floorspace leased (44%).
- Average vacancy remains low at 0.5% (as at 2H23).
- Around a third of the CY2023 supply pipeline reached completion this quarter, with 2H23 accounting for 62%.
- Positive rental growth continues, although at a slowing pace. Super prime net face rents recorded an average y-o-y growth rate of 23%.
- Average land values for 0.25 ha and 3-5 ha lot sizes have decreased marginally whilst 1.6 ha lots remained flat.
- A total of AUD 869 million of investment sales has been recorded in 4Q23, across 27 transactions (for sales > AUD 5 million).
- Super prime and prime midpoint yields have continued to expand and are now sitting at 5.33% and 5.50%, respectively.

1. Australian Government Centre for Population Projections
Source: CBRE Research Q4 2023

Demand

Take-up volumes decrease significantly in 4Q24

Gross take-up decreased significantly in 4Q23 compared to the previous quarter (c.319,000 sqm in 3Q23), totalling c.62,000 sqm. This 81% decline in floorspace take-up comes off the back of high take-up volume last quarter and a slowdown in pre-lease and existing deals.

Notable transactions in 4Q23 included deals struck by:

- ALDI at Lot 1, Light Horse Logistics Hub, Eastern Creek
- Linfox at Warehouse A, 88 Forrester Road, St Marys
- Lockheed Martin at 5 Skyline Crescent, Bringelly.

Pre-lease transactions continued to dominate leasing activity over the quarter making up just over half of total floorspace leased. We expect the share of pre-lease transactions to remain elevated over the next 12 months due to the wave of new development supply entering the market over 2024-2025.

Despite the slowdown in take-up levels over 4Q23, we forecast that take-up levels for CY2024 will surpass the 10-year annual average of c.920,000 sqm. Despite the persistence of ultra-low vacancy (0.5% in Sydney), pre-lease deals from new supply is expected to lead to higher leasing volumes.

The concentration of lease transactions over the quarter occurred within the Outer North West precinct, accounting for 74% of total take-up (by floorspace), followed by the Outer South West (17%). The Outer North West is expected to dominate leasing volumes as 62% of Sydney's new supply is forecast for the precinct over the next three years.

There were no sub-leases transacted over 5,000 sqm across the Sydney market in 4Q23. The influx of new supply expected has provided tenants with optionality, with many opting to wait for new builds to secure functionality and expansion into larger floorspace.

Retail Trade occupiers overtakes Transport, Postal and Warehousing in dominance of floorspace leased over the quarter

The concentration of floorspace leased in 4Q23 shifted to Retail Trade (44%) over 4Q23, overtaking the Transport, Postal and Warehousing sector (31%).

FIGURE 1: Sydney gross take-up 2013-2023YTD, by precinct

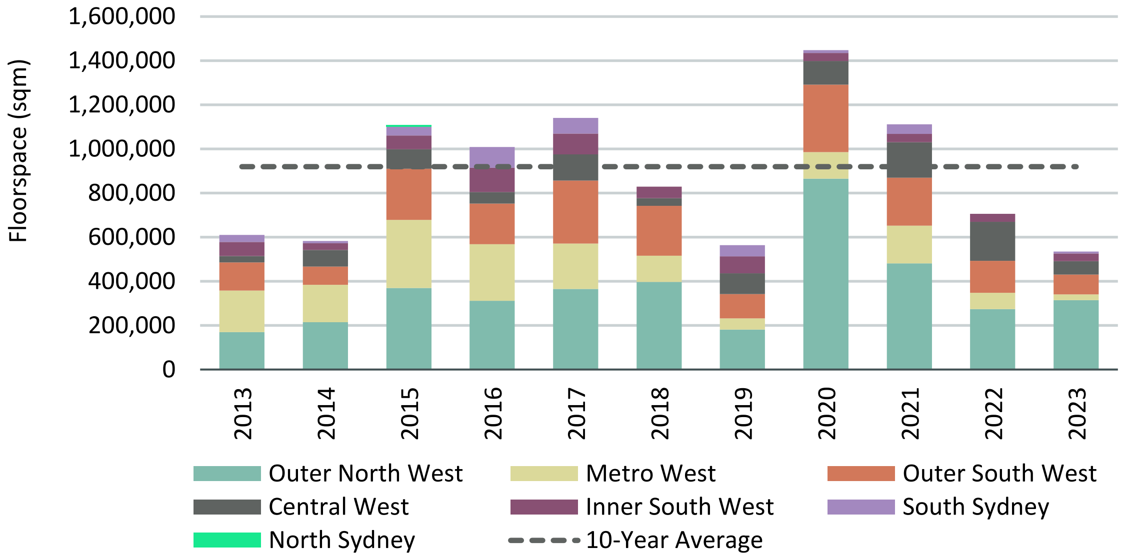
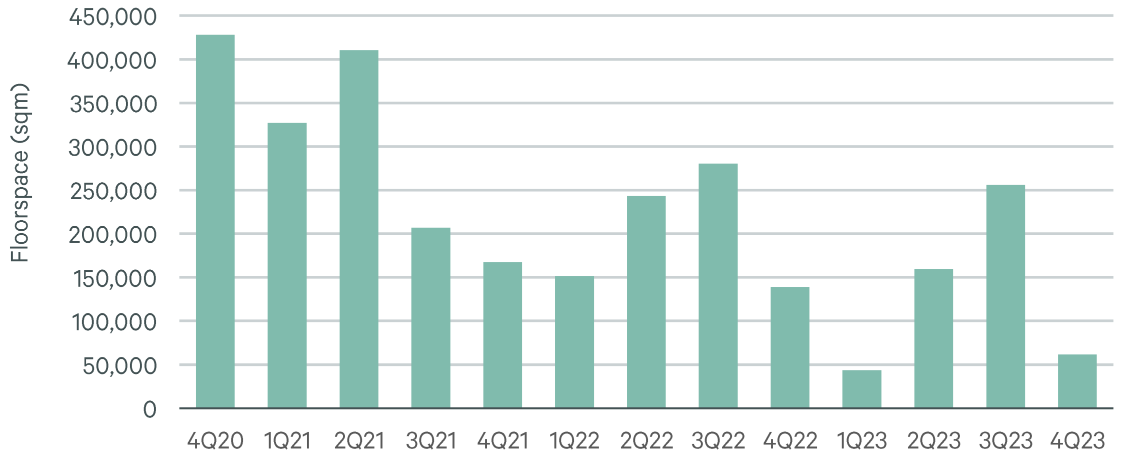


FIGURE 2: Sydney quarterly gross take-up, 4Q20-4Q23



To note: Reflects leasing transactions >5,000 sqm.
Source: CBRE Research Q4 2023

Supply

Wave of new supply expected for 2024 and 2025

New floorspace added to the market over the quarter totalled c.308,000 sqm. This is equal with last quarter (c.308,000 sqm) and higher than 2Q23 completions (c.263,000 sqm). Completion levels remained high over 4Q23 with many delayed projects being delivered over 2H23 (62% of CY2023 pipeline).

Major projects that reached practical completion in 4Q23 included Lot 202, 327-335 Burley Road, Horsley Park (33,460 sqm) and Warehouse 3, Elevation at Greystanes, 44 Clunies Ross Street, Greystanes (28,184 sqm). The CY2023 supply totalled close to 1 million sqm, which is almost double the long-run average (565,000 sqm).

Around c.270,000 sqm of space is expected to be added to the market next quarter. Development projects expected to complete in 1Q24 include:

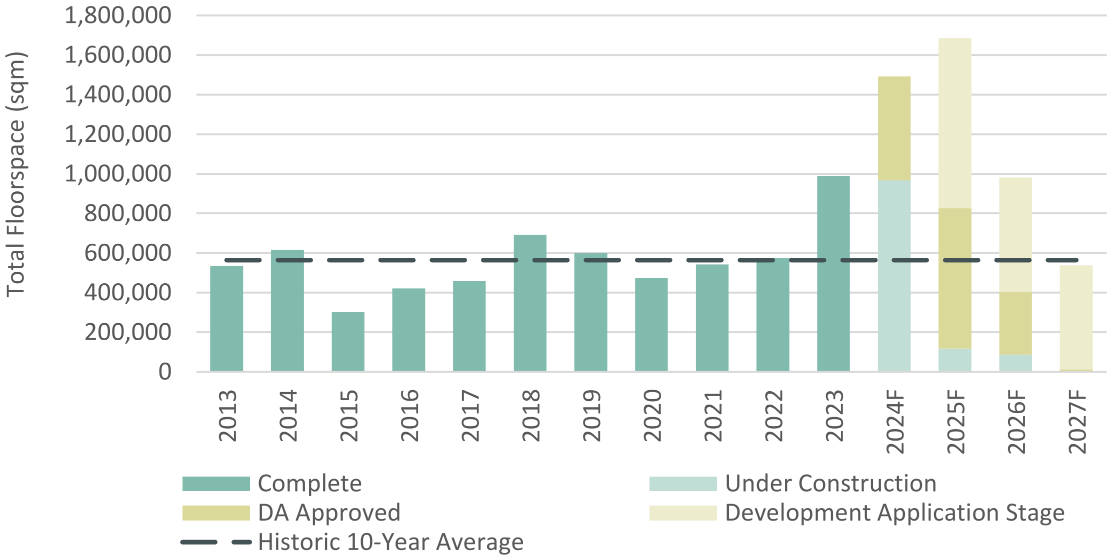
- Winnings Appliances Warehouse, Aspect Industrial Estate, 804-882 Mamre Road (66,600 sqm)
- The Yards, Warehouse 13, Kemps Creek (31,681 sqm)
- The Yards, Warehouse 2, Kemps Creek (30,320 sqm).

A major portion of the supply pipeline for CY2024 (c.1.5 million sqm) is expected to be contributed from The Yards (14%), owned by Frasers Property and Aware Super, the LOGOS consortiums Moorebank Intermodal Precinct (11%) and Goodman and Brickwork's Oakdale West Industrial Estate (7%).
The occurrence of development delays reduced significantly in 4Q23 with many planned projects being completed.

With construction costs and interest rates showing signs of a peak, the 2024 and 2025 pipeline is expected to see less projects being pushed back, especially given the strong pre-commitment levels. As at 4Q23, almost half the 2024 and 2025 combined supply pipeline is pre-committed.

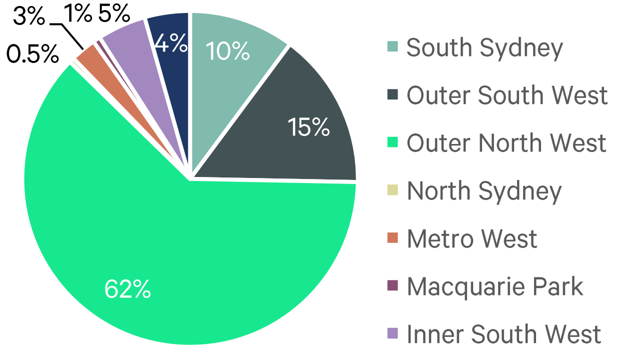
The Outer North West precinct is forecast to account for almost 62% of all new developments between 2024 and 2026.

FIGURE 3: Sydney development supply pipeline 2013-2027F



To note: Reflects new projects >5,000 sqm.
Source: CBRE Research Q4 2023

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



To note: Reflects new projects >5,000 sqm.
Source: CBRE Research Q4 2023

Leasing Market

Rental growth continues to slow over the quarter

Sydney average super prime and prime rents have increased by 3.6% and 2.9% (q-o-q), respectively. The Central West precinct super prime rents recorded the strongest growth over the quarter of 11.8% (q-o-q). Higher rent growth in the Central West is attributed to occupiers' continued appetite for in-fill locations.

Sydney maintains a low vacancy rate of 0.5% (2H23), which continues to drive rents as occupiers have minimal options to attain the floorspace and fit out that suits their needs. New developments continue to be rapidly occupied and pre-leased by occupiers looking to improve size and functionality needs. Average face rent growth over the quarter for secondary assets was 2.2%, highlighting the movement to more modern and higher-grade warehouses.

Effective rent growth was less as incentives increased over 4Q23. Average prime and secondary grade incentives increased by 2% to a new of average of 12% and 13%, respectively. Super prime increased by less over the quarter (1%), and now averaging 10%. This shows the pressure on landlords with older warehouses to compete with the high volume of super prime developments entering the market. We expect incentive levels to rise over the next 12 months across all grades as landlords continue to compete with the oncoming wave of supply.

We expect rents to remain positive over 2024, albeit at more normalised rates. Despite the heightened supply expected over 2024 and 2025, new developments have been pre-committed at a steady rate, which softens the downward pressure on rental growth. Incentives will likely be the main instrument that landlords use to compete once existing leases expire.

On a year-on-year basis, Sydney super prime average net face rents increased by circa 23%, and prime and secondary both grew by 15%. Evidently, rental growth has continued, albeit at a decreasing rate.

Source: CBRE Research Q4 2023

FIGURE 5: Average Sydney Net Face Rent Growth y-o-y, by Asset Grade (2013-2023)

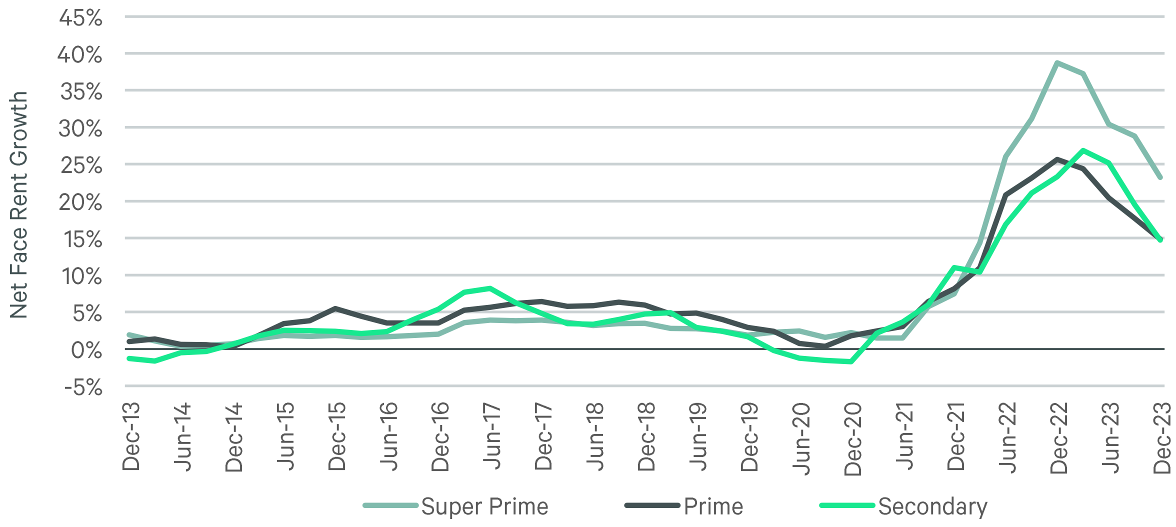
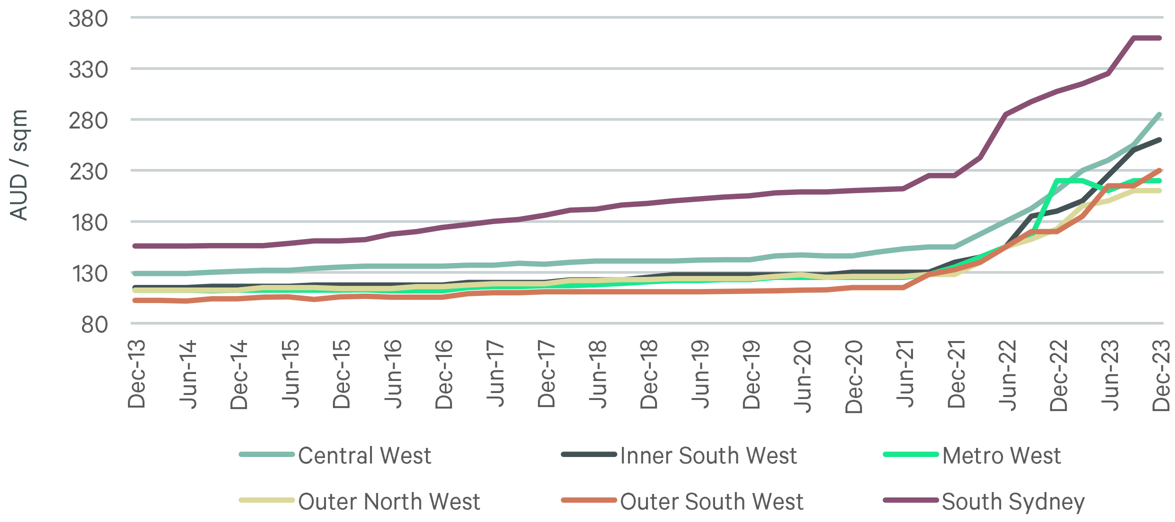


FIGURE 6: Average Super Prime Net Face Rents, by Precinct (2013-2023)



Source: CBRE Research Q4 2023

Land Values

Infill precinct land values show resilience in 2023

Demand for all lot sizes of industrial zoned land in Sydney remained relatively flat over the quarter. Average land values for 1.6 ha and 3-5 ha lot sizes have decreased marginally by 1.0% and 1.6% (y-o-y), respectively. Furthermore, 0.25 ha lots showed the only positive y-o-y growth of 0.7%.

Land values over 4Q23 recorded movements of -0.2%, 0.0% and -0.4% q-o-q for 0.25 ha, 1.6 ha and 3-5 ha lots, respectively. This marginal decline in land values for 0.25 ha and 3-5 ha lots over the quarter reflects the slowdown in developer interest to build on new parcels of land. Signs of a reversal from peak land values was confirmed in 4Q24 with persistently high interest rates creating inertia for protentional investors.

Land values in all precincts remained flat this quarter for 1.6 ha lots, except in the Central West (-3%) and the Metro West (3%). Whilst the cost of capital remains high and institutions remain uncertain about the timing of an interest rate reversal, investment in land is expected to remain stagnant. This is validated by the subdued transaction volume over 2023.

Average land values in Northern precincts and South Sydney proved to be the most resilient over 2023. Land values in the North Shore and North Sydney increased by 6% and 7% y-o-y, respectively for 1.6 ha lots, whilst South Sydney remained flat. The rest of Sydney's precincts recorded a y-o-y decrease for the same sized lots. The "infill" status and proximity to the CBD and Kingsford Smith Airport continues to support inner precincts such as North and South Sydney. Land values in these precincts are more than double the average land values of Outer Western precincts.

There is currently around 13,131 ha of zoned industrial land within the Sydney Metropolitan Region. Of this total, around 75% is developed and the balance is undeveloped (as at 2Q23).

The Outer North West precinct has the largest amount of developed land (2,834 ha), as well as the highest total of undeveloped land supply (2,054 ha). However, only 10% (or 197 ha) of the undeveloped land in the Outer North West precinct is serviced.

Source: CBRE Research Q4 2023

FIGURE 7: Average Land Values (0.25 ha lots), by precinct (4Q23 vs. 4Q22)

FIGURE 8: Average Land Values (1.6 ha lots), by precinct (4Q23 vs. 4Q22)

Source: CBRE Research Q4 2023

Investment Market

Investment sales volume increased in 4Q23

A total of AUD 869 million of investment sales has been recorded in 4Q23 across 27 transactions (for sales > AUD 5 million). The two largest transactions were confidential and totalled AUD 387 million. Other notable transactions include 57-65 Templar Road, Erskine Park, acquired by ESR for AUD 107 million, and 51 Eastern Creek Drive, Eastern Creek, acquired by Pittwater Industrial for AUD 87 million.

Investors are attracted to the Sydney market due to the city having the highest population concentration in the country, in turn, generating greater demand activity in terms of both consumer driven and occupier activity. Despite the wave of new supply expected over the next two years, pent up occupier demand coupled with record low vacancy supports continued rental growth for the sector, although at lower levels than what was witnessed over 2022 and 2023. This resilience is attractive to potential investors.

Yields have expanded by approximately +29bps over the quarter - with the midpoint yield over 4Q23 for super prime grade assets at 5.33%. Prime yields also increased by +31bps over the quarter to a midpoint yield of 5.50%. Further expansion in cap rates of up to 25 basis points is anticipated over the next 6 months.

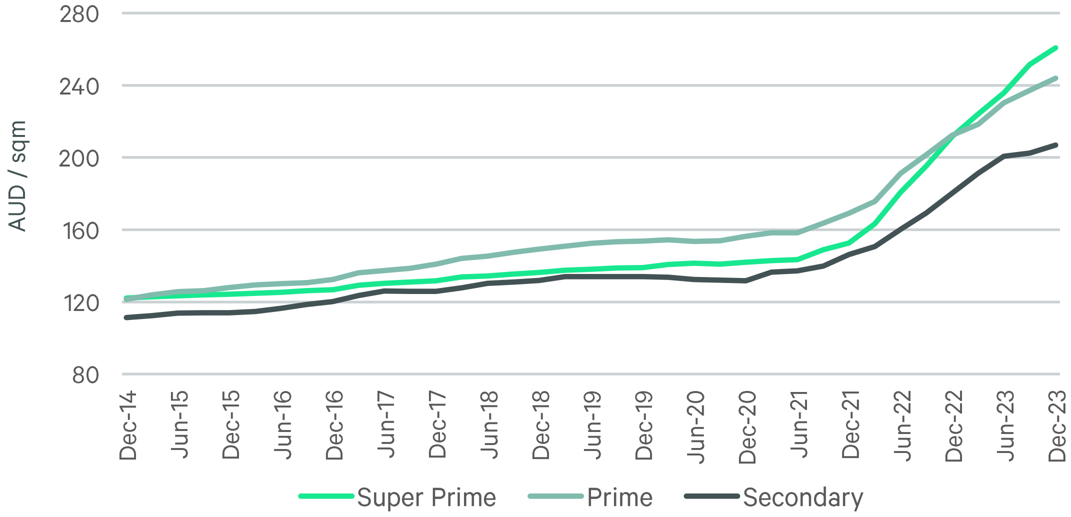
FIGURE 9: Midpoint Yields 4Q19-4Q23, by Precinct

Source: CBRE Research Q4 2023

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

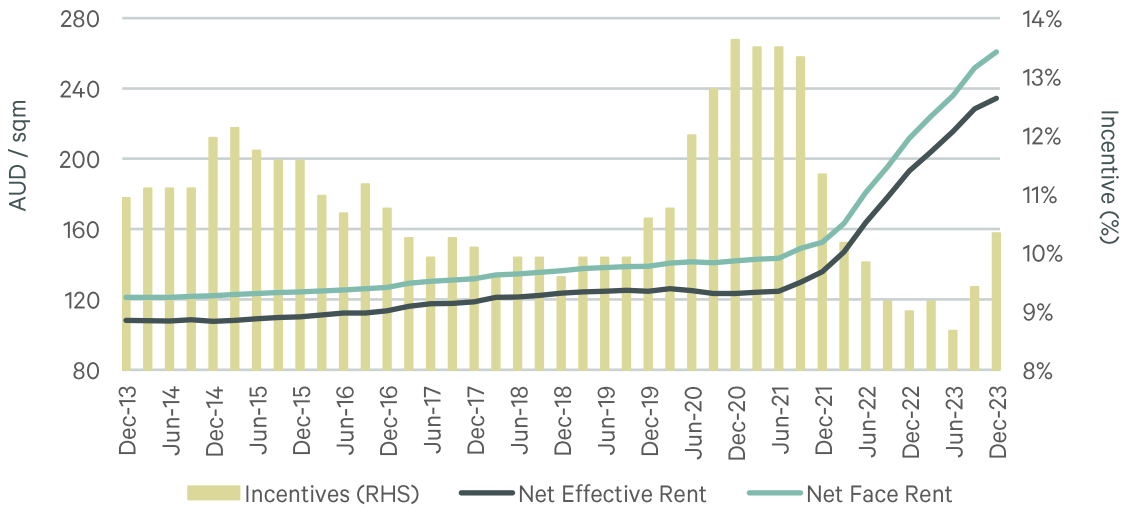
To note: Does not include land/development sales.
Source: CBRE Research Q4 2023.

FIGURE 11: Average Sydney Net Face Rents, by Asset Grade (2013-2023)



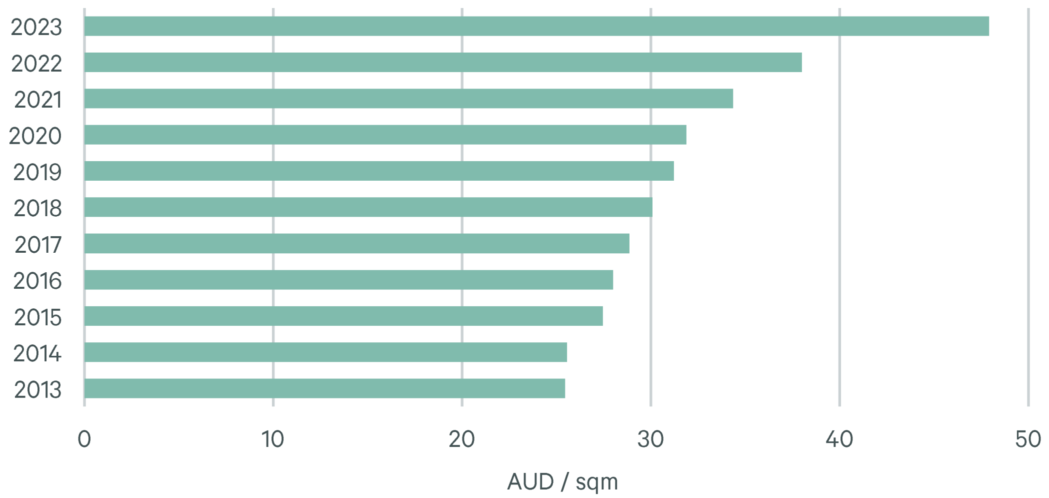
Source: CBRE Research Q4 2023

FIGURE 13: Average Sydney Super Prime Rents and Incentives (2013-2023)



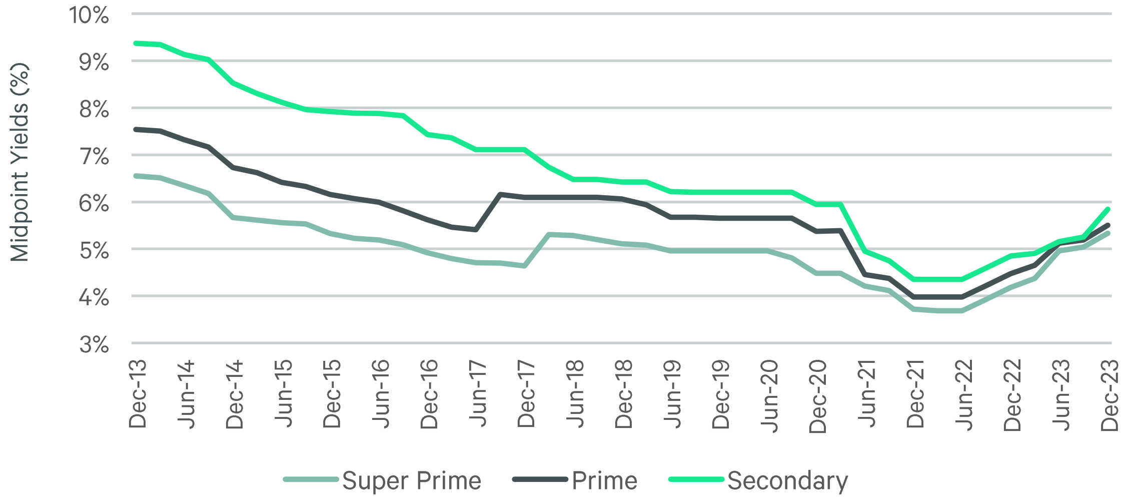
Source: CBRE Research Q4 2023

FIGURE 12: Average Sydney Historical Outgoings, 2013-2023 (excludes Strata and Hi-Tech)



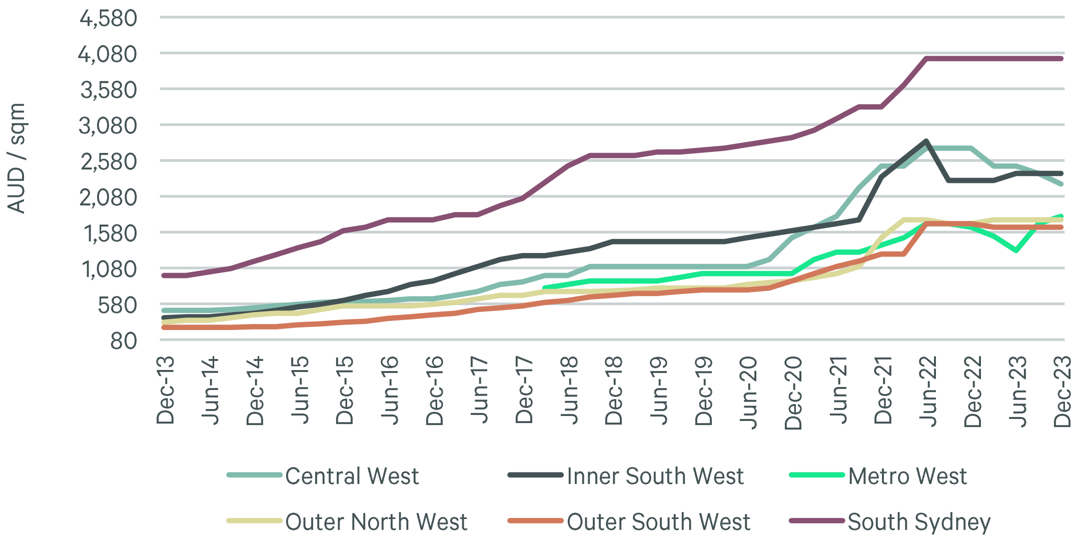
Source: CBRE Research Q4 2023

FIGURE 14: Midpoint Sydney Yields, by asset grade (2013-2023)



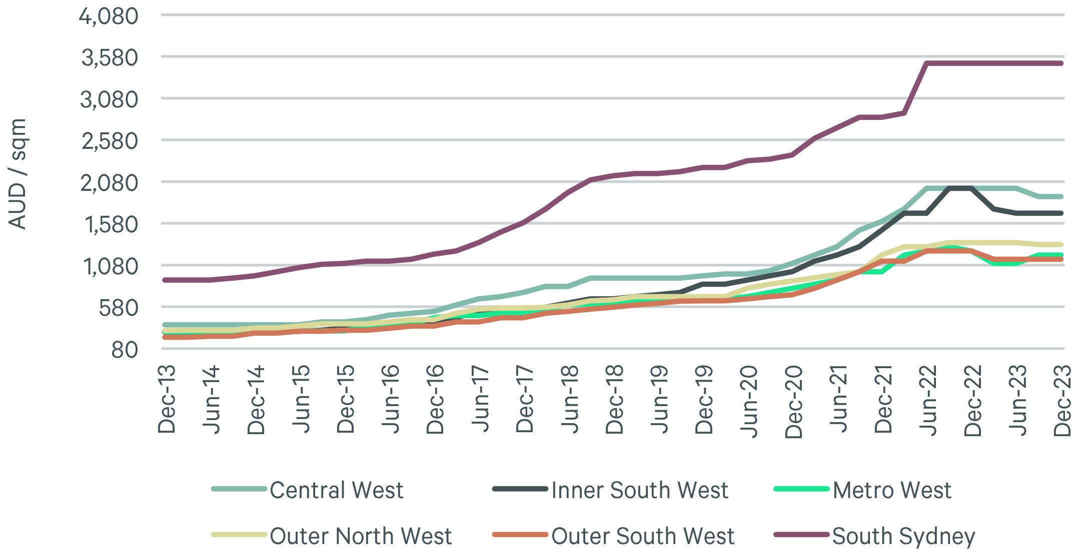
Source: CBRE Research Q4 2023

FIGURE 15: Average Land Values (0.25 ha lots), by Precinct (2013-2023)



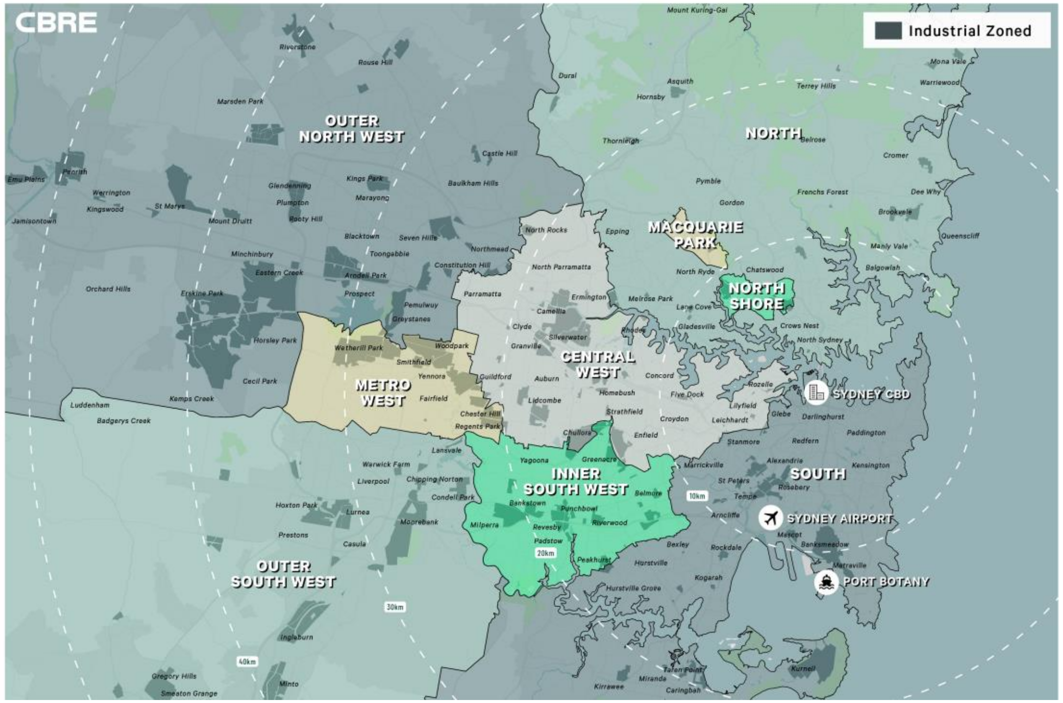
Source: CBRE Research Q4 2023

FIGURE 16: Average Land Values (1.6 ha lots), by Precinct (2013-2023)



Source: CBRE Research Q4 2023

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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