

FIGURES | INDUSTRIAL & LOGISTICS | Q4 2023

Rental growth begins to normalise amidst signs of weakening demand

2.4%

VIC Annual Population Growth FY23-27¹

▼ c.260,000 sqm ▼ c.270,000 sqm ▲ 5.64%

4Q23 Gross Take-Up

4Q 23 Supply Completions

Average Super Prime Midpoint Yield

Note: Arrows indicate change from previous quarter.

Key Points

- Gross take-up in 4Q23 totalled c.260,00 sqm, a 40% reduction from the level recorded in 3Q23.
- New floorspace added to the market over the quarter totalled c.270,000 sqm across 16 projects, with most of the supply delivered within the West precinct (43%), followed closely by the South-East (40%).
- Melbourne’s total vacancy rose 50bps to 1.6% as of 2H23, driven primarily by greater availability in Melbourne’s West.
- Average super prime, prime and secondary rent growth normalised in 4Q23, with q-o-q growth rates of 2.7%, 1.8% and 1.8% respectively.
- Land values across some precincts have fallen, driven by economic feasibility concerns, combined with construction and holding cost increases.
- A total of AUD 307 million of investment sales (for transactions greater than AUD 5 million) was recorded in 4Q23 across 11 transactions, with yields expanding across all grades and precincts.

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

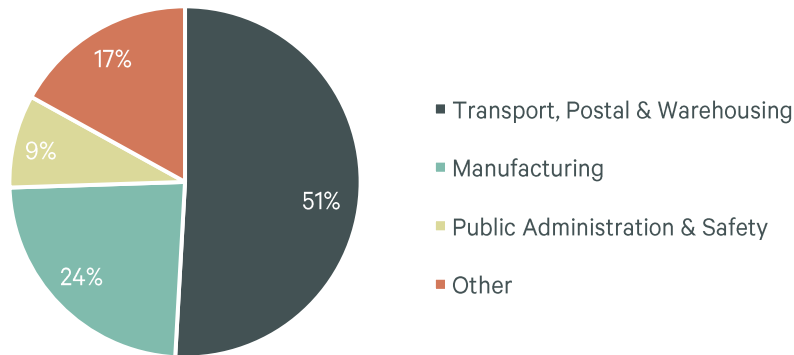
Demand

Pre-lease activity subsides with 2/3rd of transactions taking place in existing stock.

Gross take-up over 4Q23 decreased by 40% compared to the levels recorded 3Q23. Around 260,000 sqm of leasing activity was recorded this quarter, across 22 transactions. The 4Q23 total represented the second consecutive quarter of leasing activity declining. Industrial vacancy in Melbourne remaining relatively low, currently averaging 1.6% (as at 2H23), is one of the factors in the reductions in take-up activity over the past 6 months. In addition to this, however, occupier demand has begun to decrease across Melbourne over 4Q23, which also contributed to dampened take-up levels. Pre-lease activity as a percentage of volume in 4Q23 reached the lowest level seen since 2021, accounting for less than 20% of floorspace leased this quarter. Given the expected higher confidence on the future progression of rental and incentive movements as well as an increase in available stock, occupiers have begun to delay decision making until space requirements are solidified.

Given the vacancy rate in Melbourne’s West (2.9%) being more than double that of the closest precinct in East & South-East (1.4%), take-up in the West precinct accounted for close to 50% of volumes over 2023. Geographic and transport factors in Melbourne’s West are key reasons for the dominance of this precinct in take-up volumes, as well as the larger amount of stock in this market.

FIGURE 1: Melbourne Take-Up 4Q23 by Industry Sector (Top 3 Sectors)



Source: CBRE Research

FIGURE 2: Melbourne Gross Take-Up 2012-2023, by Precinct

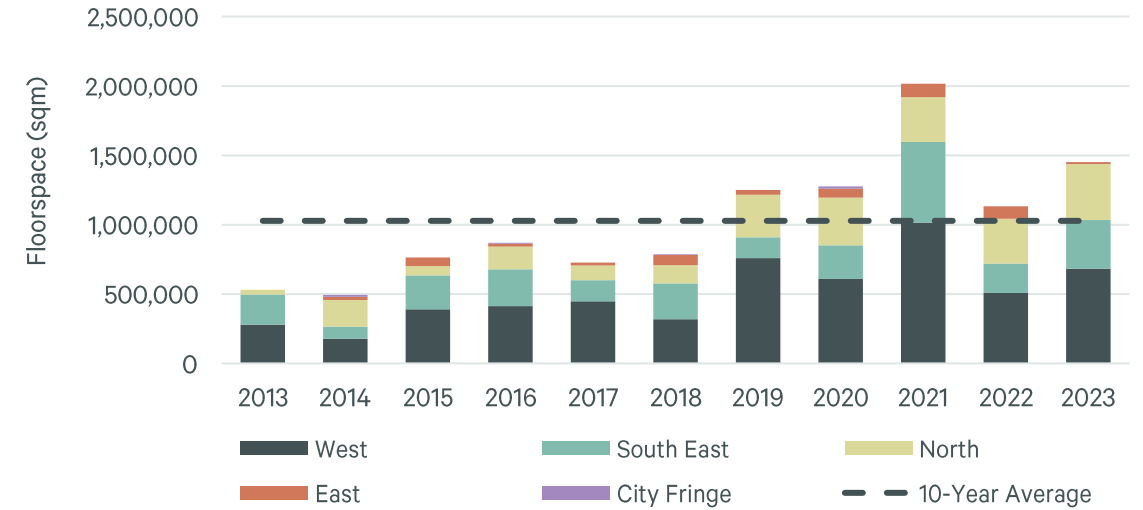
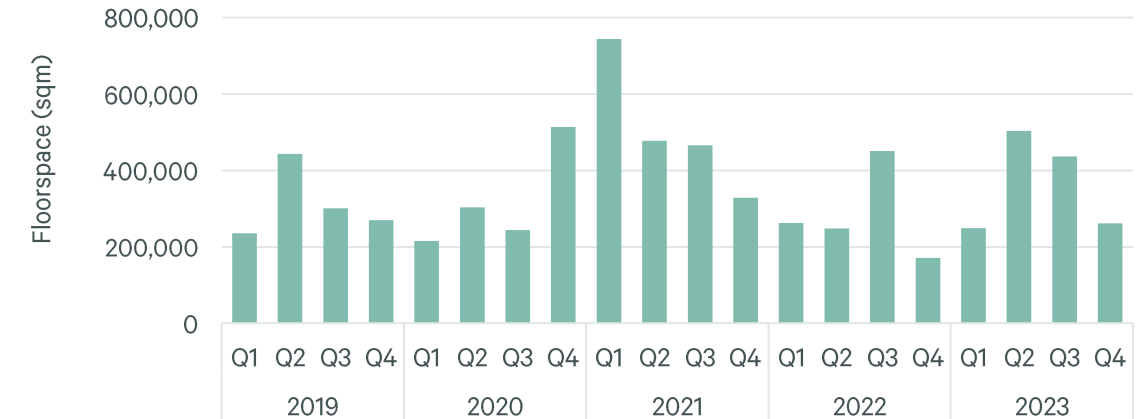


FIGURE 3: Melbourne Quarterly Gross Take-up, 2019-2023



*To note: Reflects transactions >5,000 sqm.
Source: CBRE Research

Supply

Supply completions moderate over 4Q23 amidst project delays.

Supply completions in 4Q23 totalled c.270,000 sqm across 16 projects, a moderate reduction from the c.330,000 sqm completed in 3Q23. Melbourne’s West and South-East accounted for most of the stock brought to market in 4Q23, with approximately 43% and 40% respectively. Despite significant stock coming out of Melbourne’s South-East this quarter, it is expected only 17% of future new supply will be added to this precinct. Melbourne’s West is forecast to account for just over 60% of the new supply over 2024-2026.

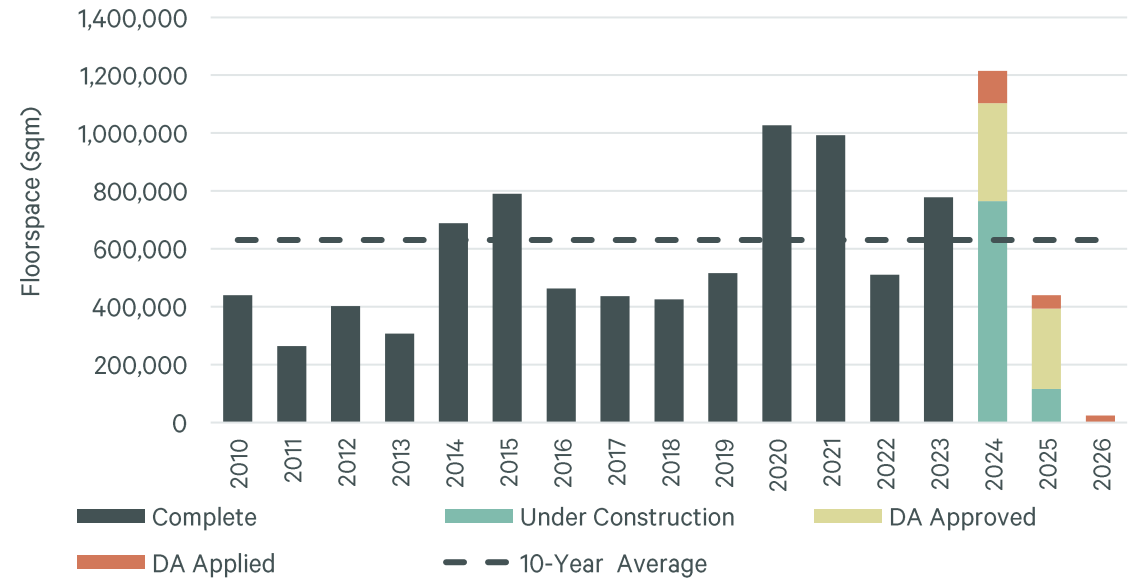
The 2024 new supply pipeline was expected to total 1.6 million sqm, however CBRE Research have identified over 400,000 sqm of this 2024 total as delayed and have now been shifted to a new forecast completion year of 2025. Rising funding costs and weakening demand are key factors in the changes to project timing, as development groups re-evaluate pipelines in the ever-changing local landscape. Despite recent project delays, the 2024 pipeline is expected to total c.1,200,000 sqm, which is more than 90% above the 10-year annual average.

Low pre-commitment levels increase may create increase in mooted developments.

The pre-commitment rate for 2024 is currently at approximately 30% (as at 4Q23). CBRE research expects pre-commitment levels to increase over 1H24, however if certain speculative developments fail to reach certain pre-commitment levels throughout the year, projects may be delayed/mooted. Developers will need to assess the risk-return profile of any project which fails to meet pre-commitment requirements.

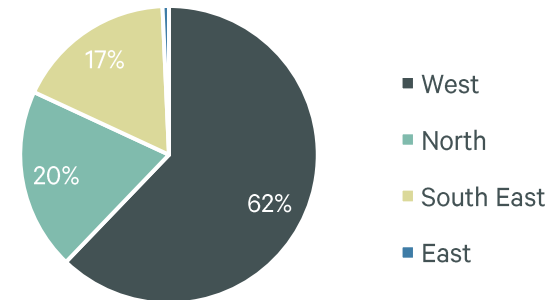
Uncertainty around the timing of projects in the existing supply pipeline (Figure 5), is elevated when considering the rise in sublease vacancy across Melbourne and weakened demand that has already begun to be seen over the latter half of 2023.

FIGURE 4: Melbourne Development Supply Pipeline 2010-2026F



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

FIGURE 5: Development Supply 2024F-2026F Floorspace Share, by Precinct



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

Leasing Market

Rents see a minor quarterly increase, with new highs being reached on a year-on-year basis.

Average net face rental growth over 4Q23 in the Melbourne market moderated compared to the previous quarter. Despite the moderation in growth rates observed across Melbourne in 4Q23, average year-on-year growth rates increased across all asset grades. Continued normalisation in face rental growth is expected over 2024.

The combination of rising vacancy and normalising demand are key factors contributing to the dampened increase in rental growth this quarter, with some landlords and asset owners seeking out longer term leases to increase certainty around income. This is a stark contrast to the short term leases landlords were seeking over recent years to take advantage of rapidly rising face rents amidst historically high demand levels.

Upward pressure on incentives as landlord certainty becomes a priority.

Beyond the stickiness of face rents in 4Q23, incentives increased across Melbourne over the quarter. The largest increase in incentives over the quarter was recorded for super prime grade assets, increasing by 360bps to a new average of 18%. Prime and secondary grade incentives also increased, and now average 14% and 10%, respectively.

We expected vacancy to continue to rise in Melbourne’s industrial market. As a result, landlords for existing and future developments may be put into an increasingly tenant-favourable market. Industrial landlords have already begun to raise incentives to increase attractiveness to prospective tenants, favouring certainty over potential future gains associated with the possibility of rising rents.

FIGURE 6: Melbourne Average Net Face Rent Growth Year-on-Year by Grade

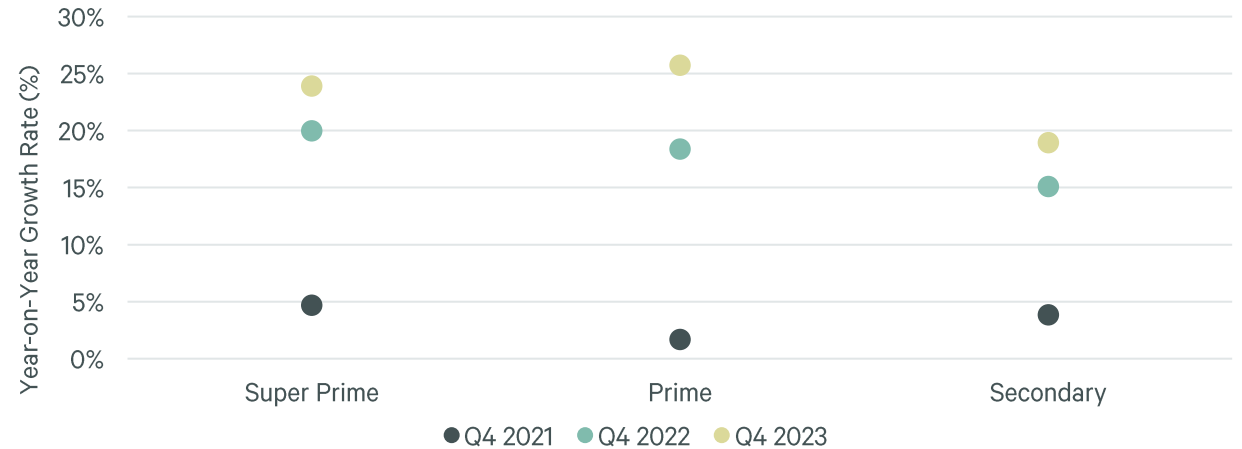


FIGURE 7: Melbourne Super Prime Net Face Rents by Precinct and Year



Source: CBRE Research

Land Values

Land values decline in some precincts amidst combination of economic feasibility concerns, holding and construction cost increases.

Land values in various precincts and lot sizes have seen downward movements in 4Q23 on both a quarterly and yearly basis. Most notably for small lots (0.25ha), the Inner precinct saw the largest year-on-year decline of 23%, followed by declines of 8% and 4% seen in the east and West precincts, respectively. The largest year-on-year decline in large lots (1.6ha) was observed in Melbourne’s inner precinct, declining by 19%. Melbourne’s East and South-East also saw year-on-year declines in large lots of 17% and 10% respectively.

Three key themes have been raised concerning the current state of land values in Melbourne’s industrial market. The most notable one is that of the economic headwinds faced by development groups. With the cost of debt remaining elevated, feasibility concerns have begun to be raised creating hesitation amongst groups. Whilst this may have contributed to a decline in activity in development and investor groups, it is noted that owner-occupiers have remained the most active segment in the acquisition of sites, particularly in Melbourne’s North, where land values have remained stable on a year-on-year basis.

Rising pressure on construction costs is another key factor in the land value declines observed in 4Q23. Whilst construction costs have eased in some areas from the highs observed during 2021-2022, the elevated cement and steel prices already seen are likely to persist given high energy costs, putting continued pressure on Industrial developers.

Increasing lead times around decision-making, particularly amongst international groups are also a major reason contributing to the rise in holding costs. With holding costs rising, groups are faced with another variable decreasing profit margins from a potential investment in the space. Notably, these pressures are less relevant for owner-occupier groups who view industrial land investments from a different lens.

FIGURE 8: Average Land Values (0.25 ha lots), by Precinct and Year.

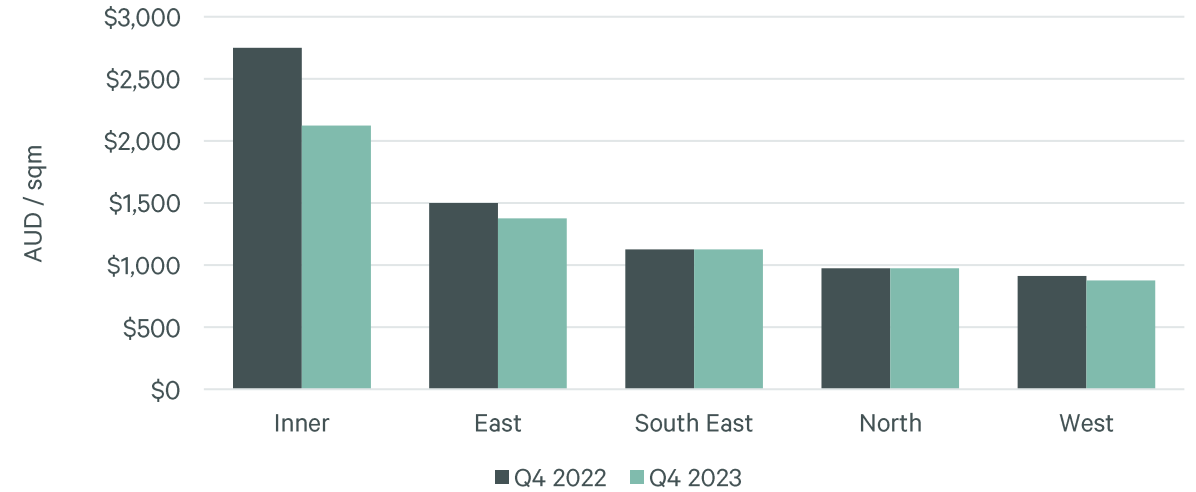
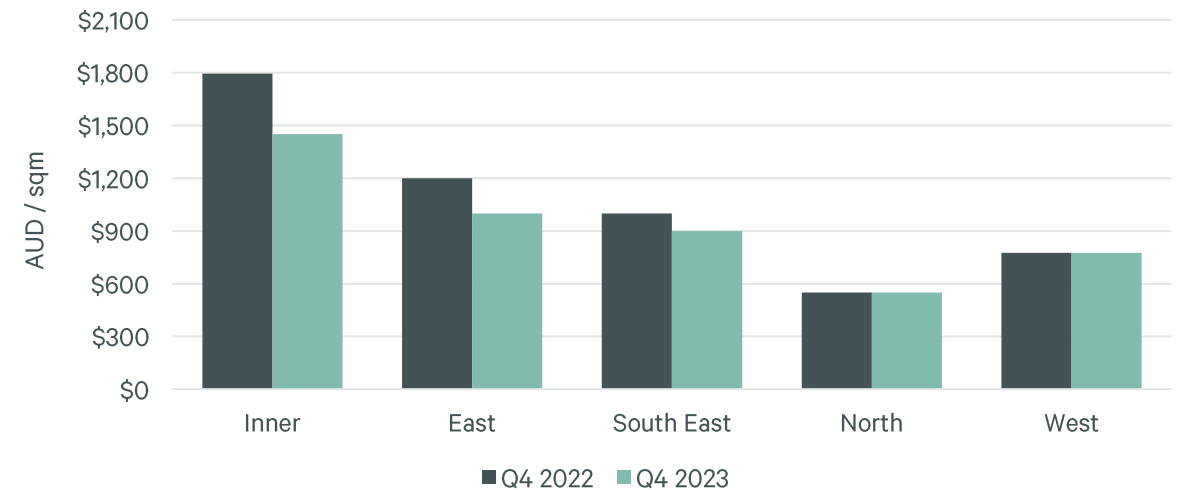


FIGURE 9: Average Land Values (1.6 ha lots), by Precinct and Year.



Source: CBRE Research

Investment Market

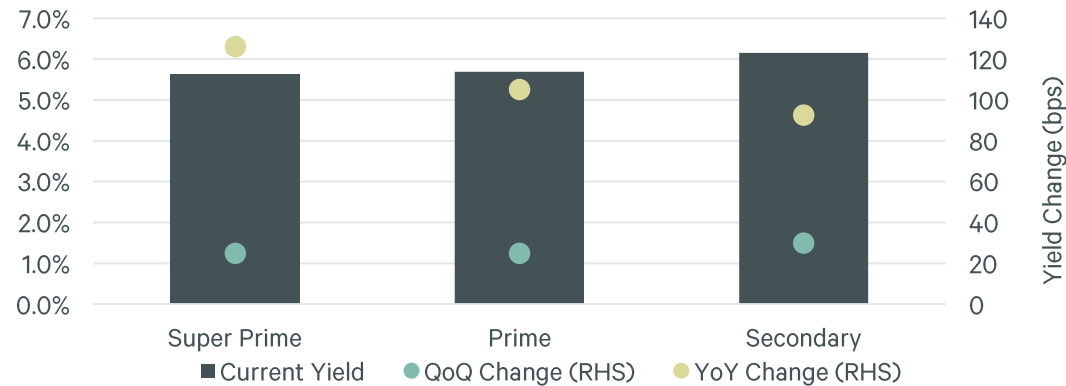
Sales in 4Q23 see a steep decline with total 2023 volume consistent with the historical average.

Total sales volumes in 4Q23 reached AUD \$307m across 11 transactions, a large decline from the \$821m recorded in 4Q22. Whilst volumes have declined, they remain relatively healthy with strong deal evidence being observed in the market. Notably, CBRE research notes a continuing trend observed in Melbourne of the difficulty for long WALE assets to trade, given the appeal of a market seeing double-digit year-on-year rental growth.

Yields expansion continues as valuations continue to normalise.

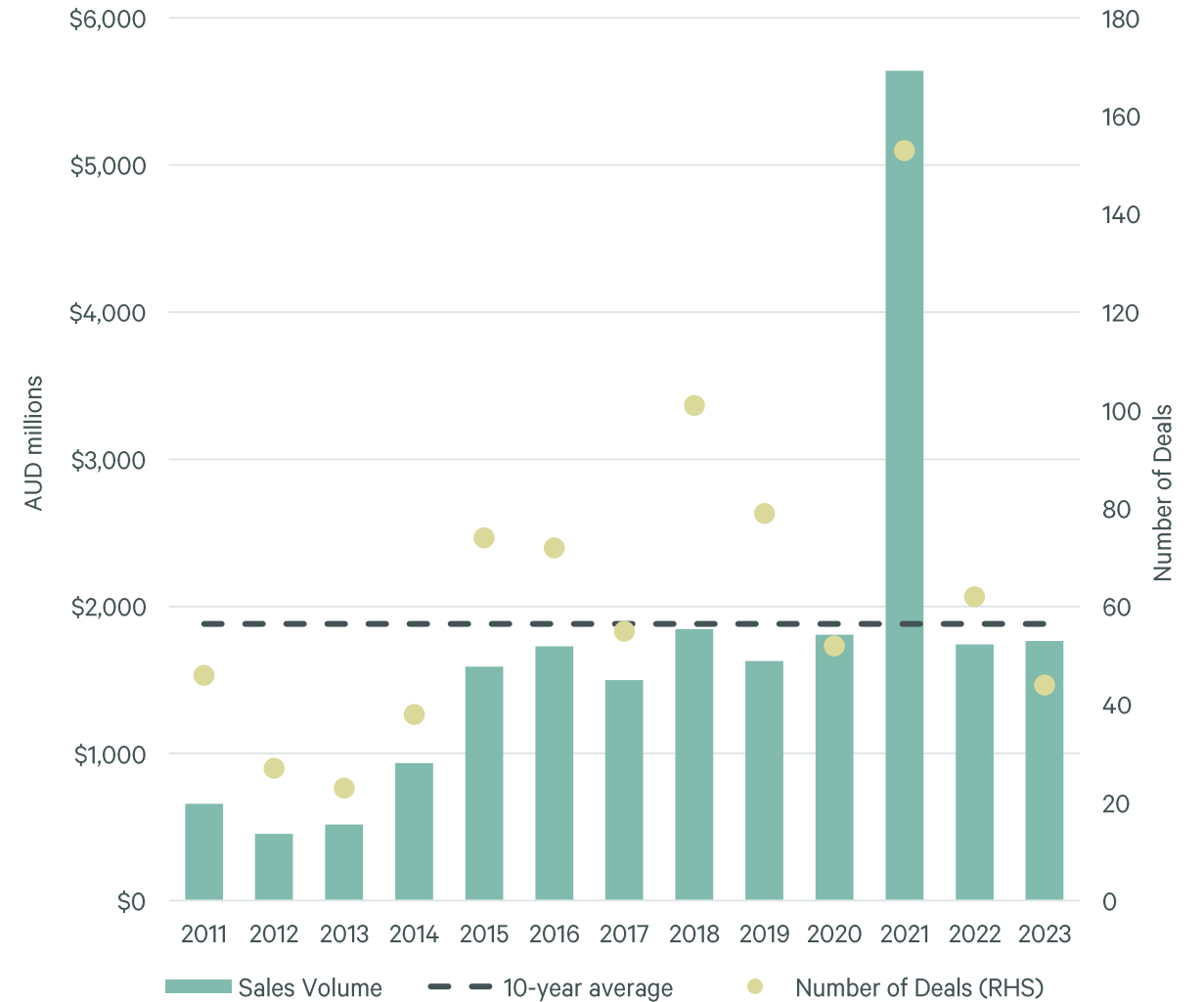
Average yields across all asset grades increased in 4Q23, with both average super prime and prime grade stock seeing expansion of 25bps. Super prime yields 4Q23 ended the year with the highest year-on-year increase of more than 125bps, as valuations for these assets have seen the largest normalisation over 2023. Buyer-Vendor expectation mismatches are a consistent trend being observed in Melbourne, consistent with other commercial real estate asset classes. However, the strong appeal of Industrial assets amongst institutions and large private investors has aided the continued trading of Melbourne assets.

FIGURE 10: Midpoint Yields 3Q19-3Q23, by Grade



Source: CBRE Research

FIGURE 11: Melbourne Industrial Investment Sales (greater than AUD 5 million).



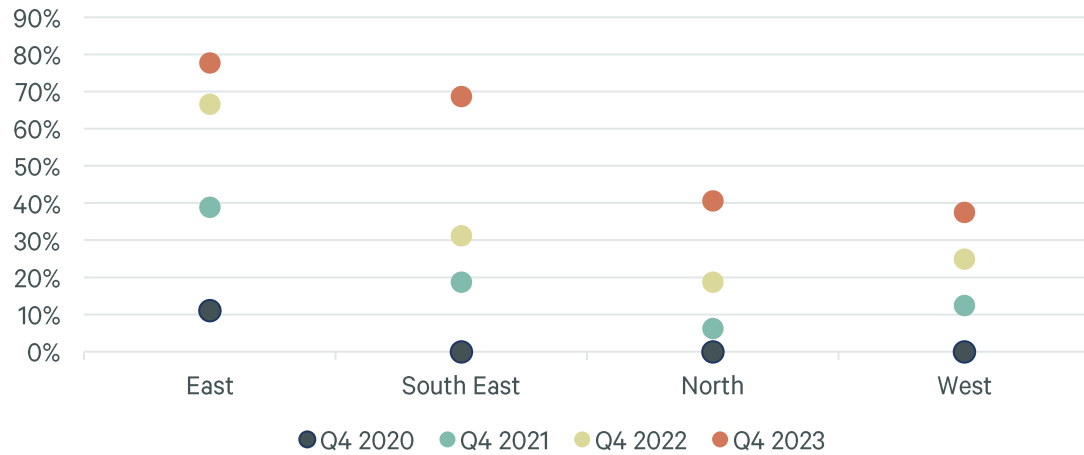
To note: does not include land/development sales.
Source: CBRE Research

FIGURE 12: Super Prime Incentives, by Precinct and Year



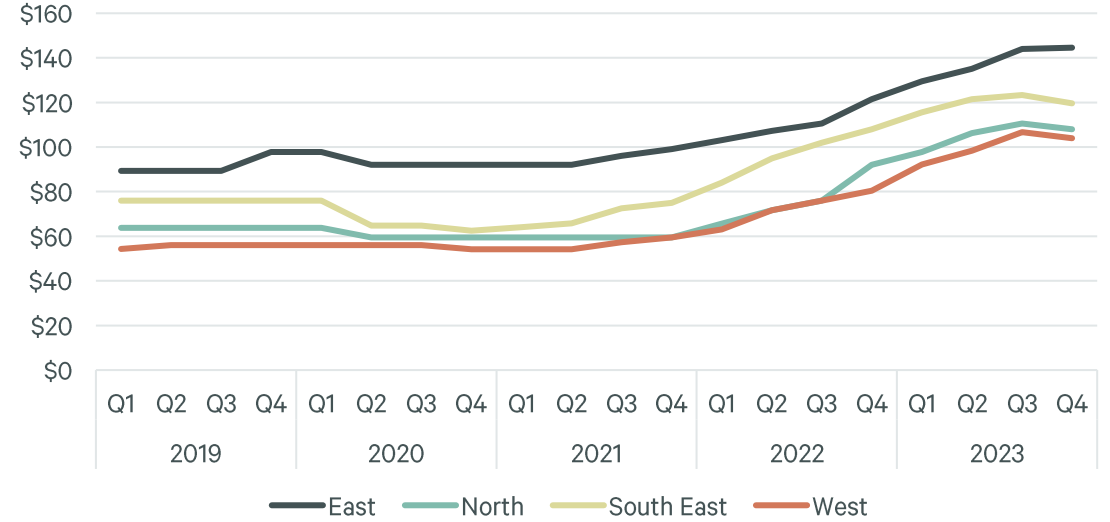
Source: CBRE Research

FIGURE 13: Melbourne Super Prime Outgoing Percentage Increase from Base Period (Dec-19) by Precinct



Source: CBRE Research

FIGURE 14: Melbourne Super Prime Net Effective Rents by Precinct



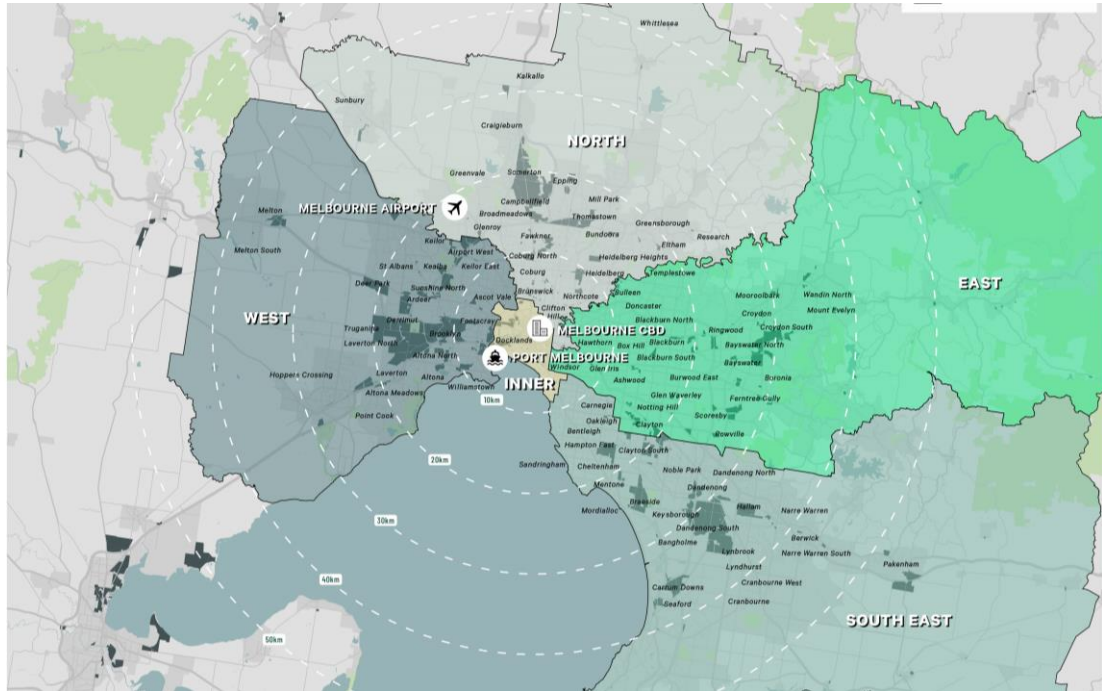
Source: CBRE Research

FIGURE 15: Melbourne Super Prime Current Yields and Basis Point Change by Precinct



Source: CBRE Research

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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