Sydney rental growth stabilising and demand normalises

1.1%	▲ c.204,000 sqm	▼ c.51,000 sqm	▲ 5.6%
NSW annual population growth FY24-33[1]	New industrial supply 2Q24	Gross take-up 2Q24	Super prime midpoint yield

Note: Arrows indicate change from previous quarter.

Key Points

- Gross take-up decreased compared to 1Q24, totalling circa 51,000 sqm over 2Q24. The Transport, Postal & Warehousing dominated total floorspace leased (40%).
- Average vacancy rate has risen, however remains relatively low at 2.0% (as at 1H24).
- Development supply increased over the quarter, with 204,000 sqm of new floorspace added to the market.
- Rental growth stabilised over the quarter with super prime net face rents unchanged. The y-o-y growth rate has decreased to 12.4% (average super prime grade assets). Incentives to continue to rise.
- Average land values for all lot sizes have remained stable with ‘infill’ precincts showing the most resilience on a y-o-y basis.
- A total of AUD 286 million of investment sales has been recorded in 2Q24, across 14 transactions (for sales ≥ AUD 5 million).
- Super prime and prime midpoint yields have softened by 25bps.

1. Deloitte Access Economics.
Source: CBRE Research Q2 2024

Demand

Leasing activity slows over 2Q24 as demand normalises

Gross take-up slowed in 2Q24 compared to the previous quarter (c.124,000 sqm in 1Q24), totalling c.51,000 sqm. This is the lowest recorded take-up for Q2 in the Sydney market. The slowdown in leasing activity is partially owing to the prolonged market uncertainty, with many occupiers continuing to assess the market and the new options becoming available.

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 were no sub-lease transactions greater than 5,000 sqm over the quarter.

Notable lease transactions in 2Q24:
- An existing warehouse leased by PAC Trading in Sydney's Central West
- A pre-lease by Wallace International in the Inner South West
- A pre-lease by Ninja Logistics in the Central West

Pre-lease transactions made-up just over one-third of total floorspace leased over the quarter - this compares to 73% recorded in 1Q24. Given greater stock becoming available in the market, coupled with new projects reaching completion, we expect the share of pre-lease deals to reflect similar levels to what was recorded in CY2023 (i.e. 44%).

The concentration of lease transactions over the quarter occurred within the Central West precinct, accounting for 40% of total take-up (by floorspace), followed by the Outer South West (32%).

Total gross take-up for 2024YTD equates to only c.175,000 sqm, which is less than a quarter of the 10-year average (c.920,000 sqm). As such, we expect total take-up for the CY2024 to once again total less than the long-run average.

Transport, Postal and Warehousing continues to dominate leasing over the quarter

Occupiers within the Transport, Postal and Warehousing sector dominated lease activity over the quarter - accounting for 46% of the total floorspace leased. Wholesale and Retail occupiers accounted for 22% and 21% of floorspace take-up, respectively.

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

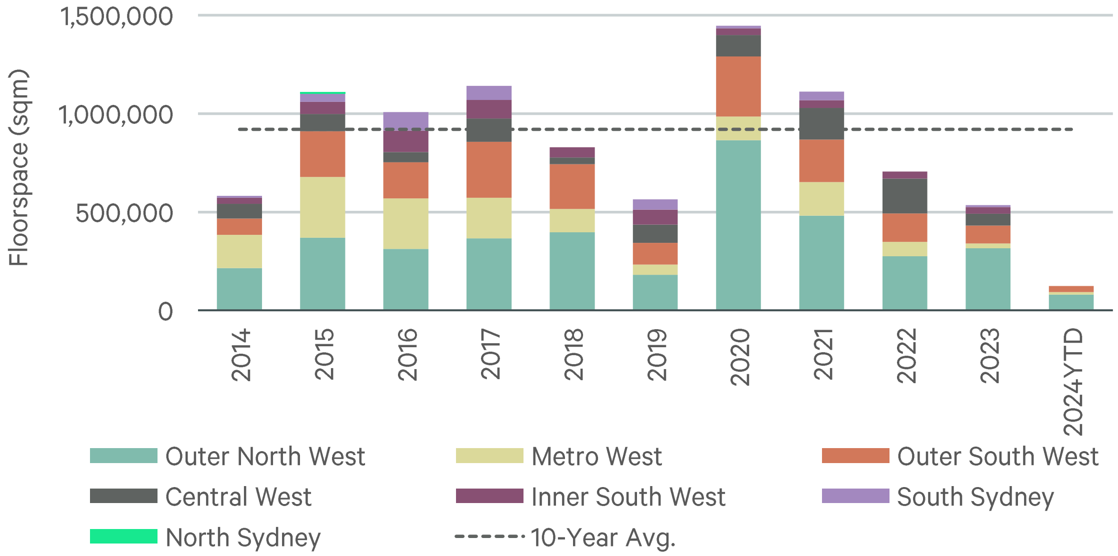


FIGURE 2: Sydney quarterly gross take-up, 2Q21-2Q24

To note: Reflects leasing transactions >5,000 sqm.
Source: CBRE Research Q2 2024

Supply

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

New floorspace added to the market over the quarter totalled c.204,000 sqm, which falls short of 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 2Q24 included three warehouses at The Yards, in Kemps Creek (79,586 sqm), and two warehouses at the Moorebank Intermodal Precinct (49,754 sqm).

All developments that are due to complete in 2H24 are currently under construction. The CY2024 supply pipeline is expected to total just over 1 million sqm, which is almost double the long-run average.

Just over half a million 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)
- Momentum Industrial Estate Lot 11 & 12, 813-913 Wallgrove Road, Horsley Park (c.31,720 sqm)
- Lot 71-72 Eastern Creek Drive, Eastern Creek (c.18,560 sqm).

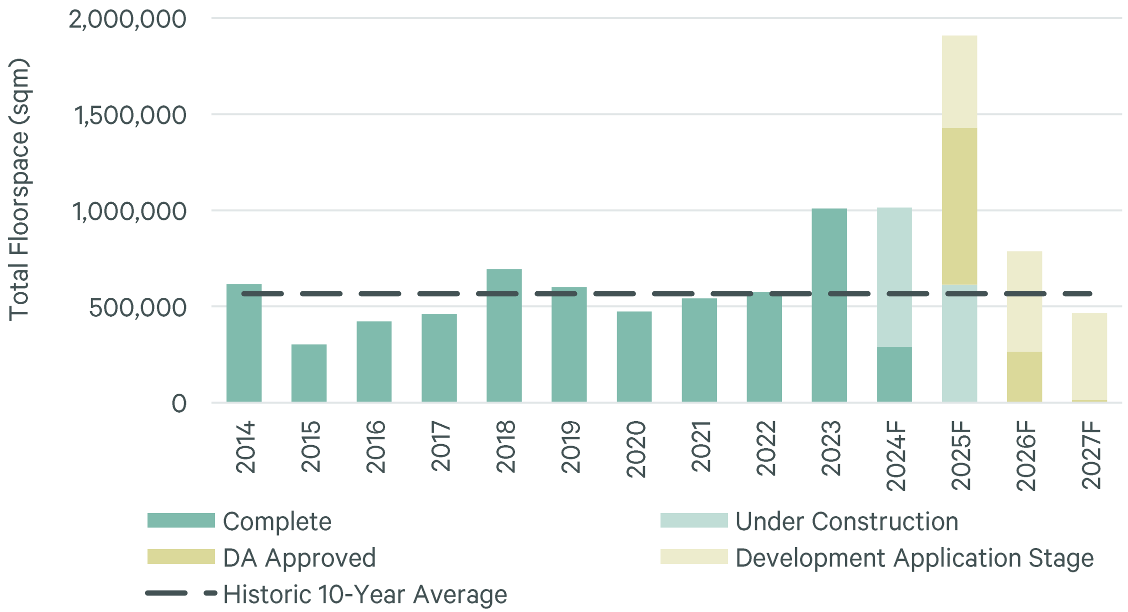
The pre-commitment rate for the 2024 pipeline is strong with close to 80% of the new supply committed.

The 2025 pipeline is expected to reach a record high of close to 2 million sqm, however it is important to note that c.70% of this space is still in DA stage. We also expect a large portion of the development pipeline to be pushed back into 2026 or further as high construction costs and market uncertainty continue to erode development feasibilities.

Despite the total supply in 2025 forecast to reach triple the long-run average, as at 2Q24, the pre-commitment rate stands at just over one-third.

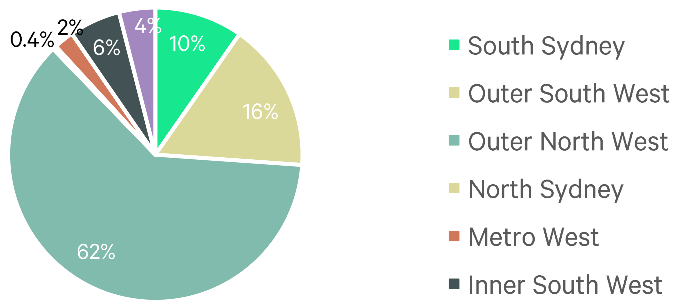
The Outer North West precinct is forecast to account for 62% of all new developments between 2024 and 2026.

FIGURE 3: Sydney development supply pipeline 2014-2027F



To note: Reflects new projects >5,000 sqm.
Source: CBRE Research Q2 2024

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



To note: Reflects new projects >5,000 sqm.
Source: CBRE Research Q2 2024

Leasing Market

Rental growth continues to stabilise over the quarter

Sydney average super prime and prime net face rents remained relatively stable over the quarter at 0.0% and 0.5%, respectively. On a year-on-year basis, super prime average net face rents increased by 5%, and prime and secondary rents grew by 6% and 5%, respectively.

Super prime net face rents within the Outer North West was the only precinct where growth was recorded, at 2.4% (q-o-q). The Outer North West has recently attracted greater demand from occupiers located within Inner Sydney precincts seeking newer facilities. Despite rents increasing, incentives also increased within this precinct by 2% over the quarter. The positive rental change recorded in the Outer North West was offset by a decrease in average rents within the Inner South West (-1.9%) over the quarter for super prime grade assets.

Despite the average vacancy rate in Sydney increasing to 2.0% (as at 1H24), new developments continue to be readily absorbed by tenants looking for scale and functionality. Positive rental growth is still expected in the short to medium-term for some precincts, albeit at a decreasing rate, as occupiers have limited options to attain the floorspace and fit out that suits their needs. Average secondary face rents recorded marginal negative growth of -0.6%, highlighting the occupier shift to modern warehouses, especially as new developments reach practical completion.

Sydney net effective rents decreased marginally across all asset grades as incentives increased over 2Q24. Average super prime, prime and secondary grade incentives increased by 1% and now average 13%, 14% and 15%, 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. Increasing vacancy has pressured institutional developers to raise incentives for new developments to secure pre-lease deals prior to reaching practical completion. We expect incentive levels to continue to rise over the remainder of 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 subdued 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.

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

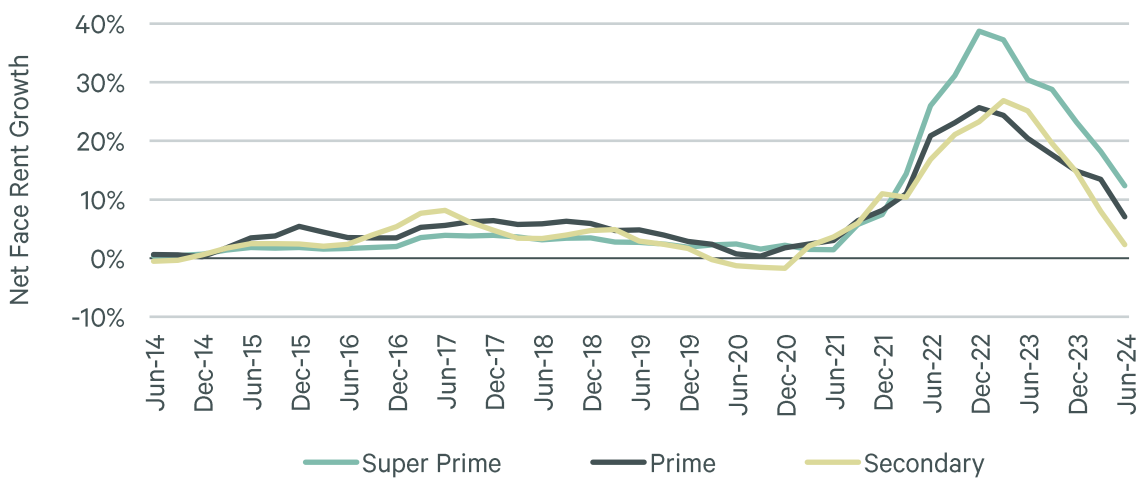
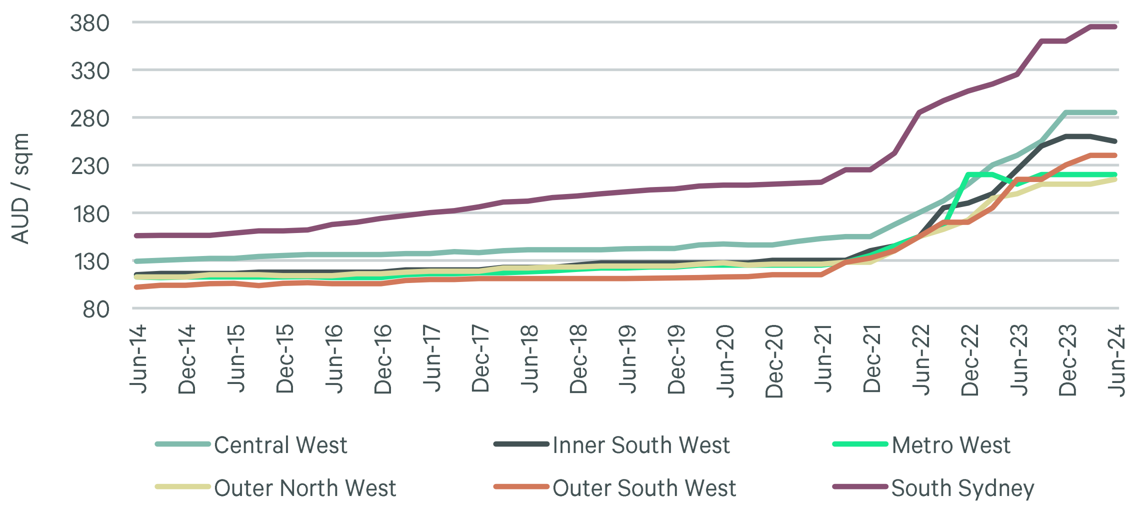


FIGURE 6: Average Super Prime Net Face Rents, by Precinct (2014-2024)



Source: CBRE Research Q2 2024

Land Values

Land values stabilise over the quarter

Demand for all lot sizes of industrial zoned land in Sydney decreased on a y-o-y basis. Average land values for 1.6 ha lots decreased by -1.8% (y-o-y). A marginal decline in land values for 0.25 ha and 3-5 ha lot sizes was also recorded of -1.4% and -1.2% y-o-y, respectively. Elevated capital costs and uncertainty surrounding interest rate movements continue to dampen institutional appetite for land investment. Furthermore, inertia from high construction costs on development feasibilities continues to constrain the development supply pipeline. This confluence of factors is expected to perpetuate subdued land acquisition activity in the near term.

Land values over the quarter remained flat across all lot sizes. This slowdown reflects the lack of developer interest to build on new parcels of land - a result of impeding high construction costs and increasing land taxes. On average, land values have been declining since 2Q23, however this quarter showed signs of values stabilising.

The Outer North West precinct recorded the only positive quarterly growth of 2.0% for larger 3-5 ha lots. The Precinct has the largest amount of undeveloped land supply (2,054 ha) in Sydney, however only 10% of this is serviced. Land values in the Outer North West currently average AUD 1,325/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 (critical mass of industrial activity), there has historically been greater land sales.

Infill precincts, notably South Sydney, North Sydney, and the Metro West, have demonstrated superior resilience in land values over recent years, contrasting with broader market trends. This stability is primarily attributed to the acute land constraints characterising these precincts. Their infill status, coupled with strategic proximity to the CBD and Kingsford Smith Airport, underpins a robust outlook for medium-term land value appreciation. Notably, current land values in these inner precincts command a significant premium, exceeding those in Outer Western precincts by more than double.

Source: CBRE Research Q2 2024

FIGURE 7: Average Land Values (0.25 ha lots), by precinct (2Q23 vs. 2Q24)

FIGURE 8: Average Land Values (1.6 ha lots), by precinct (2Q23 vs. 2Q24)

Source: CBRE Research Q2 2024

Investment Market

Investment sales volumes remain muted in 2Q24

A total of AUD 286 million of investment sales for income-producing assets was recorded in 2Q24 across 14 transactions (for sales ≥ AUD 5 million). The largest investment transaction was 133 Vanessa Street, Kingsgrove acquired by Blackstone for AUD 55.8 million. Other notable transactions include 25 Williamson Road, Ingleburn acquired for AUD 39.4 million and 118 Denison Street, Matraville for AUD 36.5 million.

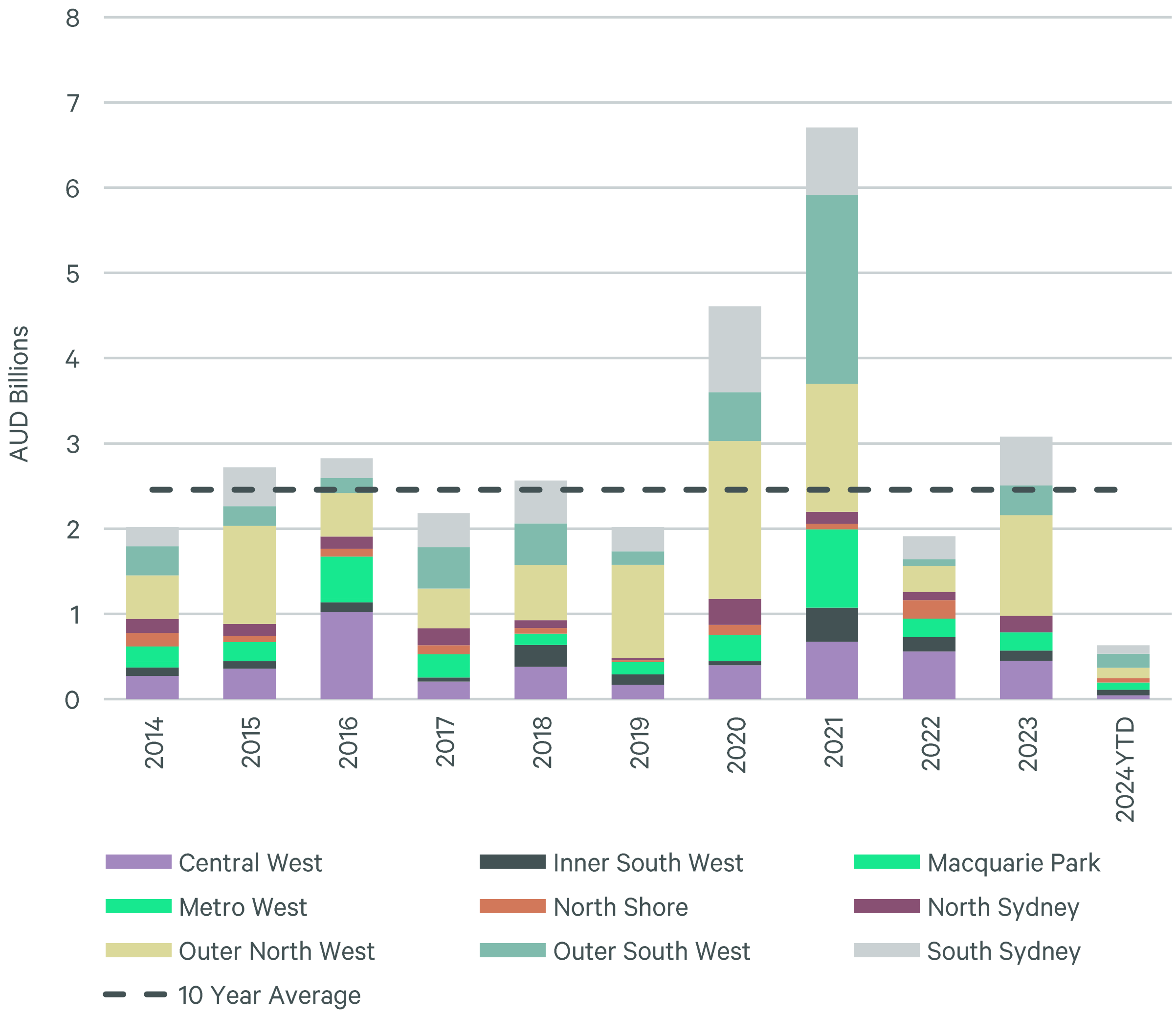
Total investment sales activity was significantly lower in 2Q24 compared to the 2023 quarterly average of AUD 770 million. However, we expect to see greater investment sale activity over the next 12-18 months if interest rates ease and financing becomes more affordable.

The prospect of continued rental appreciation over the coming 12 months presents a compelling investment thesis for capital allocation within the Australian industrial sector, especially as the bid ask spread between investors tightens. Yields are expected to stabilise over 2H24 after softening this quarter and asset values becoming more attractive to buyers. Midpoint yields over the quarter softened by 25bps across all asset grades and precincts. Super prime and prime grade asset midpoint yields currently sit at 5.6% and 5.8%, respectively.

FIGURE 9: Midpoint Yields 2Q20-2Q24, by Precinct

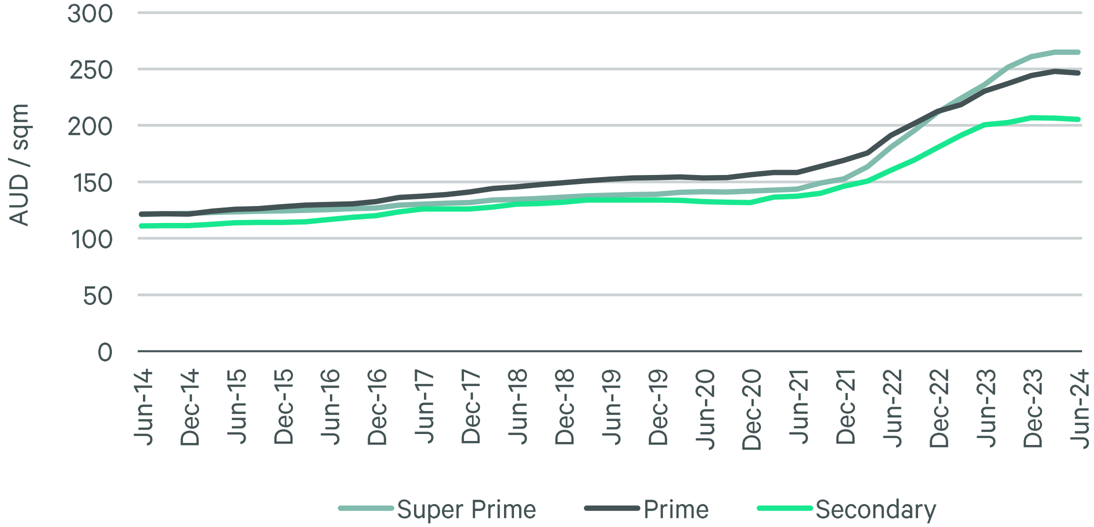
Source: CBRE Research Q2 2024

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



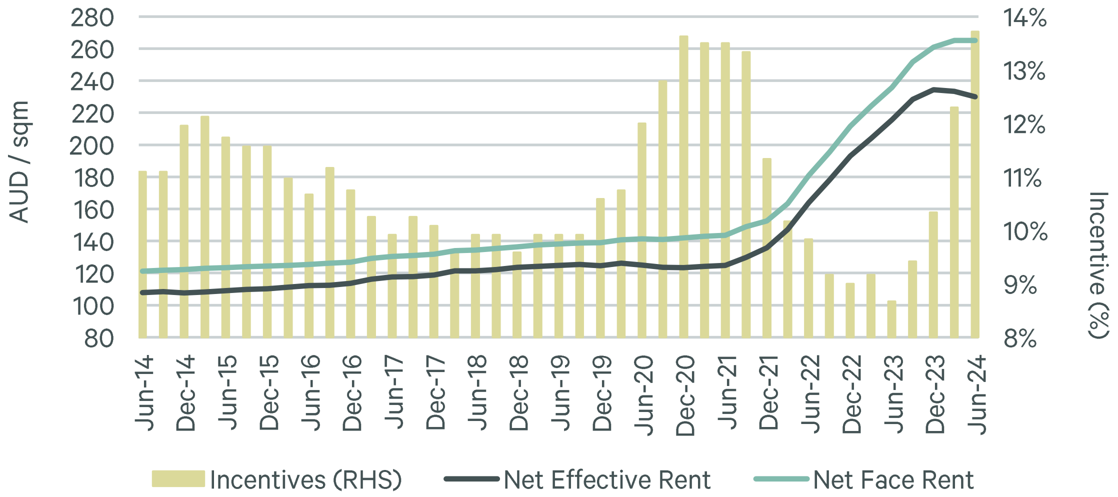
To note: Does not include land/development sales.
Source: CBRE Research Q2 2024.

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



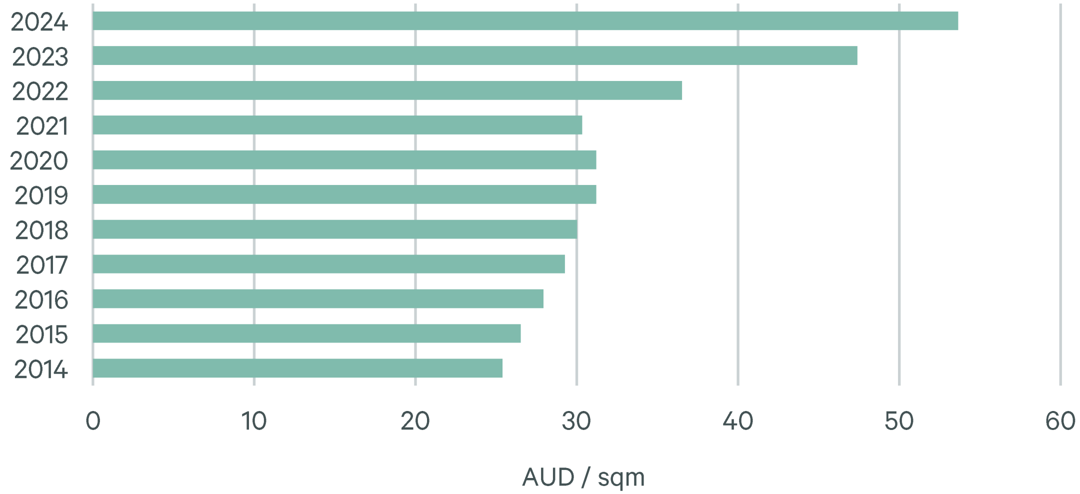
Source: CBRE Research Q2 2024

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



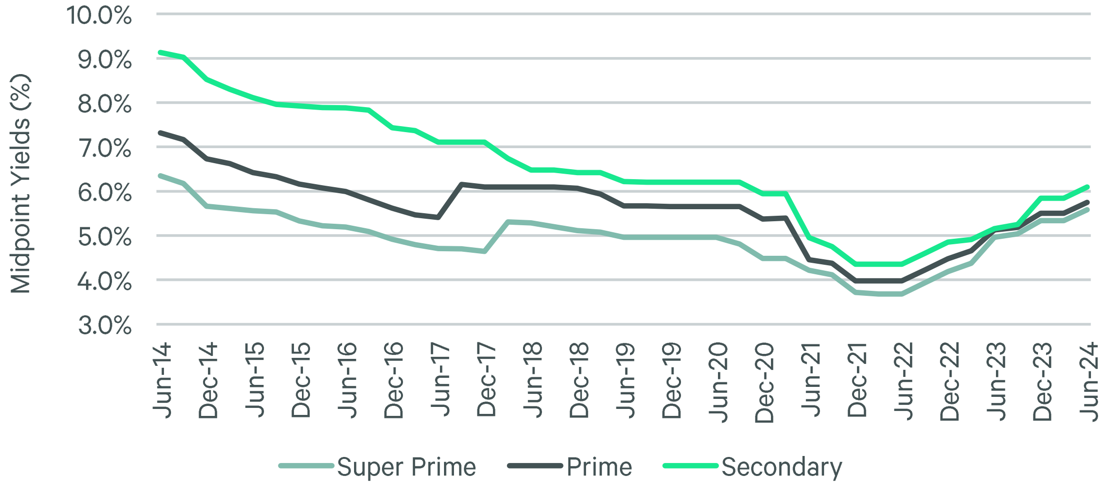
Source: CBRE Research Q2 2024

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



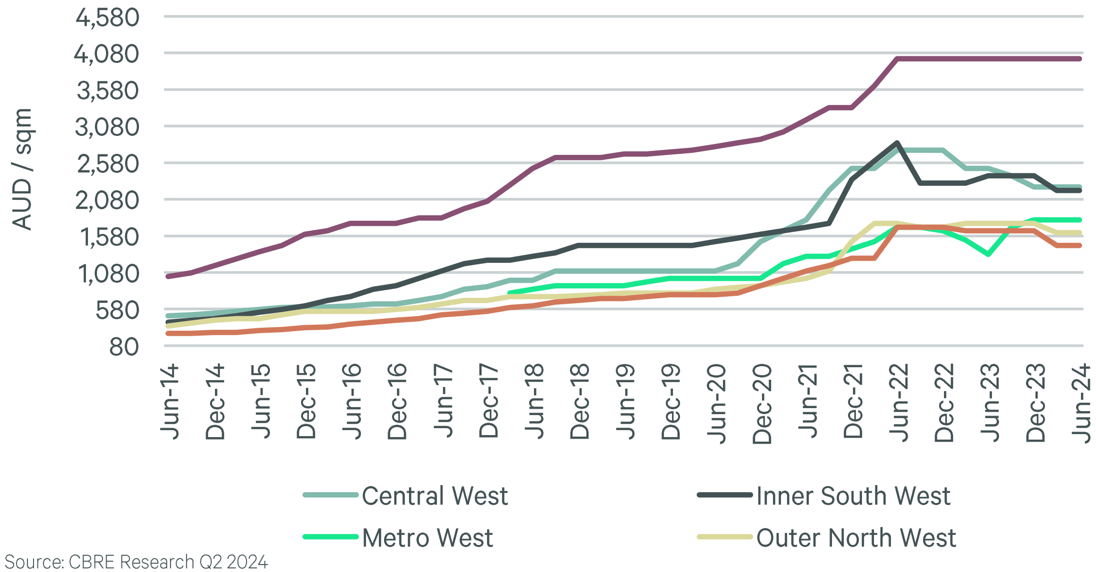
Source: CBRE Research Q2 2024

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



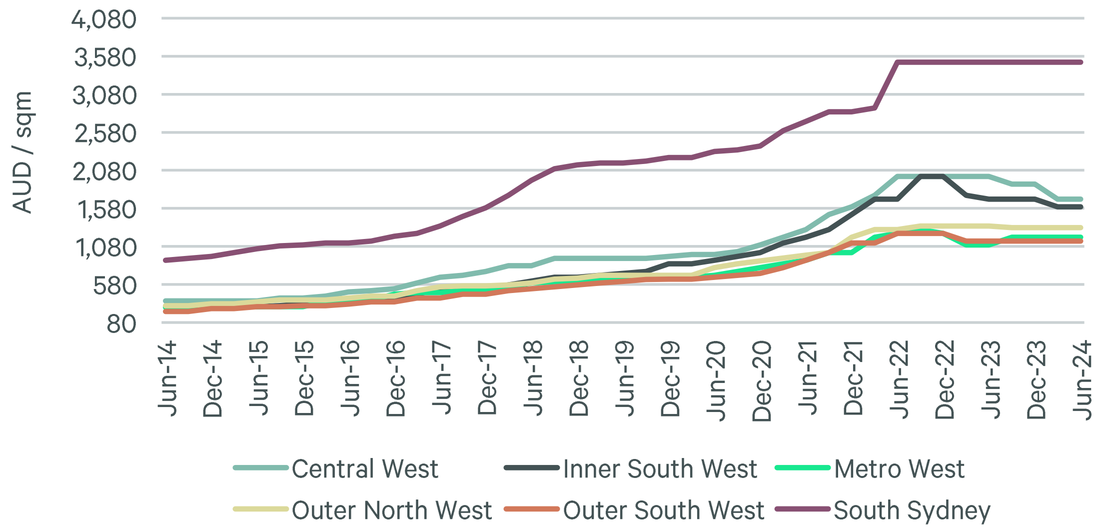
Source: CBRE Research Q2 2024

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



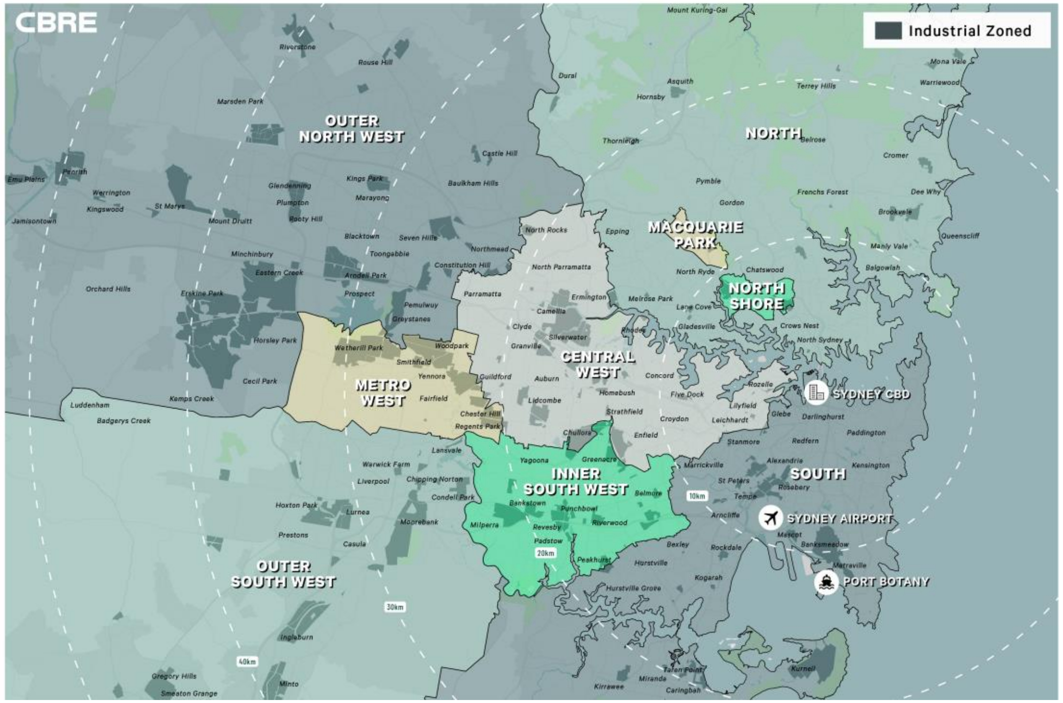
Source: CBRE Research Q2 2024

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



Source: CBRE Research Q2 2024

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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