HMW REAL ESTATE ADVISORY

SEQ INDUSTRIAL MARKET OUTLOOK

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Overview

The industrial sector emerged from the COVID-19 pandemic as a popular asset class with investors. Whilst the pandemic softened demand fundamentals in the more traditional sectors of office and retail, the industrial sector benefited from heightened occupier demand, driven by numerous factors including strong e-commerce growth and a return to more localised manufacturing. More recently, strong population growth has been a major driver of continued strength in the occupier market.

As a result of strong occupier demand, coupled with construction delays, the industrial market has witnessed extremely low vacancy rates. As of Q4 2023, the vacancy rate was recorded at 1.9%. The low vacancy rate has driven rental growth at levels not seen before, as well as a sharp reduction in incentives, over the past year.

Following record levels of investment activity over previous years, transaction values have been subdued during 2023. Investors have displayed heighted caution this year given the uncertain economic and pricing environment. These conditions have resulted in a softening of circa 100 basis points in both prime and secondary industrial yields across the South East Queensland market.

The manufacturing industry's contribution to the economy has broadly trended downwards since the 2007-08 financial year. Despite ticking up during the pandemic, it tapered back again during the 2022-23 financial year. The Transport, Postal and Warehousing industry's contribution to the economy declined sharply during the start of the pandemic, before rebounding over the past two fiscal years, driven by growth in e-commerce, business's focus on supply-chain efficiencies, and higher business inventory levels ("just in case" inventory management). This trend has been reflected in industrial space absorption, with users from the Transport, Postal and Warehousing industry consistently accounting for significant shares of leasing demand.

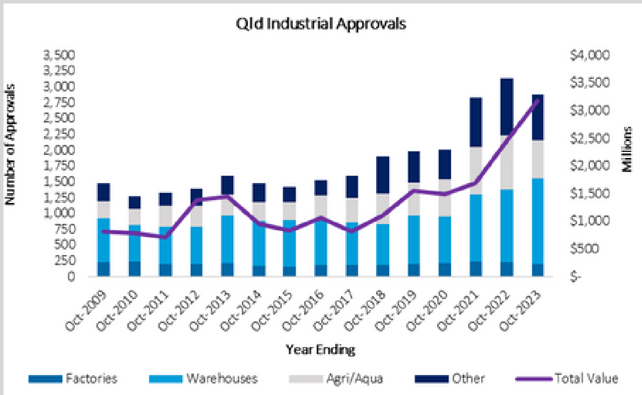
Supply

The number of industrial building approvals declined over the year ending October 2023, compared with the previous 12-month period; however, the total value of industrial approvals rose to over $3 billion. By value, the $20 to $50 million bracket has seen exceptionally strong growth in the number and value of approvals over the past two years, driven by growth in warehouse approvals.

The Draft Shaping SEQ 2023 Update states that key areas of SEQ are approaching a critical shortfall of industrial land, with the Brisbane LGA having an estimated 10 to 15 years supply (with the impacts expected to be felt on land pricing in particularly within 5-10 years).

The Update establishes a regional approach to industrial land planning to complement Local Government planning and identifies future industrial land, particularly in the Redland, Sunshine Coast and Gold Coast LGAs. Furthermore, the LGAs of Gold Coast, Ipswich and Logan are expected to play key roles in meeting future demand, due to freight and logistics networks and freight volumes from the southern states.

Consultation on the Draft Shaping SEQ 2023 Regional Plan closed on 20 September and the final update took effect on 15 December 2023.



Source: ABS, HMW Real Estate Advisory
Note: building approvals $250,000+

The significant number of Logistics and Industrial projects were completed during Q4 2023, with an approximated 400,000 square meters of new supply being introduced to the market.

For the year through 2023, an approximate 750,000 square meters of new floorspace was added.

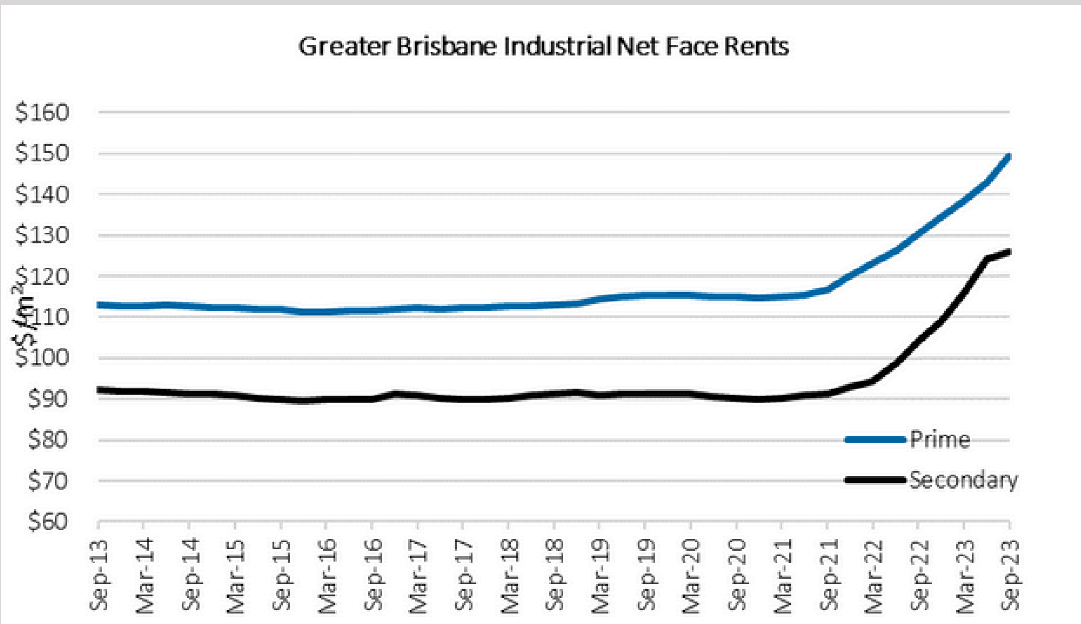
A further supply of 900,000 square meters is anticipated for 2024, with approximately 30% already under construction.

Rents

Data to September 2023 indicates that prime net face rents were averaging circa $150 per square metre and secondary net face rents were averaging circa $125 per square meter. The Australia Trade Coast continues to attract a premium to the remaining sub-markets. The spread between prime and secondary rents has diminished over recent years due to the tight vacancy rate.

Net face rents have seen strong growth over the past year, offsetting, to some degree, the effect of softening yields on industrial property values. Agents at the coalface are suggesting that these trends are continuing and that net face rents are closer to circa $160 plus per square meter. Prior to this recent growth, rents across Brisbane had been largely stable for a number of years. Effective rents have seen even stronger growth due to declining incentives. Incentives averaged circa 15% for prime buildings during Q4 2023.

The industrial market remains a landlord's market. Tight vacancy rates have limited the number of lease deals that have occurred over recent years and contributed to strong rental growth. Activity has been strongest in the south and southwestern markets, which is where the majority of the new supply has been completed. However, we note that landlords that signed long-term leases with tenants without the provision for market reviews will be unable to take advantage of the strong rental growth environment and are possibly locked in on long remaining lease terms with passing income that is substantially lower than market income.

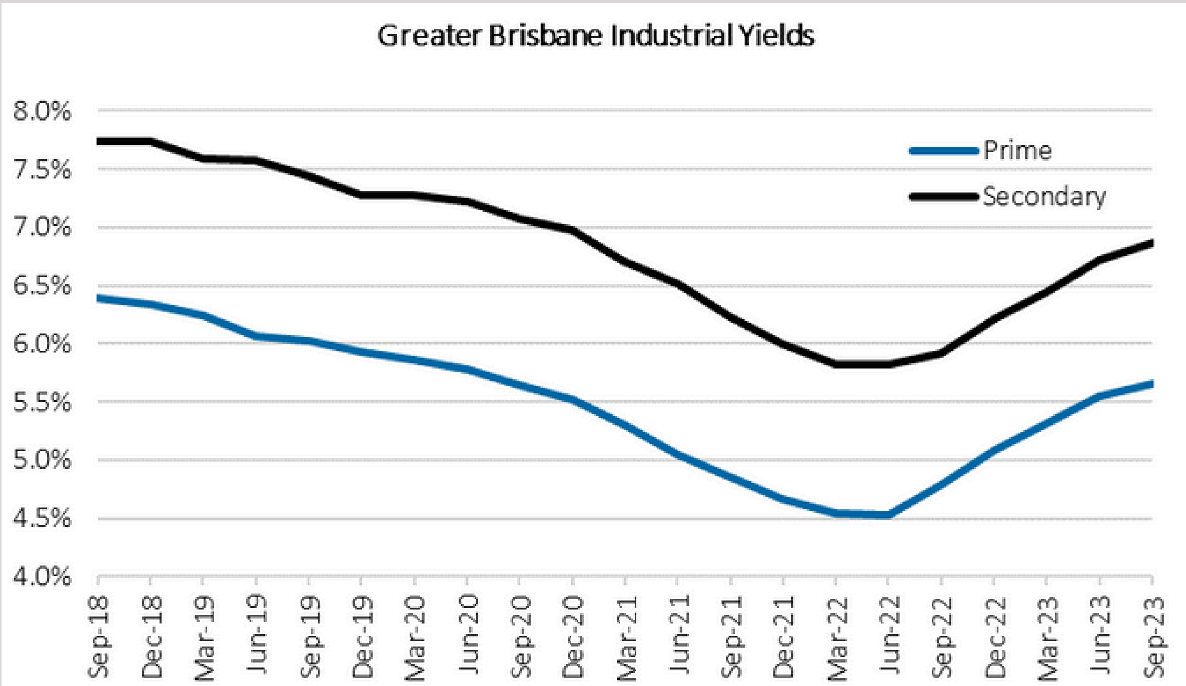


Source: HMW Real Estate Advisory

Investment market

Sales volumes have declined considerably during 2023 due to the higher interest rate environment and the disconnect between vendor and vendee expectations. Lower leveraged buyers such as private investors and owner occupiers have accounted for a larger proportion of sales this year than they have during previous years. Private investors have been acting more opportunistically whilst owner occupiers have likely been influenced to buy rather than rent due to the increasing costs associated with renting.

Yields have softened since mid-2022, with prime yields currently averaging circa 5.75 to 6.50% and secondary yields averaging circa 6.5 to 7.0%. Over the past 12 months, yields have softened by circa 100 basis points for both prime and secondary assets. However, strong rental growth has partially supported capital values despite this softening in yields. After a period of rapid growth in land values, values have stabilised over the past year.



Source: HMW Real Estate Advisory

Outlook

Leasing demand is forecast to remain elevated through 2024.

There is a strong pipeline of supply expected to hit the market throughout 2024/25 which will not outstrip demand.

However, over the medium-term, we expect that occupier demand will strengthen, resulting in the potential for above historical average levels of rental growth over the medium- to longer-term. This forecast is based on:

- Robust population growth forecast for South East Queensland.
- Construction of infrastructure and facilities for the 2032 Olympic Games.
- Demand from national occupiers without a Brisbane / SEQ presence.
- Reducing land availability.
- Improving economic conditions.
- Continued growth in online retailing.

When compared with the office and retail sectors, which are still in many respects feeling the pain of COVID-19 induced demographic changes (i.e. working from home and shopping online), we are of the view that industrial properties remain a standout investment option, backed by sound longer-term fundamentals and increased certainty regarding occupier demand going forward.

Investment demand is expected to increase from early next year following an expected stabilisation in interest rates and higher certainty regarding the cost of debt.

The opportunity in this sector relates to under-rented investment properties which are now on a lease where the rent was set pre-COVID at a rent(s) which are below current market rents. We expect further increases in market rents in the short term which may increase the rental spread between rentals of existing leases and market yields. The yields need to allow the vendor to take into account the risk associated with the vendor taking on the risk of the impending reversion and market movements prior to the reversion transpiring.

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