Research Report

November 2014

The Rise of "New Industrial" in South Sydney

Key Points

- "New industrial" occupiers are increasingly taking-up once traditional industrial space for showroom, hospitality, creative office, and recreational use in order to service the growing local residential population.
- Competition between New Industrial and traditional industrial occupiers is driving change in market pricing dynamics.
- Owners are repositioning assets to cater for smaller occupier space requirements, while developers are also adapting with smaller strata plan projects.
- There are significant rent and value differences between New Industrial and traditional industrial premises, reinforcing the lifecycle of industrial property, and creating capital value growth and re-rating of the area as an adaptive re-use precinct.
- The expanding local residential population will continue to support further up-take of industrial space by New Industrial occupiers.

Introduction

South Sydney is undergoing rapid transformation. A precinct once associated with logistics and manufacturing is becoming increasingly recognised as a residential growth hub. Greater high density development and ongoing gentrification are underpinning the evolution of South Sydney from a blue collar, industrial working class area to an upmarket, mixed-use precinct with a rapidly growing local residential population.

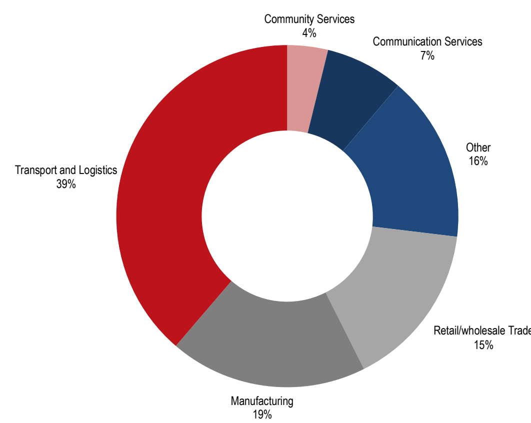
A consequence of this transformation is the increasing take-up of traditional industrial space by non-traditional industrial occupiers, particularly in the suburbs of Rosebery and Alexandria. These "New Industrial" occupiers are adaptively re-using traditional warehouse and office space and converting them into showroom, hospitality, creative and recreational use.

New Industrial occupiers are increasingly competing with traditional industrial occupiers such as manufacturing, wholesale/retail trade and transport and logistics firms for industrial space. This has far reaching implications for the South Sydney industrial market. This paper will examine the changing dynamic between New Industrial and traditional industrial occupiers, and the resulting structural shift in occupier composition, industrial stock and asset values.

Traditional industrial vs "New Industrial"

The traditional industrial occupier market in South Sydney is broadly typical of most mature industrial precincts in Sydney. Take-up data recorded since 2007 shows that the most dominant industrial occupiers have been transport and logistics firms, followed by firms in manufacturing and retail/wholesale trade (Figure 1). It should be noted the data reflects users greater than 5,000 sqm which are less common in South Sydney today.

Figure 1: Industrial gross take-up by industry since 2007



Source: JLL Research

However, these traditional industrial occupiers are increasingly being "squeezed" out of the market by New Industrial occupiers. New Industrial occupiers are firms that take-up traditional industrial or office space but are not considered typical industrial space users and generally require some adaptive re-design of the space.

In South Sydney, the most active New Industrial occupiers are:

- Showroom / bulky goods retailers
- Hospitality companies
- Alternative office boutiques
- Recreational firms

In order to establish a presence in the South Sydney market, many of these New Industrial occupiers are beginning to take-up traditional industrial space. Areas where competition is greatest are generally in neighbourhoods undergoing significant gentrification such as Rosebery and Alexandria. These suburbs are often more suitable for New Industrial than traditional industrial occupiers due to increasing road congestion and older building designs which limit the efficiency of traditional industrial occupiers.

Given a rapidly expanding local resident population, the need for the services provided by New Industrial occupiers is mounting. A greater number of food establishments, childcare centres, recreational facilities, and professional and domestic services firms are required to service the growing population. Table 1 provides a number of examples of New Industrial firms that have moved into South Sydney.

Demand for these services is expected to grow strongly as the 3,000 or so high density dwellings in South Sydney complete over the next few years. According to ID Consulting, in the period between 2011 and 2021, the local resident population in Botany Bay LGA is expected to increase by 23%. Even greater growth is forecast for Sydney City LGA (which includes Alexandria and Zetland), with 30% growth expected.

Table 1: New Industrial occupiers in South Sydney

Tenant	Usage	Address
Gallen and Gray	Medical/office	Lvl 4/244 Coward St Mascot
Little Dynamos	Recreation	14/33 Maddox St, Alexandria
Kitchen by Mike	Hospitality	1/85 Dunning Ave, Roseberry
Renault	Showroom	93 O'Riordan St, Alexandria

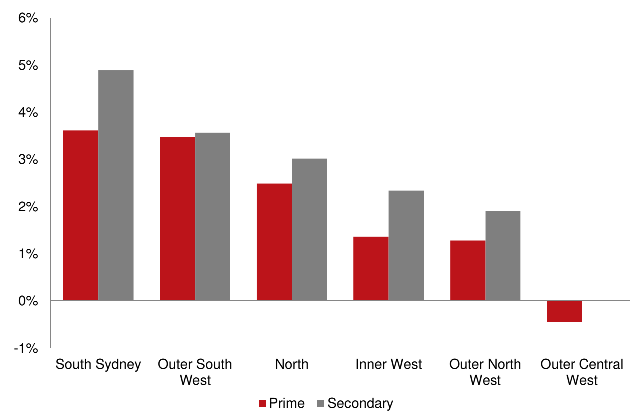
Source: JLL

Rental and value upside

The push into South Sydney by New Industrial occupiers is creating significant uplift in industrial rents and values in two distinct ways. Firstly, adaptive re-use to cater for New Industrial occupiers has further reduced the traditional industrial stock base, thereby placing upward pressure on rents for the remaining existing traditional stock. This has been most evident in Botany and Matraville which have increased in strategic importance for logistics operations close to the Port and Airport. Strong rental outcomes are being achieved in these locations.

As Figure 2 illustrates, rental growth in South Sydney has significantly outperformed the broader market, particularly for secondary grade facilities. New Industrial occupiers so far have tended to occupy secondary industrial space.

Figure 2: Average industrial rental growth since 1Q13



Source: JLL Research

Secondly, the alternative uses employed by New Industrial occupiers generally command a higher rental rate per sqm. As Table 2 highlights, the rental differential between New Industrial and traditional industrial usage is significant. On a typical lease over a GLA of around 5,000 sqm, traditional industrial occupiers in South Sydney would expect to pay between AUD 130 per sqm and AUD 160 per sqm. This is well below the achievable rents for New Industrial occupiers. To illustrate, firms in the hospitality sector will generally pay an average of between AUD 300 per sqm and 400 per sqm; while showroom users or bulky goods retailers will pay between AUD 200 per sqm and AUD 300 per sqm.

Table 2: Rental differentials between use types

Use type	Average rent per sqm (AUD)
Traditional Industrial	130 - 160
Recreational	190 - 210
Showroom / bulky goods	200 - 300
Hospitality	300 - 400
Alternative office	380 - 420

Source: JLL

Significant value upside is clearly achievable for existing owners through adaptive re-use. However, this adaptive re-use can often incur significant capital expenditure from owners and must be weighed against the risks. Consideration must be given to a site's suitability to adaptive re-use such as zoning, existing built form, location and street frontage, car parking allowances, site accessibility, existing competition and the effects of clustering. All of these factors will impact the viability of creating a product suitable for New Industrial occupiers.

Changing dynamic of the industrial market

Traditional industrial occupiers in South Sydney will have to adapt to a more competitive occupier market and an ongoing diminishing stock base, while asset owners and developers in turn need to assess and respond to changing occupier requirements.

Many larger format occupiers (> 10,000 sqm) are increasingly favouring Outer Western Sydney locations over South Sydney. There are two main reasons for this – the comparative cost advantages available in Western Sydney, and the relatively limited availability of suitable large format warehouses in South Sydney. Rents in Outer Western Sydney are on average 42% lower than the average rent in South Sydney. Consequently, the majority of leasing deals in South Sydney is now typically in the 1,000 sqm to 3,000 sqm GLA cohort. Only one lease over 5,000 sqm has been recorded in 2014, with Woolworths taking up approximately 9,900 sqm at 306 Coward Street, for a new dark store distribution centre.

Some owners of traditional industrial property have responded to greater demand from smaller occupiers by subdividing larger tenancies of 10,000 sqm to 15,000 sqm into smaller offerings. An example of this is Goodman's property at 1a Hale Street, Botany. Goodman is expected to subdivide Buildings 1 and 2, with tenancies starting from just 2,000 sqm. This not only caters to smaller occupiers (where the majority of current demand is coming from), but also to New Industrial occupiers who do not require large format warehouses.

Developers are also adapting to the requirements of smaller occupiers, with more unit and strata developments being brought to the market. These projects are proving popular with both tenants and owner occupiers. A strata development at 4-10 Anderson Street, Botany is now completely sold out, with approximately 92% of the 41 units exchanged prior to registration of the strata plan. Sizes in the development are between 73 sqm and 153 sqm. Another significant strata development, located at 95 Burrows Rd Alexandria, is currently under construction. All but 3 of the 13 units have sold, with units ranging from 130 sqm to 308 sqm. In line with New Industrial entrants into the market, the development is also set to house a childcare centre.

Conclusion

The transformation of South Sydney from an industrial precinct to a high density residential and mixed use area is set to accelerate in the coming years. This ongoing gentrification raises significant implications for the South Sydney industrial market, particularly in terms of the structural shift in occupier composition and demand, and the flow-on effects of these changes on rents and values.

With New Industrial occupiers supported by the growing local residential population, traditional industrial occupiers will face greater competition for space. Nevertheless, key industries will remain in South Sydney, particularly transport and logistics groups. The precinct's close proximity to the CBD, Sydney Airport, Port Botany and important road corridors underline the strategic importance of the area as an industrial hub. However, more traditional warehouse users will increasingly look to the M5 South West corridor and the Inner West unit estates for accommodation. This cascade of occupier activity over the next few years – supported by similar urban activation of industrial precincts in North Ryde, Macquarie Park, Epping and Homebush – will eventually result in a round of new development activity in the Outer West as existing market rents increase and make new development options more attractive.

For more information, please contact:

Peter Guevarra
Manager
Research
JLL
tel: +61 2 9220 8727
peter.guevarra@ap.jll.com
www.jll.com.au

Keegan Ridings
Associate Director
Industrial & Commercial - NSW
JLL
tel: +61 2 9693 9815
keegan.ridings@ap.jll.com
www.jll.com.au

Jones Lang LaSalle offices

Adelaide
Level 22, Grenfell Centre
25 Grenfell Street
Adelaide SA 5000
tel +61 8 8233 8888

Brisbane
Level 33, Central Plaza One
345 Queen Street
Brisbane QLD 4000
tel +61 7 3231 1311

Canberra
Level 7, 121 Marcus Clarke Street
Canberra, ACT, 2601
tel +61 2 6274 9888

Glen Waverley
Building 2
540 Springvale Road
Glen Waverley VIC 3150
tel +61 3 9565 6666

Mascot
Level 3, Sydney Airport Centre
15 Bourke Road
Mascot, NSW, 2020
tel +61 2 9693 9800

Melbourne
Level 21, Bourke Place
600 Bourke Street
Melbourne VIC 3000
tel +61 3 9672 6666

North Sydney
Level 27, North Point
100 Miller Street
North Sydney NSW 2060
tel +61 2 9936 5888

Parramatta
Level 8, 79 George Street
Parramatta NSW 2150
tel +61 2 9806 2800

Perth
Level 29, Central Park
152-158 St George's Terrace
Perth WA 6000
tel +61 8 9322 5111

Sydney
Level 25, 420 George Street
Sydney NSW 2000
tel +61 2 9220 8500

www.jll.com.au