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INDUSTRIAL CAP RATE ANALYSIS

Post A-REIT Reporting Season - September 2020

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5.4% average industrial cap rate

12bps six month cap rate compression

$75.1 million average asset value

Australian industrial and logistics property is currently the most sought after property asset class, underpinned by favourable structural tailwinds which continue to positively impact the sector. With investment in the sector remaining significant at or during the COVID-19 period, headlined by 11, $100 million + acquisitions, capitalisation rates continue to compress, evidenced by the completion of the June 2020 A-REIT reporting season.

The rapid increase in e-commerce penetration coupled with expansion requirements from supermarkets and pharmaceutical companies has had a positive impact on Australian REITs (A-REIT) with exposure to industrial property, despite headwinds as a result of COVID-19. The impacts of the pandemic on the Australian industrial and logistics sector have been modest to date, particularly when compared to other real estate sectors. The largest impacts have stemmed from supply chain disruptions and the inability of some occupiers to pay rent; however, this has been concentrated at the smaller end of the market and from an overall portfolio perspective, they have accounted for only a minor share of tenants.

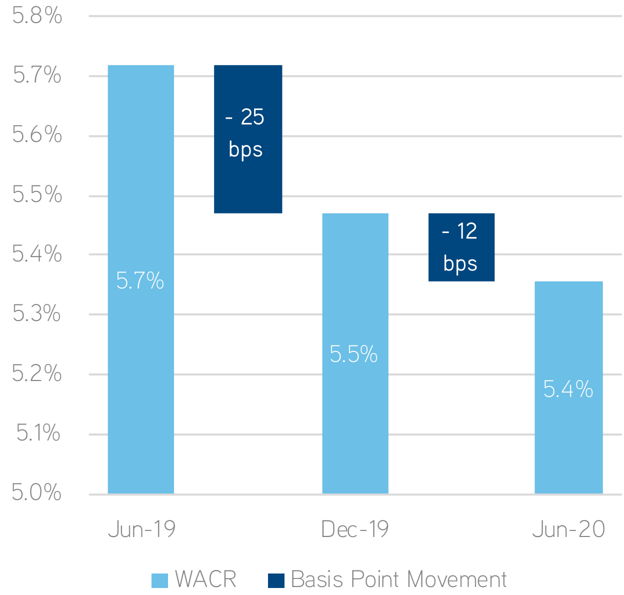
While share prices experienced large falls at the depths of COVID-19, they have since recovered. Prior to the pandemic, the S&P/ASX200 A-REIT Index reached 1,706 points and fell to a low of 877 points in late March as both global and domestic economic conditions deteriorated. By mid-August, the index was up at around 1,260 points and represents growth of 44% from the low point in March.

Following the completion of the June 2020 A-REIT reporting season, the data highlights the resilience of the industrial sector with a modest level of firming in capitalisation (cap) rates being recorded over the six months to June 2020. Notably, this contrasts to steady or modest levels of softening in some cases within the office and retail sectors. Cap rate compression has been driven by continued favourable fundamentals and a significant weight of capital chasing defensive industrial assets with strong demand from both domestic and offshore investors.

The weighted average capitalisation rate (WACR) of the major A-REITs industrial assets firmed by 12 basis points (bps) over the past six months and 37 bps over the past year to currently average 5.4%.

Where information at an individual asset level is available, all states recorded cap rate compression over the six months to June 2020, led by Queensland (-9 bps) and New South Wales (-7 bps). The rate of compression in Victoria was more modest at 3 bps over the same period.

Australian REIT Industrial Cap Rate Analysis



Source: Company Reports, Colliers Research

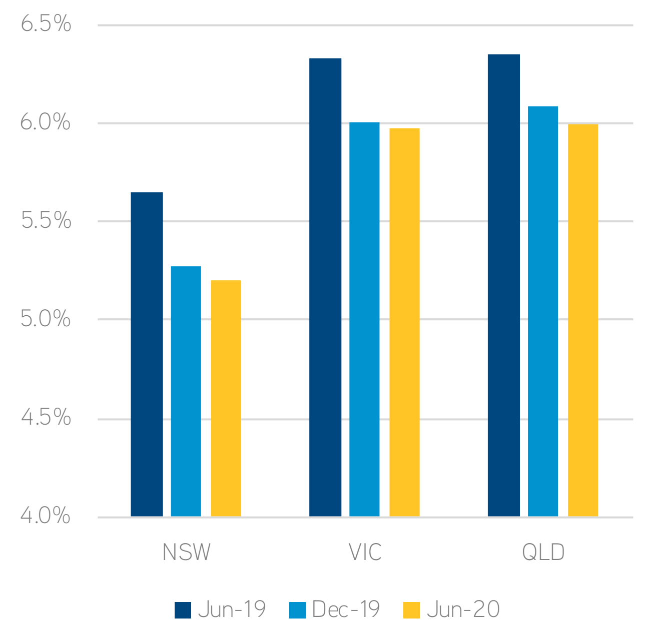
The underlying fundamentals within the industrial and logistics sector support the possibility of further cap rate tightening in the near term. In addition, with the spread between bonds and property yields being close to historical highs and the cost of debt remaining affordable, select core markets will see a continued re-pricing on assets, particularly as the buyer pool remains significant post COVID-19. We estimate that there is ~$20 billion worth of capital looking to be placed in the Australian industrial and logistics market. With just over $3.5 billion trading so far in 2020 ($10m+), it highlights the mismatch between demand and supply.

Recent benchmark industrial and logistics sales that have occurred in recent months imply yield compression for well located, modern warehouses with secure long-term leases in place. Most notably, this includes 40 Lockwood Road, Erskine Park (4.50%), the Aldi portfolio (4.64%), 1 Botero Place, Truganina (4.79%) and the Kemps Creek Sigma asset (4.48%). The recent 50% sale of Frasers' remaining stake in the Coles cold storage distribution centre at Parkinson to DWS is a live example of continued cap rate compression at or during the COVID-19 period. The first 50% stake was acquired by DWS in mid-2019 on a yield of 5.63% ($134.2 million) while the remaining 50% sold on a yield of 5.11% ($152.5 million), reflecting 52 bps of compression over the year.

Beyond the macro themes supporting the sector, multiple A-REITs are reweighting their portfolios to the industrial sector and include Charter Hall, GPT, Stockland and Lendlease. At the same time, traditional dominant players such as Goodman remain active in the sector and are focussing their attention on their existing land banks and development. Over the medium term, this will see the quality of industrial assets improve, as secondary assets are recycled, in effect replaced over time with prime grade speculative and design and construct assets. This will drive relative yield compression going forward as the quality of the average portfolios improve.

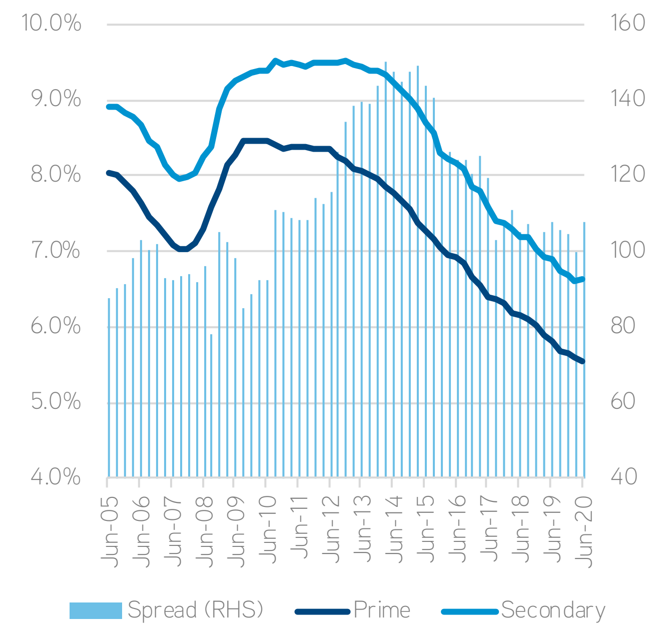
2020 will be remembered as the year of securing the right asset, backed by a strong tenant covenant. While the cap rate split between prime and secondary A-REIT assets is not available, our view is that secondary assets will see some modest upward movement in cap rates as risk becomes priced in. Up until recently, risk was often overlooked as groups aggressively expanded their presence in the market and as a result, there was little (if any) discount applied to weaker assets that didn't have the covenant or length of lease of prime core offerings. In saying that, there has been very few secondary assets to trade in 2020 and those that have sold have been highly sought after and are showing very limited yield softening at this stage.

Australian REIT Industrial Cap Rate Analysis by State



Source: Company Reports, Colliers Research
Note - only includes A-REITs who publish data at an individual asset level

National Industrial Yields by Grade



Source: Colliers Research

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