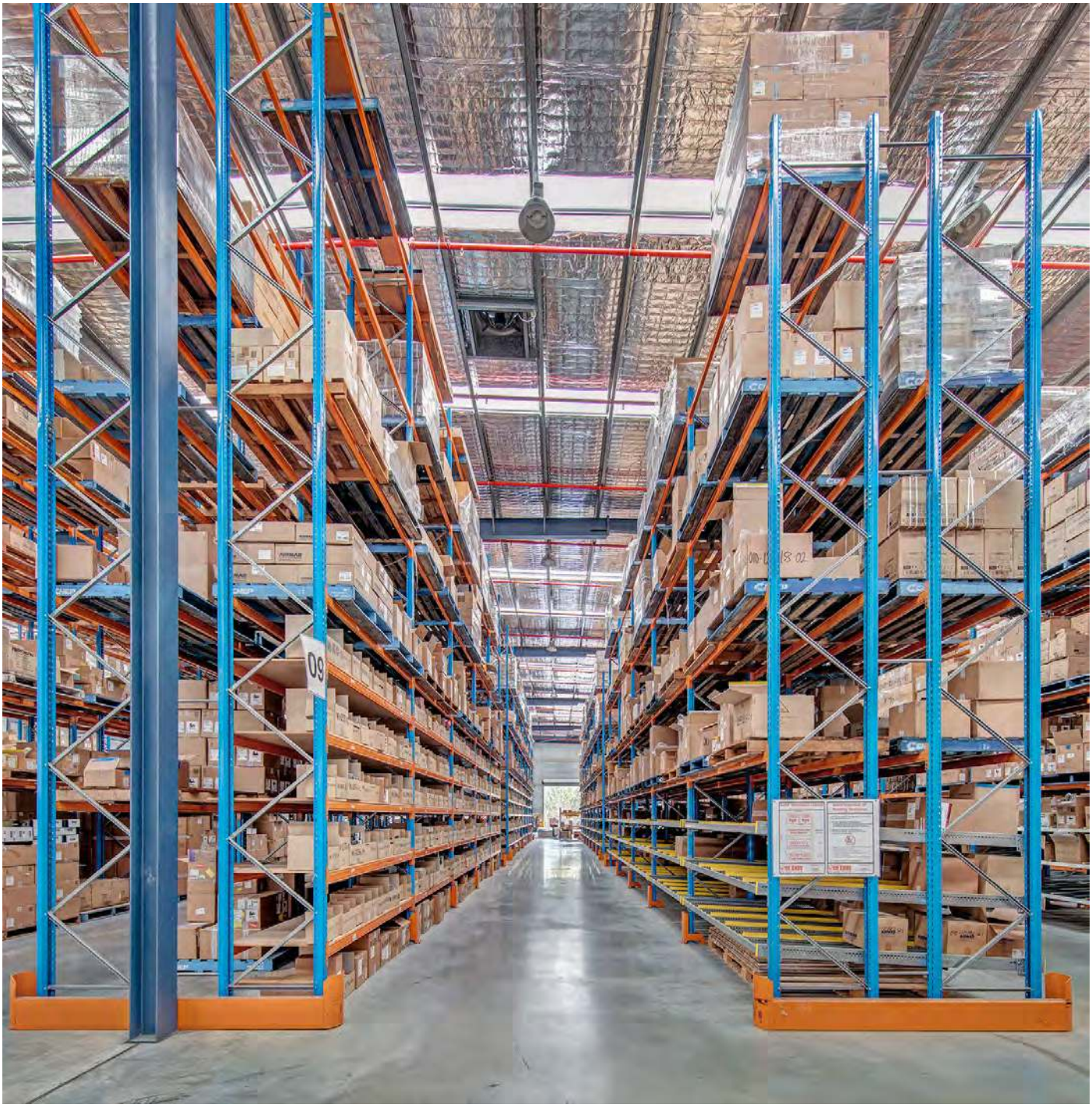
Centuria



How Australia's 2020 infra peak will fuel industrial property

ASX | CIP

5 market movements that matter:

The infrastructure investment boom, combined with e-commerce, manufacturing trends, and other developments, signals both change and good news for industrial real estate.

The link between infrastructure and industrial property has always been tight – increased spend stimulates the local economy, providing jobs and fueling demand for industrial property. In NSW, the government is spending more on infrastructure now than any other state – and the effects are set to be felt across the State. But there are other factors at play – economic and social forces which make the playing field, and likely consequences of current infrastructure spending, very different.

There is a close link between spending on infrastructure and economic growth. According to the most recent[1] report by Infrastructure Partnerships Australia, the Australian Federal Government currently spends just over 1% (1.04%) of its budget on infrastructure – almost $9.4 billion on transport alone in the four years to FY2012-2022 – and the investment is getting higher. In his 2019 Federal Budget, Treasurer Josh Frydenberg announced an increased infrastructure spend of $100 billion over 10 years. This spells good news for economic growth in the areas where the spend is highest, and good news for property markets as a whole.

2018-19 Australian Infrastructure Funding Levels, Ranked by Share of Budget Expenditure

1st NSW	
Share	17.65%
Total	$65.71b
Change	**+16.06b**

3rd QLD	
Share	11.57%
Total	$29.11b
Change	**+2.38m**

5th ACT	
Share	10.76%
Total	$2.76b
Change	**+285m**

7th TAS	
Share	9.89%
Total	$2.56b
Change	**+518m**

2nd VIC	
Share	11.77%
Total	$33.65b
Change	**+806m**

4th NT	
Share	11.39%
Total	$3.03b
Change	**+185m**

6th SA	
Share	10.17%
Total	$8.56b
Change	**+1.47m**

8th WA	
Share	6.16%
Total	$7.72b
Change	**-1.14m**

Commonwealth	
Share	1.04%
Total	$21.47b
Change	**-2.02m**

Key
Share of budget expenditure on infrastructure funding
Total infrastructure funding (over forward estimates)
Change to infrastructure funding programme

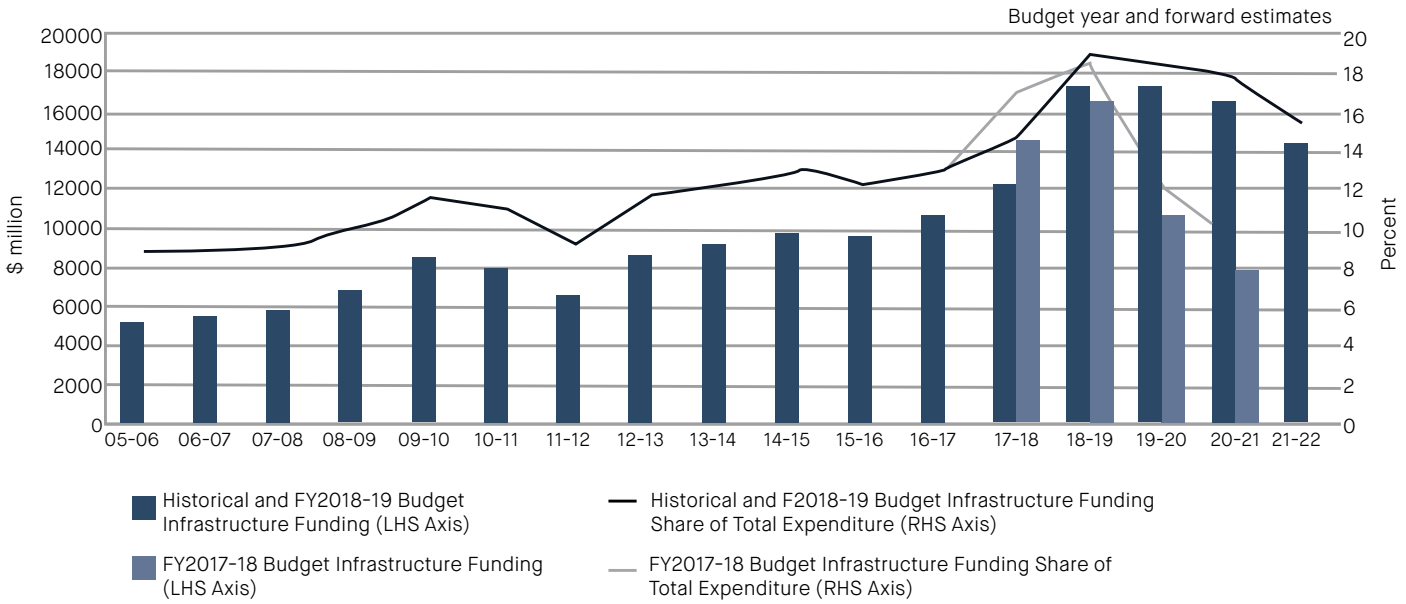
* The Commonwealth Government primarily funds state infrastructure projects. As such it is not formally included in the rankings. We include it in the report to provide a comprehensive view of funding commitments.
Source: Infrastructure Partnerships Australia calculations, based on 2018-19 and 2017-18 Budgets

[1] "Australian Infrastructure Budget Monitor 2018-19"; Infrastructure Partnerships Australia

The same report points to strong commitments to infrastructure in all states, with the exception of Western Australia, but in NSW, spending is higher than it has ever been. In FY2018-19, NSW will spend 17.65% of its total budget on infrastructure – over $16 billion, an increase of 32% over the previous year, and 50% over the past five years. In fact, between them, NSW and Victoria account for 65% of total infrastructure spending[2] across Australia.

In NSW, the overwhelming majority of the infrastructure spend – a record $51.2 billion[3] – will be allocated to transport, headlined by the $3 billion Sydney Metro West, the biggest public transport project in Australia[4] after the Sydney Metro Northwest and the Sydney Metro City & Southwest, which came in at a combined total of $20.8 billion.[5]

New South Wales General Government Infrastructure Funding[+]

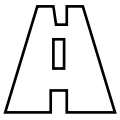


New South Wales Infrastructure Statistics[+]

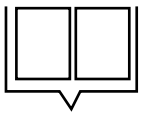
Value	Description
17.65%	Average share of budget dedicated to infrastructure over the forward estimates
11.87%	Decade average share of budget dedicated to infrastructure
$65.71b	Total infrastructure funding over forward estimates
+16.06b	Increase this budget

Major New Funding Allocations in New South Wales[+]

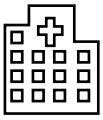
Rail $3 billion
Sydney Metro West



Road $1.2 billion
F6 Corridor Stage 1



Education $2.2 billion
for education infrastructure



Health $740 million
Liverpool Health and Education Precinct

The value of major NSW infrastructure projects, Colliers Research and Forecast Report: Industrial First Half 2019

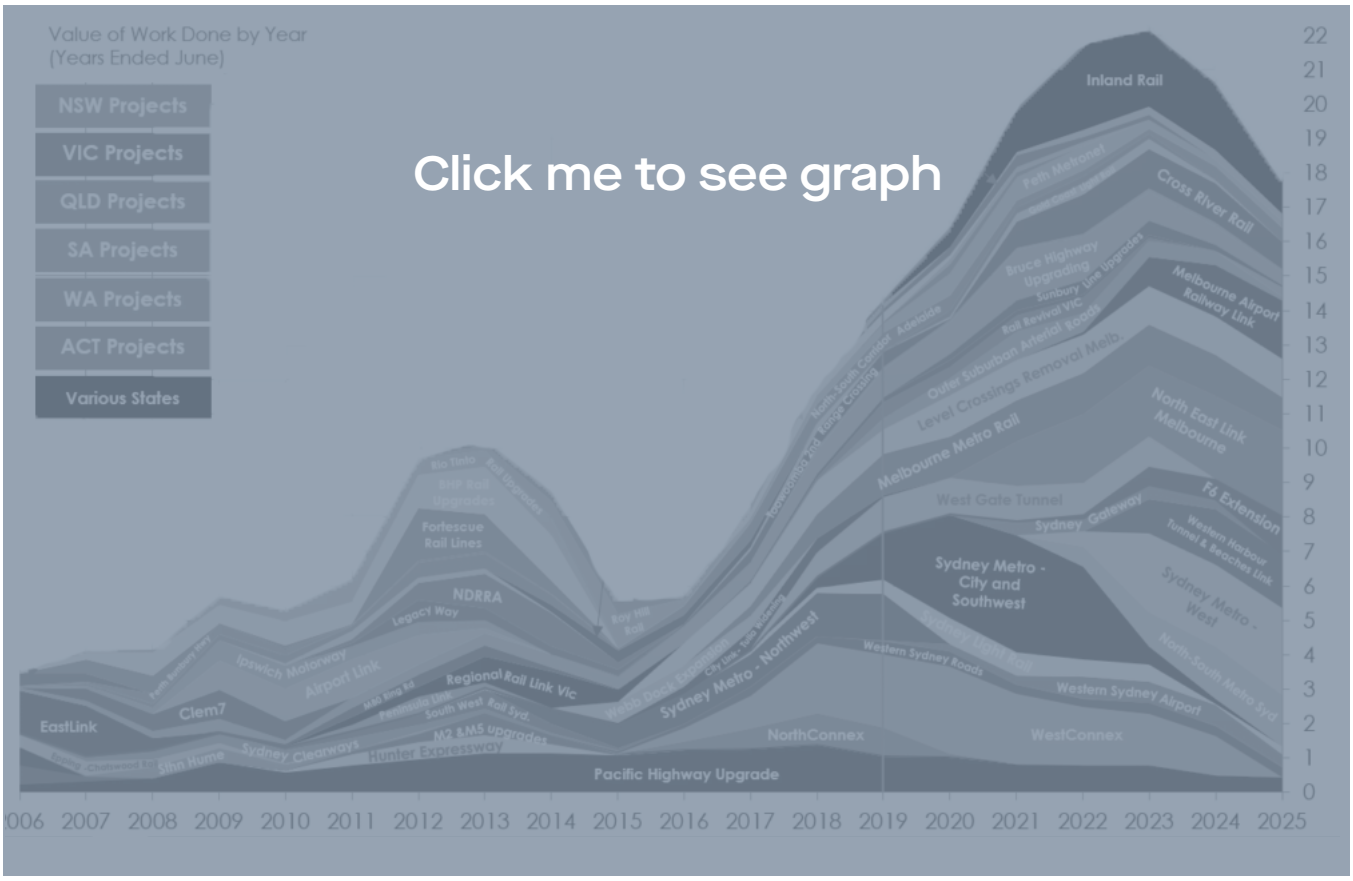
[2] "Australian Infrastructure Budget Monitor 2018-19"; Infrastructure Partnerships Australia
[3] Ibid
[4] "Sydney Metro," Australian & NZ Infrastructure Pipeline
[5] Ibid
[+] "Australian Infrastructure Budget Monitor 2018-19," Infrastructure Partnerships Australia

Infrastructure

Big spenders: an era of infrastructure investment and ongoing economic growth

1 International Drive, Westmeadows, VIC

Major Transport Infrastructure Projects - Australia



Source: Macromonitor, CIMIC Group

Investment in infrastructure is good news for the economy - and for commercial real estate markets. There is a strong positive link[6] between infrastructure spend and economic growth, because when money is allocated to infrastructure, it creates anti-recessionary fiscal expansion, which is particularly important in a low-growth, low-rate environment – like the one we are experiencing now. And in the longer term, there is strong evidence to support a positive relationship between infrastructure investment and productivity growth.[7]

In fact, infrastructure is the backbone of a healthy economy. When traffic is congested and transport links poor, employees struggle to get to work, freight costs rise and business' operating costs go up. Infrastructure enables trade, powers businesses and connects workers to jobs. Reliable infrastructure is needed to connect supply chains, to move goods and services efficiently and to connect households to opportunities for employment, healthcare and education across cities and regions.

Money spent on infrastructure powers industrial property. It provides economic stimulus and increased employment opportunities – in both the short and longer term. In the short term, industrial sites are needed during the development and construction phase of an infrastructure program, and in the longer term, better roads and transport mean a better-connected city – which attracts businesses and creates economic and jobs growth, in turn creating demand for industrial space.

According to the most recent report from CBRE there is evidence that this is already happening in NSW. Demand for industrial property has already increased on the back of the needs of infrastructure development and construction companies.[8] Construction has picked up, and this in turn is supporting similar growth in logistics and industrial property. The chart below highlights the massive increase in infrastructure spend over the years to 2023 – signaling green shoots ahead for the entire industrial sector.

[6] "The Potential Macroeconomic Benefits from Increasing Infrastructure Investment"; Economic Policy Institute; July 2017
[7] Ibid
[8] "Real Estate Market Outlook 2019 Australia"; CBRE Research APAC

92 Robinson Avenue, Belmont, WA

At the same time, low interest rates and weak economic growth aren't great news for commercial property markets. When the economy is weak, and house prices fall – there is a flow-on effect to consumption which means fewer goods pass through the supply chain. In the case of NSW, CBRE nonetheless predicts that limited supply will offset the weaker economy, and allow industrial rents continue to grow this year.

Evidence for this view can be seen in the prices for industrial space, which have already risen this year, pushing down yields. Sydney has seen the greatest increase in land value – average lots have increased in price by nearly 48% over the past three years, and super prime yields have come down to 4.85% (compared with the Australian average of 6% as at 31 December 2018).[9]

Additionally, land in desirable locations (central locations) is becoming scarce. This in turn puts pressure on supply chain efficiencies. Given that half of supply chain costs come from transport, and only 5% from occupancy costs, finding a location which will minimise those costs is key – which means a location with good access to suppliers and customers. In Sydney, close to either a port or the city centre is appealing, but as residential developers are also vying for the same land – pressure is rising.

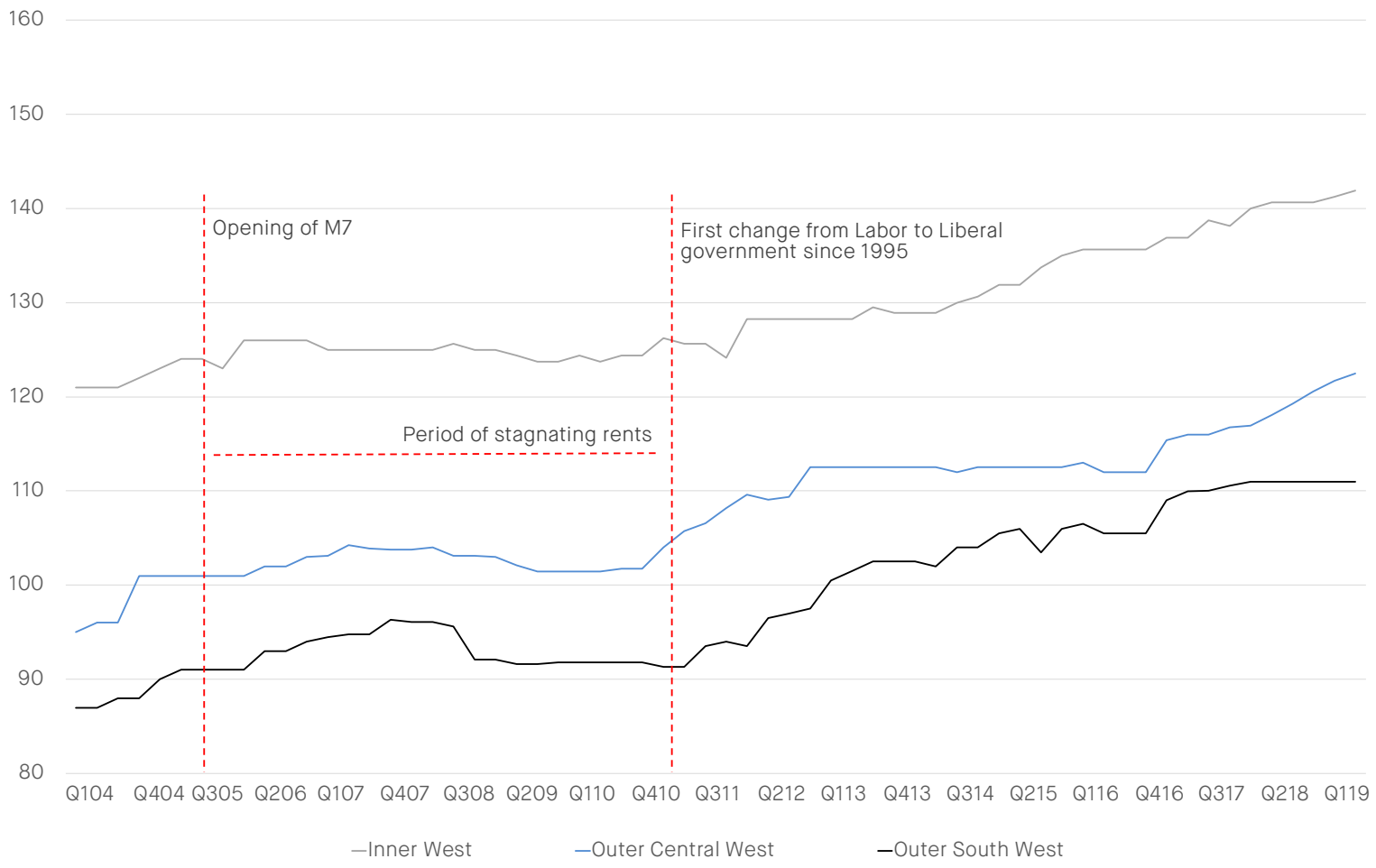
[9] "Real Estate Market Outlook 2019 Australia"; CBRE Research APAC
[10] Ibid

Location

It's all about the 'where': location as a determining factor

69 Rivergate, Murarrie, QLD

Sydney industrial rents dating back to 2004



What is interesting this time, is that the current infrastructure program is likely to pay out in a different way – creating a stronger positive for some parts of the industrial property market over others – much more so than in previous cycles.

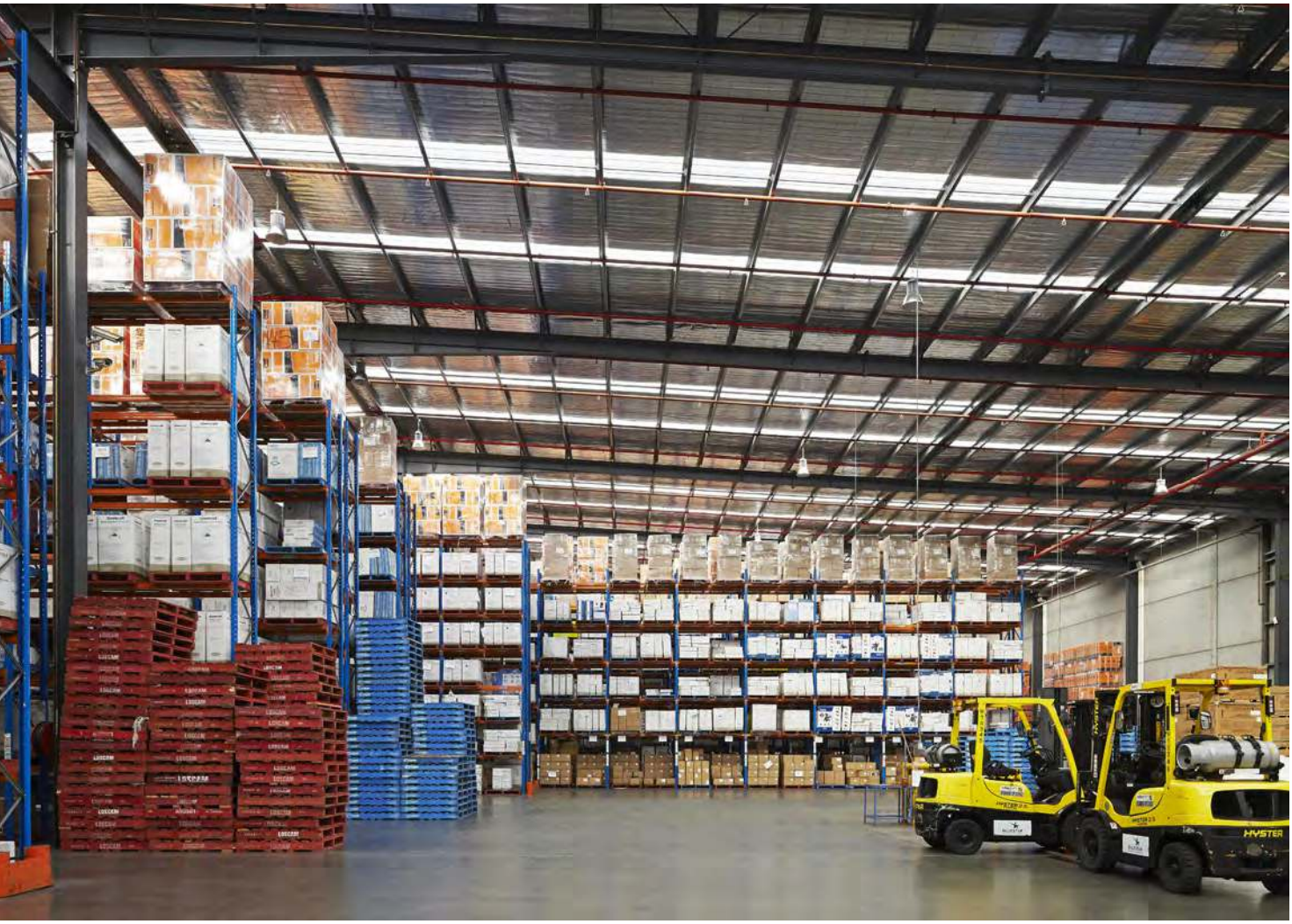
If we look at the last major road infrastructure project in NSW, the M7 motorway – the net effect was negative for industrial property. Construction took place outside the geographical footprint of Sydney – and the M7 itself provided access to greenfield land, which resulted in a spike in the supply of new, cheap industrial sites. Unfortunately, when this supply spike was not met with equally strong demand, rents stagnated, affecting rental growth for almost 10 years.

The most recent program of spending is taking place within the geographical borders of Sydney – which means that not only will there be no access to new land, but land is actually being removed from the market – increasing pressure on prices and rents.

But perhaps more importantly, there are a number of larger economic and social themes which are creating significant change in industrial markets generally, with a flow-on effect to the type of industrial property most likely to be in demand.

E-Commerce

Just a little click: the rise (and rise) of e-commerce and the frictionless sale



24-32 Stanley Drive, Somerton, VIC

9-13 Caribou Drive, Direk, SA

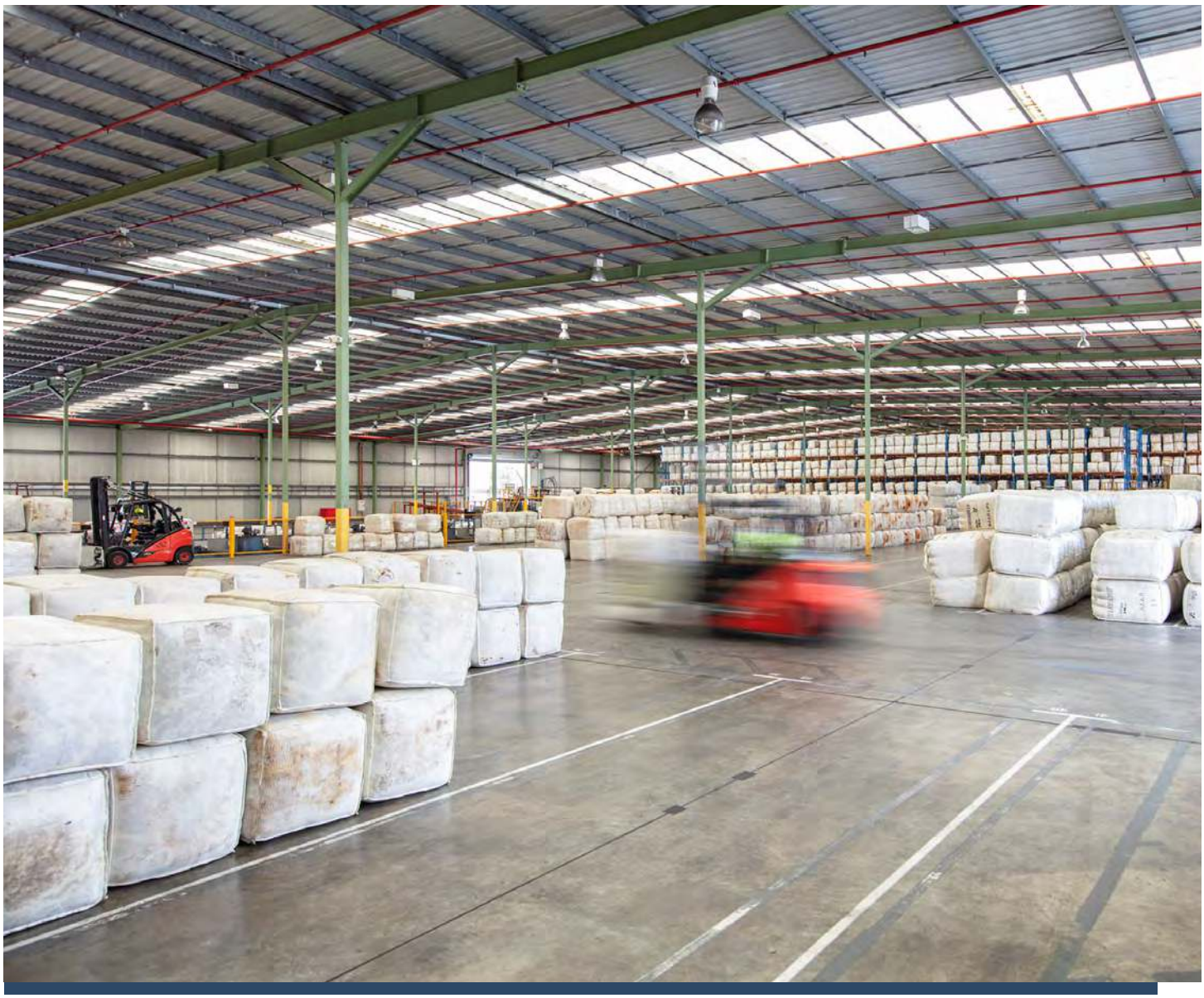
E-Commerce has changed traditional retailing forever – warehouses are the new shopping centres, and the effect has been felt in falling demand for traditional bricks and mortar retailing space – which has declined in line with increasing demand for industrial space in which to store, pack and ship packages. Over the year to February 2019, total online retail turnover, including both pure-play e-commerce and multi-channel online retail trade increased by 31.3% to reach $18.2 billion[11] – yet comparisons with global markets indicate that there is still plenty of room for growth.

Australian online retailing accounts for only 5.6% of total retail sales – a low figure by global standards. The online share of retail sales in the US is 11.2%[12] and the UK retail sales account for a whopping 21.5%[13] of total sales. By even the most conservative estimates of online penetration, and allowing for our different geography, Australia has a long way to go.

According to CBRE, growth in e-commerce will create a requirement for an additional 350,000 sqm of new industrial and logistics space in Australia leading up to a peak in 2022. Some of this space will take the form of large distribution centres, like Moorebank Logistics Park and the new Australia Post centre in Chullora – but there will also be increased demand for infill development to facilitate fast delivery.

At the same time, online consumers are becoming more exigent and time-sensitive – placing additional pressure on e-retailers looking for a competitive advantage. So-called last-mile delivery, or the trip from the transportation hub to the final delivery destination is receiving lots of attention – and has been identified as a key differentiator[14] by major e-commerce players. And for good reason – nearly a quarter of all consumers say they would pay more for same-day delivery – and global management consulting firm McKinsey predicts that same-day delivery will take about 25% of the market by 2025.

[11] "International Research and Forecast Report: Industrial First Half 2019"; Colliers
[12] "The rise of E-Commerce in the United States"; Statista
[13] "E-Commerce in the United Kingdom"; Statista
[14] "How Customer Demands are Reshaping Last-Mile Delivery"; McKinsey & Company; October 2016



310 Spearwood Avenue, Bibra Lake WA

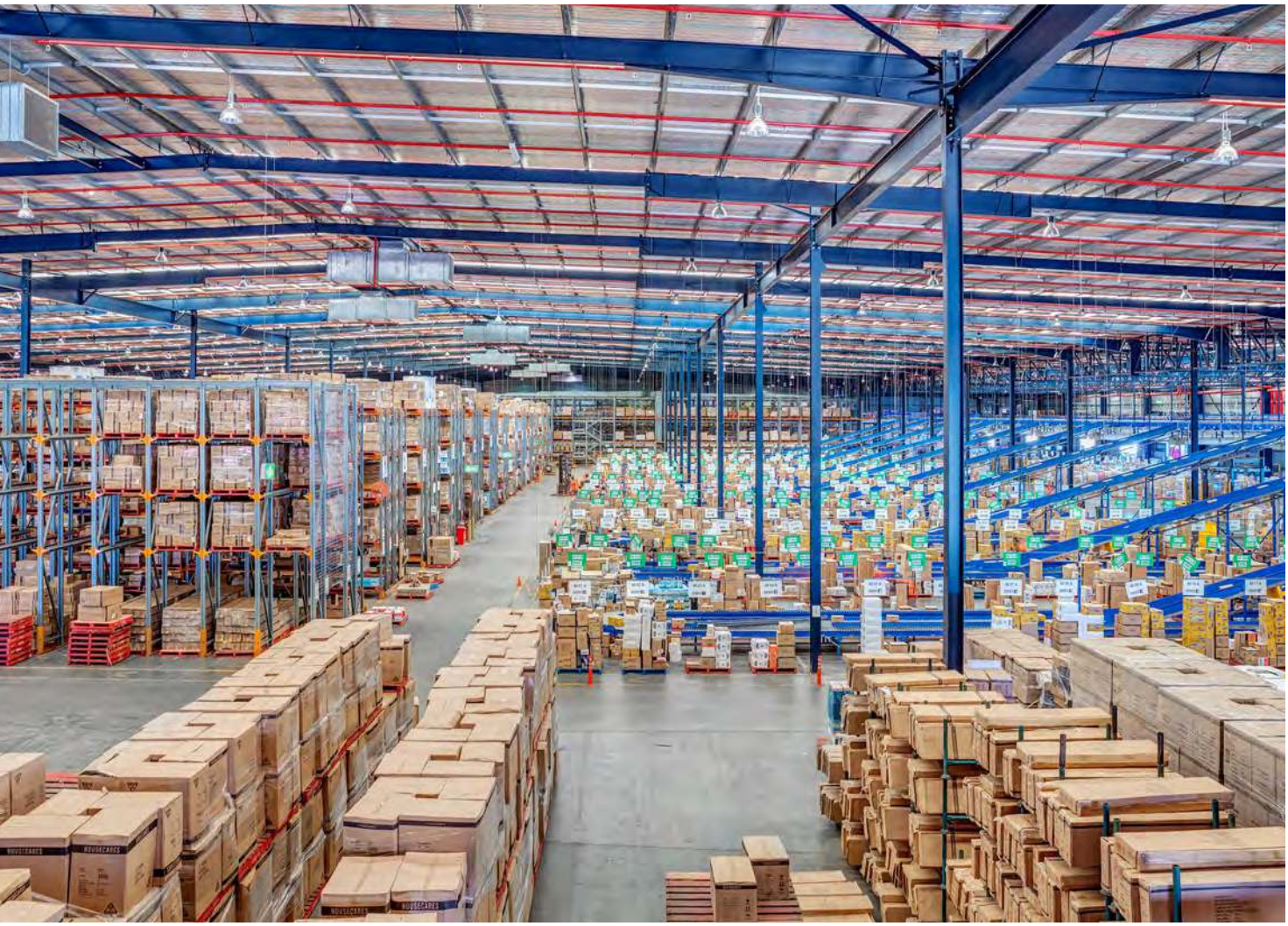
But how does this affect industrial property? If demand for same-day delivery is on the rise, then the need to be close to consumers is rising also. There's no point offering same day delivery when your stock is located 100kms from the customer's home. Smaller, more centrally-located properties are where you want to be.

Consumer demand for quick seamless and frictionless delivery (and returns), combined with trends towards mass customization has changed industrial needs, but it has also had a major flow-on effect to other areas – in particular logistics and manufacturing. Logistics because smooth delivery and returns of online purchases is an essential competitive advantage, and manufacturing because shipping requires packaging. More than 30% of online purchases are returned compared with only 9% of in-store purchases[15] – and customer expectations that these returns will be simple and free, is putting more pressure on e-commerce businesses' profit margin – and the need for cutting edge logistics management.

[15] "E-Commerce Product Return Rate – Statistics and Trends"; Invesp

Logistics

The $ in getting from A to B: institutional investors put their money on logistics

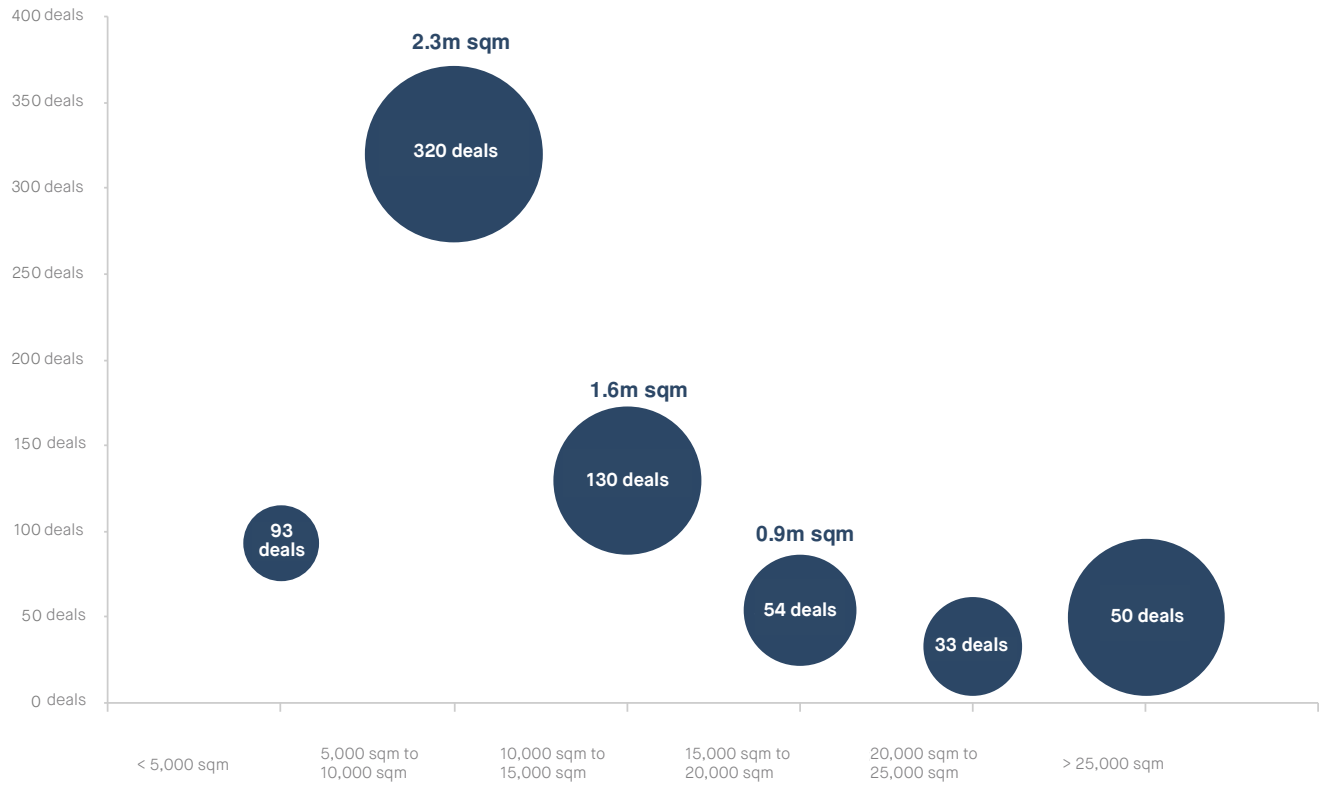


1 Ashburn Road, Bundama, QLD

“Logistics is our highest conviction global investment theme today, and we look forward to building on our existing portfolio to meet the growing e-commerce demand.”

Ken Caplan, global co-head of Blackstone Real Estate

Strong leasing activity in CIP core market segments [1, 2]



[1] Source: JLL Research. Includes greater than 5,000sqm for NSW and VIC and transactions greater than 3,000dqm for other markets

[2] Includes leasing transactions from 1Q 2016 to 4Q 2018

The need for faster, more efficient delivery of packages has led to increased demand for small industrial sites and logistics as an investible asset class. In the largest global real estate deal ever done - and a clear indication that well-placed industrial assets are hugely sought after by institutional capital – global private equity giant Blackstone paid USD$18.7 billion for industrial assets – in a logistical play designed to "meet the growing e-commerce demand".

Blackstone is betting big on the shopping centre becoming a warehouse – in a deal which netted them over 179 million square feet of urban logistics properties.[16] What is particularly interesting is that despite the large dollar value of the deal, the individual assets are relatively small – 42,000 sqm on average and located in high-growth markets.

[16] "Blackstone bets $18.7 billion on Amazon effect in warehouse deal," Bloomberg, 3 June 2019

23 Selkis Road, Bibra Lake, WA

And Blackstone isn't the only institutional investor betting on industrial property. According to BIS Oxford Economics[17], industrial property is likely to remain the hottest real estate sector in Australia (and globally) for at least another three years, on the back of ongoing strong demand for logistics space due to the growth of e-commerce and online retailing, and also because global bond rates will remain low. BIS is predicting an increase in prime industrial rents in Sydney alone of between 7.8% - 12.5% over the next three years, and yield tightening by 15 to 25 basis points. The net result will be solid capital gains, with values expected to increase by 10.5% to 15.2%.

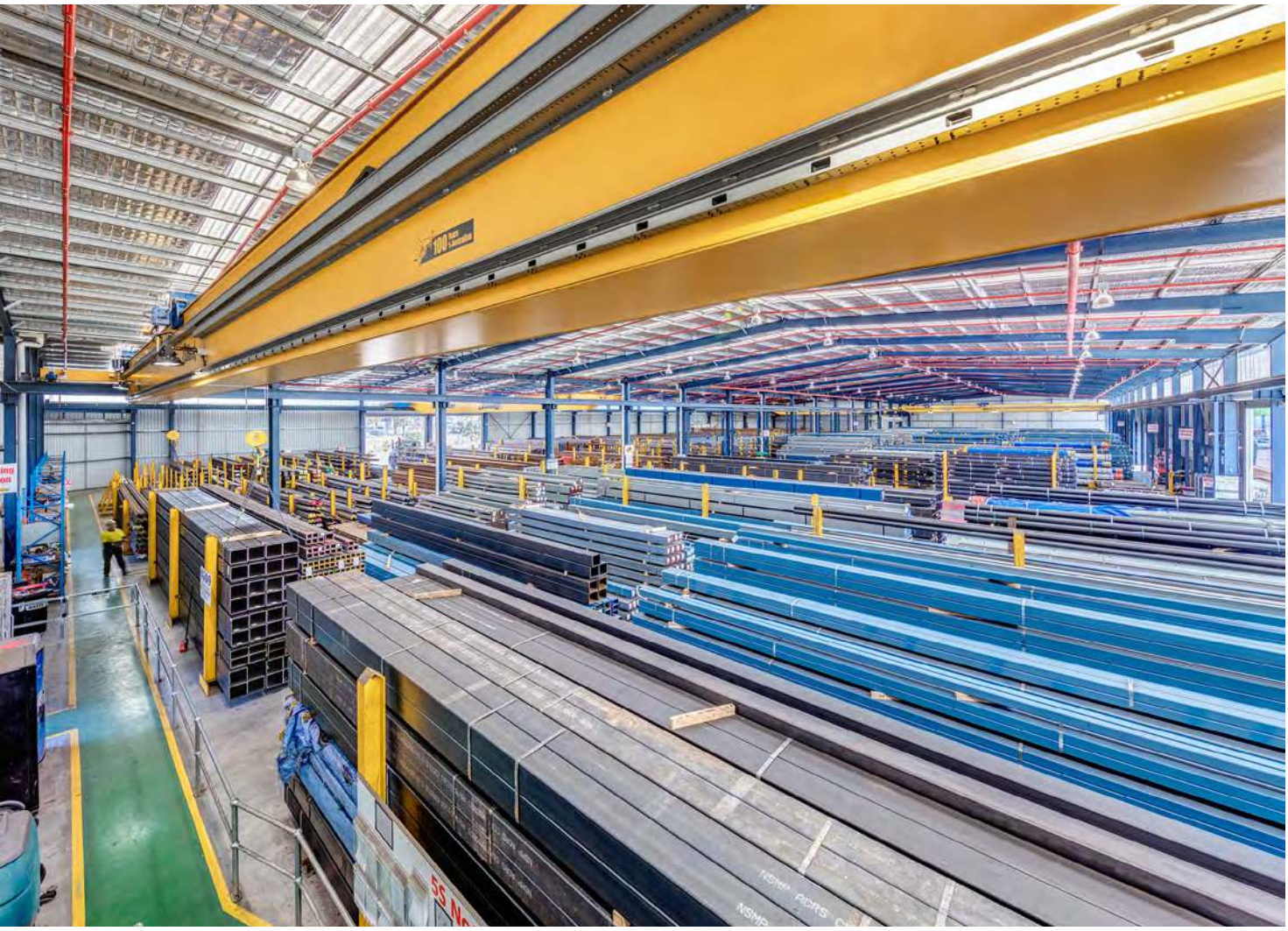
At the same time, demand for large industrial distribution centres, as the first sorting point, particularly for imported goods, is also on the rise. The Moorebank Intermodal Company, for example (wholly owned by the Australian Government and seen as a landmark infrastructure project) aims to facilitate growth in freight moving through Sydney. It will move containerized freight (up to 1 million shipping containers annually) more quickly through Port Botany directly to Moorebank via a direct dedicated rail line – taking 3,000 heavy truck movements off Sydney's roads every day – and allowing for a more seamless delivery and distribution experience.

In addition, Mirvac recently spent $94.2 million on an industrial site in Auburn in Western Sydney – close to Sydney's second CBD, Parramatta – and which it has earmarked for a $250 million industrial estate and logistics hub, aimed to cater to e-commerce businesses by offering flexible warehouse an office space. Mirvac has described the facility as "premium last mile distribution facilities".

[17] "Industrial property surge has another three years to run: BIS"; Australian Financial Review; June 27, 2019

Manufacturing

Clean, lean machines:
clean manufacturing on the rise



10 Williamson Road, Ingleburn, NSW

2 Keon Parade, Keon Park, VIC

The final driver of changes to the industrial real estate market is the renaissance of manufacturing in Australia. The Australian Performance of Manufacturing Index (PMI) - which measures the overall economic health of the manufacturing sector – has been positive for almost three years.[18] And there is no question that clean manufacturing is on the rise in Australia, as a result of the so-called 'fourth industrial revolution', or the use of transformative technologies to connect the physical world with the digital world.

Trends such as the use of advanced automation and robotics, machine-to-machine and human-to-machine communication as well as artificial intelligence and machine learning are helping Australian manufacturers control two of their long-standing challenges – high labour costs and distance to markets.

Real-time access to production information, logistics and monitoring means better connectivity between customers and supply chains, as well as greater flexibility to produce differentiated products and services on a small scale.

According to a report by global management consultancy Bain & Company, automation powered by the rise of artificial intelligence, will be a key driver of change. [19]

[18] "Performance of Manufacturing Index"; AI Group, May 2019
[19] "The Collision of Demographics, Automation and Inequality"; Bain & Company, February 2018

14 Sudlow Road, Bibra Lake, WA

In their view, the adoption of new automation technologies will give rise to new opportunities (and risks), and investment in automation could stimulate as much as $8 trillion globally in incremental investments, in part offsetting slowing labour force growth due to the ageing population.

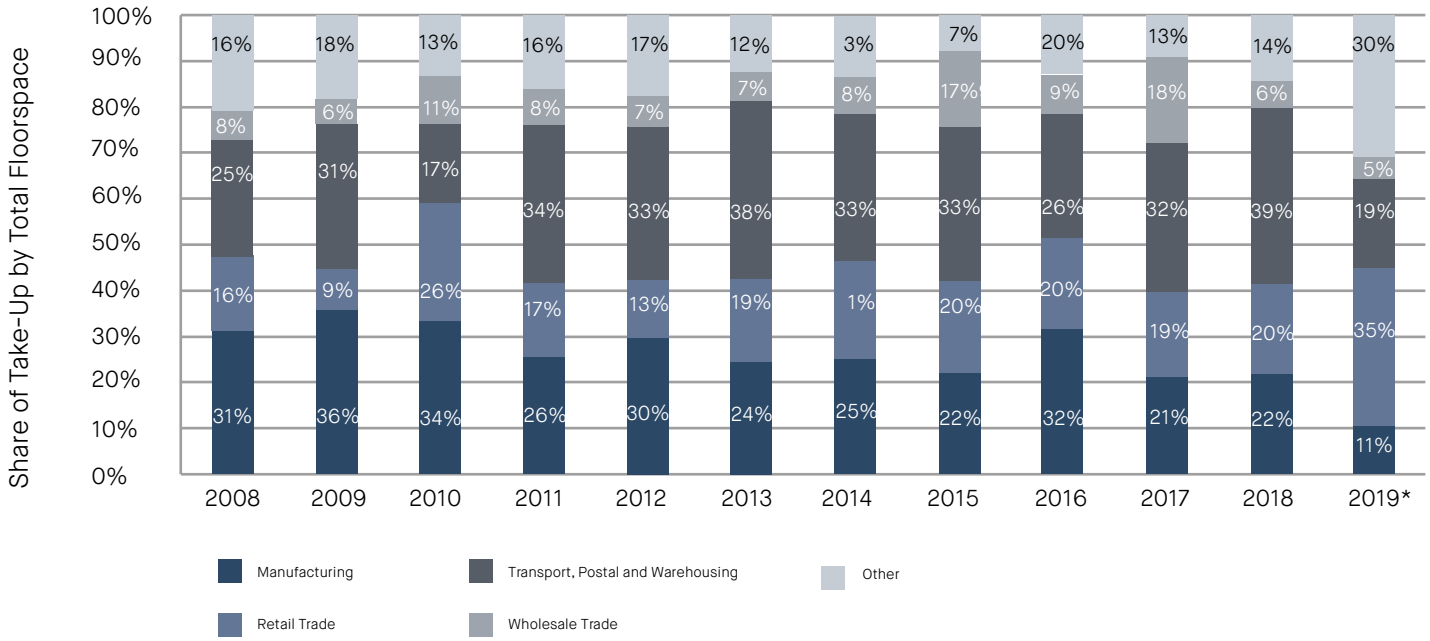
What is particularly interesting is the prediction that the small Australian market is likely to be a real beneficiary of the effects of automation – because automation and de-scaling of production means that small markets can compete in a way they never could before. Some areas of manufacturing, which previously relied on scale, are opening up to competitors able to use technology to overcome size limitations.

Moves towards 'on-demand' manufacturing, which requires less inventory, and allows for a certain degree of customization, as well as increases in speed to market, are changing the playing field forever. Amazon has received a patent for an on-demand manufacturing process – and has created a computerized system which produces clothing and other products only after a customer order is placed. The items are produced in batches, based on factors such as the customer shipping address – in order to aggregate orders from different geographic locations.

This kind of on-demand manufacturing is a twofold benefit for industrial property owners with smaller, more centrally located sites. Because on-demand means less inventory, smaller industrial properties are suitable sites in a way they might not have been in the past, but at the same time, more sophisticated manufacturing techniques require specialist machinery. This machinery is usually expensive to buy and install – which means tenants are more likely to sign longer leases to minimise the risk (and costs) associated with moving and fitting out new premises.

“Three-to-five year leases were very much the standard a couple of years ago – it was difficult to get industrial tenants to agree to any longer. Now, leases of 5-10 plus years and more are not uncommon – something I attribute, in part at least, to the large financial investment that tenants are making in new technologies.”

Australia's Industrial Gross Take-Up by Industry, 2008 to 2019YTD



* As at 1Q19.
Source: JLL Research

On average, manufacturing has rented over 26% of industrial property floorspace in Australia over the last 10 years – and never less than 21% in that time.

There are pockets of weakness in Australian manufacturing, no question, and it's not all positive for all manufacturers. However, for those businesses able to benefit from the fourth industrial revolution, and which are also tied into other major economic themes, the future is bright. Packaging business Visy, is one such success story.

Visy recently put its newly-completed Hamilton, NZ manufacturing and distribution facility up for sale. The property contains some of the world's most modern technology – and is being offered to the international market complete with a 20-year lease to Visy Industries.

In the 10 years since current owner, Anthony Pratt took over what was an Australian-based manufacturer, he has more than doubled the size of the business by expanding into the US – where one paper mill in Macon, Georgia has grown into 70 factories in 27 states. If we look at Visy's experience in the US, and consider that the penetration of e-commerce in Australia is low by global standards, there is every reason to suppose that Visy will follow the same growth trajectory here – and that demand for suitable industrial property will grow as a result.

Summary

The many, not the few: what's next for Australian industrial real estate?

2 Woolworths Way, Warnervale, NSW

29 Glendenning Road, Glendenning, NSW

The industrial landscape is changing in line with changing economic and social themes – and the flow-on effect will naturally be felt in industrial real estate markets. The current program of transport infrastructure has already provided a short-term boost to industrial property needed during the construction phase – but longer term it will continue to provide positive upside. A more connected city is more attractive to industrial tenants, both domestic and international, and the fact that industrial space is being removed from the market during construction of the metro means that supply will continue to be tight. All positives for industrial property.

At the same time, major economic and social themes – the rise of e-commerce, the increased demands of time-sensitive consumers and the flow-on effect to logistics management as a competitive advantage will all affect demand for industrial property as well as the type of industrial property most likely to be in demand. The fourth industrial revolution in the form of automation and the rise of artificial intelligence will re-shape national economies and profoundly impact labour markets – with flow-on effects to property markets – as some businesses thrive, and others struggle. Key to success will be keeping a keen eye on the societal and economic trends which most profoundly affect the economy and property markets – and adapting investment portfolios to respond.

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Industrial REIT

FURTHER INFORMATION

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