

IS OVERSUPPLY AN OVERSTATEMENT?

EXAMINING AUSTRALIA'S
LOGISTICS & INDUSTRIAL SUPPLY
PIPELINE

Q3 2024



OVERVIEW

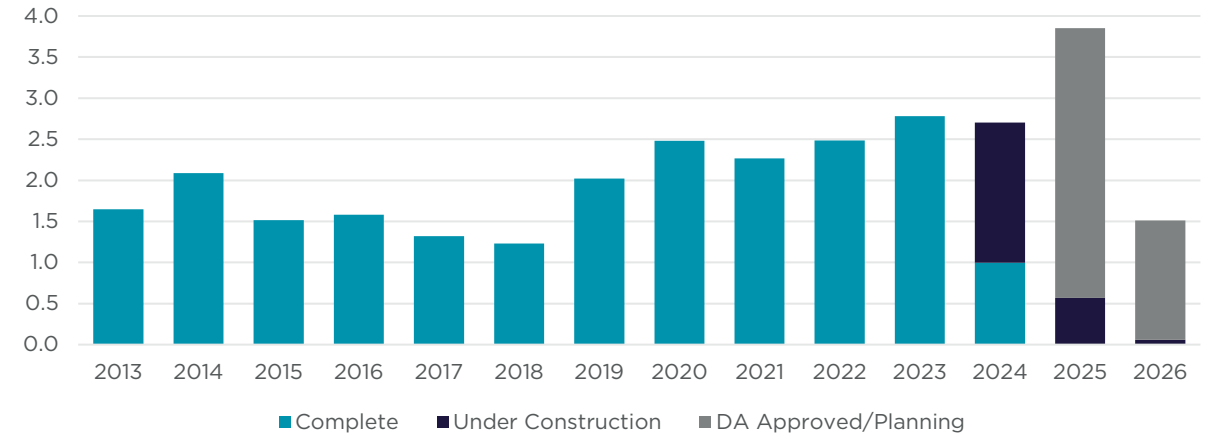
Strong market fundamentals have underpinned a large rise in warehouse supply within the Australian market in recent years. Almost 11.0 million sqm of new stock has been added to the market since 2020, equivalent to around eight years of pre-pandemic supply.

The landscape going forward is more complex, led by shifting market fundamentals and capital constraints for many developers. On one hand, occupier demand has somewhat normalised in 2024, which is likely to have implications for the overall supply pipeline as the case for speculative strategies in select markets is reassessed. On the other hand, demand will continue to gravitate towards new builds, given the associated efficiencies and greater ESG credentials. At the same time, higher construction costs and planning and servicing delays in several key precincts add further complexity and costs to developers, which will test the feasibility of projects. However, even if all supply in the pipeline is delivered on time, Australia is forecast to remain an undersupplied market.

For developers, strategies to mitigate risk in the current environment include:

- Where possible, having a flexible development strategy, which could include actively marketing a site for pre-lease during the planning phase for speculative development.
- In the right markets, smaller sub-8,000 sqm product options should be considered, thereby providing a point of difference in the market and capitalising on the most liquid size bracket in the leasing market.
- For markets with high barriers to supply, such as Sydney's Central West, Melbourne's Inner South East and Brisbane's Trade Coast, brownfield conversions should be explored, taking advantage of the outperformance of infill locations and strong demand from business-to-consumer businesses.

National L&I Supply Pipeline by Status



Source: Cushman & Wakefield Research

Strategies for occupiers in the current environment include:

- The window of opportunity for occupiers could be short-lived as projects are paused or delayed, which could coincide with a resurgence of demand in 2025.
- Occupiers are recommended to rethink their current lease strategy in order to take advantage of greater availability and higher incentives in several markets in the near term.
- Early discussions with the existing landlord(s) should occur to ensure minimal business disruptions during the relocation period if their new build is delayed.
- For larger occupiers with multiple facilities, consider staggering lease expiries to take advantage of real estate's cyclical nature.

HOW BIG IS THE SUPPLY PIPELINE?

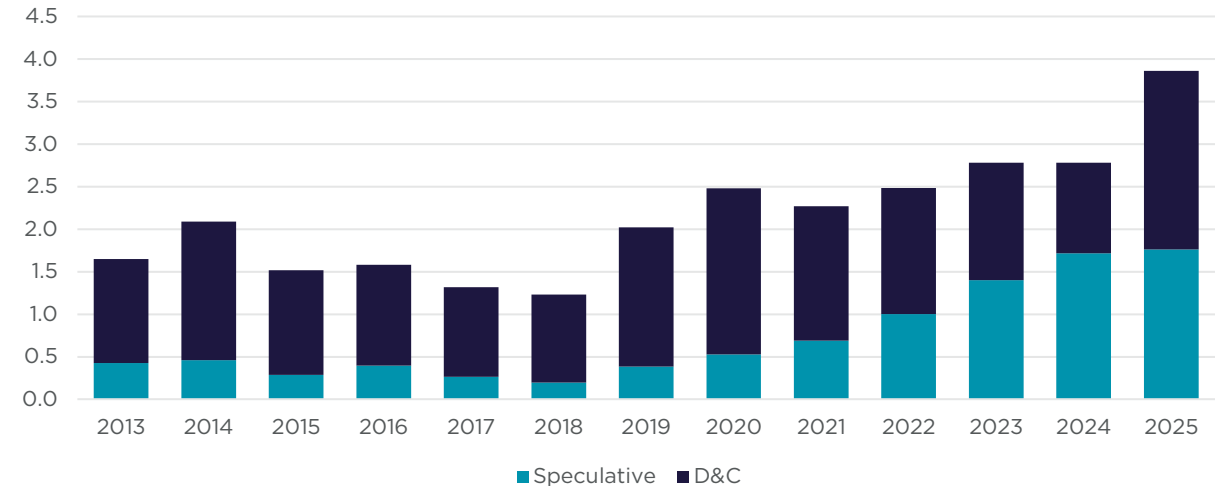
Nationally, approximately 2.8 million sqm of supply (across speculative and D&C) is in the pipeline for 2024, 35% of which has already been delivered in the first half of the year. Supply in the period is evenly split between the Sydney and Melbourne markets at approximately 1.0 million sqm respectively, while Brisbane and Perth will record supply completions above historical benchmarks.

For 2025, there is the potential for approximately 3.8 million sqm of new additions (based on the guidance provided by developers), noting that just 570,000 sqm of this supply is currently under construction.

Speculative vs D&C Supply

The big shift in supply since the beginning of 2022 has been the increased delivery of speculative builds. Historically, speculative supply additions only accounted for 20-25% of supply in any given year and were largely done on the back of an adjacent pre-commitment, taking advantage of construction efficiencies. However, given record low vacancy levels and unprecedented growth in rents, developers pivoted to a more speculative build strategy, and such developments have represented 51% of total supply nationally since 2022. The share is even higher in 2024 at 62% and will represent a record year of speculative additions at just over 1.7 million sqm.

National L&I Supply Pipeline, Speculative vs D&C (sqm)



2024 -2025 Speculative Pipeline by City (000s - sqm)



US Comparison



The US is more of a speculative-led development market. Since 2011, 60% of new additions across the US have been on a speculative basis. However, this increased to almost 85% in 2023, while it currently represents 75% of the pipeline for 2024.

IS SUPPLY EVEN ACROSS ALL SIZE RANGES?



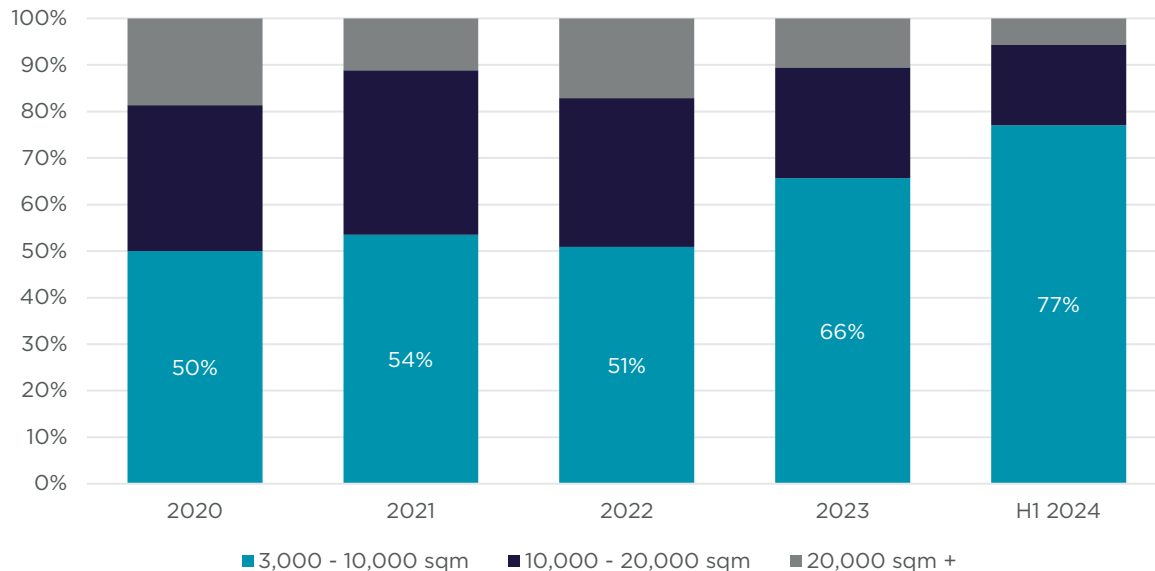
As occupiers built out their supply chains over the past four years, we saw robust demand for facilities above 20,000 sqm, supported by warehouse consolidation becoming more pronounced. As a result, the average warehouse size built since 2020 is 63% above the pre-pandemic average, driving developers to maximise the size of new builds as they look to build out estates.

However, demand has shifted in 2024, with smaller leases being the most active by a substantial margin. In the first half of 2024, 77% of lease deals nationally (by number) were in the 3,000 - 10,000 sqm size bracket, while the average deal size has fallen 45% from the level recorded in 2022.

The challenge with the drop in average deal size is that the supply pipeline doesn't match this, largely because plans were submitted and approved prior to 2024 when demand was still robust for big box facilities. In 2024 and 2025, 40% of supply additions at this stage will stem from facilities above 20,000 sqm, while just 22% is for facilities between 3,000 - 10,000 sqm, highlighting the mismatch between demand and supply.

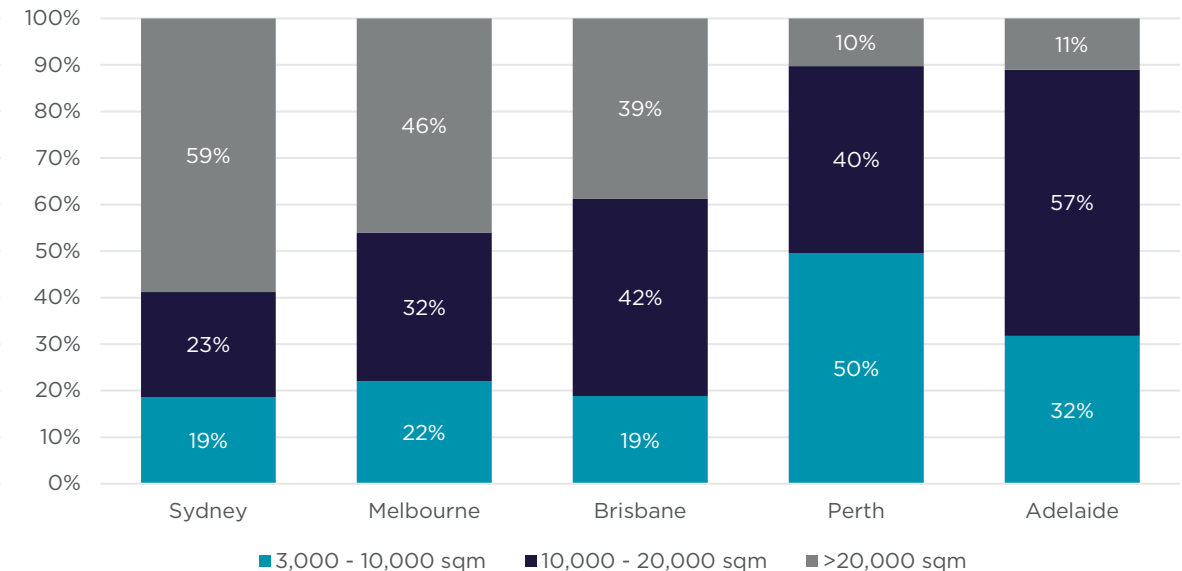
Ultimately, for the supply that has yet to commence construction, some developers are expected to rethink their development plans. This could result in the delayed commencement of select projects as pre-commitment is sought.

National Lease Deals by Warehouse Size (by Number)



Source: Cushman & Wakefield Research

2024 - 2025 Supply Pipeline by Size (Spec & D&C) - Share of Stock



Source: Cushman & Wakefield Research

Note - Tenancies have been split out

WILL SUPPLY BE LOWER IN REALITY?



While there is clarity on the quantum of supply for 2024 given that it's either been completed or is under construction, there remains uncertainty and challenges in the delivery and timing of some projects for 2025. At this stage, just 15% of the 2025 pipeline has commenced construction, and compares to 30% at the same point in 2023 for the 2024 pipeline. Further, just 23% of the 2025 supply pipeline is committed, while a considerable share of the balance will only proceed once a pre-commitment is secured.

The main challenges in the delivery of this supply includes:

- **Elevated construction costs:** While steel prices have fallen over the past 12 months, this is being offset by higher costs for cement and labour which continues to test project feasibility for new developments.
- **Planning and servicing delays:** In a number of key precincts, there remain continued delays in facilitating the delivery of supply. This is most acute in Outer Western Sydney within the Mamre Road Precinct, where supply remains held up by infrastructure and servicing challenges.
- **Capital constraints:** A large number of developers are in the process of raising capital to fund their development pipeline. The current economic environment makes this process more challenging, which is likely to put the brakes on the delivery of some projects.

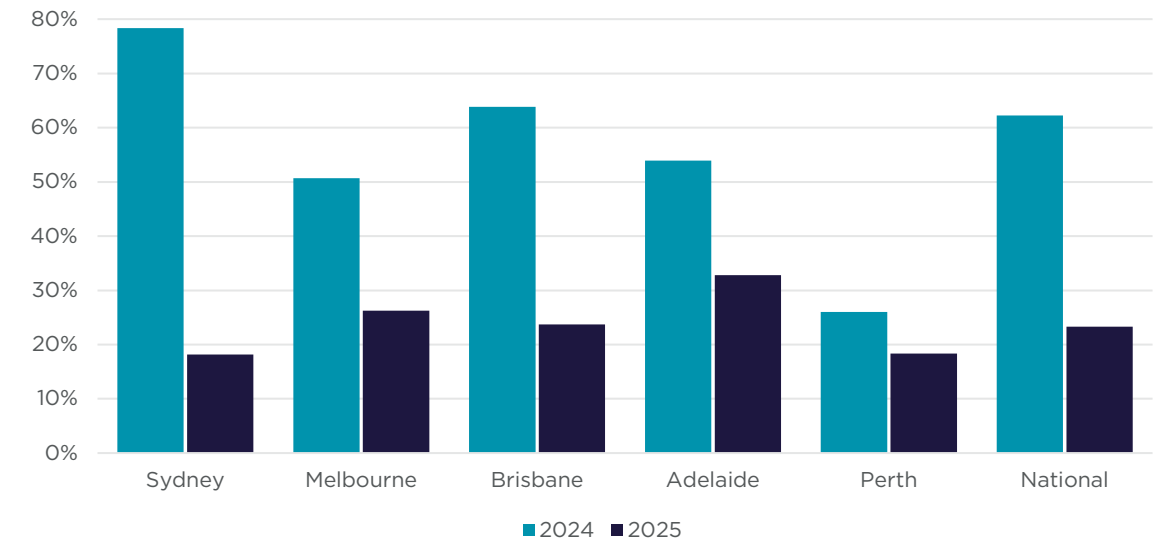
At the same time, tenant enquiry is becoming much more specialised and bespoke to the end user as automation and technology adoption increases. Generally, a better outcome can be achieved via a D&C route, particularly if fixed automation, such as automated storage and retrieval systems (AS/RS) is being incorporated. A number of developments currently flagged as speculative are expected to instead become pre-lease developments, or a mix of both, which will push the timing out.

How Much Supply Is Likely To Be Delivered In Reality?

To assess how much supply is likely to be delivered in 2025, history paints a clear picture. Over the past decade, approximately 20% of supply anticipated to come online at the beginning of each year was delayed and pushed into the following year. As an example, we were forecasting approximately 3.4 million sqm of supply in 2024; however, delays meant this was downgraded to approximately 2.8 million sqm.

Assuming a similar scenario plays out and some projects pivot to D&C, supply for 2025 is likely to settle closer to 2.8-3.0 million sqm.

2024 & 2025 Pre-Commitment Rates



Source: Cushman & Wakefield Research

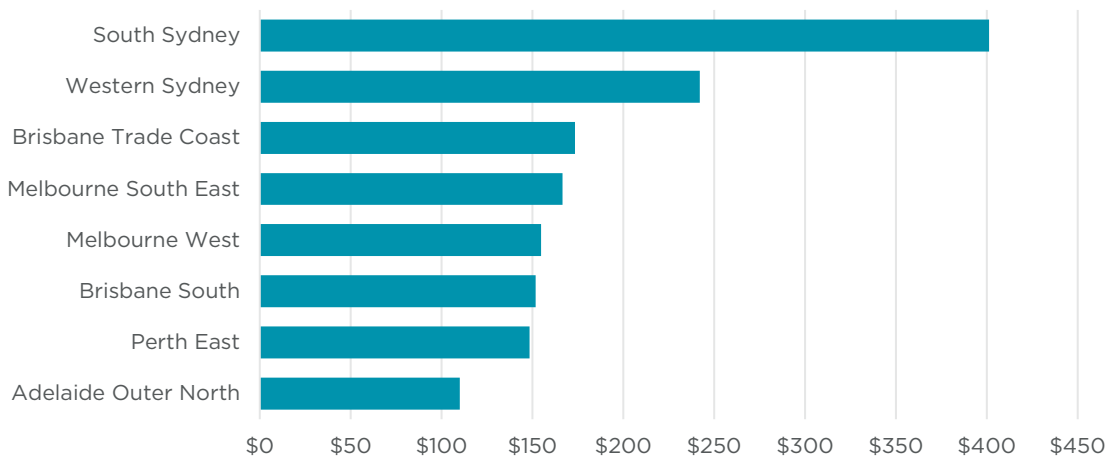
WAREHOUSE CONSTRUCTION COSTS



Building new warehouses in the current high-cost, high-interest, and labour-constrained environment is challenging to make project feasibilities stack up. Currently, indicative warehouse construction costs average \$1,250/sqm, up from \$750/sqm in 2020. Multi-level developments in Sydney are substantially higher at \$3,000 - \$3,700/sqm.

Going forward, the pace of price growth for construction costs is expected to settle closer to 2.5% per annum. In combination with land values holding steady over the past two years and approximately 180 basis points of yield expansion, economic rents have shifted higher in order to make developments feasible.

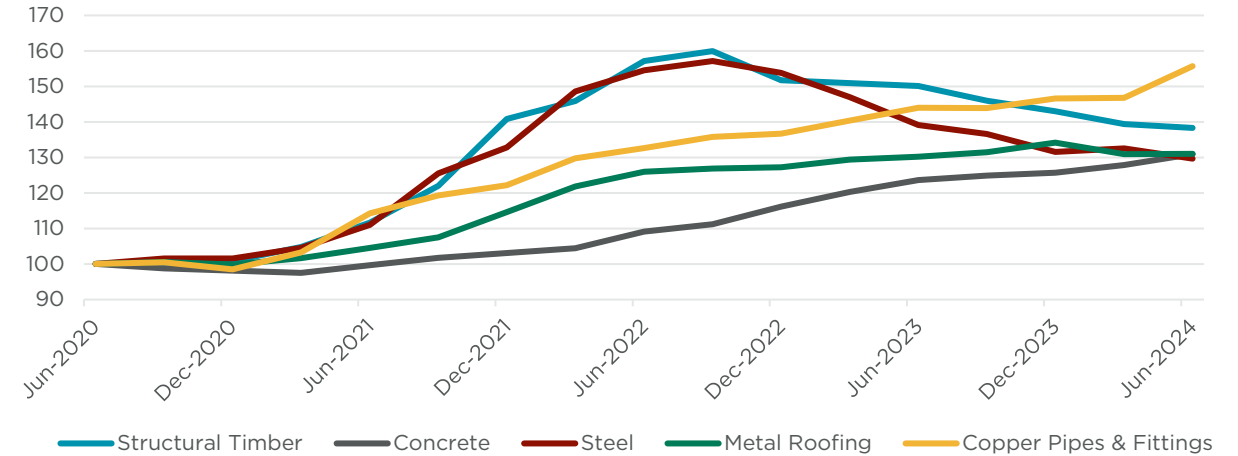
Indicative L&I Economic Rents by Market*



* Based on current land values, 10% development profit and prevailing construction costs and market yields

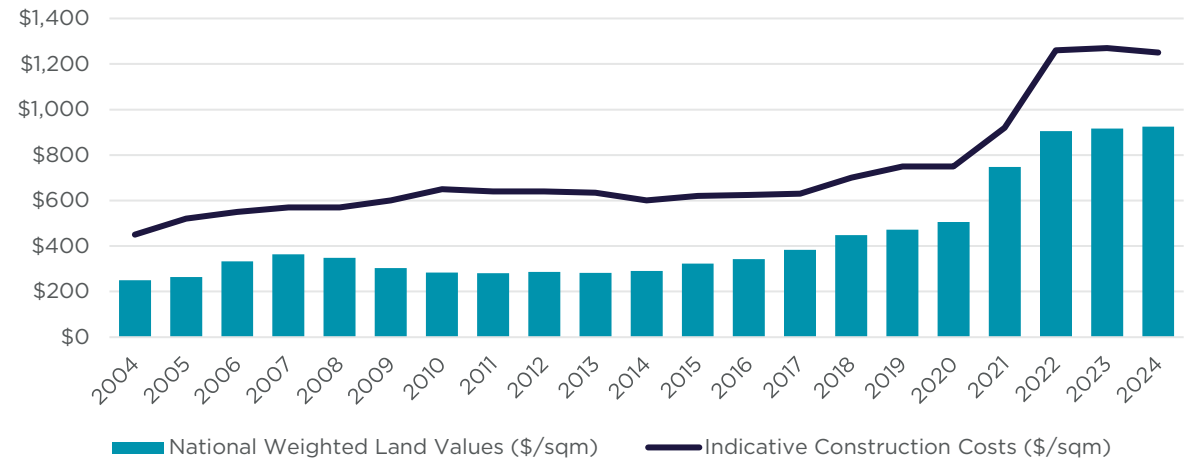
Source: Cushman & Wakefield Research

Warehouse Input Costs - Indexed at 100 in June 2020



Source: ABS, Cushman & Wakefield Research

Warehouse Construction Costs & Land Values



Source: BMT, Cushman & Wakefield Research

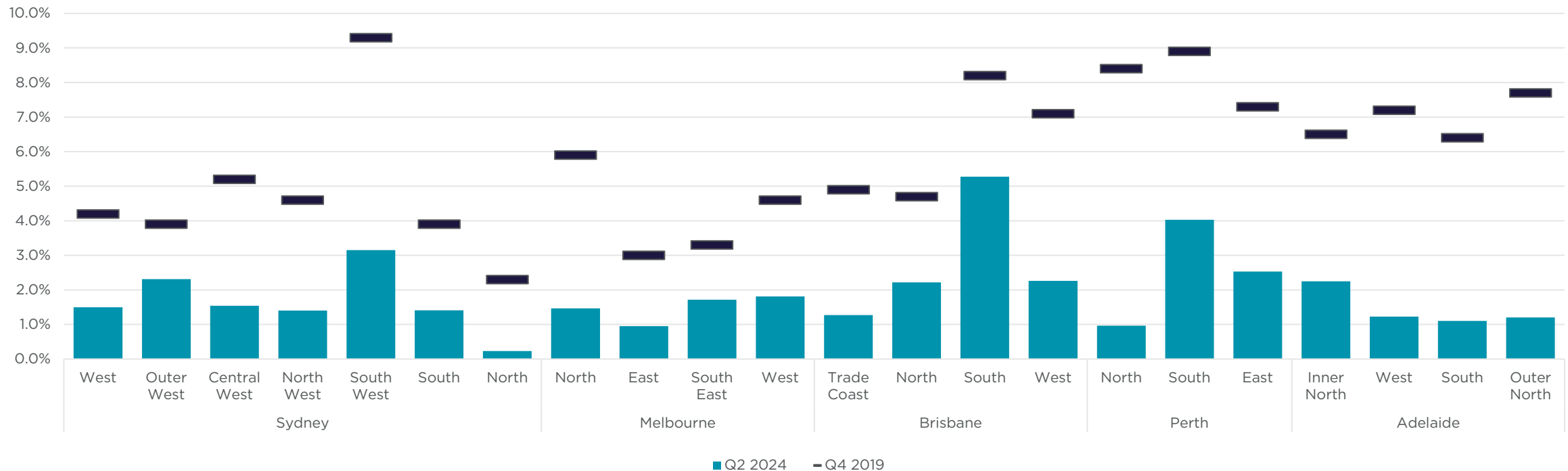
VACANCY RATES REMAIN SUPPORTIVE OF MORE SUPPLY



Vacancy rates have edged higher in 2024 and currently sit at 2.0% nationally; however, they remain well below where they sat at the end of 2019 across all submarkets. In our view, the market equilibrium sits at 5.0%, although this can vary from market to market. While some supply earmarked for 2025 is likely to be delayed, current vacancy rates remain supportive of new development. Over 5.0 million sqm of new supply would need to be added for the vacancy rate to reach 5.0% (excluding backfill additions to vacancy).

Much like the office sector currently, as more supply is added to the market, there will be a flight to quality as occupiers have more options available to them. Given a focus on operational efficiencies, tenant demand is strongest for newer facilities which offer higher clearances, wider column spacing, more loading docks, and ample car and trailer parking. Highlighting this, over the past four years, 49% of new leasing transactions nationally occurred within facilities built since 2020, although this represents just under 10% of current stock nationally.

Vacancy Rate by Submarket, Q2 2024 vs Q4 2019



Source: Cushman & Wakefield Research

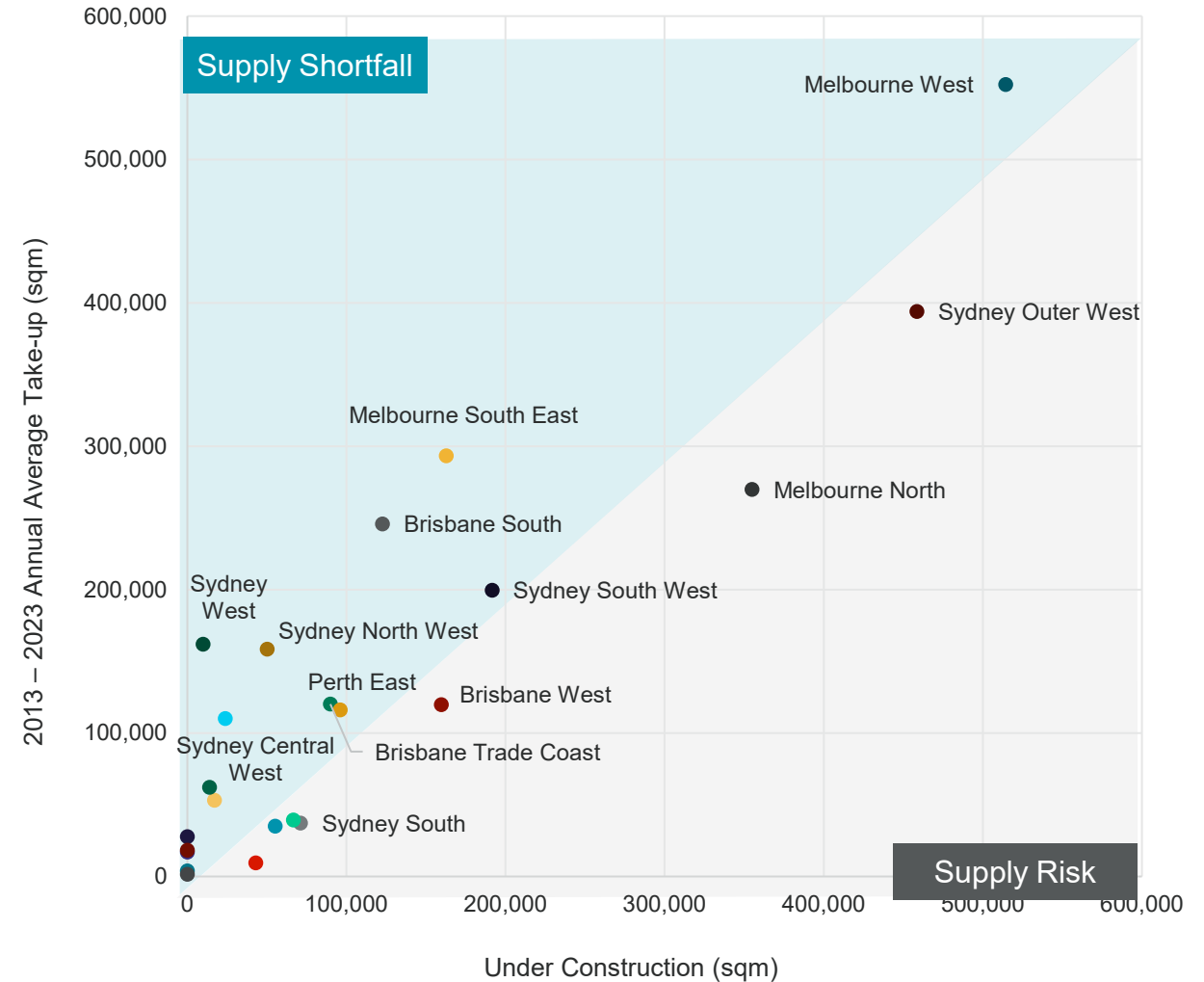
IS THERE AN OVERSUPPLY RISK?

At present, approximately 2.3 million sqm of supply is currently under construction, 73% of which is scheduled for completion in the second half of 2024. However, five submarkets account for 72% of the under construction pipeline, led by Melbourne's West, Sydney's Outer West, and Melbourne's North.

Looking at the under-construction supply pipeline against the 10-year annual average level of take-up shows that supply is well balanced across the country, alleviating concerns of an oversupply. Even for Melbourne's West, while just over 500,000 sqm is under construction, this is matched by a similar level of annual take-up.

Submarkets where supply moderately outpaces long-term take-up volumes include Brisbane's West, Melbourne's North and Adelaide's Outer North; however, in each case, vacancy rates remain well below balanced levels. Alternatively, supply in Melbourne's South East, Sydney's Central West and West and Brisbane's Trade Coast falls short of annual demand levels, which is expected to drive an outperformance of rental growth.

Supply Under Construction vs 2013 – 2023 Annual Take-up Volumes



Source: Cushman & Wakefield Research

WHAT DOES THIS MEAN?

Ultimately, this analysis demonstrates that Australia will remain an undersupplied market as vacancy rates remain below the 5.0% market equilibrium and the supply pipeline is, in fact, likely overstated.

Looking at the 2025 supply pipeline through a different lens, there is potential for 135 facilities above 10,000 sqm to be delivered. However, overlaying demand, there have been 172 lease deals per annum above 10,000 sqm on average over the past three years.

While demand and enquiry have softened in 2024, even if we assume a 20% fall in deals above 10,000 sqm, it still matches supply in this size bracket (138 deals per annum), and with vacancy rates currently at just 2.0%, it suggests the severe undersupply of warehouse space will likely remain. However, as highlighted earlier, not all of this supply is expected to eventuate, exacerbating the undersupply issue.

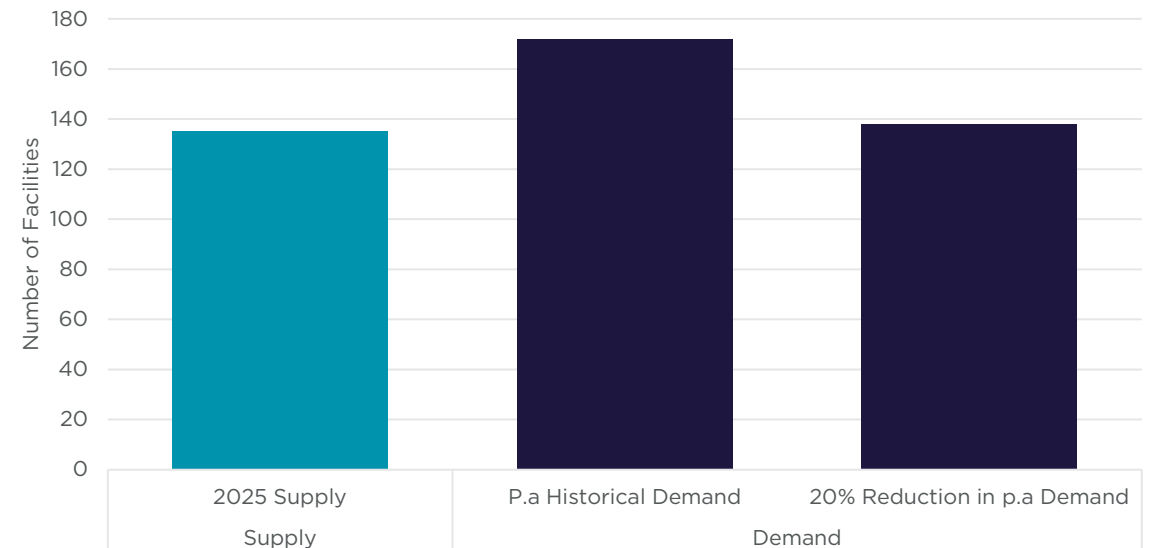
By city, the largest shortfall under this approach is within Sydney, while supply in the remaining cities either matches or falls short of demand.

The sectors that have driven demand above 10,000 sqm are transport & logistics and retail trade occupiers, which have collectively accounted for 68% of deals (by number) over the past three years. While demand has been patchy in 2024 for these sectors, take-up is expected to increase over the next 18 months, driven by improving economic conditions, positive real income growth, and contract renewals for the transport & logistics groups, which will trigger deal activity.

Warehouse Space Per Capita Has Fallen

Further compounding the undersupply of warehouse space is the reduction in floorspace per capita over the past two decades. Currently, there is 3.8 sqm of warehouse space per capita nationally, representing a 5.0% fall from where it sat in 2004 at 4.0 sqm per capita. In order for Australia to reach 2004 per capita levels, an additional 5.5 million sqm of warehouse space would need to be delivered, while continued population growth will drive warehouse space requirements over and above this.

2025 Supply Vs Demand, Number Of Facilities (>10,000 Sqm)



RECOMMENDATIONS



Developers

- The current environment is all about minimising leasing risk, particularly with regard to speculative development. While almost 90% of speculative developments since the beginning of 2021 were leased at or prior to completion, letting-up periods have become more varied in 2024.
- In the current environment, flexibility in development strategies is crucial, particularly within estate projects. Where possible, it is recommended that a site is actively marketed for pre-lease during the planning phase for speculative development. Doing so would minimise leasing risk and provide flexibility to capture both pre-lease and speculative demand.
- Consider smaller unit developments. The sweet spot of demand is within the 3,000 – 8,000 sqm size bracket and is consistent across each capital city. However, supply is heavily concentrated in big boxes (20,000 sqm +). In the right markets, smaller sub-8,000 sqm product options should be considered, thereby providing a point of difference in the market. This is particularly true in smaller markets such as Perth and Adelaide where the average lease deal remains below 5,000 sqm in size.
- For larger developments, flexibility is critical to minimise letting up periods. The ability to divide the facility into multiple facilities would cater to a broader mix of occupiers.
- Developers need to understand the end target user for their market which will best match facilities to the sweet spot of demand.
- For markets with high barriers to supply, such as Sydney's Central West, Melbourne's Inner South East and Brisbane's Trade Coast, brownfield conversions should be explored, taking advantage of the outperformance of infill locations and strong demand from business-to-consumer businesses.

Occupiers

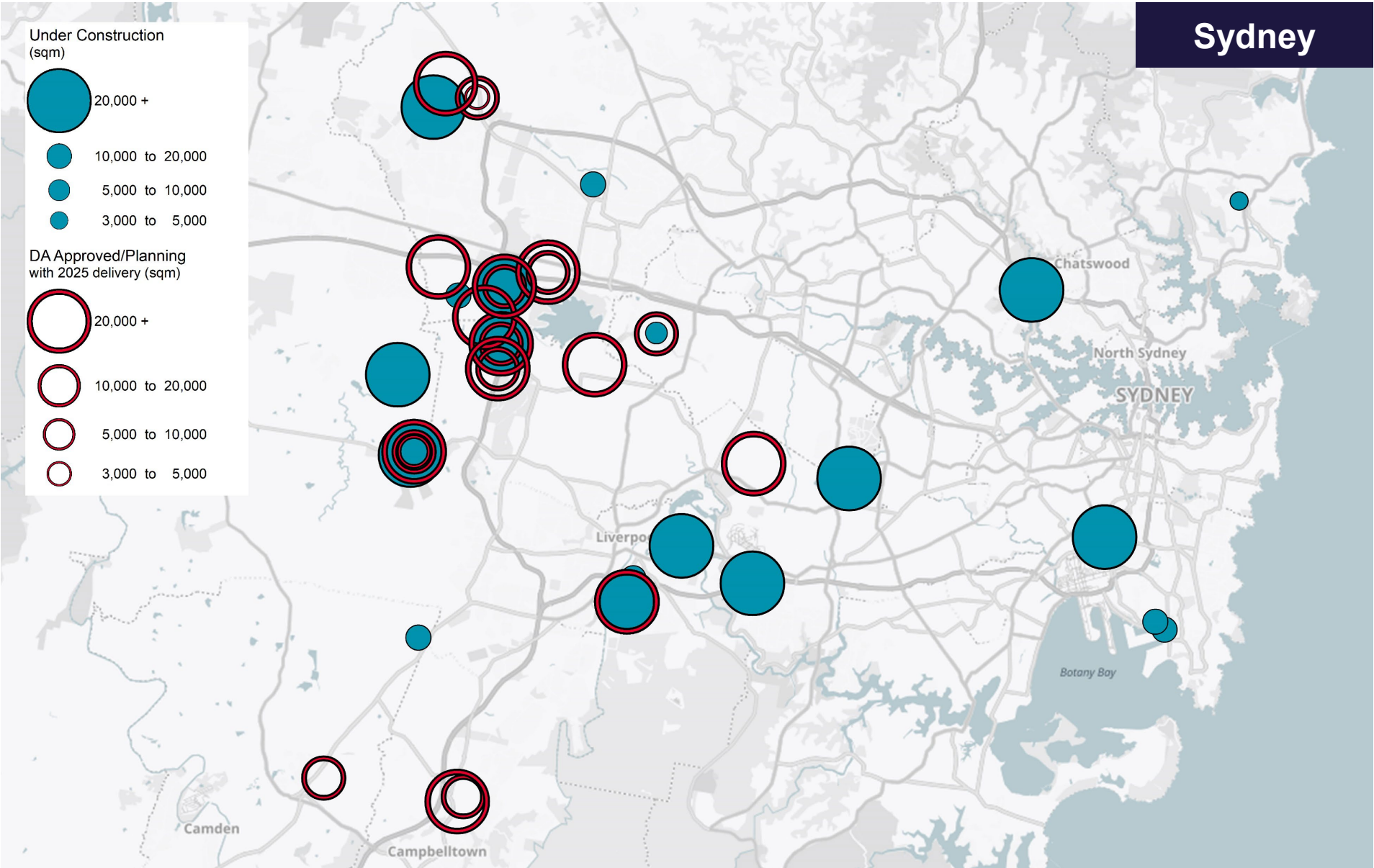
- The current increase in the vacancy rate is providing occupiers with more options to expand their footprint or relocate. However, occupiers need to be mindful, as this is market and submarket-specific. Infill markets and land-constrained locations will remain tight, and there will still likely need to be a compromise for space in these precincts (i.e. secondary grade space with a lower height clearance).
- Greater availability and higher incentives in several markets have created the best leasing conditions for occupiers since 2019. Proactive occupiers should capitalise on this opportunity and rethink their lease strategy before the pendulum potentially shifts back to the landlord over the next 12 months.
- The window of opportunity for occupiers could be short-lived as projects are paused or delayed at a time when there is a resurgence in demand. We are forecasting a 16% increase in take-up levels in 2025 compared to 2024, led by improving economic fundamentals. This will drive greater competition for new projects that enter the market.
- Occupiers should continue to focus on supply chain optimisation and undertake a deep study of their supply chain to understand pinch points. The right warehouse in the right location can go a long way to minimising or removing these pinch points. It is recommended that occupiers engage early and be clear on the desired outcome.
- With projects likely to be delayed given continued planning and servicing constraints, early discussions with the current landlord should occur to ensure minimal business disruptions during the relocation period if their new build is delayed.
- For larger occupiers who have multiple warehouse facilities, consider staggering lease expiries to take advantage of real estate's cyclical nature.



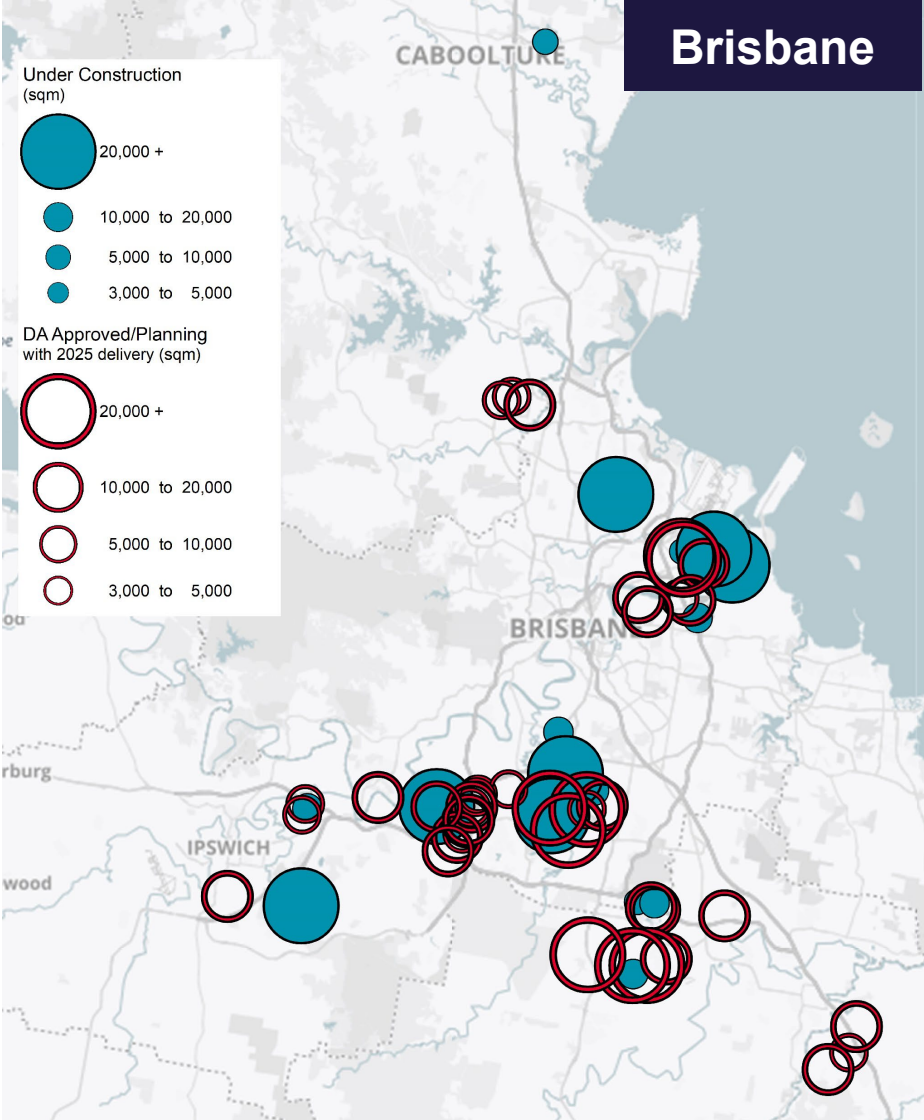
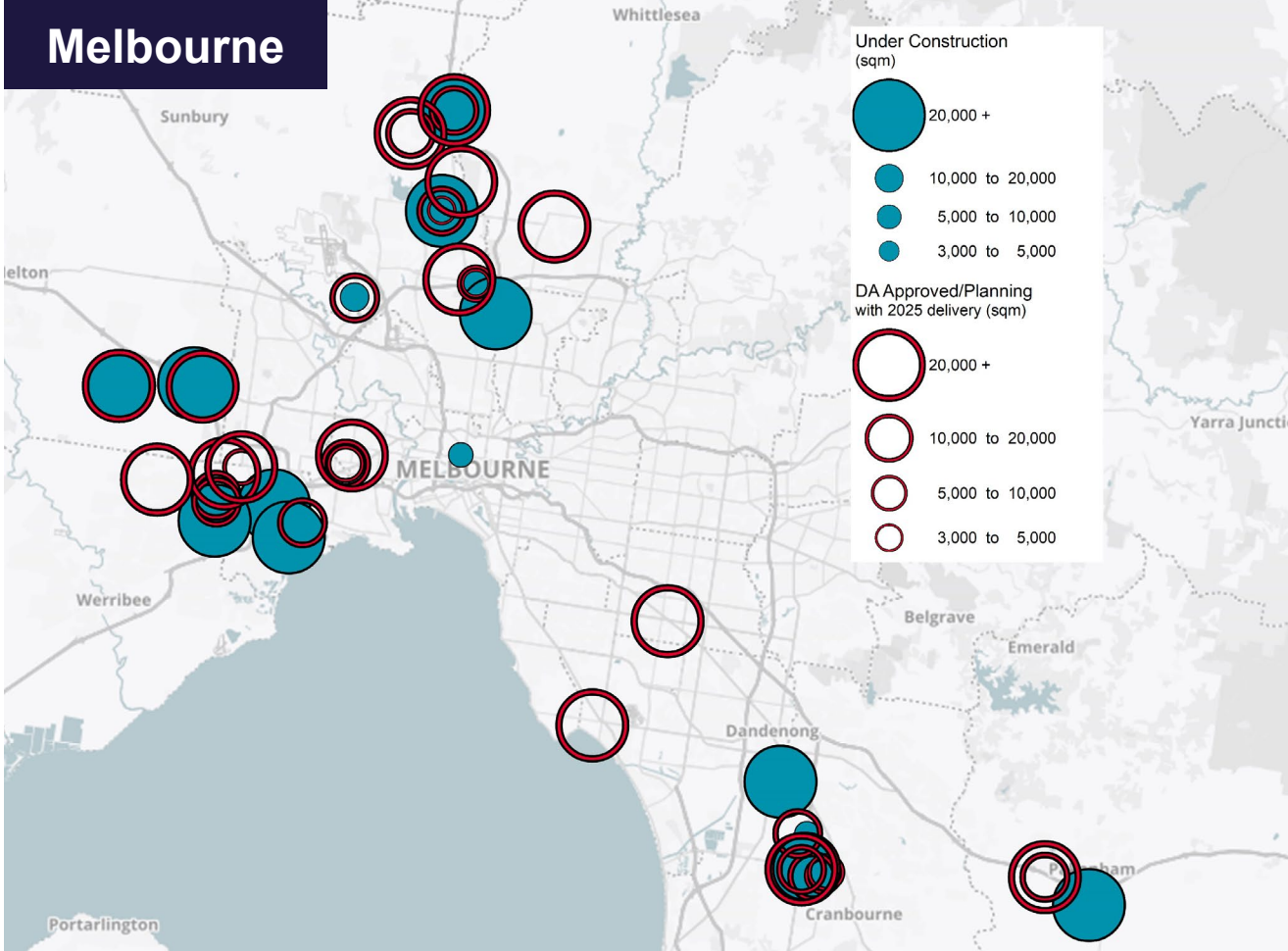
CAPITAL CITY SUPPLY MAPS

SYDNEY, MELBOURNE, BRISBANE,
ADELAIDE & PERTH

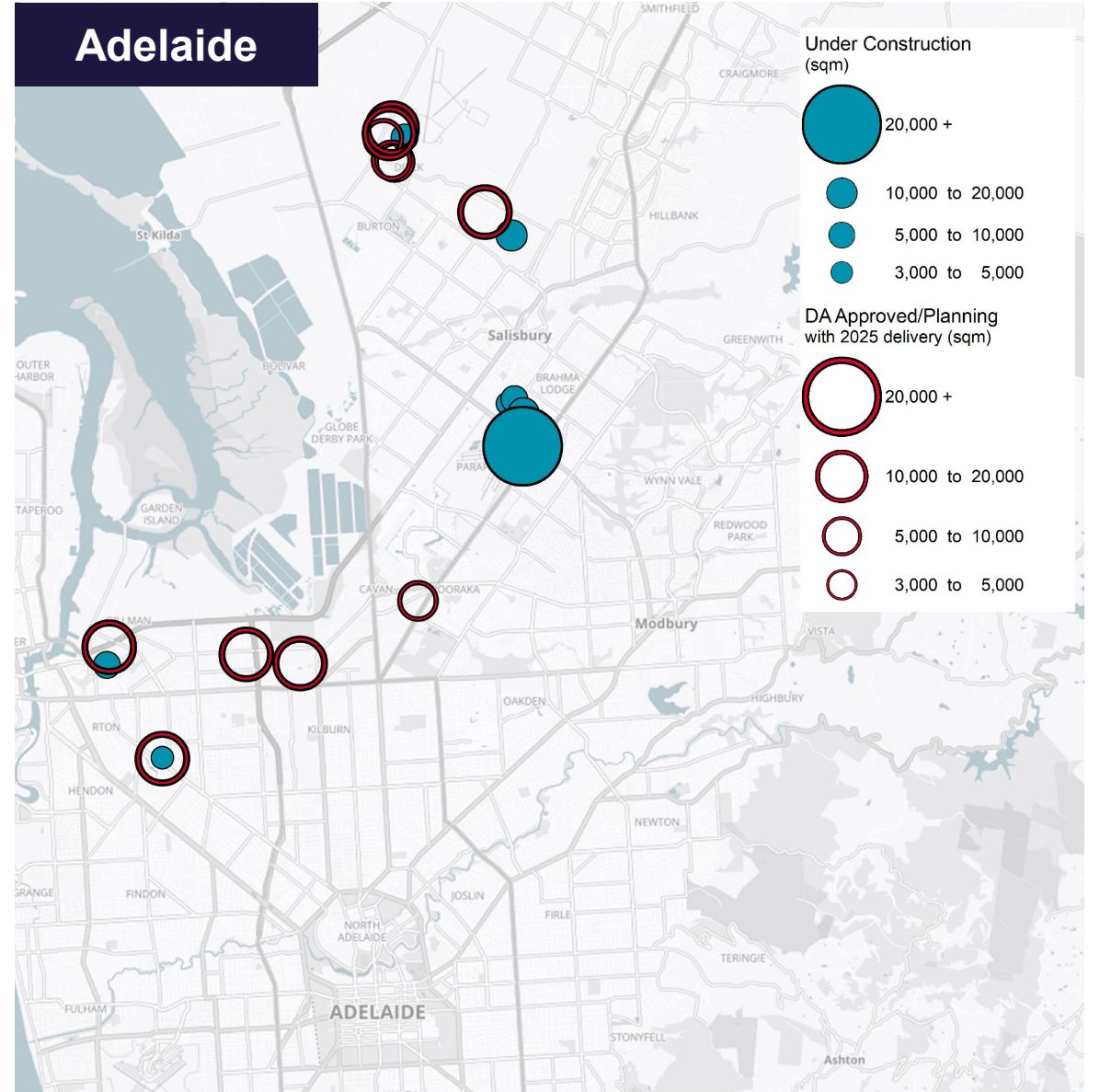
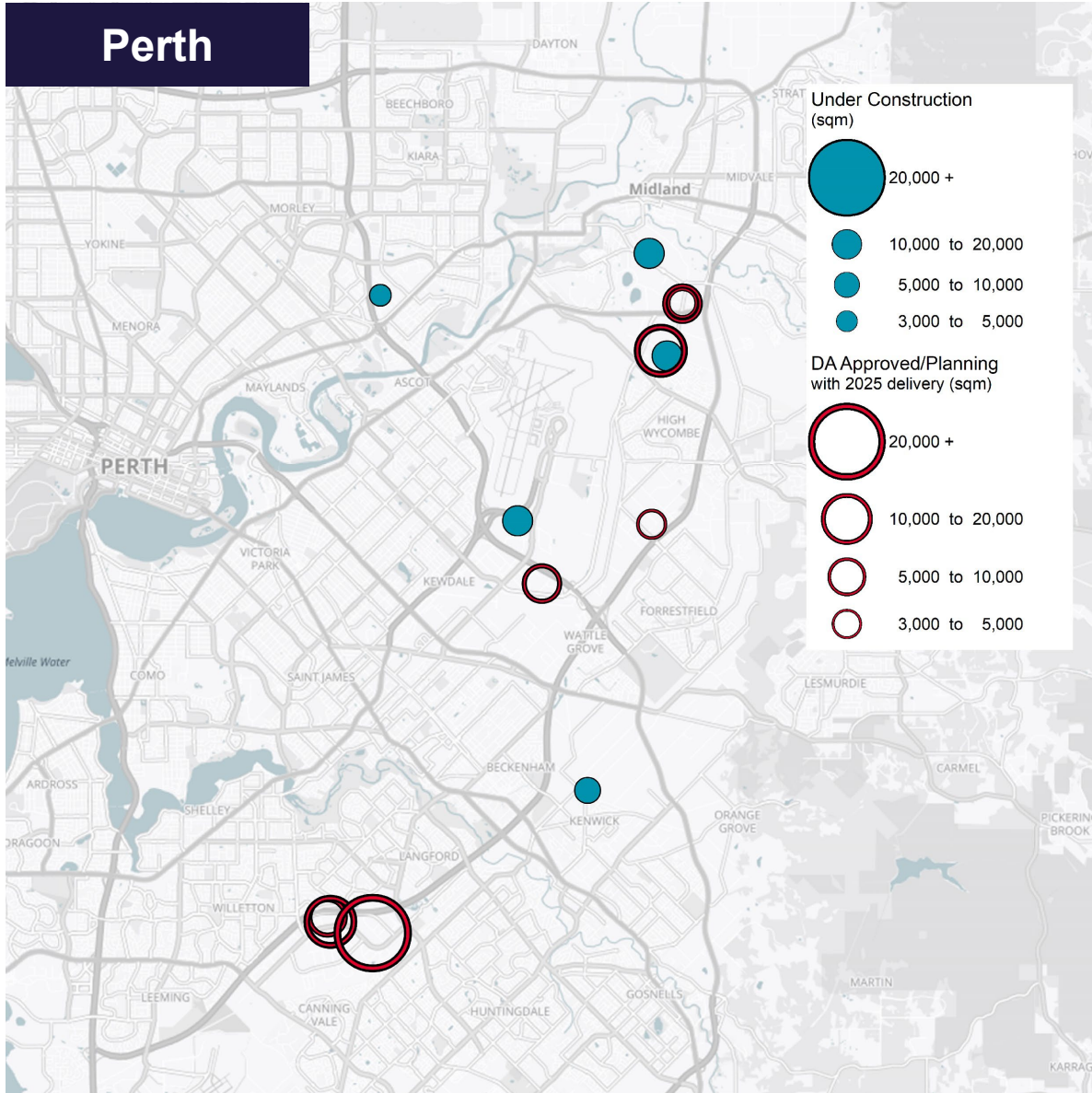
Capital City Supply Maps



Capital City Supply Maps



Capital City Supply Maps





LUKE CRAWFORD

Head of Logistics & Industrial Research, Australia
Luke.crawford@cushwake.com



CAITLYNE HALABI

Logistics & Industrial Research Analyst
Caitlyne.halabi@cushwake.com

About Cushman & Wakefield

Cushman & Wakefield (NYSE: CWK) is a leading global commercial real estate services firm for property owners and occupiers with approximately 52,000 employees in nearly 400 offices and 60 countries. In 2023, the firm reported revenue of \$9.5 billion across its core services of property, facilities and project management, leasing, capital markets, and valuation and other services. It also receives numerous industry and business accolades for its award-winning culture and commitment to Diversity, Equity and Inclusion (DEI), sustainability and more. For additional information, visit www.cushmanwakefield.com.