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Melbourne

Industrial Market Update

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Overview

Unfortunately for the Tenant, the Melbourne industrial market continues to boom and for the reasons outlined below, we have assessed the Melbourne Industrial market as Tenant Unfriendly. New supply is limited, and the little amount of new floor space being constructed is almost exclusively for pre-commitment transactions.

LPC Industrial Barometer

Demand for space remains high and largely unserviced and as a result vacancy levels across all regions of Melbourne have fallen even further. The average Vacancy Rate across the Melbourne Metropolitan region is now 1.1% with the Western region at an unprecedented 0.7%. As a result, there continues to be upward pressure on rentals in all markets across the Melbourne metropolitan region which have all experienced double digit growth over the past 12 months.

Market Trends

The table below summarises the trends within each of the sub-markets across metropolitan Melbourne: (Source: CBRE Research, LPC Research)

Region	Rental (Net $/m2 pa)	Trend	Incentives (% of Gross Rent)	Trend	Vacancy	Trend	Land Values (1.6Ha Lots)	Trend
Melbourne	**$105**	⬆	**15%**	-	**0.3%**	-	**$950**	⬆
West	**$92**	⬆	**10-15%**	-	**0.7%**	-	**$900**	⬆
North	**$92**	⬆	**15-20%**	-	**1.5%**	-	**$600**	⬆
East	**$130**	⬆	**10-15%**	-	**1.4%**	-	**$1,200**	⬆
South East	**$115**	⬆	**10-15%**	-	**1.4%**	-	**$1,100**	⬆

Opportunities

It is without doubt a landlord's market and the tenant is faced with a number of challenges. Very low levels of available stock, increasing rents, incentives for new tenants drying up, demand outstripping supply - all of which swings the pendulum in favour of the landlord.

However, a number of strategies can be adopted which may result in a more favourable outcome for a tenant. This will depend on where the tenant is in the lease cycle, i.e. new lease, just commenced, mid-term, approaching renewal with further options, or approaching lease expiry with no options. These strategies involve:

Engage early

The sooner negotiations commence the more likely an acceptable outcome can be achieved. We recommend that lease negotiations, whether they be a renewal, lease expiry or new premises, commence to the very least 12 months prior to the last day of the current lease.

Making it known to the market (and landlords) that you are considering several options is a good way to induce them to engage and to provide a competitive proposal. Even in tight markets, our experience is that competitive tension promotes creative options that improve tenant outcomes.

Consider pre-commitment opportunities

By commencing your negotiations early will enable you to consider new opportunities that are yet to be built. However, to be able to participate in an early pre-commitment to a new build requires some lead time, which will vary depending upon the size and complexity of the new build.

Review processes and adopt technology

Rather than relocate, perhaps there is an opportunity to review process and business models and adopt technological advancements. This is particularly relevant to the larger tenant, who is exposed to a significant rental bill due to the amount of area occupied. Modern systems and technology have made significant improvements in space utilisation and productivity.

Artificial Intelligence (AI) and robotics are becoming the norm rather than the exception. Modern racking systems and loading and retrieval systems allow for greater storage heights, which have led to higher warehouse clearance and reduced footprints (thereby reducing rental costs). While the capital outlay can be significant, the annual operational savings can lead to a short payback time frame.

Consider emerging precincts

This approach will not suit every business as many need to be close and accessible to their markets, but businesses that are not locationally dependant, can consider industrial precincts that are further afield or regional locations. Land is generally more available and as a result values and rentals are often lower than the major capitals.

Focus on flexible and favourable lease terms

Given the current market dynamics it is difficult to counter the arguments for increased rentals and lower incentives. We are advising our clients that it's more appropriate at this time to focus on lease terms that provide greater flexibility, share risk equally with the Landlord or place obligations on the Landlord. LPC focuses on 5 key areas in its lease negotiations, which are Cost, Risk, Flexibility, Obligations and Guarantees.

Seek specialist advice

The industrial real estate market is predominantly controlled by the supply side (landlords, developers, and leasing agents) which is concentrated, well-organised and powerful. In contrast, the demand side(or the tenant) is fragmented and under-represented, with far less influence on tenancy arrangements.

As a result, tenants find it difficult to access reliable information, and real estate decisions can be ill-informed and ill-advised. To mitigate this risk, we recommend that industrial tenants call on experienced advisors such as LPC who only represent tenants and are well placed to improve occupier outcomes in a tight market.

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