

## Property Observer

### Performance of Investment in Industrial Property

*By Lev Driker – Atchison Consultants*

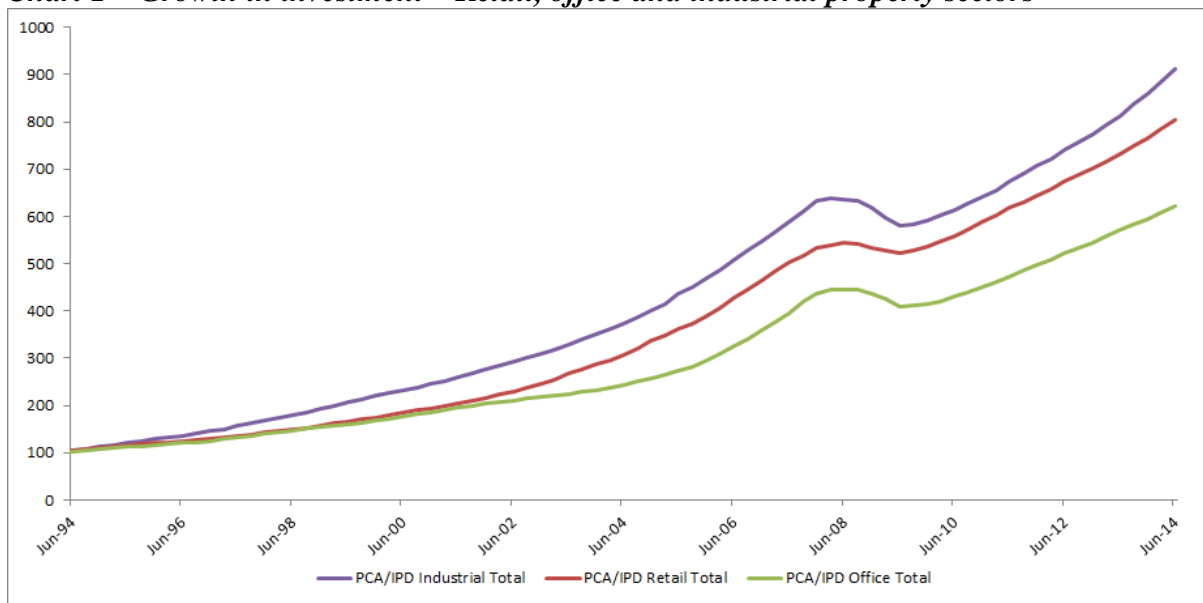
Industrial property has experienced a strong return of 12.1% over the year to 30 June 2014. This exceeds the returns from the other two major commercial property sectors being retail and office property which generated returns of 9.8% and 9.0% respectively.

The strength of the industrial property sector has resulted from strong demand for distribution and warehousing services generated by increases in retail spending in the Australian economy. New supply of industrial property has been significant and has restricted rental growth over the year to June 2014. Over the year to June 2014 industrial property generated an income return of 8.4%, while retail and office property generated lower income returns of 7.0% and 7.2% respectively.

Capital has flowed into the sector from investors seeking high yields. Industrial property offering yields of 8.4% is attractive. Strong investor demand has driven a rise in industrial property valuations generating capital growth for the year of 3.4%, which is greater than both retail and office property. A compression of capitalisation rates of industrial property occurred from 8.5% in June 2013 to 8.2% in June 2014.

Performance from industrial property over the longer term has also been positive. In chart 1 is shown the growth in value of \$100 invested over 20 years from June 1994 to June 2014 in the retail, office and industrial property sectors.

**Chart 1 – Growth in investment – Retail, office and industrial property sectors**



Source: PCA/IPD

It is shown in chart 1 that industrial property generated a higher cumulative return than any other major commercial property sector over a 20 year period to 30 June 2014. Industrial,

retail and office property generated returns of 11.5% p.a., 10.8% p.a. and 9.4% p.a. respectively.

The income return for industrial property over the long term has also been greater than that of retail and office property. Industrial property income return was 9.0% p.a. over 20 years to 30 June 2014 while retail and office property income return was 7.4% p.a. and 7.3% p.a. respectively. Rental yields on industrial property are higher than retail or office property reflecting the greater ease in developing new industrial property and the tendency for single tenants in assets.

Capital growth for the industrial property sector was 2.3% p.a. over 20 years to 30 June 2014 while capital growth for retail and office property was 3.2% p.a. and 2.0% p.a. respectively. The income return generated by industrial property over 20 years to 30 June 2014 has more than compensated for the lower capital return from industrial property compared with retail property.

Demand for distribution and warehousing services is expected to grow over the medium term from increased retail spending and growth in internet retail sales. Industrial property is a key component of internet retail sales which require efficient delivery systems through technology in logistics. Rents are expected to remain stable as new supply emerges. Rental yields on industrial property remain attractive being 4.7% higher than Commonwealth Government bond yields. The yield premium may shrink as the Australian economy strengthens and interest rates rise.

Strong investor demand for industrial property is expected maintaining upward pressure on prices. Capital growth will be positive as a result.

Market conditions will be favourable for industrial property in the medium term with a combination of demand for warehousing and distribution services underpinning rental income and investor demand for high yields driving growth.