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COVID-19 INDUSTRIAL IMPLICATIONS

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The outbreak of COVID-19 has had a significant impact on financial markets globally. As a result, it is now likely that global economic growth will contract over the short term. In terms of the impact on industrial and logistics property in Australia, it's still too early to draw any major conclusions as the situation is still unfolding. However, industrial property is well placed to ride out the short-term uncertainty given the recent growth in demand for transport and logistics and its key role to play in keeping the basic day to day necessities of Australians in supply.

Notwithstanding the short-term impacts, fundamentals within the Australian industrial and logistics market remain favourable with several structural and cyclical changes playing into the hands of the sector. Bringing it back to basics, the key drivers of the industrial market in recent years have been population growth, infrastructure investment, growth in e-commerce and low cost of debt.

Population growth over the short term is expected to take a hit as net overseas migration drops significantly off the back of travel restrictions and the closure of the Australian borders to non-citizens. Our current estimates are that population growth will fall to less than 200,000 people over the year to September 2020, after growth of 371,000 over the year to 2019. We must stress, however, that these are early estimates and based on significant assumptions being made as to the length of time the travel restrictions are in place. Regardless, the outlook for the other key drivers in the current environment remains unchanged, particularly e-commerce which continues to expand structurally, and the coronavirus outbreak is expected to result in a pick-up in online retail sales and hence demand for industrial space.

Past experiences, including SARS suggest that once the outbreak is contained, the negative impact to near-term growth will largely reverse as pent-up demand brings a surge in economic activity thereafter. Using past outbreaks as a guide, the COVID-19 should largely be contained by the first half of 2020 and we are already seeing a large drop in coronavirus infections in China. That being said, this virus is different to SARS in that it has not be contained to a small region, and the economic fallout from enforced lockdowns globally are markedly different.

With stores adjusting their hours and political leaders asking the public to stay home, the value of e-commerce has increased exponentially. Demand for large distribution and warehouse facilities is expected to continue its strong run over the past few years, particularly for last-mile locations. The one component to industrial which will see hard times in the near term will be the import/export industry.

The recent announcement of Government stimulus packages by both federal and state governments will provide a cushion effect to businesses within the logistics space. The fiscal and regulatory measures are designed to keep small to medium enterprises (SMEs) operating and employing workers during this time. By providing cash payments to employing SMEs, the Federal Government will help keep those businesses connected to the economy and their employees connected to their businesses. In addition, the $130 billion JobKeeper Payment which provides eligible employees with a flat rate of $1,500 per fortnight will inject more cash into the economy, with the e-commerce sector to directly benefit.

It is worth mentioning that the impact of COVID-19 is not yet visible in the official data but given China's position at the centre of many global supply chains, a temporary negative impact of some scale is likely.

Occupier Market

At the beginning of the year we were expecting 2020 to be a record year in terms of demand. In 2019, approximately 3.8 million sqm of industrial space was leased (1,000sqm+), representing the second highest annual total on record. While enquiry levels remain buoyant, the number of lease deals completed has moderately slowed over the past month as businesses put their relocation and expansion decisions on hold. However, certain businesses such as supermarkets and 3PLs have bucked this trend with demand levels increasing to satisfy a spike in demand for goods. Should the virus run its course in the first half of 2020, we expect a busy second half to 2020 as occupiers regroup and press ahead with urgent projects.

Food companies, logistics companies, warehousing and to some extent manufacturing have shown how important they are in times of "social distancing" and keeping the supply chain open. Similarly, it is expected there will be an increase in demand and requirements from omnichannel and pharmaceutical related product fields.

The panic buying of consumer staples during uncertain times like these has put food manufacturers and suppliers in the position of making sure their network of distribution and warehousing facilities are adequate to handle these types of demand spikes on a regional basis. These companies may need to expand their industrial footprint in metro areas to keep up with the increased demand. Highlighting this was the announcement in late March that Coles will open three 'pop-up' distribution centres in New South Wales, Victoria and Queensland to cater towards the rapid growth in food and grocery purchases.

While there will be short term impacts to the sector as a number of occupiers adopt a "wait and see" approach with regards to relocations and expansions, the long-term fundamentals remain sound. Once coronavirus is contained, it may in fact play into the hands of the industrial sector as consumers become more accustomed to online shopping (particularly food and groceries) which will lead to a pick-up in demand for new space, including cold storage logistics.

On the supply side, construction levels are expected to wane as sourcing building materials from offshore markets becomes increasingly more difficult. Consequently, this will have a knock-on effect to development costs and timeframes and as a result, we expect the development of speculative facilities will slow over the next 12 months. This is likely to lead to high levels of pent-up demand for new facilities, particularly once the outbreak is contained and businesses begin to regroup and move ahead with previous capital expenditure plans.

Investment Market

Investment volumes are likely to be weak over the first half of 2020 before the possibility of a steep and rapid recovery in sentiment and investment in the second half of 2020 once the pandemic is contained. So far in 2020, approximately $300 million of industrial and logistics assets have traded, compared to $1.2 billion at the same time last year. The slowdown is the result of several investors postponing investment decisions.

The recent events will however create an opportunity for cashed up investors looking to enter the market and to strategically acquire assets. Notably, this has seen the return of private investors over the past quarter as they look to capitalise on a period of uncertainty. Pent-up demand will rebound quickly and will come at a time of a large mismatch in supply and demand as stock remains tightly held. Despite the current circumstances, there is still significant capital seeking medium to long-term logistics investment opportunities within Australia. Assets providing steady and long-term income streams are expected to be the focus for investors and the continued growth of e-commerce will further strengthen this demand.

For vendors, there remains significant amounts of capital chasing assets, with COVID-19 having limited impact on the investment mandates of many groups. As a result, it represents a favourable time to offload long-held assets and take advantage of strong capital gains recorded over the past five years.