chill out
refrigerated logistics and distribution
Over the past several years, cold storage and temperature controlled facilities have benefitted from capitalisation rate compression to the same extent as ambient logistics assets.

Consequently the sector has seen a huge inflow of institutional capital both globally and here in Australia. Most major investment groups have an allocation to cold storage in their portfolios, including Goodman, Blackstone, Charter Hall, Dexus and Mapletree.
Investors continue to demonstrate a strong appetite for core Australian industrial assets with national transaction volumes totalling just over $5 billion over the last year.

Despite transaction volumes dropping from 2016-17, demand for industrial assets nationally remains exceptionally strong, particularly from local REITs and foreign investors looking to grow their portfolios.

Further, owners are increasingly reluctant to sell their existing holdings, as forward-looking drivers for rental and capital value growth strengthen, leading to a significant amount of unsatisfied capital seeking core investment opportunities in Australia’s industrial sector.

Transactional activity is expected to remain steady over the next 12 months, however the ability to unlock investment stock is expected to become more challenging, as owners hold on to income returns.

Whilst refrigerated logistics and distribution facilities are a relatively specialised asset class, strong growth in Food and Café & Restaurant retailing has significantly increased visibility of the asset class, making it a viable investment choice for all types of investors. With growth in these retail categories likely to remain strong, we are seeing refrigerated logistics and distribution facilities becoming highly pursued, aided by their strong core characteristics.

This report explores the fundamental demand drivers of the refrigerated logistics and distribution sector and the unique characteristics that have make the asset class an increasingly attractive investment.
As Australia’s largest manufacturing sector, the food and grocery industry is a key demand driver in the refrigerated logistics and distribution industry.

**Population Growth**

Given its non-discretionary nature, we have seen a direct correlation between Australia’s strong population growth and a surge in demand for food and supermarket retailing, this is in spite of challenges faced by the broader retail sector.

Australia’s population grew by 1.6% in the 12 months to June 2018 (ABS), with population growth forecast to be the strongest of its developed peers globally. According to projections made by the IMF’s World Economic Outlook in October 2018, Australia’s population is forecast to grow by 14.0% over the next five years.

As such, demand for food, supermarket and café and restaurant retailing, will continue to exhibit healthy growth, with requirements from both domestic and overseas suppliers to grow in-line with the population, propelling the need for refrigerated logistics facilities.

A lower Australian dollar is also likely to boost international visitors, notably aiding growth in café and restaurant retailing. International tourists are expected to grow by 6.2%pa over the next 10 years (compared to historical 20 year average of 4.2%pa).

**Australian Population**

![Graph showing Australian population growth from 1982 to 2018.](Source: ABS / Savills)
Import/Export Volumes

Food is one of the most challenging import/exports for any country as it necessitates precise delivery timing, strict customs compliance and sophisticated and reliable technology to maintain freshness and prevent contamination. Despite these challenges, the import and export of food and beverages in Australia has grown substantially over the past decade.

Food and Beverage exports in FOB Value have increased 5.2%pa in the 10 years, while imports in Customs Value have increased 5.0%pa over the same period.

Australia’s existing relationships with Asia are largely built around commodity exports. However, the growth of Asia’s middle class and the maturing of Asia’s economies means that the demand profile of products and services is changing and the demand for products like safe and high-quality food will continue to increase.

According to the Australian Food and Grocery Council: State of the Industry Report 2017, the fresh produce sector is dependent on the export market with 76.8% of locally produced goods being consumed overseas.

Australian consumers’ appetite for imported goods also remains strong with Australia being a net food importer across six major food categories – seafood; processed fruit and vegetables; soft drink, cordials and syrup; confectionary; bakery products and oils and fats (ABARES 2017).

Food & Beverage Imports/Exports

Source: ABS / Savills
Consumption Growth

The domestic food market is continuously expanding, with Australia's household food requirements increasing over time, particularly as population and household sizes grow. Additionally, there has been a broad shift towards spending at cafes and restaurants, which has diversified the domestic food supply chain with increased opportunities to sell consumables to the food services industry.

Total food and café and restaurant retail turnover accounted for circa 55% of total retail turnover in the year to October 2018, up from 50% in the preceding 10 year period. Café and restaurant retailing grew at a compound rate of 5.9%pa over the past 10 years, compared to a 10 year CAGR of 3.7% for the total retail sector. The 10 year CAGR for the food retail sector was recorded at 4.1% over the same period.

While not at the same pace as the overall online retail sector, online grocery retailing is also developing traction.

Australian consumers have been slow to take up online grocery shopping, given the current offerings provided by bricks-and-mortar stores through the extensive network of major supermarket chains, Coles and Woolworths.

However, according to Nielsen research there was a 22.9% increase in new online grocery shoppers in 2017, with the fresh produce category growing by 14.5% over the same period. An ageing population and a growing younger working population will significantly boost the number of online grocery shoppers over the short to medium term.

In order to accommodate this growth, manufacturers, retailers and wholesalers have altered their supply chain processes and are holding less stock on hand.

As a result, these users are increasingly outsourcing warehousing to third-party operators, boosting demand for refrigerated logistics and distribution services.

Total Retail Turnover

![Total Retail Turnover Chart]

Source: ABS / Savills
In recent years and through greater visibility, we have seen refrigerated logistics and distribution facilities evolve from a niche asset class to one that is highly sought-after.

Whilst the operation of these facilities are specialised, the underlying characteristics are representative of the standards that are attractive to core investors. These characteristics include modern facilities of scale, core locations, long WALEs and strong covenants.

**Favourable Lease Terms & Structure**

Given the specialised development requirements, refrigerated logistics facilities are generally set with long term leases and further option periods. The longer lease terms provide developers assurance of income to offset the higher development outlay while offering tenants a longer period of time to recover the costs invested into the operation of the facility.

Developers will also apply higher rental rates to reflect the high development cost and ongoing operational costs. Unlike traditional warehousing, the cost of operating and maintaining refrigerated facilities is quite expensive, attributable to higher insurance premiums, significant energy costs and maintenance of sophisticated plant and machinery. In some circumstances developers may implement triple net leases which sees the tenant responsible for taxes, insurance and maintenance.
Diverse needs driven by end users make it difficult to provide a one-size-fits-all solution to refrigerated logistics and distribution facilities. As such, these facilities are typically developed specifically for major supermarket chains, food distributors and 3PL providers.
Specialised Fit Out Strengthening Tenant Commitment

Tenants invest heavily in the automation, software, sophisticated plant and machinery and overall fit out required to operate these facilities. This initial capital outlay is one of the major barriers of entry into the market.

Conversely, the capital outlay is also a compelling factor in the decision making process for tenants at the end of their lease terms. Whilst tenants will still evaluate their decision based on organic growth and capacity, flexibility of facility and changes to their supply chain, the initial capital required makes tenants more likely to take up option periods or renew existing leases.

Despite the specialised fit outs, most modern cold storage facilities are designed in a way that they can easily be converted to operate as traditional ambient warehouses at any given point in time.

Major Tenant Pool

As discussed earlier, growth in the food industry is driving demand for refrigerated logistics and distribution space. Occupation of these facilities has traditionally been dominated by major supermarket chains Coles, Woolworth and Metcash.

However, corporate outsourcing of distribution services to 3PL providers is attracting further sources of demand. Major providers including Emergent Cold (formerly Swire Cold Storage), Rand Refrigerated Logistics (part of AHG) and Montague Cold Storage are expanding their footprints as they continue to win new contracts.
While relatively specialised, refrigerated logistics and distribution assets possess the characteristics that core investors look for including scale, long WALE and strong covenants.

Investors can look to refrigerated logistics and distribution assets for favourable lease terms including long dated leases and higher rents, committed tenants given their heavy investment into the asset and a healthy tenant pool of major supermarket chains, food manufacturers and 3PL providers.

These asset characteristics are backed by the strong outlook for the fundamental demand drivers with growth in food demand largely supported by population growth, strong import/export volumes and consumption growth.

Overall, given the amount of unsatisfied capital looking to deploy into the Australian logistics market, investors should consider the refrigerated logistics and distribution asset class.
## Major transactions

<table>
<thead>
<tr>
<th>Address</th>
<th>Date</th>
<th>Sale Price (million)</th>
<th>GLA (sqm)</th>
<th>WALE (years)</th>
<th>Capital Value ($/sqm)</th>
<th>Purchaser</th>
</tr>
</thead>
<tbody>
<tr>
<td>102 Trade Street, Lytton QLD</td>
<td>Nov 18</td>
<td>$55.0</td>
<td>14,479</td>
<td>14.5</td>
<td>$3,799</td>
<td>Blackstone</td>
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<tr>
<td>71 Cocos Drive, Bibra Lake WA</td>
<td>Sep 18</td>
<td>$12.4</td>
<td>7,150</td>
<td>7.0</td>
<td>$1,734</td>
<td>Quadrant Investments</td>
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<tr>
<td>158 Kurnall Road, Welshpool WA</td>
<td>Dec 17</td>
<td>$26.75</td>
<td>9,047</td>
<td>20.0</td>
<td>$2,957</td>
<td>Blackstone</td>
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<tr>
<td>40 Solomon Road, Jandakot WA</td>
<td>Dec 17</td>
<td>$44.75</td>
<td>18,222</td>
<td>N/A</td>
<td>$2,445</td>
<td>Blackstone</td>
</tr>
<tr>
<td>84 Lahrs Road, Ormeau QLD</td>
<td>Jul 17</td>
<td>$22.0</td>
<td>7,485</td>
<td>7.0</td>
<td>$2,939</td>
<td>Ozprop LC P/C as TTE</td>
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<tr>
<td>115-121 Jedda Road, Prestons NSW</td>
<td>May 17</td>
<td>$59.0</td>
<td>15,030</td>
<td>12.0</td>
<td>$3,925</td>
<td>Charter Hall</td>
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<tr>
<td>1 Moondo Street, Greenacres NSW</td>
<td>May 17</td>
<td>$33.85</td>
<td>12,813</td>
<td>14.0</td>
<td>$2,642</td>
<td>Charter Hall</td>
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<tr>
<td>7-23 Dunmore Drive, Truganina VIC</td>
<td>Apr 17</td>
<td>$66.6</td>
<td>16,960</td>
<td>16.8</td>
<td>$3,892</td>
<td>Deutsche Asset Management</td>
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<tr>
<td>60-80 Southlink Street, Parkinson QLD</td>
<td>Dec 16</td>
<td>$37.1</td>
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<td>$4,410</td>
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<tr>
<td>45 Fulton Drive, Derrimut VIC</td>
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<td>10,848</td>
<td>9.7</td>
<td>$3,319</td>
<td>Deutsche Asset Management</td>
</tr>
</tbody>
</table>
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