Factors affecting the value of industrial property

As you know by now, a large element of the valuation process is concerned with comparisons between the subject property and sales and/or rentals of comparable properties. However, in order to make such comparisons you need to know the main factors affecting the value of specific properties. For example, location, number of bedrooms, and land dimensions are three significant factors that affect the value of residential cottages. This section is concerned with the main factors that affect the value of industrial property—in other words, the things you look for when inspecting the property and the research and analysis needed to arrive at a valuation.

External factors

Location

This is probably the main factor affecting the value of real estate in general. There are good, average and poor industrial locations—regardless of whether you’re talking about the Sydney industrial market, industrial markets in regional centres such as Bathurst/Orange, or country towns. High demand locations command higher values and rents than those subject to a lower level of demand. Most of the other factors to be looked at here affect the demand for particular locations. However, before proceeding you should be aware of the following points. Firstly, be cautious if you need to use ‘comparables’ from an industrial location having a different type of demand from the subject property. For example, in the Sydney industrial market you should not make comparisons between ‘high tech’ areas like North Ryde, and warehousing areas such as Silverwater. If you are valuing an industrial property in a country town and cannot obtain comparable sales and/or rentals, then think carefully about the validity of using transactions from another country town.

Secondly, remember that market values and rents are determined by the interaction of demand and supply. Circumstances that give rise to an increase in demand for industrial properties in a particular locality will affect industrial values and rents in that and nearby localities.
An example of this is the effect on industrial values and rents in the south-western and north-western areas of Sydney, now that the Western Orbital ring road is a reality.

Changes in the structure of the economy

For some years manufacturing industry has been in decline. Most industrial premises are currently used for:

- warehousing (storage and distribution of goods)
- ‘high tech’ purposes associated with the computer and research industries
- light engineering works.

Demand patterns reflect the types of properties required. Warehouses require high internal clearances (distance from the floor to the underside of the roof framing); ‘High tech’ industries require a large proportion of specialised office type space with air conditioning for the computing equipment, whilst manufacturing industries generally require relatively large premises. Currently, there is reduced demand for buildings with small internal clearances, and many of the large holdings have been subdivided. Presumably, if there is a boom in the manufacturing industry, demand would increase for larger holdings close to a labour force.

Nearness to the labour force

In general, this is not as important a factor as it was in previous years. This is because of:

- the decline of manufacturing industry (traditionally labour intensive)
- the increased mechanisation of manufacturing processes
- public transport improvements
- the increase in private car ownership.

Nonetheless, you have to treat each valuation on its merits. For example, if you were undertaking a valuation of a proposed industrial establishment in a country area, you would need to investigate whether or not a suitable labour supply is available. As another example, if you had to value an industrial land subdivision located on the outskirts of Sydney, some distance from established residential areas and not serviced by public transport, you would have to take into account the possibility of saleability problems with the subdivision.
Nearness to major transport routes

This is especially important.

Industrial premises, notably warehouses, need to be able to obtain and distribute goods and materials in a cost and time-efficient manner. For example, the Eastern Creek industrial area is very close to the geographical centre of Sydney and is located between the major traffic thoroughfares of the Western Motorway (M2) and the Western Orbital.

Nearness to public infrastructure

The importance of this factor on value depends on the demand for the type of infrastructure involved. Certain types of industry need to be located close to airports or port facilities, and as a generalisation, the further away from the facility, the lower the value. Rail sidings are generally not considered a significant factor on industrial values in Sydney. However, the situation may well be different when valuing industrial properties in semi-rural and rural areas. For example, a rail siding on the land, or close access to one, may be a requirement for an abattoir or a flour mill.

Supply of industrial land for development or re-development

There is very little land available in established industrial areas of Sydney such as Silverwater, Bankstown, Brookvale and Artarmon. In addition, there are very few older industrial estates left for refurbishment or redevelopment in the established industrial areas. There has also been a major shift in South Sydney, where large tracts of land have been rezoned for residential development. This has been due to the introduction of a new rail line to the airports, with stops at Green Square and Wooli Creek. The affect of this depletion of supply, assuming demand exceeds supply in established areas, is twofold:

1. it puts upward pressure on prices and rents in established areas
2. it increases demand for fringe locations, which over time become established industrial areas.

Similarity to other industrial developments

Two generalisations on this point may be made. Firstly, as industrial areas become more intensively developed, values and rentals seem to increase. Secondly, values and rentals are ‘held back’ when areas are in the transitional stage for a change of use—particularly from residential to industrial.
The probable reason for this is that there is a degree of interdependence within industrial areas—for example:

- some businesses (say, panel beaters and auto electricians) have similar requirements
- amenity curbs on industrial traffic flow in areas that also have a high proportion of residential land use
- intensively developed industrial areas have an ‘in demand’ visual impact that less intensively developed areas lack.

Therefore exercise a degree of caution of using ‘comparables’ from an intensively developed industrial area, to value a property located in an emerging industrial area, and vice versa.

**Technological change**

No doubt, the examples given below will seem tame if you are reading this five years from now. Technological change is important because it results in better construction techniques and materials and possible reductions in real building costs (costs adjusted for inflation). It can change the demand characteristics relating to industrial premises—a typical example is the high proportion of air conditioned office space with special flooring required for computer installations in the ‘high tech’ industries.

Technological change can also render existing industrial premises obsolete or severely reduce the demand for them. For example, improvements in forklift technology have made the internal clearance (distance from floor to underside of roof frame) one of the most important considerations in industrial valuations. As a rough estimate, average internal clearances have increased from four metres between 1978 and 2002.

Another example of the relationship between technological advance and obsolescence in existing industrial premises occurs as a result of changing reliance on containers. Since about 1978, containers have increasingly become the method of storing goods. As a result, there has been a lessening of demand for industrial buildings that do not have vehicle entry points high enough for a motor vehicle and container. The minimum height requirement for vehicle entry points to take containers is about 4.75 metres.

Be aware of any change in major technology and user requirements. If they become the standard, there will be a lessening of demand for industrial buildings that do not meet the standard.

**General factors for consideration**

Are interest rates static, increasing or declining? Are investment opportunities better for other types of real estate, such as commercial? Is the
real estate market performing better or worse than other sectors of the economy, such as the share market? Is the industrial real estate market currently affected by changes to income tax legislation (for example, changed provisions for capital gains tax), decentralisation policies (for example, subsidies to re-locate), or an increase or decrease in the level of overseas demand (for example, is the value of the Australian dollar increasing or decreasing?)?

Internal factors

Site location

Is it in an established industrial area? Does it have a frontage to a main road? If it does, it may have added value relative to properties in side streets because of the exposure and advertising potential. On the other hand, a heavy traffic flow may cause access problems to the site. Is the property a corner site? If it is, then there is generally more flexibility with development, and if one frontage is to a main road, then there is probably advertising potential and no undue problems with access to and from the site.

Shape

Regular sites generally offer more flexibility for development than irregular ones.

Land area

Generally, large sites have a lower value per square metre/hectare than small ones. However, if the council code for development is very restrictive in terms of building setbacks from boundaries and provision of landscaping and on-site parking, the reverse may apply because of the limited development potential of smaller sites.

Topography

Heavy timber, rock outcrops, land fill and rock sub-strata make it more expensive to develop or redevelop a site. Industrial users normally prefer level land. However, note that a sloping site may lend itself to certain industries and may also have utility in terms of basement level vehicle parking.
Land dimensions

If the frontage is too narrow or the depth too shallow, then development potential is limited. With already-developed sites, utility is restricted. For reasons of advertising, access and storage, narrow frontages are generally more limiting than those of shallow depth. However, if the depth is too shallow, then the potential for on-site parking and storage is limited.

Town planning zoning

Industrial zonings fall under the ‘4’ classification in the land use tables that form part of Council’s Land Environment Plan(s). The two main zonings are:

- ‘Industrial 4 (a)’. Subject to Council consent being obtained, this allows for the broad range of industrial uses and is primarily a zoning for ‘heavy’ industry, such as large manufacturing concerns. A notable omission from the allowable uses is noxious industry. A Tannery or an oil refinery would be considered noxious industry.

- ‘Industrial 4 (b)’. This zoning caters for light industry such as merchandising, and light engineering.

When valuing industrial properties, be very careful if you intend to use comparable rents or sales that do not have the same industrial zoning as the subject property. It is not a perfect world in terms of market information, and at times you just have to use second best ‘comparables’. Generally, because the ‘Industrial 4 (a)’ zoning allows a much wider range of uses than the ‘Industrial 4 (b)’ zoning, it will have higher value per hectare/per square metre. This means you have to exercise care if you are going to use ‘comparables’ zoned ‘Industrial 4 (a)’ to value a property zoned ‘Industrial 4 (b)’, and vice versa. However, in some localities it may be the case that the predominant demand is for light industrial usage, and that land zoned ‘Industrial 4 (a)” has a similar value per hectare/square metre to land zoned ‘Industrial 4 (b)’. The only way to ascertain whether or not the values are similar is to analyse and compare sales transactions that fall under each zoning.

There are also specialised industrial zonings, to cater for the requirements of particular localities. These zonings include ‘waterfront industrial’, and noxious uses such as steelworks and oil refineries.

If you have to value a property with a specialised zoning, and find that you cannot get any guidance at all from ‘comparables’ under the same zoning (for example, the sales are out of date), then the main avenue open to you is to use sales of industrial property under another industrial zoning and use a lot of professional judgement in making the comparison.
Development codes

Ascertain what are the requirements for on-site parking, landscaping, building set backs and council contributions. Remember, a very restrictive council code can severely limit the utility, and hence the value, of small sites. At the same time, ascertain the floor space ratio under the zoning, for this determines the maximum size of building allowable. For example, a floor space ratio of 1:1 means that a site with an area of 500 m² can have a building with a maximum area of 500 m². However, because of requirements such as building set backs and on-site parking, this would normally equate to an effective factory/warehouse area of, say, 300 m² and an upper level office area of, say, 100 m².

Note: It is rare for the maximum floor square ratio to be achieved because of the need to allow for on-site parking, landscaping, and building set backs. One of the factors you must take into account in comparing the subject property with ones that have sold is the floor space ratio. The higher the floor space ratio the greater the building area allowable. Normally, floor space ratios for industrial properties are 1:1, 1.5:1, or 2:1.

Finally, there may be special clauses relating to a particular zoning. For example, retailing may be permitted, or—as in the case of the North Ryde industrial estate in Sydney—the premises may have to be used in a manner that is to some extent integrated with an educational institution (in this case, with Macquarie University).

Building codes

Please note the following considerations if you are using the ‘hypothetical development’ method of valuation, to arrive at the value of, say, land suitable for industrial subdivision. Then before you can arrive at the gross realisation (value on completion) you have to hypothetically design the building or buildings. If you have to estimate the value of a development on completion for, say, mortgage purposes, then the valuation would need to be subject to a satisfactory building certificate (formerly know as certificate of compliance). When valuing improved properties, if the improvements do not conform to existing building codes, then the value of the property will be adversely affected. This last point will be taken up in the next section when we look at the factors affecting the value of the building. Also, the building code or other information from the building section will stipulate the minimum dimensions necessary for vehicle entry points in order to allow for entry of vehicles with containers.

Building wall construction

Pre-cast concrete panels or brickwork are the modern standards (brickwork has been around for some time in terms of factories, but it is still more desirable and more in demand than most of the alternatives). Be careful of
concrete or concrete block construction of external walls. The fact that concrete blockwork absorbs water has an adverse affect on the value of the property, relative to either pre-cast concrete panels or brick construction. Industrial premises that have asbestos cement wall cladding are of concern. Because of the problem of asbestosis there is a relatively low demand for such properties. Additionally, it is very difficult and certainly very expensive, to have repairs carried out to premises that have asbestos cement construction features. Galvanised iron wall cladding is also a ‘lower valued’ type of wall construction.

If you find yourself valuing either a galvanised iron or asbestos cement clad industrial building, then give consideration to how much value the building adds to the land. One of the considerations involved here would be analysis of sales of similarity constructed buildings, if such sales are available.

**Floor construction**

Industrial usage requires a heavy-duty concrete floor. In general, this means a floor having a thickness of at least 110 mm (4.5 inches). Timber floors are very rare, and normally have an adverse affect on value. However, you need to be aware of two factors. Firstly, in some industries—such as clothing—wooden floors are necessary in order not to damage the fabric. Secondly, where the industrial process being carried out requires timber flooring, it is common for timber to be placed over an existing concrete floor.

**Age and condition of the buildings**

**Roof framing**

Clear span space is more usable than space that contains columns. In addition, the framing should be strong enough to support a one tonne, and preferably a two tonne, lifting hoist. Steel portal frame and ‘tilt-slab’ construction technologies provide optimum clear span utility in modern factories.

**Roof cladding**

As already mentioned above, in the section ‘Building wall construction’, there are problems associated with asbestos cement cladding, which is corrugated when used for roofing. Metal decking is probably the most desirable roof covering, followed by corrugated galvanised iron. It is also reasonably common to have concrete slab roofing over all or part of the premises, as this can provide roof-top car parking.
Number and size of loading docks and bays

Modern industrial premises normally provide for loading bays whereby vehicles can enter the premises for loading and unloading purposes.

Number and size of vehicle entry points

A (capital) major factor is whether or not there is sufficient height to take a vehicle and a container at lifted height. The minimum height for this purpose is normally 4.75 metres, but this should be checked by examining the minimum requirement specified under the local council building code.

Internal clearance

This is the distance from the floor to the underside of the roof framing, and is one of the major elements in the value of industrial properties. The higher the internal clearance, the more the storage capacity and ability to move items by hoist. Modern industrial premises generally have internal clearances between 7 and 9 metres. Because of the significance of internal clearance in the value of industrial properties, extra diligence is required if making comparisons between properties with great differences in this area.

Electricity supply

Industrial usage requires three phase power, which is 415 volts. The type of electricity supply available can be ascertained by examining the electricity meter box. It would be unusual for industrial premises to have a domestic two-phase power supply, which is 240 volts.

Standard of natural light

Obviously, the more natural light the better. When inspecting industrial premises check the number and size of windows and any skylights—particularly if it is a ‘dull’ day. With regard to skylights, it is preferable that they be vertically installed in the roof and/or on top of the walls. Skylights are normally made of fibreglass, and horizontal ones will make the premises very hot and difficult to work in during summer.

Standard of office space and amenities

Is the office space air conditioned and carpeted? Are the amenities appropriate? An example of appropriate amenity positioning would be the provision of male and female toilets on the ‘factory floor’, as well as in the office section. Do the amenities meet the requirements of the relevant legislation? If not, think about deducting an amount from the valuation that is sufficient to bring the amenities up to the required standard.
Ratio of office space to total space

In merchandising and light manufacturing the office and amenities space is normally between 10–15% of the total floor space area. An excessive ratio will narrow the demand for the property. The requirements for the so-called ‘high tech’ industries are different. The computer installation and ancillary office space means that in excess of 50% of the total area is required for office and amenities space.

Hoists and gantry cranes

Hoists are required in industrial premises and—assuming they are a fixture—can sometimes add value. The lifting capacity and name of the hoist is normally written on the hoist, and guide to its value can be obtained from the manufacturer or distributor. Gantry cranes have a much larger lifting capacity and run on single or dual overhead rails supported on steel columns. The rails normally run the length of the building and quite often extend out into the yard area. They are only required for a heavy industry that is fairly specialised. When valuing industrial premises with a gantry crane, be mindful of the fact that there is limited demand for them, and that they are expensive to remove.

Other factors

Building Code of Australia (BCA)

Does the building comply with the BCA? The BCA is covered in other construction modules in great detail. However, if the building does not comply with the BCA then allowance must be made for this in the valuation. Councils are gradually making all properties comply with the BCA, and will almost certainly do so on change of use or ownership. If the building does not comply with the BCA then it should be valued as follows:

- Value of the property on the assumption that the building does comply with BCA less expenditure necessary to make the building comply with BCA.

Nature of occupation

Is the property leased? If it is and the current rent is above the market level then this will increase what would otherwise be the market value. Conversely, if the current rent is below market level this will adversely affect the market value, as would onerous terms, such as long intervals between rental reviews. Remember, always value ‘to the lease’. Is the property owner-occupied? If it is, then you will have to estimate the rental
value of it, from comparable rents, in order to value it by the ‘capitalisation
method’. Is the property vacant? If it is then you may have to make
allowance for a ‘letting up’ period; this will be dealt with later in this
section.

Existing use rights

The ‘land use controls’ you have studied earlier dealt with local
environment plans invariably providing for a continuation of an existing
use, when a change in zoning no longer permits that use. You will probably
recall that such uses are also know as non-conforming ones, because the use
being made of the property is not allowable under the new zoning. In the
context of industrial valuations you will undoubtedly encounter properties
being legally used for industrial purposes but the land is not zoned
‘industrial’. If the new zoning, say for residential flat buildings, is the
‘highest and best use’ of land then the value of the property is in accordance
with the new zoning. In other words the industrial improvements add no
value to the land. If the property is leased you will need to deduct any value
attaching to the lessee’s interest from the value under the new zoning, to
establish the ‘highest and best use’.

Note that there is now the EPA Amendment (Existing Uses) Regulation
2006.

In summary, the procedure is:

• value of land and improvements in industrial usage, OR
• value of the land under the changed zoning, less deduction for
demolition costs of the industrial improvements, and any value
attaching to a lessee’s interest.

The higher of the two valuations is the market value of the property.

A point that has to be made is: how do you value the property under an
existing industrial use? It is considered that you should not put the full
industrial value on the land and improvements, as obtained from comparable
sales and rentals, on the subject property. This is because council will look
to make the use less non-conforming each time there is a change in
ownership or tenancy. For example, council may require a ‘lighter’ use, or
one that generates less traffic so the land does not enjoy the full benefits of
an industrial zoning (at best, council will allow a use that is non-conforming
to the same extent as the current one on charge of ownership).

The question then arises as to what amount you reduce the market value as
industrial to allow for the constraints imposed by the existing use rights? If,
as is likely, a significant number of properties have been rezoned from
‘industrial’ to the new zoning, then comparable sales information should be
available. Failing this, use a capitalisation rate higher than those analysed
from sales of ‘industrially zoned’ property. In terms of a ‘summation’
valuation you could analyse sales of ‘industrially’ zoned property, and take a percentage of the analysed rate per square metre for the land and improvements. These methods of adjusting capitalisation rates, and rates per square metre are for guidance only. You will have to make a professional judgement on the appropriate adjustments, after your investigations and enquiries in the field.

We have now looked extensively at the way in which various factors affect the value of industrial property. Before looking at methods of valuation and associated examples, this is an appropriate time to reinforce your understanding of these factors by a self-assessment exercise.