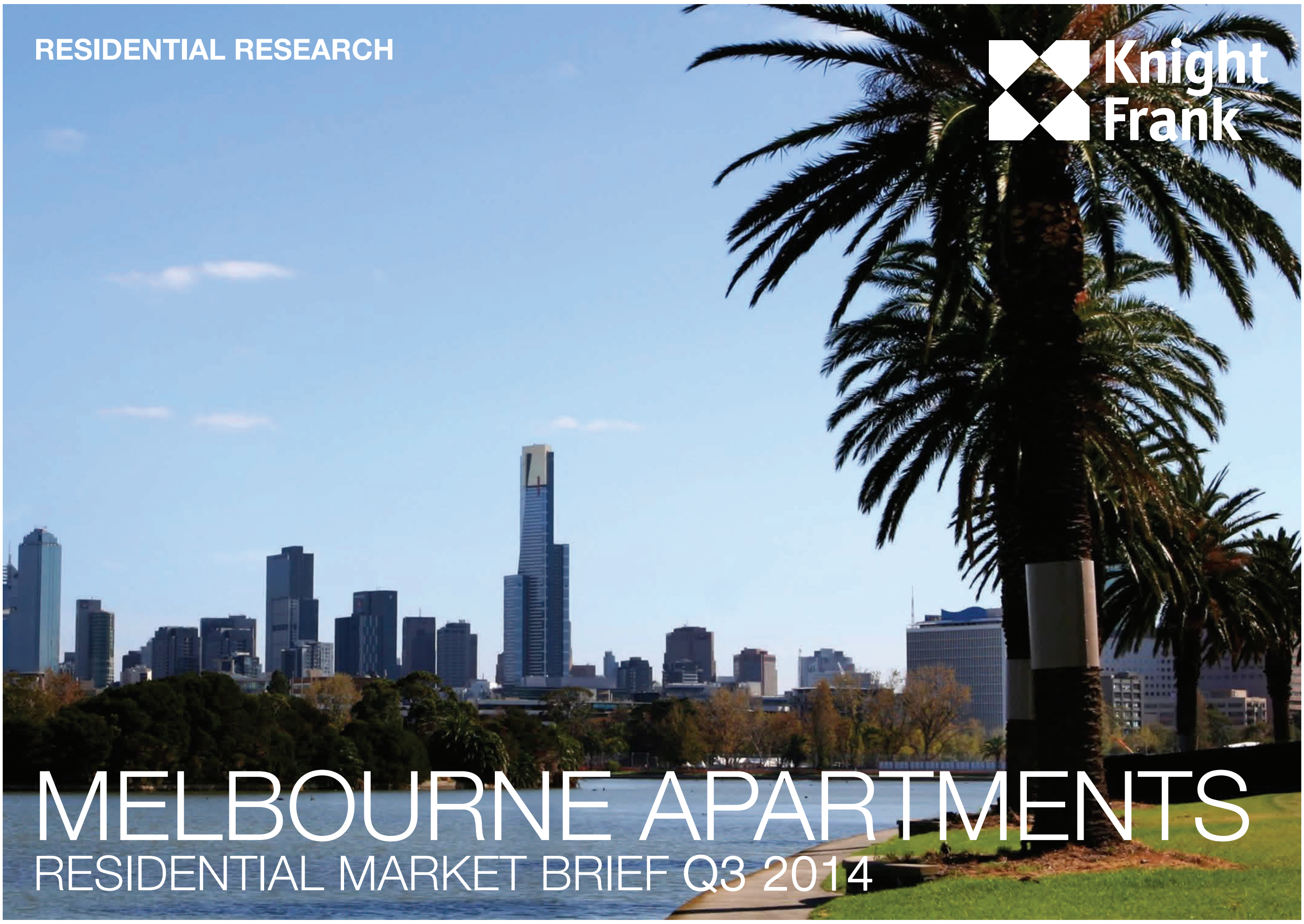
RESIDENTIAL RESEARCH



MELBOURNE APARTMENTS

RESIDENTIAL MARKET BRIEF Q3 2014

Key Facts

Upward annual trajectory continues in apartment values (up 6.0%) and rents (up 2.6%); vacancy is stable at 2.9%**.**

Building approval momentum is driving a rise in lending finance

Residential development site sales totalled $1.4 billion in the last year; 36% sold to foreign developers

Key transport infrastructure projects are in the pipeline for next ten years

MICHELLE CIESIELSKI

Associate Director

Follow Michelle at @MCiesielski_AU

Fuelling investment in metropolitan Melbourne apartments, foreign investors and developers continue to be drawn to the top ranked global city for quality of life, as well as, the world's most liveable city.

Overview

In August 2014 Melbourne received the title of 'World's Most Liveable City' for the fourth year in a row —defeating 139 other global cities to top The Economist Intelligence Unit's Global Liveability Index. Earlier in the year, Melbourne was ranked best global city for quality of life in the Knight Frank Global Cities Survey. The strengths in the fields of healthcare, education, infrastructure and sport continues to elevate Melbourne as a popular destination for enquiries into apartment sales by foreign and local investors.

Strong population is projected for metropolitan Melbourne coming in just behind Perth, across the major cities across Australia. Projections of 2.0 percent per annum, over the next thirty years, will sustain demand for housing, as it has in the past ten years annually trending at 2.1 percent.

Sustained low interest rates over the past eighteen months have continued to push building approvals upwards and driven up sales volumes and housing finance.

Development Sites

Over the twelve months to August 2014, $1.4 billion worth of major sites have been purchased, potentially suitable for high density residential development in the Melbourne metropolitan area. A comparison to the previous year, shows a 57.7 percent increase in sales volume.

Foreign buyers made up 36 percent of the total number of sales including the record sale of 93-119 Kavanagh Street, Southbank for $145 million to Malaysian developer, PJ Development Holdings in June 2014 and a month later, China based Australia Star Tower Development Pty Ltd purchasing the Kinnears Rope Factory site in Footscray for $60 million.

Singapore's Aspial Corporation purchased the site for the 100 storey tower to be

PIPELINE OF PROPOSED KEY TRANSPORT PROJECTS

Dingley Bypass [2016] Construction of the next stage of the Dingley Bypass between Warrigal Road, Oakleigh South to Westall Road, Dingley Village. Key to improving traffic and freight movement in South-East Melbourne.

Upgrade and construction of level crossings and stations [2018] The removal of multiple level crossings at St Albans, Ormond, Glen Iris, Blackburn, Murrumbeena, Carnegie, Clayton and Noble Park.

East West Link—Eastern Section [2019] A freeway for cross-city connection running from the Eastern Freeway to CityLink. The **Western Section [2023]** will extend from the Eastern Freeway to the Western Ring Road. Key to providing an alternative route for east-west travel.

Melbourne Rail Link [2024] New underground stations at Fishermans Bend (Montague) and Domain, as well as, twin tunnels from Southern Cross to South Yarra with new underground platforms to support a new Frankston to Lilydale/Belgrave line.

Melbourne Airport Rail Link [2024] Construction of a railway line to connect Melbourne Airport to Southern Cross Station in the city and the Cranbourne-Pakenham corridor. Train-tram interchanges at the new underground stations.

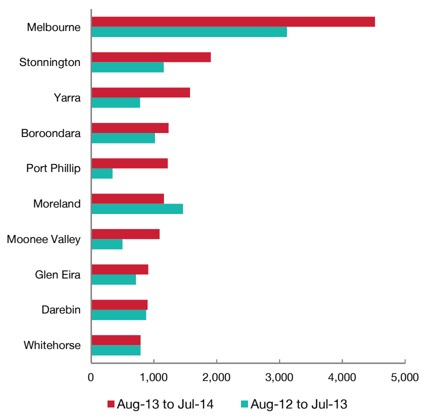
known as 70 Southbank Boulevard, Southbank for $42.3 million and 383 King Street, West Melbourne for $41.0 million.

Planning

With the exception of Moreland, the top ten Local Government Areas (LGA) witnessed an upward trajectory in apartment approvals between 2012/13 and 2013/14.

Melbourne LGA continued to dominate building approvals in the 2013/14 financial year with 4,520; outstripping the next ranked, Stonnington LGA at 1,907 approvals.

FIGURE 1
Building Approvals, Highest LGAs
Total number of new residential apartments



Source: Knight Frank Residential Research, ABS

The number of building permits for residential apartments, issued by certifying authorities in the state of Victoria, totalled 23,370 in the year to July 2014. This increased 9.4 percent on the year before, and overall exceeds the ten year average of 15,540 building approvals per year. It is forecast that building approvals will continue to increase over the coming twelve months with the number of apartments to accommodate recent development sites transacted.

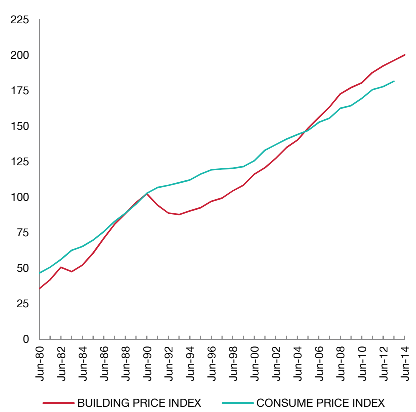
The volume of building approvals in the pipeline currently outweighs other capital cities; however strong population is projected for the Melbourne metropolitan area and demand remains supportive. If this level of population is not reached, or only provisionally met, it is likely that vacancy will trend above the market equilibrium of three percent over the medium term.

Over the next ten years, there are a number of key proposed rail and road projects in the pipeline for metropolitan Melbourne. The Dingley Bypass and the East West Link have been planned to improve congestion and freight movement on Melbourne roads, whilst the Melbourne Rail Link and Airport Rail Link are proposed to support the increased number of commuters travelling on the existing rail network.

Construction

Cranes have dominated much of Melbourne's skyline for the best part of the last decade. Over this period, according to the Rawlinsons Building Price Index, costs of construction have increased 4.3 percent year-on-year. The Building Price Index is based on the effect of building costs brought about by periodic variations in the rates of labour and materials, as well as, reflecting the cost effect of building activity and resource availability at any time. In June 2005 the Building Price Index overtook the Consumer Price Index for the first time since June 1989 and has continued on an upward trajectory.

FIGURE 2
Building Price Indices Melbourne Metropolitan
Building Price Index v Consumer Price Index



CPI is based on All Group Index Numbers as issued by the Australian Bureau of Statistics

Source: Knight Frank Residential Research, Rawlinsons Construction Handbook, 2014, ABS

TABLE 1
Key Indicators, Apartments, June 2014

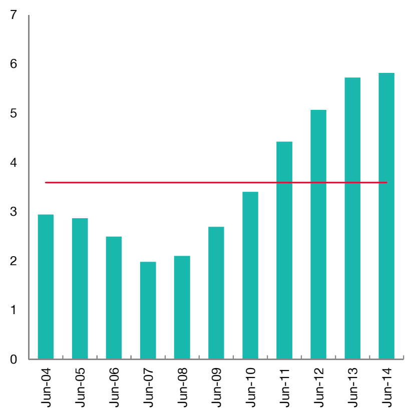
Region	Median Capital Value ($)	Capital Growth Last Quarter (%)	Capital Growth Last Year (%)	Gross Rental Yield (%)	Sales Volume Last Year (no.)	Median Weekly Rent ($)
Melbourne, 3000	441,500	2.4	5.4	5.71	2,625	475
CBD & Inner/North West	422,000	2.1	4.1	4.89	14,616	395
North East	492,000	1.3	7.2	4.14	6,226	390
South East	459,000	1.2	6.5	4.37	6,589	385
Bayside/Frankston	494,000	1.6	6.9	4.28	7,140	405
Melbourne Metropolitan	462,500	1.9	6.0	4.47	34,285	395
Australia	436,000	2.1	7.7	4.92	159,834	410

Source: Knight Frank Residential Research, Residex

Completions

In Victoria, the total value of work completed on new residential apartments, less the direct effects of price changes, has shown upward momentum since 2007. Trending well above the ten year average, the total value of work completed tallied to $5.82 billion in the year to June 2014.

FIGURE 3
Value of Work Completed, VIC
$billions, new, residential apartments



Source: Knight Frank Residential Research, ABS

Apartment Values

Apartment values in metropolitan Melbourne have experienced positive annual growth for the two years to June 2014, with the last year witnessing growth of six percent. This was upheld in the last quarter with growth of 1.9 percent; only slightly below the Australian benchmark, to stand at a median capital value of $462,500.

FIGURE 4
Median Values Melbourne Metropolitan
% annual change in growth for apartments

Source: Knight Frank Residential Research, Residex

The Bayside/Frankston region, closely followed by the North East region, achieves the highest median capital values, with $494,000 and $492,000 respectively.

Volume increased 16.4 percent over the past twelve months to record 34,285 sales in metropolitan Melbourne, with a large portion of these sales, as expected to be apportioned to the CBD & Inner/ North West region.

Apartment Rents

Melbourne metropolitan rents were up 2.6 percent over the twelve months to June 2014 to a median weekly rent of $395. At the same time, gross rental yields compressed marginally, by 4bps, to 4.47 percent, as prices rose. The suburb of Melbourne achieves a weekly rent at $475. Located in the Inner (0-10km) ring, the 6-month average vacancy trend was recorded at 3 percent in August 2014, steady over the last month.

The metropolitan Melbourne trend also remained steady at 2.9 percent, just shy of the three percent market equilibrium. This is likely to increase slightly in the coming months, although this is also dependent on the rate of take-up with the growing population, supporting demand.

The CBD & Inner/North West region continues to achieve the best gross rental yields at 4.89 percent. The suburb of Melbourne achieves a yield of 5.71 percent, driven by the performance of the one-bedroom apartments market, whilst the two-bedroom market remains steady.

TABLE 2
Total Vacancy
% 6-month average trend

Ring	Aug-14	Jul-14
Inner (0-10km)	3.0	3.0
Middle (10-20km)	3.1	3.0
Outer (20km+)	1.9	1.9
Total	2.9	2.9

Source: Knight Frank Residential Research, REIV

Outlook

- Gross State Product in Victoria is forecast at 2.4 percent per annum over the next five years; averaging 21.1% as a share of Australia's output
- Low interest rates are forecast to remain steady with no change expected until mid to late 2015 and banks are lending at competitive rates.
- Population growth to continue, projected annually at 2.0 percent over the next thirty years remaining supportive of apartment demand.
- Projected overall construction costs to increase 0.4 percent per quarter until March 2015 (AECOM).
- Building approvals will continue to rise over the coming twelve months with the number of apartments to accommodate recent development sites purchased.
- With interest rates remaining low and strong population growth, the rate of capital growth is likely to be sustained for the remainder of 2014, with growth steady heading into 2015.
- As more new supply comes on line after a long period of work completed annually, it is likely that vacancy will trend above the market equilibrium of three percent for the medium term.

RESIDENTIAL RESEARCH
Michelle Ciesielski
Associate Director
+61 2 9036 6659
Michelle.Ciesielski@au.knightfrank.com

Matt Whitby
Head of Research and Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

PROJECT MARKETING MELBOURNE
Daniel Cashen
Director
+61 3 9604 4749
Daniel.Cashen@au.knightfrank.com

Richard Drummond
Director
+61 3 9604 4610
Richard.Drummond@au.knightfrank.com

INTERNATIONAL PROJECT MARKETING
Erin Van Tuil
Associate Director
+61 2 9036 6699
Erin.VanTuil@au.knightfrank.com

VALUATIONS RESIDENTIAL DEVELOPMENT
David Way
Director
+61 3 9604 4704
Dway@vic.knightfrankval.com.au

VICTORIA
James Templeton
Managing Director
+61 3 9604 4724
James.Templeton@au.knightfrank.com

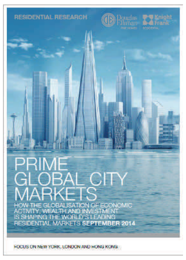
Knight Frank Residential Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

Knight Frank Residential Research regions:
CBD & Inner/North West – postcodes 3000 to 3079
North East – postcodes 3080 to 3140
South East – postcodes 3141 to 3180
Bayside/Frankston – postcodes 3181 to 3207

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Sydney Apartments Residential Market Brief October 2014

Melbourne Suburban Strips Market Brief September 2014



Prime Global City Markets 2014

Global House Price Index Q2 2014

Knight Frank Research Reports are available at **KnightFrank.com.au/Research**

© **Knight Frank 2014** This report is published for general information only. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no legal responsibility can be accepted by Knight Frank Research or Knight Frank for any loss or damage resultant from the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank in relation to particular properties or projects. Reproduction of this report in whole or in part is not permitted without prior consent of, and proper reference to Knight Frank Research.