RESEARCH

MARCH 2011

MELBOURNE INDUSTRIAL

Market Snapshot

Knight Frank

HIGHLIGHTS

- Tenant demand for existing buildings (excluding pre-lease deals) was strong, with 195,412 m² of space taken-up in the third quarter alone. Limited options in prime space meant that take up of secondary stock was the greatest proportion of total leased space over the past three quarters.
- The pre-commitment market performed strongly in 2010. Pre-lease commitments to over 200,000 m² of space meant construction on a number of purpose built sites were able to proceed. Large scale retailers and logistics companies such as Kmart and Cadbury all increased their presence in the Melbourne market agreeing to pre-lease 102,000 m² of space between them.
- Despite a number of recent deals suggesting a bias for growth, average rental levels across most regions have remained relatively flat throughout the year to January 2011.
- A combination of competitive rents, provision of infrastructure and improved market sentiment has been the catalyst for a small rise in land values throughout the establishing industrial regions in the West, North and South East.

MELBOURNE INDUSTRIAL OVERVIEW

Table 1
Melbourne Industrial Market Indicators January 2011

Precinct	Avg. Prime Rent		Avg Secondary Rent		Core Market Yields (%)		Avg. Land Value			
							<5,000m^2		1 – 5 ha	
	$/$m^2$ net	(%p.a)	$/$m^2$ net	(%p.a)	Prime	Secondary	$/$m^2$	(% p.a)	$/$m^2$	(% p.a)
North	70	-2.8%	58	3.6%	8.00 – 8.75	9.00 – 10.25	230	4.1%	197	0.5%
West	69	-1.4%	62	-0.9%	8.00 – 8.75	9.00 – 10.50	165	5.8%	140	1.4%
East	82	0.0%	64	3.2%	8.00 – 9.00	9.25 – 10.75	300	0.0%	n/a	n/a
South East	75	-1.3%	59	1.7%	8.00 – 9.00	9.25 – 10.75	230	3.6%	185	1.6%
City Fringe	125	-0.8%	85	-1.3%	7.50 – 8.25	8.50 – 9.75	600	0.0%	n/a	n/a
Total *	**74**	**-1.3%**	**61**	**1.9%**	**7.50 – 9.00**	**8.50 – 10.75**	**231**	**2.9%**	**174**	**0.8%**

Source: Knight Frank * excludes City Fringe
Note: City Fringe excludes former Industrial areas of Richmond, Collingwood and South Melbourne that are now predominantly residential through gentrification.
Core Market Yield: The percentage return/yield analysed when the assessed fully leased market income is divided by the adopted value/price which has been adjusted to account for property specific issues (ie rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

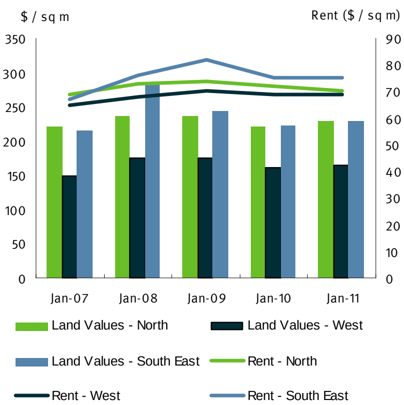
Industrial Overview

After an extended period of limited activity, Australia's largest industrial market is exhibiting some signs of a revival on the back of improving demand and limited new supply. H2 2009 and H2 2010 presented contrasting market conditions. The second half of 2009 was constrained by enduring global economic fears and a restrictive funding environment. In contrast, the last half of 2010 was highlighted by greater take up of space and dwindling vacancies. A relatively upbeat outlook for the states economy has seen a marked improvement in investor sentiment which is now translating into greater transactional activity. The pre-commitment market is healthy with a number of significant deals confirmed and several more reportedly under negotiation. As at October 2010, vacant industrial space had fallen to just 650,477 m^2 across the major industrial nodes, representing a vacancy rate of circa 3%. Take up of space has outstripped construction since the first quarter 2009. As a result both rents and land values have made progress towards recouping losses experienced through the GFC.

Occupier Demand

The second quarter of 2010 seemingly marked a period of renewed interest in the Industrial leasing market. Take up of space above 5,000 m^2 for Q3 2010 was amongst the strongest quarterly results this decade, with absorption of 195,412 m^2 recorded. Of this space, the South East and North attracted the greatest demand for non pre-commit space combining for over 85% of all leased buildings.

Figure 1
Melbourne Industrial market
Rents and Land Values <5,000m^2



Source: Knight Frank Research

Also worth noting, total secondary industrial space leased over the last half significantly outstripped that recorded for prime despite demand for quality buildings. Limited options that meet tenant requirements coupled with competitive rents are giving rise to a strong pre-commitment market.

Development & Land Values

Development over the past year has primarily been driven by capital efficient developers who have secured major pre-lease deals. A strict lending criterion set by financial institutions has meant new developments have been sparse in 2010. Despite cautious sentiment now slowly converting to optimism, there has been a reluctance to commence construction of speculatively built stock. Recent anecdotal evidence has suggested that this scenario may be about to change as the opportunity to capitalise on tenant interest for purpose built accommodation becomes more attractive. Construction is well down on levels experienced pre 2009. As a result, tightening of supply has acted as a re-balancing mechanism for industrial land values adversely affected by the downturn in the market in 2008.

Table 2

Major Industrial Leasing Transactions Melbourne Region

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Date
3 Myer Place, Rowville	E	Undisc	20,145	10	Sigma	Sep 10
72 - 96 Station Street, Nunawading	E	62	22,541	15	Autobarn	Aug 10
5 -11 Stephen Road, Dandenong	SE	65	13,070	5	BMW Plastics	Sep 10
1 Ordish Road, Dandenong^	SE	Undisc	10,000	n/a	Ascent Pharmaceuticals	Aug 10
Somerton Logistics Centre	N	65	31,765	5	Caterpillar	Aug 10
Somerton Logistics Centre	N	69	10,486	2.5	Mainfreight Logistics	Aug 10
201 – 205 Maidstone Street, Altona	W	65	5,221	5	Ceva Logistics	Sep 10
24 William Angliss Drive, Laverton North	W	55	7,723	9	Fastline International	Dec 10
65 - 75 Strezlecki Avenue, Sunshine	W	68	23,286	6	NorthLine Pty Ltd	Jan 11

Source: Knight Frank ^D&C/pre-commitment
E East, SE South East, N North, W West, CF City Fringe

Table 3

Major Transaction Activity – Investment/Vacant Possession/Development Properties Melbourne Region

Address	Sale type	Region	Price ($ m)	GLA (m²)	Core Mkt Yield (%)	WALE (yrs)	Purchaser	Date
290 – 320 Boundary Rd, Derrimut	Investment	W	11.7	15,108	9.73	4.5	Private Investor	Sep 10
23 Fiveways Boulevard, Keysborough	Investment	SE	5.1	4,666	8.18	10.0	Private Investor	Jun 10
165 – 211 Robinson Road, Ravenhall	Investment	W	6.6	7,200	7.95	12.0	Private Investor	Aug 10
1 – 5 Siddons Way, Hallam	Investment	SE	7.3	9,386	9.43	10.6	Private Investor	Jun 10
125 - 129 Somerton Road, Somerton	Investment	N	7.6	9,714	9.36	15.0	Private Investor	Apr 10
11 – 20 Horsburgh Drive, Altona North	Investment	W	23.2	6,318	8.62	n/a	Charter Hall	Jul 10
15 Corporate Avenue, Rowville	VP	E	6.17	7,755	VP	VP	Owner Occupier	Aug 10
170 Australis Drive, Derrimut	VP	W	4.4	5,493	VP	VP	Owner Occupier	Sep 10
93-97 Normanby Road, Notting Hill	VP	E	3.3	6,066	VP	VP	Owner Occupier	Jul 10
232-246 Blackshaw Rd, Altona North	VP	W	3.12	7,986	VP	VP	Owner Occupier	Aug 10
161 – 189 Turner St, Port Melbourne	VP	CF	10.5	5,753	VP	VP	Govt Dept	Sep 10
75 – 77 Dohertys Road, Laverton North	VP	W	6.0	7,755	VP	VP	VIP Pet Food	Aug 10
830 Lorimer St, Port Melbourne	Development	CF	8.35	14,300 *	site	site	Next DC	Sep 10
21 – 27 Brunswick Rd, Brunswick East	Development	N	16.0	10,000 *	site	site	Private Developer	Sep 10
635 Waverley Road, Glen Waverley ^	Development	E	9.0	28,000 *	site	site	Private Developer	Jun 10

Source: Knight Frank
E East, SE South East, N North, W West, CF City Fringe * Indicates site area ^ Includes 15,021m² of improvements that were vacant at time of sale

Sales & Investment Yields

Continued investment in infrastructure and a resilient state economy has buoyed market confidence and spurred transactional activity throughout 2010. Both the number of transactions and volumes jumped notably over the past half as a range of buyers entered the market. Owner occupiers and private investors continued to have a dominant presence, particularly in the West and South East, while a number of private developers acquired strategic properties in tightly held fringe locations. Prime yields appear to have stabilised and have shown a firming bias throughout the second half of 2010. Despite a solid turnover of stock, secondary yields haven't shifted significantly over the past twelve months.

Outlook

Forecasts on leading industrial market indicators point to a relatively positive outlook for the State. Limited starts in new construction of speculatively built stock, coupled with strong absorption of space should broadly re-align rents and land values to levels experienced at the last cyclical peak around mid 2008. A key issue for investors in industrial assets will be the future delivery to market of new supply. Melbourne's abundance of zoned industrial land and responsive development market should suppress significant upward pressure on rents and land values, keeping the local market competitive against the national backdrop. Knight Frank anticipates demand for industrial space to remain especially robust in areas such as the West and South East, which have benefited from strong transport links and infrastructure provision. The pre-lease market is expected to remain active throughout 2011 as sentiment continues to improve and companies follow through on expansion plans.

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