RESEARCH

MAY 2012

MELBOURNE INDUSTRIAL

Market Overview

Knight Frank

HIGHLIGHTS

- Total industrial vacancy in Melbourne is at historically low levels. As at April 2012, just 298,446m² of space above 5,000m² was available within 33 buildings. This represents a 9.9% decrease from the result six months prior.
- The new industrial supply pipeline is forecast to total 578,862m² over the course of 2012, 27.9% below the 12-year historical average. Limited prime options for tenants have ensured a pick-up in pre-lease activity and absorption of speculatively constructed buildings.
- The total value of industrial sales across all regions in Melbourne in the twelve months to April 2012 was $544.21 million. Private investors have remained the dominant purchaser type, while there has been some activity from AREIT’s, Unlisted Funds/Syndicates and Offshore investors.

INDUSTRIAL OVERVIEW

Table 1
Melbourne Industrial Market Indicators April 2012

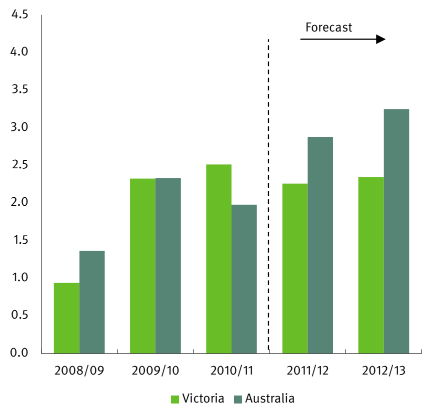
Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields		Avg Land Value <5,000m²		Avg Land Value 1 – 5 ha	
	$/m² net	(%p.a)	$/m² net	(%p.a)	Prime	Secondary	$/m²	(% p.a)	$/m²	(% p.a)
City Fringe	130	4.0	80	0.0	7.50 – 8.25	8.50 – 9.75	730	12.3	630	14.6
North	75	1.4	59	0.0	8.00 – 8.75	9.00 – 10.75	230	0.0	200	0.0
East	85	0.0	65	0.0	8.00 – 8.75	9.00 – 10.75	300	0.0	250	0.0
South East	80	3.9	63	-1.6	8.00 – 8.75	9.00 – 10.75	230	0.0	200	5.3
West	72	1.4	65	-0.6	8.00 – 8.75	9.00 – 10.75	168	1.5	138	0.0
Melbourne Average*	**78**	**1.6**	**63**	**-0.6**	**8.00 – 8.75**	**9.00 – 10.75**	**232**	**0.3**	**197**	**1.3**

Source: Knight Frank Note: Rents are assessed on all sites between 3,000 – 5,000m² * Excludes City Fringe
Prime: Asset with modern design, good condition & utility with an office component 10-30%. Located in an established industrial precinct with good access.
Secondary: Asset with an older design, in reasonable/poor condition, inferior to prime stock, with an office component between 10%-20%.
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)

Economic Snapshot

The Australian Economy remains hinged on the resolution of various issues and the consequential effects of the world's major economies, notably the European sovereign debt issues and whether China's boom has finally matured. The flow on effects of economic reform is likely to have an impact on the Australian economy's growth prospects. Ultimately Australia's growth prospects are reliant on business confidence which is currently subdued.

Figure 1
Economic Growth
Australia GDP and Victoria GSP % pa growth



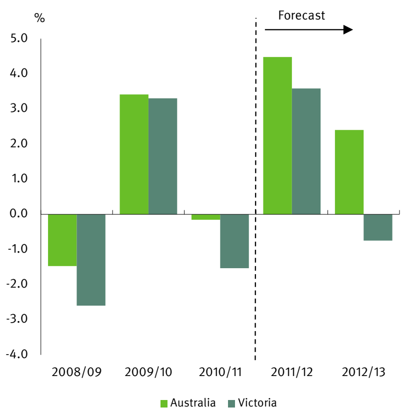
Source: Deloitte Access Economics

Despite this, Victorian Gross State Product (GSP) over the 2010/2011 financial year grew by 2.5%. Deloitte Access Economics has forecast growth to ease to 2.3% over the current financial year demonstrating the resilience of the Victorian economy.

Although the continued strength of the $AUD adversely affects the state's manufacturing sector, it continues to drive imports and therefore higher container volumes at the Port of Melbourne. As consumer confidence slowly improves on the back of interest rate cuts, traditional retailers and more recently e-commerce driven "e-tailers" have required more space. These retailers are seizing the opportunity to locate their operations into logistics centres across Melbourne as their inventory holding requirements grow and also allowing them to offer an online version to complement their retail store front presence.

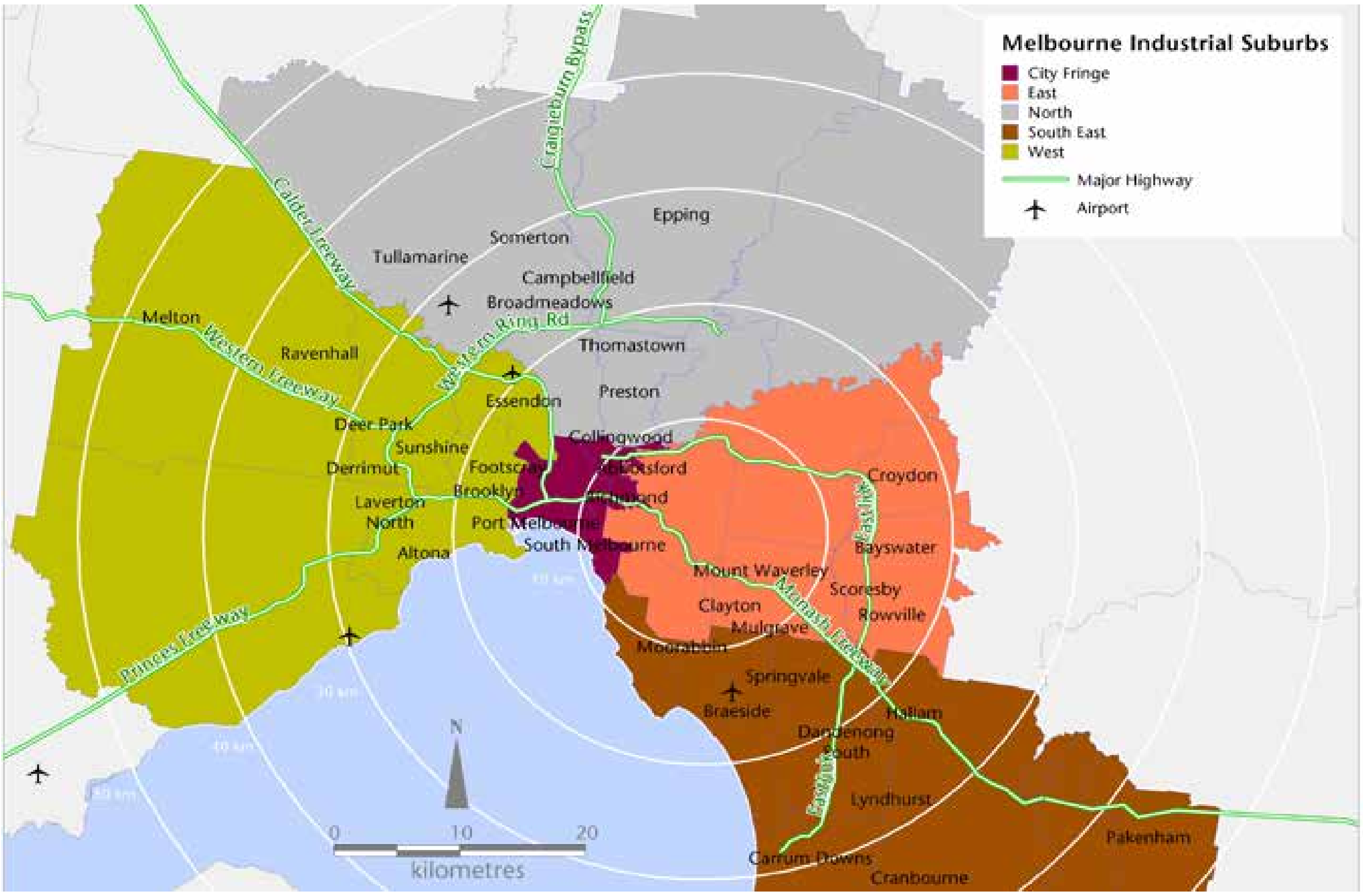
For the 12 months to March 2012, Melbourne industrial property posted a total return of 11.0% with a capital growth of 2.0%. Melbourne's industrial returns have now returned back to 15-year averages and well above the 5.2% total return average over the past five years. While Melbourne industrial was outperformed by Melbourne CBD office (11.4%) industrial property surpassed Victorian Retail assets' total returns (10.2%) over the past 12 months. With the Melbourne industrial income returns (8.8%) being higher than Office and Retail asset averages, this is likely to see the industrial asset class outperform the other asset classes over the next 12 months due to the attractive yield.

Figure 2
Investment Performance Index
% Change (Year to Mar-12)



Source: IPD

In comparison to Australia's other industrial markets, Melbourne recorded the highest capital growth, highlighting the investor appetite.

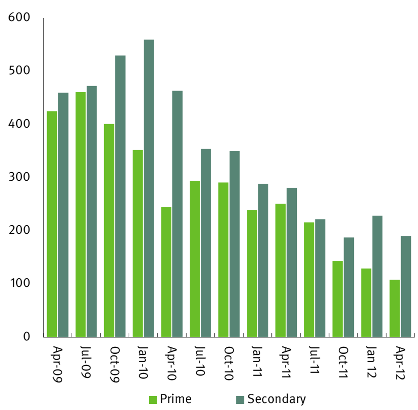


Industrial Vacancy

Figure 3

Melbourne Industrial Available Space

'000m² by grade



Source: Knight Frank

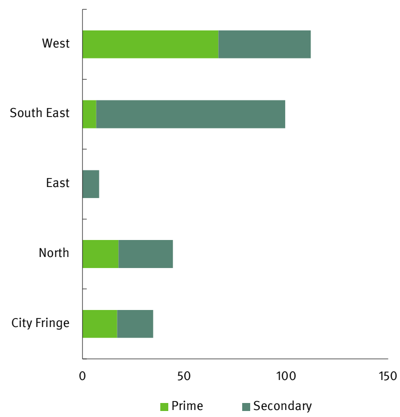
The total amount of space available greater than 5,000m² reduced by approximately 60,000m² in the three months to April, to a new record low vacant stock level of 298,446m²; 52% below the long term average. Available space is dominated by the secondary market representing 64% of available stock. With an average asking rental of $69/m² this vacant secondary space ranges from sites with restrictive access through to older but highly functional. Prime accommodation accounts for 36% of the available stock, although given the relative lack of new supply over the past two years most of this is within existing buildings rather than brand new stock.

In terms of region, the Western precinct has the greatest amount of available industrial space as at April 2012, with over 60% of this prime accommodation. The South East's available stock is dominated by secondary accommodation making up for 93% of this space; however this is expected to reduce over the next quarter on the execution of two lease deals nearing finalisation. Currently, there is only one prime option available in the South East. The City Fringe and the Northern precincts provide a relatively equal amount of prime stock as a proportion of total stock.

Figure 4

April 2012 Available Space

'000m² by Quality & Precinct



Source: Knight Frank

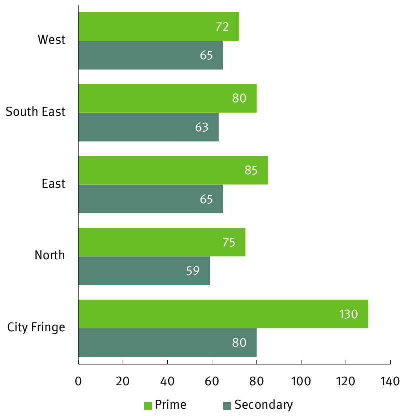
OCCUPIER DEMAND & RENTS

Analysis undertaken by Knight Frank indicates that in the six months to April 2012 the total amount of absorption for industrial accommodation greater than 5,000m² (excluding D&C's) was 169,669m², with 92,882m² (54.7%) of this being taken up in the first quarter of 2012. Although this absorption level is low when compared to the historic average, available stock has diminished, indicating that the Melbourne Industrial Market remains active.

In the six months to April 2012 the strongest amount of take up (>5,000m²) was recorded in the Western precinct, with 74,574m² of industrial space leased. In the year to April 2012, the pre-lease market within the Western precinct has not been as prevalent when compared to the results posted in 2010 and 2011. Half of the prospective tenants with large requirements seem to prefer a speculatively constructed building rather than wait 12 months for facilities to be constructed, highlighted by Fastline's lease of a spec-built 17,347m² Office/Warehouse within the DEXUS Industrial Estate. However, given the lack of quality space, pre-leases and D&C's are still likely to be pursued as recently demonstrated by commitments from Kraft in Derrimut and the PFG Australia D&C in Australand's Westpark Industrial Estate.

The South East precinct, recorded a relatively low take up of 38,612m² of take up over the six months to April 2012, with the majority of this within secondary grade buildings indicating a lack a high quality options available for tenants. The Northern precinct recorded 38,547m², which is considered a relatively strong result given the limited options available, particularly the lack of prime space. However there are indications that interest remains strong for smaller sized industrial accommodation options in locations such as Campbellfield and Tullamarine. In the City Fringe there was 17,936m² of take up within two buildings above 5,000m², however this is not reflective of the demand within this region, with strong interest in space sub 2,000m².

Figure 5
Melbourne Region Industrial Rents
$/m² net market rent by precinct – April 2012



Source: Knight Frank

Average prime net rental levels across the Melbourne market grew by 1.6% in the year to April 2012. Over the same period average secondary rents decreased by 0.6%; a result of an abundance of secondary stock being vacated as prospective tenants continue to seek quality space, causing downward pressure on rental levels. Prospective tenants are finding it increasingly difficult to locate quality existing space, especially in the South East market, where prime rents grew by 3.9%. City Fringe prime rents rose by 4.0% due to limited supply and strong demand deriving from the increased presence of retailers looking at being located close to the ports. Further upward pressure on City Fringe rents is expected from prospective tenants wanting to locate to the inner city due to the gentrification of West Melbourne, North Melbourne and Richmond.

Table 2
Industrial Leasing Transactions Melbourne Industrial Market

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Date
19-39 Studley Court, Derrimut *	West	75	23,455	5	Kraft	Q2-12
56-58 Ajax Road, Altona	West	75	4,877	8	Petrogas	Q2-12
Unit 1, 80-96 South Park Drive, Dandenong	South East	70	10,000	7	Shriro	Q2-12
1535 Centre Road, Clayton	South East	76	8,500	10	Total Tyre Service (Goodyear)	Q1-12
Store D, 437 Plummer Street, Port Melbourne ~	City Fringe	80g	12,936	5	Chrysler	Q1-12
83-89 Freight Drive, Somerton	North	65	12,660	n/a	Super A-Mart	Q1-12
2-10 Distribution Drive, Laverton North #	West	75	17,347	5	Fastline International	Q4-11
Unit 1, 365 Plummer Street, Port Melbourne	City Fringe	115	2,178	4	Liquor Logistics	Q4-11
75 Fulton Drive, Derrimut	West	79	3,916	3	General Carrying	Q4-11
12-14 Tradepark Drive, Tullamarine	North	71	8,000	5	CT Freight	Q3-11
WH A, Atlantic Drive, Keysborough #	South East	80	15,800	10	Early Settler	Q3-11

Source: Knight Frank * Pre-lease deal # Speculative Development ~ Sub-lease g Gross Rent

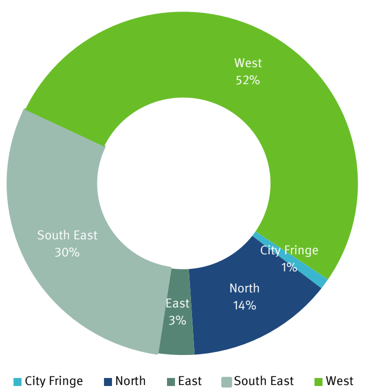
DEVELOPMENT & LAND VALUES

In 2012, new industrial accommodation across the major Melbourne Industrial regions (> 1,000m²) is forecasted to total 578,862m². Despite the cautious sentiment stemming from global economic uncertainty and continued constraints on financing, the underlying fundamentals of the Melbourne industrial market are quite favourable for developers. Land values are now relatively stable and with substantial enquiry from prospective tenants and vacant stock levels at historical lows - leaving very few prime grade options to those who want to consolidate, expand or upgrade - development activity will begin to pick up.

Figure 6

Melbourne Region Industrial Supply

% of total supply expected over 2012



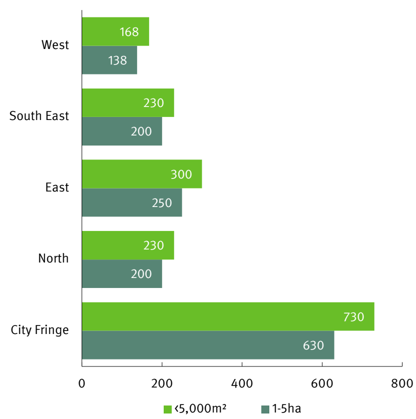
Source: Knight Frank

Looking across the regions, the Western and South East precincts are expected to deliver the majority of new industrial supply, accounting for 82.1% of the total delivered in 2012. In the Western precinct, recent tenant enquiry of some 160,000m² is anticipated to be taken up in the short to medium term, solidifying already strong demand in the region. Larger developers are especially active in the speculative construction market, with the aim of capturing some of this demand, as illustrated by DEXUS' decision to build 15,564m² within a facility in Derrimut.

Figure 7

Melbourne Region Land Values

$/m² value of land by precinct & size – April 2012



Source: Knight Frank

In addition, Australand has proposed a further 32,000m² soon to commence within the Key Industrial Estate, Keysborough and another 26,000m² in the Westpark Industrial Estate, Truganina, expected to be delivered late 2012. As developers seek to take advantage of the improved demand for land, Places Victoria, Australand and Goodman are among those due to release land in the near future. The Northern precinct accounts for 14% of the total stock in the pipeline for 2012, however there are no larger sized industrial buildings being added, with no single building above 5,000m². The new industrial stock is within smaller-sized unit developments such as MAB's 18 unit development University Hill, Bundoora. The pipeline of new supply in the Northern is anticipated to pick up with future land expected to be released at the end of the year within industrial estates developed by MAB, Salta, Vaughan, and Goodman, amongst others. The City Fringe is expected to bring to market 1% of the total, constrained by the limited land supply. The new 3-unit development for 2,159m² at 610 Lorimer Street, Port Melbourne is typical of the type of industrial stock coming to the City Fringe market.

Over the six months to April 2012, limited transactional evidence saw values for land less than 5,000m² remain stable, with the exception of the City Fringe having recorded a rise of 4.3%. The shortage of land available in this precinct, strong tenant demand and constrained development have triggered transactional prices above asking prices, a trend that hasn't been experienced since pre-GFC.

Table 3

Land / Development Sales Activity Melbourne Industrial Market

Address	Region	Price ($ m)	Area (m²)	$/m² of site area	Vendor	Purchaser	Date
Donnybrook Road, Mickleham	North	40.0	144,000	278	AMP/Folkestone	Commonwealth Govt	May-12
551 Chandler Road, Keysborough*	South East	n/a	15,100	n/a	n/a	Elite Property Group	Apr-12
Lot 56 & 57, Corner High Street & Heyington Avenue, Thomastown	North	3.61	14,680	246	MAB	Undisclosed	Mar-12
Lot C7 & C8, Corner High Street & Heyington Avenue, Thomastown	North	2.02	7,758	260	MAB	Austex Industrial Fabrics	Mar-12
18-24 Banfield Court, Truganina	West	1.14	8,136	140	Goodman Group	Owner Occupier	Nov-11

Source: Knight Frank * Property sold on a lease-back arrangement

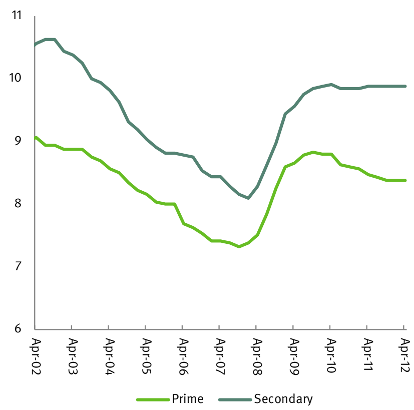
SALES & INVESTMENT YIELDS

Despite the on-going fears surrounding the sovereign debt crisis in Europe, coupled with the high $AUD causing turmoil within one of Victoria's biggest industries (manufacturing), the Melbourne Industrial investment market remains relatively buoyant.

Sales have largely been underpinned by long term leases and good quality tenants. Industrial sales that were greater than $5 million across all regions in the 12 months to May 2012 totalled $544.21 million across 34 properties. During the 12 months to May 2012, private investors and owner occupiers continued to have a dominant presence, combining for 54.3% of total sales. However other buyer groups such as unlisted funds/syndicates and off-shore investors are also entering the market as they accounted for 18.2% and 16.3% of total sales respectively. The Western and the South East precincts remain the focus for larger industrial assets, where $447.64 million was exchanged on 28 industrial properties. After securing a prime asset on Ferntree Gully Road in the last half of 2011, Lend Lease remained active, acquiring another on Mt Derrimut Road, demonstrating the preference for prime investments within these regions. Investor appetite remains strong for new assets with long leases. One such example was the Gibb Group's sale of the new Kraft facility having recently secured a pre-commitment which was sold to a private investor on a yield of 8.21%. The City Fringe recorded two sales totalling $66.20 million; however this includes the Salta sale of 650 Lorimer Street, Port Melbourne to GPT for $61.00 million. Despite only two sales, there remains strong interest for City Fringe assets especially from private investors and self-managed superfunds for investments at the lower end of the scale below $1 million. Sales activity in the Northern precinct was modest, where $30.37 million was transferred over four properties. However market enquiry in the region indicates that there is interest from owner occupiers for space sub 1,000m² in which will likely be exacerbated if interest rates continue to fall.

Prime core market yields have tightened slightly over the past year to April, with more sales being completed at the lower end of the yield range, as investors are attracted to high quality space, located within close proximity to amenities and infrastructure. The current range for prime grade industrial assets has contracted slightly and now lies between 8.00% - 8.75%. The resurgence from owner occupiers seeking prime grade buildings given the tightening supply of available prime stock has also led to increased competition. In contrast, yields in secondary assets have remained stagnant at a range between 9.00% - 10.75%. Access to finance coupled with an investor preference for prime assets, has led to an increasing disparity in yield spreads between prime and secondary industrial assets, the largest risk premium since April 2002.

Figure 8
Melbourne Industrial Yields
Average Core Market Yield (%)



Source: Knight Frank

Table 4
Sales Activity Melbourne Industrial Market

Address	Region	Price ($ m)	Bld Area (m²)	Core Mkt Yield (%)	Vendor	Purchaser	Date
103-121 Western Avenue, Tullamarine	North	7.31	6,117	8.63	Peet Limited	Private Investor	May-12
Mt Derrimut Road, Derrimut	West	14.00	12,070	##	Australand	PFG Australia	Apr-12
20 Rocco Drive, Scoresby	East	5.30	4,642	7.82	TNF Group	Private Investor	Apr-12
19-39 Studley Court, Derrimut	West	21.43	23,455	8.21	Gibb Group	Private Investor	Feb-12
650 Lorimer Street, Port Melbourne	City Fringe	61.00	28,808~	9.50	Salta	GPT	Feb-12
557 Mt Derrimut Road, Derrimut	West	22.18	28,024	8.47	Rimcorp via Wellington Capital	Lend Lease	Dec-11
39 Wright Road, Keilor Park	North	5.08	4,020	7.80*	Corplex	Private Investor	Nov-11
130 Northcorp Boulevard, Broadmeadows	North	5.76	5,280	8.46	Commercial Stone Pty Ltd	Private Investor	Nov-11
Corner Mt Derrimut Road & Australis Drive, Derrimut	West	19.00	21,600	8.31x	Australand	IOOF Investment Management	Oct-11
1464 Ferntree Gully Road, Knoxfield	East	31.50	21,987	8.25	CVC Property Fund	Lend Lease	Sep-11

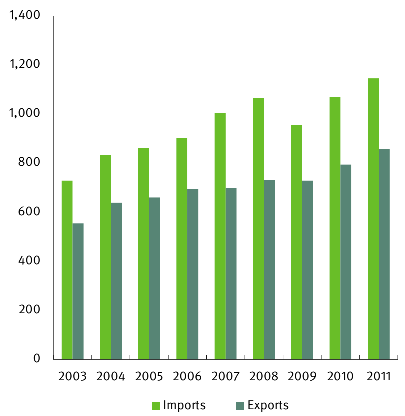
Source: Knight Frank * Initial Passing Yield ~ Comprises 50.2% office accommodation ## Turnkey development
x includes five year rental support from Vendor

OUTLOOK

The continued strength of the $AUD threatens to put pressure on the already uncertain growth prospects of the State because of its implications on one of Victoria's biggest industries. The manufacturing industry looks more than likely to remain encumbered by softer demand, the strength of the $AUD, the looming carbon tax, and whether infrastructure can continue to service the industrial sector.

Conversely the strong $AUD should continue to spur imports especially in Victoria which accounts for 35% of Australia's imports. This subsequent demand for imports has led to a growing presence of online retailers committing to space, particularly in Fringe space. The recent rate cuts have also had corresponding effects on this retail trend and warehousing demand appears to have picked up with online retailers committing to space in the Western, City Fringe and the South East precincts. In particular, Port Melbourne is one of the preferred locations for online retailers due to its access to the Ports, the CBD and major road arterials.

Figure 9
Port of Melbourne Container Trade
(000's) Imports vs Exports T.E.U



Source: Port of Melbourne Corporation

As at April 2012, Knight Frank forecasts that 578,862m² of new industrial supply (>1,000m²) will be delivered in 2012;

Figure 10
$AUD vs. $USD
2000-2012 Units of $USD per $AUD

Source: RBA

underpinned by an under-supply of prime industrial stock and rising tenant demand. Of the new stock scheduled for completion, just over half (51%) is to be delivered in the Western precinct, Melbourne's fastest growing Industrial market. Given the convenient access to Melbourne's port and airport, prospective tenants and owner occupiers continue to be attracted to the Western precinct.

With tenant demand expected to outstrip supply over the remainder of the year, vacancy levels are expected to continue to trend downward. Current levels of vacant industrial space, above 5,000m², represent a new low for the total available space, as recorded by Knight Frank. As tenants continue to upgrade to better quality accommodation, a further drop in already low stock levels for prime grade space is anticipated over the next six months. While available space has steadily diminished, average prime and secondary market rents have begun to respond to the tightening market, with modest increases in the six months to April 2012. With limited prime space available, Knight Frank Research anticipates a further uplift in rental levels across the Melbourne industrial market. It is expected that Melbourne will outperform other Victorian asset classes underpinned by its relatively attractive income returns.

Speculatively developed industrial stock is likely to grow into a bigger proportion of the industrial new supply pipeline. With land prices relatively affordable, very low levels of available prime stock, significant tenant demand and tightening prime yields, the current market conditions appear to be very well suited for speculative development. Furthermore, strong interest from some of the larger requirements, especially in the Western region, indicates that most have a preference for a speculative development as opposed to a pre-commitment or a D&C due to the current economic uncertainty. Tenants appear to be unsure of their mid to long term future requirements, and are more motivated to commit to space currently available before rental levels start to rise further.

Over the six months to April 2012, the prime yield range has narrowed, with a firming bias to the upper end of this range. With the strong investor preference for prime grade stock, it is anticipated that downward pressure will remain on prime yields over the second half of 2012. However, yields for secondary stock are expected to continue to offer a higher risk premium, given the investor interest in prime stock, and the difficult financing environment. Private Investors are expected to remain the predominant buyer type through the course of 2012. It is anticipated that unlisted/syndicate groups, AREITs and off-shore investors will continue to be drawn to the larger prime industrial stock.

Infrastructure has always been intrinsic to the industrial market. The 2012/13 State Government detailed a number of major transport and logistics projects that are likely to have an impact on the Melbourne industrial market. These include; $350 million to remove level crossings in Springvale and Mitcham, $156 million for the next stage of the Dingley Bypass, and $4 million for the Port of Hastings Development Authority to commence preparations for the expansion of the Port of Hastings to handle international container trade within 10-15 years.

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