RESEARCH

Knight Frank

MAY 2013

MELBOURNE INDUSTRIAL

Market Overview

HIGHLIGHTS

- Total vacant industrial space increased over the first quarter of 2013. As at April 2013, there was 410,508m² of industrial space above 5,000m² available within 39 buildings. Although industrial vacancy is at its highest levels since July 2011, it still remains 23% below the historical average of 533,280m².
- The new industrial supply pipeline is forecast to total 558,163m² over the course of 2013, a 4% decrease when compared to 2012. The new supply pipeline is likely driven by demand from Transport, Postal & Logistics and Retail Trade based tenants.
- The total value of industrial sales (>$5 million) across all regions in Melbourne over the twelve months to April 2013 was $389.0 million. Offshore groups (32%) were the dominant purchaser type, largely as a result of the capital partnering between DEXUS and the National Pension Service of Korea in the establishment of a portfolio of Australian industrial properties. There was also strong activity from unlisted funds/syndicates (29%) and private investors (27%).

INDUSTRIAL OVERVIEW

Table 1
Melbourne Industrial Market Indicators as at April 2013

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	0.0	80	0.0	7.50 – 8.00	8.50 – 9.75	730	0.0	630	0.0
North	75	0.0	60	1.7	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	0.0	63	0.0	8.00 – 8.75	9.00 – 10.75	210	-8.7	180	-10.0
West	75	4.2	65	0.0	8.00 – 8.50	9.50 – 10.75	150	-10.7	120	-13.0
Melbourne Average*	**79**	**1.0**	**63**	**0.4**	**8.00 – 8.69**	**9.13 – 10.75**	**223**	**-4.1**	**188**	**-3.9**

Source: Knight Frank * 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 vacancy, incentives etc)

Economic Snapshot

The status of the global economies continue to encumber the Australian economy. Although the European sovereign debt issues appeared to have paled slightly, it is still widely believed that Europe will remain in recession for at least another year. China's growth appears to have plateaued in response to modest policy restraint. And lastly the US economy's growth prospects appear to be improving with new housing starts and house prices beginning to rise.

Figure 1
Vic & Australia Economic Growth
VIC GSP & Aust GDP % annual change

Source: Deloitte Access Economics

Victorian Gross State Product (GSP) over the 2011/12 financial year grew by 2.3%. Deloitte Access Economics has forecast growth to decline to 2.2% over the current financial year. Given the Victorian economy's high exposure to industries affected by exchange rates, the high Australian dollar has slowed employment growth and business investment. Encouraged by the high dollar, the trend of consumers buying goods offshore remains strong, fuelling import levels. Driven by these high import levels, much of the recent take up of industrial space has come from retailers/wholesalers, importers and associated logistics services.

While manufacturers will continue to be hindered in the short term, impacted by the strength of the $AUD, the sector appears to have now stabilised. After three consecutive years of contraction in Victorian industrial production, growth is anticipated to gather momentum from 2014.

Industrial Overview

According to the IPD Performance Index for the 12 months to December 2012, Melbourne industrial property posted a total return of 9.3% with capital growth of 0.3%. The total returns of Melbourne industrial continues to perform below Melbourne CBD office (10.4%) but outperforms Victorian retail (9.0%). Income returns for Melbourne industrial (9.0%) are higher than the office and retail asset averages, demonstrating the attractiveness of the yields on offer for industrial assets. Within the Melbourne industrial market the total returns of the South East precinct performed the best (11.6%), followed by the City Fringe (9.6%) and the West/North (8.2%).

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

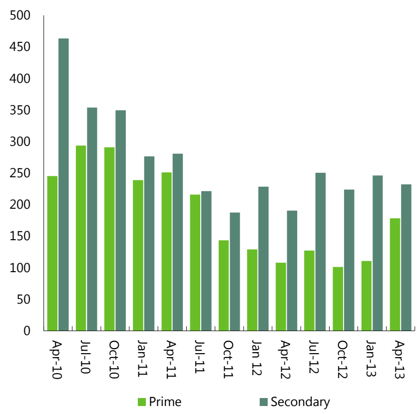
Source: IPD

Industrial Vacancy

Figure 3

Melbourne Industrial Available Space

'000m² by Grade (>5,000m²)



Source: Knight Frank

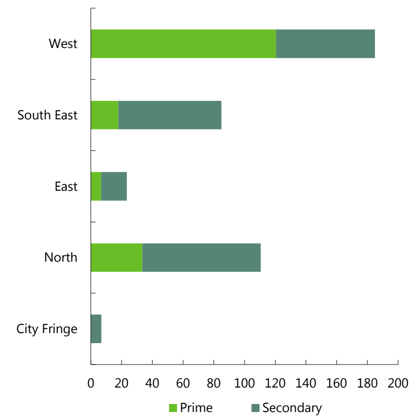
The level of available space greater than 5,000m² within the Melbourne industrial market has increased over the first quarter of 2013. At 410,508m², the total available space is 53,283m² more than the January 2013 level, but remains 23% below the historical average of 533,280m². As at April 2013, there was 178,378m² of available prime space, accounting for 43% of total available stock. The increase in prime space came as a result of prime-grade backfill space becoming available, and two speculatively developed projects commencing during the first quarter of 2013. Vacant secondary space has fallen slightly as tenants have absorbed available space with the limited prime options. This prime space has an average asking rental of $76/m² compared with secondary space at $65/m².

By region, the greatest amount of space available for lease is located in the Western precinct as at April 2013, with 184,902m². Of the available space within the Western precinct, 65% is classed as prime, however approximately half of this space is within speculative stock under construction. The South East remains dominated by secondary stock, with only one prime grade option in the form of a 17,850m² speculative development by Australand that was recently completed within The Key Industrial Estate, Keysborough.

Figure 4

Available Industrial Space

'000m² by Grade & Precinct (>5,000m²) – Apr 13



Source: Knight Frank

OCCUPIER DEMAND & RENTS

Analysis undertaken by Knight Frank indicates that in the six months to April 2013, there were 20 vacant buildings above 5,000m^2 (excluding D&C's), totalling 182,805m^2 which were absorbed. Eight of the buildings leased were prime grade assets, three of which were speculatively developed buildings wholly or partly leased prior to completion. Recent commitments to speculatively developed stock include: DB Schenker, Nu-Pure and Albi Imports. Despite increased levels of speculative construction, the trend of tenants committing to space prior to completion is expected to continue given the limited quality options available.

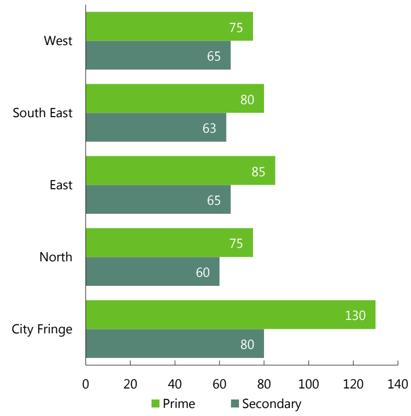
The pre-lease market has strengthened over the past six months; exacerbated by the difficulty for prospective tenants to find and secure suitable space that satisfy their specific requirements. Recent pre-commitments from Fastline International and Toll Transport to purpose built facilities by Australand and DEXUS respectively, demonstrate the willingness of tenants to design and construct a building that perfectly suits their needs. Capitalising on the tight vacancy levels, several developers have also speculatively built facilities adjoining (or nearby) previously secured pre-lease projects; thereby diversifying risk and utilising the cost benefits of the efficient use of committed labour already on site.

Analysis by Knight Frank indicates that of the total number of leasing transactions for buildings greater than 1,000m^2 over the 12 months to April 2013, 45% of them were for buildings between 1,000m^2 and 4,999m^2. Buildings between 5,000m^2 and 9,999m^2 accounted for 25%, whilst buildings greater than 10,000m^2 made up the remaining 30%. Given the limited prime options available, leasing absorption is likely to increase for larger users as speculative development for buildings greater than 10,000m^2 has risen; accounting for four of the five buildings under construction as at April 2013.

Average prime net rental levels across the Melbourne market grew by 1.0% in the year to April 2013 to reach \$79/m^2. Over the same period, average net secondary rents increased by 0.4% to reach \$63/m^2. While prime rents have grown over the past two years, assisted by the shortage of quality available space, the increase of speculative development is likely to steady rental growth over 2013. In contrast, the increased level of prime available stock through speculative development and backfill opportunities is likely to maintain downward pressure on secondary properties.

Of the current tenant requirements, Transport, Postal & Logistics and Retail Trade users account for 45% of industrial space sought in the market continuing the trends of the past 12 months. In addition larger developers are taking advantage of the constrained supply conditions with speculative development levels rising.

Figure 5
Melbourne Industrial Rents
\$/m^2 net market rent by precinct - April 2013



Source: Knight Frank

Table 2
Major Industrial Leasing Transactions Melbourne Region

Address	Region	Net Rent (\$/m^2)	Area (m^2)	Term (yrs)	Tenant	Date
44-54 Raglan Street, Preston ^	North	n/a	26,980	6	Australian Paper	Q3-13
2-30 Saintly Drive, Truganina *	West	72	21,970	10	Fastline International	Q2-13
45-125 Glasscocks Road, Dandenong South *	South East	Undis	21,505	10	ITW Proline	Q1-13
89 Drake Boulevard, Altona #	West	75	14,030	7	DB Schenker	Q1-13
2-10 Toll Drive, Altona	West	80	6,273	5	WA Freightline	Q1-13
59 Calarco Drive, Derrimut	West	82	6,358	3	Kuehne & Nagel	Q1-13
5 Dunlop Road, Mulgrave	East	64	5,146	5	Newlitho	Q1-13
Unit 5, 706 Lorimer Street, Port Melbourne	City Fringe	116	3,021	5	Total Tools	Q1-13
A&B, 1-16 Andretti Court, Truganina #	West	75	26,376	7	Catch Of The Day	Q4-12
1 Pacific Drive, Keysborough *	South East	85	12,100	5	BIC	Q4-12
28-30 Distribution Drive, Truganina *	West	87	18,670	n/a	Toll Transport	Q4-12

Source: Knight Frank # Speculative Development * Pre-lease ^ Renewal

Knight Frank

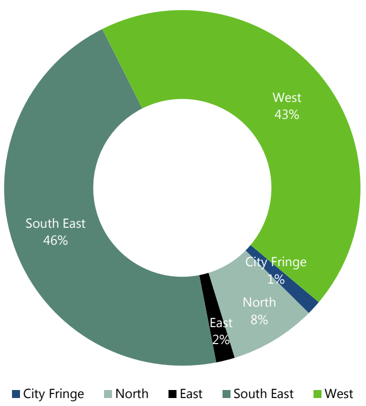
DEVELOPMENT & LAND VALUES

During the course of 2013, new industrial accommodation across the major Melbourne industrial regions (>1,000m²) is forecast to total 558,163m², boosted by the increase in speculative space that is progressing. Following the successful absorption of the majority of speculatively built developments in 2012, coupled with the relatively low amount of prime available space, the level of speculative development is expected to increase through 2013 with tenants eager to upgrade their current accommodation without the disruption to their operations.

Figure 6

Melbourne Region Industrial Supply

% of total supply expected over 2013



Source: Knight Frank

Looking across the regions, the Western and South Eastern precincts are expected to deliver the bulk of the new industrial supply, accounting for 89% of the 2013 pipeline. In addition to the scheduled 2013 completions of Fastline's 21,970m² facility and Toll Transport's 18,670m² warehouse, both in Truganina, tenant enquiries totalling 96,000m² are currently seeking premises in the Western industrial precinct. New industrial supply for 2013 in the West is forecast to total approximately 240,000m², a 9% decrease from 2012 levels.

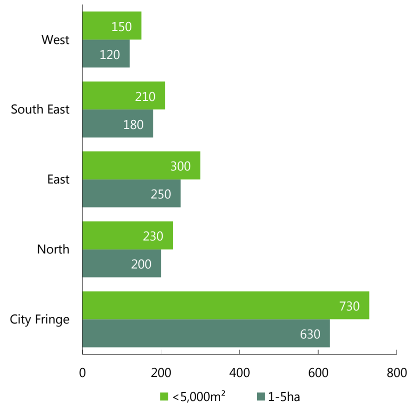
The South East has also become home to a number of pre-lease and D&C projects. Recently within The Key Industrial Estate, Australand secured commitments from BIC for a 12,100m² warehouse, Symbion for a 12,800m² facility, and Rinnai for a 14,800m² D&C project. Elsewhere, within the Glasscocks Industrial Estate; Goodman Group secured a precommitment from ITW Proline for a 21,505m² distribution centre which recently reached practical completion.

As at April 2013, there were five speculative projects under construction, with a further two more reaching practical completion. There is a healthy amount of speculative stock anticipated to come through the new supply pipeline from the likes of Australand, DEXUS and Goodman. Upward pressure on prime grade rental levels is expected to ease as this new supply comes to market, accommodating tenants requiring high quality industrial space.

Figure 7

Melbourne Industrial Land Values

$/m² value of land by precinct – April 2013



Source: Knight Frank

Over the six months to April 2013, land values for land less than 5,000m² remained stable across all regions given limited transactional evidence to justify any substantial movements. Although actual land sales have been limited over the past 12 months, anecdotal evidence suggests average land values for sites between 1 and 5 hectares average $188/m² as at April 2013, falling 4% from a year earlier. Downward pressure remains on land values with development finance still relatively limited.

Table 3

Major Land / Development Sales Activity Melbourne Region

Address	Region	Price ($ m)	Area (m²)	$/m² of site area	Vendor	Purchaser	Date
297-303 Palmers Road, Truganina	West	7.74	307,600	25	Undisclosed	Private Investor	Mar-13
Part 600 Lorimer Street, Port Melbourne	City Fringe	10.40	13,000	800	Undisclosed	Undisclosed	Mar-13
Frankston Dandenong Road, Dandenong South	South East	8.58	52,000	165	Pellicano/ISPT	Lettieri Group	Feb-13
10 Fulton Drive, Derrimut	West	4.00	37,940	105	Costa Group	Makland	Jan-13

Source: Knight Frank

SALES & INVESTMENT YIELDS

Analysis by Knight Frank shows that industrial sales greater than $5 million across all regions in the 12 months to April 2013 totalled $389.0 million across 27 properties. This was a softer result when compared to the sales total for the 12 months to April 2012, where $544.2 million exchanged hands across 34 properties, representing a 29% decrease. Despite the resultant drop in sales activity, demand for prime assets with long lease terms and blue chip covenants remains strong, notably in the West and South Eastern precincts.

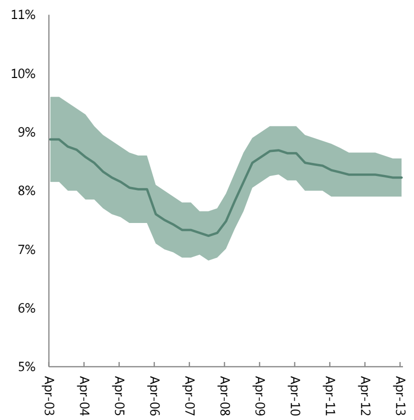
During the 12 months to April 2013, offshore buyers were the dominant purchaser class, accounting for 32% of transactions by value. This burgeoning offshore interest was demonstrated by the $360 million capital partnering between DEXUS and the Korean based National Pension Service in the establishment of a portfolio of Australian industrial properties. The Victorian component of the Australian portfolio comprised of eight industrial properties solely located within the Western precinct totalling $233.3 million. Additionally institutions remain interested in prime grade assets, as they seek to increase their exposure to the Australian industrial market, attracted by the high yields on offer and potential compression in the future. Recent transactional evidence includes IOOF's $24.0 million purchase of a 26,376m^2 speculatively developed building at 1-16 Andretti Court, Truganina and Core Logistics Partnership (CLP) acquiring a 36,213m^2 industrial building at 1420 Ferntree Gully Road, Scoresby for $39.63 million.

Despite the increasing investor appetite for industrial property, average prime yields have only compressed by 12 bps between April 2011 and April 2013. The current average Melbourne industrial prime yields range between 8.00% and 8.69% for prime assets.

Over a 10-year period to April 2013, prime yields are averaging between 7.77% and 8.72%. Despite the difficult financing environment, it appears that investment activity is hindered more so by the shortage of quality investment options in the market. Given the total returns of Melbourne industrial property coupled with the positive rental outlook, investor appetite in the sector is likely to continue to gain momentum. Although prime yields appear to have stabilised, it is anticipated that yield tightening will occur given the attractiveness of prime grade industrial investments.

Average secondary core market yields have softened over the past two years and currently range between 9.13% and 10.75%. Whilst investor appetite is likely to increase for secondary assets as a result of a shortage of prime investment opportunities; significant yield compression for secondary assets is unlikely in the short term.

Figure 8
Melbourne Industrial Prime Yields
Core Market Yield Range & Median -2003 to 2013



Source: Knight Frank

Table 4
Sales Activity Melbourne Region

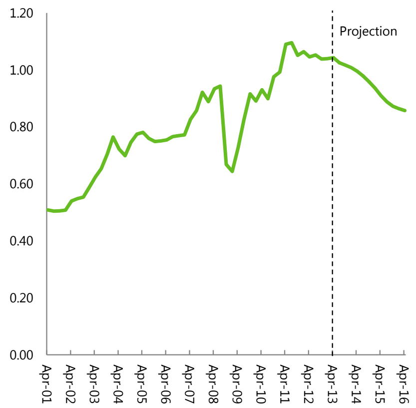
Address	Region	Price ($ m)	Bldg Area (m^2)	Core Mkt Yield (%)	Vendor	Purchaser	Date
18-22 Salmon Street, Port Melbourne	City Fringe	12.14	8,470	9.40%*	AMP	Strategic	Mar-13
1420 Ferntree Gully Road, Scoresby	East	39.63	36,213	8.23%*	Amcor Limited	Core Logistics Partnership (CLP)	Feb-13
11 Dansu Court, Hallam	South East	5.00	4,253	7.50%	Australian Unity	UNI Properties	Feb-13
15-21 Enterprise Drive, Rowville	East	9.40	6,468	7.50%*	Australand Property Group	Charter Hall (DIF 2)	Jan-13
1-16 Andretti Court, Truganina	West	24.00	26,376	8.24%	Australand Property Group	IOOF Investment Management	Nov-12
DEXUS/NPS Portfolio Joint Venture (eight Victorian Assets)	West	116.66#	185,268	n/a	DEXUS	National Pension Service (Korea)	Oct-12
2-20 McDonalds Lane, Mulgrave	East	10.55	12,240	9.28%*	Lend Lease	Salta	Oct-12

Source: Knight Frank * passing yield # 50% share (total value of eight assets $233.32 million)

OUTLOOK

Australia is closely monitoring the state of the major economies around the world. Europe is expected to remain in recession over the next year whilst China's growth appears to have plateaued with forward looking indicators being more subdued than expected. A rise in new housing starts and house prices, has given new hope to the US economy confidence and growth prospects.

Figure 9
Units of $USD per $AUD
2001 – 2016



Source: RBA/Deloitte Access Economics

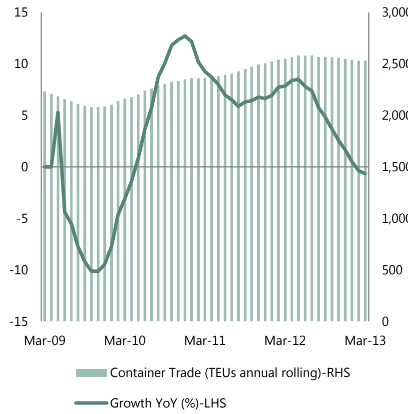
The continued strength of the $AUD will maintain pressure on industrial production as it has an adverse effect on the manufacturing sector, one of Victoria's biggest industries. Conversely the strong $AUD should continue to cultivate the import market in Victoria which accounts for 35% of Australia's imports. The subsequent presence of Transport, Postal & Logistics and Retail Trade based tenants has been apparent with recent leases to Catch Of The Day and numerous logistics based users.

Knight Frank forecasts 558,163m^2 of new industrial supply (>1,000m^2) will be delivered over the course of 2013; underpinned by an increase in speculative development and pre-leasing activity. Of the total new supply pipeline, 89% of this stock is anticipated to be delivered in the Western and South Eastern precincts, where the infrastructure in these areas is well developed, encouraging industrial development. The level of available space is expected to gradually increase in 2013, from record lows recorded in 2012, as speculative activity increases, and quality backfill options become available.

With the recent completion of the Peninsula link, coupled with the Government's long term plan for expansion of Port of Hastings, it is anticipated that tenants and investors are likely to continue to be attracted to the South East region, solidifying the South Eastern precinct as a major industrial hub.

Recently announced by the State Government is Australia's largest urban renewal area Fisherman's Bend, located approximately 3km south-west of the Melbourne CBD. The precinct comprises approximately 240 hectares, consequently rezoned as part of an expanded Capital City Zone. Fisherman's Bend is earmarked for residential and mixed use development, which will subsequently put upward pressure on land values. Coupled with the zoning changes, industrial users are likely to continue to investigate alternative locations outside of the City Fringe market.

Figure 10
Port of Melbourne Container Trade
(000's) Container Trade T.E.U



Source: Port of Melbourne Corporation

Despite the uncertain economic conditions, tenant demand is expected to continue to outstrip supply. Over the first quarter of 2013, the level of prime available space increased to 43% of the total, the first time prime space levels have reached over 40% since October 2011. It is anticipated that prime space levels will remain at or around this ratio, given the increased levels of speculative construction, tempered by the flight to quality from prospective tenants looking to upgrade or expand into prime quality industrial accommodation.

With upward pressure on prime rents over the past two years exacerbated by the shortage of quality available space, the increase in speculative development is likely to steady rental growth over the remainder of 2013. Conversely, the increase in prime available stock deriving from speculative development and backfill opportunities is likely to maintain downward pressure on secondary grade industrial stock.

While over the six months to April 2013, the prime yield range has remained stable, it is anticipated that yields will come under increasing pressure to compress. Investor appetite has rallied in the past six months with fundamentals for Melbourne industrial property solid, particularly for prime passive assets. AREIT's and offshore investors are anticipated to remain active, particularly focused on prime industrial stock and portfolio investment opportunities.

THE RECENT PHENOMENON OF THE ABSORPTION OF SPECULATIVE SPACE PRIOR TO COMPLETION IS EXPECTED TO CONTINUE

Likewise, private investors, syndicates and unlisted funds have re-emerged as industrial investors, seeking higher returning investments compared to bonds and cash.

RESEARCH

Americas
USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf
Bahrain
Abu Dhabi, UAE

Knight Frank Newmark Global

Knight Frank Research
Matt Whitby
National Director
Head of Research & Consultancy
+61 2 9036 6616
matt.whitby@au.knightfrank.com

Richard Jenkins
Director – Research VIC
+61 3 9604 4713
richard.jenkins@au.knightfrank.com

Rodney Wong
Research Analyst – VIC
+61 3 9604 4608
rodney.wong@au.knightfrank.com

Knight Frank Valuations
Joe Perillo
Joint Managing Director – Valuations
+61 3 9604 4617
jperillo@vic.knightfrankval.com.au

Michael Schuh
Director – Valuations
+61 3 9604 4726
mschuh@vic.knightfrankval.com.au

Industrial Agency Contacts
James Templeton
Managing Director – Victoria
+61 3 9604 4724
james.templeton@au.knightfrank.com

Gab Pascuzzi
Director – Industrial Investments
+61 3 9604 4649
gab.pascuzzi@au.knightfrank.com

Matt Crofts
Associate Director – Industrial
+61 3 9604 7468
matt.crofts@au.knightfrank.com

Ben Hackworthy
Associate Director – Industrial
+61 3 9604 4731
ben.hackworthy@au.knightfrank.com

Adrian Garvey
Associate Director – Industrial
+61 3 8545 8616
adrian.garvey@au.knightfrank.com

Knight Frank Research provide strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at KnightFrank.com.au