RESEARCH

OCTOBER 2013

MELBOURNE INDUSTRIAL

Market Brief

HIGHLIGHTS

- Over 2013, new industrial supply is forecast to total 476,082m^2 (>5000m^2), of which 247,006m^2 is already complete. Total new expected supply this year is down 15% against 2012 levels, largely as a result of limited pre-committed completions through 2013.
- Improving tenant sentiment and large commitments to newly built prime grade buildings have steadily maintained prime rent levels. Tenants continue to prefer committing to completed speculative developments with pre-commitment levels significantly down on historical levels.
- Industrial sales activity (>$10 million) has gathered momentum through 2013, with AREITs emerging as a dominant purchaser class accounting for 67% of transactions, followed by unlisted funds and syndicates. Transactions in 2013 to date have already surpassed sales achieved in the entire year of 2012, boosted by a tranche of major portfolio sales.

Table 1
Melbourne Industrial Market Indicators as at October 2013

Precinct	Avg. Prime Rent		Avg. Secondary Rent		Core Market Yields (%)		Avg. Land Value			
							<5,000m²		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	800	9.6	800	33.3
North	75	0.0	60	0.0	8.00 – 8.75	9.25 – 10.25	230	0.0	200	0.0
East	85	0.0	65	0.0	8.50 – 8.75	9.00 – 10.75	300	0.0	240	-4.0
South East	80	0.0	63	0.0	7.50 – 8.25	9.25 – 10.75	215	-2.4	160	-11.1
West	75	0.0	65	0.0	7.75 – 8.25	9.00 – 10.00	159	5.8	115	-4.2
Melbourne Average*	**79**	**0.0**	**63**	**0.0**	**7.95 – 8.50**	**9.10 –10.45**	**226**	**2.1**	**179**	**-4.8**

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 vacancies, incentives etc)

Occupier Demand & Rents

The volume of vacant space within the Melbourne industrial market currently stands at 608,513m², and is above the five year average of 545,556m². At its current levels, it is 47% higher than twelve months ago, with the majority of this additional industrial space becoming available in the West due to completion of speculative properties.

In the third quarter of 2013, industrial property take-up in all precincts totalled 128,750m², close to its historical average, but 44% higher than the first quarter of 2013. Interestingly in the past twelve months, tenant demand has risen for newly built prime grade buildings, which steadily maintained the prime rent levels despite the pressure from increasing vacant stock. Whilst confidence levels have improved since the Federal election, tenants continue to prefer committing to completed speculative developments rather than pre-committing to D&C facilities. Recent commitments to speculatively developed warehouses include Hitachi (8,000m²), United Wholesales (8,000m²) and Encore Tissue (10,670m²). In contrast, higher levels of vacancy stemming from backfill and sublease space are likely to put secondary rentals under pressure as landlords compete for tenants. Within the City Fringe, changes to the zoning around Fishermans Bend has limited growth in rental levels as a result of the trend of landlords offering shorter lease terms with development clauses.

Table 2
Major Industrial Leasing Transactions Melbourne Region

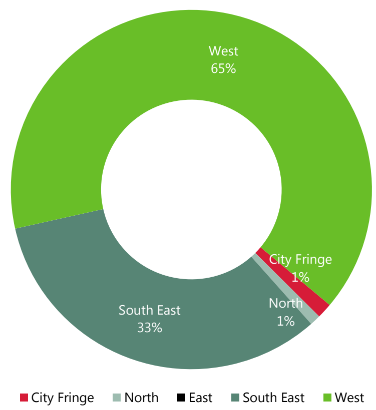
Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Date
Bayliss Rd, Dandenong	SE	70	43,000	10	Bunnings*	Q3-13
33-47 Dohertys Rd, Laverton North	W	82	15,742	7	Orix	Q3-13
195-203 Forster Rd, Mount Waverley	E	n/a	6,151	3	Sims.E.Recycling	Q3-13
76-80 Carroll Rd, Oakleigh	SE	70	6,255	n/a	Steinhoff Aust	Q3-13
332 Plummer St, Port Melbourne	CF	66	6,800	n/a	Brand Developers	Q3-13
103-121 Western Ave, Tullamarine	N	110	6,117	10	Direct Couriers	Q3-13

Source: Knight Frank Region: SE South East, W West, E East, CF City Fringe, N North
* pre-lease

Development Activity

To date in 2013, 247,006m² (>5000m²) of new supply has been completed with a further 229,076m² scheduled for completion by the end of the year, down from the 561,817m² in 2012. Improving tenant sentiment is expected to lead to further large commitments with 383,317m² already under construction across 28 properties for completion next year. As a result of the recent rezoning around Fishermans Bend, industrial land values in the City Fringe precinct have grown steeply with residential development now offering the higher and better use.

Figure 1
Melbourne Region Industrial Supply
% of supply under construction Q4 2013 – Q4 2014



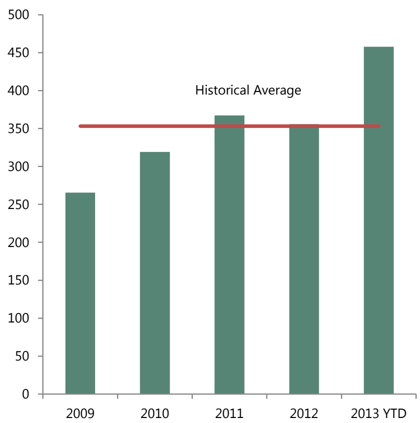
Source: Knight Frank

In contrast, the average industrial land value in Melbourne (excluding City Fringe) fell by 4.8% for larger (1-5ha) sized land parcels. Owner-occupier investment has risen, boosted by the record low interest rates, as demonstrated recently by Ego Pharmaceutical which has plans for a purpose built 89,000m^2 development on their site.

Sales & Investment Activity

Industrial sales (greater than $10 million) in 2013 year to date across all regions currently totals $457.74 million across 16 properties. Transactions in 2013 to date have already surpassed sales achieved in the entire year of 2012, boosted by major portfolio sales. Recent portfolio sales transactions include: APN's purchase of Australand's unlisted wholesale property fund, Fife Capital's recent purchases for a newly-listed Australian Industrial REIT and Growthpoint's purchase of three properties, under construction, from Australand.

Figure 2
Melbourne Industrial Investment Sales
($m) sales over $10 million



Source: Knight Frank

In 2013 to date, AREITs were the dominant purchaser class, accounting for 67% of transactions followed by unlisted funds and syndicates. Despite an increase in the total value of sales, the volume of transactions remains relatively limited compared to the rising investor interest which has placed downward pressure on prime asset yields.

Table 3
Major Industrial Land/Development Sales Melbourne Region

Address	Region	Price ($ m)	Area (m^2)	$/$m^2$ of site area	Purchaser	Date
44-58, Marshall Rd, Altona	W	3.62	34,510	105	Owner-Occupier	Q4-13
120 Colemans Rd, Carrum Downs	SE	6.60	104,900	63	Salta Properties	Q3-13
49 Calarco Drv, Derrimut	W	1.76	16,000	110	Blackwood Downs	Q3-13
Logis Estate, Dandenong	SE	15.0	95,000	158	Ego Pharmaceuticals*	Q3-13

*Owner-Occupier

Major Improved Sales Activity Melbourne Region

Address	Region	Price ($m)	Bldg. Area (m^2)	Initial Yield (%)	Purchaser	Date
Somerton Logistics Centre, Somerton	N	121.00	131,763	7.70	Charter Hall	Q4-13
24-32 Stanley Drv, Somerton	N	23.70	24,350	9.50	Fife Capital	Q4-13
169 Australis Drv, Derrimut	W	20.96	30,994	8.00^	Abacus Property Group	Q4-13
704-744 Lorimer St, Port Melbourne	CF	26.30	26,023	9.51	Centennial Property Group	Q3-13
45 Atlantic Drv, Keysborough#	SE	17.40	12,800	7.50	Growthpoint properties	Q3-13
9-11 Drake Bvld, Altona#	W	24.10	25,728	8.25	Growthpoint properties	Q3-13
19-20 Southern Crt, Keysborough#	SE	18.80	17,834	8.25	Growthpoint properties	Q3-13
86-102 Whiteside Rd, Clayton South	E	7.20	8,741	8.50	Virtus Property Group	Q3-13
69 Studley Crt, Derrimut	W	20.00	27,171	8.00	360 Capital Industrial Fund	Q2-13

Source: Knight Frank
Region: SE South East, W West, E East, CF City Fringe, N North
under-construction ^ Core market yield

Outlook

Though the increased vacancy levels have slowed down speculative development, increasing business and consumer confidence is likely to lead to higher levels of pre-committed developments next year as highlighted by Bunnings' new 43,000m^2 purpose-built warehouse in Dandenong. As a result of the increasing levels of backfill anticipated next year, prime rental rates are expected to remain relatively steady. However, tenants' preference for A-grade accommodation may result in the further softening of secondary rentals. As a result of the disproportion between surplus availability of capital and limited investment opportunities, further yield compression, particularly for prime assets offering long leases is likely as AREITs, unlisted funds and offshore groups all seek to increase their exposure to the Australian industrial market.

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