RESEARCH

MELBOURNE

INDUSTRIAL MARKET BRIEF NOVEMBER 2014

Key Facts

Industrial vacancy has grown for **eight consecutive quarters** and now measures **864,108m^2**.

Melbourne's industrial property posted **total returns** on **par with CBD office**, while **outpacing Victorian retail**.

Supply forecast for **2014** is **46%** higher than **2013,** yet **15% below the 10-year average**.

Investment sales in **2014** to date totals **$658.5 million** just below the **$706.2 million** sold during the entire **2013** year.

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Melbourne's industrial supply is forecast to total 514,736m^2 in 2014, 46% higher than 2013, boosted by pre-lease development and purpose built facilities for owner-occupiers.

According to IPD, total returns from Melbourne's industrial property remained steady at 10.0% in the 12 months to June 2014, similar to the preceding year, but marginally up from its five-year average of 9.9%. Melbourne's industrial property posted total returns on par with CBD office (10.0%) although did outperform Victorian retail property (9.6%) .

Victoria's economy continues its shift from traditional manufacturing to other macro drivers such as retail trade and housing construction. In the 12 months to September 2014, private housing approvals grew by 15.9% while retail trade grew by 6.8%. Contractions in manufacturing have impacted industrial leasing activity, with many of the old manufacturing facilities being converted into either residential or mixed-use developments. Kinnears Ropeworks' factory at 124-128 Ballarat Road, Footscray was recently sold with residential and mixed-use approvals on the 4ha site. Increasingly industrial construction activity is shaped by warehousing and logistics users driven by tenant demand from online retailers, food refrigeration facilities, transport and freight services.

Occupier Demand & Rents

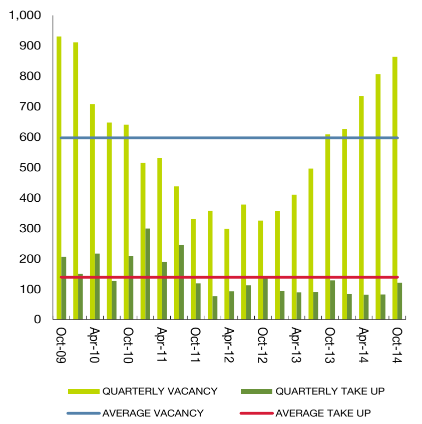
Melbourne's vacant industrial space (>5,000m^2) measures 864,108m^2 as at October 2014 which is 7% higher than the previous quarter and 45% above its five year average. Vacancy has grown by 42% over the past 12 months; 86% of all vacancy is categorised as existing accommodation. While the majority of this vacancy is located in the West (34%), consistent tenant demand coupled with a slowdown in new speculative commencements has reduced available space in the region by 14% from 12 months ago.

In the third quarter of 2014, prime space accounted for 43% of the total vacancy, impacted by a rise in backfill stock resulting from tenant relocations. While some tenants

FIGURE 1

Melbourne Industrial Market

'000m² available space vs take-up (excl D&C)



Source: Knight Frank

moved to purpose built facilities, many users relocated in to smaller properties.

Gross absorption totalled 121,097m² in the third quarter of 2014, the strongest take-up since the third quarter of 2013. Although absorption levels have improved, they continue to remain below their historic average for an eighth consecutive quarter, largely impacted by the soft business confidence levels. Seven out of 12 buildings leased were prime facilities, reflecting the continued tenant preference for quality accommodation. The West accounted for 47% of the gross take-up, outperforming all other regions since July 2011.

Melbourne's average net face prime rents remained unchanged at $79/m² from 12 months ago. However, increasing vacancy especially in existing space, has provided strong competition to attract tenants, resulting in a rise in the incentive levels.

Development & Land Values

Gross new industrial supply (>5,000m²) is forecast to total 514,736m² in 2014. Looking ahead, a further 593,653m² is scheduled for completion in 2015. Though total supply in 2014 is 46% higher than 2013, it remains 15% below the 10-year average. The rise in new supply during 2014 largely resulted from an increase in pre-leases signed during late 2013 including Goodyear (24,000m²) and Bunnings (43,150m²). Several D&C facilities were also built for owner-occupiers in addition to these pre-commitments as demonstrated by Australia Post (15,500m²), L'Oreal (29,336m²), Murray Goulburn (8,500m²) and Swire Cold Storage (18,000m²).

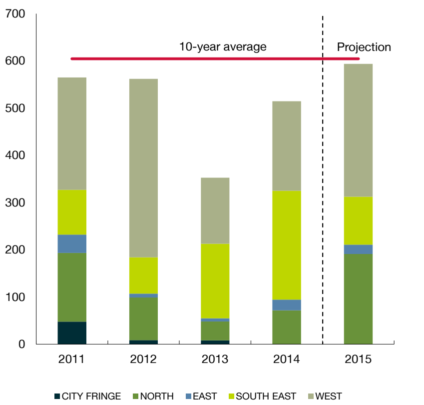
The West will continue to deliver the bulk of the new industrial supply, accounting for 47% of the forecast supply in 2015. While developers have slowed speculative construction in the region, pre-lease activity remains solid, highlighted by Austrans' warehouse (14,500m²) at 31-33 Sunline Drive in Truganina and Woolworths (25,000m²) cold storage facility at 441 Dohertys Road in Laverton North. The Northern region is forecast to deliver 32% of the upcoming supply next year, resulting from the major pre-commitments of Toll Transport (71,000m²) and TNT Freight (38,000m²) within the Melbourne Airport precinct in Tullamarine. In addition, the Melbourne Markets (76,070m²) in Epping is scheduled for completion in mid 2015.

Despite the pessimism linked with the declining manufacturing industry and its impending effect on the South East, the region will add 17% of the total new

FIGURE 2

Melbourne Industrial Supply

'000m² annual gross supply



Source: Knight Frank

supply pipeline. Tenant preference continues to shift to warehousing facilities as reflected by the recent Adairs' pre-lease who will occupy Australand's warehouse (6,698m²) at 77-89 Atlantic Drive, Keysborough upon its completion in 2015. Developers such as Australand, Goodman and Pellicano are now building over 48,000m² of speculative warehousing space.

Developers have been largely utilising their prevailing land banks for building new projects. Industrial lots (1ha+) have not seen much transactional activity over the past year limiting growth (excluding City Fringe) to 0.7% year on year. In fact, in the 12 months to October 2014, only two industrial sites greater than 5ha have been sold. In contrast, land below 5,000m² has seen its value increase by an average of 4.3% y-o-y, as a result of sustained demand from private investors and owner-occupiers.

TABLE 1

Melbourne Industrial Market Indicators as at October 2014

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields (%)		Avg Land Values			
							<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	7.25—7.75	8.00—9.25	1,000	25.0	850	6.3
North	75	0.0	60	0.0	8.00—8.50	9.00—10.00	230	0.0	190	-5.0
East	85	0.0	63	-3.1	8.00—8.50	9.00—10.25	300	0.0	240	0.0
South East	80	0.0	60	-4.8	7.25—8.00	9.25—10.25	230	7.0	160	0.0
West	75	0.0	65	0.0	7.50—8.00	8.75—9.75	175	10.0	124	7.6
Melbourne Average*	**79**	**0.0**	**62**	**-2.0**	**7.70—8.25**	**9.00—10.00**	**234**	**4.3**	**178**	**0.7**

Source: Knight Frank

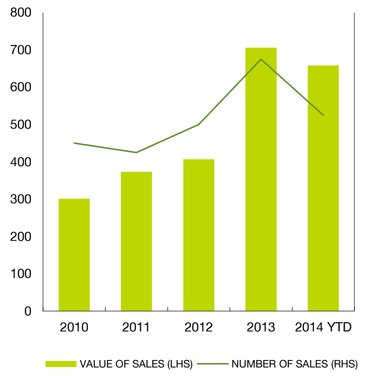
*Excludes City Fringe

Sales & Investment Activity

Melbourne's industrial sales (>$10 million) in 2014 to date totals $658.5 million from 21 properties, just below the $706.2 million that was transacted during the entire 2013 year, across 27 properties. Investment levels remained comparatively balanced across the South East (25%) and the East (24%), whilst the West continued to attract the highest proportion, with 29% of the total transactional activity by value.

Domestic institutions acquired 92% of all purchases by value in 2014 and continued to outbid offshore investors. Unlisted funds and syndicates sought assets with long term leases to blue chip tenants; and remained the top purchaser type. Propertylink has been the most active unlisted fund, boosted by a number of portfolio transactions; including 144-168 National Boulevard, Campbellfield ($18.5 million) and 1-5 Lakes Drive, Dingley ($14.1 million). Charter Hall, through its unlisted funds, CPIF and CLP, were also active investors

FIGURE 3
Melbourne Industrial Sales
($m) industrial sales $10million+

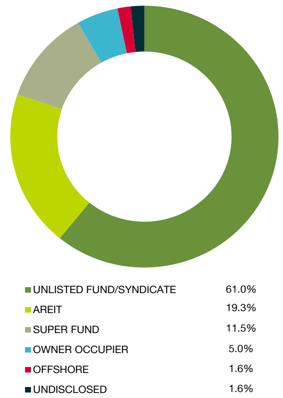


Source: Knight Frank

having purchased 32-58 William Angliss Drive, Laverton North ($43.5 million) and 254-294 Wellington Road, Mulgrave ($62 million) this year. The low interest rate environment has also attracted sitting tenants to become owner-occupiers. Booth Transport purchased 183 Fitzgerald Road, Laverton North ($14 million) while ARB Corporation bought its formerly leased premises at 42-44 Garden Street, Kilsyth ($19 million).

Strong investor appetite has compressed yields further; with average prime yields tightening by 25 basis points over the year to now range between 7.70% and 8.25%, although assets with 10+ years WALEs are likely to transact below 7%.

FIGURE 4
Melbourne Industrial Sales
By purchaser type $10million+ 2014YTD



Source: Knight Frank

TABLE 2
Recent Leasing Activity Melbourne

Address	Region	Net Rent $/m²	Area m²	Term (yrs)	Tenant	Date
181-193 Forster Rd, Mt Waverley	E	65	6,840	5	Print-bound	Q3-14
Cnr of South Centre Rd and Link Rd, Tullamarine	N	U/D	38,000	15	TNT Australia^	Q3-14
17-45 Pound Rd, Dandenong South	SE	75	24,235	U/D	Reece Plumbing	Q3-14
28 Distribution Drv, Truganina	W	75	11,854	5	Linpac Packaging	Q3-14
2 Cyanamid St, Laverton North	W	60	8,000	5	Peter Sadler Transport	Q3-14
437-461 Plummer St, Port Melbourne	CF	85	6,855	2	Brand Developers	Q2-14

TABLE 3
Recent Improved Sales Activity Melbourne

Address	Region	Price $ mil	Bldg Area m²	Core Mkt Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
495-501 Blackburn Rd, Mt Waverley	E	63.00	23,724	8.64	5.4	AMP Wholesale Fund	EG Funds (CPF)	Q3-14
32-58 William Angliss Drv, Laverton North	W	43.50	46,218	8.08	3.4	Goodman Property Group	Charter Hall (CPIF)	Q3-14
215 Browns Rd, Noble Park	SE	21.77	43,949	9.92	2.5	Aspen Group	UP Property	Q3-14
Cooper St, Epping	N	77.40	76,070	9.60*	5.4	Vic Government	Propertylink	Q3-14
13-15 Joel Crt, Moorabbin	SE	19.00	17,512	8.44	15.0	Pact Group	CorVal Partners	Q2-14

E East, N North, SE South East, W West, CF City Fringe   *Initial Yield   U/D refers undisclosed   ^Pre-commitment

Source: Knight Frank

Outlook

Vacancy in Melbourne's industrial market is expected to continue to rise into 2015 as additional backfill space enters the market. Vacancy levels have tracked upwards over the past two years which has limited rental growth for prime grade properties and added further downward pressure on secondary grade rents, as tenants continued to upgrade their accommodation. This trend is likely to remain unchanged in the near term.

Tenant demand for prime space is likely to continue to be driven by the transport, logistics and retail sectors. Growing housing construction is expected to further augment Melbourne's industrial take-up and become a key driver. Secondary space is likely to remain a short-term choice for many users uncertain of their business conditions, providing flexibility; particularly from the manufacturing sector.

According to Deloitte Access Economics, as the economy continues to recover, the retail trade and transport & storage sectors are expected to grow at 3.5% and 2.6% respectively in 2015. These sectors are likely to continue to drive the majority of new industrial supply in 2015, which is forecast to surpass 2014 levels by 15%.

Assets with long term leases and blue chip tenants will continue to be competitively sought after, as investors look to expand their exposure to Melbourne's industrial sector. Stronger capital flows coupled with limited investment opportunities are likely to see core market yields continue to tighten; albeit marginally.

Definitions:
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 with 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).

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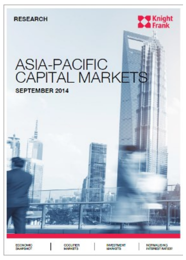

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