RESEARCH

Knight Frank

MELBOURNE INDUSTRIAL

MARKET OVERVIEW JUNE 2015

HIGHLIGHTS

New supply in 2015 is projected to be 32% higher than last year, and its highest level since 2008. New development is forecast to be underpinned by record levels of supply in the Northern region.

Pre-lease activity continues to gather momentum, with 40% of total pre-lease commitments over the past three years coming from the transport and logistics sector.

Industrial investment was focused in the Western region which accounted for 45% of total sales. The depreciation of the Australian dollar has also led to an increase in offshore-based investment.

KEY FINDINGS

New supply is forecast to total 612,109m² over 2015 driven by increased pre-lease and owner-occupier activity.

Victoria's strong population growth continues to boost tenant demand from **logistics and retail** based occupiers.

Prime and secondary industrial rental levels continue to diverge as tenants seek to upgrade their facilities.

The number of **sale and leaseback transactions** have increased driven by the strong levels of investment demand.

MONICA MONDKAR

Analyst, Research & Consulting

INDUSTRIAL OVERVIEW

Boosted by the impending opening of the Melbourne fruit and vegetable market, the bulk of the pipeline of Melbourne's new supply is forecast to be within the Northern region setting a new record high in 2015.

Vacancy Snapshot

In the three months to April 2015, industrial vacancy (5,000m²+) increased by 13,088m² to reach 903,724m², spread across 82 properties. Although vacancy across the Melbourne industrial market continued to grow, the increase is progressing at a slower rate. Melbourne's industrial vacancy increased by 1.5% over the past quarter, compared to the quarterly growth of 17.3% recorded a year ago.

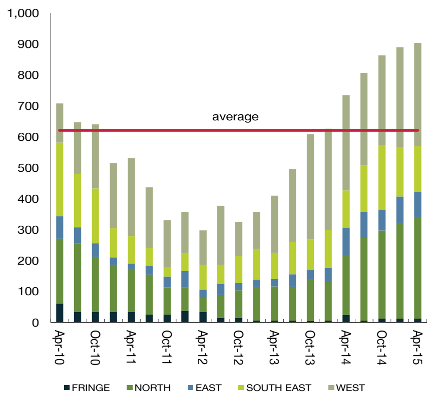
Melbourne's industrial vacancy was dominated by secondary stock and was 9% higher than the previous quarter to reach 488,211m². The level of secondary space has reached its highest level since January 2010. In contrast, prime stock actually fell by 6% over the past quarter, declining to 415,513m², its first decrease since January 2014.

Melbourne's South East and East regions both recorded falls of 6% in their available space. In comparison, available space in the North climbed by 6% and the vacancy in the West rose by 3%. Melbourne's industrial vacancy remains dominated by the West with 40% of the total available space located within the precinct; whereas, the City Fringe region remained the tightest region of the Melbourne industrial market.

FIGURE 1

Melbourne Industrial Market

Available space by region ('000m²)



Source: Knight Frank

Melbourne's industrial vacancy continues to be dominated by existing buildings, which totals 791,583m². In contrast speculative development now under construction totals 20,409m², 60% below its historical average and accounts for only 2.3% of the total vacancy.

TABLE 1

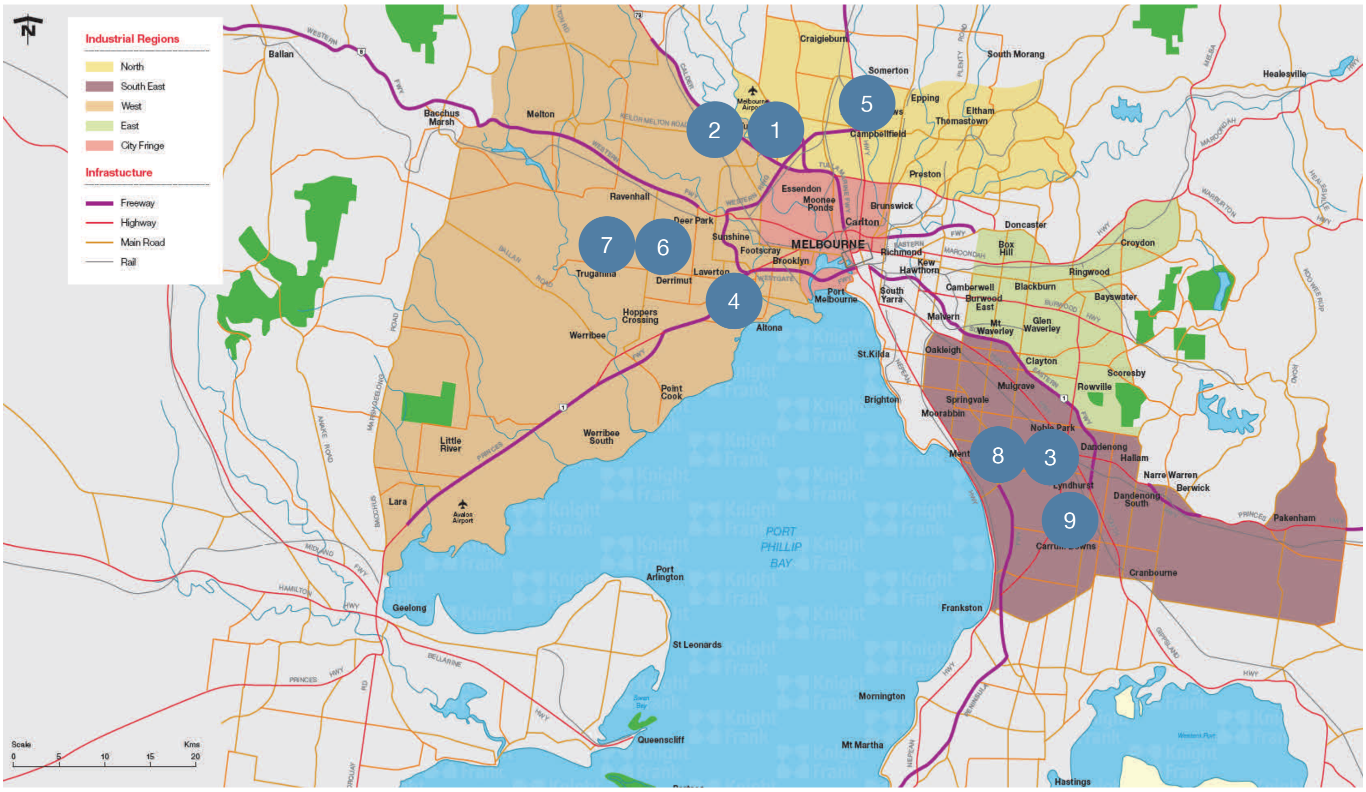
Melbourne Industrial Market Indicators as at April 2015

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields (%)		Avg Land Values 2,000—5,000m²		Avg Land Values 1—5 ha	
	$/m² net	(%p.a)	$/m² net	(%p.a)	Prime	Secondary	$/m²	(%p.a)	$/m²	(%p.a)
City Fringe	125	-3.8	80	—	7.00—7.50	7.75—9.00	1,000	25.0	850	6.3
North	75	—	60	—	7.75—8.50	8.50—9.50	230	—	190	-5.0
East	85	—	63	-3.1	7.75—8.25	9.00—10.00	300	—	230	—
South East	85	6.3	60	-4.8	7.00—7.75	8.75—9.75	250	16.3	180	—
West	75	—	65	—	7.25—7.75	8.50—9.50	175	—	124	—
Melbourne Average*	**80**	**1.6**	**62**	**-2.0**	**7.25—8.25**	**8.50—9.75**	**239**	**3.9**	**181**	**2.4**

Source: Knight Frank

*Excludes City Fringe

INDUSTRIAL PRECINCTS



MAJOR INDUSTRIAL SUPPLY

2015 Major Supply

1. 41-53 Skye Rd, Tullamarine— 38,000m^2 Pre-lease *TNT Freight*
2. 25 Skye Rd, Tullamarine— 71,000m^2 Pre-lease *Toll Transport*
3. Lot 51 Atlantic Drv, Keysborough— 15,000m^2 Pre-lease *Miele Australia*
4. 18-34 Aylesbury Drv, Altona— 12,370m^2 Speculative *Godfreys*
5. Alliance Business Pk, Epping— 36,000m^2 Turnkey *Mainfreight Logistics*
6. 71 Foundation Rd, Truganina— 25,000m^2 Pre-lease *Woolworths*
7. 612-680 Dohertys Rd, Truganina— 21,000m^2 Turnkey *Country Road*
8. Lower Dandenong Rd— 13,300m^2 Turnkey *McCormick Foods*
9. 945 Taylors Rd, Dandenong South— 12,000m^2 Turnkey *Genfac*

Tenants in Italics

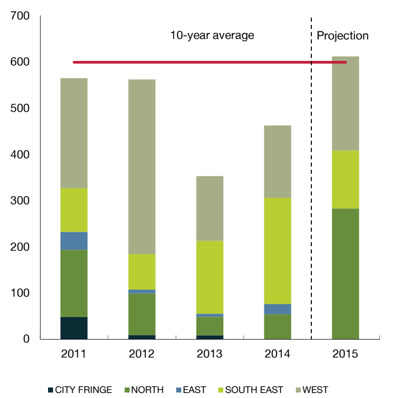
Gross supply (>5,000m^2) in Melbourne's industrial market has continued to increase since 2013, and is forecast to reach 612,109m^2 in 2015, 32% above 2014 levels.

In 2014, gross supply levels were boosted by a number of major completions in the South Eastern region. New supply in the South East reached an all-time annual high in 2014 and accounted for 50% of the total supply. Major completions included Bunnings' new 43,150m^2 distribution centre in Lyndhurst.

New industrial supply scheduled for completion in 2015 is 2.5% higher than the 10-year average and its highest annual level since 2008.

Total forecast supply for 2015 is driven by increased levels of construction of purpose built facilities which are expected to total 415,311m^2, up from 241,624m^2 recorded in 2014. In addition, speculative construction is forecast to account for 32% of new supply, down from the 48% share recorded last year.

FIGURE 2
Melbourne Industrial Gross Supply
By region ('000m^2, >5,000m^2)



Source: Knight Frank

DEVELOPMENT & LAND VALUES

In 2015, the bulk of the new supply is located in the North, accounting for 46% of the total new supply, up from 13% in 2014. New supply in the North is forecast to total 286,000m^2, surpassing previous record highs achieved in 2008. In fact, new supply in the Northern region will surpass both the Western and South Eastern regions for the first time ever. New supply in the North has been boosted by a number of major purpose built facilities concentrated in the Airport region and Epping precincts. In addition to the completion of the Melbourne Markets (76,070m^2), Mainfreight Logistics' 36,000m^2 warehouse is scheduled for completion in 2015 in MAB's Alliance Business Park. In the Melbourne Airport Business Park at Tullamarine, major pre-lease facilities forecast to be completed this year include Toll Transport (71,000m^2) and TNT Freight (38,000m^2).

Elsewhere, across the industrial regions of Melbourne, new supply in the West in 2015 is forecast to increase to 202,886m^2, its highest level since 2012. In contrast, constrained by the continued demand for residential development, gentrification within the Eastern and City Fringe industrial regions has limited industrial development with no industrial facilities in excess of 5,000m^2 forecast to be constructed in those regions in 2015. Looking forward, Victoria's high population growth continues to boost tenant demand from the housing, retail and food sectors. Paint maker Dulux has recently announced that it will establish a $165 million paint manufacturing facility opening in 2017 at MAB's Merrifield Business Park in Melbourne's Northern region. In addition, fruit & vegetable wholesaler Rainfresh has committed to Alliance Business Park in Epping and Woolworths has revealed plans to build a $350 million grocery distribution centre in the South Eastern region. Outdoor clothing retailer Kathmandu has also pre-committed to a 25,650m^2 warehouse at the DEXUS Industrial Estate at Laverton North, with construction commencing in mid-2015 and completion expected in mid-2016.

D&C Activity

Despite the increased levels of speculative development and owner occupier transactions, pre-lease activity is also active. Pre-lease commitments totalled 189,822m^2 in 2014 with already 174,150m^2 announced in 2015, already above the 10-year average. Pre-lease activity remains underpinned by the transport and logistics sector who have accounted for 40% of total pre-lease commitments over the past three years.

In addition to the logistics sector, growth in retail spending has contributed to rising occupier demand from both food and non -food based retailers. Recent major retail-based pre-leased facilities users include: Fisher & Paykel (12,600m^2), Woolworths (25,000m^2), Miele (15,000m^2) and eStore (15,800m^2).

Historically low interest rates have also increased demand from owner occupiers seeking design & construct facilities as highlighted by the recent turnkey developments of: Country Road (21,000m^2), Hellman Logistics (10,200m^2), McCormick Foods (13,300m^2).

Land Values

According to the Department of Transport, Planning and Local Infrastructure there are 25,729 hectares of industrially zoned land across metropolitan Melbourne with 7,246 hectares of that being vacant.

Aligned with increasing levels of new supply, take up of land has also started to pick up since 2011. In the year to July 2014, 201 hectares were absorbed.

While there have been limited industrial land transactions in Melbourne over the past two years, activity in 2015 to date has picked up with four major industrial land parcel sales reported. Owner occupiers Mainfreight Logistics and Rainfresh recently purchased sites for future facilities with local developers purchasing the other sites sold this year.

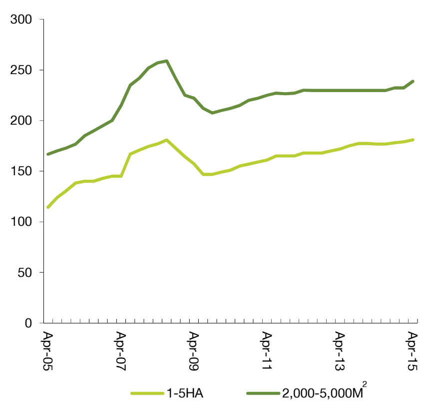
As a result of the Victorian Government's plans to expand the Fishermans Bend urban renewal project, the quantum of inner city industrial zoned land will reduce further. As part of an expanded capital city zone, the proposed Fishermans Bend precinct will increase from 250 to 455 hectares. This diminishing availability of industrial zoned land within the City Fringe has resulted in a significant increase of industrial land values in the precinct.

Excluding the City Fringe, average land values for small sized lots (>5,000m^2) have increased by 4.1% over the 12 months to April 2015 to reach $239/m^2, led by growth in the South East region. Land value growth in the South East has been underpinned by the success of Australand's The Key Industrial Park in Keysborough and the Dandenong LOGIS Estate in Dandenong South.

Supply of larger serviced industrial lots (1-5ha) remains restrained leading to limited transactional activity over the past year with land values recording growth of 2.4%, increasing to $181/m^2.

While the supply of serviced industrial lots continue to steadily decrease, largely driven by owner occupiers and local developers; average land values remain below the peak levels recorded in 2008.

FIGURE 3
Melbourne Industrial Land Values
Average value serviced lots by size ($/m²)



Source: Knight Frank

OCCUPIER DEMAND & RENTS

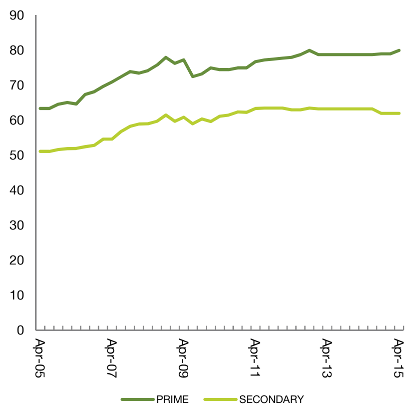
Absorption (excluding D&C) levels over the first quarter of 2015 totalled 102,199m² across 11 buildings, of which 57% was within prime grade space. Gross take-up levels continue to remain below the historical average, with levels largely been sub-average since October 2011.

Prime space absorption has substantially outpaced secondary space take-up since July 2013, as reflected by the gross absorption of 525,166m² within prime grade buildings compared to 330,811m² in secondary assets over the past eight quarters.

Over the quarter, the Western region was the only precinct that recorded absorption levels above its historical average with 65,372m². Collectively the West and the South East regions accounted for 93% of Melbourne's gross industrial absorption. Take-up within existing stock accounted for 67% of the total absorption over the quarter, reflecting tenants' preferences for immediate accommodation solutions.

Over the 12 months to April 2015, average prime net face Melbourne industrial rents (excluding City Fringe) increased by 1.3%, to reach $80/m², equalling 10-year highs. In contrast however, the increasing vacancy levels in the secondary market, resulted in average secondary rents declining by 1.6% over the year to $62/m².

FIGURE 4
Melbourne Industrial Rents
Net face rent by grade ($/m²)



Source: Knight Frank

TABLE 2
Recent Leasing Activity Melbourne

Address	Region	Net Rent $/m²	Area (m²)	Term (yrs)	Tenant	Date
West Industry Park, Truganina	W	U/D	90,000	10	CEVA Logistics^	Q3-16
West Industry Park, Truganina	W	71	12,400	10	Fisher & Paykel^	Q3-15
22 Efficient Drv, Truganina	W	71	12,505	10	Maxi Trans^	Q2-15
105-115 Paramount Blvd, Derrimut	W	50	15,800	5	eStore Logistics^	Q2-15
47-69 Pound Rd West, Dandenong South	SE	73	10,611	10	Award Brands	Q2-15
2/173-175 Salmon St, Port Melbourne	CF	192	573	3	BBC Digital	Q2-15
Melbourne Airport Business Park, Tullamarine	N	U/D	38,000	15	TNT Freight	P/C
Melbourne Airport Business Park, Tullamarine	N	U/D	71,000	U/D	Toll Transport	P/C
Innovation Park Estate, Dandenong South	SE	U/D	16,000	7	Cyclone Industries^	P/C
Lot 51 Atlantic Drv, Keysborough	SE	85	15,000	7	Miele Australia^	P/C
Orbis Business Pk, Ravenhall	W	60	8,500	10	BTI Logistics^	P/C
9-19 Leakes Rd, Laverton North	W	75	5,305	5	Pro Pac Packaging	Q1-15
DEXUS Industrial Estate, Laverton North	W	c.71	25,650	10	Kathmandu^	P/C
Unit 1, 3 Taras Ave, Altona North	W	75	5,600	U/D	Signorino Tile Gallery#	Q1-15
Westpark Industrial Estate, Truganina	W	75	14,330	7	DB Schenker#	Q1-15
70-86 Atlantic Drv, Keysborough	SE	90	6,761	5	Bluestar Print Group#	Q1-15
Lot 8 Henderson Rd, Rowville	E	90	6,772	5	Eaton industries#	Q1-15
Bldg 1/81-125 Princes Hwy, Dandenong	SE	85	10,860	U/D	Professional Freight Services	Q4-14
8 Saintly Drv, Truganina	W	75	14,055	12	Fastline International#	Q4-14
18-34 Aylesbury Drv, Altona	W	80	12,372	10	Godfreys#	Q4-14

E East, N North, SE South East, W West, CF City Fringe   c Circa   U/D Undisclosed   ^Pre-commitment   #Spec   P/C Practical Completion

Source: Knight Frank

INVESTMENT ACTIVITY & YIELDS

Investment sales activity (above $10 million) in the 12 months to April 2015 within the Melbourne industrial market totalled $776.40 million from 30 properties. While the volume of sales achieved in the 12 months to April 2015 was lower than the preceding 12 months, when $978.5 million was transacted, the decrease represents the lack of prime grade opportunities rather than diminishing investment appetite.

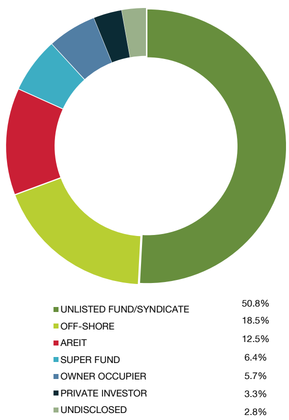
Melbourne industrial investment over the 12 months to April 2015 was led by those located in the Western region which accounted for 45% of all industrial transactions (by value) totalling $350.7 million. The South East industrial region followed , with investment totaling $191.8 million from 10 assets. All regions recorded falls in investment volume in comparison to the previous 12 months with the exception of the South East.

Unlisted funds and syndicates continue to be prominent buyers in the industrial market (similar to other asset classes) accounting for half of the transactions by value, spending $394.7 million. Propertylink ($170.1 million) and Charter Hall ($63.5 million, through its unlisted fund vehicle) were the most active unlisted purchasers. Significant purchases made by unlisted funds in the 12 months to April 2015 included:

FIGURE 5

Melbourne Industrial Sales ($10mil+)

By purchaser type - 12 months to April 2015



Source: Knight Frank

"The decline in investment levels represents the lack of prime grade opportunities rather than diminishing investment appetite."

Warrington Property's purchase of part 81-125 Princes Highway, Dandenong from Cbus Property for $39.25 million and GM Property Group's purchase of 600 Geelong Road, Brooklyn for $19.65 million.

Owner occupier investment increased in comparison to the previous 12 months,

TABLE 3

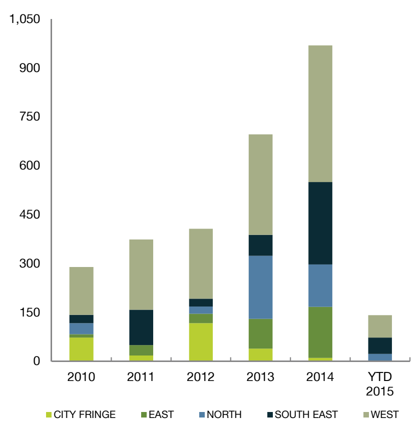
Recent Improved Sales Activity Melbourne

Address	Region	Price $ mil	Bldg Area m²	Initial Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
78-118 Cherry Ln, Laverton North	W	35.50	9,170	c6.00	10.0	U/D	AIMS Property Securities Fund	May-15
1500 Ferntree Gully Rd & 8 Henderson Rd, Knoxfield	SE	36.55#	22,009	7.86	8.4	Brown & Watson International P/L	Growthpoint Properties	May-15
6 Kingston Park Crt, Knoxfield	SE	11.10^	7,645	7.25	7.1	Brown & Watson International P/L	Growthpoint Properties	May-15
600 Geelong Rd, Brooklyn	W	19.65	31,610	9.23	2.0	Marks Henderson	GM Property Group	Apr-15
31-41 National Drv, Lyndhurst	SE	11.10	7,479	N/A	VP	Developer	Owner-Occupier	Mar-15
Part 81-125 Princes Hwy, Dandenong	SE	39.25	86,541	7.90	6.2	Cbus Property	Warrington Property Group	Feb-15
72-76 Cherry Ln, Laverton North	W	29.00#	20,500	7.80	5.0	Toll Transport	Stockland	Feb-15
16-28 Transport Drv, Somerton	N	22.30#	21,279	7.01*	14.0	Linfox (McPhee Distribution)	Cache Logistics Trust	Feb-15
2-10 Interchange Drv, Laverton North	W	20.07	20,634	7.56*	2.4	Goodman Group	Charter Hall	Feb-15
105-115 Paramount Boulevard, Derrimut	W	10.90‡	15,800	7.25	5.0	Paramount Investments Group	Private Investor	Dec-14

VP vacant possession U/D undisclosed *core market yield ^acquired as part of a portfolio ‡under construction & pre-leased #vendor leaseback & part of portfolio

Source: Knight Frank

FIGURE 6
Melbourne Industrial Sales
$million By region $10million+



Source: Knight Frank

particularly for assets below $20 million, capitalising on the historically low interest rate levels. While owner occupier investment levels increased, other occupiers took advantage of the strong investment demand with several sale and leaseback transactions. Major recent sale and leaseback sales included: Brown & Watson's recent sale of 1500 Ferntree Gully Road, Knoxfield for $36.5 million to Growthpoint Properties and Toll Transport's sale of 72-76 Cherry Lane, Laverton North for $29 million to Stockland.

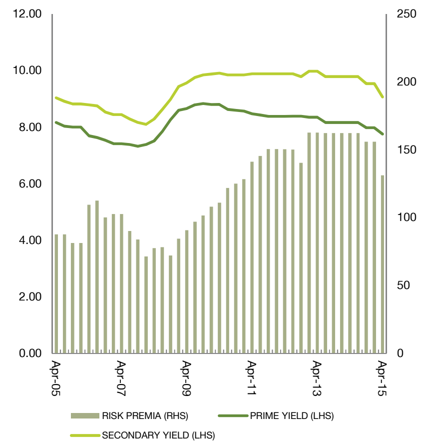
The depreciation of the Australian dollar, further intensified demand from offshore investors who spent $143.3 million in the 12 months to April 2015, up from $10.5 million spent in the previous year. Pramercia/Invesco's purchase of Kmart's distribution centre at 2-12 Banfield Court, Truganina for $94.1 million was the most notable offshore deal in the past year.

The significant weight of capital (both domestic and foreign) seeking Melbourne industrial investments has also led to several portfolio transactions providing investors immediate scale into the Australian industrial market. Over the 12 months to April 2015, Melbourne-based assets sold as part of both State and National portfolio sales totalled $203.4 million, accounting for 26% of total volume transacted over the period. Examples of Melbourne-based properties as part of portfolio sales included:

Stockland's purchase of 72-76 Cherry Lane, Laverton North ($29.0 million) as part of a $66.5 million portfolio acquisition and Cache Logistics' purchase of 16-28 Transport Drive, Somerton ($22.3 million) as part of a $70 million three-property investment.

Over the year to April 2015, average prime industrial yields compressed by 41 basis points to 7.75% and ranged between 7.25% and 8.25%. Average prime yields now stand 59 basis points lower than the historical 15-year average of 8.34% but are still some way off the benchmark yield lows of 2008. The yield spread between asset grades continues to narrow with average secondary yields compressing by 72 basis points to 9.06% and now range between 8.50% and 9.75%.

FIGURE 7
Melb Industrial Yields & Risk Spread
% Core market yield & prime vs secondary spread (bps)



Source: Knight Frank

Outlook

- While still challenging, the falling Australian dollar and interest rates should boost the Victorian state economic activity. Lower interest rates should also continue to stimulate the retail and housing construction sectors which have underpinned much of the demand for industrial space in recent years.
- After six years of below average levels of new supply, the pipeline of gross industrial supply in 2015 is forecast to be the highest annual total since 2008. Despite the relatively high levels of available speculative stock, pre-lease activity is also gaining momentum driven by the logistics sector.
- While the level of speculative development appears to be easing, backfill space due to tenants relocating to purpose-built facilities is likely to result in further vacancy rises. Secondary grade space in particular is expected to experience longer letting up periods.
- Increasing pre-lease and owner occupier activity should maintain growth in land values, albeit modest as tenants gain confidence to increase business investment levels. Mooted major infrastructure projects in the Western and South East industrial regions could also stimulate developer interest.
- As a result of the increased D&C construction levels, and subsequent backfill vacancies, average prime Melbourne industrial rents are forecast to remain steady. In contrast, rental levels within secondary assets will remain under pressure as tenants capitalise on increased incentive levels to upgrade their accommodation requirements.
- Supported by the increasing depth of purchasers, yield compression is expected to continue, particularly for core assets with extended WALE profiles, despite average yields approaching GFC lows and the recent increases in long term bond rates.

RESEARCH & CONSULTING
Monica Mondkar
Analyst, Victoria
+61 3 9604 4608
Monica.mondkar@au.knightfrank.com

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

Matt Whitby
Group Director
Head of Research & Consulting
+61 2 9036 6616
Matt.whitby@au.knightfrank.com

VICTORIA
James Templeton
Managing Director, Victoria
+61 3 9604 4724
James.templeton@au.knightfrank.com

INDUSTRIAL
Gab Pascuzzi
Senior Director, Head of Division
+61 3 9604 4649
Gab.pascuzzi@au.knightfrank.com

Matt Crofts
Director—Industrial
+61 3 9604 7468
Matt.crofts@au.knightfrank.com

Ben Hackworthy
Director, Business Space
+61 3 9604 4731
Ben.hackworthy@au.knightfrank.com

Adrian Garvey
Director In Charge
Eastern Office Industrial
+61 3 8545 8616
Adrian.garvey@au.knightfrank.com

VALUATIONS & CONSULTANCY
Joe Perillo
Joint Managing Director—Victoria
+61 3 9604 4617
Jperillo@vic.knightfrankval.com.au

Definitions:
Core Market Yield: The percentage return/yield analysed when the assessed fully leased net market income is divided by the adopted value/price which has been adjusted to account for property specific issues (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc).
Prime Grade: Asset with modern design, good condition & utility with an office component 10-30%. Located in an established industrial precinct with good access.
Secondary Grade: Asset with an older design, in reasonable/poor condition, inferior to prime stock, with an office component between 10-20%.
Vacancy Methodology:
This analysis collects and tabulates data detailing vacancies (5,000m²+) within industrial properties across all of the Melbourne Industrial Property Market. The buildings are categorised into 1) Existing Buildings – existing buildings for lease. 2) Speculative Buildings – buildings for lease which have been speculatively constructed and although having reached practical completion, still remain vacant. 3) Spec. Under Construction – buildings for lease which are being speculatively constructed and will be available for occupation within 12 months.

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Sydney Industrial
Market Overview
May 2015

Brisbane Industrial
Market Overview
May 2015

Melbourne Industrial
Top Sales
Transactions 2014

Chinese Real Estate
Investment Globally
and into Australia

Knight Frank Research Reports are available at **KnightFrank.com.au/Research**

Knight Frank
Newmark Knight Frank Global