RESEARCH

MELBOURNE

INDUSTRIAL MARKET BRIEF NOVEMBER 2016

Key Facts

Annual supply volumes have eased in 2016, despite above average levels of pre-lease commitments

Total available industrial stock increased by 3% over the past quarter to 1,092,623m^2

Prime rents remained stable at $78/$m^2$ while secondary rents increased by 1.6%

Industrial sales in 2016 to date total $666.9 million, 32% ahead of the long term average

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Despite above average levels of occupier pre-lease commitments, Melbourne's industrial completions are expected to be 24% lower than in 2015 as the speculative market remains subdued.

The Victorian economy continues to strengthen, underpinned by robust population growth combined with above average retail expenditure, strong growth in housing investment and an increase in employment levels over the past 12 months.

These factors have supported positive leasing conditions across Melbourne, with gross take-up measuring 159,139m^2 in Q3 2016, 15.7% ahead of the long term average and the highest quarterly total since Q4 2014.

Nevertheless, vacant stock reached a new series high at October 2016, underpinned by an increase in prime grade backfill options within existing stock as tenants upgraded and consolidated from multiple sites into new facilities (typically purpose built).

Despite a number of developers recently commencing speculative developments, speculative activity remains subdued and will only account for 22% of total new industrial supply delivered to Melbourne in 2016, compared with 32% in 2015.

Occupier Demand & Rents

Despite higher than average leasing activity, vacant stock levels in Melbourne rose over the past quarter, increasing by 31,961m^2 or 3.0% to reach a new series high. Total vacancy now measures 1,092,623m^2 across 95 buildings (+5,000m^2), 61% above its long term average.

Vacant stock levels continue to vary across the precincts. For the third consecutive quarter, available space in the West increased, reaching 453,148m^2. Prime space accounted for 68% of vacant stock in the West as at the third quarter, with 308,769m^2 available. Nevertheless, with no speculative construction activity in the West region, coupled with approximately 70,000m^2 of available space currently under offer, vacant stock levels are anticipated to decline in the in the short term.

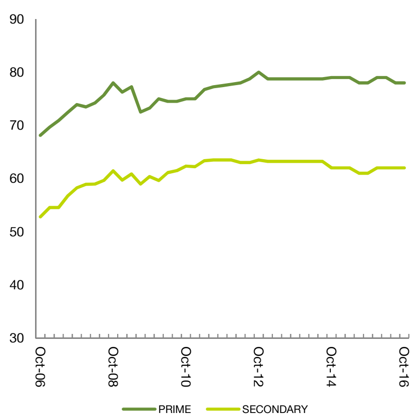
In the three months to October 2016, prime vacancy levels decreased by 2.2% with leasing activity offsetting new supply additions. Prime vacant stock currently totals 537,573m^2 and accounts for 49% of all vacancies across Melbourne. In contrast, secondary space increased 8.6% in the three months to October 2016, underpinned by the addition of nine backfill options totalling 111,715m^2.

Above average levels of take-up were recorded in the secondary market in the third quarter, with 100,080m^2 absorbed across nine buildings. Prime space only accounted for 37% of take-up in Q3 2016, of which 22,789m^2 was within speculative space. The West accounted for 51% of total take-up. Calendar year to date take-up of 399,678m^2 was recorded, 8.5% ahead of the equivalent period last year.

FIGURE 1

Melbourne Industrial Rents

Prime Vs Secondary Net Face Rents ($/m^2)



Source: Knight Frank Research

As a result of increased backfill vacancies, average prime net face rents remained at $78/m^2 in the 12 months to October 2016. Secondary rental levels increased by 1.6% to sit at $62/m^2.

Development & Land Values

Following above average levels of gross new industrial supply in 2015, Melbourne's industrial development activity has slowed in 2016. Gross new industrial supply (>5,000m^2) is expected to total 448,321m^2 in 2016, 24% below levels recorded in 2015. Looking forward to 2017, with 174,494m^2 already under construction including Ego Pharmaceuticals and Target's pre-committed facilities, supply levels are anticipated to be above the long term average.

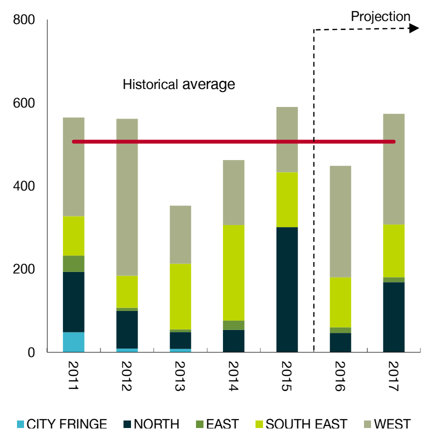
Driving the pipeline in 2016 has been the buoyant pre-commitment market led by seven commitments in excess of 10,000m^2. Pre-lease commitments in 2016 total 214,034m^2, 36% ahead of the 10-year average which include CEVA Logistics (90,000m^2), The Reject Shop (37,700m^2) and Kathmandu (25,650m^2).

In addition, a number of developers have recently commenced speculative developments. A total of 27,619m^2 of speculative stock across four developments is currently under construction. Nevertheless, speculative construction levels remain 36% below the long term average and are forecast to account for only 22% of total new supply delivered to Melbourne in 2016, down from the 32% proportion achieved in 2015 and its peak of 48% in 2014.

FIGURE 2

Melbourne Industrial Supply

'000m^2 annual gross supply



Source: Knight Frank Research

Total supply in 2016 will largely be completed within the Western and South Eastern industrial regions which together account for 87% of the industrial pipeline this year.

While there have been limited industrial land transactions in Melbourne over the past two years, average land values (excluding City Fringe) have increased over the past 12 months. For small sized lots (<5,000m^2) average land values increased by 2.1% over the 12 months to October 2016 to $243/m^2. Values continued to grow in the West, increasing by 20% over the past 12 months underpinned by diminishing available industrial land. In contrast, values for small sized lots eased in the Northern region. Similar trends were recorded for larger serviced industrial lots (1-5ha) with growth recorded in the West and South East while land values fell in the North.

TABLE 1

Melbourne Industrial Market Indicators as at October 2016

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	120	-4.0	75	-6.3	6.00—6.75	6.50—7.00	1,500	50~	-	-
North	75	-	60	5.3	7.00—7.50	8.25—9.00	220	-4.3	164	-13.7
East	80	-3.6	63	-	6.75—7.50	8.25—9.25	300	-	230	-
South East	83	3.8	60	-	6.50—7.25	8.00—9.00	255	-	195	5.4
West	76	1.3	65	-	6.50—7.25	8.00—9.00	198	20	145	12.4
Melbourne Average*	**78**	-	**62**	**1.6%**	**6.55—7.25**	**7.80—8.65**	**243**	**2.1**	**184**	-

Source: Knight Frank Research ~skewed by Fishermans Bend impact *Excludes City Fringe

Sales & Investment Activity

Investment sales activity (>$10 million) in the 10 months to October 2016 totalled $666.9 million across 21 transactions. Notwithstanding strong investor demand, a lack of available stock saw the volume of sales achieved in the year to date 28% below the equivalent period in 2015. The largest transaction to date is the Victorian State Government's acquisition of the GM Holden Site at 241 Salmon Street in Port Melbourne for approximately $130 million.

For the first time since 2010, developers were the most active purchasers, spending $193 million across seven transactions accounting for 29% of total transaction volumes in the 10 months to October 2016. Increasingly, a number of assets have recently been traded to residential developers in 2016, including: 79 Ireland Street, West Melbourne ($24 million) 14-22 Gaffney Street, Coburg South ($35 million) and 11-19 Whitehall Street, Footscray ($22 million).

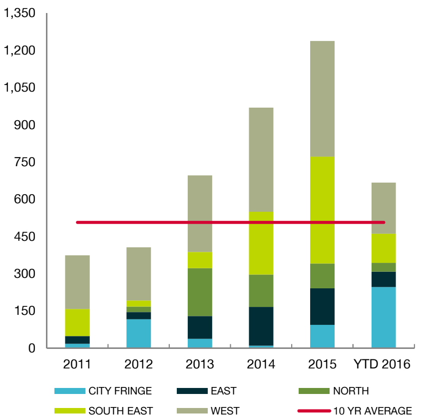
There has also been an increasing level of investment from offshore groups in 2016 with volumes totalling $144 million across five transactions, accounting for 21.6% of all industrial transactions. This compares with just one investment transaction totalling $22 million in 2015.

The Western region led sales activity, accounting for 30% of all industrial transactions (by value) totalling $206 million in the year to date. The City Fringe region followed, with transactions totalling $246 million across five assets. Prime yields compressed by 29 basis points in the year to October 2016 to 6.90% and now range between 6.55% and 7.25%. Average prime yields now stand 136 basis points lower than the historical average of 8.26%. Limited prime assets offered for sale in comparison to the capital chasing investments has led to a rise in demand for secondary properties. Secondary yields compressed by 56 basis points in the 12 months to October 2016 to range between 7.80% and 8.65%.

FIGURE 3

Melbourne Industrial Sales

($m) industrial sales $10million+

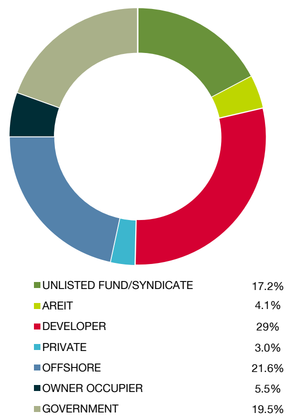


Source: Knight Frank Research

FIGURE 4

Melbourne Industrial Sales

By purchaser type $10million+ 2016YTD



Source: Knight Frank Research

TABLE 2

Recent Leasing Activity Melbourne

Address	Region	Net Rent $/m²	Area m²	Term (yrs)	Tenant	Date
71-93 Whiteside Road, Clayton South	E	71	28,195	15	Walkinshaw Automotive Group	Q3-17
Drystone Industrial Estate, Laverton North	W	U/D	63,000	10	Target ^	Q2-17
33-47 Dohertys Road, Laverton North	W	65	27,656	7	Rural Carrying Co.	Q3-16
41-55 Monash Drive, Dandenong South	SE	76	15,585	5	Yusen Logistics Pty Ltd	Q3-16
Store E, 437—461 Plummer Street, Port Melbourne	CF	80	8,288	5+5	The Creature Technology Company	Q3-16

TABLE 3

Recent Improved Sales Activity Melbourne

Address	Region	Price $ mil	Bldg Area m²	Core market Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
333 Frankston Dandenong Road, Dandenong South	SE	15.10	20,886	8.16	1.8	C. McEvoy Nominees	Undisclosed	Q3-16
241 Salmon Street, Port Melbourne	CF	c.130	200,931	N/A	N/A	GM Holden	Victorian State Government	Q3-16
31-49 Browns Road, Clayton	E	51.50	31,875	4.06	6.1	Abacus Property	Bewise	Q3-16
26-38 Harcourt Road, Altona	W	27.60	32,700	8.07	0.3	Australia Post	Mirvac	Q2-16
28 Salta Drive, Altona North	W	36.00	23,818	6.85	12.0	F. Mayer Imports	Lend Lease (APPF Industrial)	Q1-16

E East, N North, W West, CF City Fringe SE South East ^Pre-commitment

Source: Knight Frank Research

Outlook

The recent low interest rates, combined with improved business confidence levels, should continue to support retail spending and housing construction levels, maintaining solid tenant demand for industrial space over the medium term.

Nevertheless, some upward pressure on vacancy levels is anticipated over the medium term, underpinned by a combination of elevated backfill vacancy and additional properties likely to come on line from early 2017 relating to the automotive industry.

Speculative construction levels are anticipated to remain relatively low over the medium term, however total new supply levels are forecast to be above the long term average in 2017, with 174,494m² already under construction and scheduled to complete in 2017.

New industrial supply in the West is anticipated to further strengthen following the recently announced public-private partnership to invest $1.8 billion in improving nearly 700 kilometres of arterial routes throughout the Western suburban region. Construction is expected to commence in 2017 and due to be completed in 2022.

Domestic investors will continue to face strong competition from offshore groups actively seeking opportunities to grow their presence in the Australian industrial market. Stronger investment appetite coupled with limited properties offered for sale are likely to see core market yields remain firm, notwithstanding a recent spike in bond yields.

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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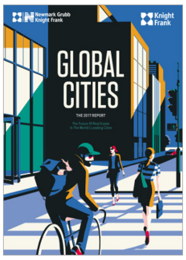

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