RESEARCH

NOVEMBER 2011

MELBOURNE INDUSTRIAL

Market Overview

Knight Frank

HIGHLIGHTS

- Total industrial vacancy in Melbourne continues to decline as limited supply is added to the market. As at October 2011, total available space above 5,000m² was 350,493m² within just 38 buildings.
- Despite a tempered level of absorption over Q3 2011 (118,661m²) total take up year to date 2011 (552,146m²) suggests the Melbourne industrial market remains relatively robust. Of the six largest speculatively constructed buildings in 2011, all but two were leased prior to completion.
- The total value of industrial sales across all major regions in the year to October 2011 was $545.23 million. Despite demand for high quality assets, investment opportunities remain limited.

INDUSTRIAL OVERVIEW

Table 1
Melbourne Industrial Market Indicators October 2011

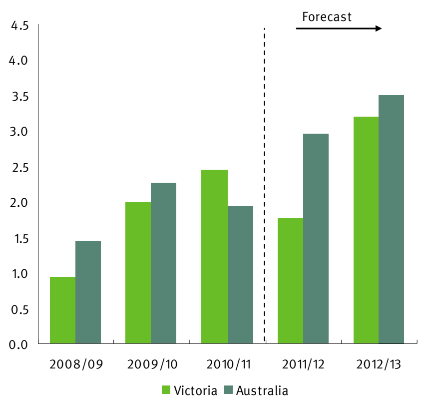
Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields		Avg Land Value <5,000m²		Avg Land Value 1 – 5 ha	
	$/m² net	(% p.a)	$/m² net	(% p.a)	Prime	Secondary	$/m²	(% p.a)	$/m²	(% p.a)
City Fringe	130	4.0	80	-3.5	7.50 – 8.25	8.50 – 9.75	700	16.7	600	10.0
West	72	1.4	65	0.0	8.00 – 8.75	9.00 – 11.00	168	1.8	138	-1.4
North	74	2.8	59	1.7	8.00 – 8.75	9.00 – 11.00	230	0.0	200	1.0
East	85	3.7	65	0.0	8.00 – 8.75	9.00 – 11.00	300	0.0	250	0.0
South East	78	4.0	65	4.8	8.00 – 8.75	9.00 – 11.00	230	0.0	190	2.7
Melbourne Average*	**77**	**3.0**	**64**	**1.6**	**8.00 – 8.75**	**9.00 – 11.00**	**232**	**0.3**	**195**	**0.7**

Source: Knight Frank Note: Rents are assessed on all sites between 3,000 – 5,000m² * 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 (i.e. rental reversions, rental downtime for imminent expiries, capital expenditure, current vacancies, incentives, etc)

Economic Snapshot

After several periods of outperformance in key economic drivers, growth in Victoria is starting to soften and fall broadly in line with the rest of the nation. Victorian Gross State Product (GSP) over the 2010/2011 financial year was 2.4%. Delloitte Access Economics has forecast this to drop back to 1.8% over the current financial year as global economic volatility dampens consumer confidence

Figure 1
Economic Growth
Australia GDP and Victoria GSP % pa growth

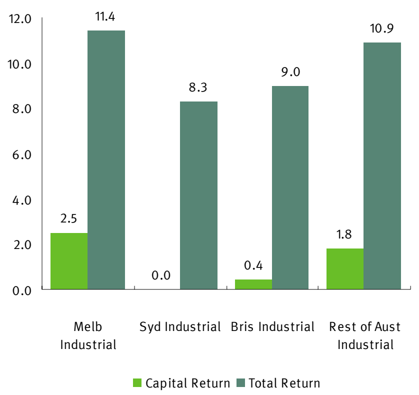


Source: Deloitte Access Economics

and the continued strength of the $AUD impacts the state's manufacturing industry. A strong indication of this contraction is in the state's industrial production in the 10/11 financial year (0.4%). Despite the current challenges facing the Victorian economy, there remain some positive indicators for the local industrial market. The strength of the $AUD is driving increased demand for imports and hence higher container volumes through the Port of Melbourne. It is also allowing retailers, who are anticipating improved operating conditions as confidence returns on the back of expected interest rate cuts, greater buying capacity when placing forward inventory orders. This will undoubtedly lead to sustained demand for warehousing.

A STRONG $AUD IS DRIVING GREATER IMPORTS VIA THE PORT OF MELBOURNE

Figure 2
Investment Performance Index
Industrial Property by Location (Year to Jun-11)



Source: IPD

Despite a period of softening growth in the state economy, Victoria has provided investors with solid returns. As illustrated in Figure 2, the IPD rolling annual average total industrial returns to June 2011 (11.4%), suggest there has been some upside investment potential present to the astute buyer. This result highlights the Victorian industrial markets outperformance when compared to the rest of the country over the past year.

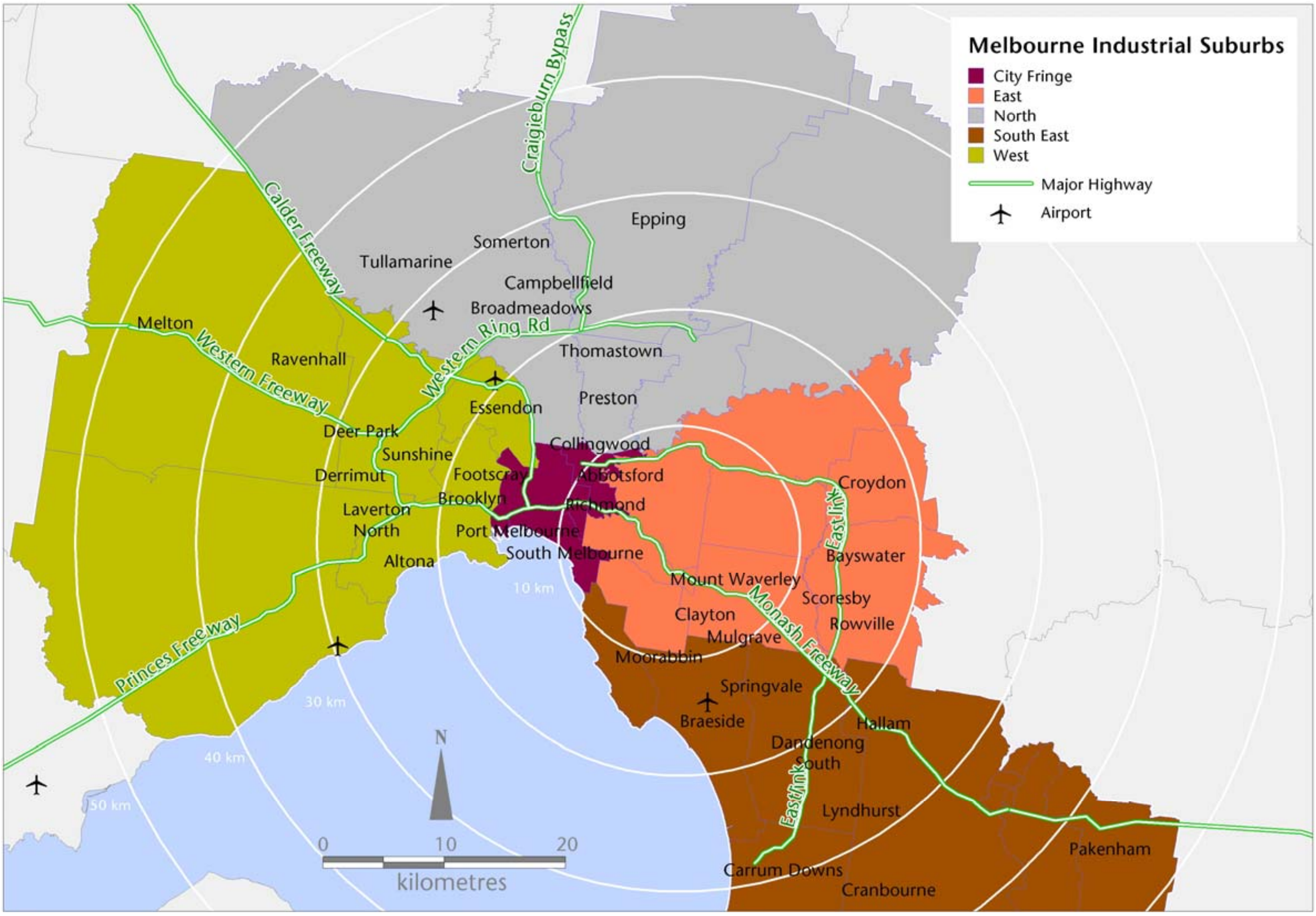
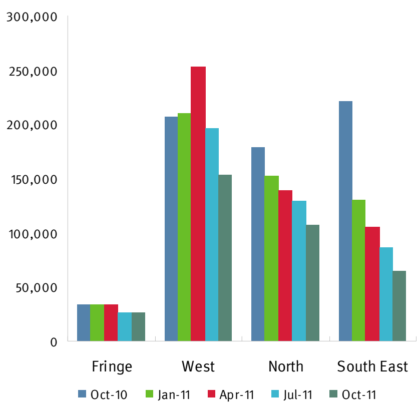


Figure 3

Melbourne Region Available space

(m²) Vacancy › 5,000m² as at October 2011



Source: Knight Frank

Industrial Vacancy

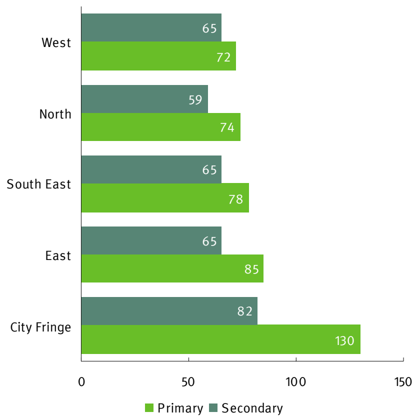
Knight Frank's quarterly vacancy survey has recorded its second consecutive decline in vacant industrial accommodation. All regions monitored experienced a drop as take-up continues to outstrip supply. Approximately 350,493m² (38 Buildings) of industrial floor space over 5,000m² was vacant at October 2011. This result compares to 640,693m² available at the same period in 2010, reflecting a 45% reduction in space available to lease. Over the six months to October 2011, vacancy in existing stock dropped by 124,487m², while continued demand for modern facilities meant vacancy in speculative buildings under construction declined by 48,151m² over the same period. The reduction in available stock was experienced across both grades as demand for prime space remained consistent and owners of secondary space sought to aggressively move stock by being willing to accept short term income.

Across the regions, the fringe remains the tightest market with just 25,936m² of space available above 5,000m². The South East has experienced the greatest decline year on year dropping from 224,540m² to 64,100m².

TENANT DEMAND & RENTS

Despite a tempered level of absorption over Q3 2011 (118,661m²), total take up year to date 2011 (552,146m²) suggests the Melbourne industrial market remains relatively robust. Following significant pre-lease agreements in late 2010 and early 2011 to companies such as Coles (68,000m²) and Pacific Brands (40,000m²), the level of pre-lease activity has slowed in the second half of the year. With only a limited number of active requirements left in the market, the absorption of speculatively developed space has been most prevalent, particularly for tenants seeking prime space 10,000m² - 20,000m². The recent major speculative developments, largely in the West and South East, have been well received with four out of six leased prior to completion.

Figure 4
Melbourne Region Industrial Rents
$/m² net market rent by precinct – Oct 2011



Source: Knight Frank

Average prime net rental levels across the Melbourne industrial market grew by 3.0% in the year to October 2011. Limited new supply also led to a marginal increase in secondary rents, rising 1.6% over the same period. Prime rent growth in the South East (4.0% p.a.) has been underpinned by a lack of available space. The Northern region, which has long had muted rental growth, is now showing signs of recovery as an improved level of demand is derived from fringe tenants seeking more affordable rents in a region that has access to major transport links. The West region, which holds the greatest level of available space, remained relatively flat. Soft enquiry from Fringe tenants pushed owners to drop rents for secondary space; hence -3.5% was recorded (year to Oct 11).

Table 2
Industrial Leasing Transactions Melbourne Industrial Market

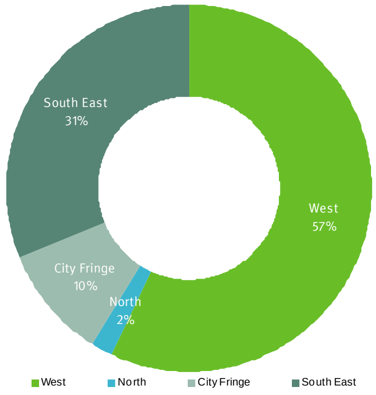
Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Date
73-75 Licola Crescent, Dandenong	South East	62.0	3,848	7	Pavex Davco	Q4-11
28-32 Ventura Place, Dandenong	South East	85.0	1,000	3	Newell Australia Pty Ltd	Q4-11
Unit 1, 365 Plummer Street	City Fringe	115.0	2,178	4	Liquor Logistics	Q4-11
23-29 Westgate Drive, Altona North ^	West	74.5	6,837	2	Toyota	Q3-11
Doherty's Road, Truganina *	West	74.0	68,000	20	Coles	Q3-11
WH B Atlantic Drive, Keysborough #	South East	82.0	10,395	10	Tyres 4 U	Q3-11
47 Jessica Road, Campbellfield	North	67.0	2,323	5	Sprint Gas Australia	Q3-11
WH A Atlantic Drive, Keysborough #	South East	80.0	15,800	10	Early Settler	Q3-11
12-14 Tradepark Drive, Tullamarine	North	71.0	8,000	5	CT Freight	Q3-11
350-352 Boundary Road, Dingley	South East	69.0	3,100	5	Innovatec (Directbuy.com.au)	Q3-11
Unit 2, 365 Plummer Street, Port Melbourne	City Fringe	139.0	1,010	3	Piling Systems	Q2-11
90 Mills Road, Braeside	South East	65.0	31,745	10	Simon National Carriers	Q2-11
65 Lathams Road, Carrum Downs	South East	60.0	9,640	10	Monopumps	Q2-11
WH1, Sunline Drive, Truganina #	West	72.5	11,993	7	Freight Specialists	Q2-11
WH2, Sunline Drive, Truganina #	West	74.5	14,132	10	Tasman Logistics	Q2-11
7-15 Foundation Road, Truganina *	West	76.0	6,534	10	Loscam	Q2-11
33 Dohertys Road, Laverton North	West	60.0	32,600	Undisc	Wettenhalls	Q2-11
Wyndham Industrial Estate, Laverton North *	West	61.0	40,000	Undisc	Pacific Brands	Q1-11
101 Makland Drive, Laverton North *	West	71.0	12,600	Undisc	Stora Enso	Q1-11
65 Strezlecki Avenue, Sunshine ^	West	68.0	23,286	6	Northline	Q1-11

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

DEVELOPMENT & LAND VALUES

Upon completion of new buildings under construction, the total new supply across the major Melbourne industrial regions is forecast to be 323,989m² in 2011. Development in the Melbourne industrial market continues to be driven by a combination of pre-lease deals and some speculative development. Major land owners have been varied in their approach to delivering new supply to the market. Large private developers continue to be risk adverse, choosing to adopt a long term view by securing an extended lease term through a pre-commitment. Economic volatility and financial lending constraints have contributed to forming this sentiment.

Figure 5
Melbourne Industrial Region Supply
% of total supply expected over 2011

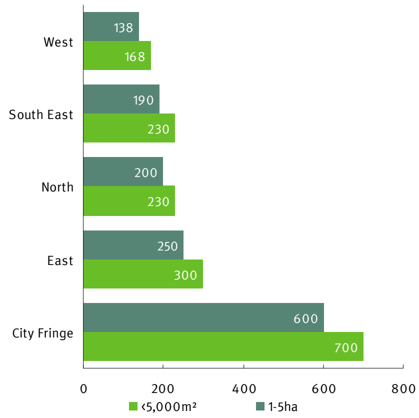


Source: Knight Frank

Other developers such as Australand (The Key, Keysborough) and DEXUS (DEXUS Industrial Estate, Laverton North) proceeded with a number of speculative developments and managed to successfully lease the majority of their stock prior to completion. These developments were supported by strong access to transport links, well serviced amenity and high quality buildings.

With an abundance of industrial land sitting on the books of major land holders, there has been adequate zoned land to meet the demand of developers. Hence land values are yet to experience a significant uplift. The exception to this is in City Fringe where land sub 2,000m² has attracted a premium over the year to October 2011 as land values increased 16.7%. A rise of 2.7% was recorded in the South East for land between 1-5ha over the same period. Lack of well serviced land parcels in the South East has formed a level of pent up demand over 2011 and created upward pressure on land values. This is evidenced by the strong take up of land recently released at Vic Urban's Dandenong Logis Eco-Industrial Park.

Figure 6
Melbourne Region Land Values
$ / m² value of land by precinct & size – Oct 2011



Source: Knight Frank

Table 3
Land / Development Sales Activity Melbourne Region

Address	Region	Price ($ m)	Area (m²)	$/m² of site area	Vendor	Purchaser	Date
18-24 Banfield Court, Truganina	West	1.14	8,136	140	Goodman Group	Owner Occupier	Nov-11
250 Fairburn Road, Sunshine	West	1.47	9,229	160	Salta	Private Investor	Oct-11
275 O'Herns Road, Epping	North	Undisc	622,400	n/a	Private Developer	MAB	Oct-11
2-12 Jessica Way, Truganina	West	1.35	11,608	125	Private Developer	Private Investor	Sep-11
70-74 Lambeck Drive, Tullamarine	North	1.45	6,500	223	Private Developer	Undisclosed	Sep-11
12-62 Cook Street, Port Melbourne	City Fringe	2.03	2,822	709	MAB	Undisclosed	Aug-11
162-163 Radnor Drive, Derrimut	West	4.10	30,250	136	Investa	Private Investor	Jul-11
4 Capital Place, Carrum Downs	South East	1.32	6,455	205	Gardens Pty Ltd	Moama	May-11
Lot 31 Bessemer Road, Dandenong South	South East	1.00	4,006	250	Vic Urban	Private Developer	Apr-11
Lot 30 Bessemer Road, Dandenong South	South East	1.02	4,100	250	Vic Urban	Private Developer	Apr-11

Source: Knight Frank

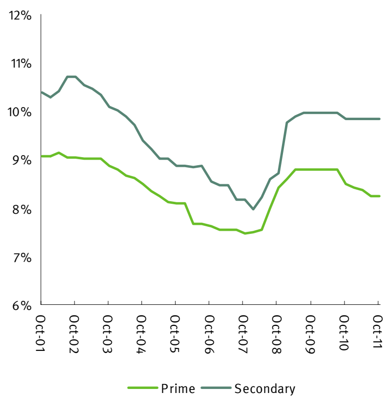
SALES & INVESTMENT YIELDS

The total value of industrial sales across all regions in the year to October 2011 was $545.23 million. Despite demand for high quality assets, investment opportunities remain limited. Owner occupiers and private investors continued to have a dominant presence, particularly in the West and South East. Offshore investor, GIC has shown confidence in the market acquiring a number of prime industrial properties from Vaughan Constructions and Australand. Lend Lease's Industrial fund also secured a prime asset on Ferntree Gully Road in the South East.

Sales analysis (properties › $5 million) across the regions suggests purchasers were most active in the West and South East, where $442.58 million was exchanged on twenty nine properties in the year to October 2011. Both regions remain the focus for investors seeking larger investment assets. The City Fringe recorded four sales totalling $59.90 million. Demand for properties sub $5 million remains strong as owner occupiers and private investors are still seeking warehouse assets within proximity to the Port and CBD. Limited stock has encouraged land owners to carve up sites, leading to increased interest from the owner occupier market. Most building owners are now seeing value in retaining assets; limiting the number of large transactions occurring in the Fringe market. Despite just $42.75 million transacted on three properties in the North, anecdotal evidence suggests there is renewed interest in the region. Tightening vacancy in the North is attracting private developers, while owner occupiers are particularly attracted by the access to major transport links and proximity to the Airport.

Prime core market yields have remained static over the past six months with only a handful of deals at the lower end of the yield range. The current range for prime stock is between 8.00% - 8.75%. Secondary assets which showed a firming bias towards the end of 2010, have also remained steady and range between 9.00% – 11.00%.

Figure 7
Melbourne Industrial Yields
Average Core Market Yield (%)



Source: Knight Frank

Table 4
Sales Activity Melbourne Industrial Market

Address	Region	Price ($ m)	Bld Area (m²)	Core Mkt Yield (%)	Vendor	Purchaser	Date
1464 Ferntree Gully Road, Knoxfield	East	31.50	21,987	8.25	CVC Property Fund	Australian Prime Industrial Fund	Sep-11
6/42 Sabre Drive, Port Melbourne	City Fringe	0.86	318	8.00	Sabre Drive Developments	Private Investor	Sep-11
Lot 14 Permas Way, Truganina	West	35.52	44,262	8.04	Vaughan Constructions	GIC	Jun-11
4-28 Ordish Drive, Dandenong South	South East	33.24	28,181	8.16	Vaughan Constructions	GIC	Jun-11
97-103 Boundary Road. Laverton North	West	6.00	7,020	7.98 *	Australian Unity	Private Investor	Jun-11
Dohertys Road, Truganina	West	69.80	68,000	7.21 *	Berton Investments	Andrew Roberts	Jun-11
44 Raglan Street, Preston	North	9.50	12,840	VP	Undisclosed	Owner Occupier	Jun-11
65 Lathams Road, Carrum Downs	South East	7.60	9,640	8.69	Australian Unity	Private Investor	May-11
162 Australis Drive, Derrimut	West	20.15	23,212	8.85	Australand	GIC	May-11
513 Mt Derrimut Road, Derrimut	West	10.4	12,601	8.75	Thorpe Logistics	Private Investor	Apr-11
7-15 Foundation Road, Truganina	West	11.72	6,534	7.93*	DEXUS Property Group	Private Investor	Mar-11

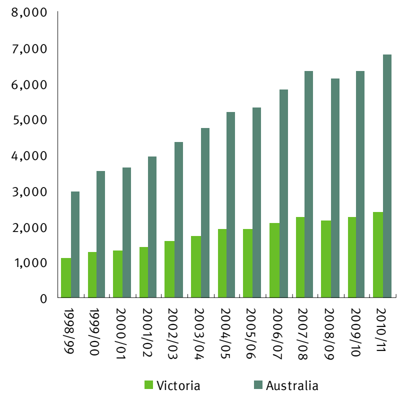
Source: Knight Frank *Passing Yield

OUTLOOK

The potential resolution of Europe's debt woes and an interest rate cut on the back of softening inflation should go a long way to smoothing out some of the volatility witnessed in the domestic economy. A significant risk remains with the ongoing strength of the $AUD and its effect on one of the state's biggest industries, manufacturing. Deloitte Access Economics forecasts a softening in industrial production, which reflects the dollar's negative impact on manufacturing. Nevertheless, Port container movements suggest an underlying strength from imports, partially a result of the burgeoning online retailing movement and greater retailer buying capacity. Melbourne accounts for 35% of the nation's imports and has maintained its status as the country's primary port and logistics hub. Rising imports in concert with a rate cut could spur increased demand for warehousing and assist in countering the negative impact of the $AUD on the state's manufacturing industry.

The medium term supply outlook is likely to be driven by pre-commitments to new prime buildings as most industrial land owners seek large tenants on favourable lease terms.

Figure 8
Victoria vs. Australia Container Trade
(000's) Net Import/Export T.E.U



Source: Ports Australia Trading Stats

With a number of developers experiencing recent success in leasing speculatively constructed buildings in the South East and Western regions, it is anticipated that further speculative development could be on the horizon; albeit limited.

Figure 9
$AUD vs. $USD
2000-2011 Units of $USD per $AUD

Source: RBA

Anecdotally, there has been a rise in the number of development sites being marketed in highly sought after locations in the South East and West. Drystone Estate in the Western region is the most recent example and provides some indication that the smaller developers are finding some confidence in the Melbourne industrial market outlook, particularly given the tightening vacancy scenario.

Knight Frank forecasts new supply in 2012 to be 369,701m², with the greatest proportion to be delivered to the West off the back of large pre-lease deals and some speculative construction.

Tenant demand is expected to continue to outstrip supply over the coming year, putting further downward pressure on vacancy levels. Occupiers seeking logistics, supplier or warehousing space are likely to continue to focus their accommodation requirements around the West and South East, however recent enquiry suggests the North may experience an increased level of absorption in 2012. The City Fringe market should continue to experience high demand from owner occupiers. Industrial space sub 3,000m² in this region is expected to remain highly sought after as tenants seek to maintain proximity to the Port and CBD.

Driven by limited available prime space, it is expected that rental levels may rise marginally, particularly for highly specified buildings. Further tightening in the vacancy of secondary stock is likely to lead to moderately higher rents being achieved. Average incentives for prime stock are expected to range between 8-12%, whilst secondary leases should attract between 10-12%.

Strong demand for well located serviced land parcels provides some indication that land values are likely to show some modest growth over coming year. The greatest movement in land values is likely to continue to be in the City Fringe market, where limited stock and the gentrification of Port Melbourne is placing a premium on land.

CITIUS's Drystone Estate at 441 Dohertys Road, Laverton North
The first stage of the 95ha estate has commenced development

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