RESEARCH

MELBOURNE

INDUSTRIAL VACANCY OCTOBER 2017

Key Facts

Total available space fell by 10.7% over the past quarter to measure 776,870m^2.

Prime vacant stock decreased by 8.4% while secondary vacant stock decreased by 14.4%.

Speculative space under construction accounted for 12.2% of available stock.

Year-to-October 2017 take-up was 57.6% ahead of the same period in 2016.

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Melbourne's industrial vacancy reached its lowest level since Q1 2014, underpinned by the West and South East, with quarterly gross take-up being two-thirds above the series average.

For the fourth consecutive quarter, industrial vacancy in Melbourne declined, falling by 10.7%, or 93,137m^2, as at Q3 2017. At this time, total vacant space measured 776,870m^2 across 74 buildings. The West accounted for nearly half of total vacant space. Despite vacancy falling to its lowest level since Q1 2014, it remains 9.1% above the series average.

Existing vacant stock accounted for 81.6% of total vacancy while vacant completed speculative space accounted for 6.2% as at Q3 2017. Speculative space under construction accounted for the remaining 12.2%. Two new speculative developments commenced construction over the past quarter with speculative space under construction totalling 12,450m^2.

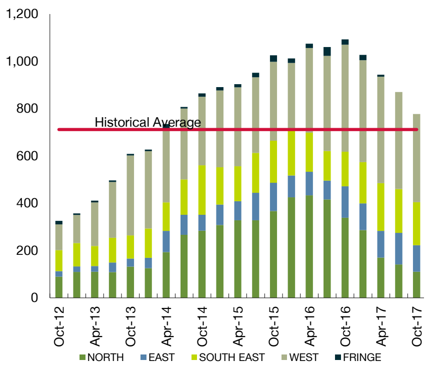
The fall in vacancy was underpinned by strong leasing activity across all precincts except in the City Fringe which had no vacancy for the second consecutive quarter.

Gross take-up increased by 61.8% over Q3 2017 to measure 233,808m^2, supported by above-average levels of take-up in the West and South East. Leasing activity was the most active in the West, accounting for nearly half of gross take-up. Year-to-October 2017 take-up was 629,869m^2, 57.6% ahead of the same period in 2016.

FIGURE 1

Melbourne Industrial Market

'000m² available space



Source: Knight Frank Research

Quality of Stock

Prime vacant stock decreased for the second consecutive quarter, falling by 8.4% to measure 492,338m^2. The decrease was underpinned by strong leasing activity offset by new vacant supply additions. Major backfill options to come online in Q3 2017 included the former Krafts Food space at 19-39 Studley Court, Derrimut (23,528m^2) and Award Brands' backfill space at Warehouse B, 47-69 Pound Road West, Dandenong South (10,738m^2).

Nevertheless, prime vacant space accounted for the majority of total vacant space at 63.8% as tenants continue to upgrade and consolidate from multiple sites into purpose-built facilities.

Secondary vacant stock decreased for the fourth consecutive quarter, falling by 14.4% to measure 284,532m^2, its lowest level since Q2 2013. This was driven by limited additions to existing vacant stock combined with above-average levels of secondary take-up in the West and South East.

Vacant completed speculative space fell by 43.6% to measure 48,517m^2 as three speculative buildings were leased in Q3 2017. Vacant completed speculative space continues to be well-absorbed with 231,157m^2 leased in the first three quarters of 2017, 51.4% ahead of the same period in 2016. As at Q3 2017, vacant completed speculative stock was 58.1% below the quarterly average.

Speculative space under construction fell for the first time since Q2 2016 to measure 94,308m^2 as two speculative developments completed construction over the past quarter. New speculative developments to commence construction over Q3 2017 included Frasers Property's Warehouse B, Spec 6, Atlantic Drive, Keysborough (7,357m^2) and Goodman Group's 13 Industrial Drive in Westside Industrial Estate, Truganina (5,093m^2). The West accounted for 74.3% of total speculative space under construction while the East and South East accounted for 8.6% and 17.1% respectively. Although speculative space under construction decreased, approximately 70,000m^2 of new speculative developments across the Melbourne industrial market are anticipated to commence construction over the next six months.

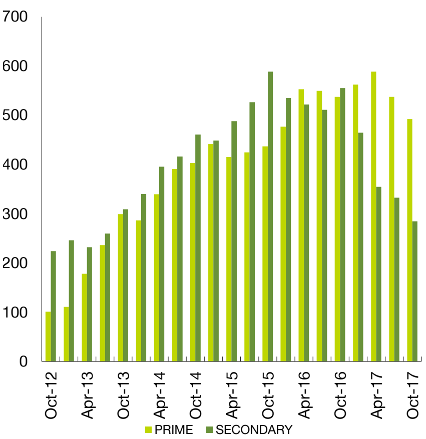
Distribution by Precinct

Vacancy levels decreased across all precincts over Q3 2017. For the second consecutive quarter, the City Fringe had no vacant options above 5,000m^2.

The North recorded the largest decrease in vacancy, falling by 21.4% to measure 110,559m^2 across 10 buildings, its lowest level since Q2 2013. Vacancy in the North decreased for the sixth consecutive quarter, falling by a total of 81,256m^2 since the start of the year. The continuous fall in vacancy has been supported by a lack of new speculative developments, improvements in existing and new infrastructure to Northern industrial pockets, and competitive rentals and incentive levels offered by both private and institutional landlords.

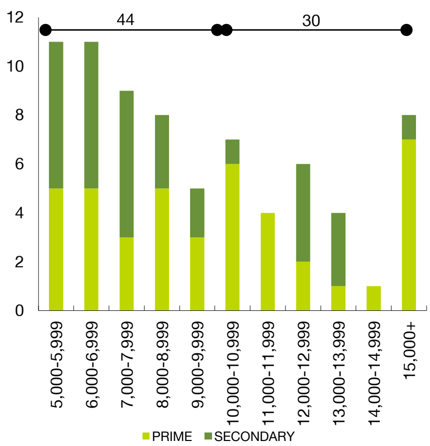
Vacancy in the West fell by 9.1% to measure 372,931m^2 following above-average levels of take-up. Prime space accounted for 72.8% of vacant space within the West with approximately 18.8% being speculative space under construction.

FIGURE 2
October 2017 Available Space
'000m² by grade



Source: Knight Frank Research

FIGURE 3
October 2017 Available Space
No. of buildings by size and quality



Source: Knight Frank Research

TABLE 1
Melbourne Industrial Available Space 5,000m²+ as at October 2017

Precinct	Available Space m²	No. of Buildings	Av Asking Rent $/m² net	Change Past Qtr (m²)	Change Past Year (m²)	Building Quality Prime %	Building Quality Secondary %
City Fringe	0	0	N/A*	0	-22,155	0	0
North	110,559	10	75	-30,131	-228,160	76	24
East	111,688	13	79	-22,216	-20,768	21	79
South East	181,692	20	79	-3,470	35,547	62	38
West	372,931	31	72	-37,320	-80,217	73	27
Total	**776,870**	**74**	**76**	**-93,137**	**-315,753**	**63**	**37**

Source: Knight Frank Research *no vacancy

The East recorded a 16.6% decrease in vacancy to measure 111,688m², its lowest level since Q2 2016 following above average levels of take-up combined with no new vacancies coming online in Q3 2017.

Vacancy in the South East fell by 1.9% to measure 181,692m². Although above average levels of take-up were recorded, this was offset by a total of 61,054m² of new vacancies coming online. This resulted in only a slight reduction in vacancy.

Size & Type of Stock

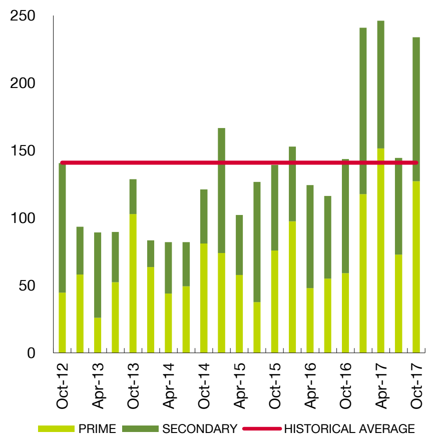
Of the 74 vacancies available in Melbourne as at Q3 3017, 44 were sub-10,000m² options. There were 30 options available for 10,000m²+ users, 21 of which were prime quality grade. For larger 20,000m²+ users, there were six options available, four of which are located in the West.

Building Take-up

Gross take-up in Q3 2017 totalled 233,808m², up by 61.8% from the previous quarter and 66.0% above the series average. Year-to-October 2017 take-up was 57.6% ahead of the same period in 2016.

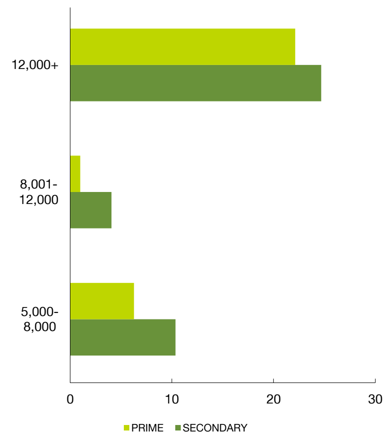
Prime gross-take up totalled 127,163m², up by 74.5% from the previous quarter. The most notable transaction was

FIGURE 4
Melbourne Industrial Take-up
'000m² est Take-up buildings (excl. D&C)



Source: Knight Frank Research

FIGURE 5
Letting-up Period by Size & Grade
Average no. of months — October 2017



Source: Knight Frank Research

Amazon leasing the former Bunnings distribution centre at 29 National Drive in Pellicano Group's M2 Industry Park, Dandenong (24,387m²). This follows Bunnings' pre-commitment to a purpose-built 43,000m² warehouse at Salta Property's Portlink Estate, Dandenong South.

In the secondary market, 106,645m² was absorbed across 10 buildings in Q3 2017, up by 49.0% from the previous quarter. The largest transaction was Unitrans Australia-Steinhoff leasing Warehouse A, 20 Henderson Road, Knoxfield (24,476m²), expanding its current premises of approximately 13,000m² within the site after Toll Group vacated the premises in 2015.

FIGURE 6
Take-up 3 Months to October 2017
'000m² est Take-up buildings (excl. D&C)

Source: Knight Frank Research

> "Vacancy in the North decreased for the sixth consecutive quarter to measure 110,559m²."

By region, the West continued to record the highest level of take-up, accounting for 43.3% of the total with 103,622m² absorbed in Q3 2017. One notable transaction included Storage Material Handling Group (SMHG) leasing 27-43 Toll Drive, Altona North (16,314m²). SMHG agreed on a three-year lease term, paying $75.60/m² to consolidate its five facilities.

Take-up in the North totalled 24,149m² with two buildings leased in Q3 2017. The largest transaction was Direct Couriers leasing 45-55 South Centre Road, Tullamarine (14,091m²), consolidating its facilities after acquiring EB Transport at the beginning of the year.

In the East, take-up totalled 31,476m² across two buildings. In the South East, take-up totalled 79,470m², its highest level since Q1 2011. This was driven by Amazon's leasing transaction and Lots 18 & 19, 24 Logis Boulevard, Dandenong South (15,610m²) being acquired by UR1 International for their own occupation.

The properties leased had been available for an average of 11.4 months, made up of 9.8 months for prime space and 13.0 months for secondary space.

Strong leasing activity in existing stock continued in Q3 2017, accounting for 87.8% of total gross absorption. Gross take-up of speculative stock measured 28,622m² compared with 17,926m² in the previous quarter.

Outlook

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

The arrival of Amazon into the Australian market coupled with the growth of online shopping will boost demand for industrial space by competitors, particularly well-located warehouse and logistics facilities to service their customers directly. For example, Costco Wholesale will open its first online store in Australia in the next 12 to 18 months, having recently leased a distribution centre in Sydney. It has plans to open an additional five to six distribution centres in Australia over the next five years.

Despite the potential for further increases in speculative stock, vacancy will continue to stem from backfill space in the medium term. As a result, vacancy levels are anticipated to remain above the series average in 2017, albeit with signs that total vacancy has now reached its peak having decreased for four consecutive quarters.

There are a number of major transport infrastructure projects currently planned across Melbourne. The Victorian Government recently announced they will partner with Transurban in the $5.5 billion West Gate Tunnel Project which includes the Monash Freeway upgrade and access improvements for Webb Dock, improving access and reducing travel time to the Port of Melbourne. Construction is expected to commence in 2018 and be completed in 2022.

Methodology:
This analysis collects and tabulates data detailing vacancies within industrial properties across all of the Melbourne Industrial Property Market. The analysis only includes building vacancies which meet the following criteria. 1. The sample data includes buildings with a minimum floor area of 5,000m². 2. Buildings are categorised into the below three types of leasing options. A) Existing Buildings – existing buildings for lease. B) Speculative Buildings – buildings for lease which have been speculatively constructed and although have reached practical completion, still remain vacant. C) Spec. Under Construction – buildings for lease which are being speculatively constructed and will be available for occupation within 12 months.

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