RESIDENTIAL RESEARCH

MELBOURNE RESIDENTIAL DEVELOPMENT

MARKET OVERVIEW H2 2015

HIGHLIGHTS

At the end of August 2015, sites suitable for higher density development in Greater Melbourne averaged $102,500 (ranging from $35,000 to $200,000) per apartment, up 19.9% on the prior year.

Many sites in the Melbourne CBD can allow for larger-scale developments, when compared to other capital cities; although height restrictions are currently under review by the Victorian government.

Melbourne recently retained the title as the ‘World’s Most Liveable City’ for the fifth consecutive year. Accordingly, the city continues to attract the highest offshore interest for apartments across the country.

KEY FINDINGS

Greater Melbourne higher density residential development site sales tallied $1.79 billion in the year ending 31 August 2015.

In the past year, by value, **47.6% of Greater Melbourne development sites were sold to foreign investors**.

Foreign investors have a proposed $10.41 billion worth of residential developments in the pipeline in Victoria.

Lone person households are projected to have the highest growth of 2.2% per annum over the next twenty years

Pipeline of committed major infrastructure projects to ramp up from 2017

Currently there are 24,770 apartments under construction in Greater Melbourne—led by the CBD & Inner/North West region.

MICHELLE CIESIELSKI
Director—Residential Research

MELBOURNE RESIDENTIAL DEVELOPMENT SITES

Local and foreign purchasers continue to fuel sales activity for development sites with potential for higher density apartments, despite many cranes spanning the horizon. Melbourne has recently retained the title, for the fifth consecutive year, as the 'World's Most Liveable City' by The Economist Intelligence Unit's Global Liveability Index. Accordingly, the city continues to attract the highest offshore interest for apartments across the country.

Sales Volume

Sales turnover of major sites likely for higher density development in Greater Melbourne totalled $1.79 billion in the year ending 31 August 2015.

As shown in Figure 1, this was down 10.7% on the previous year, although significantly greater than sales recorded in the years to 2011 and 2012. The sales volume achieved in the year to 31 August 2014, at $2.07 billion, was a distinct benchmark given the large volume of sales transacting in that year, with the most notable being to Malaysian developer, PJ Development Holdings. In June 2014, they purchased a 2.03 hectare site at 93-119 Kavanagh Street, Southbank for $145 million.

FIGURE 1
Total Residential Site Sales Volume Greater Melbourne
Potential Higher Density Development, $5M+

Source: Knight Frank Research

Over the past two years ending August 2015, the Inner/North West region recorded the highest volume of residential development site sales with $1.53 billion, followed by the Melbourne CBD with $1.02 billion. The Bayside & Frankston region, which includes Port Melbourne, saw sales turnover in the order of $472.81 million over the same time. The North East region, which currently has the new Box Hill to Ringwood bike path underway, totalled $331.81 million in site sales whilst the South East, which is soon to welcome the new Dingley Bypass, saw $530.57 million transacted.

The most recent Melbourne major development site sales, with potential for higher density, have been listed in Table 1 on page 4.

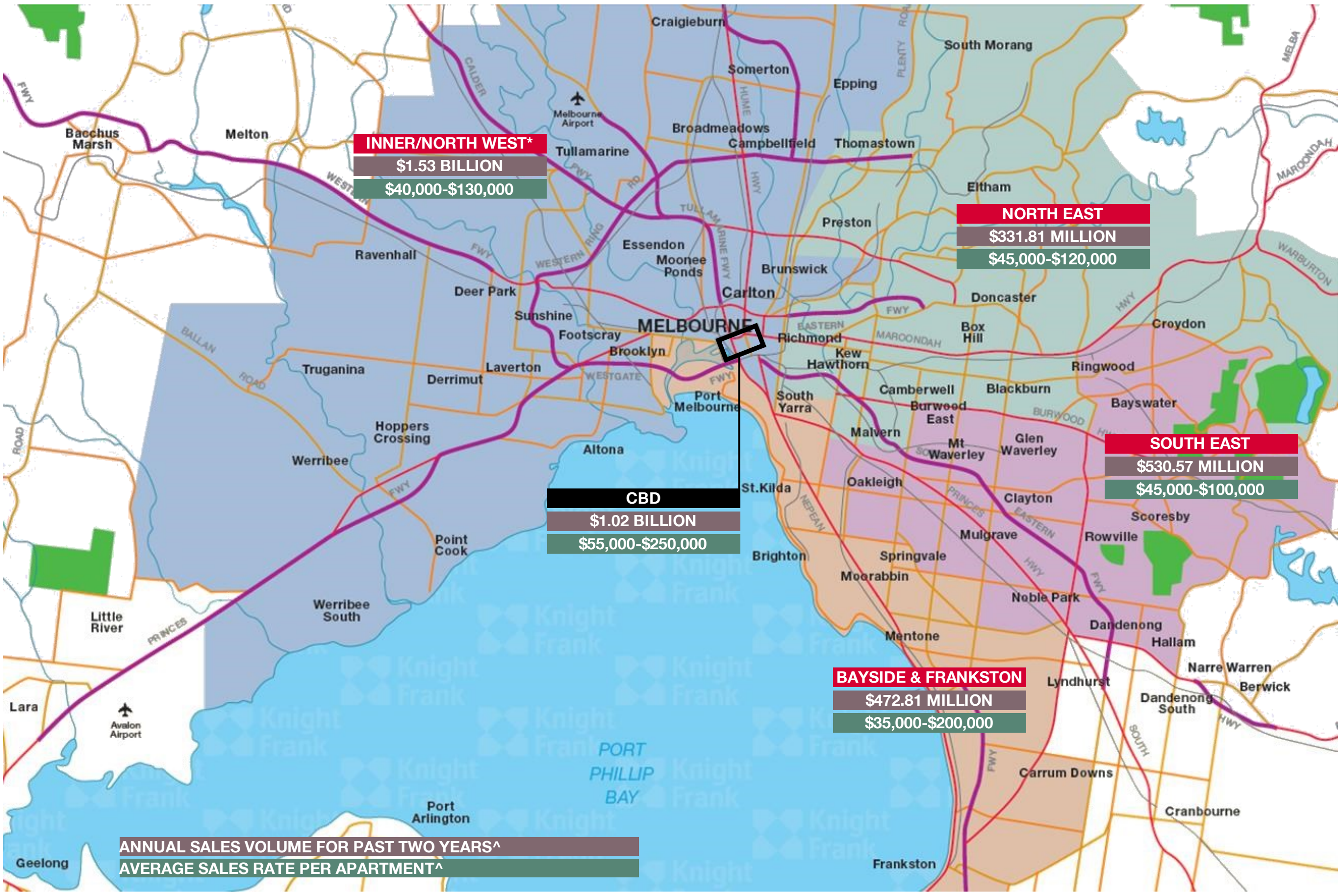
Average Rates

As at 31 August 2015, sites suitable for higher density development averaged $102,500 per apartment across Greater Melbourne, trending up by 19.9% when compared to the prior year.

Many sites in the Melbourne CBD can allow for larger-scale, high-density developments, when compared to other capital cities across the country, and as a result, sales range from $55,000 to $250,000 per apartment. Height restrictions of these towers is currently under review with the Victorian government, following a succession of tall tower projects approved by the former planning minister.

The Inner/North West region ranged between $40,000—$130,000 per apartment, which includes Footscray, a key suburb earmarked for new apartments due to come on line over the next three years.

RESIDENTIAL REGIONS—GREATER MELBOURNE SITES WITH POTENTIAL FOR HIGHER DENSITY DEVELOPMENT



Source: Knight Frank Research *Excludes CBD ^As at 31 August 2015

The Bayside & Frankston region trended a wider range starting from $35,000 through to $200,000 per apartment closer to the city. In the east, average site sales were closer to $45,000 to $120,000 per apartment in the North East, whilst trended $45,000 to $100,000 per apartment in the South East.

Type of Purchasers

A closer analysis of development sites transacted with potential for higher density development, purchased in the year ending 31 August 2015 in Greater Melbourne, found that foreign purchasers accounted for 47.6%. Major foreign purchasers included groups such as Hengyi, Dahua Group and China Poly Group, from China, and Kasen International Holdings and Kangoala from Hong Kong. Overall, China made up 77.4% of all foreign purchasers over this time.

FIGURE 2
Proposed Investment in Residential Developments
Distribution by Foreign Investors, when applications submitted in 2013/14

Source: Knight Frank Research, FIRB

As the Australian Dollar (AUD) remains low and the federal government continues to encourage investment into Australia, its likely that we will continue to witness offshore interest for Melbourne residential development sites over the next twelve months.

As reported by the Foreign Investment Review Board (FIRB), it is projected that foreign investors have sort approval to invest $10.41 billion into Victorian residential developments; continuing to be the preferred state to invest. New South Wales is not far behind with $10.39 billion planned to be developed, while to a much lesser extent are the states of Queensland ($2.81 billion) and Western Australia ($1.32 billion).

TABLE 1

Major Sales—Development Sites With Potential For Higher Density Apartments, Greater Melbourne

Address	Sale Price $ mill	Site Area m²	No. Apts~	Price $/Apt~	Price $/m²	Vendor	Purchaser	Sale Date
Carlins Auto Site 6-78 Buckhurst St South Melbourne±	42.00	9,000	1,023	41,056	4,667	Carlins Automotive Auctioneers	Consortium of Builders∞	May-15
Waterline Place Ann St & Nelson Pl Williamstown^	50.00	5,151	850	58,824	9,707	Undisclosed	AV Jennings	May-15
Fmr Moonee Ponds Market 40 Hall St & 34-36 Margaret St Moonee Ponds^	45.00	13,400	1,200	37,500	3,358	Leighton Properties JV Qualitas	Caydon Property	Apr-15
8 Bouverie St 156-172 Victoria St Carlton^	64.80	2,927	1,035	62,609	22,139	Chip Eng Seng∞	Hengyi (Shandong HYI Group)∞	Apr-15
The Fawkner 499 St Kilda Rd Melbourne^	80.00	6,070	253	316,206	13,180	IGB∞	Qualitas	Dec-14
185 Rosslyn St West Melbourne^	40.25	9,206	501	79,840	4,345	Australia Post	Trenerry Property	Dec-14

Source: Knight Frank Research ~Estimate/Potential ∞Foreign Vendor/Purchaser Residential Regions (see map): ^CBD & Inner/North West ±Bayside & Frankston

KEY DEVELOPMENT DRIVERS

The Economy

The building and construction sector continues to contribute significantly to the Victorian economy, in an otherwise sluggish Australian economy that is feeling the fallout of a slowing Chinese economy. According to the Australian Bureau of Statistics (ABS), growth in Victorian State Final Demand in the quarter to June 2015 grew 0.9%, after recording 1.7% growth in the previous quarter; to total 3.0% over the year to June 2015. The low AUD continues to attract local tourism and foreign purchasers to buy new dwellings to add to the housing stock.

Interest Rates

In September 2015, the Reserve Bank of Australia (RBA) left the cash rate at the all -time historic low of 2.00%; last cutting the rate by 25 bps in May 2015. Low interest rates have directed investors to actively invest in the property market over the past two years, with capital values rising to record highs in Sydney and to a lesser extent, in Melbourne.

Lending Environment

Once total lending to investors overtook the value of finance being obtained by owner occupiers, the Australian Prudential Regulatory Authority (APRA) became concerned that a reduced and more responsible lending target should be endorsed. Since May 2015, banks have started to reduce their maximum LVR's, introducing new variable rates and requiring customers to provide evidence of existing loan repayments before being accepted. This is in addition to applying serviceability repayment loading buffers to existing mortgage repayments as part of borrowers serviceability assessment in a higher interest rate environment. These overall housing lending standards are only part of the concern, with APRA, more recently, commenting on the current lending environment; where house prices are high, interest rates are low and income growth is subdued. In addition, the potential for a slow but steady erosion of credit quality in home loan portfolios as investor lending (and the rate of growth) rises with interest-only loans and increased use of third-party originated lending. The tightened lending environment is expected to have some impact on investors, although the measures endorsed by APRA could be negated should any further cuts be made to the cash rate.

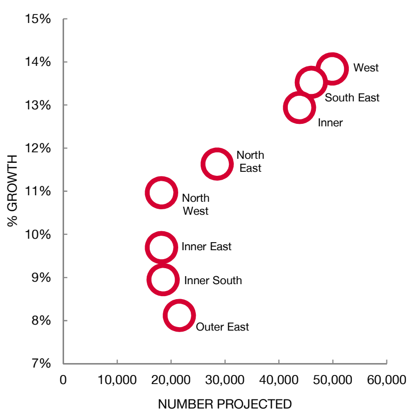
Employment Growth

Unemployment as at June 2015 stood at 5.7% for Greater Melbourne, trending below the 6.4% recorded a year earlier. The Department of Employment have projected employment growth in Greater Melbourne, by SA4 ABS regions, over the next five years to November 2019. As shown in Figure 3, the West (with 49,890 jobs), South East (45,995) and Inner (43,820) are likely to see the most growth in employment of between 12.9% and 13.8%.

Cost of Construction

Holding the greatest number of apartments in the supply pipeline across the country with sustained high demand for construction products and services, there has been much focus on the cost of

FIGURE 3
Employment Growth Projections Greater Melbourne, SA4 level
Five years to November 2019



Source: Knight Frank Research, ABS, Department of Employment

construction in a heated residential market. Despite this, in order to become established in the Australian market, many foreign developers continue to build and jeopardise profit margins after paying in some cases, a premium for the development site.

Greater Melbourne building costs have increased an estimated 2.3% over the twelve months to June 2015, according to Rawlinsons. This is slightly below the annual average growth recorded over the past five years of 2.5%. With a solid pipeline of projects projected, there are no signs of cost growth easing, with Rawlinsons expecting this to increase by another 1.0% in the second half of 2015, in total rising a projected 2.5% over the year of 2015.

Rawlinsons estimate a standard high-density, multi-storey apartment project in Greater Melbourne would now cost on average $2,030/m² to $3,065/m² for a basic finish build (or equivalent to a range of $105,500—$113,700 per apartment) plus GST. A project built with a prime finish would be closer to an average $3,045/m² to $4,355/m² (or equivalent to a range of $578,500—$623,500 per apartment) exclusive of GST.

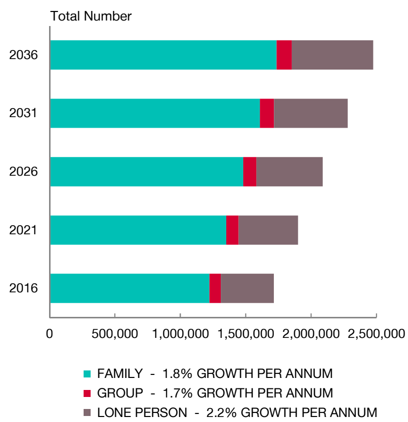
Projected Population

Net overseas migration remains strong in Victoria, and in 2014, net interstate migration was the highest in Australia. Greater Melbourne is projected to reach a population of 6.4 million by 2036; growing 1.7% per annum and outstripping the projected Australian average of 1.4%. Greater Melbourne experienced 2.2% population growth between June 2013 and June 2014, led by Cranbourne East (24.1%), Truganina (16.8%) and Tarneit (11.7%).

Projected Households

The ABS have projected the number of Greater Melbourne households to reach 2.48 million by 2036, therefore required to grow 1.9% per annum until this time. Over this time, 'Lone Person' Households would grow the most, at 2.2% per annum, compounding to total 622,700 additional households required to accommodate this dweller. The 'Family' composition still dominates household structure as highlighted in Figure 4.

FIGURE 4
Household Projections By Type Greater Melbourne



Source: Knight Frank Research, ABS

The Apartment Market

Mainstream apartments in Greater Melbourne saw capital growth of 3.2% over the last year to June 2015—the third highest in the country behind Sydney and Hobart. Greater Melbourne sales turnover has strengthened, up 10.8% to the highest volume on record at 37,993 in the year to June 2015. Vacancy continues to trend close to market equilibrium with vacancy at 2.9% in June. Gross rental yields were down 7 bps to 4.40% in the twelve months to June 2015 as capital growth outpaced rental growth.

PIPELINE OF MAJOR PROPOSED INFRASTRUCTURE PROJECTS—GREATER MELBOURNE

2016
Dingley Bypass

Box Hill to Ringwood Bike Path

2017
CityLink-Tulla upgrade

West Gate Distributor

Ravenhall Prison

2018
Level Crossings—17 removal and upgrades

2019
Cranbourne-Packenham Rail Corridor upgrade

2023
Level Crossings—remainder (approx. 33) removal and upgrades

2025+
Melbourne Metro Rail

KEY SUBURBS FOR APARTMENT PROJECTS DUE BY END 2018— GREATER MELBOURNE

CBD & INNER/ NORTH WEST
Melbourne CBD
Southbank
Docklands
West Melbourne
Footscray

BAYSIDE & FRANKSTON
Montague
St Kilda
South Melbourne
Port Melbourne
Elsternwick

NORTH EAST
Doncaster
Box Hill
Richmond
Hawthorn East
Hawthorn

SOUTH EAST
South Yarra
Clayton
Carnegie
Dandenong
Armadale

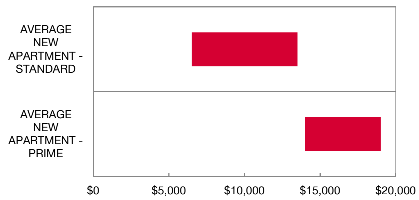
Projected New Apartment Pipeline

Since January 2011, 41,045 new apartments have been added to the Greater Melbourne residential stock, led by the CBD & Inner/North West, as detailed in Figure 6. In total across Greater Melbourne, there are currently 24,770 apartments under construction, with another 54,095 with DA approval which are expected on-line by the end of 2018.

The largest increase in higher density apartment stock until the end of 2018, taking into consideration projects under construction and DA approved, is in the CBD & Inner/North West region which is forecast to see an additional 52,110 apartments; an extra 144% on the prior 2011-2014 period. The North East is forecast to add another 10,510 apartments by the end of 2018 and the South East region will see an extra 9,465 apartments; 136% and 130% respectively, more built than over the previous four years in each region.

Apartment numbers in Greater Melbourne could increase further when approval is granted for the additional 31,720 apartments currently submitted. Although if demand is not met through pre-sales, many of these projects are likely to be pushed out beyond this time.

FIGURE 5
New Apartment Price Range Greater Melbourne
Average rate per m^2



Source: Knight Frank Research

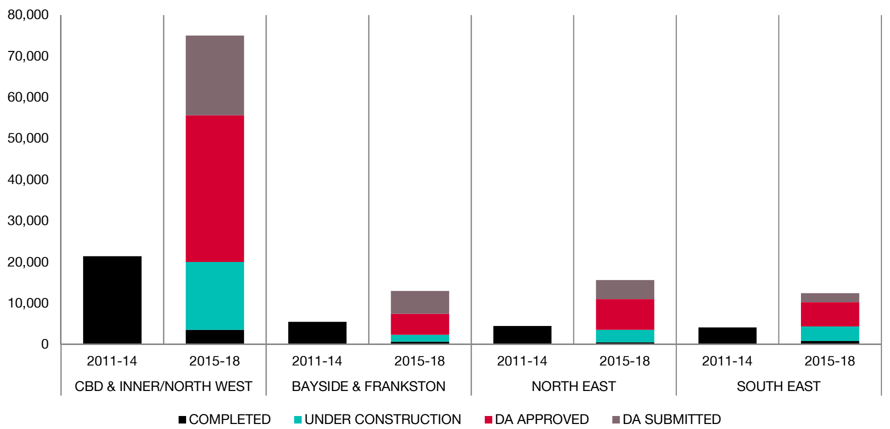
New Apartment Price Range

New apartments in Greater Melbourne can range in price subject to the distance of key train and tram lines with access to the city and vibrant shopping strips, proximity to universities, school zones and the bay, as shown in Figure 5. An average new apartment of standard finish can range from $6,500/$m^2$ through to $13,500/$m^2$ whilst an average prime apartment currently trends between $14,000/$m^2$ and $19,000/$m^2$.

Foreign Investors

The Federal government has confirmed it will proceed with an initial fee of at least $5,000 for all foreigner investors purchasing into the Australian property

FIGURE 6
New Apartment* Pipeline Greater Melbourne
Number of Apartments



Source: Knight Frank Research

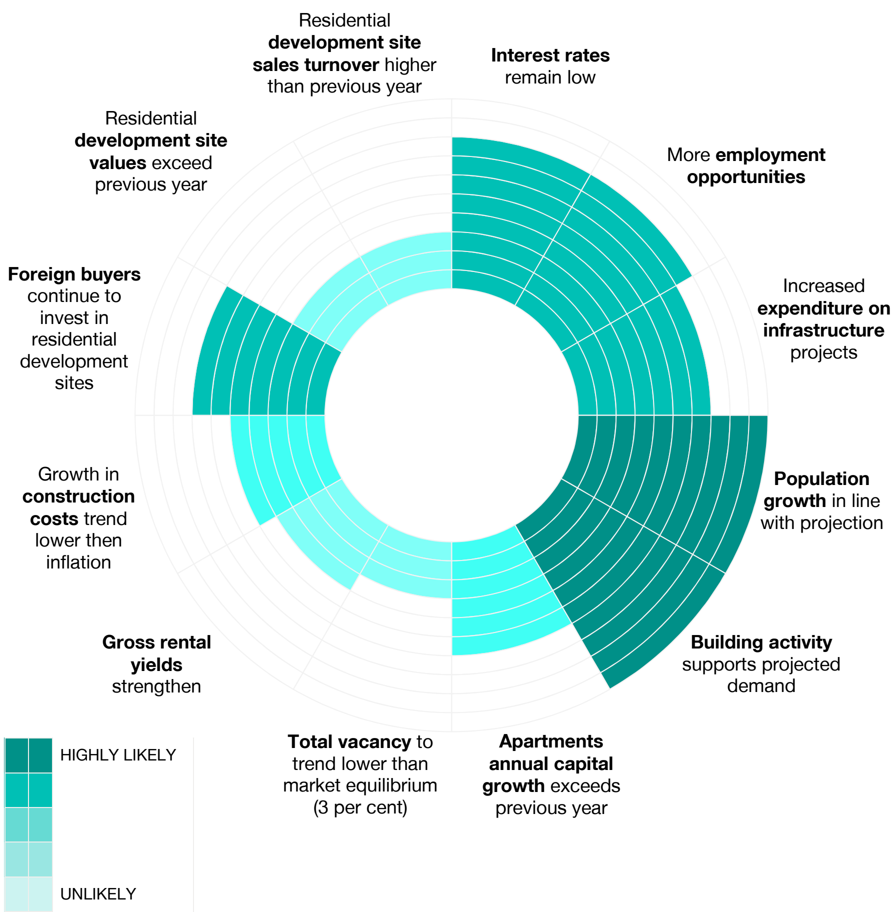
*Includes projects 4+ storeys with 25+ apartments in complex market, with an additional $10,000 payable for every million dollar increment in the value of the property; slated from 1 December 2015.

The Victorian State Government has introduced two new taxes for foreign investors purchasing property in Victoria under the State Taxation Amendment Act 2015 (Act); this is in addition to the application fee payable to the Australian government. The Victorian Act came into effect on 29 June 2015 and materialises the State Governments budget announcements for the additional stamp duty surcharge for 'foreign purchasers' and land tax surcharge for 'absentee owners'. As of 1 July 2015, foreign investors buying residential property in Victoria will now be taxed an additional duty of 3% of the purchase price, whether acquired directly or indirectly, that is, through a company or trust that purchases the residential property. For off-the-plan sales, the additional 3% duty will be calculated on the whole of the consideration paid. Current off-the-plan concessions will still be available to foreign purchasers when calculating the normal stamp duty rate payable.

As at 1 January 2016, an ‘absentee person’, considered to be a foreign purchaser not residing in the property (purchased by the foreign purchaser in Victoria) will be charged an extra 0.5% land tax rate in addition to the general land tax rates and the surcharge rates for trusts. This is intended for properties that remain vacant for extended periods.

No other Australian states and territories have indicated they plan to introduce similar measures.

FIGURE 7
Key Development Drivers—One Year Outlook Greater Melbourne



Source: Knight Frank Research

OUTLOOK

- Low interest rates are likely remain over the next year, with another 25bps cut possible and not being lifted before late 2016.
- The pipeline of infrastructure projects is expected to ramp up from 2017 which should bring more employment opportunities as a result.
- Population in Greater Melbourne will continue to trend above the longer term ABS projection of 1.7% annual growth to 2031.
- Given the higher sales turnover, it is likely that apartment capital growth will be sustained over the next year, although most likely not to exceed the ten year historic growth of 5.2%.
- Vacancy is expected to trend above 3% equilibrium as the higher level of new supply is completed; although incessant population growth will not see vacancy rise too far above.
- There are no signs of construction costs easing, Rawlinsons are projecting a total increase of 2.5% in 2015, on-par with the past five year annual price rise.
- It is likely that offshore investment will remain strong, while the AUD remains low, for both Melbourne development sites and apartments.
- There has yet to be any impact of the recent additional fees by the Federal and Victorian state governments, however the changes may have an impact on those marketing to foreign investors as there has been increased concern from foreign buyers to ensure that they are not impacted under the new penalties also introduced at the same time.
- Given Victoria had previously held one of the lowest stamp duty taxes payable for off-the-plan properties, this will now increase the relative competitiveness of other states in Australia. While these additional fees may deter some foreign investors, the majority of buyers are looking for longer term return, such as the lifestyle, a place to accommodate family when studying and a transparent ownership structure.

RESIDENTIAL RESEARCH
Michelle Ciesielski
Director
+61 2 9036 6659
Michelle.Ciesielski@au.knightfrank.com

Matt Whitby
Head of Research and Consulting
+61 2 9036 6616
Matt.Whitby@au.knightfrank.com

RESIDENTIAL SITE SALES
Paul Henley
Head of Commercial Sales, Australia
+61 3 9604 4760
Paul.Henley@au.knightfrank.com

RESIDENTIAL PROJECT MARKETING
Daniel Cashen
Director, Melbourne (Vic)
+61 3 9604 4749
Daniel.Cashen@au.knightfrank.com

Richard Drummond
Director, Melbourne (Vic)
+61 3 9604 4610
Richard.Drummond@au.knightfrank.com

Erin Van Tuil
Director, International Project Marketing
+61 2 9036 6699
Erin.VanTuil@au.knightfrank.com

Michael Robinson
Head of Project Marketing, Australia
+61 3 9604 4775
Michael.Robinson@au.knightfrank.com

VALUATIONS
RESIDENTIAL DEVELOPMENT
David Way
Joint Managing Director (Vic)
+61 3 9604 4704
DWay@vic.knightfrankval.com.au

TOWN PLANNING
Rebecca Stockley
Director (Vic)
+61 3 9602 5722
Rebecca.Stockley@au.knightfrank.com

COMMERCIAL SALES
Martin O'Sullivan
Head of Institutional Sales (Vic)
+61 3 9604 4619
Martin.O'Sullivan@au.knightfrank.com

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

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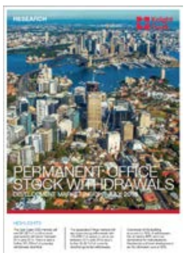

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