RESEARCH

MELBOURNE

INDUSTRIAL MARKET BRIEF JUNE 2017

Key Facts

Total available industrial space fell by 8.1% over the past quarter to 943,277m^2.

Average industrial land values (ex. City Fringe) for small and medium sized lots increased by 8.2% and 6.6% respectively in the past year.

Prime net face rents increased by 1.6% per annum to average \$79/m^2.

Industrial sales in the 12 months to June 2017 totalled \$813.3 million, 67% ahead of the long term average.

KIMBERLEY PATERSON

Associate Director, Research & Consulting

Follow at @patersonkimber1

Improved leasing conditions combined with the ongoing erosion of industrial land in the Northern and Western regions has resulted in rental growth across prime and secondary markets.

Occupier Demand & Rents

The Victorian economy continues to strengthen, supported by strong population growth, increased infrastructure investment and a jobs market that accounted for the highest number of new jobs created in the 12 months to May 2017. With the low interest rate environment state economic growth has outperformed the national average, growing at a pace of 3.3% per annum for the 2015/16 financial year.

These factors have supported positive leasing conditions across the Melbourne industrial market, with gross take-up measuring 251,534m^2 in the three months to April 2017. Volumes were 79% ahead of the series average and the highest quarterly total since Q1 2011. By precinct, the Western region recorded the strongest level of leasing activity at 110,907m^2, accounting for 44% of gross take-up in Q1 2017. 3PL groups continue to be the primary drivers of industrial space in Melbourne.

Positive tenant demand resulted in vacant industrial stock falling for the second consecutive quarter to measure 943,227m^2 across 83 buildings, its lowest level since Q1 2015.

Vacant stock levels continue to vary across the precincts. The Northern and City Fringe precincts both recorded a fall in vacancy while the Western and South Eastern regions recorded an increase in vacant stock in the three months to April 2017. Vacant stock in the South East now measures 201,434m^2 while vacancy reached 450,260m^2 in the West.

On the back of improved leasing conditions and a reduction of available land in the Northern and Western regions, average prime and secondary net face rents across Melbourne increased in the 12 months to April 2017.

Prime net face rents increased by 1.6% YoY to \$79/m^2 as at April 2017, while a similar level of growth was recorded in the secondary market, with average net face rents increasing by 1.6% to $62/m^2. By precinct, the Northern region recorded the strongest increase in net face rents, with prime rents increasing by 1.3% per annum to $76/m^2 and secondary rents increasing by 3.4% per annum to $60/m^2.

Development & Land Values

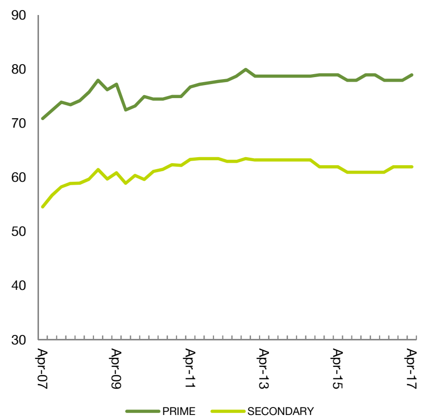
Following above average levels of gross new industrial supply in 2015, Melbourne's industrial activity slowed in 2016. Gross supply (>5,000m^2) totalled 374,860m^2, 36% below levels recorded in 2015, largely the result of limited speculative development through 2016.

By precinct, new gross supply in 2016 was concentrated in the West, accounting for 63% of Melbourne's new supply. Major completions included CEVA Logistics (90,000m^2) and the Reject Shop's (37,700m^2) purpose built facilities at West Industry Park, Truganina and Drystone Industrial Estate, Laverton North respectively.

FIGURE 1

Melbourne Industrial Rents

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



Source: Knight Frank Research

During 2017, new industrial supply is forecast to total 650,650m^2 of which 174,494m^2 is already complete. Gross supply in 2017 is anticipated to be 20% higher than the 10-year average, and its highest annual total since 2008, largely underpinned by above average levels of pre-lease activity. There are eight pre-committed facilities (in excess of 10,000m^2) anticipated to come online in 2017 totalling 252,254m^2, 60% ahead of the 10-year average. Major pre-lease commitments include Ego Pharmaceuticals (89,000m^2), Target (63,000m^2) and PFD (25,484m^2).

In addition, a number of developers have recently commenced speculative developments. A total of 119,082m^2 of speculative stock across nine developments is currently under construction, reaching a new series high. The majority of the industrial speculative development is located within the Western region with Dexus, IntraAUS and Frasers Property expected to complete speculative developments in 2017.

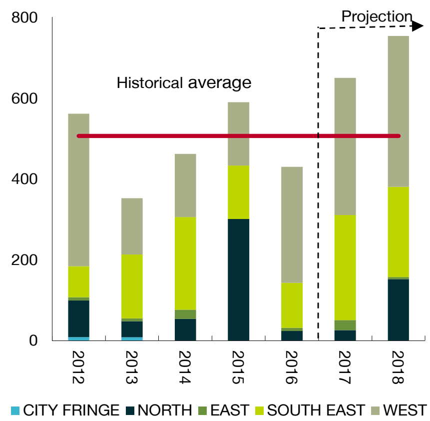
Nevertheless, speculative construction levels are forecast to account for only 17% of total new supply delivered to Melbourne in 2017, down from the 32% proportion achieved in 2015 and its peak of 48% in 2014.

By region, total gross new supply in 2017 will largely be completed within the Western and South Eastern industrial precincts which together account for 92% of the industrial pipeline this year.

FIGURE 2

Melbourne Industrial Supply

'000m^2 annual gross supply



Source: Knight Frank Research

While there have been limited industrial land transactions in Melbourne over the past two years, increased pre-lease and owner occupier activity is putting upward pressure on industrial land prices across Melbourne.

With available industrial land in both the West and South Eastern precincts continuing to shrink due to the strong construction pipeline, average land values have risen strongly in over the past 12 months. In the South East average land values for small sized lots (<5,000m^2) increased by 18.9% to $300/m^2 and medium sized lots (1-5ha) increased by 16.2% to $215/m^2. Industrial land values for small and medium sized lots in the West increased by 18.9% and 11.7% respectively.

With a significant amount of industrial land being converted to residential, the City Fringe has seen land values increase by 50% over the past two years with small sized lots sitting at $1,500/m^2.

TABLE 1

Melbourne Industrial Market Indicators as at April 2017

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	-	80	6.7	6.00—6.75	6.50—7.00	1,500	-	N/A	-
North	76	1.3	60	3.4	7.00—7.50	8.25—9.00	214	-	164	-
East	80	-	63	-	6.75—7.50	8.25—9.25	300	-	230	-
South East	83	-	60	-	6.50—7.25	8.00—9.00	300	17.6	215	16.2
West	78	4.0	65	-	6.50—7.25	8.00—9.00	220	18.9	162	11.7
Melbourne Average*	**79**	**1.6**	**62**	**1.6**	**6.55—7.25**	**7.80—8.65**	**259**	**8.2**	**193**	**6.6**

Source: Knight Frank Research

*Excludes City Fringe

Sales & Investment Activity

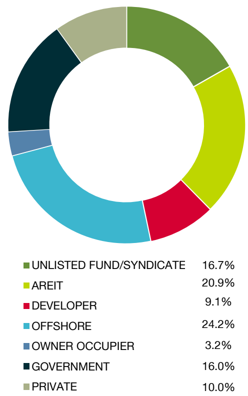
Although investor appetite remains strong for Melbourne industrial assets, investment sales volumes (>$10 million) in the 12 months to June 2017 fell by 32% from the preceding 12 months, impacted by a scarcity of investment opportunities. In the 12 months to June 2017 $813.3 million across 25 transactions was recorded, down from the $1.19 billion recorded in the equivalent period in 2016.

Transactional activity was supported by two sales above $100 million recorded in the 12 months to June 2017. These included the Victorian Government purchasing the General Motors Holden (GMH) site at 241 Salmon Street, Port Melbourne for $130 million and Charter Hall's acquisition of the Coles distribution centre at 485 Dohertys Road, Truganina for $102.5 million.

FIGURE 3

Melbourne Industrial Sales ($10mil+)

By purchaser type—12 months to June 2017



Source: Knight Frank Research

Offshore groups were the most active buyers in the 12 months to June 2017, with sales totalling $196.4 million accounting for 24.2% of all sales by value. Volumes were underpinned by the sale of 31-49 Browns Road, Clayton where Chinese developer Bewise acquired the asset for $51.5 million. A-REITs were also active purchasers, with volumes totalling $169.6 million accounting for 20.9% of sales by value.

The Western region led sales activity, accounting for 41% of all industrial transactions (by value) totalling $338.1 million in the year to June 2017. The City Fringe region followed, with transactions totalling $221.5 million across four assets, skewed by the GM Holden site sale.

Prime yields compressed by 15 basis points in the year to June 2017 to 6.50% and now range between 6.55% and 7.25%. Average prime yields now stand 136 basis points lower than the 10-year 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 32 basis points YoY to range between 7.80% and 8.65%.

TABLE 2

Recent Leasing Activity Melbourne

Address	Region	Net Rent $/m²	Area m^2	Term (yrs)	Tenant	Date
The West Park Industrial Estate, Truganina	W	72.50	14,871	6	National Tiles	Q3-17
120 Link Road, Tullamarine	N	75.00	26,517	10	The Workwear Group	Q2-17
70 Sydney Road, Somerton	N	76.00	10,111	4	Chemist Warehouse	Q2-17
Drystone Industrial Estate, Laverton North^	E	U/D	63,000	10	Target	Q2-17
64 Westpark Drive,, Derrimut	W	73.50	20,337	6	Silk Contract Logistics	Q2-17
Felstead Rd, Truganina	W	75.00	10,294	10	PGG Wrightson Seeds	Q1-17

TABLE 3

Recent Improved Sales Activity Melbourne

Address	Region	Price $ mil	Bldg Area m²	Core market Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
13-27 & 29-43 Whiteside Rd, Clayton South	E	23.00	39,720	6.56	7.75	DMS Glass Properties	Private	Q2-17
27-43 Toll Dr, Altona North	W	27.30	21,720	U/D	3.9	Cadence Property Group	LOGOS Property Group	Q1-17
217-225 Boundary Rd, Laverton North	W	22.25	36,250	7.40	10	Challenger Life	Cache Logistics	Q1-17
241 Salmon St, Port Melbourne	CF	c.130	200,931	N/A	N/A	GM Holden	Victorian State	Q3-16
31-49 Browns Rd, Clayton	E	51.50	31,875	4.06*	6.1	Abacus Property Group	Bewise	Q3-16

E East, N North, W West, CF City Fringe SE South East ^Pre-commitment *Possible redevelopment opportunity to residential in the medium term.

Source: Knight Frank Research

Outlook

The positive outlook for the Victorian economy is expected to sustain strong leasing conditions over the next 12 months, with state GDP forecast to be above the 10-year average at 2.8% in 2017. While vacancy levels appear to have reached their peak, rental growth over the next 12 months is likely to remain relatively modest as a result of backfill vacancies continuing to come to the market.

There are currently a number of major transport infrastructure projects under construction 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 will complete in 2022.

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

The relatively deep pool of unsatisfied capital will continue to maintain the high level of demand for investment opportunities in 2017. Domestic investors will face strong competition from offshore groups actively seeking opportunities to grow their presence in the Australian industrial market.

With strong investment appetite from both domestic and offshore purchasers, coupled with limited industrial properties offered for sale, there is further scope for yield compression over the next 12 months in both prime and secondary markets.

RESEARCH
Kimberley Paterson
Associate Director, Victoria
+61 3 9604 4608
Kimberley.paterson@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
Victoria
+61 3 9604 4649
Gab.pascuzzi@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
Michael Schuh
Joint Managing Director—Victoria
+61 3 9604 4726
mschuh@vic.knightfrankval.com.au

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).

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

Sydney Industrial Market Brief May 2017

Melbourne CBD Retail Market Brief June 2017

Australia Infrastructure Insight June 2017

The Wealth Report 2017

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

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.

Knight Frank

Newmark Knight Frank Global