RESEARCH

Knight Frank

# MELBOURNE INDUSTRIAL

## MARKET OVERVIEW AUGUST 2019

## SPEC DEVELOPMENT DRIVES INDUSTRIAL MARKET

## HIGHLIGHTS

More than half of all new industrial development expected to land in Melbourne in 2019 is comprised of speculative development.

A surge in land values has placed upward pressure on rents, in particular in the south east where rents have risen by almost 10% since July 2018.

Investors are shifting their property portfolio exposure away from non-core retail assets towards industrial assets.

## MARKET DRIVERS

**Population Growth**

AUS: 1.6% VIC: 2.2%

*YoYΔ: Dec '18*

**Economic Growth**

AUS: 2.8% VIC: 3.5%

*YoYΔ: Jun '18*

**Unemployment Rate**

AUS: 5.2% VIC:4.5%

*As at: Jun '19*

**Online Retail Trade**

AUS:+12% (at $1,644.7m)

*YoYΔ: May'19*

**Investment in Infrastructure**

VIC: $14.2bn

*FY '19-20*

Source: ABS, Department of Treasury and Finance

FINN TREMBATH
**Associate Director**

# ECONOMY & DEMAND

The continued rise of E-commerce and recent tight supply have fueled demand for speculative development in Melbourne's industrial market.

### Surging population stimulates growth in E-commerce

Victoria's economy continues to perform strongly off the back of record population growth. According to the Australian Bureau of Statistics, over the last CY Victoria's population grew by 2.2%, ahead of the national growth figure of 1.6%, and in line with this over the 2017-18 FY the state's economy grew by 3.5%, against the national rate of 2.8%.

Victoria's booming population is having a flow-on effect on E-commerce. According to Australia Post, at a state level Victoria recorded the second strongest YOY growth in online shopping, with the number of online sales up by 22.2%.

### E-commerce and tight supply drives Melbourne's industrial market

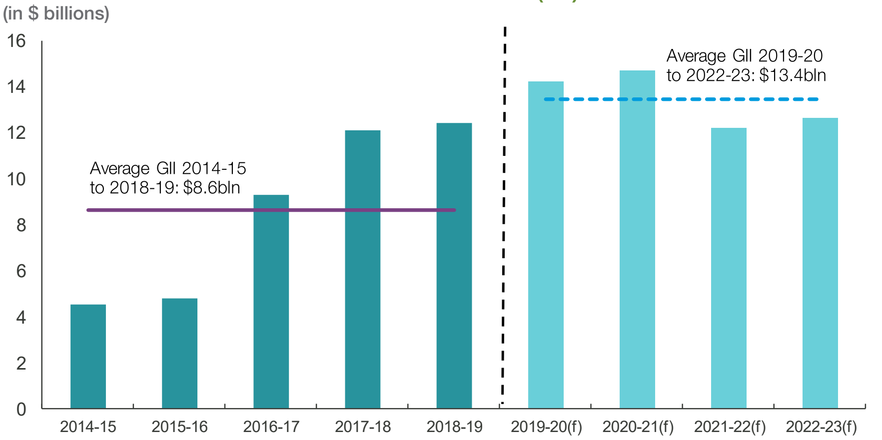
Set against the backdrop of an increasingly tight industrial property market, the growth in online shopping is creating significant demand for logistics and warehousing space, and this is creating an appetite for speculative development with much of this development concentrated in Melbourne's western suburbs.

### Record infrastructure investment, especially in Melbourne's west

The State Government has responded to Melbourne's unprecedented growth – a record $54.4 billion worth of infrastructure projects are currently underway in Victoria, with the potential for a further $80 billion of investment. Reflecting the growth in industrial activity in Melbourne's west, a considerable focus of Victoria's current infrastructure development lies in the western suburbs.

Most notably, the western roads upgrade will transform 8 priority roads in the west with many of these in the key industrial suburbs of Truganina (Palmers road and Leakes road) and Laverton North (Doherty's road), and the West Gate Tunnel project will deliver a vital alternative to the West Gate Bridge, providing a much needed second river crossing, quicker and safer journeys, and remove thousands of trucks from residential streets.

FIGURE 1
**Victorian Government's Infrastructure Investment (GII)**
(in $ billions)




Source: Department of Treasury and Finance

# VACANCY & RENTS

## Record take-up levels drive decline in prime vacancy

Melbourne's industrial vacant space (5,000 sq m+) sits at 712,044 sq m. Vacancy has increased by 10% since the start of the year off the back of a 30% increase in existing secondary stock levels, with this increase driven by the north where secondary vacancy has increased by 145.1% since January.

Despite the rise in overall vacancy, the amount of prime grade vacant space has declined by 5.6% since January, with prime vacancy levels now among the lowest recorded for half a decade.

FIGURE 2

**Melbourne Industrial Vacancy**

Available Space by Grade


Source: Knight Frank Research

Currently in the east there is no prime vacant space, and vacancy in the south east has declined by 16.4%. The decline in prime vacancy can be linked to a record 267,678 sq m of prime stock that was absorbed over the last quarter, with the bulk of this take-up emanating from the west and south east regions. Underlying tenant demand has been driven by the E-commerce and food manufacturing sectors. The brief uptick in prime vacancy in Q1 2019 was caused by the increase in spec stock presented to the market, which has since been taken up with most of this supply coming from the west. And yet despite the high levels of spec activity, supply is lagging in the west with 150,000 sq m of supply being met with 200,000 sq m of enquiry.

2020 supply levels are likely to exceed long term averages, driven by the recent uplift in spec development. However, the expectation is this stock will be absorbed quickly given the demand for quality warehousing space is expected to remain strong.

## Rents rise from the increase in land values

A surge in land values has placed upward pressure on rents, in particular in the south east where rents have risen by almost 10% since July 2018 in line with land values rising by 100%. Rents have also risen considerably (25%-30%) in the supply starved Fringe. Rents are expected to grow further due to expectation of continued tight supply, sustained tenant demand and the need to cover rising development costs related to the need for automation and technology.

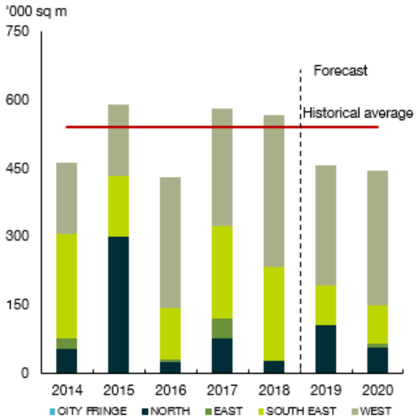
### Rents, Incentives & Outlook

| (per sq m) | Prime | Secondary |
|---|---|---|
| **Rents** | $88 | $71 |
| *YoYΔ Jul'19:* | *+6.0%* | *+5.2%* |
| **Incentives** | 16.0% | 14.6% |
| **Rents Outlook** | ↗ | ↗ |

FIGURE 3

**Melbourne Industrial New Supply**

New Industrial Developments by Precincts

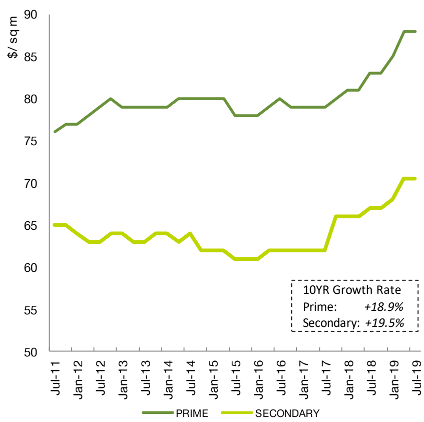



Source: Knight Frank Research/ CoreLogic

FIGURE 4

**Melbourne Industrial Rents**

Net Face Rents by Grade excl. City Fringe




Source: Knight Frank Research

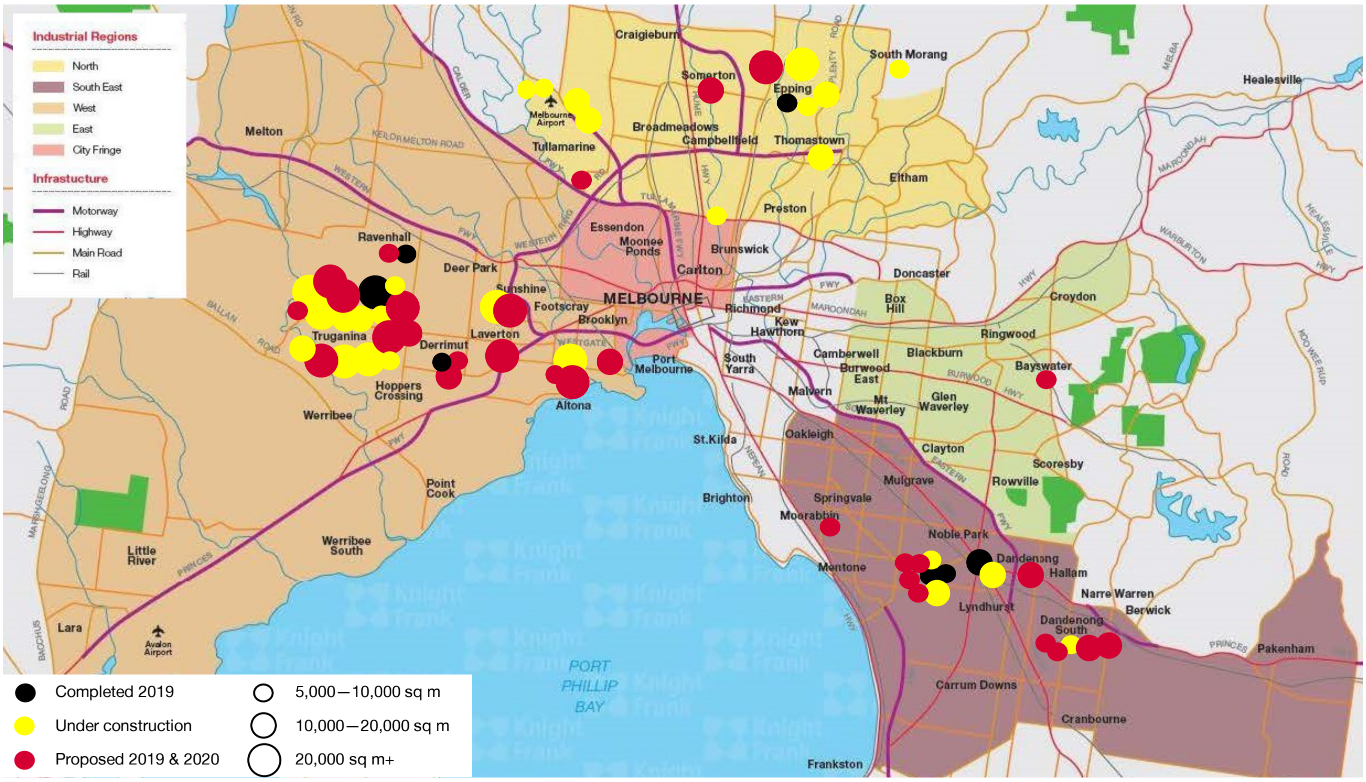
TABLE 1

**Recent Leasing Activity Melbourne (YTD June 2019)**

| Address | Region | Net Rent ($/sq m) | Area (sq m) | Type | Tenant |
|---|---|---|---|---|---|
| 47 & 53 Foundation Rd, Truganina | West | 78.0* | 33,310 | Spec | Seacon Group |
| Maker Pl, Truganina | West | 75.0 | 30,885 | Spec | HB Commerce |
| 52 Dunmore Dr, Truganina | West | 80.0 | 20,946 | Spec | ADN |
| 24 Logis Blvd, Dandenong South | South East | 75.0* | 15,797 | Direct | AFS Logistics |
| 2 Beyer Rd, Braeside | South East | 90.0 | 9,146 | Spec | Gale Pacific |

Source: Knight Frank Research
Note: Spec– Speculative. *Estimated

# DEVELOPMENT & LAND VALUES




## Land values take off

Industrial land values in Melbourne have increased considerably in the last 12-24 months, driven by increases in prices recorded in the south east and west. In the last 3 years, the value of 1-5 hectare lots in the south east has grown by 10-15% YOY, while the value of 10+ hectare lots in the west has soared in the last 12 months - in May 2019, a land parcel in Truganina sold for $237/sq m; 12 months earlier land in the same area sold for $102/sq m. The surge in land values has been brought upon by strong demand, low levels of new supply and in turn rising rents, underpinned by convenience of location. Strong pre-leasing activity and a restricted short term supply pipeline in the east and south east will ensure land values continue to rise.

## Spec development drives industrial activity

The rise in land values has had a flow-on effect on rents, which coupled with a rise in demand for logistics and warehousing property spurred by the continued growth of E-commerce has created an appetite for speculative development, especially within Melbourne's west where there is the greatest capacity for expansion. The strong demand for spec development is reflected in short take-up periods with spec builds averaging 2 months on the market following completion.

More than half (56%) of the industrial development due to land in Melbourne in 2019 is speculative. In total 280,000 sq m of spec build is scheduled for 2019, which is more than double what was recorded in 2018 (110,500 sq m). And 142,334 sq m of this spec development is due to land in the west, which is approaching double what was recorded in 2018 (87,390 sq m). Demand in the west is such that more than half the spec space due to come online in the west is already under offer.

### Land Values & Outlook

| (per sq m) | < 5,000 | 1-5 ha |
|---|---|---|
| **Values**<br>*YoYΔ Jul'19* | $440<br>*+14%* | $320<br>*+20%* |
| **Outlook** | ↗ | ↗ |

TABLE 2

### Recent Land/Development Sales Activity Melbourne

| Address | Region | Price $ mil | Area (sq m) | $ / sq m | Purchaser | Sale Date |
|---|---|---|---|---|---|---|
| 875 Taylors Rd, Dandenong South | South East | 80.0 | 413,000 | 194 | Frasers Property | Apr-19 |
| 62-87 Horsburgh Dr & 720 Kororoit Creek Rd, Altona North | West | 54.7 | 209,300 | 261 | ISPT | Mar-19 |
| 210 Swann Dr, Derrimut | West | 11.5 | 45,310 | 254 | Air Trunk | May-19 |
| 1-4/678 Boundary Rd, Truganina | West | 6.2 | 26,267 | 237 | CRC Group | May-19 |

Source: Knight Frank Research

# INVESTMENT ACTIVITY & YIELDS

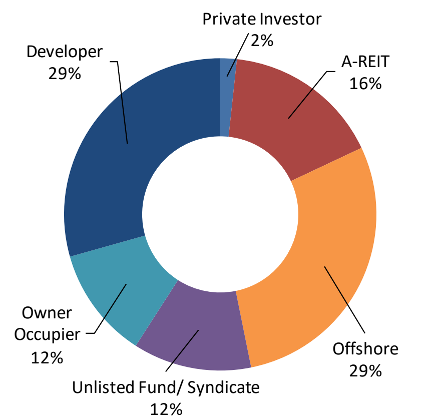
### Current Yields & Outlook

| (in %) | Prime | Secondary |
|---|---|---|
| Yields<br>*YoYΔ Jul'19:* | 5.85 - 6.55<br>*-30bps* | 6.50 - 7.50<br>*-30bps* |
| Outlook | ↘ | ↘ |

## Transaction volumes decline despite rising demand

In the first half of 2019 Melbourne's industrial sales volume ($10 million+) totaled $615.2 million across 23 transactions. At the current rate, 2019 CY transaction volumes will fall marginally short of what was recorded in CY 2018 ($1.42 billion) and CY 2017 ($1.38 billion). The decline in sales volume however should not be interpreted as a reflection of waning demand for industrial assets. Rather, strong tenant demand and rising rents have made industrial assets increasingly attractive to investors and set against a backdrop of an already tight market this has made accessing prime grade industrial properties increasingly challenging.

FIGURE 5
**Melbourne Industrial Sales ($10 mil+)**
Purchaser Profile—YTD Jun '19



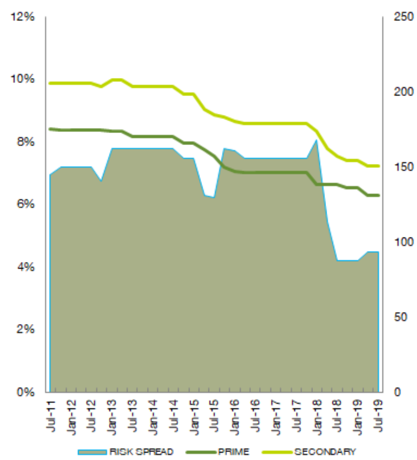

Source: Knight Frank Research, RCA

## Industrial the future of 'new' retail

Indeed, the outlook for industrial property is very promising. Lured by the promise of strong long term returns, a weight of capital is now looking to invest in industrial assets as investors display renewed confidence in an industrial property market buoyed by the growth of the E-commerce sector.

Responding to the headwinds presented by the downturn in the retail sector, institutional investors are shifting the focus of their property portfolios away from non-core retail assets towards industrial assets with an emphasis on logistic and warehousing facilities. As evidence of this broader structural change, as part of a retail divestment strategy Stockland recently sold their Tooronga shopping centre in Glen Iris to Newmark Capital for $63 million, and in late 2018 GPT purchased land at Shiny Drive in Truganina with a view to speculatively developing 130,232 sq m of warehouse space.

FIGURE 6
**Melbourne Industrial Yields**
Yields by Grade plus Risk Spread




Source: Knight Frank Research

## Yield compression arc nearing completion

A climate of sustained tight supply of investment grade assets and strong demand caused yields to compress notably throughout the course of FY 2018, with current yields sitting at 30 year record lows.

In light of the recent strong uptick in land values, the primary driver of performance in the industrial property market is likely to transition from yield compression to rental growth. While yields may well continue to tighten, with the recent interest rate drop, the rate of compression is expected to slow. Indeed, already yields have remained unchanged over Q2 2019.

TABLE 3
**Recent Sales Activity Melbourne**

| Address | Region | Price $ mil | Bldg Area (sq m) | Core Mkt Yield (%) | WALE (yrs) | Vendor | Purchaser | Sale Date |
|---|---|---|---|---|---|---|---|---|
| 30 Logistics Dr, Truganina | West | 69.6 | 48,769 | 5.3* | 10.0 | Goodman Group | LOGOS Property | Q2-19 |
| 182-198 Maidstone St, Altona | West | 41.2 | 37,906 | 7.6* | 3.0 | Abacus/ GAW Capital | Cache Logistics/ ARA | Q1-19 |
| 63-69 Pipe Rd, Laverton | West | 25.2 | 25,774 | 6.8 | 4.5 | DEA Nominees Pty Ltd | Harmony Property | Q4-18 |
| 414-416 Somerville Rd, Tottenham | West | 22.0 | 24,343 | 6.5 | 2.9 | ITI Timber | Centennial Property | Q4-18 |
| 5-9 Kitchen Rd, Dandenong South | South East | 23.0 | 18,372 | 6.4 | 10.0 | Shearform | Centennial Property | Q4-18 |

Source: Knight Frank Research, RCA *Initial yield

# PRECINCT HIGHLIGHTS

## City Fringe

### Vacancy

| | |
|---|---|
| Prime: | N/A* |
| Secondary: | 17,404 sq m |

### Land

| | |
|---|---|
| <5,000 sq m: | N/A* |
| 1-5 ha: | N/A* |

### Rents

| | |
|---|---|
| Prime: | $150/sq m |
| Secondary: | $130/sq m |

### Yields

| | |
|---|---|
| Prime: | 5.50% - 6.25% |
| Secondary: | 5.75% - 6.50% |

*No availability

- Re-development of existing industrial properties into residential properties has resulted in a lack of industrial stock in the City Fringe. At present, there are only two vacancies over 5,000-6,000 sq m in the City Fringe.
- Recent times has seen a rapid exodus of fringe based tenants to the west, south east and north. An example of this is Aust Pac who moved to a 24,662 sq m property in the west.


| | |
|---|---|
| **Address:** | 164-168 Roden Street, West Melbourne |
| **Price:** | $17.0 million |
| **Sale Date:** | Jan 2019 |
| **Vendor:** | Oliver Hume |
| **Purchaser:** | Private owner occupier |
| **Comment:** | Permit to develop 157 apartments |

## North

### Vacancy

| | |
|---|---|
| Prime: | 70,332 sq m |
| Secondary: | 95,005 sq m |

### Land

| | |
|---|---|
| <5,000 sq m: | $400/sq m |
| 1-5 ha: | $300/sq m |

### Rents

| | |
|---|---|
| Prime: | $83/sq m |
| Secondary: | $73/sq m |

### Yields

| | |
|---|---|
| Prime: | 6.50% - 7.00% |
| Secondary: | 6.75% - 7.75% |

- The last 18 months has seen a substantial take-up of large lots in existing business parks and this has resulted in a shortage of serviced land for development.
- Vacancy is tight in the North with only 6 properties over 10,000 sq m available.
- The north has experienced strong leasing demand from the logistics/warehousing and manufacturing sectors.


| | |
|---|---|
| **Address:** | 1735 Sydney Road, Campbellfield |
| **Price:** | U/D |
| **Sale Date:** | May 2019 |
| **Vendor:** | Ford Australia |
| **Purchaser:** | Pelligra Group |
| **Comment:** | Sold along with Geelong site, will be subdivided and revived as a new industrial estate |

## East

### Vacancy

| | |
|---|---|
| Prime: | N/A* |
| Secondary: | 89,644 sq m |

### Land

| | |
|---|---|
| <5,000 sq m: | N/A* |
| 1-5 ha: | N/A* |

### Rents

| | |
|---|---|
| Prime: | $92/sq m |
| Secondary: | $69/sq m |

### Yields

| | |
|---|---|
| Prime: | 5.75% - 6.50% |
| Secondary: | 6.50% - 7.75% |

*No availability

- Vacancy in the East continues to decline. For the third consecutive quarter there is no available prime stock, and secondary stock continued a decline that started in Q2 2018
- Strong competition—especially from developers looking to acquire land to convert into strata—has resulted in infill development land values rising steadily in recent years, however prices have recently started to come back.


| | |
|---|---|
| **Address:** | 649 Springvale Road, Mulgrave |
| **Price:** | $26.0 million |
| **Sale Date:** | Feb 2019 |
| **Site Area:** | 48,600 sq m |
| **Price/sq m:** | $534 |
| **Vendor:** | Private |
| **Purchaser:** | Fife Capital |

## South East

**Vacancy**

| | |
|---|---|
| Prime: | 72,962 sq m |
| Secondary: | 106,526 sq m |

**Land**

| | |
|---|---|
| <5,000 sq m: | $620/sq m |
| 1-5 ha: | $505/sq m |

**Rents**

| | |
|---|---|
| Prime: | $93/sq m |
| Secondary: | $70/sq m |

**Yields**

| | |
|---|---|
| Prime: | 5.75% - 6.50% |
| Secondary: | 6.50% - 7.75% |

- Rents continue to rise in the South East. Over the last 12 months prime rents have increased by 8.1% whereas secondary rents have risen by 9.4%.
- The recent sale of 875 Taylors Road in Dandenong South to Frasers is expected to translate to speculative development and pre-lease activity towards the back end of 2020

"A paradigm shift in commercial property is occurring, with the traditional bricks-and-mortar retail sector being absorbed by an industrial sector driven by E-commerce"

## West

**Vacancy**

| | |
|---|---|
| Prime: | 201,670 sq m |
| Secondary: | 58,501 sq m |

**Land**

| | |
|---|---|
| <5,000 sq m: | $380/sq m |
| 1-5 ha: | $275/sq m |

**Rents**

| | |
|---|---|
| Prime: | $84/sq m |
| Secondary: | $70/sq m |

**Yields**

| | |
|---|---|
| Prime: | 5.75% - 6.50% |
| Secondary: | 7.00% - 7.75% |

- 142,000 sq m of speculative space is anticipated to land in the west this year.
- E-commerce is driving the Western industrial leasing market, as evidenced by the recent HB Commerce (30,885 sq m) and HUT group (5,117 sq m) deals.
- A long term lens reveals that rents in the west are now approaching parity with the East.


| | |
|---|---|
| **Address:** | 210 Swann Drive, Derrimut |
| **Price:** | $11.50 million |
| **Sale Date:** | May 2019 |
| **Vendor:** | ABC Tissue |
| **Purchaser:** | Air Trunk |
| **Site Area:** | 45,310 sq m |
| **Price/sq m:** | $254 |

**Definitions:**
**Core Market Yield:** The percentage return/yield analysed when the assessed fully leased net 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).
**Prime Grade:** Asset with modern design, good condition & utility with an office component 10-30%. Located in an established industrial precinct with good access.
**Secondary Grade:** Asset with an older design, in reasonable/poor condition, inferior to prime stock, with an office component between 10-20%.
**WALE:** Weighted Average Lease Expiry.
**Methodology:**
This analysis collects and tabulates data detailing vacancies, net face rents and yields (5,000 sq m+, sales of $3mil+) within industrial properties across all of the Melbourne Industrial Property Market. The buildings are categorised into 1) Existing Buildings – existing buildings for lease. 2) Speculative Buildings – buildings for lease which have been speculatively constructed and although have reached practical completion, still remain vacant. 3) Spec. Under Construction – buildings for lease which are being speculatively constructed and will be available for occupation within 12 months.

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RESEARCH
**Finn Trembath**
Associate Director, Victoria
+61 3 9604 4608
Finn.Trembath@au.knightfrank.com

**Kanwal Singh**
Research Analyst, Victoria
+61 3 9604 4627
Kanwal.singh@au.knightfrank.com

**Ben Burston**
Partner, Head of Research & Consulting
+61 2 9036 6756
Ben.Burston@au.knightfrank.com

INDUSTRIAL
**Gab Pascuzzi**
Partner, Head of Division
+61 3 9604 4649
Gab.Pascuzzi@au.knightfrank.com

**Adrian Garvey**
Director
+61 3 8545 8616
Adrian.Garvey@au.knightfrank.com

**Joel Davy**
Director
+61 3 9604 4674
Joel.Davy@au.knightfrank.com

**Marco Sandrin**
Director
+61 3 9604 4731
Marco.Sandrin@au.knightfrank.com

**Brent Glassford**
Director
+61 3 9604 4683
Brent.Glassford@au.knightfrank.com

NATIONAL
**Robert Salerno**
Partner, Head of Industrial
+61 2 9761 1871
Robert.Salerno@au.knightfrank.com

VALUATIONS & ADVISORY
**Michael Schuh**
Partner, Joint Managing Director
+61 3 9604 4726
Mschuh@vic.knightfrankval.com.au

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

Newmark Knight Frank