HIGHLIGHTS

Melbourne’s industrial market saw new supply in 2018 reach a 10-year high, although the overall level of available space still fell through the year due to strong demand.

New supply in 2019 will be constrained by the lack of development-ready sites. This, together with strong demand for industrial space, will see rents continue to increase.

Investor demand remains very strong but securing stock is a challenge, with lower transaction volumes recorded in 2018.
ECONOMY & DEMAND
Melbourne’s industrial market continues to thrive from strong growth in online retailing, warehouse automation and transport infrastructure investment.

Robust growth in Victoria driven by household expenditure and business investment

According to the latest Australian Bureau of Statistics data, Victoria is the nation’s top performing economy, recording the highest annual growth rate of any state. Household expenditure and business investment contributed to the strong annual growth, signalling strength in the household and business sectors.

The positive result comes just as Victoria’s building and manufacturing industries were announced as the nation’s best performers. This was underpinned by a lift in non-residential building approvals and strong government funding in manufacturing and infrastructure investment.

In 2018, the state government announced the following infrastructure projects: Melbourne Airport Rail Link, Suburban Rail Loop and Level Crossing Removal expansion. These projects add to the extensive list of transport infrastructure projects currently underway or in planning.

Road projects currently underway include the O’Herns Road Upgrade, Western Roads Upgrade and Monash Freeway upgrade. These projects will improve transport capacity of freeways and reduce traffic congestion over the next two to five years, offering direct benefit to the industrial sector.

Online retailing and facility upgrades driving demand

As more and more people shop online, so has the need for the E-commerce sector to occupy more industrial space. Simultaneously, customers’ rising expectations for faster delivery times and a wider range of products is prompting demand for more efficient warehousing systems.

Demand for industrial space is also being boosted by the food industry, which itself is being driven by Victoria’s strong population growth. Over the past year, a number of food production & processing companies consolidated into larger, more automated industrial facilities. Woolworths and Coles are following suit, implementing supply chain automation into their warehouses.

TABLE 1
Victoria Major Transport Infrastructure Projects

<table>
<thead>
<tr>
<th>Project</th>
<th>Status</th>
<th>Cost* $ bil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level Crossing Removal&lt;sup&gt;3&lt;/sup&gt;</td>
<td>U/C with estimated 2025 completion; 25 were recently added to the list of 50 level crossing removals</td>
<td>14.9</td>
</tr>
<tr>
<td>West Gate Tunnel</td>
<td>U/C with estimated 2022 completion</td>
<td>6.7</td>
</tr>
<tr>
<td>North East Link</td>
<td>U/C with estimated 2026 completion</td>
<td>16.5</td>
</tr>
<tr>
<td>Melbourne Airport Rail Link</td>
<td>Prospective; business case will be completed in 2020; construction is set to begin by 2022</td>
<td>10.0-15.0</td>
</tr>
<tr>
<td>Suburban Rail Loop</td>
<td>Prospective; business case to be developed to assess the proposed new rail network once funding is received</td>
<td>40.0-60.0</td>
</tr>
</tbody>
</table>

*Estimate   G.Federal/state government fully-funded
Source: Knight Frank Research
**VACANCY & RENTS**

**Vacancy falls throughout the year**

Strong leasing activity and limited vacancy additions in Q4 2018 caused industrial vacant space (5,000 sq m+) to fall for the fourth consecutive quarter. Vacancy currently sits at its lowest level in five years, totalling 671,554 sq m.

Prime vacancy increased for the first time in two years, following the additions of large speculative completions and sizeable backfill space. These buildings are expected to lease fairly quickly given tenants’ preference for new prime grade space.

**2019 new supply to fall to below historical average levels**

New supply in 2018 reached a 10-year high after 612,024 sq m was added to Melbourne’s industrial market over the year, driven by strong owner occupier and pre-lease activity. With land availability decreasing across Melbourne’s industrial market and few design & construct completions due over the coming year, new supply in 2019 is forecast to fall below the historical average. As shown in Figure 3, the majority of supply remains in the West.

**Speculative developments on the rise**

The combination of low vacancy and strong tenant enquiry levels for new builds, in particular automated facilities, has prompted developers to increase the level of speculative construction in 2019. This also comes after more than 100,000 sq m of speculative developments was absorbed by the market in 2018. The majority of speculative developments currently in the pipeline are concentrated in the West and parts of the South East, where land is more readily available.

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**TABLE 2**

**Recent Leasing Activity Melbourne**

<table>
<thead>
<tr>
<th>Address</th>
<th>Region</th>
<th>Net Rent $/sq m</th>
<th>Area</th>
<th>Term (yrs)</th>
<th>Tenant</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>67 Scanlon Dr, Epping^</td>
<td>N</td>
<td>85.00</td>
<td>5,498</td>
<td>10</td>
<td>Diseb Food Group</td>
<td>Q4-18</td>
</tr>
<tr>
<td>160 Bridge Rd, Keysborough</td>
<td>SE</td>
<td>85.00</td>
<td>16,397</td>
<td>U/D</td>
<td>Wallara Logistics</td>
<td>Q4-18</td>
</tr>
<tr>
<td>Units 1-3, 182-198 Maidstone St, Altona</td>
<td>W</td>
<td>U/D</td>
<td>36,680</td>
<td>U/D</td>
<td>Arrow Logistics</td>
<td>Q4-18</td>
</tr>
<tr>
<td>2-30 Saintley Dr, Truganina</td>
<td>W</td>
<td>76.00</td>
<td>22,000</td>
<td>6</td>
<td>Catch Group</td>
<td>Q3-18</td>
</tr>
<tr>
<td>3 Taras Av, Altona*</td>
<td>W</td>
<td>85.00</td>
<td>5,195</td>
<td>U/D</td>
<td>Adcon Group</td>
<td>Q3-18</td>
</tr>
</tbody>
</table>

N North, SE South East, W West *Speculative ^Pre-lease Source: Knight Frank Research

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**Rents, Incentives & Outlook**

<table>
<thead>
<tr>
<th>Grade</th>
<th>Prime</th>
<th>Secondary</th>
</tr>
</thead>
<tbody>
<tr>
<td>$/sq m</td>
<td>4.3% gth y-o-y</td>
<td>4.2% gth y-o-y</td>
</tr>
<tr>
<td></td>
<td>18.3% incentive</td>
<td>14.8% incentive</td>
</tr>
</tbody>
</table>

Prime and secondary rents recorded healthy annual growth rates of 4% each in the 12 months to January 2019, owing to strong demand which continues to outpace supply. In the coming months, rents are anticipated to grow at a similar rate as demand for automated facilities strengthens and capital values rise.

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Source: Knight Frank Research

**FIGURE 1**

Melbourne Industrial Vacancy

‘000 sq m prime v secondary available space

Source: Knight Frank Research

**FIGURE 2**

Melbourne Industrial New Supply

‘000 sq m gross new industrial construction

Source: Knight Frank Research/Cordell Connect

**FIGURE 3**

Melbourne Industrial Rents

Net face rents by grade ($/sq m) exc City Fringe

Source: Knight Frank Research
Land values continue to surge upward

Strong demand, low levels of new supply and rising rents in the industrial sector have encouraged developers, business owners and land bankers to maximise development site opportunities. A lack of available stock and tightening yields have also made it difficult to secure investment stock and developing is becoming an increasingly attractive way of accessing the industrial sector. As a result, 2018 saw a flurry of development site sales (where available) across Melbourne.

Nevertheless, in an environment where land availability is decreasing, industrial land prices have continued to increase. Land value appreciation was most evident in the West where <5,000 sq m and 1-5 hectare lots increased by 40% each in the past year to reach $350 and $253 respectively.

Limited new supply to dampen 2019 D&C activity

The design & construct (D&C) market recorded a new series high in 2018, following over 400,000 sq m of D&C completions. This comes after a previous series high of approximately 330,000 sq m was recorded in the year prior. Reflective of growth industries in Melbourne’s industrial sector, the D&C market in 2018 was dominated by Manufacturing (36%), Logistics (22%), Retail Trade (17%) and Wholesale Trade (17%).

D&C activity is expected to drop in 2019, a direct impact of low levels of new supply and developers shifting their focus to speculative developments. Nevertheless, there is still demand for D&C facilities from many growth industries, with D&C facilities for Dunlop Flooring (Manufacturing), Mainfreight (Logistics) and Woolworths (Retail Trade) due to complete in the two years.

<table>
<thead>
<tr>
<th>Image 42x426 to 553x748</th>
<th>Image 520x278 to 549x267</th>
<th>Image 395x299 to 416x321</th>
<th>Image 218x58 to 320x75</th>
<th>Image 221x58 to 320x75</th>
</tr>
</thead>
</table>

**TABLE 3**

**Recent Land/Development Sales Activity Melbourne**

<table>
<thead>
<tr>
<th>Address</th>
<th>Region</th>
<th>Price $ mil</th>
<th>Area (sq m)</th>
<th>$/sq m</th>
<th>Purchaser</th>
<th>Sale Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>410 Cooper St, Epping</td>
<td>N</td>
<td>20.00</td>
<td>97,000</td>
<td>206</td>
<td>Time &amp; Place Commercial</td>
<td>Dec-18</td>
</tr>
<tr>
<td>415 Cooper St, Epping</td>
<td>N</td>
<td>40.00</td>
<td>63,400</td>
<td>63</td>
<td>Frasers Property</td>
<td>Nov-18</td>
</tr>
<tr>
<td>1626-1638 Centre Rd, Springvale</td>
<td>SE</td>
<td>11.00</td>
<td>42,800</td>
<td>257</td>
<td>Ledlin Group</td>
<td>Jul-18</td>
</tr>
<tr>
<td>21-29 Radford Rd, Reservoir</td>
<td>N</td>
<td>12.00</td>
<td>53,000</td>
<td>226</td>
<td>Owner Occupier</td>
<td>Jul-18</td>
</tr>
</tbody>
</table>

N North  SE South East  Source: Knight Frank Research
shortfall of available stock as investors held on to their assets in anticipation of better asset recycling opportunities. Regardless, with many local and offshore investors still looking to expand their foothold in the performing industrial market, this has driven sales prices up and caused yields to tighten.

Yields fall in line with strong demand and limited opportunities

The combination of strong investor demand and limited investment opportunities resulted in prime and secondary yields compressing in the 12 months to January 2019. Secondary yields compressed at a higher rate than prime yields given the limited number of prime grade assets on offer and investors seeking more favourable yields.

Strong ongoing demand for industrial assets is likely to cause yields to tighten further in the next 12 months, albeit at a slower rate than the 2018 period, as investors begin to be more selective with their investment decisions.

AREITs increase their investment presence

AREITs were active investors in the past year, increasing their investment share from 8% to 22% between 2017 and 2018. This was facilitated by large acquisitions from GPT Group, Centuria and Lendlease for assets in the North and West.

Unlisted funds/syndicates held the second highest investment share at 20%, underpinned by LOGOS Property’s acquisition of the Kmart Distribution Centre in Truganina for $119 million on a 5.50% initial yield.

Seemingly, both AREITs and unlisted funds have been growing their industrial portfolios, acquiring key warehouse and logistics assets over the past year. They have reduced their holdings in the retail sector through the divestment of non-core retail assets, whose performance has been impacted by lower consumer confidence and the rise in online shopping.
**City Fringe**

- Investor interest for City Fringe development sites remains high.
- As Victoria’s population grows and higher import/export trade is required, demand for industrial space in Melbourne’s port will grow accordingly. To accommodate this, the Port of Melbourne recently launched 16.9 hectares of new industrial land across eight sites.

**North**

- Shrinking land availability and strong demand from the Manufacturing and Logistics industries have renewed development interest in the North.
- Epping is expected to cater for much of the new supply in 2019 and 2020, following the acquisitions of 70 hectares worth of development sites in 2018.

**East**

- Given limited prime vacancy, prime rents increased by 6.2% over the past year.
- The last remaining available prime grade asset at 8 Lakeview Drive, Scoresby was leased over Q4 2018 to Rust-Oleum.
- The East is the most constrained precinct for land availability, with no further land supply additions anticipated over the forthcoming years.

**Development Site Sale**

- Address: 32-38 Cook Street, Port Melbourne
- Price: $6.4 million
- Sale Date: October 2018
- Site Area: 4,413 sq m
- Price/sq m: $1,450
- Vendor: MAB Corporation
- Purchaser: Offshore investor

**Investment Sale**

- Address: 13 Ricky Way & 10 Jersey Drive, Epping
- Price: $9.3 million
- Sale Date: June 2018
- Vendor: MPG Funds Management
- Purchaser: Industria REIT
- Yield: 6.50% core market
- Comment: Manufacturing & distribution facility close to Melbourne Market

“There is a limited amount of A-grade leasing opportunities and constricted land supply in the short to medium term.”

Gab Pascuzzi
Partner
South East

- Take-up in 2018 was 17.8% up from 2017, supported by strong demand from the Manufacturing and Logistics industries.
- Similar to the East, land availability is expected to be tightly held. Land values grew by 16% year-on-year.
- Secondary yields compressed by more than 80 basis points in the 12 months to January 2019.

West

- 150,000 sq m of speculative space is anticipated to come on line in 2019.
- The Western industrial leasing market is being driven by the Logistics industry, with companies such as Arrow Transport and WWL Logistics increasing their industrial footprint over Q4 2018.
- New large supply in the West is mostly being built in Truganina and Laverton North.

Pre-Lease Completion

Address: 225 Glasscocks Road, Dandenong South
Year built: 2018
NLA: 69,217 sq m
WALE: 19.7 years (July 2018)
Tenant: Woolworths
Owner: Charter Hall
Comment: Purpose built fully automated distribution facility

Investment Sale

Address: 1 West Park Drive, Derrimut
Price: $10.57 million
Sale Date: September 2018
Vendor: Frasers Property
Purchaser: Investa
Yield: 6.62% core market
Comment: Sold fully leased to Downer Utilities Australia
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