RESEARCH

MELBOURNE INDUSTRIAL

MARKET OVERVIEW FEBRUARY 2019

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.

MARKET DRIVERS

Population Growth
Aust: 1.6%   VIC: 2.2%
ABS Jun 17 to Jun 18

Economic Growth
Aust: 2.8%   VIC: 3.4%
ABS Sep 17 to Sep 18

Household Expenditure Growth
Aust: 2.5%   VIC: 3.3%
ABS Sep 17 to Sep 18

Business Investment Growth
Aust: 2.7%   VIC: 3.4%
ABS Sep 17 v Sep 18

Non-Residential Building Approvals
Aust: -8.6%   VIC: 14.6%
ABS Nov 17 v Nov 18

JANE WONG
Research Analyst

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

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

*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.

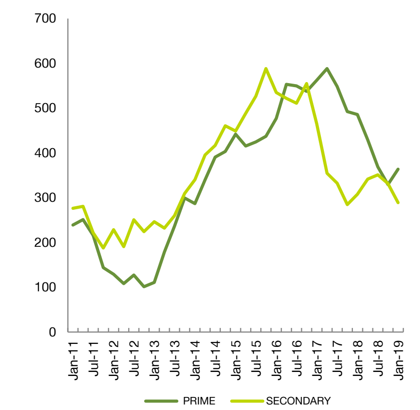
Rents, Incentives & Outlook

Prime	$85/sq m 4.3% gth y-o-y 18.3% incentive	↗
Secondary	$68/sq m 4.2% gth y-o-y 14.8% incentive	↗

Rents set to climb in 2019

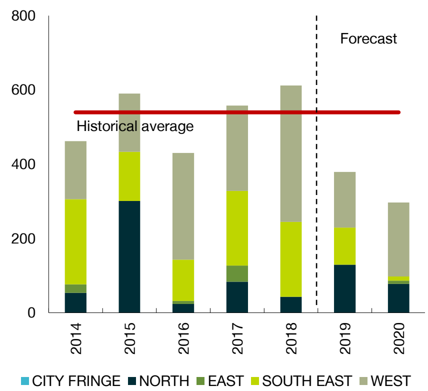
Prime and secondary rents recorded healthy annual growth rates of 4% each in the 12 months to January 2019, owing to strong demand which continues to outpace supply. In the coming months, rents are anticipated to grow at a similar rate as demand for automated facilities strengthens and capital values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

FIGURE 1
Melbourne Industrial Vacancy
'000 sq m prime v secondary available space



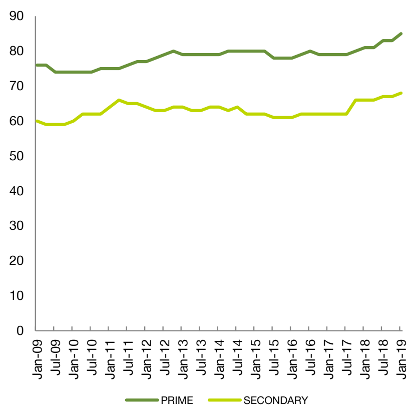
Source: Knight Frank Research

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

Speculative developments on the rise

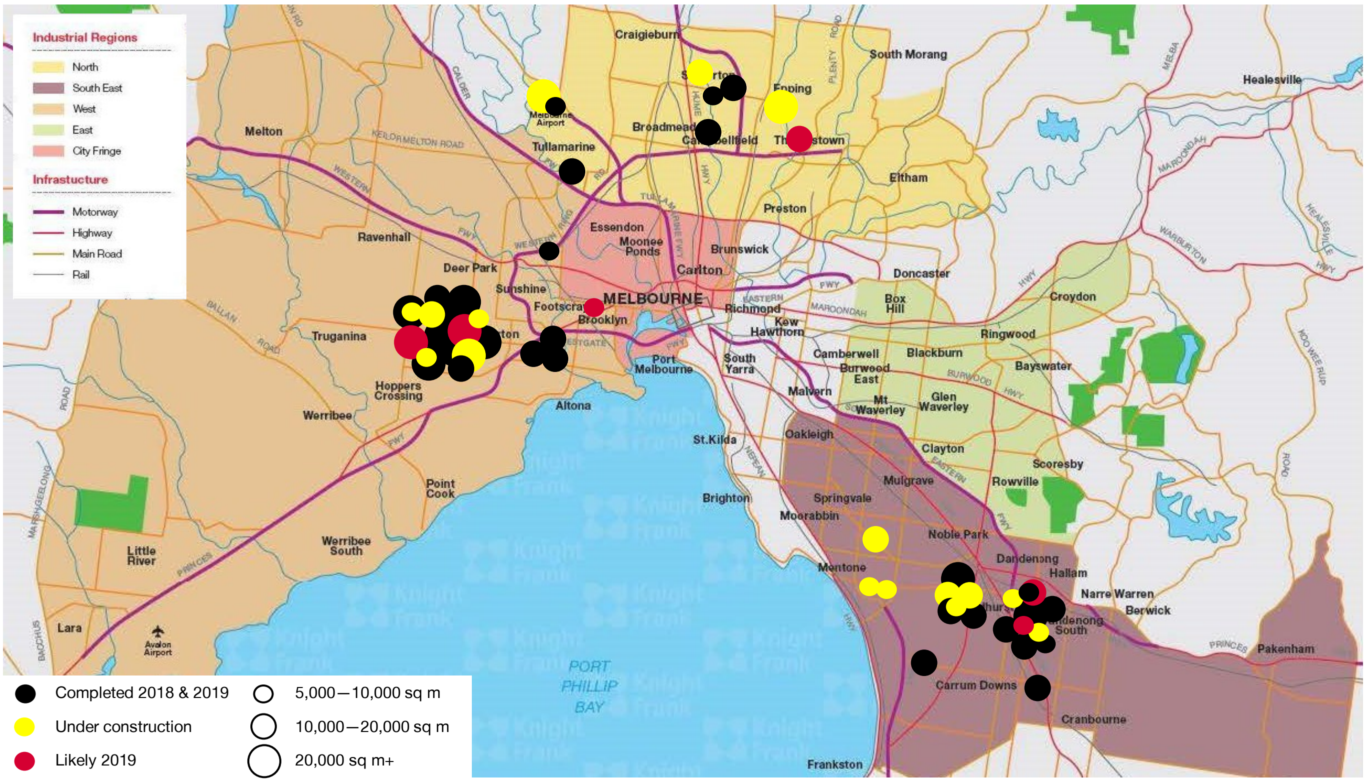
The combination of low vacancy and strong tenant enquiry levels for new builds, in particular automated facilities, has prompted developers to increase the level of speculative construction in 2019. This also comes after more than 100,000 sq m of speculative developments was absorbed by the market in 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.

TABLE 2
Recent Leasing Activity Melbourne

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

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

DEVELOPMENT & LAND VALUES



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.

Land Values & Outlook

<5,000 sq m	$410/sq m 27% gth y-o-y
1-5 ha	$290/sq m 39% gth y-o-y

TABLE 3

Recent Land/Development Sales Activity Melbourne

Address	Region	Price $ mil	Area (sq m)	$/sq m	Purchaser	Sale Date
410 Cooper St, Epping	N	20.00	97,000	206	Time & Place Commercial	Dec-18
415 Cooper St, Epping	N	40.00	634,000	63	Frasers Property	Nov-18
1626-1638 Centre Rd, Springvale	SE	11.00	42,800	257	Ledlin Group	Jul-18
21-29 Radford Rd, Reservoir	N	12.00	53,000	226	Owner Occupier	Jul-18

N North SE South East
Source: Knight Frank Research

INVESTMENT ACTIVITY & YIELDS

Current Yields & Outlook

Prime	6.05% - 6.75% -10 bps 12 mths	↘
Secondary	6.70% - 7.70% -77 bps 12 mths	↘

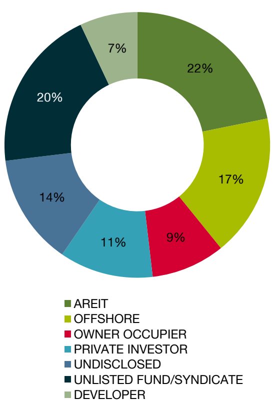
Drop in transaction volumes as investors hold on to stock

In 2018, Melbourne's industrial sales volumes ($10 million+) totalled $1.0 billion across 45 transactions. This compares with $1.4 billion across 55 transactions in 2017. The fall in investment activity was influenced by a 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.

FIGURE 4

Melbourne Industrial Sales ($10 mil+)

By purchaser type—2018



Source: Knight Frank Research

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.

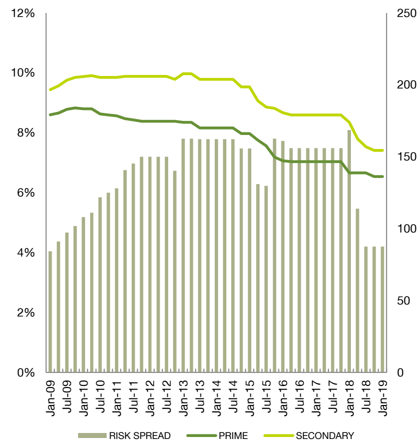
AREITs increase their investment presence

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.

FIGURE 5

Melbourne Industrial Yields

% core market yield (LHS) & bps premia (RHS)



Source: Knight Frank Research

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.

TABLE 4

Recent Improved Sales Activity Melbourne

Address	Region	Price $ mil	Bldg Area (sq m)	Core Mkt Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
1 International Drive, Tullamarine	N	42.00	25,866	7.00	2.3	Warrington Property Group	Centuria Industrial REIT	Nov-18
79-85 Cherry Lane, Laverton North^	W	24.50	17,211	6.41*	U/D	Probiotec Limited	Ascot Capital	Sep-18
508-520 Wellington Road, Mulgrave~	SE	30.50	8,049	3.06	1.6	Makhmalbaf family	Pomeroy Pacific	Sep-18
Kmart Distribution Centre, 2 Banfield Court, Truganina	W	119.00	76,938	5.30	7.5	Investec	LOGOS Property	Aug-18
54-76 Southern Road, Mentone^~	SE	24.00	32,383	U/D	0.3	Hella	Goodman Group	Jul-18

Source: Knight Frank Research N North SE South East W West *Initial yield U/D Undisclosed ^Sale-leaseback ~Potential development site

PRECINCT HIGHLIGHTS

City Fringe

Vacancy

Prime:	N/A*
Secondary:	44,340 sq m

Land

<5,000 sq m:	$1,500/sq m
1-5 ha:	N/A*

Rents

Prime:	$130/sq m
Secondary:	$100/sq m

Yields

Prime:	5.50% - 6.25%
Secondary:	6.00% - 6.75%

*No availability

- 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.

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

North

Vacancy

Prime:	64,565 sq m
Secondary:	38,755 sq m

Land

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

Rents

Prime:	$83/sq m
Secondary:	$72/sq m

Yields

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

- 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.

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

East

Vacancy

Prime:	N/A*
Secondary:	108,425 sq m

Land

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

Rents

Prime:	$86/sq m
Secondary:	$64/sq m

Yields

Prime:	6.00% - 6.75%
Secondary:	6.75% - 8.00%

*No availability

- 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.

"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

Vacancy

Prime:	99,163 sq m
Secondary:	52,699 sq m

Land

<5,000 sq m:	$588/sq m
1-5 ha:	$493/sq m

Rents

Prime:	$87/sq m
Secondary:	$66/sq m

Yields

Prime:	6.00% - 6.75%
Secondary:	6.75% - 8.00%

- 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.

Pre-Lease Completion

Image Source: Charter Hall

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

West

Vacancy

Prime:	199,880 sq m
Secondary:	54,467 sq m

Land

<5,000 sq m:	$350/sq m
1-5 ha:	$253/sq m

Rents

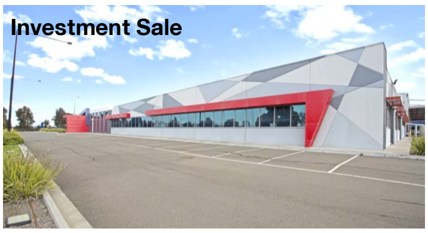
Prime:	$82/sq m
Secondary:	$73/sq m

Yields

Prime:	6.00% - 6.50%
Secondary:	7.25% - 8.00%

- 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.

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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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.
Vacancy Methodology:
This analysis collects and tabulates data detailing vacancies (5,000 sq m+) 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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