

RESEARCH



MELBOURNE INDUSTRIAL

MARKET OVERVIEW MARCH 2020

OUTLOOK FOR MORE DEVELOPMENT
COMPLETIONS IN 2020

HIGHLIGHTS

Industrial rental growth slowed in the second half of 2019, as the market adjusted to recent increases in rents witnessed since 2017.

Industrial land values in Melbourne have increased over the last 12 months, driven by increases in prices recorded in the South East and West.

Transaction volumes are in line with what was recorded in CY 2018. Since 2008 sales volume has risen consistently.

MARKET DRIVERS



Population Growth

AUS: 1.5% VIC: 2.1%

YoYΔ: Jun'19



Economic Growth

AUS: 1.9% VIC: 3.0%

YoYΔ: Jun '19



Unemployment Rate

AUS: 5.2% VIC: 5.5%

As at: Jan'20



Online Retail Trade

AUS: +19.2% (at \$2,306.0m)

YoYΔ: Dec'19



Investment in Infrastructure

VIC: \$14.2bn

FY '19-20

Source: ABS, Department of Treasury and Finance



FINN TREMBATH
Associate Director

ECONOMY & DEMAND

Take up of prime industrial stock increases in CY 2019 as the Melbourne industrial market comes to terms with recent increases in rents.

Victoria the engine behind the nation's economy

Despite a broader slowdown in growth and uncertainty over the economic outlook, Victoria is still driving the national economy. 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.

Over the 2018-2019 FY the state's economy grew by 3.0%, against the national rate of 1.9%. Health Care and Social Assistance (11.3%), Construction (4.7%) and Financial and Insurance Services (3.3%) contributed to over half of economic growth in Victoria.

Growth in online retailing drives industrial sector

Online retail penetration continues to increase in Australia, and this is having a profound effect on the industrial sector.

According to the ABS, online retail turnover as a proportion of all retail turnover has risen markedly in recent years, more than doubling from 3.0% in Dec 2015 to 6.6% in Dec 2019. And online retail turnover increased by 19.2%

in 2019 CY. With online penetration in the UK currently sitting at 19%, it would seem inevitable that online shopping in Australia will continue to grow in the coming years.

Improvements in return policies, faster delivery times, the rise of online marketplaces, the rise of shopping by phone, a broader range of delivery options, and improved tracking systems are all factors felt to be behind the rise of E-Commerce.

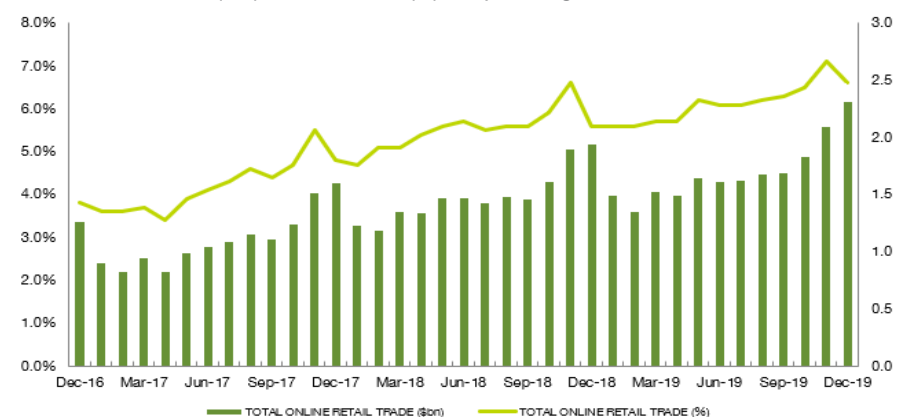
The rapid proliferation of online retail has boosted demand for industrial property. Much of Melbourne's new industrial development and tenant demand is stemming from the E-Commerce sector, and prime take up in CY 2019 (570,740 sq m) was up on what was recorded in CY 2018 (391,286 sq m).

With industrial property in strong demand, major institutional players such as GPT have responded by shifting the balance of their portfolios away from underperforming bricks and mortar retail to logistics real estate.

FIGURE 1

Online Retail Turnover

Total online retail trade (\$bn) and online trade (%) as a percentage of total retail trade



Source: ABS

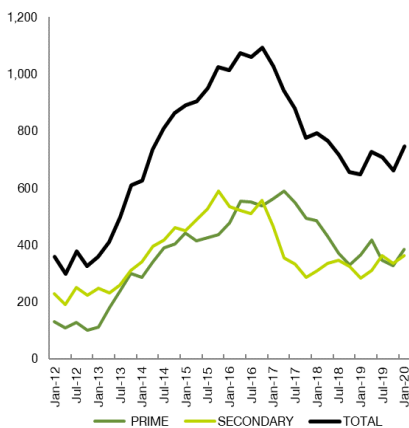
VACANCY & RENTS

Low prime vacancy due to increase in prime take up

Melbourne's industrial vacant space (5,000 sq m+) sits at 746,173 sq m. Vacancy increased by 15.2% over CY 2019 off the back of a 28.1% increase in existing secondary stock levels, with this increase driven by the South East where secondary vacancy has increased by 102.1% since January 2019.

While vacancy overall has risen, the amount of prime grade vacant space has largely remained stable, increasing from 365,442 sq m at the end of 2018 CY to 384,412 sq m at the end of 2019 CY.

FIGURE 2
Melbourne Industrial Vacancy
Available Space by Grade ('000 sq m)



Source: Knight Frank Research

And prime vacancy levels over the last 2 years (average 371,134 sq m) are notably lower than what was recorded between 2014 to 2017 (average 478,000 sq m).

In the East there has been no prime vacant space for over 12 months, and the North is recording prime vacancy levels not seen since 2013.

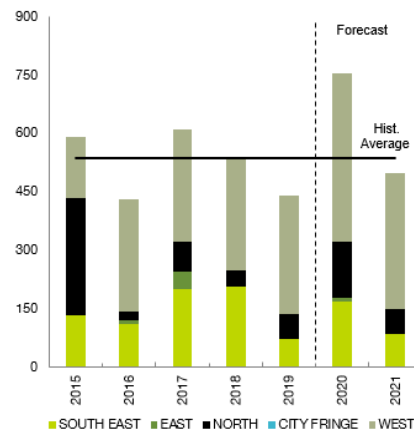
As signposted earlier, the relatively low prime vacancy is attributable to a notable increase in prime take up. The majority (71%) of this prime take up came from the West where 409,379 sq m was taken up.

Market adjusts to rent rises

A substantial increase in land values over the last CY resulted in an increase in rents. Across the Melbourne industrial market, rents increased by 7.3% for prime assets over CY 2019. However, rental growth has stalled across the board since mid-2019. This is due to the market coming to terms with the recent rise in rents (prime rents have risen 13.1% over the last 2 years).

Moving forwards, rents are expected to increase in response to the recent rise in land values. Rents should also increase in areas such as the West where demand

FIGURE 3
Melbourne Industrial New Supply
New Developments by Precincts ('000 sq m)



Source: Knight Frank Research/ CoreLogic

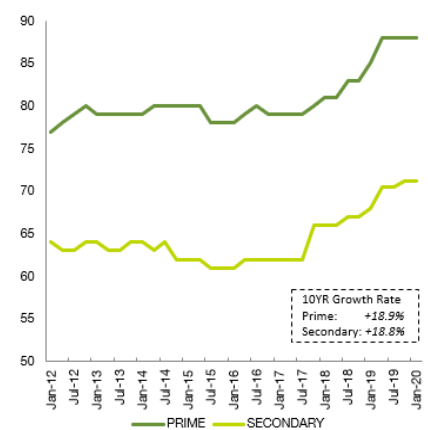
Rents, Incentives & Outlook*

(per sq m)	Prime	Secondary
Rents	\$88	\$71
YoYΔ Jan'20:	+4.1%	+5.2%
Incentives	16.0%	14.6%
Rents Outlook	↗	↗

* excl. City Fringe

for industrial property has risen and road and rail infrastructure is being improved. A record \$50 billion is currently being spent on key infrastructure projects in Victoria with many of these in Melbourne's West (Western Roads Upgrade, West Gate Tunnel, Level Crossing Removal).

FIGURE 4
Melbourne Industrial Rents
Net Face Rents by Grade excl. Fringe (\$/ sq m)



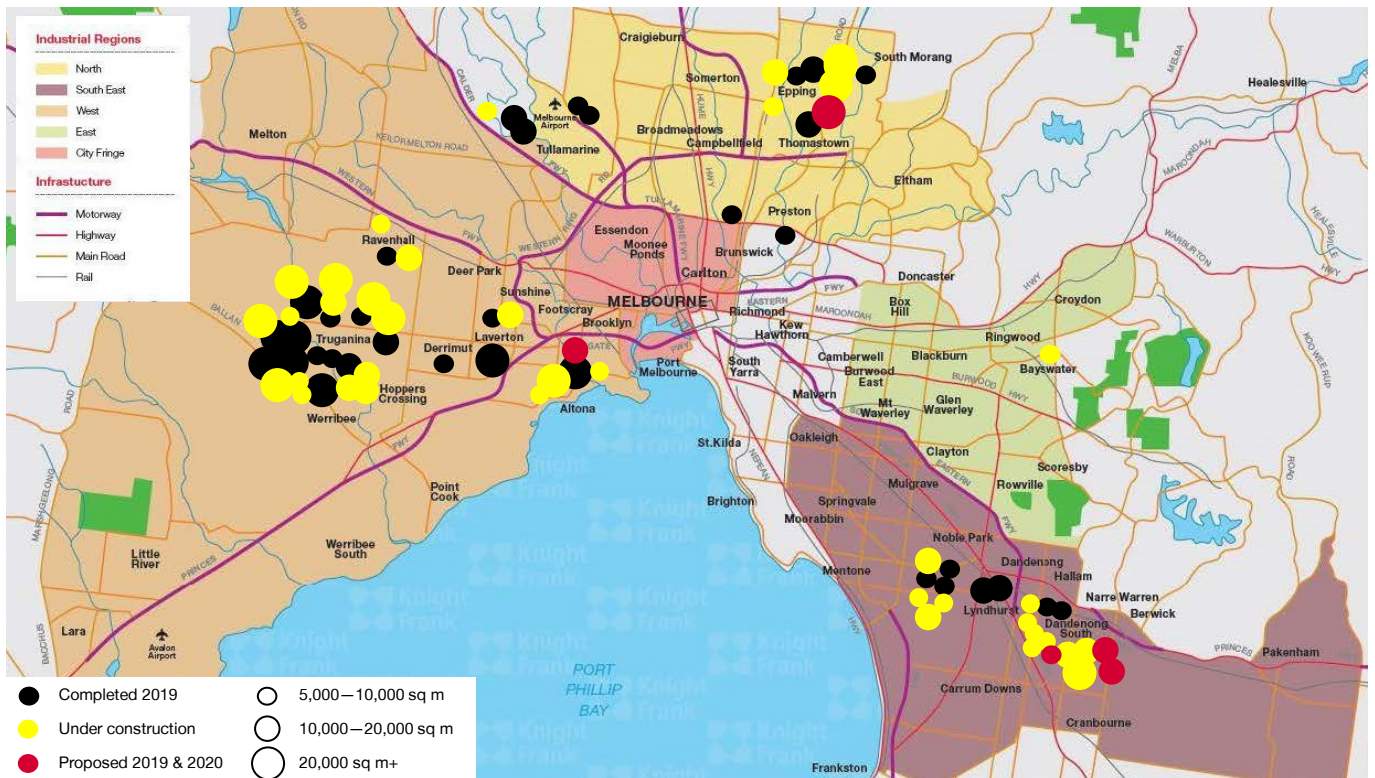
Source: Knight Frank Research

TABLE 1
Recent Leasing Activity Melbourne

Address	Region	Net Rent (\$/sq m)	Area (sq m)	Type	Tenant
445-469 Grieve Pde, Altona North	West	75	18,815	Existing	Dutton Cars
56 Toll Dr, Altona	West	80	17,907	Existing	Asaleo Care
Spec 3C & 3D, Beyer Rd, Braeside	South East	90*	14,552	Spec	Puma
1/16 Vulcan Dr, Truganina	West	75	8,383	Spec	E-store Logistics
B-8, 481 Cooper St, Epping	North	U/D	7,597	Spec	Intralox

Source: Knight Frank Research
Note: Spec- Speculative, U/D- Undisclosed, *Estimated.

DEVELOPMENT & LAND VALUES



Land values rise

Industrial land values increased over the last year, driven by increases in prices recorded in the South East and West. Most notably, over the last CY the value of <5,000 and 1-5 hectare lots in the West has grown by 8% - 9%. In the South East, respective increases of 4% and 5% have been recorded.

2020 to see wave of supply

Supply of new industrial stock in 2019 (439,023 sq m) was below the long term average (537,110 sq m), however 2020 is set to deliver an above average amount of new stock with 753,448 sq m of supply expected to land this year. Continued optimism around population growth, infrastructure spend and growth in E-commerce and logistics is driving market expansion in Melbourne. And recent strong enquiry levels should translate to continued robust take up levels as occupiers continue to seek new industrial property.

The West is set to provide more than half (57%) of this new supply. The incoming West supply will be a mix of

pre-committed stock and speculative development. In Truganina, CEVA Logistics have pre-committed to 37,307 sq m due to land in Q4 this year, and a 15,100 sq m Mapletree spec development is due to reach completion in Q4 this year.

Recent supply constraints are creating expansionary demand for new industrial property beyond existing core areas. High levels of demand for industrial real estate are such that in the West the development boundaries are being pushed beyond traditional industrial

areas such as Derrimut and Truganina. As evidence of this, ASX-listed developer Stockland in conjunction with Mount Atkinson Holdings will develop a 260 hectare, \$2 billion business park in Mount Atkinson in Melbourne's West.

Land Values & Outlook*		
(per sq m)	< 5,000	1-5 ha
Values	\$495	\$356
YoYΔ Jan'20	+6.3%	+19%
Outlook		

* excl. City Fringe

TABLE 2
Recent Land/Development Sales Activity Melbourne

Address	Region	Price \$ mil	Area (sq m)	\$ / sq m	Purchaser	Sale Date
Niton Dr, Truganina	West	35.8	149,995	239	GPT	Jul-19
865 Boundary Rd, Truganina	West	34.0	328,000	104*	GPT	Oct-19
151 Leakes Rd, Truganina	West	28.6	167,000	171	Time & Place Commercial	Aug-19
31 Fuller Rd, Ravenhall	West	23.0	207,993	111	Pelligra Group	Jul-19

Source: Knight Frank Research
Note: *Unserviced, PSP Approved

INVESTMENT ACTIVITY & YIELDS



Current Yields & Outlook

(in %)	Prime	Secondary
Yields	5.55 - 6.25	6.25 - 7.15
YoYΔ Jan'20:	-50bps	-50bps

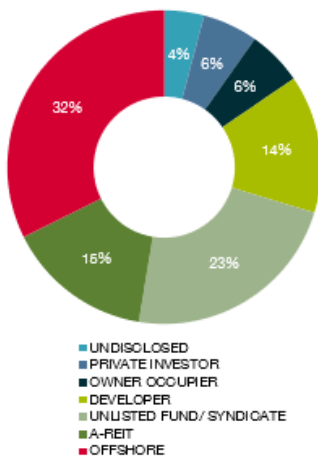
Outlook



Transaction volumes remain at high level

Industrial sales volume (\$10 million+) totaled \$2.11 billion across 76 transactions over CY 2019. Transaction volumes are in line with what was recorded in CY 2018 (\$2.29 billion). Since 2008 sales volumes have risen consistently, with sales over the last 2

FIGURE 5
Melbourne Industrial Sales (\$10 mil+)
Purchaser Profile—CY2019



Source: Knight Frank Research, RCA

years breaking the \$2 billion mark for the first time.

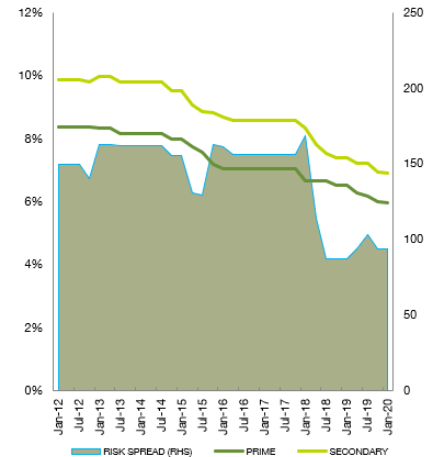
Capital raising comes easy

Major institutional funds are benefitting from the surge in demand for industrial property, with many being over-subscribed by investors when they embark on capital raising to fund industrial property acquisitions. In October 2019, the unlisted Charter Hall Prime Industrial Fund's \$725M equity fundraising was heavily over-subscribed, such was the strength of demand for industrial property. And in May 2019 Investec Australia Property Fund (IAPF) closed its \$102M capital raising offer earlier than planned, again due to strong demand from investors.

Offshore investment on the rise

2019 CY saw the return of offshore investment within the Melbourne industrial market. Offshore investors accounted for a third (33%) of all Melbourne industrial sales volume (\$10M+) in 2019, which is double what was recorded in 2018 (17%). In March, Cache Logistics Trust (Singapore) acquired 198 Maidstone Street, Altona in Melbourne's West for \$41.2M from Abacus Property Group, and in December The Straits Trading Company Limited (Singapore) transacted on 677 Springvale Road, Mulgrave in Melbourne's East for \$24M. More broadly, two large offshore groups, ESR

FIGURE 6
Melbourne Industrial Yields
Yields by Grade plus Risk Spread



Source: Knight Frank Research

Property Link (Hong Kong) and Emergent Cold (USA) purchased two large national industrial portfolios.

Yields continue to compress

2019 CY saw a relative lack of new supply hit the market and in conjunction with strong demand this resulted in yields continuing to compress over the last CY. With E-commerce and in turn the logistics and warehousing sectors expected to continue to grow, industrial property's status as a capital growth asset is assured and off the back of this yields are expected to continue to compress.

TABLE 3
Recent Sales Activity Melbourne

Address	Region	Price \$ mil	Bldg Area (sq m)	Core Mkt Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
51-95 Green Rd, Dandenong South	South East	100.0	77,124	5.75	8.0	Crescent Capital Partners	Charter Hall REIT	Q4-19
3 Maker Pl, Truganina	West	40.0	31,092	5.78	3.0	Frasers Property Australia	Growthpoint Properties	Q3-19
677 Springvale Rd, Mulgrave	East	24.0	12,157	7.10	3.1	ESR	The Straits Trading Co.	Q4-19
11 & 17 Business Park Dr, Ravenhall	West	17.0	13,014	5.83	3.3	Pellicano	Private	Q3-19
7-29 Gladstone Rd, Dandenong	South East	14.8	11,458	5.59*	6.5	Up Property	Ousson Group	Q3-19

Source: Knight Frank Research, RCA
Note: *Initial yield.

PRECINCT HIGHLIGHTS

City Fringe

Vacancy

Prime: 7,000 sq m
Secondary: 38,309 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: 5.25% - 6.00%
Secondary: 5.50% - 6.25%

*No availability

- Increases in outgoings in the form of land tax is pushing tenants out of the fringe. This is particularly evident in Port Melbourne. Tenants are looking to the West where rents are more affordable.
- Rents have stabilised since July 2019, however are up 15% (prime) and 30% (secondary) over the last CY.

North

Vacancy

Prime: 83,029 sq m
Secondary: 76,316 sq m

Land

<5,000 sq m: \$400/sq m
1-5 ha: \$350/sq m

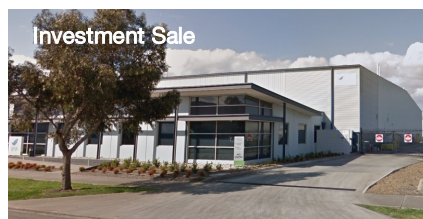
Rents

Prime: \$83/sq m
Secondary: \$73/sq m

Yields

Prime: 6.25% - 6.75%
Secondary: 6.50% - 7.25%

- Take up over the last 12 months has been low in the North (39,492 sq m in 2019, down from 108,473 sq m in 2018). The decline in take up has been driven by a shortage of stock for existing facilities, which has resulted in a lower volume of leasing deals being completed.
- Land values for 1-5 ha lots have risen by 16.7% over the last 12 months.



Address: 40 Scanlon Drive, Epping
Price: \$13.3 million
Sale Date: Aug 2019
Build Area: 9,371 sq m
Price/sq m: \$1,419
Vendor: Stockland
Purchaser: Australian Unity

East

Vacancy

Prime: N/A*
Secondary: 109,143 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: 5.50% - 6.25%
Secondary: 6.25% - 7.50%

*No availability

- Relative to the West and the South East, the East has recorded low take up over the last 12 months (35,810 sq m). This has been driven in large part by a sustained shortage of prime stock in the East.
- Both prime and secondary yields have compressed by 50 bps over the last CY.



Address: 649 Springvale Road, Mulgrave
Price: \$26.0 million
Sale Date: Feb 2019
Build Area: 19,286 sq m
Price/sq m: \$1,348
Vendor: Private Investor
Purchaser: Fife Capital



Address: 127 Todd Street, Port Melbourne
Price: \$55.0 million
Sale Date: Apr 2019
Build Area: 25,744 sq m
Price/sq m: \$2,136
Vendor: The Herald And Weekly Times Pty Ltd
Purchaser: Private Investor

South East

Vacancy

Prime: 107,583 sq m
Secondary: 106,523 sq m

Land

<5,000 sq m: \$608/sq m
1-5 ha: \$515/sq m

Rents

Prime: \$93/sq m
Secondary: \$70/sq m

Yields

Prime: 5.50% - 6.25%
Secondary: 6.25% - 7.50%

West

Vacancy

Prime: 186,800 sq m
Secondary: 31,470 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: 5.25% - 6.00%
Secondary: 6.75% - 7.25%

- Approaching a quarter (22.7%) of all take up in the Melbourne industrial market in CY 2019 stemmed from the South East industrial region.
- Both prime and secondary yields have compressed by 50 bsp over the last CY.
- Incentives have declined considerably over the last 12 months, in response to rising demand.

- Almost two thirds (62.5%) of all take up in the Melbourne industrial market in CY 2019 stemmed from the Western industrial region.
- Land values, for 1-5 ha lots and also lots under 5,000 sq m, have risen by 10.0% in the last 12 months. Land values for larger lots have doubled in the last 12 months.



Address: 51-95 Greens Road, Dandenong South
Price: \$100.0 million
Sale Date: Nov 2019
Vendor: Crescent Capital
Purchaser: Charter Hall REIT
Build Area: 77,124 sq m
Price/sq m: \$1,296



Address: 917 Boundary Rd, Truganina
Price: \$27.5 million
Sale Date: Aug 2019
Vendor: Private Investor
Purchaser: Frasers Property
Site Area: 430,000 sq m
Price/sq m: \$64

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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%.

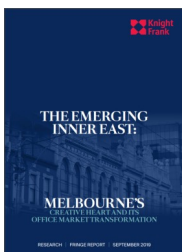
WALE: Weighted Average Lease Expiry.

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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