RESEARCH

MELBOURNE
INDUSTRIAL MARKET BRIEF NOVEMBER 2015

Key Facts

Industrial vacancy has grown for **three consecutive years** to reach a **new historical high** of 1,025,508m^2

Melbourne's industrial annual property returns at 12.2% are trending **above** the five-year average

Supply for 2015 is expected to be **28%** higher than 2014, however still **below the 10-year average**

Industrial sales in **2015** to date total **$468.1 million, 52% below** the transaction volume for the 2014 calendar year

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Melbourne's industrial development pipeline is expected to total 589,957m^2 at the completion of 2015, 28% above Melbourne's industrial completions in 2014, however annual levels remain below the 10-year average.

According to IPD, Melbourne's industrial property posted a total return of 12.2% over the 12 months to September 2015, similar to the levels reported in the prior year, trending above the five-year average of 10.7%.

The Victorian economy continued its shift away from manufacturing, with retail trade and housing construction the key economic drivers over the past year. This in turn supported warehousing demand as reflected by recent leases of: Godfreys (12,372m^2), Miele Australia (15,000m^2) and Kathmandu (25,650m^2). Looking ahead, food retailing is emerging as the major focus of industrial demand as reflected by the recent commitments of Murray Goulburn, leasing 24,662m^2 at building 3, 32-58 William Angliss Drive at Laverton North and an additional 42,000m^2 at Austrak Estate in Somerton. Additionally, Australian Diary Group leased 15,662m^2 at 25 Distribution Drive in Laverton North, whilst Fonterra (80,000m^2) and Parmalat (25,000m^2) are actively seeking space in the Melbourne industrial market.

Occupier Demand & Rents

Melbourne's vacant industrial accomodation (5,000m^2+) totals 1,025,508m^2 as at October 2015 which is 8% above the previous quarter. Vacancy has now grown for three consecutive years to reach a new historical high with 92% of the overall vacancy within existing space. Increasingly much of the vacancy is impending with tenants preferring short-term rolling lease arrangements.

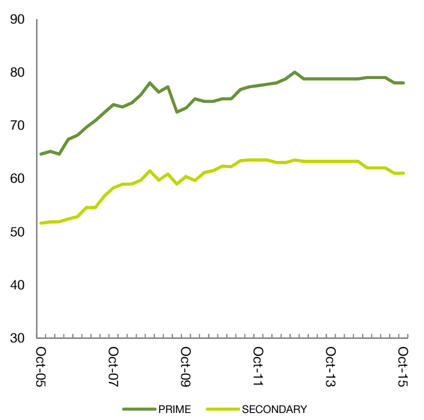
For the second consecutive quarter, the North has the highest proportion of vacant space, with 36% of Melbourne's available space located in the region, and 65% of its vacancy categorised as secondary grade. Industrial vacancy in the North has risen, largely impacted by a rise in backfill stock from tenant relocations and closures in the manufacturing sector.

In the three months to October 2015, prime vacancy levels grew by 12,307m^2 to reach 436,988m^2 remaining below the peak recorded in January 2015. In contrast, secondary space has steadily risen since January 2015, to now measure 588,520m². Vacant speculative space declined to its lowest level since January 2013 to now measure 78,174m².

Gross absorption (excl D&C) totalled 139,285m² in the third quarter of 2015, 10% higher than the previous quarter and also marginally above its historical average. Prime space accounted for 55% of the total take-up over the past quarter. The West accounted for 68% of the gross take-up, and has outperformed all other regions since July 2011.

Average prime net face rents fell by 1.3% to $78/m² from a year ago. However rising vacancy especially in existing stock, has provided strong competition to attract occupiers, resulting in an increase to incentive levels.

FIGURE 1
Melbourne Industrial Rents
Prime Vs Secondary Net Face Rents ($/m²)



Source: Knight Frank Research

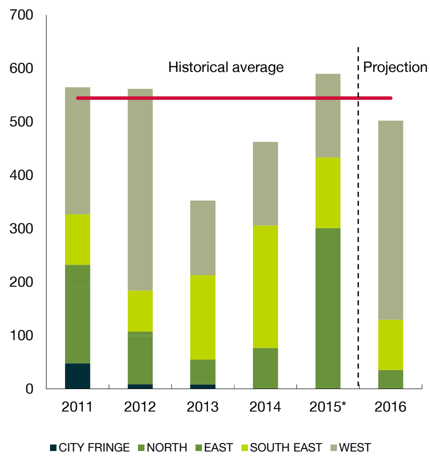
Development & Land Values

Gross new industrial supply (5,000m²+) is expected to total 589,957m² in 2015, with a further 502,211m² projected for completion in 2016. Although supply in 2015 is 28% above completions in 2014, it remains below the 10-year average. The rise of new supply over 2015 is largely as a result of elevated prelease activity which is almost double the 10 year average of prelease construction.

In 2015, the North delivered the bulk of the new supply (51%), the majority of which was purpose-built (preleased and D&C). DHL Australia (6,000m²), TNT Freight (38,000m²) and Toll Transport (71,000m²) all recently occupied preleased facilities at the Melbourne Airport Business Park in Tullamarine. Whereas major D&C facilities recently completed include: Melbourne Markets (76,070m²) and Mainfreight Logistics (36,000m²) both located at Epping.

Elsewhere, the West accounted for 27% of the new supply completed in 2015. Large pre-committed facilities built over the year included: Woolworths (25,000m²), and eStore Logistics (15,800m²). Strong demand for D&C buildings within the region was highlighted by the completions of MacGregor Logistics (16,500m²), F.Mayer Imports (8,000m²) and Laverton Cold Storage (6,000m²). The West is forecast to regain the focus of industrial development activity in 2016, leading all sub-regions for the first time since 2012. Beyond this year, notable developments scheduled for completion in 2016 include CEVA Logistics (90,000m²), Kathmandu (25,650m²), BTi Logistics (8,500m²) and The Reject Shop (37,700m²).

FIGURE 2
Melbourne Industrial Supply
'000m² annual gross supply



Source: Knight Frank Research *expected

The South East region added 22% to the overall new supply in 2015, with recent preleased completions from A&L Windows (12,600m²) and QEP Australia (7,122m²). Looking ahead, AstralPool has pre-committed to a 21,500m² warehouse from Frasers Property at 287—293 Greens Road in Keysborough, which is scheduled for completion in 2016.

Melbourne's average land values (excl City Fringe) have increased over the past year led by sustained demand for serviced industrial lots in the South Eastern region. Melbourne's average land values for small sites (2,000m²—5,000m²) increased by 3.5% to reach $238/m², while the medium sized lots (1-5ha) have seen their values rise by 2.8% to reach $184/m² from a year ago. Interestingly, values of medium sized lots are now at all time high levels.

TABLE 1
Melbourne Industrial Market Indicators as at October 2015

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	125	-3.8	80	0.0	6.75—7.50	7.75—8.75	1,000	0.0	800	-5.9
North	75	0.0	57	-5.6	7.00—7.50	8.25—9.00	230	0.0	190	0.0
East	83	-2.7	63	-0.5	7.00—7.50	8.50—9.50	300	0.0	230	-4.2
South East	80	0.0	60	0.0	6.75—7.50	8.50—9.50	255	10.9	185	15.6
West	75	0.0	65	0.0	6.75—7.50	8.25—9.00	165	-5.7	129	4.0
Melbourne Average*	**78**	**-1.3**	**61**	**-1.6**	**6.88—7.50**	**8.38—9.25**	**238**	**3.5**	**184**	**2.8**

Source: Knight Frank Research *Excludes City Fringe

Sales & Investment Activity

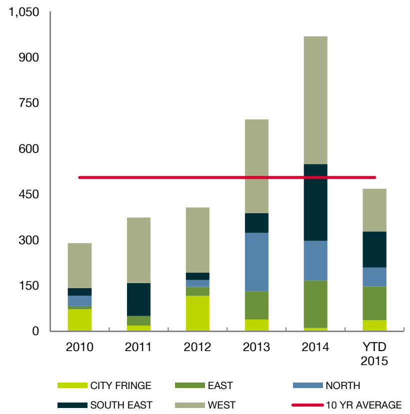
Melbourne's industrial sales ($10 million+) to date in 2015 total $468.1 million, 52% below the $969.3 million transacted during the 2014 calendar year. However, this amount excludes a number of Victorian assets which were sold within national portfolio sales. Major portfolio transactions that comprised Victorian industrial facilities included Charter Hall's purchase of a number of properties from Goodman for approximately $650 million with Victorian assets a key focus. Charter Hall's purchase included the Parkwest Industrial Estate in Derrimut and Power Park Industrial Estate in Dandenong South. In another large portfolio sale, GIC has sold 26 industrial properties to Ascendas for a value of $1.07 billion, which included nine Victorian assets.

Unlisted funds and syndicates remained the top purchasers, accounting for almost half of the transactions by value. One recent significant purchase made by an unlisted fund was AMP Capital's purchase of 704—744 Lorimer Street at Port Melbourne for $36.2 million.

FIGURE 3

Melbourne Industrial Sales

($m) industrial sales $10million+



Source: Knight Frank Research

The largest non-portfolio transaction of the year was recorded by ISPT who purchased the Scoresby Industry Park from Perfection Private Group for $73 million, in which the vendor retained a fractional share of the property.

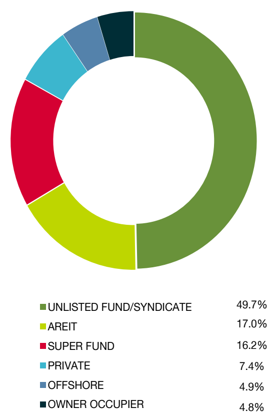
The West continued to dominate the sales activity, accounting for 31% of the total sales by value. In a recent sale, Lend Lease's APPF Industrial Fund purchased 41-55 Elgar Road, Derrimut for $18.6 million from Centreland Property.

Strong demand from investors has continued to compress yields; with average prime core market yields tightening by a further 79 basis points over the past 12 months to now range between 6.88% and 7.50%. Limited prime assets offered for sale in comparison to the capital chasing investments has led to rise in demand for secondary properties. Secondary yields compressed by 72 basis points from a year ago to now range 8.38%—9.25%.

FIGURE 4

Melbourne Industrial Sales

By purchaser type $10million+ 2015YTD



Source: Knight Frank Research

TABLE 2

Recent Leasing Activity Melbourne

Address	Region	Net Rent $/m²	Area m²	Term (yrs)	Tenant	Date
Drystone Industrial Estate, Laverton North	W	U/D	37,700	10	The Reject Shop ^	Q3-16
287-293 Greens Rd, Keysborough	SE	U/D	21,500	15	AstralPool ^	Q2-16
B/20 Henderson Rd, Knoxfield	E	75	13,607	10	Unitrans	Q3-15
Bldg 2/197-207 Discovery Rd, Lyndhurst	SE	85	11,430	5	Gale Pacific	Q3-15
9-19 Leakes Rd, Laverton North	W	75	8,320	7	Furnx Furniture	Q3-15
76 Calarco Drv, Derrimut	W	75	7,912	5	Toyo Tyres	Q3-15

TABLE 3

Recent Improved Sales Activity Melbourne

Address	Region	Price $ mil	Bldg Area m²	Initial Yield (%)	WALE (yrs)	Vendor	Purchaser	Sale Date
704-744 Lorimer St, Port Melbourne	CF	36.20	26,252	7.74	3.4	Centennial Property Group	AMP Capital~	Q4-15
Scoresby Industrial Park, Stud Road, Scoresby	E	72.95	50,017	6.52*	5.2	Perfection Private Group	ISPT	Q3-15
1 International Drv, Tullamarine	N	23.85	56,000	6.03	N/A	DEXUS	Warrington Group	Q3-15
33-69 Western Ave, West Meadows	N	16.00	24,091	VP	0.0	Fairfax Media	Zagame Group	Q3-15
41-55 Elgar Rd, Derrimut	W	18.60	21,888	6.50	5.4	Centreland Property	Lend Lease (APPF)	Q3-15

E East, N North, W West, CF City Fringe SE South East ^Prelease *Core market yield VP vacant possession ~Wholesale Australian Property

Source: Knight Frank Research

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Outlook

Available vacant stock in Melbourne's industrial market has tracked higher over the past three years and upward pressure will remain in the near term. However there are signs that vacancy is close to reaching its peak with record low levels of speculative construction now underway.

Elevated backfill vacancy levels in addition to the tenant preference for prime space, is anticipated to continue downward pressure on rents for existing stock. In addition, lengthening of letting-up periods for secondary properties is likely to further soften secondary grade rentals.

A likely improving economy is forecast to be led by growth in non-mining sectors, with retail trade, transport & storage and construction sectors forecasted to grow at 3.1%, 2.1% and 1.9% respectively in 2016. These sectors are expected to remain key drivers for industrial occupier demand over the course of next year.

New industrial supply pipeline in 2016 currently totals 518,774m^2, driven by purpose-built facilities (preleased and D&C), accounting for 64% of the forecast supply. The West is forecast to regain the focus of industrial development activity in 2016, leading all other sub-regions for the first time since 2012.

Domestic investors will continue to face strong competition from offshore groups actively seeking opportunities to grow their presence in the Australian industrial market. Stronger investment appetite coupled with limited properties offered for sale are likely to see core market yields continue to compress. Portfolio sale opportunities are likely to remain active as offshore investors continue to seek scale in the Australian industrial market.

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).

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