RESEARCH

NOVEMBER 2012

MELBOURNE INDUSTRIAL

Market Overview

Knight Frank

HIGHLIGHTS

- Total industrial vacancy in Melbourne remains at low levels. As at October 2012, there is 325,309m² of space above 5,000m² available within 34 buildings. Although vacancy recorded a 9.0% increase from its nadir recorded six months prior, it remains well below the historical average of 568,540m².
- The new industrial supply pipeline is forecast to total 469,295m² over the course of 2013, driven by demand from Transport, Postal & Logistics and Retail Trade based tenants.
- The total value of industrial sales (>$5 million) across all regions in Melbourne over the twelve months to October 2012 was $412.5 million. Private investors (29%) have remained the dominant purchaser type, however there was also strong activity from unlisted funds/syndicates (20%), AREIT's (20%) and offshore groups (18%).

INDUSTRIAL OVERVIEW

Table 1
Melbourne Industrial Market Indicators as at October 2012

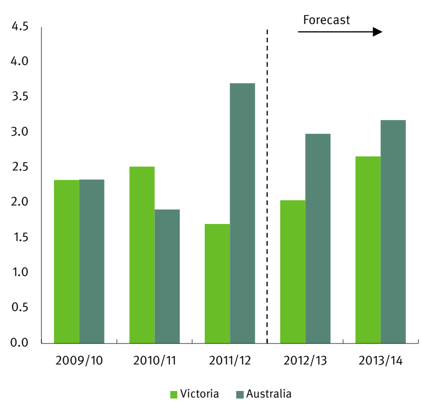
Precinct	Avg. Prime Rent		Avg. Secondary Rent		Core Market Yields (%)		Avg. Land Value			
							‹5,000m²		1 – 5 ha	
	$/m² net	(%p.a)	$/m² net	(%p.a)	Prime	Secondary	$/m²	(% p.a)	$/m²	(% p.a)
City Fringe	130	2.4	80	0.0	7.50 – 8.00	8.50 – 9.75	730	4.3	630	5.0
North	75	0.0	60	1.7	8.00 – 8.75	9.00 – 10.75	230	0.0	200	0.0
East	85	0.0	65	0.0	8.00 – 8.75	9.00 – 10.75	300	0.0	250	0.0
South East	80	2.6	63	-3.1	8.00 – 8.75	9.00 – 10.75	210	-8.7	180	-5.3
West	75	4.2	65	0.0	8.00 – 8.75	9.50 – 10.75	150	-10.7	120	-13.0
Melbourne Average *	**79**	**1.6**	**63**	**-0.4**	**8.00 – 8.75**	**9.13 – 10.75**	**223**	**-4.1**	**188**	**-3.9**

Source: Knight Frank Note: Rents are assessed on all sites between 3,000m – 5,000m² * Excludes City Fringe
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 when 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)

Economic Snapshot

Not unlike the themes that were established in the first half of 2012, the Australian economy still remains encumbered by the uncertainty stemming from global economic issues. Concerns over the European sovereign debt issues appear to have paled slightly, with attention now intensifying on the Chinese economy whose growth has slowed more than expected in recent months.

Figure 1
Economic Growth
Australia GDP and Victoria GSP % pa growth



Source: Deloitte Access Economics/ABS

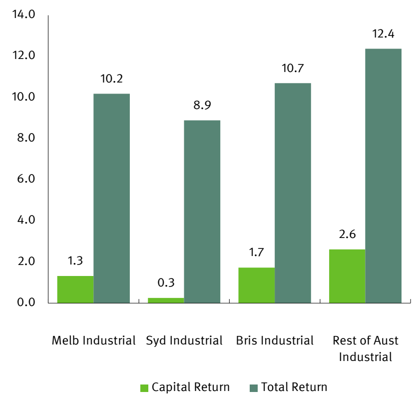
The continued strength of the $AUD has constrained Victoria's growth prospects largely due to its impact on one of Victoria's major industries, manufacturing. Victorian Gross State Product (GSP) over the 2011/2012 financial year grew by 1.7%. Deloitte Access Economics has forecast growth to improve to 2.0% over the current financial year. The Victorian economy is closely tied to the global economic outlook, given its high exposure to industries affected by the exchange rate. Nevertheless, there remains strong demand from retailers/wholesalers, importers and transport users for industrial space in the Melbourne market, as demonstrated by recent commitments.

Industrial Overview

According to the IPD Performance Index for the 12 months to June 2012, Melbourne industrial property posted a total return of 10.2% with capital growth of 1.3%. The total returns of Melbourne industrial continues to perform slightly below Melbourne CBD office (10.9%) but outperforms Victorian retail (9.8%). Income returns for Melbourne industrial (8.8%) are higher than the office and retail asset averages, which is likely to see the industrial asset class outperform the other asset classes over the next 12 months.

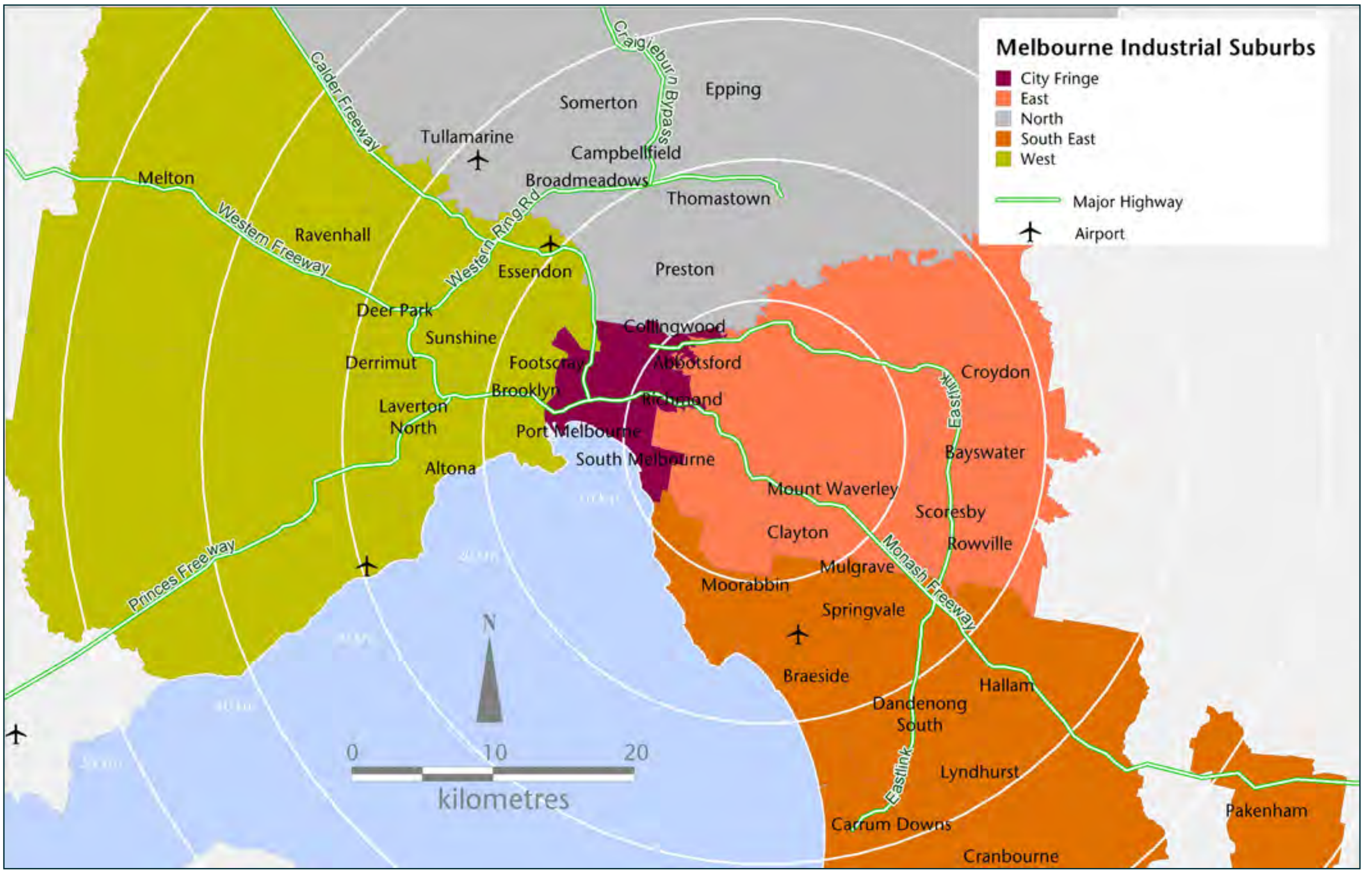
The relatively high total returns coupled with the scope for yield compression is likely to result in continued interest from investors to expand their industrial asset allocation.

Figure 2
Investment Performance Index
% Change (Year to Jun-12)



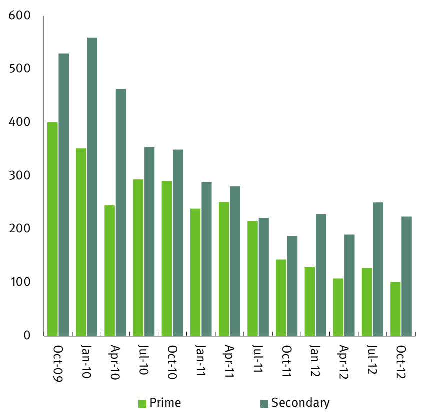
Source: IPD

When comparing IPD's results for Melbourne industrial to the other Australian industrial markets, capital growth and total return results are subdued, with the majority of the other markets outperforming Melbourne. The Rest of Australia and Brisbane industrial markets continue to outperform, boosted by their respective exposure to the investment in the resources sector.



Industrial Vacancy

Figure 3
Melbourne Industrial Available Space
'000m² by Grade (>5,000m²)



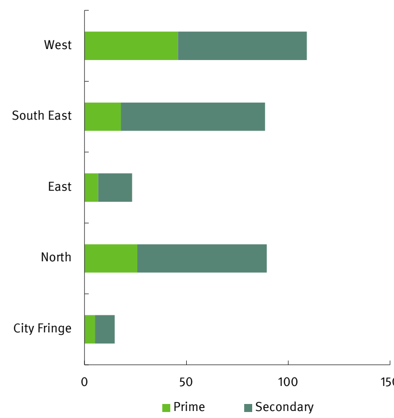
Source: Knight Frank

The amount of industrial accommodation available within premises greater than 5,000m² reduced by approximately 53,000m² in the three months to October, although it is higher by approximately 25,000m² when compared to its nadir recorded six months ago. The vacant stock level now sits at 325,309m²; 43% below the long term average. Available space continues to be dominated by the secondary market, representing 69% of available stock, with an average asking rental of $65/m² net. Prime accommodation remains scarce, and now represents only 31%, down from 36% of total vacant stock six months prior. This quarter saw three speculatively constructed buildings in the West committed prior to completion, demonstrating the strong demand for high quality prime grade buildings.

The Western precinct had the greatest amount of available industrial space as at October 2012, with 45,807m² (42%) classed as prime accommodation. The Northern precinct now contains the second highest level of available stock, after three buildings (totalling 25,383m²) became vacant. The South East's available stock continues to be dominated by secondary accommodation, accounting for 80% of the precinct's total.

Currently there is only one prime option available within the precinct, a speculative building under construction by Australand, within The Key Industrial Estate. Vacant industrial space within the East and City Fringe is also dominated by secondary stock.

Figure 4
Available Industrial Space
'000m² by Grade & Precinct (>5,000m²) – Oct 12



Source: Knight Frank

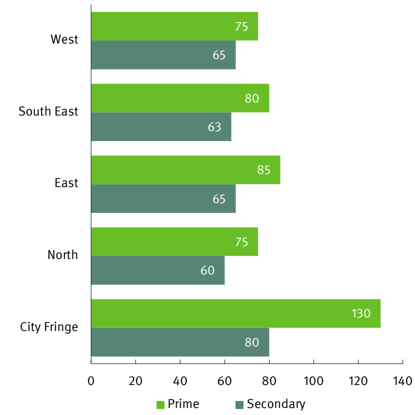
OCCUPIER DEMAND & RENTS

Analysis undertaken by Knight Frank indicates that in the six months to October 2012, the total amount of absorption for industrial accomodation greater than 5,000m² (excluding D&C's) was 252,912m² with 140,613m² (56%) being taken up in the three months to October 2012. Absorption levels are now closing in on the long term average (162,098m²). As a result of the continued strength of demand for high quality industrial accommodation, the disparity between available vacant prime and secondary grade stock continues to grow.

In the six months to October 2012 the largest amount of take up (>5,000m²) was again recorded in the Western precinct, with 152,190m² of industrial space leased. More recently the larger requirements have been fulfilled by prospective tenants committing to speculatively built space. Recent commitments to speculatively built developments include Australia Post which committed to 9,960m² at Leo Court, Truganina and COPE Sensitive Freight which committed to 7,794m² at 128 Swann Drive, Derrimut. Another tenant that committed to a speculatively constructed industrial building before completion was Catch Of The Day which leased 26,376m² across two warehouses at 1-16 Andretti Court, Truganina in Australand's West Park Industrial Estate.

The South East and Eastern precincts recorded 64,430m² of take up over the six months to October 2012, all of it within secondary grade buildings, indicating the scarcity of prime grade stock. After securing a precommitment from BIC for a warehouse within The Key Industrial Estate; Australand is also speculatively constructing an adjoining 17,850m² warehouse. The Northern and City Fringe precincts recorded absorption of 16,392m² and 19,900m² respectively however there are indications that interest remains particularly strong for smaller options within each precinct.

Figure 5
Melbourne Industrial Rents
$/m² net market rent by precinct – October 2012



Source: Knight Frank

Average prime net rental levels across the Melbourne market grew by 1.6% in the year to October 2012 to reach $79/m². Over the same period average net secondary rents decreased by 0.4% to $63/m²; with prospective tenants preferring prime grade and high quality secondary grade options. Prospective tenants continue to find it difficult to identify high quality existing stock for expansion or upgrade in the South East/East, and more recently in the West where prime rents grew by 4.2% over the past six months. The West currently has only two prime grade options within existing stock available, with another two speculative developments uncommitted but currently under construction. The City Fringe continues to be constrained by limited supply with upward pressure on rents, brought about by these constraints. As a result of vacancy continuing to tighten, coupled with restrictive financing conditions regulating development activity, further upward pressure on rents is likely in the short term.

Table 2
Major Industrial Leasing Transactions Melbourne Industrial Market

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Start Date
45-125 Glasscocks Rd, Dandenong South *	South East	undis	21,505	10	ITW Proline	Q1-13
WH A&B, 1-16 Andretti Crt, Truganina #	West	75	26,376	7	Catch Of The Day	Q4-12
1 Pacific Dr, Keysborough*	South East	85	12,100	5	BIC	Q4-12
Atlantic Dr, Keysborough *	South East	88	7,956	9	Victoria Station	Q4-12
33-65 Paramount Rd, Tottenham	West	53	15,150	1.5	ACFS	Q3-12
35 Centre Rd, Scoresby	East	80	11,322	7	HEAT	Q3-12
130 Link Rd, Tullamarine	North	73	10,479	10	Victorian Electoral Commission	Q3-12
42-60 Clayton Rd, Mt Waverley	East	72	9,835	7	Aussie Farmers Direct	Q3-12
128 Swann Dr, Derrimut #	West	86	7,818	10	COPE Sensitive Freight	Q3-12
13A, 43-63 Princes Hwy, Dandenong South	South East	65	7,615	2	Bunnings	Q3-12
A&B, 50 Cyanamid St, Laverton North	West	70	5,352	5	T2 Tea	Q3-12

Source: Knight Frank # Speculative Development * Pre-lease

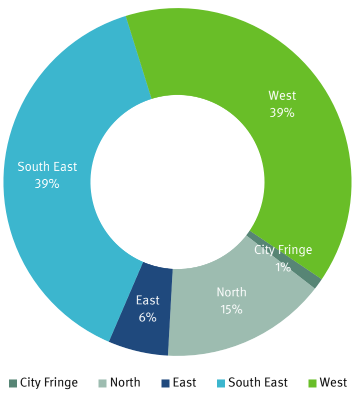
DEVELOPMENT & LAND VALUES

Just over 570,000m² of industrial stock (>1,000m²) is expected to be completed by the end of 2012, underlined by the precommitments of Kraft (Derrimut), Pacific Brands (Truganina) and Coles (Truganina). Looking forward, analysis by Knight Frank indicates the pipeline of new supply for new stock across the major Melbourne industrial regions is projected to total 469,295m² for 2013, a 19% drop from 2012. The ongoing cautious sentiment has taken its toll on developers alike, with the high $AUD, and difficult financing conditions curbing development activity.

Figure 6

Melbourne Region Industrial Supply

% of total supply expected over 2013



Source: Knight Frank

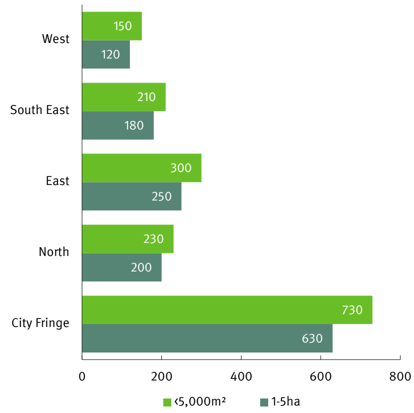
Looking across the regions, the Western and South Eastern precincts are expected to deliver the bulk of the new industrial supply, accounting for 78% of the total forecast to come online during 2013. The Western precinct remains the preferred precinct for the larger active requirements given the well-developed infrastructure, lower land values and proximity to the city and ports, with some 116,000m² of current enquiry. The South East has also become home to a number of recent precommitments. Within The Key Industrial Estate; Australand secured a precommitment from BIC for a 12,100m² distribution centre. In addition, within the Glasscocks Industrial Estate; Goodman Group secured a precommitment from ITW Proline for a 21,505m² warehouse and distribution centre set for completion in the first quarter of 2013.

Knight Frank expects the larger developers to service the majority of 325,500m² of active requirements currently in the market which is contributing to the pipeline of new supply in 2013. Of the current tenant requirements, Transport, Postal & Logistics and Retail Trade users account for 45% of industrial space sought in the market continuing recent trends of the past 12 months. In addition larger developers are taking advantage of the constrained supply conditions with speculative development levels increasing.

Figure 7

Melbourne Industrial Land Values

$/m² value of land by precinct – October 2012



Source: Knight Frank

Over the six months to October 2012, land values for land less than 5,000m² decreased in the Western and South Eastern precincts by 10.4% and 8.7% respectively. As a result of holding costs and limited finance available for non-income producing assets, pressure to divest vacant land has increased, causing land values to fall. This downward pressure derives from weaker purchaser demand which has been hindered by subdued business confidence. Whereas land values within the City Fringe and Northern precincts in 2012 to date have remained stable due to constrained supply.

Table 3

Major Land / Development Sales Activity Melbourne Industrial Market

Address	Region	Price ($ m)	Area (m²)	$/m² of site area	Vendor	Purchaser	Date
Radnor Drive, Derrimut	West	5.00	45,000	111	Investa Property Group	Intergroup	Aug-12
14 Woodruff Street, Port Melbourne #	City Fringe	25.00	40,000	625	Symex	Woodruff Street Developments	Jul-12
410 Cooper Street, Epping	North	5.50	320,900	17	n/a	Syndicate of Local Developers	Jul-12
27-45 Fitzgerald Road, Laverton North	West	10.90	184,700	59	One Steel Ltd	Private Developer	Jul-12
169 Australis Drive, Derrimut	West	4.65	56,000	83	Booth Transport	Private Developer	Jul 12

Source: Knight Frank # Sold with over 20,000m² buildings and plant

SALES & INVESTMENT YIELDS

Despite the clouded business and consumer confidence, demand for prime assets with long lease terms and blue chip covenants within the Melbourne industrial market remains strong, especially those located within the West and South East.

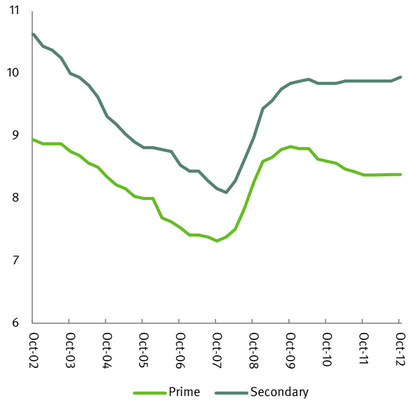
Analysis by Knight Frank shows that industrial sales greater than $5 million across all regions in the 12 months to October 2012 totalled $412.5 million across 26 properties. This was a softer result compared to the the 12 months to October 2011, where $534.6 million exchanged hands across 42 properties, representing a 23% decrease. During the 12 months to October 2012, private investors accounted for 29%, with strong activity from unlisted funds/syndicates and AREIT's. Off shore investors remain active, particularly for passive prime grade investments with long leases. One such example was the National Pension Service of Korea who bought AMP Capital Property Fund's stake in a distribution centre at 12-18 Distribution Drive, Truganina, leased to Coles until 2022 for a reported $50 million. Additionally, institutions remain interested in portfolio opportunities to increase their exposure in the Australian industrial market.

The Western precinct dominated transactions accounting for 49%, with $200.1 million across 10 industrial properties having transacted. Australand continues to be active in the West after selling two developments as turnkey projects to PFG Australia and more recently the Australian Ballet Company.

The South East/Eastern precincts combined for approximately 24% of total sales, where $97.1 million was exchanged across nine properties. Private investors acquired the majority of these investment opportunities. 72-96 Station Street, Nunawading was sold to a private investor for $18.4 million, with the site providing good infill development potential once the lease expires.

The City Fringe recorded $84.3 million across three properties; however this included the $61 million sale of 650 Lorimer Street reported earlier in the year. The North precinct was dominated by private investors who paid a total of $30.9 million across four properties. Despite the apparent lack of activity on the larger end, there is evidence that interest remains strong from SMSF's and private investors for investments sub $5 million within both these precincts.

Figure 8
Melbourne Industrial Yields
Average core market yields (%)



Source: Knight Frank

Prime core market yields have remained stable with very limited transactional evidence to suggest otherwise, and range between 8.00% - 8.75%. Secondary core market yields have eased marginally and now lie between 9.13% - 10.75%. With the difficult financing environment still constraining investment, and the investor preference for prime assets, this yield spread is expected to remain in place into 2013.

Table 4
Sales Activity Melbourne Industrial Market

Address	Region	Price ($ m)	Bldg Area (m²)	Core Mkt Yield (%)	Vendor	Purchaser	Date
12-18 Distribution Drive, Truganina (Half Share)	West	~50.0	42,954	8.91*	AMP Capital	National Pension Service (Korea)	Oct-12
18 Monterey Road, Dandenong South	South East	5.34	3,020	VP	Tatts Group	Concept Plastics Group	Oct-12
17-21 Strezlecki Avenue, Sunshine West	West	6.15	7,100	8.01	Valad Property Group	Secon Freight	Sep-12
72-96 Station Street, Nunawading	East	18.40	22,542	8.08	Aspen Diversified Fund	Private Investor	Sep-12
Kororoit Creek Road, Altona North	West	10.00	12,080	##	Australand	Australian Ballet Company	Jun-12
364-426 Old Geelong Road, Hoppers Crossing	West	39.35	52,364	8.45	Cromwell Property Group	Charter Hall Group (DIF)	May-12
103-121 Western Avenue, Tullamarine	North	7.31	6,117	8.63	Peet Limited	Private Investor	May-12
Mt Derrimut Road, Derrimut	West	14.00	12,070	##	Australand	PFG Australia	Apr-12

Source: Knight Frank * Initial Passing Yield ## Turnkey development

OUTLOOK

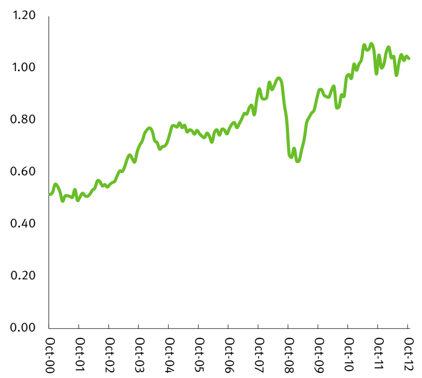
Despite fears of the European sovereign debt crisis tempering, attention has now shifted to the Chinese economy which has intensified on the back of growth indicators being more subdued than expected. The strength of the $AUD continues to encumber Australia's growth prospects further, especially in Victoria given its high exposure to manufacturing industries. The carbon tax and infrastructure issues have also impacted the industrial market, albeit at a lesser extent.

Recent absorption trends indicate that manufacturing has become less of a driver of industrial space and in some cases are scaling operations down. Despite the hindrances to Victoria's growth prospects, there is strong demand from industrial users in retailing, wholesaling, storage and distribution industries. The Melbourne industrial market now appears to be predominantly driven by these other users.

Figure 9

Units of $USD per $AUD

2000 - 2012



Source: RBA

Knight Frank forecasts 469,295m² of new industrial supply (>1,000m²) will be delivered over the course of 2013; underpinned by an under-supply of existing prime industrial stock and substantial tenant demand. Of the new industrial accommodation scheduled for completion in 2013, 78% is forecast to be delivered in the Western and South Eastern precincts, where the infrastructure in these areas encourages the industrial growth in these markets. Speculatively developed industrial stock has become more prominent as of late, especially in the Western precinct, which has been dominated by pre-lease activity over the past two years.

With the Peninsula link scheduled for completion in early 2013, coupled with the Government's long term plan for the expansion of Port of Hastings, tenants and investors are likely to continue to be attracted to the South East region, solidifying the South Eastern precinct as a major industrial hub.

Recently announced by the State Government is Australia's largest urban renewal area, Fishermans Bend, located approximately 3km south-west of the Melbourne CBD. The precinct comprises approximately 240 hectares and was consequently rezoned as part of an expanded Capital City Zone. Fishermans Bend is earmarked for residential and mixed use development, and is expected to accommodate 25,000 jobs and 50,000 residents. This will gentrify the area away from industrial uses even further and is likely to increase land values driven by residential demands and potential uses impacting the City Fringe market.

TENANT DEMAND IS SUCH THAT THE MAJORITY OF RECENT SPECULATIVE DEVELOPMENTS ARE LEASED BEFORE COMPLETION.

Tenant demand is expected to continue to outstrip supply heading into 2013. As at October 2012, available industrial space above 5,000m² totals 325,309m², far below long term averages. Existing stock available in the Melbourne industrial market is predominantly of secondary grade, currently accounting for 69%. The disparity between prime and secondary grade stock available to prospective tenants is growing, restricting prospective tenants who are looking at upgrading premises or expanding operations.

With the prime grade stock at low levels, average prime net rental levels across the Melbourne market grew by 1.6% in the year to October 2012. Meanwhile, over the same period, average secondary rents decreased by 0.4%. This upward rental pressure for prime assets is expected to continue into 2013, with rentals for secondary assets also expected to grow, as the better quality secondary grade properties continue to be sought out and committed to.

Over the six months to October 2012, land prices have dropped in the Western and South Eastern precincts, as demand for land has weakened. Looking ahead, land values are anticipated to continue to be under downward pressure for the short term with development finance still relatively limited.

With limited quality existing options available for tenants, given the total returns of Melbourne industrial property coupled with the positive rental outlook, investment appetite in the sector is likely to contuinue to gain momentum.

Over the six months to October 2012, the prime yield range has remained stable, with limited turnover of stock attributing to this lack of movement. It is anticipated that yields will come under increasing pressure to tighten given the shortage of investment options in the market for the private investors. AREIT's and institutional buyers are likely to continue to seek larger investments and portfolios as they become available having now restructured their balance sheet.

The yield range for secondary grade stock eased marginally on the lower end reflecting the investor preference for prime grade options and the difficult financing environment.

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