

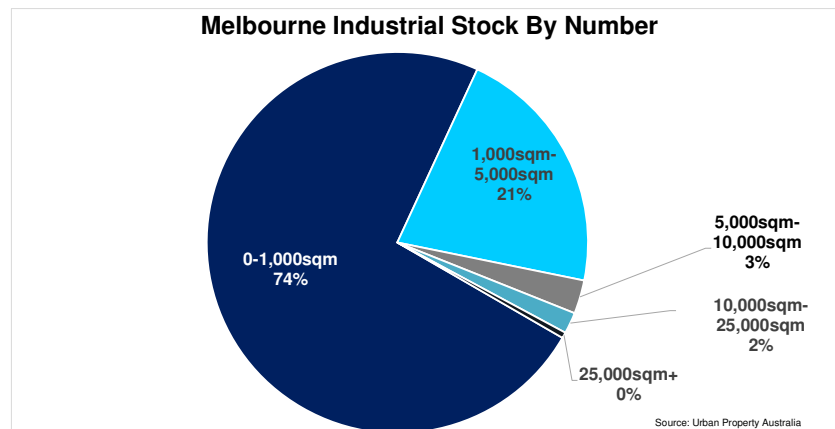
## Melbourne Industrial Market Update

The Australian economy is well positioned going into 2021 with fiscal stimulus translating to better than expected economic and employment outcomes. While the pandemic risks are still significant, we expect 2021 to be a year when the investment climate turns more positive. Australian economic growth is expected to improve, led by industries such as housing, finance, health and government.

The industrial sector has proven to be very resilient over the past 12 months. The industrial sector is in the midst of a significant transformation which is changing the shape of occupier demand and attracting significant investment in industrial real estate. Supply chains are becoming more complex as retailers seek to deliver merchandise to shops, collection points or direct to consumers homes. There is a growing emphasis on speed of delivery with consumers expecting two-day, one-day or even same-day delivery. Occupiers are increasingly valuing proximity to the consumer over distance from supplier to save time and cost. The net result is an increasing focus on inner city and sites offering immediate access to arterial roads.

Melbourne has the greatest amount of industrial and logistics floorspace of any Australian city. Traditionally Melbourne's industrial floorspace was dominated by the manufacturing sector; however, this has been in decline for the past 20 years. In recent times, Melbourne's growing port has helped to drive strong demand in the transport and warehousing sector while food production and high-tech manufacturing has seen strong growth and led to a small resurgence in the manufacturing sector. The bulk of Melbourne's industrial space is located in the South East and the West.

The vast majority of stock in the Melbourne industrial market has floorspace with 1,000 square metres or less and accounts for 74% of the number of Melbourne industrial properties.



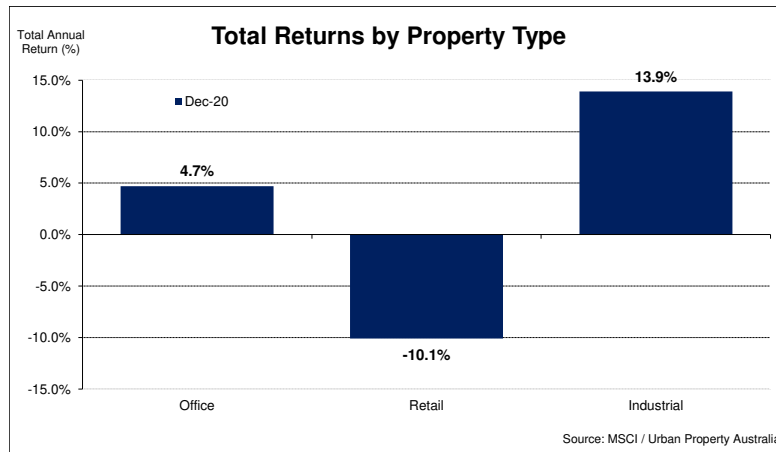
While historically the industrial property market was underpinned by the manufacturing sector, more recently, Australia's strong population growth has underpinned demand for imported goods which has boosted demand for industrial property.

In addition, the rapidly evolving e-commerce sector continues to drive a wave of industrial tenant demand across Australia. Increasingly demand for smaller warehouses is outpacing that of large distribution centres as retailers and logistics operators expand their networks to increase their proximity to consumers.

2020 saw digital technology quickly adopted with consumers shopping online and business making changes to their supply-chains and inventory. While the adoption of online shopping was already underway pre-COVID, the pandemic has driven higher rates of e-commerce and online retail penetration and bolstered demand for warehouse and distribution space across the country.

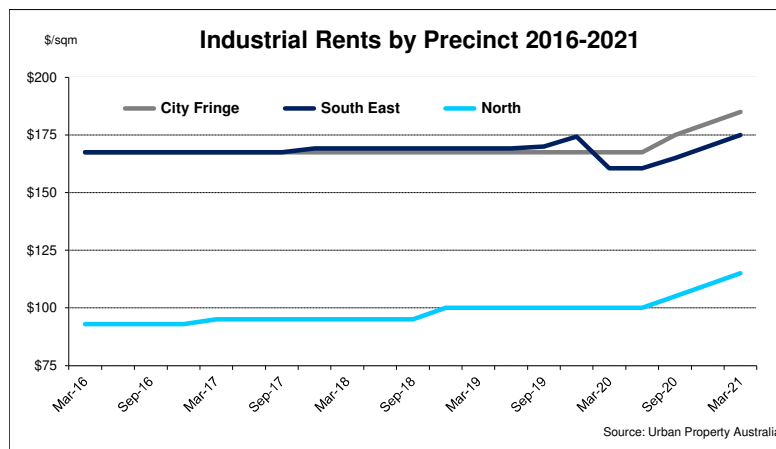
Indeed, in Australia, recent data shows that online retail sales have almost doubled since 2019 and despite a slight easing of retail sales in recent months, spending levels remain close to the new baseline that was established at the onset of the pandemic, averaging 10.3% of total retail sales since April 2020. This compares to a 6.1% share in 2019.

As a result of these structural changes supporting strong demand for industrial real estate, industrial remains the strongest performing real estate asset class in Australia. According to MSCI, the industrial sector returned 13.9% over the year to December 2020, outperforming all other Australian property sectors over the year for the fourth consecutive quarter. In contrast to other asset classes, the industrial sector has been viewed by investors as a relative safe haven with the strong positive e-commerce trends.



Increased spending on consumer staples and a rise in the manufacturing and storage of pharma goods is driving tenant demand. There is also strong demand from logistics occupiers trying to fulfil mandates for 3PL (third-party logistics) contract space and this is helping absorb some of the speculative space that has been delivered recently.

Despite this demand, rental growth has been subdued in the 12 months to March 2021 for the broader Melbourne industrial market and there has been a slight uptick in incentive levels under COVID-19 conditions. In contrast, demand for smaller warehouses (<1,000sqm) remains robust and has led to rental growth across all of Melbourne's industrial precincts over the year to March 2021.



Business confidence is an important indicator for the leasing market. While weak confidence led to some delayed decision making in 2020, a recent bounce in confidence should strengthen inquiry levels in 2021.

In the industrial land market, growth in land values continue to be supported by strong levels of underlying demand and a scarcity of developable industrial land. Strong tenant demand has run ahead of available supply, leading to upward pressure on land values as developers seek opportunities to cater to this tenant demand. Meanwhile, increased levels of development and rezoning have led to a reduction in developable industrial land

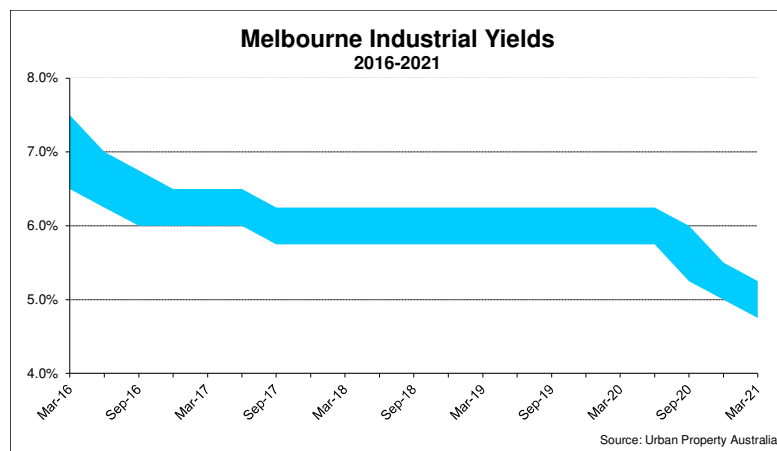
across the Melbourne industrial market. Reflecting this declining state of developable land, land values in Melbourne have experienced significant year on year growth of more than 20% over the past two years.

Investor demand for industrial assets continued to be incredibly strong in 2020, however transactional levels was constrained, adversely impacted by the pandemic. Pent-up demand caused by the pandemic is likely to carry into 2021, as the industrial sector remains in strong favour with investors, and high-quality, well-located warehouses are transacting promptly.

Investment activity was robust for properties less than \$5 million, buoyed by strong demand from owner-occupiers taking advantage of low interest rates to acquire their own premises. Although private investor interest remains in place for warehouses less than 1,000sqm, owner occupiers have been prepared to pay a premium for opportunities when available and have dominated recent sales activity. Owner occupiers, who are largely trades servicing the local population have been acutely focused on location of opportunities with vacancies in the sub-1,000sqm segment much lower than the broader market.

Albeit hampered by a shortage of investment industrial stock for sale, the lack of opportunities has not dampened investor enthusiasm for well leased industrial properties. The tight supply of industrial properties for sale coupled with strong investor demand even in the COVID-19 environment has maintained Melbourne industrial yields at historical lows. Investors have been further drawn to the industrial sector with the outlook for the retail and office sectors more uncertain comparatively. Yields for Melbourne warehouses (<1,000sqm) continue to tighten, underpinned by the falling interest rates and range between 4.75% and 5.25%.

As confidence returns more broadly to the occupier market over the next two years, we expect investors and the weight of money allocated to industrial property to push down yields further.



Looking ahead, improvements in infrastructure are expected to have significant spill-over benefits to the industrial property sector both directly through improved transport efficiency and productivity for industrial tenants and indirectly through elevated demand from a broader base of business services as well as valuation uplifts for industrial land surrounding the upgraded networks.

Based on current industrial stock levels, projections of Australia's population to reach 27 million by 2023 suggest a further eight million square metres of industrial space will be required to meet the increased population with 1.3 million square metres currently under construction will likely fuel competition for both sites and existing assets.

Research by Urban Property Australia

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