

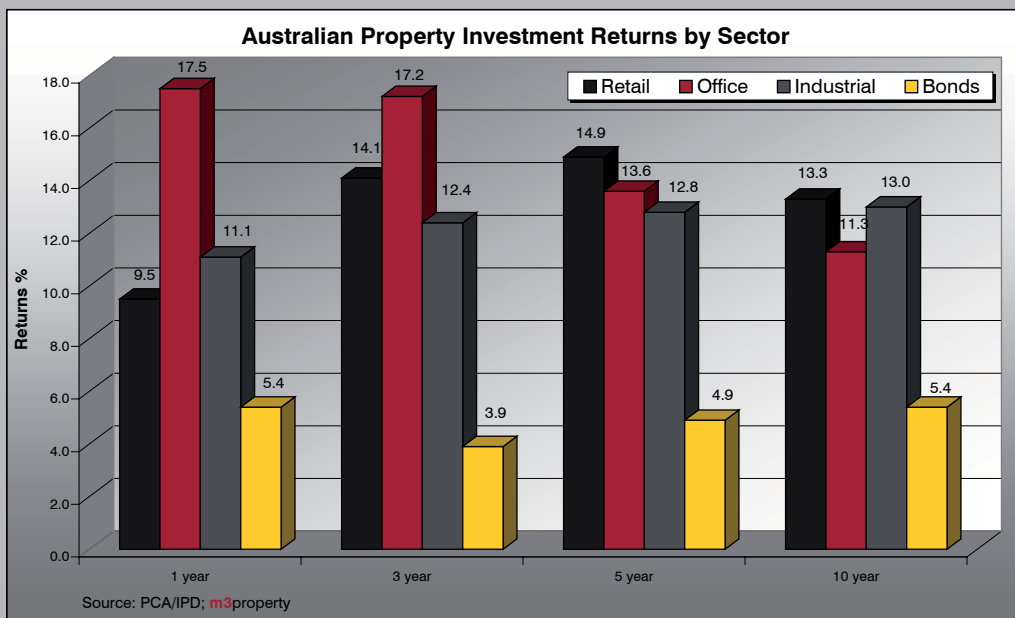


THE MELBOURNE INDUSTRIAL MARKET: DRIVERS OLD AND NEW

In this article we outline the measures customarily considered in relation to industrial markets (financial performance, demand drivers, development activity and construction costs) as well as new factors becoming increasingly important such as environmental sustainability and Australia's proposed emissions trading scheme. We do this with particular attention to Melbourne's industrial market - Australia's largest - with reference to the east coast industrial markets.

Financial Performance

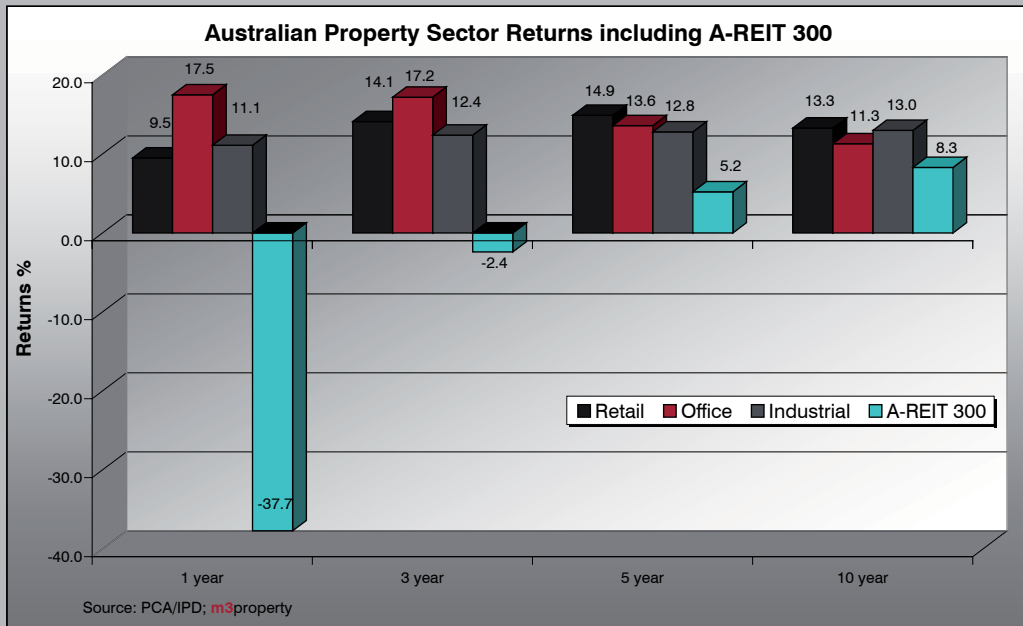
In terms of financial performance, we see from the chart below that Australia-wide industrial returns have been consistently strong over the decade to June 2008, with 10 year returns of 13% surpassing those for office (11.3%) and only marginally behind the retail sector's 13.3%.



However, the overall picture takes on an entirely new complexion when the performance of the listed Australian Real Estate Investment Trusts (A-REIT) sector (previously known as LPT's) is introduced to the chart as shown below. We see that the A-REIT sector has undergone a significant negative re-rating as the credit and property markets react to the fallout from the US sub-prime problems and higher interest rates in Australia. This has resulted in A-REIT returns more akin to the performance of the broader Australian equities market, with one year returns to June 2008 of -37.7%.

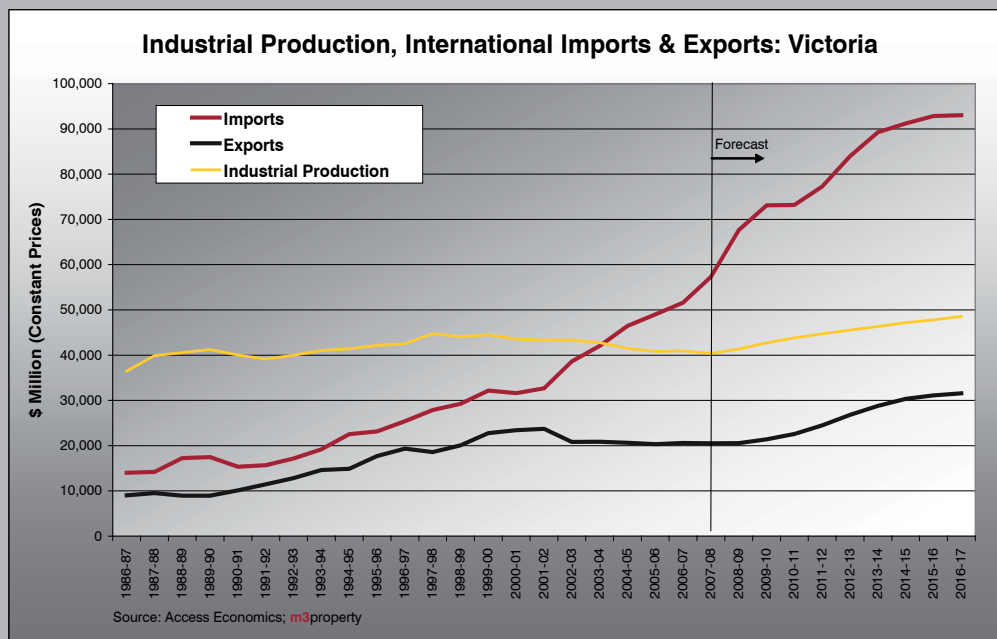
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This situation illustrates the marked divergence to date of the financial performance of the compared to the underlying property assets, in part due to the increased incidence of sophisticated debt funding, management fee income streams and development activities in the A-REITs over recent years.



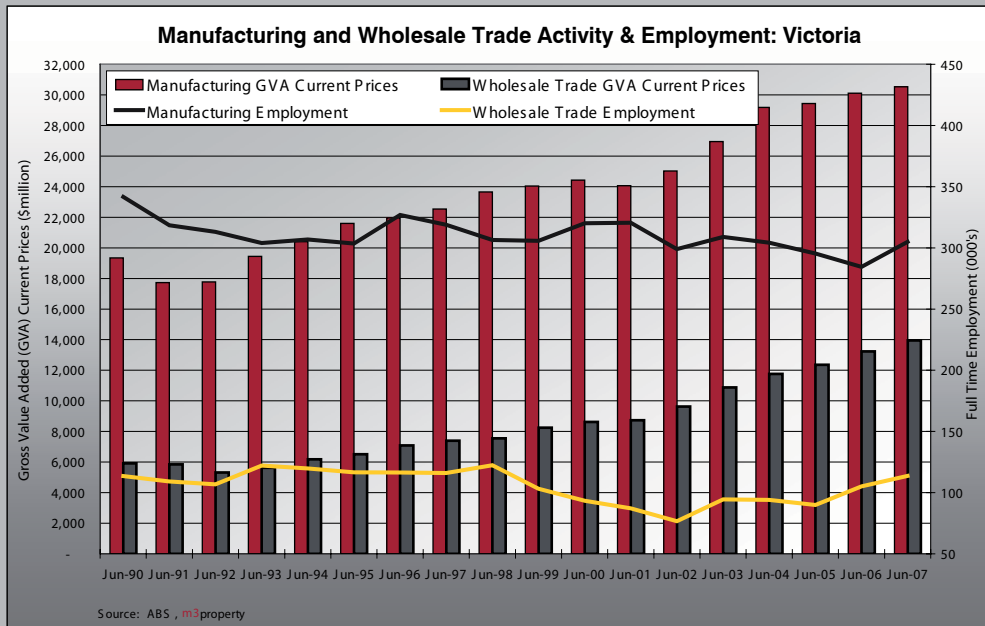
Underlying Demand Drivers

The Manufacturing and Wholesale Trade sectors are central to the demand for industrial premises, both directly and indirectly via associated transport and logistics requirements. We see in the chart below that the value of Victoria's industrial production has been largely flat over the past two decades, while imports have increased almost four-fold. Although production is forecast to rise, the gap between imports and exports is expected to continue to widen over the coming years.



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Another measure of the state of industrial demand for premises is the economic value generated by the manufacturing and wholesale trade sectors, represented by the Gross Value Added (GVA) to the Victorian economy. The chart below shows the total GVA and full time employment for these two sectors since 1990.



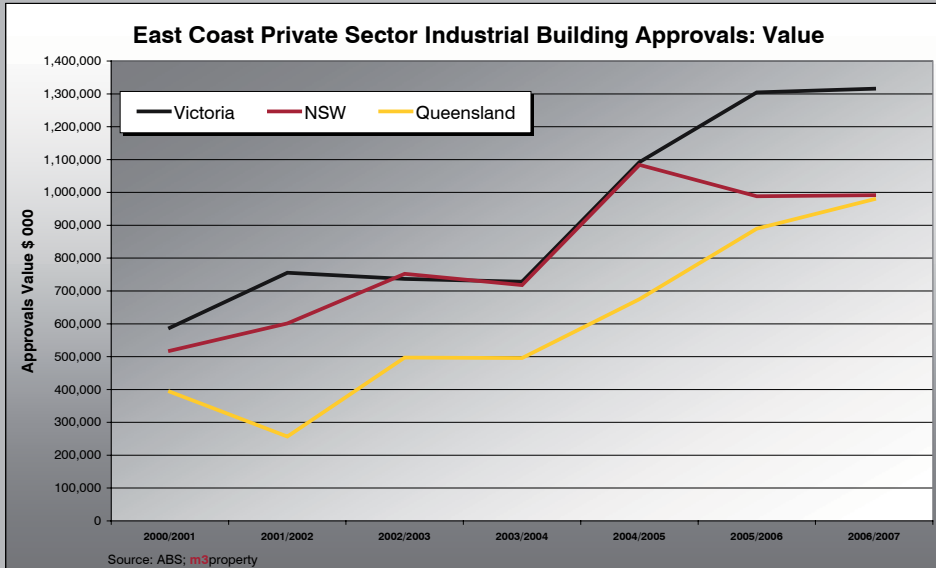
The GVA of the Manufacturing sector has increased by 58% since 1990 compared to 136% for the Wholesale Trade sector. Employment levels declined in both sectors from 1990, reaching lows in 2002, before recovering. As of June 2007, employment in manufacturing had declined by 11% overall and was back to 1990 levels for wholesale trade.

Higher GVA has been achieved with declining employment numbers, indicating improved efficiencies from improved infrastructure, technology and premises design. Over the period, Wholesale GVA steadily increased relative to Manufacturing GVA from 31% to 46%, consistent with increased import replacement of Australian manufacturing and a general shift towards a distribution business model away from more employment-intensive manufacturing activities.

East Coast Industrial Development Activity

Considering the Victorian situation in the broader context of Australia's east coast market we see that Victoria, NSW and Queensland together comprise 81% of the \$16.3 billion value of industrial (factories and warehouses) building approvals nationally over the five years to 2006/07. In broad terms, this equates to a total new building area of approximately 25 million square metres.

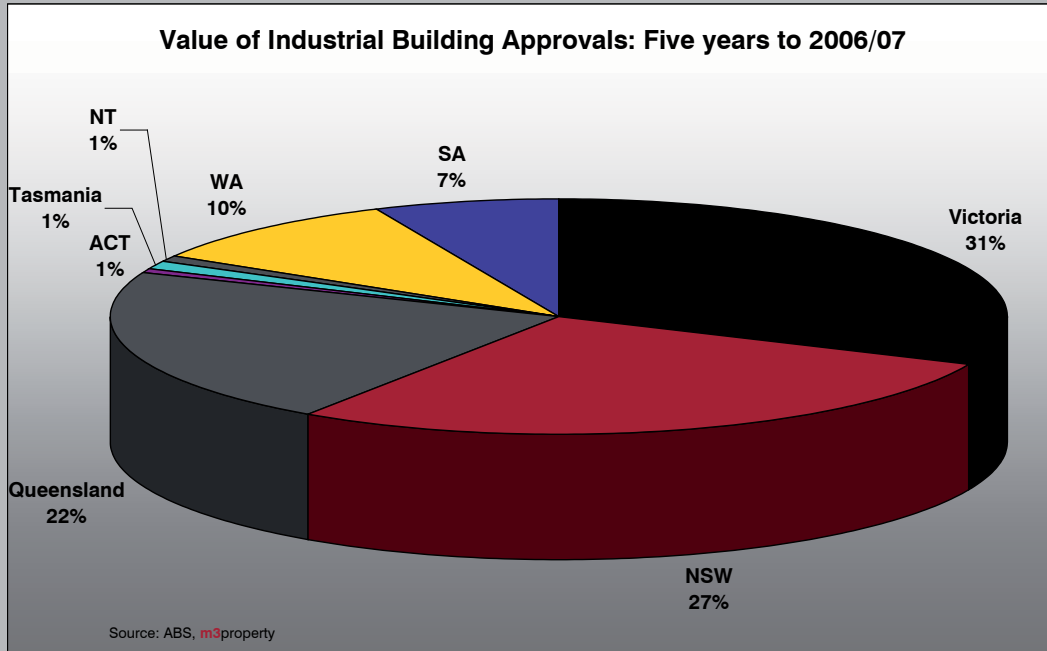
The chart below shows the annual progression of the industrial building approvals for these three states. The 2005/2006 year bears out the divergence of the activity in NSW from that in Victoria and Queensland.



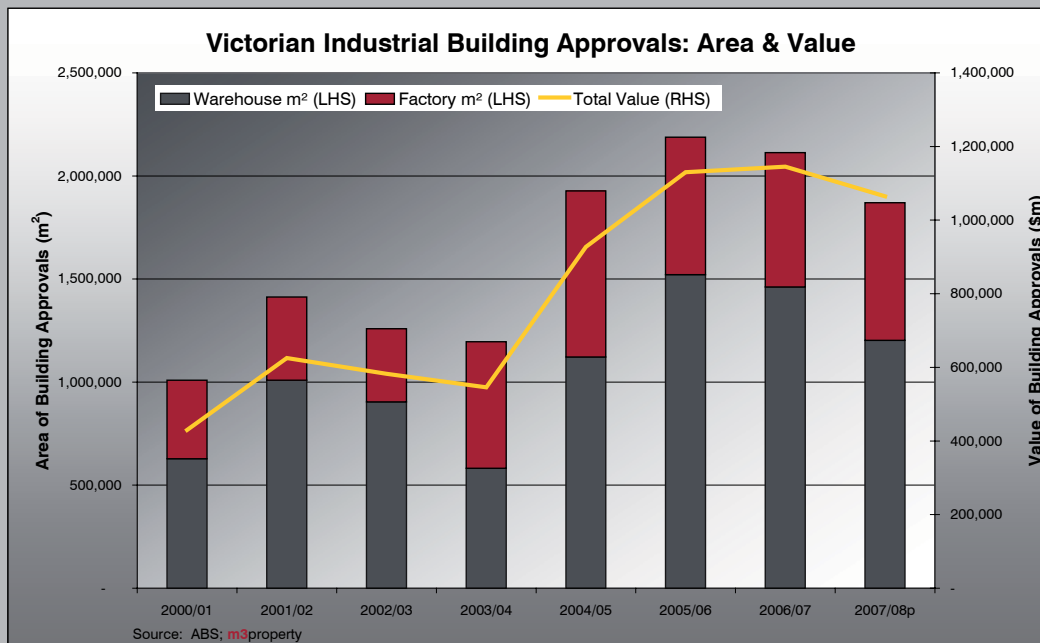
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Looked at another way, the chart below shows that over the past five years Victoria has the highest cumulative value of industrial building approvals with 31% of the nation's total, followed by NSW (27%) and Queensland with 22%.



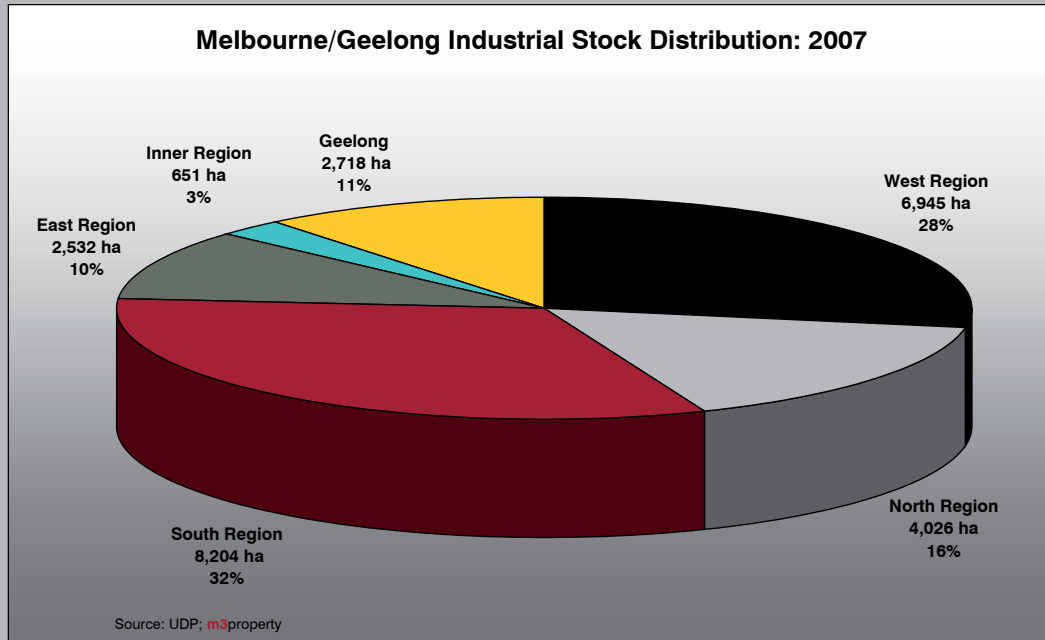
Industrial building approvals in Victoria since 2000/2001 are shown in the chart below. Over this period warehouses have comprised between 62% and 75% of the combined total on a financial year basis. Total factory approval value over the period was \$2 billion and for warehouses \$4.4 billion. In broad terms, this represents around 4.5 million square metres of factory area and around 8.4 million square metres of warehouse area.



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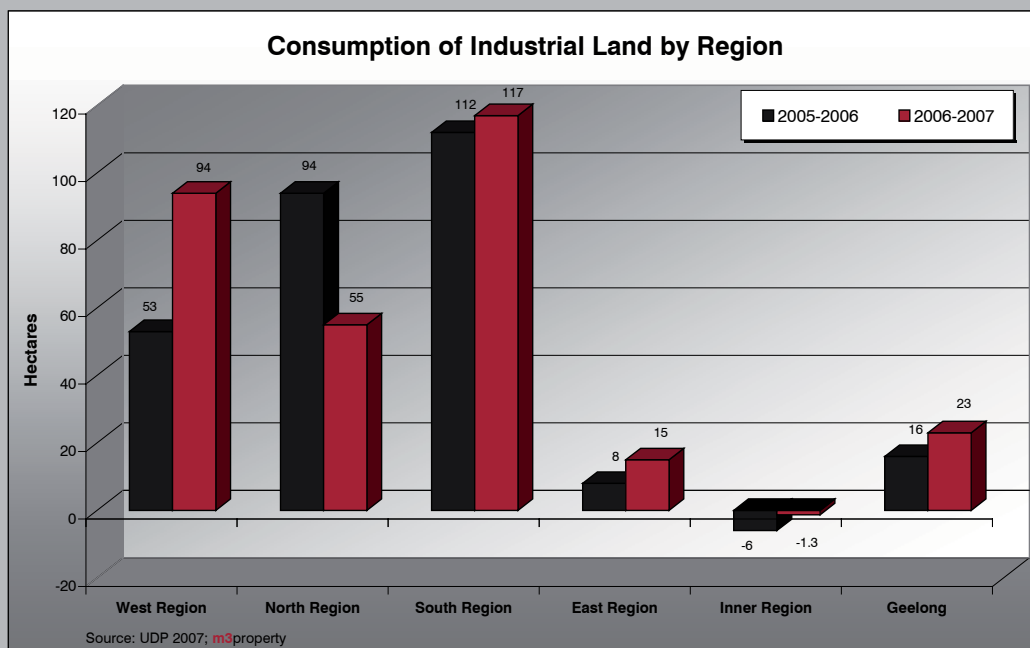
Melbourne's Distribution of Industrial Stock

Infrastructure improvements over recent years have created the impetus for new areas of development, most notably in Melbourne's west and north along the Western Ring Road. Melbourne's distribution of industrial zoned land is shown in the chart below. The two largest regions are the South and West which together account for 60% of the land stock.



Melbourne's Industrial Development Activity

While the impact of the opening up of industrial land in the west and north has been pronounced, the highest consumption of industrial land (ie development of vacant land) over the past two years has still been in the South region as shown in the chart below. The "negative" consumption depicted for the Inner Region reflects previously improved land being returned to vacant land - likely for redevelopment.

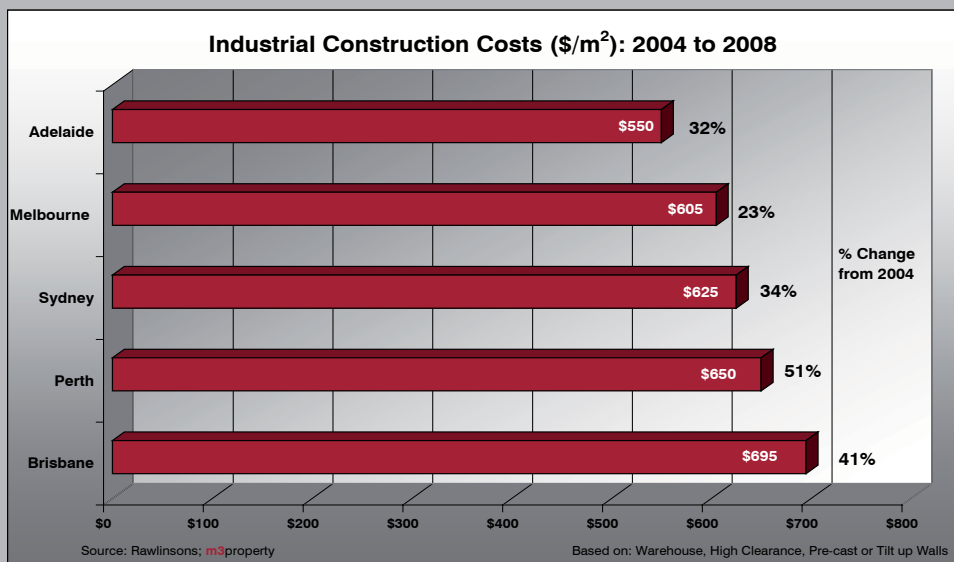


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Industrial Construction Costs

We see in the chart below that warehouse construction costs in Melbourne (\$605/m²) are now lower than for Brisbane (\$695/m²), Perth (\$650/m²) and Sydney (\$625/m²). This is in contrast to 2004 when construction costs in Brisbane and Melbourne were equally the most expensive.

Over the past four years the increase in construction costs has been significantly lower in Melbourne at 23%, while Perth (51%) and Brisbane (41%) have experienced the greatest construction cost increases.



Other Factors Influencing the Industrial Market

In addition to the fundamental demand, supply and cost considerations, a range of other factors are becoming increasingly important, including environmental issues, emissions trading and improved amenity of industrial developments.

Environmental sustainability is becoming more topical in the industrial arena. The first industrial rating tool from GBCA is due for imminent release. It is even mooted that this will include an estate rating mechanism – which could be especially important to the VicUrban Dandenong Logis and Cairnlea business precinct projects, both of which embrace estate-wide sustainability credentials.

While there is an expectation that 'green' initiatives will become increasingly important in the industrial sector over time (as they have in the office sector) evidence of clients expressing a requirement for these initiatives in their industrial properties is rare indeed.

Consistent with this, tenants generally resist paying additional rents for these elements (though this may now be starting to change).

Rather, the introduction of environmentally sensitive design elements is being driven by progressive developers such as the Pellicano Group who have an eye to the future – in terms of subsequently re-letting the properties that they hold, demand for these properties as investments, and the development of subsequent stages of the estate over future years.

Depending on how it is implemented, Australia's mooted Emissions Trading Scheme has the potential inter alia to impact on the mix of local manufacturing v imports (easing or reversing of trend), especially as the import equation has been enhanced by the historically high value of the Australian Dollar relative to the US Dollar.

Road transport links (for freight and workforce) remain crucial to successful industrial/business park developments, especially in a higher fuel cost environment. Beyond basic retail facilities such as food outlets and ATM's, extended campus-style amenities such as restaurants, child care and fitness centre facilities are increasingly being offered, though at the early stages of each project the necessary critical mass for their viability is often lacking.

Demographic changes are also relevant, especially in workforce availability and skills in the area. Melbourne's west is well placed to benefit from these changes; it contains two of Melbourne's five designated 'Growth Areas' and has been characterised by significant new residential estate activity over recent years.

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