RESEARCH

JULY 2010

ADELAIDE INDUSTRIAL

Market Overview

Knight Frank

HIGHLIGHTS

- With the bottom of the market seemingly reached in late 2009, the Adelaide Industrial market has recently been experiencing a period of stabilisation and is now well positioned to rebound in the next 12 months.

- Traditional inner industrial regions continue to dominate both leasing and sales market activity. There is however a lack of transactional evidence making it difficult to truly verify market values.

- Over the past 12 months to July 2010 there has been a stabilisation of prime yields, with the first signs of compression beginning to occur. Average prime yields are now ranging between 8.05% - 8.85%, however sub 8% could be achieved for quality assets in the inner regions.

ADELAIDE INDUSTRIAL OVERVIEW

Table 1
Industrial Market Indicators July 2010

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields		Avg Land Values <5,000m²		Avg Land Values 1 – 5 ha	
	$/m² net	(%p.a)	$/m² net	(%p.a)	Prime	Secondary	$/m²	(% p.a)	$/m²	(% p.a)
Inner North	96	1.1%	70	0.7%	8.00% - 8.75%	9.00% - 10.00%	195	5.4%	131	0.4%
Outer North	75	-0.7%	55	0.9%	8.50% - 9.25%	9.50% - 10.50%	95	-2.1%	70	-0.7%
Inner West	127	5.5%	80	5.3%	7.50% - 8.25%	8.50% - 9.50%	465	6.9%	285	5.6%
Inner South	117	3.5%	77	4.1%	7.75% - 8.50%	8.75% - 9.75%	415	2.5%	n/a	n/a
Outer South	79	-0.6%	50	1.0%	8.50% - 9.50%	9.50% - 10.50%	106	0.5%	66	1.5%
Adelaide Average	**98**	**1.8%**	**66**	**2.4%**	**8.05% - 8.85%**	**9.05% - 10.05%**	**255**	**2.6%**	**138**	**1.7%**

Source: Knight Frank
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)

National Economic Overview

After exceeding expectations in 2009, the Australian economy will still be facing a number of challenges going forward. Interest rates have increased six times since October 2009, taking the cash rate target to 4.50%. The RBA outlined that the main reason was that the global economy has resumed growth, and domestic economic policies remain relatively expansionary. There is an expectation that economy will return to trend growth this year and potentially exceed trend over 2011/12.

However, share markets around the world have been hit by concerns that the debt levels relating to Greece, Ireland, Portugal and Spain in particular could threaten the global economic recovery. There are fears that the €110 billion ($158 billion) bailout package offered to Greece in May 2010 by the European Union (EU) and the International Monetary Fund (IMF) will not be enough to prevent the debt crisis spreading to other European nations. There is now much conjecture over the possibility of a contagion effect resulting from Greece's debt crisis and its likely impact on the Australian economy.

Much of Australia's encouraging economic performance can be attributed to strong growth in China, whom continues to demand high volumes of Australian exports. This reliance has potential negative ramifications should Asian markets, particularly China suffer a significant downturn.

In July 2010 a deal was struck between the Federal Government and the mining industry in relation to the proposed Resource Super Profits Tax (RSPT). The changes will result in $1.5 billion less in Government revenue. The new Minerals Resource Rent Tax (MRRT) will apply at a 30% rate to just coal and iron ore from 1 July 2012. This has come as a relief to the mining industry, as there were real concerns that the proposed RSPT would have strangled the growth the budget was depending on by putting the nation's mining boom at risk.

State Economic Overview

South Australia has navigated its way through a difficult economic period and there is reason to believe that the state is well placed over the short to medium term. The state's economy was boosted by population growth of 1.3% in the March 2010 quarter which was its fastest growth in 36 years. South Australia's trend unemployment rate has however increased to 5.5% in June 2010, slightly above the national average of 5.1%.

South Australia also faces a number of challenges going forward with manufacturing, one of the main contributors to South Australia's Gross State Product (GSP), being hit hard in recent times. It is clear that the state cannot rely on manufacturing as a growth driver into the medium term. This means that much rests on South Australia's ability to transform itself from a major manufacturing base to a resource region.

The announcement of the MRRT in place of the proposed RSPT will also come as a relief to the South Australian (S.A.) mining industry. The proposed tax threatened to put a halt on S.A.'s mining boom and put $40 billion worth of projects at risk. S.A. would have been one of the hardest-hit states in the nation had the tax been introduced. No other state faces the position that half of its known expansionary projects are in one project – in South Australia's case, the further development of Olympic Dam. Olympic Dam is a unique project, with BHP Billiton one of the only companies globally able to source its massive expansion from predominantly internal cash flow. This project is an important factor in S.A.'s future growth potential.

Adelaide Industrial Overview

Established inner industrial precincts in the north, south and west have performed strongly in the past 6 months to July 2010, sustaining the improved levels of investor confidence that was witnessed towards the end of 2009.

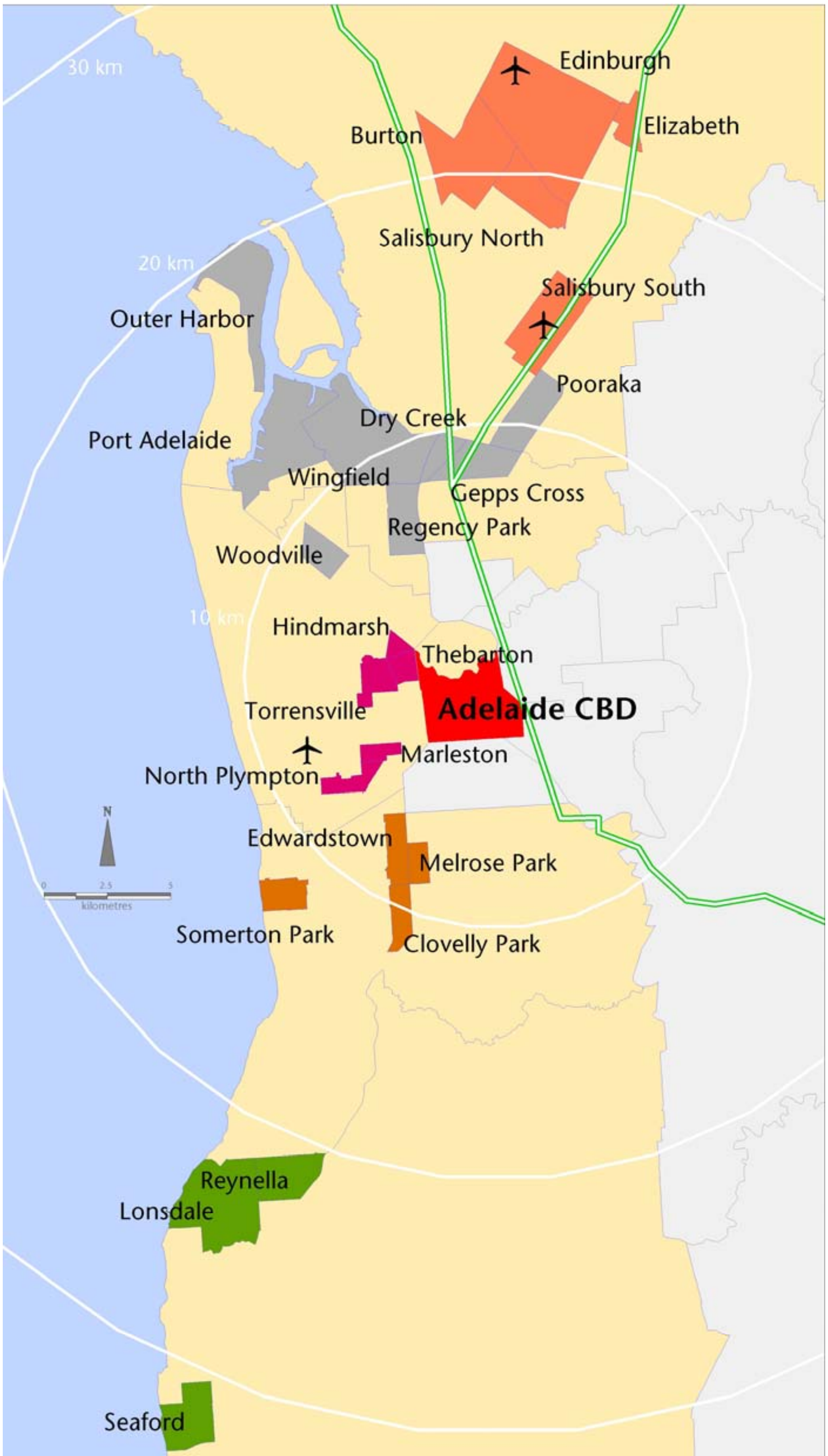
The Adelaide Industrial market managed to navigate its way through the economic slowdown in early 2009 and has experienced a period of consolidation over the past 12 months to July 2010.

The most active purchasers are currently owner occupiers and the level of major investment activity has been kept to a minimum. The strongest demand has come for quality assets in the sub $2 million market, particular in the traditional inner precincts.

Market activity has been relatively subdued over the past 12 months making it difficult to determine exactly where the market is at in terms of both rental levels and land values.

Construction activity has been subdued and the limited amount of new stock coming on to the market may put upward pressure on prices and rentals.

Following some improvements in credit conditions confidence levels have increased and although we are yet to experience a full recovery, the Adelaide industrial market is well positioned to rebound in the coming 12 months.

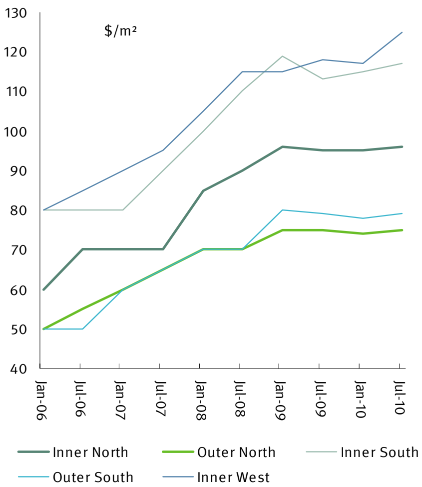


OCCUPIER DEMAND & RENTS

In 2009 declining tenant demand saw the gap widen between the less traditional outer regions and inner regions. In the six months to July 2010 this gap has been accentuated with inner areas now growing even stronger than previously compared to outer regions. Consequently we have seen average net face rents remain static in outer areas, with modest increases in the inner precincts.

Average net rents across Adelaide have showed initial signs of a recovery in the 6 months to July 2010 with both prime and secondary rents showing slight growth. The Inner West precinct recorded the largest rental increase with prime rents growing by 5.5% to $127/m² due to a shortage of high quality premises in the region. Its location adjacent to the CBD and access to major transport routes is also significant. The other standout region to record an increase was the Inner South, with secondary rents growing 4.1%, due to a shortage of available properties. The Outer North and Outer South regions remained static as market conditions began to stabilise in the first half of 2010.

Figure 1
Average Prime Net Rents
2006-2010



Source: Knight Frank

Throughout the downturn there was robust demand for quality assets in traditional industrial areas, including the Inner West, Inner South and Inner North. These regions have continued to attract relatively higher demand from small to medium sized occupiers. We would expect this trend to continue over the next six months.

Occupier demand and pre-commitments for new space picked up in the first half of 2010, following a period of weak demand in 2009. This has been evidenced by quicker take up time for prime assets and a substantial increase in tenant inquiry as market conditions improve. While the initial signs of a recovery remain positive, any significant rental growth seems unlikely for the remainder of 2010. Instead, conditions in the industrial market are expected to remain stable with a return to growth anticipated in 2011.

THERE HAS BEEN ROBUST DEMAND FOR QUALITY ASSETS IN THE INNER INDUSTRIAL PRECINCTS

In Q1 2010, 6,762m² of space was leased at the Vicinity Industrial Base at Direk to Toll NQX. The lease was negotiated for a twelve year term (with a ten year option), reflecting a net face rent of $110/m² p.a.

Artist's Impression, Vicinity Industrial Base Direk – 6,762m² leased to Toll NQX in January 2010 at a rate of $110/m² p.a.

In December last year Salmat leased 6,166m² of space at 123 Hayward Avenue, Torrensville. The lease was negotiated for a seven year term and reflected a net face rent of $87/m² p.a. This property is situated on a site of approximately 11,000m²

123 Hayward Avenue, Torrensville – 6,166m² leased to Salmat in December 2009 at a rate of $87/m² p.a.

Table 2
Recent Leasing Activity Adelaide Industrial

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Tenant	Date
Vicinity Industrial Base, Direk	ON	110	6,762	12+10	Toll NQX	Jan-10
123 Hayward Ave, Torrensville	IW	87	6,166	7+3+3	Salmat	Dec-09
3-5 Maxwell Road, Pooraka	IN	112	4,455	5	QR Limited	Jul-10
Lot 3 Bushman Ct, Pooraka	IN	111	3,388	5+5	Cav Power	Jan-10
2 Portsmouth Ct, Gillman	IN	97	3,077	3+5+5	United Pre Cast	Jan-10
7 Greenfield Drive, Greenfields	ON	60	2,700	3+3	PODS	May-10

Source: Knight Frank IN = Inner North ON = Outer North IW = Inner West

DEVELOPMENT & LAND VALUES

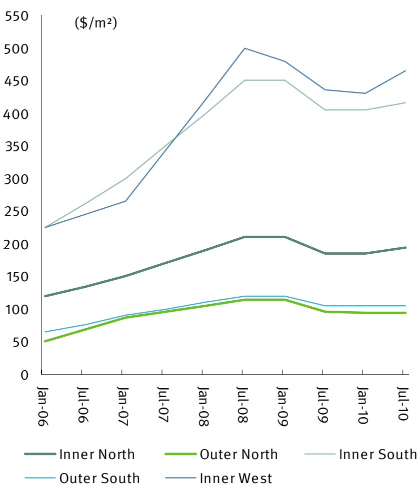
Industrial development has remained subdued in Adelaide in the first half of 2010 and consequently supply has remained limited. There is currently a gap in the market with a lack of new stock. Although lending conditions remain restrictive post-GFC, there are signs that banks may be more willing to lend with approvals increasing slightly.

Strong demand in the tightly held traditional inner industrial regions is expected to underpin future development. The pick up in rental growth in these regions means secondary and tertiary stock may become attractive for land owners to redevelop. This could be a continuing trend in the short term.

Figure 2

Average Land Values

2006 to 2010 - small lots (<5,000m²)



Source: Knight Frank

The viability of new construction in these regions will largely be dependent on the level of rental growth. Even if land values continue to rise over the next 6-12 months, rents will still need to increase further to underpin development and provide viable returns for developers. If this does not occur, then we may see developers seeking other opportunities where returns are more attractive, or awaiting strong growth to return.

After rising to around 10%, incentives for pre-leases have reduced slightly in the past 6 months as the market starts to turn.

INDUSTRIAL SUPPLY HAS REMAINED LIMITED IN 2010

Substantial infrastructure development by the State and Federal Governments has been welcomed into Adelaide's industrial property market. The ongoing upgrade of South Road and the continued work on the Northern Expressway, South Road Superway and proposed Northern Connector will greatly improve accessibility and transport efficiency to Adelaide's outer industrial regions.

In the twelve months to July 2010, average land values have stabilised across all regions. After the significant declines in land values in 2009, the market looks to have bottomed out with land values in the inner regions experiencing slight growth once again.

The most significant increases came in the Inner West and Inner North precincts, both experiencing annual growth in excess of 5%. This can be attributed to the strong demand and limited supply in these traditional industrial regions. The only region to record a decline in land values was the Outer North, as investors seek opportunities in the Inner North.

This gives a relatively accurate indication of price movement in the Adelaide industrial market in the past twelve months, however, limited transactions makes it difficult to truly verify land values.

In May 2010 a 15,350m² parcel of land at 1096-1102 Port Wakefield Road, Burton was purchased for $2.0 million (currently under contract), which represented a rate of $130/m² of the site area.

1096-1102 Port Wakefield Road, Burton – sold for $2.0 million (currently under contract to G James Pty Ltd), which represented a rate of $130/m² of the site area.

Table 3

Recent Land Sales Activity Adelaide Industrial Market

Address	Region	Price ($ m)	Area (m²)	$/m² of site	Purchaser	Vendor	Date
2-8 Mirage Road, Direk	Outer North	1.89	19,930	95	Heaslip Property Pty Ltd	Walker Direk Development Pty Ltd	Mar-10
71 Frost Road, Salisbury South	Outer North	1.35	15,500	87	BGC (Australia) Pty Ltd	Australand	Dec-09
1096-1102 Port Wakefield Rd, Burton	Outer North	2.00	15,350	130	G James Pty Ltd *	Land Mgmt Group	May-10

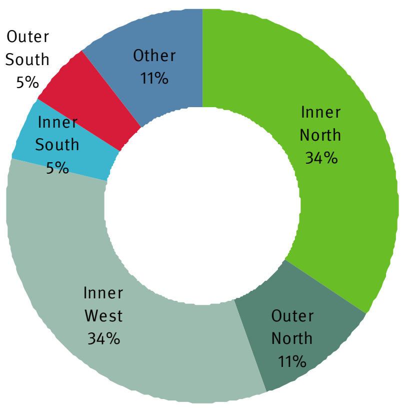
Source: Knight Frank * under contract

SALES & INVESTMENT YIELDS

Opinions at the start of 2010 that the bottom of the industrial property market was reached late in 2009 appear to be accurate. Although the initial anticipation was that yields on prime assets would reach double figures, this did not occur.

Following the yield softening of 75-125 basis points in the twelve months to July 2009, risk appetite has since improved and prime yields have remained relatively stable across Adelaide in the past twelve months and in some cases have compressed slightly.

Figure 3
Sales Activity by Region
Number of sales › $1million



Source: Knight Frank

There has been limited activity in the market over the past 6 month in particular, with investors taking a cautious approach. The major purchasers in the past 6 months have been owner occupiers in the sub $2 million bracket, with most demand coming from within a few kilometres from the CBD on main arterial roads. The market currently remains in a 'holding period' with no signs of a significant recovery yet.

The limited number of transactions makes it difficult to determine the impact of yields in the industrial market. Prime yields may experience some re-compression over the next 6 months as tenant enquiry becomes stronger, investor demand increases and the general economy improves.

RISK APPETITE IS ON THE IMPROVE IN 2010 AND PRIME YIELDS ARE STABILISING

Transactions throughout traditional industrial regions in the Inner North and Inner West have dominated recent sales activity, providing evidence of a positive investment environment within traditional inner precincts. Over the past 12 months to July 2010, these regions have accounted for 70% of total industrial sales › $1 million.

The largest sale in the past 6 months was recorded in December 2009. Lot 204 Railway Terrace, Mile End South was sold to Instruo and comprises two separate buildings. The 16,120m² site, which also had improvements of approximately 10,260m² of office and warehouse space, sold for $4.6 million.

Lot 204 Railway Terrace, Mile End South sold in December 2009 for $4.6 million which represented a building rate of $448/m²

Another large sale in the Inner West region was recorded in April 2010 when a 9,002m² parcel of land at 181 Richmond Road, Richmond sold for $3.5 million. Improvements comprise of approximately 2,733m² with a site coverage of approximately 30%.

181 Richmond Road, Richmond sold in April 2010 for $3.5 million which represented a building rate of $1,281/m².

Table 4
Recent Sales Activity Adelaide Industrial

Address	Region	Price ($ m)	Building Area (m²)	Core Market Yield (%)	Purchaser	Vendor	Date
Lot 204 Railway Tce, Mile End South	IW	4.60	10,260	VP	Instruo	Swire Cold Storage	Dec-09
181 Richmond Road, Richmond	IW	3.50	2,733	7.27	ADX Group Pty Ltd	Sadu Pty Ltd	Apr-10
13 Birralee Road, Regency Park	IN	3.35	3,320	VP	Complete Office Suppliers	Undisclosed	May-10
569-571 Grand Junction Road, Gepps Cross	IN	3.00	4,926	VP	Di Cesare Investments	Detroit Diesel – Allison Aust Pty	Dec-09
7 Valetta Road, Kidman Park	IW	2.30	1,796	7.93	Rolleb Investments	Research Lab. of Aus	Jan-10

Source: Knight Frank IN = Inner North IW= Inner West VP = Vacant Possession

OUTLOOK

Economic Outlook

Financial markets have experienced considerable volatility of late as a result of sovereign debt concerns in Europe. There is considerable uncertainty at present as the flow-on effects of the past 18 months continue to reverberate around the world.

While Australia will need to watch these flow-on effects closely, the outlook for Australia appears to be considerably brighter than that of most other advanced economies.

The Reserve Bank has raised official interest rates six times since October 2009, lifting the cash rate to 4.50%. With rates back close to long term average levels, the RBA has hinted that it felt that current interest rate settings were adequate for the prevailing economic conditions. In assessing its monetary policy stance, the RBA will be carefully monitoring the potential fallout which may result from the global economic instability.

Australia is well placed with a strong banking sector and a resource sector that will continue to benefit from strong demand from Asia for commodities like iron ore and coal. Much will depend on the level of growth in Australia's major trading partners in Asia.

With inflation hovering at the upper end of the Reserve Bank's target band of 2-3%, the RBA will be ready to apply the brakes on the economy if required by increasing the official cash rate should consumer inflation remain uncomfortably high. The need to act however may ultimately be tempered by the economic volatility caused by the prevailing financial uncertainty in Europe coupled with other destabilising global influences.

South Australian Outlook

The South Australian Industrial market has stabilised over the past year and is well positioned to rebound in the next 12 months. It has become increasingly evident; however, that South Australia cannot rely on manufacturing as a growth driver into the medium term, with the current outlook being benign. Much of South Australia's growth prospects rest in its ability to become a leading global resource based economy.

This has become more likely with the proposed 40% RSPT being replaced with the new MRRT after a compromise was reached between the Federal Government and the mining industry. The proposed tax would have left South-Australia as one of the hardest-hit states in the nation. Mining companies had already threatened to scrap investment plans if the 40% tax had come into effect raising real concerns that this new tax could have put the state's mining boom at risk. South Australia's most significant project going forward is BHP's further development of Olympic Dam, which accounts for half of the states known development projects. This could potentially contribute up to $7 billion to the state's GSP.

The short term performance of the State will be boosted by the 1.3% population growth over the past year, which was its fastest growth in 36 years.

Forecasts for the state's economy look promising in the short to medium term, however the potential influences outlined above will need to be monitored carefully.

Industrial Market Outlook

There has been greater confidence in the Adelaide industrial market as credit conditions and market fundamentals have improved. There are encouraging signs that the industrial market is heading towards a recovery. The period of stability can be expected to continue into the later stages of 2010, with a gradual upswing anticipated from 2011. Conditions in the Outer North and Outer South are expected to remain stable.

Development is expected to remain subdued in the second half of 2010 with the main driver being the level of tenant demand. If rents continue to push higher in traditional inner industrial regions, we may see more small scale developments beginning to emerge, attempting to capture this growth.

Investor demand looks set to increase in late 2010/early 2011 as investors seek attractive yields. However, as confidence increases in the market, some yield compression is likely, particularly for prime assets in the inner precincts.

With the market fundamentals improving, it appears to be an opportune time for investors to enter the market, albeit they remain cautious. A number of strong opportunities exist and this may be a period which retrospectively proves to be a good time to invest.

RESEARCH

Americas
USA
Bermuda
Brazil
Caribbean
Chile

Australasia
Australia
New Zealand

Europe
UK
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Russia
Spain
The Netherlands
Ukraine

Africa
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
Thailand
Vietnam

The Gulf
Bahrain

Knight Frank Research

Matt Whitby
National Director – Research
+61 2 9036 6616
Matt.whitby@au.knightfrank.com

Matthew Mason
Research Analyst –SA
+61 8 8233 5232
Matthew.mason@au.knightfrank.com

Jennelle Wilson
Associate Director – Research QLD
+61 7 3246 8830
Jennelle.wilson@au.knightfrank.com

Justin Mahnig
Research Manager – Research Vic
+61 3 9604 4713
Justin.mahnig@au.knightfrank.com

Industrial Agency Contacts

George Mocatta
Director
+61 8 8233 5278
George.mocatta@au.knightfrank.com

Jon Nitschke
Manager - Industrial
+61 8 8233 5204
Jon.nitschke@au.knightfrank.com

Valuation Contacts

James Pledge
Director
+61 8 8233 5212
James.pledge@sa.knightfrankval.com.au

Nick Bell
Director
+61 8 8233 5242
Nick.bell@sa.knightfrankval.com.au

Knight Frank Research provide strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, financial and corporate institutions. All recognise the need for the provision of expert independent advice customised to their specific needs.

Knight Frank Research reports are also available at www.knightfrank.com.

Knight Frank
Newmark
Global