RESEARCH

NOVEMBER 2011

SYDNEY INDUSTRIAL

Market Overview

Knight Frank

HIGHLIGHTS

- Industrial rents have continued to hold steady with very little change recorded in the six months to October 2011. The strongest leasing demand extends from larger tenants seeking predominantly prime facilities, while smaller tenants are mostly focussed on extending existing leases. Prime vacant leasing options are approximately half the level of secondary options, which is seeing prime assets absorbed more quickly than secondary assets.
- New supply of projects in excess of 5,000m² in 2011 is forecast to be 470,818m², a level more than double the completions in 2010. The majority of this supply is pre-leased, however a number of speculative projects are progressing with reasonably successful leasing outcomes to date.
- Several larger transactions of prime assets have progressed and confirm that core market yields for prime assets continue to range on average from 8.00% to 8.88%. Although secondary assets have recently benefitted from strong levels of lease renewals, values are expected to be inconsistent in the medium term as tenants look to upgrade to modern, well located premises. Nevertheless, this will provide secondary opportunities for investors prepared to take some risk and value add.

INDUSTRIAL OVERVIEW

Table 1
Sydney Industrial Market Indicators October 2011

Precinct	Avg Prime Rent		Avg Secondary Rent		Core Market Yields		Avg Land Value			
					Prime	Secondary	<5,000m²		1 - 5 ha	
	$/m² net	(%p.a)	$/m² net	(%p.a)	%	%	$/m²	(%p.a)	$/m²	(%p.a)
Outer West	102	-	92	-	8.00 - 8.75	9.00 - 10.00	350	-	250	-
Inner/Central West	113	0.8%	101	-	8.00 - 8.75	9.00 - 10.00	509	-	296	-
South West	93	0.5%	80	-	8.25 - 9.00	9.25 - 10.00	306	-	215	-
North	161	0.6%	135	-	8.75 - 9.25	9.25 - 10.00	580	-	465	2.2%
South	143	0.5%	124	1.5%	7.88 - 8.63	8.63 - 9.50	1,050	1.5%	800	2.3%
Sydney Average	**122**	**0.5%**	**106**	**0.3%**	**8.00 - 8.88**	**9.00 - 9.75**	**559**	**0.3%**	**403**	**0.9%**

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)

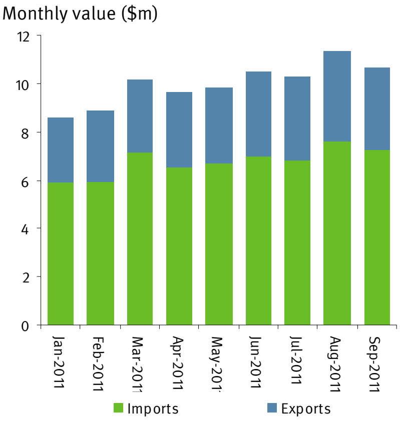
Economic Snapshot

The broad landscape for Australia's economy continues to look positive with strong growth amongst developing nations, particularly in Asia, continuing to benefit export demand. The RBA forecast national GDP growth of 2.75% in 2011 before accelerating to between 3% and 3.5% in 2012 as the economy is boosted by mining investment as well as cyclone and flood recovery. On a cautionary note, the combination of sovereign debt issues in Europe, the possible double dip recession in the US and the potential slowdown in the Chinese economy could have a flow on effect and slow the Australian economy.

However, the disparity in growth between industries remains elevated, particularly for mining compared to the currency and interest rate sensitive parts of the economy such as manufacturing and discretionary retail. This has seen a moderation in labour conditions with the October unemployment rate measuring a still healthy 5.2% and business surveys indicating some easing in hiring intentions. To the benefit of non-mining sectors, the 25bp easing in the cash rate in November sees a more neutral monetary setting and with inflation expectations having softened, there is the potential for further rate cuts if necessary to support demand.

In NSW, overall economic conditions are improving, although growth over the next three years is forecast to be lower than the national rate, largely as a result of lower business investment compared with other states. Trend growth in employment has remained positive with the October unemployment rate measuring 5.3%.

Figure 1
NSW Trade in Goods and Services
Monthly value ($m)

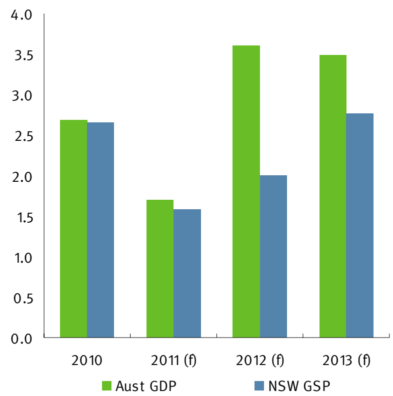


Source: ABS

To the benefit of transport and logistic users of industrial space, the high $AUD has been supportive for import volumes. The value of September imports for NSW posted annual growth of 3.6%. This is consistent with the increased container trade at Sydney Ports where September trade volumes were up 4.1% compared to the same month last year. At a national level, annual growth in inventories in the most recent National Accounts (June) indicate that inventories rose 3.3%, the highest annual growth since 2008.

Conditions for traditional users of industrial space, notably manufacturers, are less positive with manufacturing surveys posting soft readings as the high $AUD constrains competitiveness. Despite this, the shift in industrial property usage towards more transport and warehousing orientated functions has meant that overall demand for industrial property has held up relatively well to these constraints.

Figure 2
Economic Growth
NSW vs Australia – 2010 to 2013



Source: Deloitte Access Economics

Industrial Overview

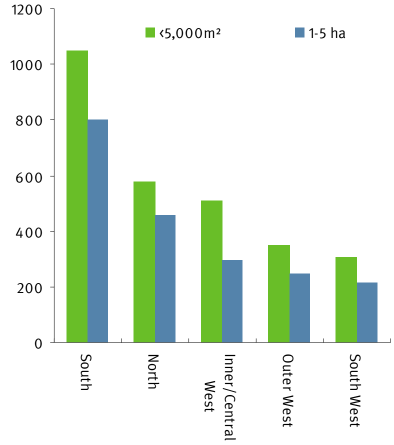
Similar to the first half of 2011, the industrial market has continued to hold steady both in terms of rental levels and values. Demand from tenants is somewhat two tiered with larger users driving the majority of new lease deals in the market, particularly in the Outer West. Retention rates are particularly high amongst small to medium sized occupiers who have been more cautious in progressing expansion or relocation plans.

New supply has lifted substantially since 2010 and completions in 2011 will be more than double the previous year. The majority of this new supply is located in the Outer West and, to a slightly lesser extent, the South West. Predominantly projects are pre-committed, however several speculative projects in Eastern Creek and Erskine Park are progressing as developers look to take advantage of the relative lower availability of larger prime leasing options. Although some success in these speculative projects has been achieved, further increases in the volume of larger enquiries are likely to be needed until there is a significant lift in speculative activity.

Figure 3

Sydney Industrial Land Values

Avg value serviced lots by precinct ($/m²)



Source: Knight Frank

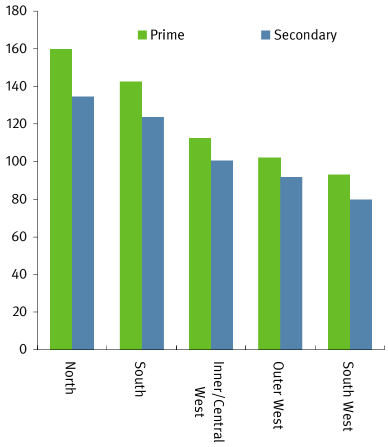
Land values continue to track sideways from the trough that was achieved in 2009. While earlier in the year buyers of vacant land consisted of well capitalised privates and owner occupiers, recent deals have seen institutional buyers increasing inventory for development pipelines.

In the improved sales market, several larger deals in the range of $70m to $100m have progressed. While in some cases these have been driven by capital initiatives and strategic wholesale partnerships, others have also indicated signs of market confidence amongst investors for well located, prime assets. These sales have transacted on yields consistent with market expectations and have demonstrated that yields have remained largely stable in 2011. Average prime core market yields across Sydney currently range from 8.00% to 8.88% and 9.00% to 9.75% for secondary assets as at October 2011.

Figure 4

Sydney Industrial Rents

$/m² net rent by precinct - October 2011



Source: Knight Frank

OCCUPIER DEMAND & RENTS

The leasing market has steadied somewhat over the past six months with caution amongst businesses seeing the majority of tenants looking to extend existing leases rather than expand into new premises. Overall this has seen rents remain relatively steady although some modest gains in the six months to October have been recorded for larger (>10,000m²) prime assets.

Of the vacant facilities in excess of 5,000m², slightly more than two thirds is secondary grade, highlighting the relative disparity between prime and secondary tenancy options. Prime leasing options tend to be absorbed more quickly than secondary, largely a result of firm demand from larger occupiers, especially integrated logistics providers such as Toll (12,405m² at Mascot) and SDV (12,910m² at Smithfield). On average, B-grade assets take longer to be absorbed with tenants being very specific in their requirements. For smaller lease sizes of less than 2,000m², demand has been softer and smaller private landlords have been prepared to reduce rents in order to ensure income certainty.

Following the strength in pre-lease deals in late 2010 and early 2011, which satisfied the bulk of enquiries, the velocity of new pre lease activity has slowed over the last six months. However encouragingly, signs of tenant interest are still present. Challenger have secured a 10 year lease pre-commitment with Bunzl for 20,200m² at The Junction Industrial Park in Enfield, while Goodman have secured Mayo to a 12,638m² lease for a 10 year term at Moorebank Business Park. Consistent with the relatively firmer demand from larger tenants, absorption of speculative developments have stemmed from larger lease deals. DEXUS have reported that they are in negotiations for, firstly, a seven year lease deal to a global logistics user commencing in February 2012 at their 21,000m² project at Templar Road, Erskine Park and also a five year lease with a transport company for 46% of the space at their 23,340m² project at Quarry at Greystanes. Additionally, Australand have achieved commitment to their speculative development at EC3, Eastern Creek with QLS Transport for 13,197m² on a seven year term.

Proximity to major road infrastructure continues to drive strong demand in the Outer West. This trend has been enhanced by transport and warehousing facility requirements stemming from increased online retailing such as Ozsale leasing 17,105m² at Smithfield. In the six months to October, approximately 75% of gross take up of industrial facilities in excess of 5,000m² was in the Outer West region. The last six months has seen a modest reduction in Outer West prime incentives to between 9% and 10% with average net face rents holding steady at $102/m².

Prime net face rents in the South average $143/m², which represents some modest rental growth in Waterloo and Roseberry. Demand in these suburbs continues to benefit from fashion warehousing shifting from CBD fringe locations.

In the Inner Central West, a number of manufacturing related businesses are looking to scale down and outsource logistics to companies located in the Outer West, which will likely see some pressure on secondary vacancies in the short to medium term. Nevertheless, demand remains supported by distribution providers with new leases such as Australia Post (circa 8,500m²) at Chullora and YHI International (6,972m²) at Camellia recorded. This has seen prime net face rents hold steady at an average of $113/m².

Prime net face rents in the South West have also held steady, at $93/m². Major recent deals have been limited to Clemenger International (5,300m²), however a number of sub 3,000m² deals have also been recorded.

Table 2
Major Industrial Leasing Transactions Sydney Region

Address	Region	Net Rent ($/m²)	Area (m²)	Term (yrs)	Lease type	Tenant	Date
34-38 Cosgrove Road, Enfield	ICW	Conf	20,200	10	Pre-comm	Bunzl	P/C
EC3, Wonderland Dr, Eastern Creek	OW	110	13,197	7	Pre-comm	QLS Transport	P/C
Moorebank Business Park	SW	Conf	12,638	10	Pre-comm	Mayo	P/C
11a Grand Ave, Camellia	ICW	103	6,972	6	Existing	YHI International	Nov-11
Euston Business Park, Alexandria	S	168	9,736*	3	Existing	Federal Express	Oct-11
149 McCredie Road, Smithfield	OW	75	17,105	5	Existing	Ozsale	Sep-11
149 McCredie Road, Smithfield	OW	75	12,621	5	Existing	Specialty Packaging Grp	Sep-11
Airgate Business Park, Mascot	S	164	12,405	8	Existing	Toll	Aug-11
Discovery Cove Industrial Estate, Port Botany	S	Conf	7,246*	3	Existing	Dateline Imports	Aug-11
28 Britton Street, Smithfield	OW	107	12,910	7	Existing	SDV	Jul-11
43-47 Lyn Parade, Prestons	SW	114	5,300	3	Existing	Clemenger Int'l Freight	Jul-11
Regents Park Industrial Estate	ICW	95	14,567	5	Existing	Matt Blatt	Jun-11

Source: Knight Frank OW Outer West SW South West ICW Inner Central West N North S South Conf refers to confidential *Lease renewal

DEVELOPMENT & LAND VALUES

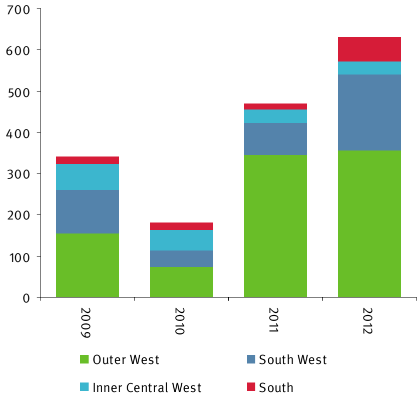
Following the cyclical low in new supply recorded in 2010, 2011 has seen a significant lift in development activity. The large majority of this supply extends from large pre-committed projects undertaken by the listed A-REITs, predominantly on terms agreed from 2010. The Outer West region is the main source of new supply with approximately half of the 2011 supply located in the Erskine Park and Eastern Creek precincts where developers such as Goodman, Australand and DEXUS have been active. Supply in the South West is dominated by Mirvac's Nexus Industrial Park in Prestons (Building 4, 23,000m² completed October, 100% leased to HPM Legrand Australia) and Hoxton Distribution Park (132,587m², due to complete 2011, however operational by March 2012). Activity is relatively softer in the Inner Central West, however Challenger's progression of stage two at The Junction Industrial Park at Enfield is expected to complete in June 2012, while a pre-commitment is still being sought for the 12,560m² stage three.

Despite the relative shortage of A-grade tenancy options, the progression of speculative developments still remains reasonably soft and at this stage is confined to the Outer West region. Currently two completed speculative developments are vacant, however the projects are relatively small at circa 6,000m² with both buildings being attached to larger, committed D&C projects. Three further speculative projects are progressing with Australand's EC3 project at Lot 4 Wonderland Drive, Eastern Creek(21,600m² due H1 2012), Goodman at Westpark Industrial Estate, Erskine Park (8,502m² due March 2012) and DEXUS at Quarry Industrial Estate, Greystanes (23,340m² due April 2012). Future speculative developments are expected to remain sporadic until there is an improvement in the depth and size of enquiry levels.

Figure 5

Sydney Industrial Development

Annual Gross Supply* (000s m²)



Source: Cordell Connect/Knight Frank

* includes developments with industrial floor area >5,000m² and excludes deferred/abandoned projects

Development land remains thinly traded with the majority of sales occurring in the western Sydney regions. Land values continue to track sideways, showing no material change over the past two years. As developers look to take advantage of diminishing prime leasing options and firmer demand amongst larger tenants, demand for land is expected to improve in the short term. Nevertheless, there is sufficient supply to keep values stable for the next 12 months.

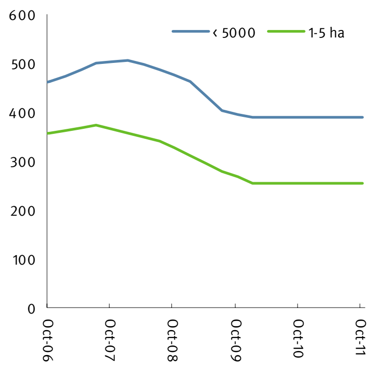
DEMAND FOR LAND IS EXPECTED TO IMPROVE

While earlier in the year the few land sales that transacted were underpinned by a range of owner occupiers, signs of larger developers looking to grow existing development pipelines have emerged with the recent reported acquisition by Australand of 32ha at Eastern Creek. In the western Sydney regions (refer Figure 6), values for small lot sizes of less than 5,000m² average $388/m². Although the average value for medium sized lots of between 1ha and 5ha is $254/m², smaller lots in this range that are serviced and in prime locations are valued closer to $300/m².

Figure 6

Sydney Industrial Land Values*

Avg. value serviced lots – October 2011 ($/m²)



Source: Knight Frank

*Average Outer West, Inner West and South West

Table 3

Major Land / Development Sales Activity Sydney Region

Address	Region	Price ($ m)	Area (m²)	$/m² of site area	Vendor	Purchaser	Date
Tesrol site, Eastern Creek	OW	Conf	320,000	Conf	Tesrol	Australand	Conf
61 Roberts Rd, Greenacre	SW	10.529	36,500	288	Mirvac Group	Private	Jun-11
3-7 O'Riordan Street, Alexandria*	S	11.5	9,978	1,153	RM Constructions	Offshore Investor	Apr-11
1-3 Templar Road, Erskine Park	OW	10.104	34,850	290	DEXUS	Digital Realty Trust	Feb-11

Source: Knight Frank Conf refers to confidential * Likely commercial redevelopment

OW Outer West SW South West ICW Inner Central West N North S South

SALES & INVESTMENT YIELDS

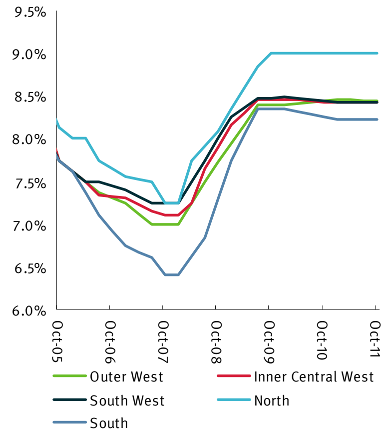
After industrial investment sales experienced a reasonably soft start to 2011, several key transactions prior to the close of the financial year as well as some recent larger deals have indicated an improvement in investor demand appetite. The anticipated sale of several portfolios currently in due diligence/negotiations will further add to the volume of transactions. Strong interest from offshore investors has also started to translate into transactions with both GIC and Aviva Investors having been active buyers in a JV capacity over the past six months.

Both portfolio re-weighting as well as the natural churn of asset ownership as developers look to recycle capital to fund new projects have underpinned a number of transactions. In May, Australand and GIC established an industrial JV into which Australand sold eight assets, including three located in Sydney (refer Table 4). The proceeds will be used for capital deployment for future logistics opportunities. Similarly, Mirvac has agreed to sell a 50% interest in Hoxton Distribution Park to Aviva Investors Australian Logistics Property Trust (AIALT) at a reported price of $97.4m. In addition to this, the parties have entered a formal Heads of Agreement to sell a further four industrial assets.

Further portfolio sales are anticipated to be forthcoming. Stockland continue to look at divesting their industrial portfolio, and while it has reportedly received offers for up to $200m worth of assets, a formal sale has yet to be announced. In addition, Altis Property Partners are reportedly in due diligence for a portfolio of seven industrial assets from the PGA Group, including the Sydney assets of 39 Britton Street, Smithfield and 34 Airds Road, Minto. For Altis, this follows the $86.75m acquisition of the St Leonards Corporate Centre on a core market yield of 9.2%, although it is noted that one third of the NLA comprises office space. Of the groups looking to divest non-core assets, there is a preference to retain prime stock as opposed to secondary assets.

A number of A-REITs are looking to increase industrial exposure, particularly to the relatively tighter prime market, with many such as Goodman, Australand and GPT looking to do so by growing development pipelines. While DEXUS is also active in the development space, they have also looked to add to core earnings with the pending purchase of Sir Joseph Banks Corporate Park. Reported to have traded at $76.8m, the sale provides a key indicator for prime assets in the South region following a period where the majority of large prime sales have been located in Sydney's western markets.

Figure 7
Average Prime Core Market Yields
Sydney Industrial Regions



Source: Knight Frank

Average yields across Sydney have continued to remain stable over the year and currently range from 8.00% to 8.88% and 9.00% to 9.75% for secondary assets as at October 2011. Nevertheless, several deals have transacted at yields below the lower end of average ranges in their respective regions. These have included the Hoxton Distribution Park at a reported yield of 7.50% and Kmart Eastern Creek at 7.96%. However rather than indicating a degree of tightening, the sales reflect the assets being brand new D&C

Table 4
Major Improved Sales Activity Sydney Region

Address	Region	Price ($ m)	Bld Area (m²)	Core Mkt Yield (%)	WALE (yrs)	Vendor	Purchaser	Date
Sir Joseph Banks Corporate Park, Botany	S	76.8*	31,658	Conf	2.9	Grosvenor Int'l	DEXUS	Pending
Hoxton Distribution Park ^‡	SW	97.4^	132,231	7.50*	23.4	Mirvac	AIALT#	Mar-12~
St Leonards Corporate Centre	N	86.8	35,502	9.20	3.8	Orchard Property	Altis Property Partners	Sep-11
101-103 Williamson Rd, Ingleburn	SW	10.8	9,488	8.80	3.6	Samashky Pty Ltd	Caleven Pty Ltd	Jul-11
KMart Warehouse, Eastern Creek	OW	72.0	51,660	7.96	15.0	Australand	GIC	May-11
Schenker Warehouse, Fairfield	OW	38.2	33,198	9.15	3.6	PacLib Pty Ltd	Kingsmede Pty Ltd	May-11
1 and 7-15 Kellet Close, Erskine Park	OW	31.25	23,267	8.33	4.7	Australand	GIC	May-11
Sigma Warehouse, Seven Hills	OW	18.25	13,555	8.38	3.7	Australand	GIC	May-11

Source: Knight Frank * reported Conf refers to confidential ^ 50% interest ‡ Conditional upon FIRB approval ~ Expected settlement date
Aviva Investors Australian Logistics Property Trust OW Outer West SW South West ICW Inner Central West N North S South

projects in prime logistical locations with very long term WALEs to quality tenants of 23.4 years and 15.0 years respectively. Other asset sales have consisted of existing facilities on WALEs of circa three to five years and these transactions have confirmed existing average yield ranges illustrating the stability in yields over the course of 2011.

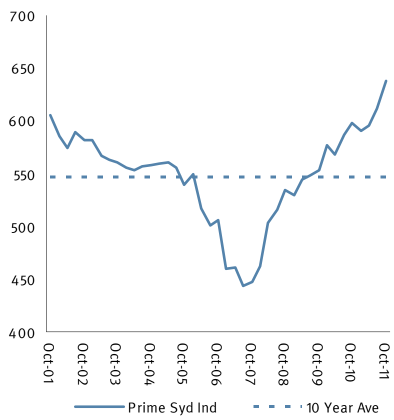
ON A RELATIVE BASIS, BOTH PRIME AND SECONDARY ASSETS REPRESENT GOOD VALUE

On a relative basis, both prime and secondary assets continue to represent good value with average yields being elevated above long run average levels. Similarly, implied risk premiums also show relative value with the spread between prime core market yields and real bond rates being approximately 90bps above the 10 year average as at October.

Figure 8

Sydney Industrial Prime Risk Premium

Yield spread to 10yr inflation linked bond



Source: Knight Frank/RBA

OUTLOOK

The current period of stable rents and values in Sydney's industrial market is expected to continue in the short term as caution and uncertainties surrounding global debt issues maintain the pensive attitude amongst many tenants. This will likely see tenants remain focused on lease renewals until they become more confident to expand into new premises or become active in the pre-lease market again.

Nevertheless, structural phenomena such as the growth in online retail and the consolidation of logistics services around major transport hubs will continue to underpin growth amongst larger occupiers. This pattern will be supportive of demand for relatively larger stock options, particularly for prime assets given the relative shortage of prime options. There are favourable opportunities for developers looking to bring new stock in excess of 10,000m² to the market and major owner developers continue to actively seek pre-commitments. The average size of pre-lease deals and the recent success in leasing speculatively developed stock is indicative of this demand. However a substantial pick up in speculative development activity is unlikely until larger enquiries start to become more abundant.

ONLINE RETAIL… CONSOLIDATION OF LOGISTICS SERVICES…. WILL CONTINUE TO UNDERPIN GROWTH AMONGST LARGER OCCUPIERS

The combination of lower vacancies in prime stock and the forecast pick up in domestic economic growth over 2012 is expected to place some modest upward pressure on rents in the next year. This will likely be in the form of lower incentives for prime stock in the South and Inner/Central West precincts, however the impact will be less pronounced in western precincts, where new supply is concentrated.

As the development pipeline grows and tenants upgrade to purpose built premises in superior locations, the backfill of secondary space is expected to increase. This will place some pressure on secondary rents with incentives expected to remain elevated as landlords compete to secure tenants.

With the outlook for rents favouring prime assets, there is a firming yield bias for well tenanted quality assets. Prime yields will continue to be supported by the shallow depth of stock available for sale, with investors showing a preference to hold prime assets. Secondary assets are expected to remain soft and inconsistent as occupiers seek modern, well located assets. The risk premium between prime and secondary assets remains elevated (approximately 25bps higher than the 10 year average and could potentially widen further) albeit providing opportunistic buying conditions for investors seeking higher yielding assets or value add potential.

While demand for development land has shown preliminary signs of improving, there is currently sufficient supply, particularly in the Outer West and South West markets, to suggest land values will remain steady for the next 12 months. Limited demand for large, unserviced parcels will maintain downward pressure on values in secondary locations. The trough in values will provide opportunities for larger developers looking to expand inventory for development pipelines.

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