

Market Link Illawarra

Introduction

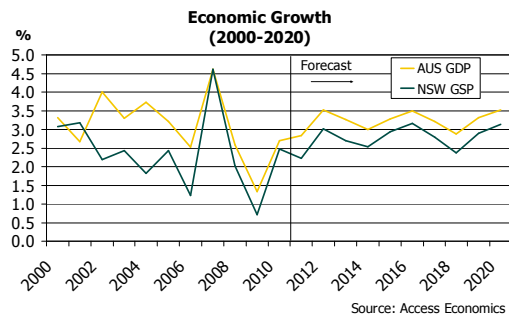
The Illawarra property market has been in a period of turmoil since the onset of the Global Financial Crisis (GFC). In addition to the re-rating of risk which impacted upon all property markets globally, confidence in the Illawarra market was also impacted by the dismissal of Wollongong Council in 2008.

More recently however, the prime office market recorded a boost in confidence with the release of space at University of Wollongong's 'Innovation Campus' being met with strong demand. Likewise the \$25 million sale of 280-286 Kiera Street Wollongong, in December last year, proved that quality properties, with strong lease covenants are still a sought after commodity within the Illawarra. In the industrial and retail markets however, declining retail sales coupled with increasing uncertainty surrounding BlueScope Steel's long term plans for the region, have placed downwards pressure on both occupier and investor interest.

Economic Conditions

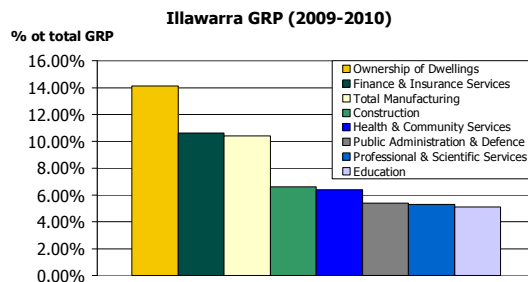
Economic Growth

The New South Wales economy has a greater exposure to the finance and professional service sectors, than the mining and resource based states. As such, economic growth within the NSW economy has under performed the Australian economy since the onset of the Global Financial Crisis in early 2008.



In the 12 months to June 2010 the NSW economy grew at a rate of 1.71% compared to the Australian economy which grew by 3.0%, over the same period.

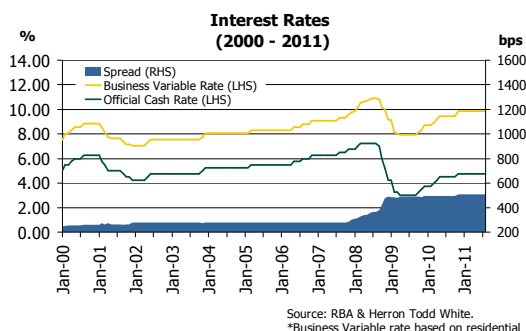
In the Illawarra, the regional economy has been undergoing structural change for some time, as the traditional dominance of the manufacturing sector gives way to higher order education and finance industries.



According to IRIS research the Illawarra economy contributed some \$15.5 billion to the NSW economy over the 2009-2010 financial year, representing 4.02% of total NSW Gross State Product.

Interest Rates

With the global economic outlook now less than certain and domestic demand seemingly reduced, the Reserve Bank of Australia (RBA) has resolved to leave interest rates on hold at 4.75% at its September meeting.



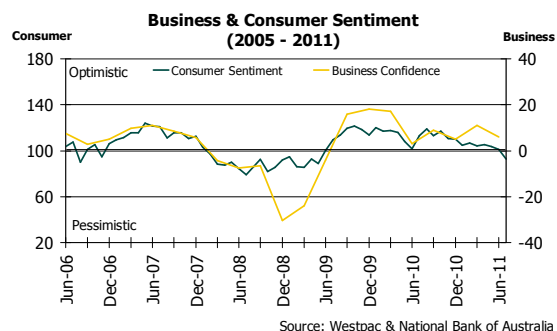
Despite the substantial increase in headline inflation recorded in the second quarter of 2011, the RBA has elected to focus on underlying inflation, and appear to be taking note of generally soft economic conditions globally.

Business and Consumer Sentiment

Business confidence levels are a key lead indicator of future spending and economic growth. After recording a rise in the March quarter, business confidence fell significantly. Confidence was most impacted in the finance and mining sectors with the high Australian dollar, continued restraint from consumers and concerns about the global outlook. Falling business confidence has the potential to limit the demand for additional office and industrial accommodation, subsequently driving up vacancy levels.

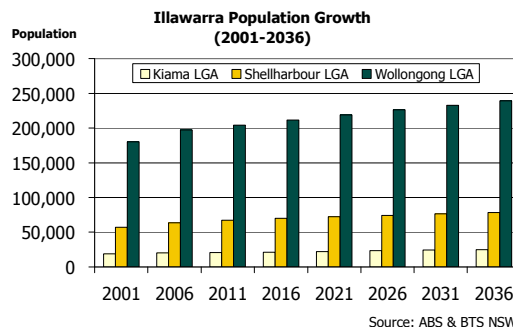
The most recent Consumer Sentiment Survey indicated a continued decline following a fall in sentiment in July. As of August 2011 the consumer sentiment index stood at 89.6 points. According to the Westpac/Melbourne Institute, consumers are now less certain of their finances compared with a

year ago and have a lower expectation of their finances over the coming 12 months, with this measurement of confidence recording the lowest rate since the early 1990's.



Illawarra Population

As of 2006, the Illawarra region had a total population of 280,111. This follows a period of significant population growth, whereby the population grew by an average of 1.9% per year from 2001-2006. As shown in the chart below, the Wollongong LGA accounts for the greatest proportion of Illawarra population, accounting for 70.28% of the population within the region.



It is not expected that the population growth recorded over the five years to 2006 will continue. According to the Bureau of Transport Statistics, the population will grow by 0.8% p.a from 2006-2011, before falling to 0.7% p.a from 2011-2016. Over the five years to 2016, the majority of growth is expected in the Kiama LGA, with the population growing by 1.1% per year within this LGA.

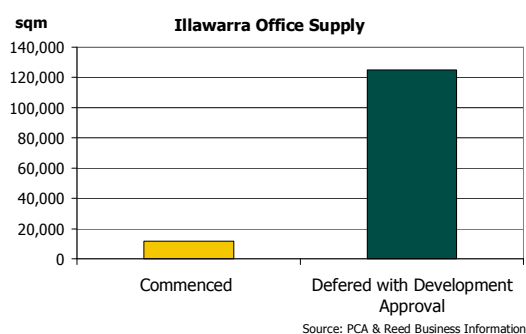
Office Market Conditions

There are three primary office locations in the Illawarra region, Wollongong CBD, Innovation Campus North Wollongong and Shellharbour City Centre, with the Wollongong CBD the largest of the three.

Market conditions within the Illawarra have been weak for some time, with the region struggling to compete with the Sydney suburban market. Recently, however, tenant demand has improved, with a number of larger and smaller tenants taking up space within Wollongong University's Innovation Campus, notably Illawarra Coal's (BHP Billiton) occupancy of the third level within the Enterprise 1 building.

Supply

The supply of additional floor space within the Illawarra is expected to remain low, with an increase in rental rates or a significant tenant pre-commitment required to stimulate development. As shown in the chart below there is only one project currently under construction, being Building Four at the University of Wollongong's Innovation Campus ('IC'). We note this is not a commercial development and the space will not be available to the broader market.



As shown in the chart above, there are a total of 15 projects totalling 125,048 sqm of floorspace which

have secured planning approval, but have been unable to progress. This is due to funding restrictions, a lack of a significant pre-commitment and **the inability to achieve the economic rents required to justify development**. An article published in the Illawarra Mercury on 31 March 2011 reported that rental rates would need to rise by 20% in order to make these developments economically viable.

Of these projects, some 114,749 sqm of floorspace is located within Wollongong. **If all projects were to be completed, this would result in a 78.1% increase in total supply (currently 146,748 sqm)**. As such it is unlikely that all of these projects will proceed regardless of rental growth.

The table overleaf, published by NSW Industry & Investment in its September 2010 Advantage Wollongong Commercial Property Report, noted the following greenfield office development opportunities, (all of which are still available).

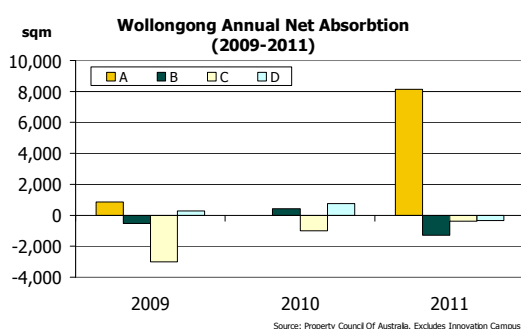
Greenfield Development Opportunities

Property	Size (sqm)	Gross Rent (\$/sqm)
Innovation Campus	250-10,000	390
25 Atchison Street	345-10,000	310
Mid City Centre	514-7,220	380
City Junction	345-2,700	400
46-48 Loftus Street	3,600	400
Ambience	400-1,600	350

Source: NSW Industry & Investment

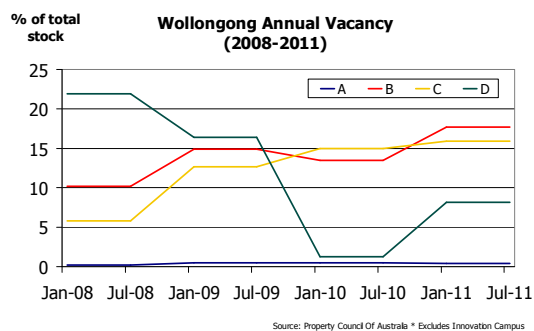
Occupier Demand

Demand for commercial office space within the Illawarra is primarily focused on the Wollongong CBD and the recently completed Innovation Campus precinct in Fairy Meadow. Over the past 12 months, some 6,095sqm of floor space has been absorbed by the Wollongong CBD market, the highest level of demand since records commenced in 2009.



As shown in the chart above there was a significant increase in net absorption of A grade buildings within Wollongong over the 12 months to January 2011. This rise in absorption came as a result of the completion and occupation of 280-286 Keira Street by ING Australia. Excluding this building the Wollongong market recorded a fall in demand, with -1,960 sqm absorbed by the market.

As of January 2011, there was some 13,147 sqm of vacant office space available in the Wollongong market, equating to a total vacancy rate of 9.0%. A grade properties currently have the lowest vacancy with only 250 sqm available (0.4%) whilst B grade properties have the highest level of vacancy with 5,493 sqm available (17.7%).



Vacancy within A grade properties has been critically low for the last four years, suggesting a significant undersupply of A grade properties. Despite this apparent under supply, **it appears that the A grade market is currently at an equilibrium**, with the lack of A grade properties failing to place any significant upwards pressure on rental rates.

Leasing Market Conditions

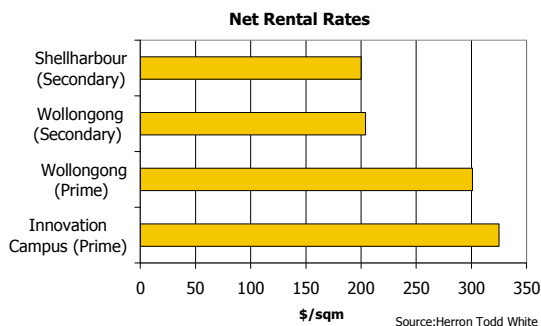
Leasing conditions at the top end of the market remain in a position of stalemate, with tenants unwilling to commit to higher rental rates, despite the general lack of quality office properties within the Illawarra. **As a result of this stalemate, there has been little movement in rental rates over the last three years.** The exception to this has been Innovation Campus, where the University of Wollongong has been successful in securing larger tenants on rental rates up to \$400/sqm gross (face).

LEASING ANALYSIS



Address:	Innovation Campus
Property:	iC Central - A three storey office building.
Details:	Renewal of a ground floor office tenancy (excludes parking).
Rental:	\$157,437 (gross)
Start Date:	28/08/2011
Floor Area:	500 sqm
Lease Term:	3 Years
\$/sqm:	\$380 (gross)

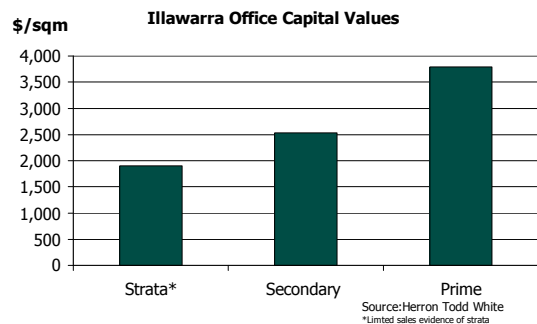
As shown in the chart below, A grade properties in the Innovation Campus precinct attract the highest rental rates ranging from \$330-\$340/sqm net.



Despite the lack of rental growth over the last three years, **rental rates within prime Illawarra properties are not expected to increase in the near future.** Currently prime rental rates in the Illawarra region are comparable to prime rental rates in suburban Sydney locations, limiting the attractiveness of the region. Given this lack of competitive advantage, further rental growth is unlikely until the market can offer a significant rental discount to Sydney based firms.

Investment Market Conditions

Over the past 12 months, transaction volumes of both prime and secondary properties have improved within the Illawarra region, with the sale of 280-286 Keira St Wollongong for \$25.5 million and several smaller office suites and mixed used sites.



Commercial office values vary widely within the Illawarra, with the market characterised by a broad range of property types and varying levels of quality. As shown in the chart above, the most recent sale of a prime office property indicated an initial yield of 8.15%, similar to the yields achieved by prime properties in suburban Sydney markets and is reflective of the strength of the lease covenant. This sale represents the top of the market, with prime values likely lower than this transaction indicates.

SALES ANALYSIS



Address:	280-286 Keira St, Wollongong
Details:	Recently completed 5-storey A grade building and a 2,396 sqm development site.
Sale Price:	\$25,250,000
Sale Date:	21/12/2010
Building Size:	7,031 sqm
Land Size:	4,591 sqm
\$/sqm:	\$3,591/sqm
Yield:	10.0% to 10.5% (after undeveloped land adjustment)

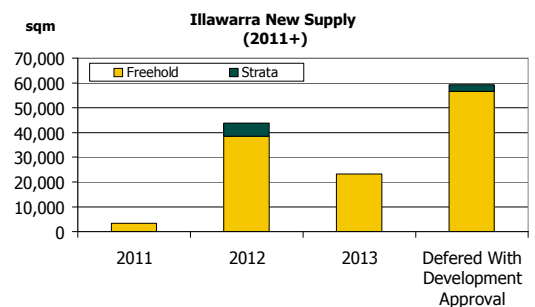
In the secondary market, a high proportion of owner occupiers purchasing on a \$/sqm has a tendency to push capital values higher than that which would be accepted by an investor. Subsequently tenanted secondary properties trade on lower yields than prime properties which generally only appeal to investors.

Industrial Market Conditions

The main industrial locations in the region include Wollongong, Port Kembla and Unanderra. In addition to these major centres, there are a number of small enclaves scattered throughout the various suburbs in the region. Although building values and rents have held up reasonably well since the GFC, the broader industrial market has been subdued over recent times, a trend experienced across the national, state and Sydney markets.

Supply

The new supply of industrial floor space is projected to be limited over the next six months of 2011, with only 3,350 sqm of additional floor space to be added to the market. Following 2011, an increase in the number and size of developments will see some 43,782 sqm of industrial space delivered to the market, with 5,203 sqm of this space comprised of strata industrial units.



In addition to the 70,487 sqm of industrial floorspace forecast for completion in the 32 months to December 2013, there is an additional 59,217 sqm of industrial floorspace deferred with development approval, as projects struggle to secure finance or tenant pre-commitments.

Industrial Building Completions July 2011 – Jan 2012

Building Address	Suburb	Total Size (sqm)	Pre-commitment (%)	Comments
9 Charcoal Close	Unanderra	1,404	100	Single warehouse
1 Mineral Road	Oak Flats	400	Unknown	Two industrial units
69 Rowllins Road	Gerringong	700	Unknown	Single Warehouse
Lot 11 Margaret Street	Gerringong	342	100	Single Warehouse

Source: Reed Business Information & Herron Todd White

Demand

With the exception of the manufacturing facilities associated with BlueScope Steel and One Steel, the majority of the industrial properties within the Illawarra consist of smaller industrial premises (<10,000sqm) occupied by support or local service industries. As a result of this market structure and a lack of comparative advantage with the Sydney industrial market, **demand for industrial space is generally limited to those companies which have a specific need to be located within the region.**

In addition to this lack of external demand, the region is characterised by a high presence of owner occupiers, limiting the extent of leasing demand. A review of upcoming supply did reveal higher levels of pre-commitment indicating heightened demand. However, analysis of these pre-committed projects revealed that the majority are initiated on behalf of the future tenant, as opposed to being speculatively developed.

Leasing demand for industrial space remains the highest for stand alone properties in the established industrial areas of Unanderra, Port Kembla and Albion Park Rail, with only limited leasing demand for industrial space within North Wollongong. Demand for strata industrial units

however is limited, with rental discounts not yet high enough to entice occupiers. This is particularly the case in Albion Park Rail, where a number of strata units remain vacant, despite reaching completion in the last two years.

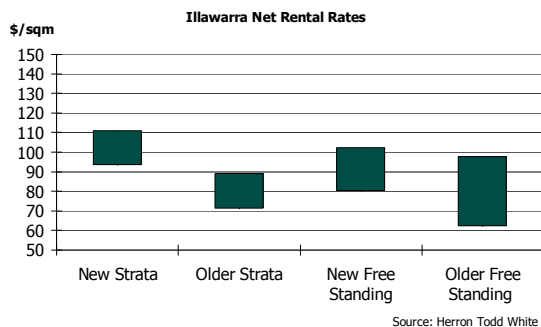
While the impact of the scaling back of production at the BlueScope Steel plant is yet to be felt, it is likely that demand for industrial space will begin to fall, as local companies which provide a support role to the steelworks feel the impact of a slowdown in the demand for their products,

Discussions with local leasing agents revealed that letting up periods up to and exceeding 12 months are common within the market, with a limited number of businesses seeking space each year.

Leasing Market Conditions

Reflecting the limited leasing demand, rental growth within the Illawarra region has been minimal for a number of years, with growth underperforming inflation over this period.

As shown in the chart overleaf, rental rates for industrial properties within the region range between \$70/sqm and \$125/sqm depending on the size, location and quality of the property. Larger newer 'super sheds' however, have secured rental rates as low as \$66/sqm.



Investment Market Conditions

Industrial capital values within the Illawarra are largely underpinned by owner occupiers, with very few properties trading on an investment basis. Over the past four years, both the cumulative number and value of industrial property transactions has fallen. As shown in the chart below, only 32 properties featuring industrial zoning sold in the 12 months of 2010, almost half the number sold in 2009.

LEASING ANALYSIS



Address: 20-24 Princess Highway
Yallah

Property: Older industrial and showroom building with exposure to the F6 Freeway. Ample yard area.

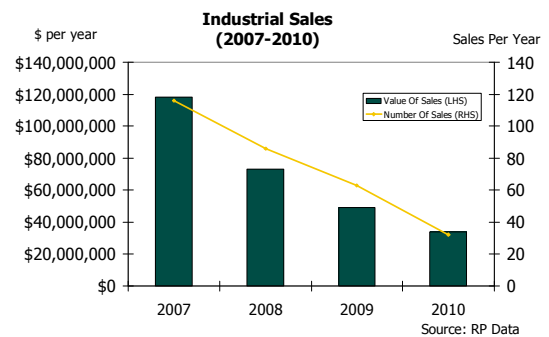
Rental: \$116,000 (gross)

Start Date: 01/07/2011

Floor Area: 1,120 sqm

Lease Term: 5 Years

\$/sqm: \$104 (gross)



Reflecting the fall in both investment and investor demand, land values have fallen significantly from pre-2008 levels. The table overleaf, indicates falls of up to 40% on both heavy and light industrial on resales of properties which also transacted prior to the Global Financial Crisis

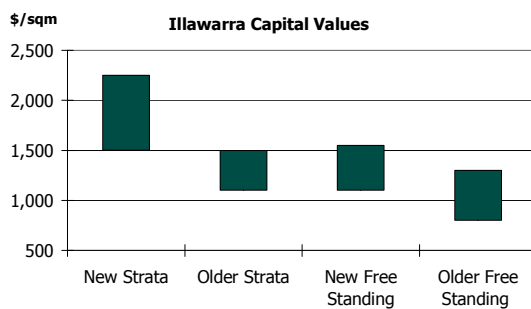
Price falls have potentially been greater in land zoned for heavy industrial, with little recent sales available to establish current values.

Industrial Land Values

Industrial Zoning	Lower (\$/sqm)	Upper (\$/sqm)	Movement since 2009
Heavy Industrial	80	120	20% fall
Light Industrial	110	165	20-30% fall

Source: Herron Todd White

As noted, the land values in the table above are based on sites greater than 5,000sqm. Land values for sites less than 5,000sqm can be as high as \$220/sqm, depending upon the location, topography and services.



Source: Herron Todd White

As a result of the higher presence of owner occupiers and relatively low rental rates, rental yields are below similar properties located in Western Sydney. Tenanted properties trade on a yield between 7.6% and 8.5%, with newer strata properties trading on yields as low as 5.4%

Industrial values vary significantly across the Illawarra, with the market characterised by a broad range of property types and quality. As shown in the previous table, new strata units attract the highest capital values ranging from \$1,500-\$2,250/sqm. Demand for units in this price range is weak however, with higher values per square metre coming as a result of the smaller property size, as opposed to heightened demand.

SALES ANALYSIS



Address: 7 Investigator Drive, Unanderra

Property: Vacant heavy industrial zoned land.

Sale Price: \$665,000

Sale Date: 08/09/2011

Land Area: 3,531 sqm

\$/sqm: \$1886

Unlike industrial land values, freehold building values did not fall significantly following the onset of the Global Financial Crisis, with the high presence of owner occupiers maintaining property values during this period. Likewise **property values in the strata unit market have not fallen significantly despite a rise in supply, with vendors preferring to hold the property rather than accepting a lower sale price.**

Retail Market Conditions

The Illawarra retail market is predominantly focused around the Wollongong CBD, with Crown Street Mall and the connected Wollongong Central represent the centre of retailing within Wollongong and the greater Illawarra region. In addition to the CBD, the Wollongong retail market is further bolstered by Westfield Warrawong (57,482 sqm), Westfield Figtree (21,688 sqm) and Stockland Shellharbour (38,735 sqm). In addition to these two major centres, the Illawarra retail market features a number of enclosed neighbourhood centres and several retailing strips located in smaller suburban and town centre locations.

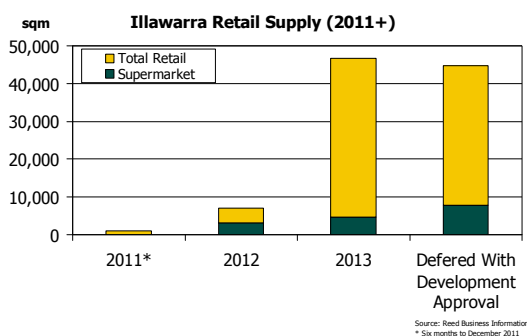
Reflecting the changing socioeconomic dynamics of the region, future retail development has focused on improving the quality and variety of retail offered. Many of these projects were however placed on hold at the onset of the Global Financial Crisis, including GPT's West Keira redevelopment (now reported to be proceeding), VALAD's Corrimal development and Belmorgans Dwyers site redevelopment (in the hands of receivers).

Despite a rise in the population within the Illawarra over the last ten years, retailers within the Illawarra face strong competition from Sydney based retailers, with Illawarra consumers commonly travelling to Sydney to fulfil their discretionary shopping needs. In a survey undertaken by Leyshon Consulting in 2007, **it was estimated that 16% of residents in the greater Wollongong region never shop within the Wollongong City Centre.**

Supply

As shown in the chart below, new supply of retail floor space is expected to be high within the Illawarra in the 2.5 years to December 2013, with some 54,815 sqm of additional retail space expected to be delivered to the market over this period.

Much of this additional floor space is located in new larger developments, with seven projects featuring greater than 2,000 sqm expected to reach completion in this 2.5 year period.



Unlike other regions within NSW, the proportion of new supply dedicated to supermarket and food retailing will be limited, with **developers favouring bulky goods, discount department stores and specialty goods retailers.** This shift in the retail development mix is likely the result of the current high level of escaping discretionary expenditure within the Illawarra.

Demand

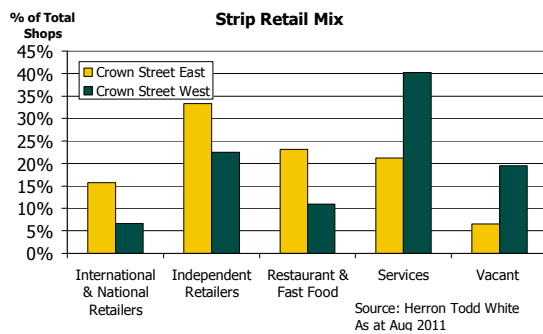
Due to the fragmented nature of the Illawarra/Wollongong retail market, demand for retail space is mixed, with the level of demand for enclosed centres seemingly higher than the demand for space within retail strip precincts. In addition a lack of quality bulky goods retailing, coupled with a growing population has boosted the demand from bulky goods retailers .

Major Retail Projects

Project Name	Retail Size (sqm)	Status	Completion	Comments
GPT West Keira	18,000	Proceeding	2013	Three level centre including a Coles and 80 speciality stores.
Shellharbour Square	36,247	Proceeding	2013	Total size once completed 75,000 sqm. Will include a Myer department store.
Valad Corrimal Centre	15,315	On hold	n/a	Centre to include a supermarket and a discount department store. Site currently for sale.
Dwyers Site	26,300	On hold	n/a	Mixed use commercial/retail project to include a supermarket, cinema and discount department store.

Source: Reed Business Information and Herron Todd White

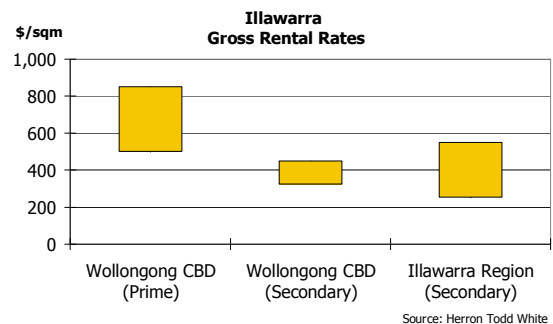
In central Wollongong, demand for strip retail space is highest along the eastern parts of Crown Street, between Corrimal and Keira Street (encompassing Crown Street Mall). As shown in the chart below, vacant shops account for 6.5% of all shop fronts in this strip. Whilst lower than the vacancy rate recorded in the Crown Street west, **the level of vacant space within the prime end of Crown Street is some cause for concern, with the redevelopment of Wollongong Central likely to place some pressure on strip retail landlords.**



Demand for space in the western portion of Crown Street is significantly lower, with some 19.5% of all shopfronts vacant as of August 2011. In addition to the higher vacancy, Crown Street west is further characterised by a high number of services and lower order retailers, suggesting that demand is even lower than the vacancy rate above suggests.

Leasing Market Conditions

Reflecting the broader retail market and the limited demand for existing retail space within the Illawarra, rental growth has been limited for some time. In the secondary market, landlords are facing increasing pressure to drop face rents in order to prevent a lengthy vacancy. This situation is particularly prevalent in secondary central Wollongong locations, where landlords have been forced into accepting service based tenants agreeing to rental rates comparable with office properties.



As a result of the broad range in quality of retail premises with the sub-region, letting up periods can vary greatly. Discussions with local agents revealed that vacancy periods greater than six months are common in many secondary Illawarra retail properties. Furthermore it was noted that

older, poorly located properties can be subject to letting up periods far greater than six months, unless significant rental discounts are offered.

LEASING ANALYSIS



Address: Shop 3, 115-119 Crown Street, Wollongong

Property: Older style office/retail building with frontage to Crown Street Mall.

Details: Located at rear of building with access from side pedestrian walkway.

Rental: \$23,400 (gross)

Start Date: 21/04/2011

Floor Area: 66 sqm

Lease Term: 3 Years

\$/sqm: \$355 (gross)

As shown in the adjacent chart, **rental rates are highest in prime Wollongong CBD properties**, with these locations favoured by international and national retailers seeking high exposure. Looking outside the CBD, rental rates vary significantly, ranging from \$250 - \$550/sqm depending on the location, exposure, quality of the property and the surrounding retail market.

Investment Market Conditions

The retail investment market within the Illawarra is dominated by private investors and owner occupiers, with these buyers attracted to the relatively lower entry price of these assets when compared to retail assets in Sydney. As a result, investment yields of these properties can be lower than comparable properties in Sydney.

As shown in the table below, capital values are significantly higher for prime retail assets, with these properties recording between \$4,200 and \$5,700/sqm. The higher values of these assets is reflective of the increased rental rates and greater income security offered by national and international tenants, when compared to the lower quality tenants found in secondary properties.

Retail Investment Matrix

Grade	Average Capital Values (\$/sqm)		Average Yield (%)	
	High	Low	High	Low
Prime	5,700	4,200	6.75	6.00
Secondary	4,200	2,600	7.50	6.70

Source: Herron Todd White

In the secondary market however, a general lack of investors and lower rental rates limits the capital values of these assets, with values ranging between \$2,600 and \$4,200/sqm. As shown in the table above, investment yields for these assets are commonly 100-150 basis points softer than those recorded in the prime market.

SALES ANALYSIS



Address:	84 Bong Bong Rd, Horsley
Property:	A neighborhood convenience centre.
Sale Price:	\$1,725,000
Sale Date:	15/06/2011
Floor Area:	610 sqm
Yield:	8.50%
\$/sqm:	\$2,828

Market Outlook

With growing concerns about the state of the global economy and more locally the viability of manufacturing within the Illawarra, the outlook for the Illawarra office, industrial and retail markets is shrouded in uncertainty.

On the upside demand remains strong for prime commercial office property, with vacancy unlikely to become an issue in the near future. In the secondary markets however, higher levels of vacancy and limited investor demand will limit the performance of these properties.

In the retail markets, the rejuvenation of the Crown Street precinct and the re-development of

Wollongong Central has the potential to stimulate rental growth of neighbouring properties. This growth however, will be dependent on a return to higher levels of consumer confidence and a subsequent boost in retail sales nationally.

While BlueScope Steel is unlikely to change its occupational requirements as a result of the scaling back of its operations within the Illawarra, a fall in business activity of local firms which support the steel works, will likely limit the performance of the industrial market in the near future.

Overall, the Illawarra office, industrial and retail markets will all face significant pressure in the coming 12 months, with both occupier and investor demand remaining low.

Further Information

For a more in depth understanding of the current market conditions within the Illawarra and how they relate to your property, or for further information regarding any Herron Todd White service please contact either:

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