March 2011

Sydney Industrial Market Report

Introduction

The performance of the Sydney Industrial market is highly fragmented. At one end of the market institutional properties have returned to favour, with the number of sales transactions increasing, subsequently driving yield compression. In the non institutional space however, investor demand remains weak, with owner occupiers behind the majority of purchasers.

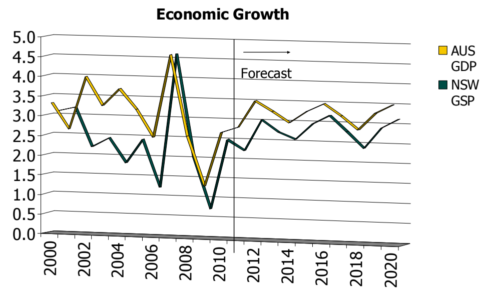
For the purpose of this report, we have focused on the non–institutional sector (properties sub $10mil). To provide the reader with a greater understanding of the market dynamics concerning a current or upcoming investment, this report analyses the conditions in both the unit estate (strata) and free standing warehouse markets within the greater Sydney region.

Economic Conditions

Economic Growth

The Australian economy slowed in the December quarter of 2010, with quarterly economic growth rising from 0.1% in the September quarter to 0.7% in the three months to December. Much of the rise in economic growth has come as a result of an increase in non-farm commodity exports. The release of the results in March did however, come with a warning from the Australian Treasury Department however, with lower output over the Jan-March quarter expected as a result of the Queensland floods.

As opposed to other states, 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.

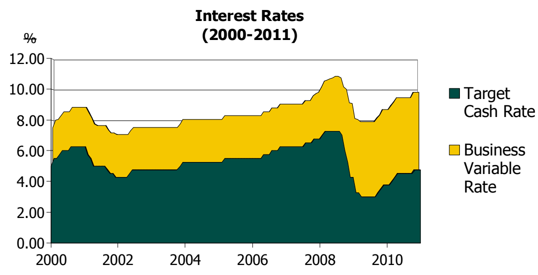


Source: Access Economics

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.

Interest Rates

With the RBA seemingly more confident on inflation following the increase in interest rates from 4.50% to 4.75% in November 2010, the RBA board has left interest rates on hold in its last three meetings in December, February and March.

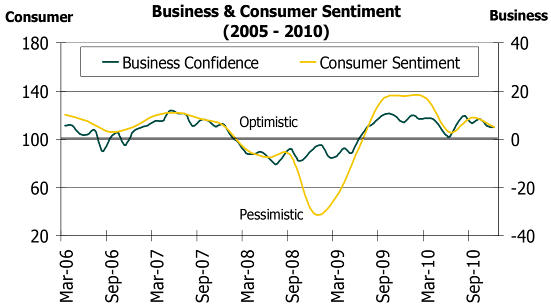


Source: Reserve Bank of Australia

Inflationary pressures are now of less concern to the RBA, with CPI consistent with the medium term objective of monetary policy and expected to remain within that range over the year to come. The Reserve has noted that despite the record high terms of trade, caution in spending and borrowing and a rise in the household spending rate is limiting inflationary pressures. The Reserve has however noted that short term price increases are likely as a result of the flooding in Queensland and Victoria, with the loss of both crops and production.

Business and Consumer Sentiment

Business confidence levels are a key lead indicator of future spending and economic growth. Following a fall in the June Quarter, business confidence has continued on a downwards trend, falling again in the September quarter. Despite the confidence index slipping in September, it now sits at 9 points, above the ten year average of 5 points

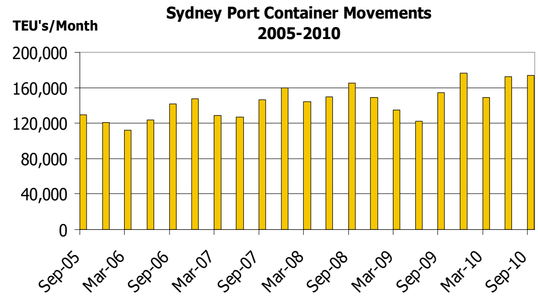


Source: Westpac & National Bank of Australia

Results of the most recent consumer sentiment survey have indicated a rise in consumer sentiment following a substantial fall in sentiment as a result of the Queensland floods. Despite this improvement sentiment still remains lower than before the floods, with the index standing at 106.6 index points compared with 110 index points in December 2010 prior to the floods. The modest rebound in consumer sentiment has been driven by a significant re-rating of the 12 month economic outlook, with the outlook only rising by 1.1% in February, despite a 15.7% fall in January.

Container Movements

Freight movements are a key leading indicator as to the demand for storage and warehousing space. As shown in the chart below, movements of containerised freight grew slightly over 2010, rising from 1,765,262 Twenty Foot Equivalent Units (TEU) in the 12 months to November 2009 to 1,990,882 TEU'S in the 12 months to November 2010.



Source: Sydney Ports

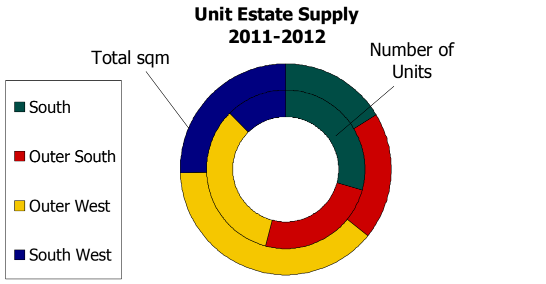
With port facilities in Sydney now predominantly catering to container based freight following the relocation of the Sydney Harbour port facilities to Port Kembla, demand for container unloading facilities and subsequently goods warehousing within Sydney will increase.

Unit Estates

The Sydney unit estate market has witnessed significant growth over the last 15 years, following a surge in the number of small to medium business which require industrial floorspace. Since the onset of the global financial crisis however, a fall in occupier demand has seen rental rates fall and investor demand wane. Capital values have however, been somewhat maintained by a high presence of owner occupiers who have taken advantage of lower interest rates to secure a business premises.

Supply

The Sydney industrial market is expected to grow by some 332,904 sqm of industrial floorspace over the 12 months of 2011. New unit estates account for very little of this new supply, with only 25,517 sqm of additional unit estate floorspace due to be released to the market over this 12 month period. The fall in unit estate development follows a period of intensive development, in which all Sydney industrial markets witnessed a substantial increase in the quantity of unit estates. As such many of these markets are now suffering from an over supply, with vacant space remaining in many developments completed over the last 12 months.



Source: Reed Business Information

As shown in the chart above, the Outer West sub-region will account for the greatest proportion of new unit estates within the greater Sydney area in the 12 months to Jan 2012.

Building Completions 2011-2012

Building Address	Suburb	Total Size (sqm)	Pre-commitment (%)	Comments
38 Waterview Street	Carlton	2,254	0	A two storey 11 unit development
27 Richland Street	Kingsgrove	3,716	100	A two story 7 unit development to be occupied by Australia Post
1 Charles Street	St Marys	1,500	0	Two industrial units
71-75 Princes Street	Riverstone	2,000	0	Two industrial units
1-3 Belfast Place	Glendenning	2,326	60	Five industrial units
42 Peter Brock Drive	Eastern Creek	3,500	0	Seven industrial units
32 Peter Brock Drive	Eastern Creek	2,600	0	Eight industrial units
50-52 Victoria Street	Riverstone	2,000	100	Three industrial units
51-53 Bourke Road	Alexandria	3,141	55	21 Industrial units
9 Austool Place	Ingleburn	522	0	Two industrial units
14 Hollylea Road	Leumeah	1,958	0	Four industrial units

Source: Reed Business Information and Herron Todd White

Over this period 24 units totalling 11,925 sqm of floorspace are due for completion in the Outer West. Outside the Outer West, supply of new unit estates will be greatest in the South West, Outer South and South sub-regions respectively.

Occupier Demand

As shown in the table above, pre-commitment levels remain low, with only 8,838 sqm or 34.6% of the 25,517 sqm of upcoming supply pre-committed. While higher levels of speculative development generally precede an improvement in demand, an increase in demand is not expected in the near term, with these new developments expected to add to the existing oversupply of unit estates within the greater Sydney market.

Despite the lower level of demand for unit estates within Sydney, real estate agents have commented that this property type has the shortest letting up period of all industrial property types. Looking across the Sydney market, quality properties in the Inner West and the North benefit from the strongest demand. Unit estates in the Outer West however, suffer from both a lack of demand and an oversupply of stock, as a result of increased development over the past five years.

Leasing Market Conditions

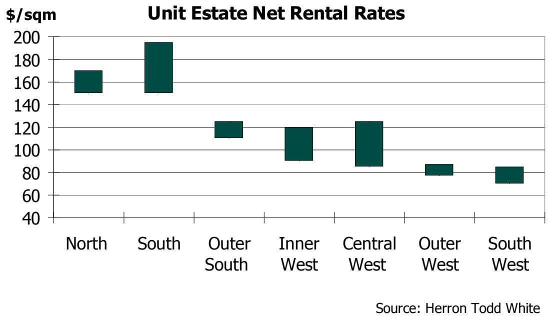
With demand remaining low, unit estate rental rates within the Sydney market recorded minimal growth over the last 12 months. As shown in the chart below, prime unit estates in the South sub-region achieve the highest rental rate in Sydney, with firms willing to pay a premium in order to secure a newer property within close proximity to the CBD, Port Botany and Sydney Airport.

Discussions with local leasing agents within each of the sub-regions revealed that the market still remains very much in favour of lessees, with very few firms looking to move or take up additional space. As lengthy vacancy periods are likely following a tenant relocation, landlords have focused on securing a steady income, rather than attempting to raise rental rates.

SALES ANALYSIS

Address:	15 Jubilee Ave Warriewood
Details:	Site sold with development approval for 24 factory units. Total floor space on completion 4,409 sqm
Sale Price:	$2,225,000
Sale Date:	07/05/2010
Land Size:	4,554 sqm
$/sqm Land:	$488
$/unit:	$92,708
$/FSR:	$504

Despite demand remaining low and vacancy becoming an issue in some sub-regions, incentives have not yet risen above traditional levels. This is in part due to the nature of unit estate investors, who typically are cash poor and rely upon a steady income return from their investment. Discussions with local agents revealed that some owners have shown a preference for offering a rent free period at the back end of the lease, in order to capture an immediate cash flow.



Investment Market Conditions

Demand for unit estate investments remains low, following the falls in capital values after the onset of the Global Financial Crisis. As shown in the table below, capital values are highest in the Sydney South sub-region, with values ranging between $2,600/sqm and $1,900/sqm. The higher capital values of unit estates within the South are part in due to the value of land in the sub-region, but also due to the areas higher proportion of newer stock, when compared to other industrial sub-regions within Sydney.

Average Unit Estate Capital Values

Market	Primary $/sqm	Secondary $/sqm
North	2,100	1,500
South	2,600	1,900
Outer South	1,700	1,200
Inner West	2,000	1,800
Central West	1,600	1,000
Outer West	1,600	900
South West	980	737

Source: Herron Todd White

The unit estate market within Sydney is dominated by a high proportion of owner occupiers, with these assets appealing to small business owners seeking security of tenure or a real property asset to appease business lending standards. As a result of the increased proportion of owner occupiers, who may not have the same motives as an investor, capital values in relation to rents, have risen to a point whereby investors are unable to justify a purchase. This is particularly the case in the Outer West, were rental rates in places such as Glendenning were an increase in demand from owner occupiers, has not been counted with an increase in rental rates, driving yields as low as 5.0%. Discussions with real estate agents across Sydney revealed that investors are generally unwilling to commit to an industrial investment with a yield below 8.0%.

SALES ANALYSIS

Address: 1/79 Mandoon Road Girraween

Details: Secondary strata unit sold fully leased. Features ground floor showroom and 220 sqm hardstand.

Sale Price: $950,000

Sale Date: 05/10/2010

Building Size: 1,170 sqm

$/sqm: $811

Yield: 9.48%

Market Outlook

Conditions within the Sydney Unit Estate market are not expected to record any significant improvement over 2011. An improvement of business conditions will likely see occupier demand rise as small businesses seek expansion. At the same time higher interest rates will swing the rent/buy pendulum back in favour of leasing. Rental growth however will be highly dependent on location and the level of stock remaining vacant following the last development cycle. Likewise there are a number of unit estate projects with development approval that were placed on hold at the onset of the global financial crisis, which are likely to commence construction over the coming two years.

Despite a slight softening of lending standards, investor demand is not expected to improve in the unit estate market, as lower rental rates coupled with higher capital values, limit investor interest. Similarly demand from owner occupiers is expected to wane over 2011, as higher interest rates, increase the occupational costs of owning a business premises.

Given the uncertain outlook for unit estates within the greater Sydney region, significant capital growth is not expected over the 12 months of 2011.

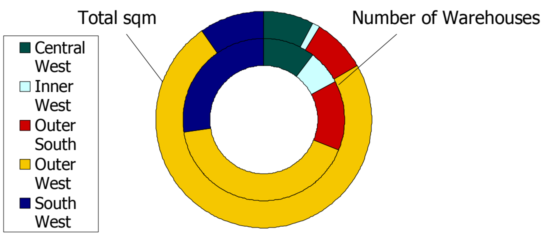
Warehouses

The non institutionalised warehouse market within Sydney has been subdued for some time. Tenant demand remains weak and lengthy letting up periods are common. Investor interest has also yet to return to this sector, with investors remaining hesitant about the long term growth prospects for these properties.

Supply

The Sydney industrial market is expected to grow by some 332,904 sqm of industrial floorspace over the 12 months of 2011. New warehouses account for the majority of this new supply with 103,438sqm of additional warehouse floorspace expected to be released to the market over this 12 month period.

Warehouse Supply



Source: Reed Business Information

The increase in warehouse development follows a period of subdued supply following the onset of the Global Financial Crisis. In addition to the increase in basic warehouse floorspace, the Sydney industrial market will see an additional 155,220 sqm of distribution centre floorspace released to the market over the coming 12 months. As shown in the chart below, much of the development consists of larger projects, as opposed to a large number of smaller projects.

Occupier Demand

As shown in the table below pre-commitment levels are currently at record high levels. Across the Sydney market, 96.7% of 2011 supply is pre-committed, with only 8,589 sqm of the 268,120 sqm floorspace due over 2011 currently seeking a tenant. While high levels of pre-commitment generally reflect a heightened level of demand, the current levels of pre-commitment have come in part as a result of tightened lending standards which require higher levels of pre-commitment prior to commencing construction.

While an improvement in demand has led to an increase of the supply pipeline, demand for existing premises remains low. Discussions with leasing agents throughout the Sydney market revealed that demand is particularly weak for larger and older properties, with lengthy letting up periods common in these properties.

Leasing Market Conditions

Reflecting the limited demand for industrial property within Sydney, rental rates recorded minimal growth over 2010. As shown in the chart below, prime warehouses in the North sub-region currently attract the highest rental rates, recording $180/sqm as at January 2011. This premium is due mainly to the higher quality of warehouse stock within the North Sub-region.

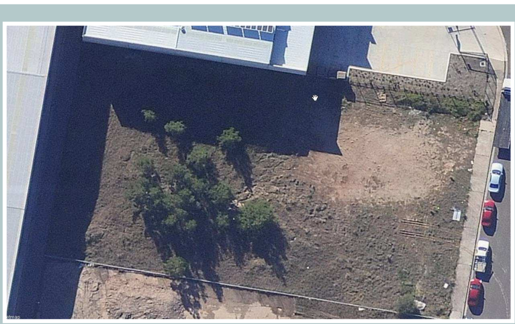
Selected Warehouse Completions 2011-2012

Building Address	Suburb	Total Size (sqm)	Pre-commitment (%)	Comments
8-14 Hallmark Street	Pendle HIll	6,490	100	Purpose built factory with associated office space.
210 Martin Road	Badgerys Creek	3,968	100	Purpose built packing shed.
51-63 Lenore Drive	Erskine Park	10,000	100	Purpose built Linfox workshop facility.
175 Bonds Road	Riverwood	1,050	100	A single story warehouse/office
23 Liberty Road	Huntingwood	2,050	100	Purpose built single story warehouse
99 Station Road	Seven Hills	11,000	100	Single story warehouse
10 Waller Crescent	Smeaton Grange	1,005	100	Factory and warehouse
9 Austool Place	Ingleburn	522	0	Two detached warehouses
122 Old Wallgrove Road	Eastern Creek	36,000	100	Purpose built Best and Less distribution centre.
24 Muir Road	Chullora	33,810	100	Purpose built Volkswagen distribution centre.
2 Wonderland Drive	Eastern Creek	51,600	100	Purpose built Kmart distribution centre.

Source: Reed Business Information & Herron Todd White

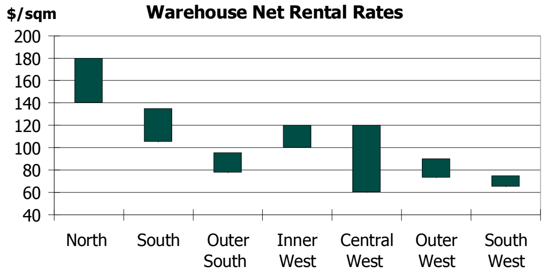
With the exception of pre-lease deals, incentives have not proven to be a significant factor in lease negotiations, with landlords and tenants alike, willing to accept relatively low incentives. Across the Sydney market incentives generally equate to 8.5% or one month rent free for every year committed to the lease.

SALES ANALYSIS



Address:	16 Yulong Close, Moorebank
Details:	Site sold with development approval for a 2,000 sqm Warehouse.
Sale Price:	$975,000
Sale Date:	24/05/2010
Land Size:	2,264 sqm
$/sqm Land:	$430

Similar to leasing conditions within the unit estate market, a lack of demand is limiting any potential rental growth, with firms unwilling to take up additional space given the uncertain economic outlook. Discussions with leasing agents revealed that rental discounts upon lease renegotiation have been highly dependent upon the quality of the property and its location. At one end of the scale, the fall in speculative development following the onset of the Global Financial Crisis, has limited the availability of quality warehouses, favouring landlords. At the other end of the scale, an almost non existent demand for older warehouses has forced landlords into taking what ever they can get, to prevent a lengthy vacancy period.



Source: Herron Todd White

Investment Market Conditions

Demand for warehouse investments remains low, the re-rating of risk following the onset of the Global Financial Crisis is continuing to impact warehouse capital values, with secondary properties the most impacted. At present capital values for secondary warehouses in Sydney range between $665/sqm and $1,600/sqm.

Average Warehouse Capital Values

Market	Primary $/sqm	Secondary $/sqm
North	2,250	1,500
South	2,400	1,600
Outer South	1,830	1,350
Inner West	1,830	1,350
Central West	1,700	1,100
Outer West	1,270	975
South West	865	665

Source: Herron Todd White

SALES ANALYSIS

Address:	3 Green Street, Revesby
Details:	Circa 1970's warehouse with 106sqm of office. Sold with a short term lease in place. Purchased by an owner occupier.
Sale Price:	$1,130,000
Sale Date:	01/09/2010
Building Size:	722 sqm
$/sqm:	$1,565
Yield:	6.20%

A survey of real estate agents throughout Sydney revealed that investors remain on the sidelines, with doubts surrounding the demand for older industrial properties in the future. In the south west however, where owner occupiers dominate the market, agents have noted that lower land values are resulting in many warehouse purchasers, choosing to buy a vacant parcel of land and develop a purpose built facility if a suitable existing property can not be located.

Market Outlook

As shown in the chart above, the Outer West sub-region will account for the greatest proportion of new unit estates within the greater Sydney area in the 12 months to Jan 2012. Over this period 24 units totalling 11,925 sqm of floorspace are due for completion. Outside the Outer West, supply of new unit estates will be greatest in the South West, Outer South and South.

Further Information

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

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