

Industrial Property Less Resilient

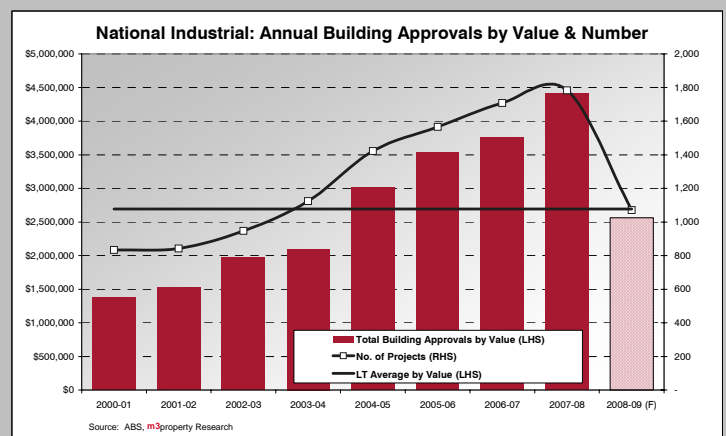
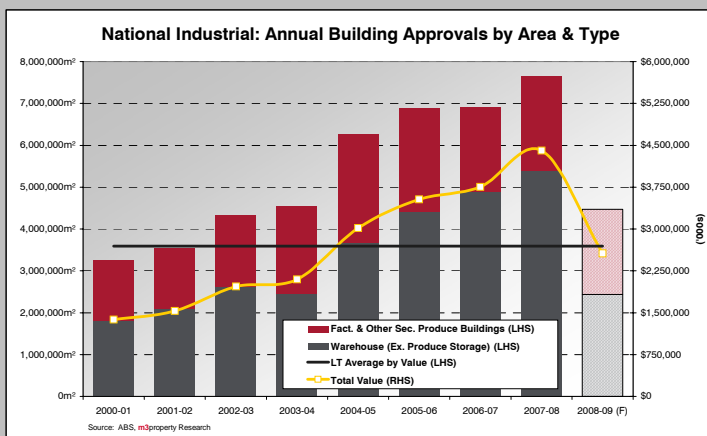
May 2009

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Historically, industrial property markets are closely aligned to the state of the economy when compared to other non-residential sectors. With the fall-out from the global financial crisis, the industrial market continues to be negatively impacted by a weak export market. As poorer economic forecasts continue to escalate, business and consumer confidence has fallen along with the demand for manufacturing and distribution factories and warehouses.

To date, the economic slowdown has resulted in around 1.5 million square metres of national industrial projects being shelved. Supply under construction has slowed from 2.2 million square metres proposed in early 2008 to around 1.5 million square metres currently. Looking back, industrial related building approvals by value had more than doubled from over \$2.25B in 2001-02 to almost \$6B in 2007-08. This was largely due to the growth in warehouse construction. The relatively short lead and construction times for industrial property have seen the new development pipeline reduce rapidly. Accordingly, the number of projects has fallen back to 2002-03 levels. After the recent peak, activity is expected to near the long term annual average (\$2.7B) before an upswing over 2010-11 driven by improving economic fundamentals.



Despite a fall in new stock completions, a steadied rise in industrial vacancy has become evident since mid-2008. The rise in empty warehouses has occurred on the back of failing businesses and consolidating operations rather than excessive speculative development. This has resulted in wider leasing options for any prospective tenants (limited, they may be) and placed downward pressure on rents while landlords under stress are selling properties with vacant possession. With this slow down in tenant demand, incentives are on the rise. Land values continue to fall and are expected to adjust based on local market fundamentals, falling on average around 20% nationally since mid-2008.

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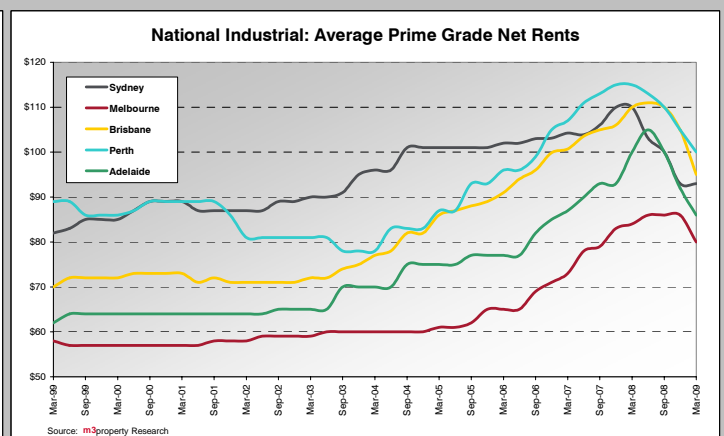
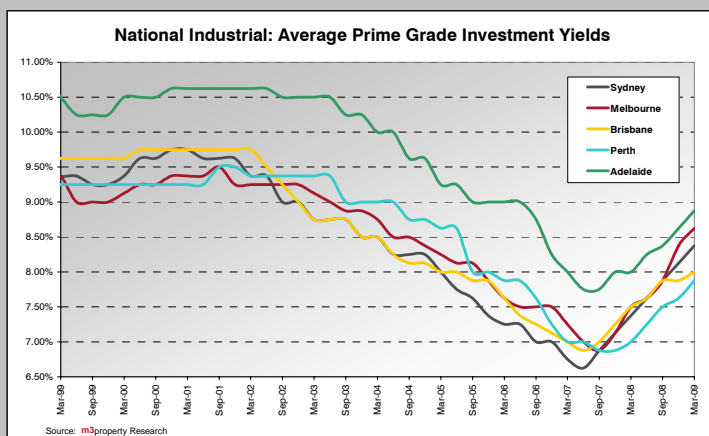
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Heavily-g geared property trusts continue to seek purchaser interest of their industrial assets and deleverage. Private investors and syndicates remain the sole purchasers in the market while greater consolidation and rationalisation of the sector is freeing up stock with the number of sale and leaseback properties increasing. The anticipated re-emergence of syndicates in 2009, which will fill the void left by institutional investors, should be keen to acquire prime grade investment properties with good lease covenants. The question remains from the perspective of buyers as to when the market trough will be reached. Yields have softened rapidly over the last 12 months and it is expected that further softening will occur this year before a moderation phase begins in 2010 once economic fundamentals improve. Currently, lack of liquidity remains the issue for purchasers seeking debt as banks are still reluctant to lend in this property sector.

At the state level, Sydney and Melbourne are witnessing developers unwilling to propose new projects as well as those with development approval also unlikely to proceed as vacancy continues to rise and construction funding remains scarce. Tenants are opting to remain in existing space rather than commit to new developments as leasing market terms shift in their favour. In Perth and Brisbane, commodity prices have fallen and investor interest has slowed considerably yet these markets are underpinned by some remaining pent-up demand due to the historic shortage of prime grade manufacturing space. Adelaide's lack of prime grade warehousing together with expanding mining and defence sectors continues to drive leasing requirements, albeit at minor levels.

The charts below identify long term average prime grade investment yields (for properties above \$10m) and rents nationally. Yields reached their lowest point in the June 2007 quarter averaging 7% nationally, rising to 8.25% as at the March 2009 quarter. m3property Research forecast a further softening of 50 to 75 basis points over 2009-10 and expect yields to stabilise during 2010-11. Similarly, warehouse rents peaked at a national average of \$104 per square metre net in early 2008 with Perth leading the market and Melbourne the most affordable. Over the 12 months to the March 2009 quarter, average rents have fallen 13%. It is expected both yields and rents will continue to correct in the face of slower economic and property fundamentals, as well as a lack of buyer and occupier interest.



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