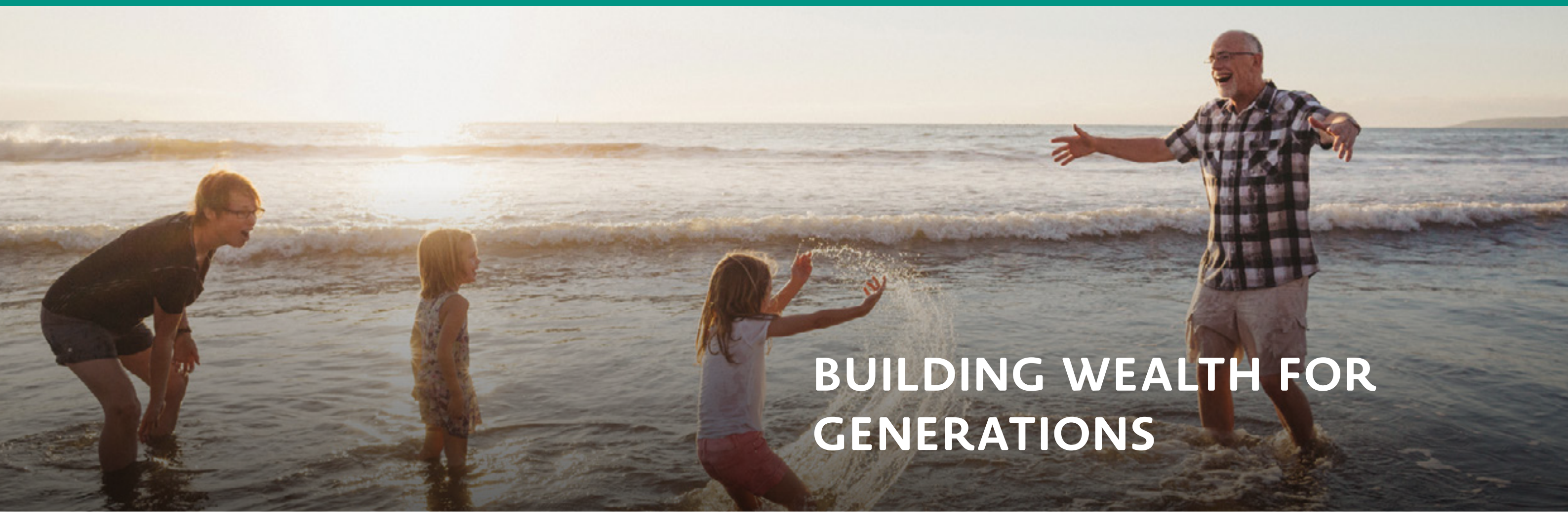
INTERGEN INSIGHT

ISSUE 1 | SPRING 2016



BUILDING WEALTH FOR GENERATIONS

25 YEARS
of GDP growth above 2% in Australia

4.1%
Parramatta office vacancy forecast in 2018

250
basis point compression for prime Sydney industrial assets since 2013

28%
of retail transactions from foreign capital into Australia

EXECUTIVE SUMMARY

- **Following the Brexit and continued volatility in global markets, domestic business confidence remains positive,** propped by the resilient non-mining sectors of the economy. Within Australia, the NSW economy continues to out perform other states driven by strong population growth, a buoyant job market and solid retail spending.
- In NSW, the historically **high infrastructure spend is aiding the suburban office investment proposition,** especially assets positioned close to the new Sydney Metro line. While investment market activity is elevated, opportunities exist within well located, good quality secondary stock.
- **Investment appetite for Sydney industrial assets continues as investors remain attracted to core product with solid covenant and long lease terms.** The budgeted $68.6b infrastructure spend will provide a substantial improvement to accessibility and connectivity for the wider Sydney area, areas such as Western, South West and Outer South West will receive the greatest uplift in value off the back of this spending.
- Following a record breaking level of transactions in 2015, **retail continues to show strong growth, with yields across almost all assets classes anticipated to compress further.** We believe neighbourhood and large format retail centres will be the best retail oriented places to focus, at a more liquid price point and offering greater security from non-discretionary spending.

In the following pages, the team at Intergen discuss some important issues in the commercial property market place and offer some advice on key investment areas to watch over the remainder of the year.

WHY INVEST IN SYDNEY?

After 25 years of uninterrupted GDP growth, Australia has cemented itself as one of the leading global economies. While global markets continue to fluctuate, domestic business confidence remains positive. Indicators such as low unemployment (5.8%) and relatively strong GDP growth forecast for 2016/2017 (3%) are being propped by the resilient non-mining sectors of the economy.

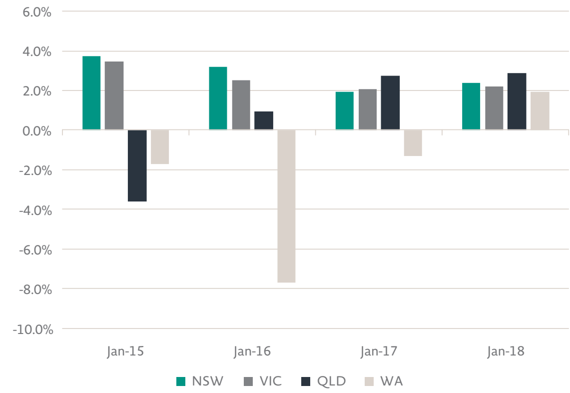
The RBA's 25 basis point interest rate cut in August however suggests weakness in some areas with the board outlining their main concerns were the falling commodity prices, low inflation environment and easing housing credit growth. **As the mining boom recedes and the economy transitions towards more service based industries, state by state performance has been mixed across the country.** The states of NSW and VIC are leading the recovery driven by strong performance in IT, tourism, education and the financial sector.

The NSW economy continues to outperform other states driven by a buoyant job market; a projected $68.7 billion infrastructure spend over the next 4 years and surging growth in service based industries. Intergen are confident that these positive indicators will continue to drive the strength of the Sydney property market over the short to medium term.

The NSW office, retail and industrial sectors continue to build on the solid performance that played out over 2015. Capital values rose, transaction volumes were robust, foreign direct investment continued to increase, and rental rates recorded growth in most areas. 2016 has proven to hold onto these key themes and is expected to broadly be seen as a period of consolidation across the Australian property market.

While we anticipate some counter-cyclical opportunities in other states, we expect that prolonged weakness in the property markets outside of the country's South-East corner will make investing in NSW and Victoria more rewarding.

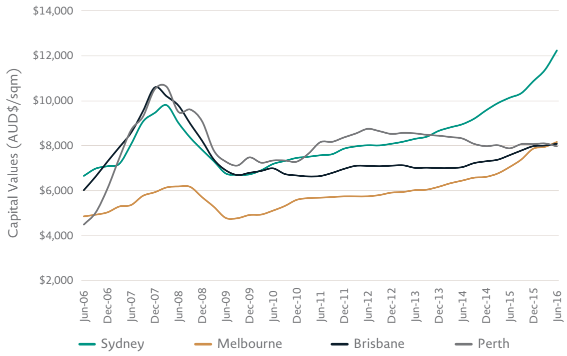
State Final Demand | State by State 2015 – 2018



Source: Deloitte Access Economics, Colliers Edge, Intergen Property Partners

"The NSW economy continues to out-perform other states driven by strong population growth, buoyant job market and solid retail spending."

Office Capital Values | 2006 – 2016



Source: Colliers Edge, Intergen Property Partners

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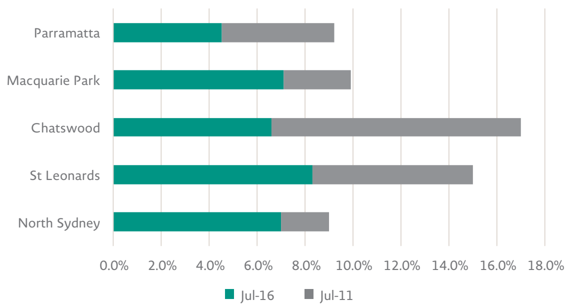
KEY SYDNEY SUBURBAN OFFICE THEMES - SYDNEY

Sydney's Suburban office market performance is mixed across different precincts with demand catalysed by the limited space within the CBD. The historically high infrastructure spend is adding further incentive for investment, especially in areas that are directly impacted by the new Sydney Metro Rail.

- **Vacancy is dropping to historical lows, with Parramatta recording the National low at 4.5% followed by Sydney Fringe at 4.7%.** Limited speculative supply for these markets in the short to medium term will result in vacancy remaining low, especially in Parramatta where infrastructure spend and improved amenity is lifting the attractiveness of the precinct.
- While suburban markets enjoy a significant rental affordability advantage to CBD stock, **the prospect of rental growth is realistic** due to the limited amount of prime grade space in the market place.
- **With prime investment product becoming hard to find in CBD locations, liquidity is beginning to focus more on non-CBD office markets.** This is clearly illustrated by 33% (by value) of the total amount of transactions over 2015 coming from non-CBD assets.
- **Secondary assets with value add or opportunistic characteristics are trading above book value due to scarcity of prime grade product on the market. We expect this trend to continue,** with the yield gap between prime and secondary assets in Parramatta, for example, sitting at a wide 400 basis points (6.25%-10.25%). Intergen sees an opportunity to acquire and strategically reposition fundamentally sound secondary assets, which may have been mispriced.

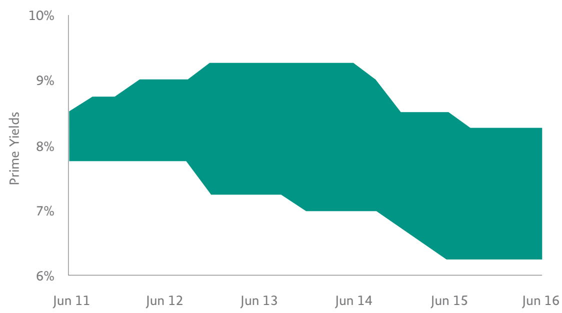
Sydney Metro Vacancy Rates | 2011 vs 2016



Source: Colliers Edge/PCA OMR, Intergen Property Partners

> "With prime investment product becoming hard to find in CBD locations, liquidity is beginning to focus more on non-CBD office markets."

Parramatta Prime and Secondary | Yields



Source: JLL Research, Intergen Property Partners

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KEY INDUSTRIAL THEMES - SYDNEY

Investment demand remains largely concentrated at the prime end of the market, with capital focusing in long WALEs and strong lease covenants in core industrial locations.

- **The Sydney industrial market is benefiting from solid regional economic growth.** The labour market has improved strongly, and is aiding industrial demand, with industrial parks situated close to transport hubs and key arterial routes receiving the highest appetite from occupiers.
- **Investment appetite for Sydney industrial assets continues as investor remain attracted to core product with solid covenant and long lease terms.** The Coles distribution centre in Wetherill Park traded at $253 million, reflecting a 5.78% yield, which illustrates that investors will pay a premium for a long WALE and good covenant to secure a passive investment play.
- **A scarcity of prime investment product and elevated asset pricing levels is pushing some investor focus to secondary industrial assets** that may inherit some leasing or vacancy risk. We therefore see opportunity in a select number of higher quality secondary assets to undergo yield compression over the remainder of the year.
- **NSW government has budgeted to spend $68.6 billion over the next 4 years on infrastructure.** Intergen views the significant infrastructure improvements coming from the Westconnex, Moorebank Intermodal and the proposed Badgerys Creek airport will provide a substantial boost to accessibility and connectivity around the wider Sydney area.
- **We believe the Western and South Western industrial precincts will experience the greatest growth in demand from investor and occupiers moving forward.** The underlying fundamentals of these areas are projected to continue to track at positive levels boosted by the infrastructure spend. We see assets in these key areas to outperform with growth in rentals levels and demand expected to remain strong.

Growth Statistics | 12 Month Period

Source: Colliers Edge, ABS Final Demand, ABS Labour Force, ABS Retail Turnover, Intergen Property Partners

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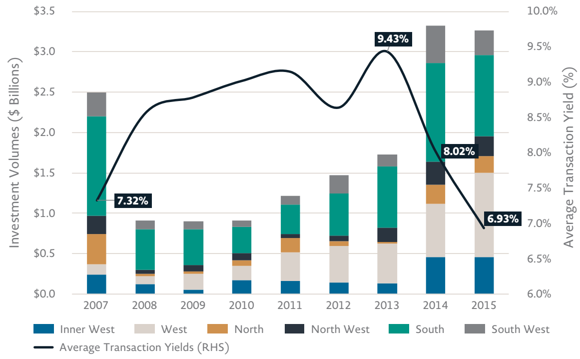
Sydney Industrial Market



Source: Colliers Edge, Intergen Property Partners

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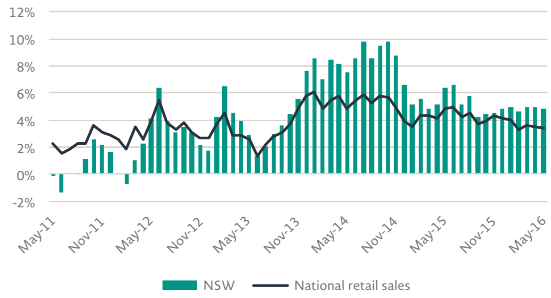
KEY RETAIL THEMES - NSW

Following a record breaking level of transactions in 2015, retail continues to show strong growth, with yields across almost all assets classes anticipated to compress further.

- **Retail in NSW continues to outperform other states** with anticipated continued increases in retail turnover strengthening leasing demand.
- Retail assets continue to attract foreign investors, with **offshore investors being the largest buyer group at 28% of purchases over 2015** across Australia reaching a record level in value terms.
- Rentals in the large format retail sector have remained stable over the past six months, with select markets starting to see some upside in rents. **Vacancy rates continue to track at relatively low levels as demand remains high for large format tenancies.**
- **Transaction volumes of large format retail remain above average** which has led to a yield tightening of 100 basis points over the 12 months to June 2016.
- **The strong housing market is also underpinning demand for household goods and large format retail,** with elevated discretionary spending levels helping the retail investment prognosis.
- **We expect a significant tightening of neighbourhood centre and large format yields as investors are drawn to the lower price point and security of non-discretionary spending.** Intergen believes these two asset classes are a risk adverse investment option in the current economic climate supported by low interest rates, the low Australian dollar and reduced fuel prices.

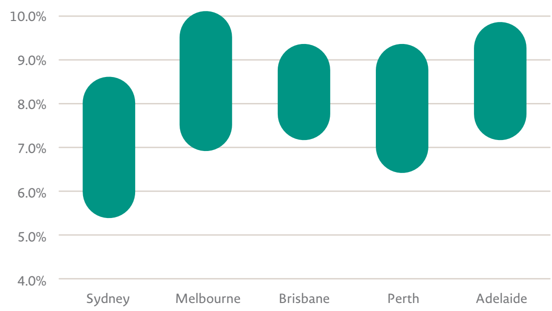
ABS NSW Retail Sales | YoY % change



Source: Colliers Edge, Intergen Property Partners

> "Retail in NSW continues to outperform other states with anticipated continued increases in retail turnover strengthening leasing demand."

Large Format Retail | Yield Range 2Q16



Source: Colliers Edge, Intergen Property Partners

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INTERGEN'S INSIGHT

- **The Australian economy,** despite being fronted with a number of headwinds, **is expected to continue to outperform over the short to medium term** as global market instability continues to play out. The constant threats coming from the middle east coupled with instability between the EU and the UK is further instilling that Australia is a comparative safe haven for investment. We believe that global capital flows into Australia will remain a theme as investors seek low risk stable investment options.
- With the majority of **prime office assets trading at pre-2007 levels** across Sydney, pricing has grown beyond what we see as sustainable, driven by the high foreign investor presence. We see the greatest opportunities coming from well located assets that are close to existing or new infrastructure hubs. **We recommend markets such as Parramatta, Sydney Fringe and Macquarie Park as key investment areas in the office sector.**
- **Western, South Western and Outer South West industrial precincts are poised to receive the greatest uplift** in value in the sector, largely from planned infrastructure improvements. Assets with a long WALE and good covenant will continue to be well received by the market, however, we see opportunity in the strategic repositioning of fundamentally sound secondary properties.
- **Large format and neighbourhood centres present the greatest opportunity for value uplift in the retail sector,** with investors attracted to the relatively high yield compared to core assets. We are also confident that retail spending levels, especially for non-discretionary goods, will track at positive levels over the short to medium term, supporting our view that these centres will continue to trade well over the remainder of 2016 and into 2017.

Meet the team

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