A Hartigan Bolt

Investor Report

Spring 2007

The markets are well positioned but have the easy gains been had?

With good reason many owners question why they would consider selling at a time when they have seen huge capital appreciation and forecasts that commercial markets are set to tighten further over the next 2 years.

For the last 2 years or so capital appreciation has been substantial. In one of our recent sales the owners saw a 40% increase in just 2 years of ownership. Whilst some of this can be attributed to capital improvements and securing new leases, the most significant impact was a major drop in yields. In this case the sale yield was close to 7%, a level that is now commonplace and in some markets would be regarded as high.

With yields now ranging from 5% or lower in the prime markets up to low 7's in suburban areas, new investors are having to factor in rental growth to produce a return that will exceed the cost of debt.

In some markets growth is already apparent and can be relied upon with a high degree of certainty. The stand out markets include the Sydney CBD and North Ryde where vacancy rates have now fallen to 5.6% and 7.9% respectively. More importantly these locations have a clear business focus which helps to retain existing tenants and attract new ones. This is essential if occupiers are going to absorb significant increases in rent.

Whilst other CBD markets are seeing a reduction in vacancy rates and can expect to see rental growth emerge the pressure on space may not be as acute. CBD's such as North Sydney and St Leonards continue to see major tenants move away to brand new developments at North Ryde. The ageing nature of these CBD's is also an issue with owners having to consider major refurbishments in order to attract tenants and secure increased rents.

Even in an improving leasing market there is still the need for a pro-active approach to targeting tenants, and to ensure that the buildings presentation allows rents to be maximized and leasing periods reduced to a minimum.

Owners can therefore look forward to an improving market but they and their agents will still have to work hard to make sure that they benefit form the upside.

As a boutique agency focused on the North Shore we understand these issues and our leasing and management teams are well equipped to help owners with the challenges ahead.

What's inside?

Recent Investment sales

Fortunately it doesn't suit every owner to hold all their assets and in the past 6-9 months we have been able to secure strong sale prices for the following vendors:

176 Pacific Highway, St Leonards

Well known as the former offices of radio station 2UE this 2,200sqm office on ground and four upper floors was sold following refurbishment to an investor for $8.4M.

194 Miller Street, North Sydney

Following an extensive upgrade and leasing campaign which resulted in the net income lifting to $930,000pa this 2,100sqm office building was sold for approx' $13M representing an uplift of over 40% over 2 years.

10 Help Street, Chatswood

On behalf of Investa Property Group we sold this 10 storey, 7,600sqm office building to a private investor for about $25M.

115 Sailors Bay Road, Northbridge

On behalf of a syndicate of investors we sold this 2,500sqm office and retail building for over $10.7M with approx' 40% vacant.

Obsolescence
– a real challenge

Whilst all owners are likely to benefit from rising rents and values over the next 2 years the big winners will be those who own modern buildings with large floor plates which are in so much demand by today's tenants.

For owners of older buildings, such as those that dominate North Sydney and St Leonards the options for maximising returns will be more complex and require much greater input.

For some, the answer may be redevelopment but this will depend on many factors including:

- Whether it is possible to create a site capable of providing 1,000 – 1,500sqm floor plates. In many cases ownerships are too fragmented or subject to tenancies that make this difficult.
- A further complication is the high proportion of buildings that have been strata titled which can make site amalgamation almost impossible.
- Whether the planners will allow a sufficiently large building to justify knocking down older stock.

Refurbishment will become more common as owners see the potential to increase rents. This however requires owners to take on the role and risks of the developer.
Issues that will arise include:

- Being prepared to lose existing tenants and income whilst refurbishing.
- Putting in place the right scheme and budget appropriate to the building and the market.
- Getting hold of the right consultants and contractors.

There is no question that a well-thoughtout and executed refurbishment can yield excellent results and provide a significant uplift to a buildings value.

Recent examples in North Sydney include 54 Miller Street which was refurbished and leased and then on sold at $10.7M higher before costs.

Our client Lend Lease has almost completed the refurbishment of 75 Miller Street, a 12 storey office building of 4,900sqm. The building has a 385sqm floor plate with light on 3 sides which has allowed a flexible leasing policy of whole floors or smaller suites. This together with the quality of the refurbishment has resulted in over 70% of the building being committed.

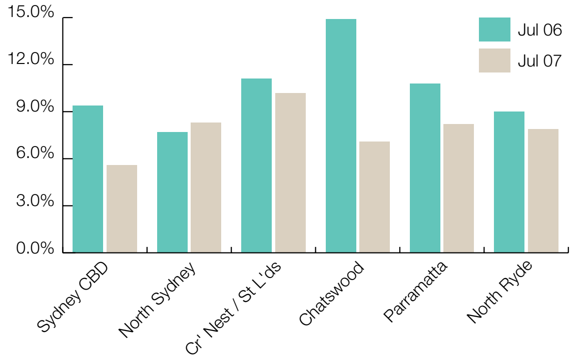
For those owners who conclude that the options above require too much time or capital the option of selling into a strong market may be attractive and should yield a great sale price.

Facts and Figures

Sydney's office markets are moving forward with reduced vacancy rates, driven by strong take up and generally, low levels of new construction. There are however significant variations in different markets.

- The move to lower vacancy rates is seen most acutely in the Sydney CBD and North Ryde. In these two areas vacancy rates have now fallen to 5.65% and 7.9% respectively. As you would expect these markets have recorded the strongest take up of space.
- Chatswood was one market that surprised in the last 6 months with a reduction in vacancy from 13% to 7.1%. The market however is comparatively small and more prone to large swings. On the plus side it has a large % of newer A Grade buildings which appeal to tenants and from next year will have a train link direct to North Ryde. Going forward the vacancy rate may rebound as Optus are due to vacate a significant amount of space.
- The markets that really failed to move forward in the first half were North Sydney and St Leonards where vacancy rates have moved only marginally and net take up was equally poor. North Sydney may record better take up over the next 12 months as it has 2 new developments, currently being leased and the refurbished 101 Miller Street coming on stream during 2008.
- What is clear is that tenants will move to get the quality and flexibility of space that they require.
- The threat posed by North Ryde to the traditional North Shore markets is set to increase with the area growing at a rapid rate. This combined with quality of space and vastly improved infrastructure will present the older CBD's and their owners with a real challenge.

Office Vacancy Rates



Location	Jul 06	Jul 07
Sydney CBD	9.4%	5.6%
North Sydney	7.7%	8.3%
St Leonards	11.1%	10.2%
Chatswood	14.9%	7.1%
Parramatta	10.8%	8.2%
North Ryde	9.0%	7.9%

Net Take Up

Location	Jan-Jun 06	Jul-Dec 06	Jan-Jun 07
Sydney CBD	78,124	65,756	86,933
North Sydney	13,374	8,030	2,149
St Leonards	7,956	3,892	2,059
Chatswood	-5,058	6,812	17,513
Parramatta	2,652	11,329	11,437
North Ryde	19,818	-714	14,954

Source PCA

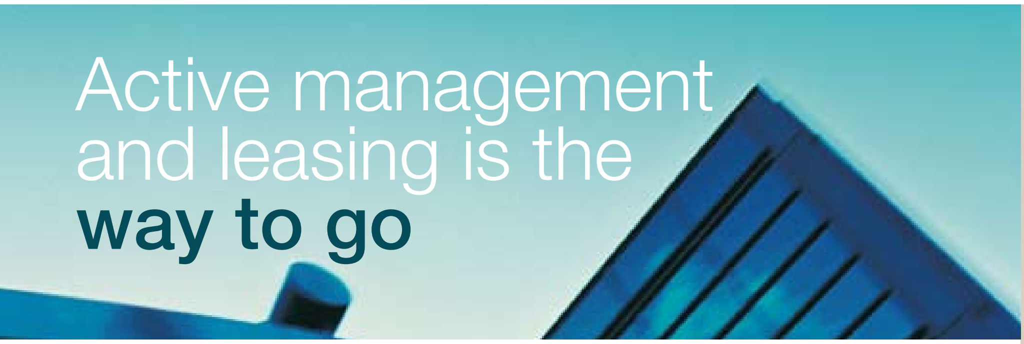
Recent sales for refurbishment or re-development

In the last 3 months we have sold the following properties in St Leonards and Epping which had reached the point where they required either a major refurbishment or redevelopment.

63 Chandos Street, St Leonards – comprised a 3 storey retail and office building approximately 50% leased and having a total area of 620sqm on a site of 430sqm. The property was sold to a partial owner occupier for a price in excess of $2M.

16-18 Cambridge Street, Epping – comprised a 4 level office building of 2,300sqm plus 75 car spaces located close to Epping train station. The building was approximately 70% leased on mostly short term leases and was sold for in excess of $6.4M.

72 & 74 Chandos Street, St Leonards – comprised 2 small, adjoining cottages on an under developed site of 430sqm. On behalf of the vendor and part occupier we secured a sale to a developer at a price close to $1.7M.



Active management and leasing is the **way to go**

Whilst it will be welcome news to building owners that the office market is on an improving path many owners will still be frustrated by the time and expense required to get new tenants. This is particularly so if the space is of a size or age where there is still plenty of competition.

Whilst A Grade floors of 1,000sqm might be in short supply, smaller areas of 300-400sqm are more plentiful and will still require concerted effort to get them leased.

Owners will have to grapple with the age-old problem of having to strip out existing partitioning so the floor presents well only then to give the new tenant a rent free period so that they can re-fit.

Decisions such as this are hard but the real enemy is time. The longer it takes to get a new tenant the total cost of the vacancy quickly mounts. The trick is to confront all issues early, make the space good as quickly as possible and if you have to offer a large incentive do so at the earliest opportunity before you have burnt into a lengthy void.

Our approach to management is to deal with buildings as if they were our own and to adhere to the following principles:

- Confront all issues head on and get them resolved.
- Chase all rents until they are paid.
- Build good relationships with tenants on the basis that it is a business arrangement where they have to comply with their obligations.
- Provide realistic advice to get space leased as quickly as possible and make sure that all potential tenants are covered.

Having taken over the management of a number of properties in the last 12 months we have inherited issues that other managers had put in the too hard basket including rental arrears, un-authorised tenants, inappropriate improvements and a lack of attention to essential works. Bit by bit we have resolved these issues and currently have a portfolio with no arrears.

We would welcome the opportunity of discussing how we could assist you with the management and leasing of your property.

Recent **lettings**

Our leasing team has had a successful 2007 with deals including:

144 Pacific Highway, North Sydney
– 419sqm leased to Knarps of Sweden

115 Sailors Bay Road, Northbridge
– 180sqm leased to the McGrath Foundation

73 Walker Street, North Sydney
– 305sqm leased to Holocentric

54 Miller Street, North Sydney
– 2 whole floors of 500sqm leased to Hones Lawyers and Cumberland Newspapers

75 Miller Street, North Sydney
– 837sqm leased in 8 separate deals

31 Victoria Street, McMahons Point
– 172sqm leased to OnComm

89 Chandos Street, St Leonards
– 280sqm leased to Sony DADC

Chatswood Central, Chatswood
– 100sqm leased to Hamilton James Bruce

35 Hume Street, Crows Nest
– 96sqm leased to The Frank Team

272 Pacific Highway, Crows Nest
– 156sqm leased to Smart Solutions

Details of all of our listings and successes can be found on our web site:

www.hartiganbolt.com.au

Investment **opportunities**

With the sales market running hot and most owners keen to hold onto their assets there are only limited buying opportunities around. Investors are, having to be more pro-active to secure buildings that are not openly on the market but where the owner is open to an approach.

A number of our sales over the last year have been off market and we continue to work with owners and investors to structure deals that suit both parties.

A close knowledge of the markets and long standing relationships are two of the keys to success in this area.

We are working on a diverse range of potential sales ranging from $5M up to larger assets of $25-30m. Many of these require active ownership and will involve taking on some refurbishment and leasing but in the longer term may offer better overall returns than buying a fully leased building.

To find out more about these opportunities please contact David Bolt.

Contact Details

Call **David Bolt** or **Chris Hartigan** on

9955 9211

- Leasing
- Investment Sales
- Property Management

HARTIGAN BOLT
COMMERCIAL PROPERTY AGENTS

www.hartiganbolt.com.au