TRIDENT
REAL ESTATE CAPITAL

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Australian Real Estate Strategic Outlook

March 2013

Highlights

- **Financial strains appear to have lessened.**
Governments are still battling structural problems in many of the advanced economies, however, financial strains appear to have lessened over recent months.

- **Euro must go.**
Europe's economic woes will continue in 2013 and although steps will be taken to resolve the debt crisis politicians will need to accept that the peripheral countries must let the Euro go.

- **Australian economy has proven itself resilient.**
The Australian economy in 2012 experienced growth that is close to its long term-trend led by large increases in capital spending in the resources sector. Notwithstanding, the near-term outlook for investment outside the resources sector, looks subdued. Housing financing commitments have fallen while dwelling investment is only slightly improving.

- **CBD fringe apartments have the greatest potential for outperformance.**
Trident Real Estate Capital is bullish on CBD fringe apartments in the $450,000 to $800,000 price bracket where market fundamentals are driven by a large and growing undersupply on the one hand and population growth on the other.

- **Demand for office space is expected to remain under pressure.**
Leasing office activity will remain challenging, particularly in Melbourne, as a result of corporates scaling back and pipeline supply outstripping tenant demand.

- **Sydney's gross supply of industrial space is tight.**
Sydney's pipeline of new supply of industrial stock in 2013 will remain tight, primarily due to the soft pre-lease environment and the difficulties developers are facing to obtain finance. As a result of the tight supply, the design and construct approach has become a necessary solution for most users with limited alternative options for tenants seeking leasing options in excess of 15,000 square meters.

- **Melbourne's commercial outlook to suffer.**
Melbourne's commercial outlook will experience downward pressure as a result of the contracting manufacturing sector, which has fallen for ten consecutive months according to the PwC Performance of Manufacturing Index, as well as the general weakness in Melbourne's economy attributed to the downturn in construction, the decline in public sector investment and slowing private consumption.

- **Retail to experience another flat year.**
Retail will have another flat year with sales growth of 1%-2% becoming the new norm. The retail leasing environment will continue to be difficult as demand is affected by local retailers undergoing network rationalisation or falling into administration. Contrastingly, the food majors continue to punch above their weight gaining market share and searching for stores of 3,500 square meters or larger to expand.

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Snap Shot of the Global Economy

2013 has begun with a burst of optimism taking hold of the financial markets, with sentiment supported by the positive steps taken in the Eurozone to address the debt crisis, greater trust in US politicians to resolve the fiscal standoff and improved global economic data. Notwithstanding, there should be no illusions. Governments are still battling structural problems in many of the advanced economies. The IMF has most recently acknowledged the existing problems by making a downward revision of world growth to 3.5% from the 3.6% predicted in October 2012.

United States Economy

In the US, the sequester's impact and the fiscal stalemate continue to rattle the economy. Yet consumers are confident that Congress will not allow the country to fall victim to a fiscal crisis. On the economic front, investors were caught off guard when US gross domestic product (GDP) grew at a mere 0.1% annual rate for the fourth quarter of 2012, economists were hoping for 0.5% growth. The shortfall was blamed on the deep cuts in defense expenditure. The number of people filing their first claim for unemployment benefits for the week ending 2 March 2013 fell to 340,000, a decrease of 8,750 against the 4-week moving average. For February 2013, the unemployment rate edged down to 7.7%, but this figure has shown little movement, on net, since September 2012 according to the US Bureau of Labour Statistics. A further 8 million people were working part time because their hours had been cut back and they were unable to find a full time job.

Unsurprisingly, as a result of the US economy's slow economic growth, the US Federal Reserve has agreed to continue to purchase mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. Taken together, it is hoped that these actions will maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative. (Federal Reserve Press. Release December 2012). The highly accommodative monetary stance will be appropriate at least as long as the unemployment rate remains above 6.5% and inflation does not rise above the 2% benchmark.

Despite all the political and global economic uncertainty, corporates have deleveraged and improved the health of their balance sheets. A housing recovery is now well on the way with the S&P/Case Shiller Home Price Indices rising 6.8% in 2012. Oil and shale gas production has surged, thanks to fracking, with daily crude output averaged at 6.4 million barrels a day in 2012. Output is now at a 15-year high, according to the American Petroleum Institute. Manufacturing has experienced somewhat of a renaissance thanks to low unit labour costs, cheap energy and the low US dollar. The Institute for Supply Management's Manufacturing Index climbed to 54.2% in February 2013 an increase of 1.1% from January's reading, indicating expansion in manufacturing for the third consecutive month.

Trident Real Estate Capital believes that the private sector recovery and an inevitable meeting of the minds by the Democrats and Republicans combined with the resolution of the foreclosure process, and private capital interest will result in an accelerated recovery in the housing sector. The commercial real estate sector will continue to be attractive primarily because of large spreads above fixed-income investments and the greater stability over stocks that commercial real estate commands. The expansion of the Panama Canal and the ability of Post-Panamax vessels to pass the canal will mean industrial property will see strong investor interest especially around East Coast ports.

Europe

Europe, unfortunately, is not faring as well as its trans-Atlantic neighbour. The Euro area is in recession with the third consecutive negative GDP growth rate of -0.6% in the fourth quarter of 2012, following -0.1% decline in the third quarter of 2012. Among Member States for which data are available, Latvia (+1.3%) recorded the highest growth compared with the previous quarter, and Portugal (-1.8%), Cyprus and Slovenia (both -1.0%) the largest decreases. (Eurostatistics Issue No. 36/2013).

Greek Economy

The crisis in Greece continues to bubble, albeit somewhat less aggressively. According to the IMF, Greece is projected to contract by 6% in 2012 and 4.25% in 2013. In December 2012, after an extended political crisis, Greece finally received €34.3 billion as part of the latest bailout program which triggered Standard & Poor's to raise its rating on Greece to B-minus from selective default. Greece is closing the competitive gap with wages declining by 7.5%, year on year according to the IMF. The country's fiscal position continues to improve. Morgan Stanley predicts in The Global Macro Analyst January 2013 that Greece will reach a budget surplus in 2013. Notwithstanding, the economy continues to contract unabated and the risk of domestic political instability remains high. The Greek real estate market has continued to suffer since 2008 as a result of the introduction of the 'xaratsi' tax burden, the unstable economic environment of the country, as well as restricted bank financing. In Athens nominal apartment prices during the crisis to the third quarter of 2012 have fallen by 23.9% according to the Bank of Greece *Monetary Policy Interim Report December 2012*. Trident Real Estate Capital hopes that Greek politicians use the current crisis as an opportunity to: Firstly, reduce the size and the inefficiencies of the public sector. Secondly, to push forward with tax administration reform. Thirdly, to restructure the economy by eliminating red tape that hampers business innovation.

Italian Economy

Italy is currently suffering the longest recession for the last twenty years, contracting for six consecutive quarters. The country's economy shrank by 2.2% in 2012 (ISTAT statistics) and is burdened by a high level of public debt, 127% of GDP. The technocrat government, headed by Mr Monti, has boldly gone where no elected government would dare to venture, introducing structural reforms in terms of fiscal austerity, liberalisation, labour market reform and anti-corruption measures. Unfortunately, the recently held elections have produced a hung parliament, as the backlash against austerity resulted in a strong showing for the Five Star Movement and Mr. Berlusconi. The current divided state of parliament means that the necessary structural reform to remedy the country's anemic growth concerns is unlikely to continue. Should reform not continue the country may fail to qualify for support from the European bail-out fund. This will translate into soaring Italian bond yields and renewed risk of a break up of the Euro.

Spanish Economy

According to Spain's National Statistics Office, Spain's economy shrank a worse than expected 0.7% in the fourth quarter of 2012 compared with the previous three-month period. Unlike Greece that has been eagerly awaiting its next hand-out, Spain has committed all its energy to avoid applying for assistance from the bailout fund and the European Central Bank. As of the date of writing, Spain's regional rescue fund, the FLA, has ensured that the Spanish 10 year bond yields have retreated to around 4.8%. Unfortunately the cash strapped regions of Spain have swamped the government with requests, making the status quo no longer viable.

The Euro Must Go

The ECB's intervention, which involves the purchase of government bonds for fiscally challenged countries, together with Angela Merkel's new tune of "more Europe, not less," has assisted in sedating investor concerns, at least for the short term, and allowing peripheral countries access to the credit markets. However, the fact that many of the peripheral European countries continue to shrink will mean that there is little, if any, possibility that these economies will be able to grow their way out of their mountainous debt piles. In our view, the effort to save the Euro at any cost is misguided. Peripheral countries should consider letting the Euro go and reestablishing their own national currencies, allowing for the necessary adjustment to fiscal and competitive imbalances, as well as a necessary default on foreign debt. Unsurprisingly, we consider that the greatest risk to the global economy and the real estate market is the Euro Zone. In 2013, expect to see political tension rise as parties debate whether fiscal austerity measures are the solution and what policies may be implemented to generate real GDP growth.

Chinese Economy

China's most recent statistics have showed business activity remained on track for a gradual recovery with HSBC China PMI of 50.1 in February. Such momentum is likely to be sustained in the short term as a result of government stimulus policies, including US$150bn of infrastructure approvals, an easing monetary policy and the cutting of the reserve-requirement ratio for bank deposits. Economic growth is, however, relatively low, with an annual GDP growth of 7.9% for 2012 being the lowest reported since 1999. Investors should be reminded that local governments are responsible for reporting accounting data in China and that such numbers are not always reliable. Most recently, Moody's changed its outlook for China's property industry from negative to stable, noting that easing mortgage financing for first-time home buyers, increasing development of mass-market products, solid underlying demand, and continuing urbanization will lead to improved sales, which in turn will lower the inventories of property developers (Moody's *China Property Industry: Improving Sales and Access To Funding Support Stable Outlook November 2012*). Trident Real Estate Capital's most concerning long term issue is the country's ever increasing supply of housing on the one hand and the low birth rate on the other. For now, the new President, Xi Jinping, faces several challenges including boosting domestic demand, moving toward services and away from agriculture, as well as progressing liberalisation, including floating the renminbi.

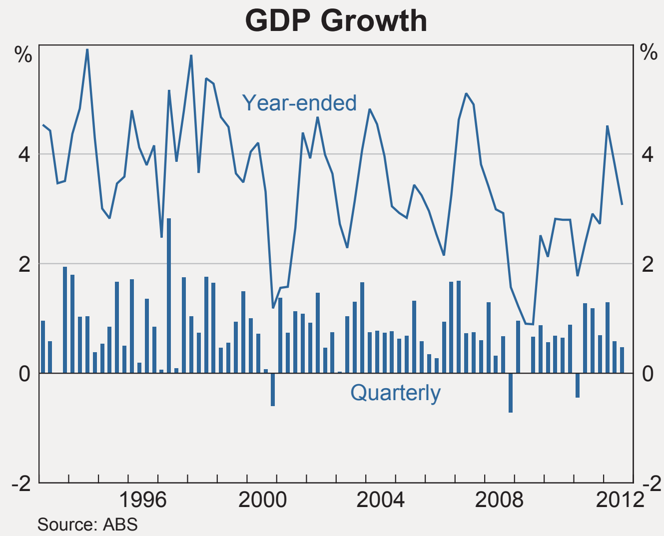
Australian Economy

Shifting our attention to Australia, the economy has proven itself resilient since the GFC. In the December 2012 quarter, GDP grew by 0.6% bringing annual GDP growth down to 3.1% from 3.8% in 2011 according to the Australian Bureau of Statistics (ABS). The slowing growth was in line with declining pubic demand as a result of fiscal consolidation efforts. GDP growth is expected to be a little below trend in 2013 at circa 2.5% according to the Reserve Bank Australia (RBA). The most recent ABS Employment figures showed that the unemployment rate had drifted to 5.4% rising 0.2% over the last 12 months. Over the same period, the participation rate had declined and the average hours worked were lower. Many economists expect the unemployment rate will continue its upward trajectory to almost 6% by the end of 2013, as losses in retail and manufacturing, undermined by the high dollar, outweigh the gains from the recent recovery in iron ore prices.

Inflation is consistent with the RBA's medium-term target of 2.2% (ABS). Along with the softening of the labour market and unemployment edging higher, conditions are working to contain pressure on labour costs. Moreover, businesses are focusing on improving efficiency to remain competitive. These trends should help keep inflation in check.

Surveys of business conditions remained below average for most industries. According to NAB's Business Survey for January 2013, business confidence improved, but the net balance statistic remained negative, continuing below-trend growth. The Australian Performance of Construction Index fell in January 2013 to 36.2, with house building the worst performing sub-sector. Housing financing commitments fell for the second consecutive month in December 2012 by 2.6% according to the ABS. Notwithstanding, there have been some signs that the housing market has firmed with house price growth and rentals picking up.

At the time of writing, the S&P/ASX 200 had climbed above the 5,100 mark, with a rise of over 26% since June 2012. The bull market phenomena has been a case of investors chasing better dividend yields and bonds being considered overvalued. Unsurprisingly, property stocks have significantly benefited from the recent rise in the stock market. The most recent ASX Listed Managed Investment report found the market cap of AREITs increased by 23.4% to $92.34 billion as at January 2013, up from $75 billion in the same period a year ago. Simon Wheatly of Goldman Sachs believes that AREITs have peaked for now, noting that a range of measures, such as premium to net tangible assets, currently at 18%, and price-to-earnings premium, at



an average price of 15x, are near historic highs.

AREITS are currently experiencing a revival of merger activity as a result of the availability of cheap debt and a surge of confidence partly caused by rising stock prices. GPT and allegedly Mirvac are currently courting Australand. The former has made a $3billion bid for Australand's industrial and commercial assets, although it is believed that this offer will be sweetened in due course.

For property investors, the key issue is to understand where interest rates are headed in 2013 and where rates will be when they attempt to exit their investment. Currently, the cash rate is at a record low of 3%. Going forward, the requirement to shift the economy's dependence from the mining sector, the stubborn strong Australian dollar and the need to kick start manufacturing will mean further monetary easing is expected of at least 50 basis points for the next twelve months. At these low rates, the pro forma models for real estate investing seem very attractive.

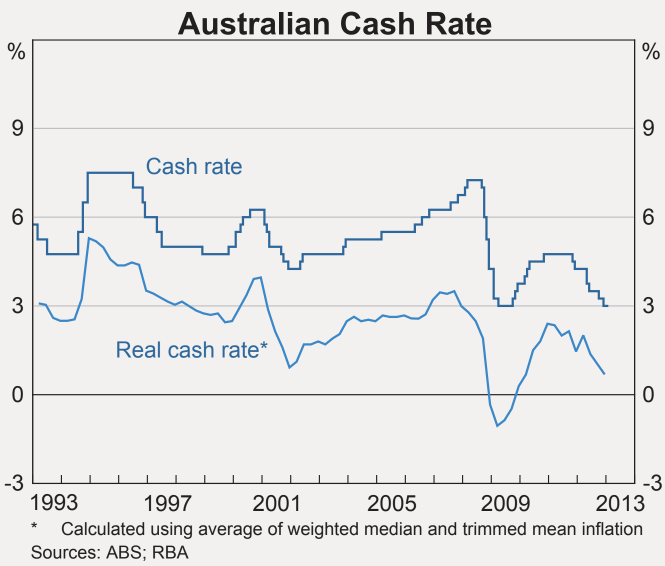
Trident Real Estate Capital believes, as the RBA drops rates and provides a short-term sugar rush to the Australian economy, commercial property investors should focus on transactions that provide a large margin of safety and a sizeable cash yield upfront.

Property Types in Perspective

Residential Market

According to RP Data, capital city home values were up 0.3% in February 2013, following a 1.2% rise in January, taking the annual movement in dwelling values back into the black with a 1.3% increase over the past twelve months. The strength in the monthly result was driven by Melbourne, where dwelling values were up 1.5%. The trend for most cities remained positive with six of the eight capital cities showing growth. The average number of days it took to sell a property also decreased to 55 days in December 2012, which is a significant improvement from the 76 days recorded in February 2012.

The highest rental yields, according to RP Data, were enjoyed by Darwin houses with gross rental yields of 6.2% and Darwin units providing a yield of 6.3%. The lowest rental yields were experienced by landlords in Melbourne, where rental houses only returned gross yields of 3.6% and units provided a 4.4% yield.



Source: ABS

Trident Real Estate Capital believes that the housing market and especially unit dwellings within 5km of the CBD will perform particularly well in 2013 and enjoy capital growth of at least 3% for the following reasons. Mortgage rates are low, with the average variable mortgage rate being recorded at 6.45% and three year fixed rates are at 5.55%, according to the RBA. Consumer sentiment has continued to improve with the Melbourne Institute Survey of Consumer Sentiment being above 100 points for three successive months. Dwelling approvals remain soft. Dwelling approval numbers have remained fairly static over the last two decades, according to RP Data. Last but no least, population growth is driving demand. In the last 12 months to June 2012, Australia's population increased by 1.6%, mostly driven by overseas migration (ABS). In summary, market fundamentals for housing are being driven by a large and growing undersupply on the one hand and population growth on the other.

John McGrath recently explained that weekend clearance rates of 69% for the under $750,000 in the Sydney market mean that Sydney still remains the "BHP of Australian real estate." Demand is expected to be derived from local investors seeking to withdraw cash from term deposits to chase higher yields, Asian investors and young professionals and families taking their first step on the property ladder.

Office Market

Demand for office space, particularly in Melbourne, is expected to remain under pressure as a result of continuing economic uncertainty and large financial institutions scaling back and shedding costs as a direct result of permanent structural change. Jones Lang LaSalle reported in their Office Investment Market Review and Outlook February 2013 that corporate Australia is nervous about its short-term revenue outlook and as a result, corporates are looking to rationalize their cost base to protect margins. Unsurprisingly, there is limited organic growth in the market, meaning that tenants will opt for the more cost effective option of staying put.

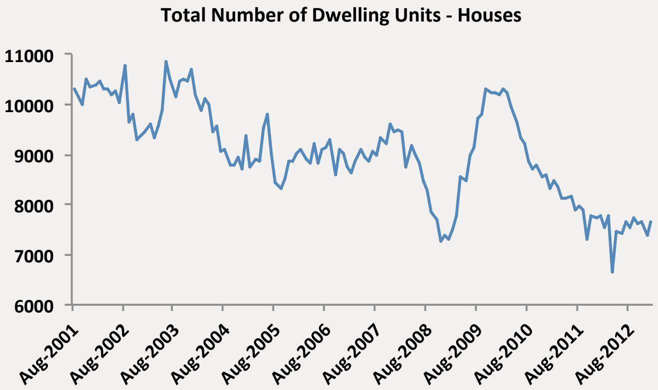
Index Results as at 28 February 2013

Region	Change in dwelling values			Total Gross	Median
	Month	Quarter	YoY	returns	dwelling prices
Sydney	0.1%	0.9%	2.7%	7.3%	$540,000
Melbourne	1.5%	2.2%	-0.7%	3.1%	$482,000
Brisbane	-1.1%	0.6%	1.2%	6.2%	$420,000
Adelaide	-0.8%	-0.3%	-1.1%	3.3%	$380,000
Perth	-0.8%	1.1%	3.7%	8.5%	$465,000
Hobart	-0.9%	4.2%	-2.3%	3.0%	$310,000
Darwin	2.3%	-2.5%	5.9%	12.4%	$510,000
Canberra	1.9%	2.3%	2.7%	7.6%	$500,000
City Aggregates	0.3%	1.2%	1.3%	5.7%	$460,000
Rest of State*	-1.1%	-0.7%	-0.7%		$340,000

*Rest of state change in values are for houses only to end of December

Source: RP Data- Rismark

Leasing office activity will remain challenging for the following reasons: Firstly, corporates are scaling back as reflected by the ANZ job advertisement series, which as at January 2013 had decreased by 18.4% over the year. Secondly, supply challenges lie ahead. In 2013, around 633,000 square meters of office space will be released. In 2014, an additional 244,000 square meters will be expected to come online while in 2015, the market will



be swamped with Barangaroo and other developments coming online and creating 769,000 square meters (Property Council of Australia Office Market Report January 2013). Thirdly, demand is weak. The Australian office vacancies increased from 7.8% to 8.4% over the last six month period. Vacancy increased in Melbourne, Brisbane, Canberra and Adelaide according to the Property Council of Australia. Australian CBD office markets recorded 55,900 square meters of net absorption in 2012 – approximately one-fifth of the ten-year average. Last but not least, the recent trend of activity-based working, that will be adopted by one in three organisations, according to Colliers International Office Tenant Survey 2012, has the potential to reduce the demand for office space requirements by up to 20%.

Unsurprisingly, Perth stands out from the crowd with an office vacancy rate of only 5.7%. The city, however, is also suffering from a resource industry engine that is no longer purring but chugging and a troubled service sector. Notwithstanding, going forward, demand will be sourced from the mining industry's commitments in the form of long term off-take agreements for commodities such as iron ore and coal.

The Melbourne CBD has received negative press with the office vacancy rate rising from 5.6% to 6.9% over the last 6 months. According to BIS Shrapnel's Melbourne Commercial Property Prospects 2012 – 2022, the Melbourne office market is set to experience two years of hardship as conditions will be worse than they were in the early 2000s downturn. The report notes that several factors are pointing to the weakness in the economy: Firstly, dwelling construction is expected to decline over the next two years. Secondly, the high Australian dollar is negatively impacting manufacturing, tourism, education and financial services. Thirdly, the cuts to public spending, which are projected to intensify over the next two to three years. Finally, the Victoria Liberal Party's recent crisis, triggered by the resignation of Ted Baillieu, has not helped. Trident Real Estate Capital believes that the abovementioned factors, combined with the upcoming new office supply from projects such as the Docklands as well as backfill space arriving on the market, means that vacancy rates may approach 10% by the end of 2013. In turn, office landlords will suffer rising incentives and falling effective rents.

Acquisition of prime office buildings by offshore investors will continue in 2013 due to the large yield gap, Australia's strong regulatory system and a transparent market. Recent examples include Hines Global REIT which shelled out $92 million for an office building at 465 Victoria Avenue, Chatswood, Sydney, its largest acquisition to date, from FKP Property Group and MGPA's purchases of 6-10 O'Connell Street in the Sydney CBD for $105.1 million. Trident believes that the relative limited offering for prime core assets will result in firmer cap rates for this asset class in 2013.

Australian CBD Vacancy and Key Indicators as at January 2013

Market	Vacancy Rate Jan 13 (%)	Vacancy Rate Jul 12 (%)	Net Supply Additions 6 Mths to Jan-13 (sqm)	Withdrawals 6 Mths to Jan-13 (sqm)	Net Absorption 6 Mths to Jan-13 (sqm)
Perth CBD	5.7%	4.2%	21,981	17,347	- 18,332
Melbourne CBD	6.9%	5.6%	73,190	7,220	5,340
Sydney CBD	7.2%	8.1%	48,637	87,903	8,466
Darwin CBD	8.0%	9.1%	-	4,366	- 1,676
Brisbane CBD	9.1%	8.0%	29,786	2,715	2,406
Hobart CBD	9.4%	5.9%	12,239	732	- 2,013
Adelaide CBD	9.5%	7.7%	44,179	7,482	9,557
Canberra	11.9%	9.8%	87,582	6,746	23,328
Total (all CBD market)	8.1%	7.3%	317,594	134,571	27,076

Source: Property Council of Australia

Industrial Market

According to the IPD Australian All Property Index for the 12 months to December 2012, industrial property posted a total return of 9.6% with capital growth of 0.8%. Income returns for Australian industrial space (8.7%) was higher than the office and retail asset averages. This relative higher return is likely to attract interest from investors seeking to reweigh their asset allocation.

Knight Frank's *Industrial Overview for November 2012* noted gross supply of industrial projects measured 540,000 square meters for 2012, which was 27% below the annual average gross completion rate. The pipeline of new supply of industrial stock in 2013 will therefore remain tight, primarily due to the soft pre-lease environment and the difficulties developers are facing to obtain finance.

As a result of the tight supply, the design and construct approach has become a necessary solution for most users with limited alternative options for tenants seeking leasing options in excess of 15,000 square meters.

According to Savills' *Spotlight Sydney Industrial Report January 2013*, the transport and logistics sector has been the major driver of demand, leasing 43% or 378,069 square meters of industrial space in 2012. Trident Real Estate Capital expects demand to continue to shift from the traditional manufacturing businesses to the warehouse, logistics and transport sector as a result of higher energy and input costs, the changing behaviour of consumers who are now switching to online purchases and the strong Australian dollar.

In South Sydney, where Trident Real Estate Capital is active, there has been a noticeable softening in supply as a result of the City of Sydney's new Planning Controls that have rezoned industrial areas into residential use. Notwithstanding, there is strong owner occupier demand for strata industrial units ranging in size from 140 square meters to 300 square meters. The lack of quality space has resulted in a strong growth in demand for land and development sites across South Sydney with owner occupiers, developers and the City of Sydney Council all being active players. Land ranges in value from $500 to $600 per square meter in the Botany area and $1,000 to $1,200 per square meter in Alexandria and Mascot.

Property Council / IPD Australia All Property Index as at 31 December 2012

	Total Return for year to			Income Return for year to	Capital Growth for year to
	Jun-12	Sep-12	Dec-12	Dec-12	Dec-12
All Property	10.0%	9.6%	9.4%	7.4%	1.9%
Retail	9.0%	8.9%	9.0%	7.0%	1.8%
Office	10.4%	10.0%	9.7%	7.4%	2.2%
Industrial	10.0%	9.8%	9.6%	8.7%	0.8%
Residential					
Other*	12.7%	11.6%	10.6%	8.1%	2.3%
Val. Evidence	95.8%	82.5%	75.0%	75.0%	75.0%

*March 2005=100

Source: IPD Australia Property Database as at December 2012

Melbourne is the largest industrial market in Australia. 40% of Australia's container shipping travels through the Port of Melbourne, a key driver for the State's industrial market. According to *Savills' Spotlight Melbourne Industrial Report January 2013* just 358,176 square meters of space was reported leased at the end of the third quarter of 2012. This compares to the previous 12 months where 738,487 square meters was leased. Developers and landlords suffered a difficult year with a noticeable fall in activity. Unsurprisingly, average net rentals for prime space were flat, rising by a mere 1.6% to $76 a square meter, while secondary rents decreased by 0.4% to $63 a square meter (Knight Frank's Industrial Market Overview November 2012).

With prime grade yields in the range of 7.5% to 8.75% (*Savills' Spotlight Melbourne Industrial Report*), Trident Real Estate Capital predicts rental growth in Melbourne to continue to weaken over the next 24 months. Downward pressure will be caused by the contracting manufacturing sector, which has fallen for ten consecutive months according to the PwC Performance of Manufacturing Index, as well as the general weakness in Melbourne's economy attributed to the downturn in construction, the decline in public sector investment and slowing private consumption. On a positive note, some of this downward pressure is to be offset by the fall in interest rates and a return in business confidence as is evident by the recent surge in the S&P/ASX 200.

Retail Market

The ABS released improved January 2013 retail sale figures

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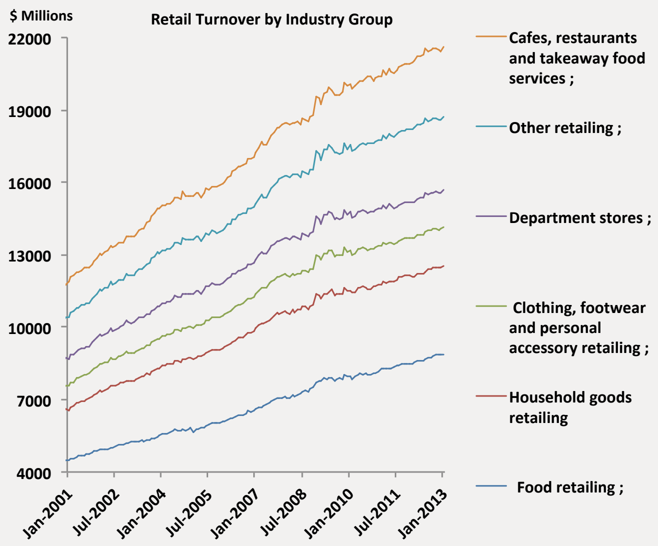
which rose 0.9%, following disappointing December retail sales figures for the Christmas season which dropped by 0.2%. The largest contributors to the rise were department stores (0.4%) and food retailing (0.2%).

The lackluster sales picture has been attributed to a number of factors. Firstly, the higher rate of personal savings at 10.6% of net disposable income as at the third quarter of 2012, which compares with -2% in May 2002 (ABS) means that consumers are spending less. Savings are being used to pay off mortgages, with more than half of all mortgage borrowers ahead of schedule according the RBA Financial Stability Review. Secondly, as a result of the appreciated

Australian dollar, 33% of Australians are travelling overseas and spending their money outside Australia (ABS). Finally, the impact of the internet is hurting domestic retail figures. The most recent NAB Online Retail Sales Index noted that Australians spent around $13 billion on e-tailing in the year to January 2013, an equivalent of 5.8% of brick and mortar sales. Purchasing online often provides a cheaper option than purchasing from high street retailers as well as a wider selection to satisfy consumer taste.

As the online trend continues, Trident Real Estate Capital expects to see shopping centre mixes redefined with more dining and entertaining venues and less clothing stores. Online retail will become more integrated into the Australian shopping experience. Retailers may concentrate on one, or several, large flagship stores to communicate a brand, while blurring the boundaries between physical store and online marketing according to Urbis' report, *Online Retailing in Australia*. Physical retail stores will reduce their floor size and their purpose will change to focus on providing the customer with an "experience" that will ultimately focus on entertainment. Mini-majors, defined as retail outlet of between 600 square metres to about 1500 square metres such as JB Hi-Fi and Apple, have become the darlings of retail as key customer generators.

Unsurprisingly, the supply of retail floor space has slowed each year between 2000 and 2007 from over 1 million square meters to 598,000 square meters in 2012 (Jones Lang Lasalle *Australian Shopping Centre Review and Outlook February 2013*). This slowing pace is the result of building costs – according to CostWeb a developer would incur costs of $1,623 per square meter for the construction



Source: ABS

of a suburban shopping mall – as well as a difficult leasing environment and financing issues.

Contrastingly, the food majors, namely Woolworths and Wesfarmers, have punched above their weight, gaining market share. The duo has now captured 56% of the grocery market according to Macquarie Private Wealth. Both majors continue to grow and are actively looking for stores of 3,500 square meters or larger. In 2013, Woolworths intends to open 36 new supermarkets (Woolworths First Half Year Sales Results to December 2012). Some analysts have argued that innovation has been the key for the food majors' ability to go from strength to strength. The introduction of iPads to look up recipes, the availability of mobile apps, click and collect services as well as stores changing the product mix up to three times a day has all contributed to growing sales revenues.

Recently, in order to safeguard their expansion plans and in the face of the limited supply of retail space, the food majors have been forced to wear the hat of a developer in order to build their own shopping centres. Accordingly, Trident Real Estate Capital expects the majors to become more active on the development front in 2013.

Australia is currently experiencing a wave of international retailers entering the market with a majority being classified as fast-fashion retailers including Zara, Top Shop and Miss Selfridge. Colliers reported in their *International Retailers, Australia is Hot Property February 2013 White Paper* that take up from the latest wave of international brands has totaled approximately 32,500 square meters. Based on the medium term outlook, Colliers anticipates international retailers will require approximately 235 stores, equating to an additional demand of 220,000 square meters. For property owners, this means that international retailers will take up some of the supply left behind by local retailers who have fallen into administration or undergone store rationalization.

According to Jones Lang Lasalle's *Australia Shopping Centre Investment Review February 2013*, sales of retail assets gained momentum in 2012, rising to $6.3 billion, in line with all time record highs reached in 2003 and 84% above 2011 transaction levels. Risk aversion drove most investors, namely unlisted property trusts and private investors, towards core product. Jones Lang Lasalle reported a marginal tightening of regional centre yields (-11bps to 6.28%) and a mild softening for sub-regional centre yields (4bps to 7.66%), while bulky good yields were static at 9.55% as development slowed. The yield spreads between retail formats remain at historic highs.

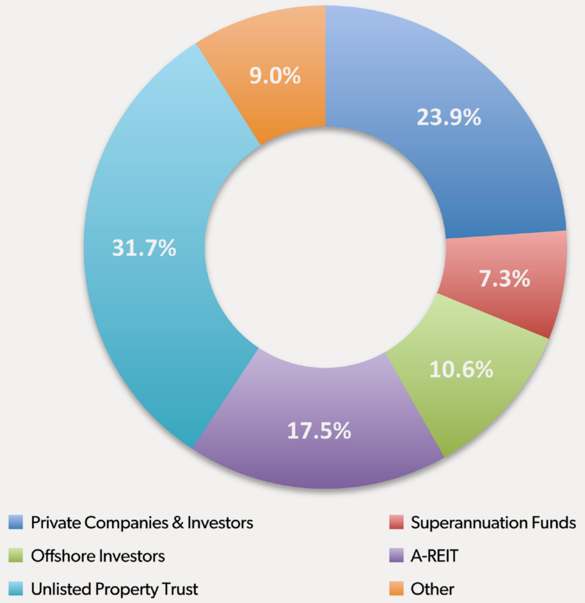
On the investment outlook, Trident Real Estate Capital believes that prime and CBD strip space will see a moderate pick up in investment activity in 2013 with demand driven by favourable yields. Retail on high streets outside the CBD and other more secondary locations will, however, continue to suffer and result in rents coming under pressure. Expect shopping centres to have lower rates of growth in the future with expansion limited to centre extensions and refurbishments. Non-retail tenants such as banks and medical centres will become vital to bring customers into centres.

Market Outlook and Best Bets in 2013

Global growth for 2013 is forecasted to be below average, but the financial strains appear to have lessened over recent months.

Europe's economic woes will continue in 2013 and although steps will be taken to resolve the debt crisis, politicians will need to accept that the peripheral countries must let the Euro go. The US's low interest rate environment is creating motion in the economy but Trident believes that quantitative easing is creating an unhealthy subsidized interest rate climate. This climate may be preventing some corporates from carrying out their investment activities. China's most recent statistics have showed business activity remains on track for a gradual recovery sustained by government stimulus policies, infrastructure spending and easing monetary policy. Notwithstanding, President Xi Jinping, faces several challenges including boosting domestic demand as well as calming a frothy real estate market.

Retail Buyer Profile - 2012



Source: Jones Lang Lasalle

The Australian economy in 2012 experienced growth that is close to its long term trend, led by large increases in capital spending in the resources sector. Other sectors, such as manufacturing, suffered continuing decline. Sentiment in the financial markets is much improved with some commentators calling the current stock market rally a bull market. Notwithstanding, the near-term outlook for investment outside the resources sector looks subdued. Housing financing commitments have fallen, while dwelling investment is only slightly improving. More positively, capital city home prices are rising along with rental yields.

When considering each of the property types, Trident Real Estate Capital is bullish on CBD fringe apartments in the $450,000 to $800,000 price bracket, where market fundamentals are driven by a large and growing undersupply on the one hand and population growth on the other. Trident Real Estate Capital is least confident with Melbourne's commercial outlook, which will suffer in the near-term as a result of the downturn in construction, the decline in public sector investment and slowing private consumption. Retail will have another flat year with sales growth of 1%-2% becoming the new norm. The retail leasing environment will continue to be difficult as demand is affected by local retailers undergoing network rationalization or falling into administration. Property owners of retail space should anticipate lower rents and more generous incentives.

Regardless of property type preference, in this difficult market, investor pitfalls may be avoided by focusing on upfront income generating properties and factoring a large margin of safety in pro forma models.

If you have any questions or would like more information, contact Trident Real Estate Capital.

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Trident Real Estate Capital is a real estate investment and advisory firm which is active in the Australian commercial property market. We draw upon 30 years of real estate market experience and utilise an advanced suite of property data and analytical tools to provide client tailored specialist real estate advice including market assessments and forecasts, due diligence and location analysis to a variety of corporate, investor and institutional clients.

In addition to our research, Trident Real Estate Capital publishes its own blog, which you can subscribe to by visiting **www.tridentrealestate.com.au/blog**.

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