



Discovery Investment Services

# Commercial Office Fund



Quarterly Performance Report  
For the quarter ended 31 December 2006

Commercial Office Fund  
ARSN 115 845 871



## Quarterly Performance Report

As at 31 December 2006

### Introduction

The Commercial Office Fund's ("the Fund") performance was in line with expectations over the December quarter.

The Fund owns 8 commercial office properties in the major office markets of Australia and New Zealand, as well as 50% interests in two separate trusts that own two major Sydney office properties. During the quarter no further acquisitions were made.

On 1 October 2006 the unit price was \$1.0493. Based on progressive valuations the price increased further on 27 December 2006 to \$1.1027.

Within the period, the weight of capital impacted the market and investment performance has been driven by a further tightening of investment yields. Continuing rental growth remains a fundamental strength of many markets, and a key source of returns, particularly across the markets to which the Fund has exposure.

If you have any feedback, comments or queries regarding this report, please contact us using the details supplied on the last page.



235 Pyrmont Street, Sydney, NSW

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### Fund performance summary

#### Commercial Office Fund

Unit Price	<b>\$1.1027</b>
Fund Size	<b>\$520m</b>
Distribution (quarter) cents per unit	<b>2.1000c</b>
Distribution (rolling 12 months) cents per unit	<b>8.3000c</b>
Distribution Yield (rolling 12 months)	<b>8.30%</b>

Returns are net of all management fees and Fund expenses.  
Past performance is no indication of future performance.




## SAITeysMcMahon investment outlook

Despite the 25 basis point increase in the official interest rate in November, the outlook for commercial property in Australia remains positive. Quarterly core inflation measures have eased from recent quarters, allowing both annual core and headline inflation to be held between 2 – 3%. Although inflationary risks are still apparent, we believe that the RBA will be content to hold interest rates in 2007.

Commercial property is expected to continue to see record high investor demand, despite macroeconomic issues and governing constraints.

In traditional sectors such as office, further tightening of investment yields is expected as increases in rental income look likely to continue across many markets, particularly where a lack of supply exists.

### Key influences summary

	Trend	Fund comment
<b>Interest rates</b> 	<ul style="list-style-type: none"> <li>■ The Reserve Bank of Australia lifted the official cash rate by 0.25% to 6.25% on 8 November and retained a tightening bias for the official interest rate, in response to increasing demand and inflationary pressures.</li> </ul>	<p>The majority of the Fund's debt has been fixed to take advantage of low interest rates, and to minimise downside performance risk.</p> <p>The current interest rate environment is expected to support a continuation of demand for office space across the major markets.</p>
<b>Availability of suitable assets</b> 	<ul style="list-style-type: none"> <li>■ Greater competition for traditional and non-traditional assets.</li> <li>■ Increased focus on quality commercial office property for investors.</li> </ul>	<p>The weight of funds and the lack of suitable quality investment property are expected to continue to underpin the appeal of quality office property in prime locations.</p> <p>However, the opportunity to add further quality office property will be rigorously evaluated in terms of impact on the overall investment proposition of the Fund.</p>
<b>Forecast market impacts on performance</b> 	<ul style="list-style-type: none"> <li>■ Generally strong investment climate for property.</li> <li>■ Correction of decade-long underweight property allocation to continue.</li> </ul>	<p>Market conditions are likely to drive asset values up across the board, while yields have further room to be driven down.</p> <p>The Fund is expected to benefit as a result of strong office market fundamentals around Australia (and New Zealand).</p>

# Australian office property market update\*

## Construction activity

Nationally new office supply was robust over the quarter. Successful completions included Brisbane Square (55,000m<sup>2</sup>), Port 1010 (15,000m<sup>2</sup>) in the Melbourne Docklands and Glasshouse (16,000m<sup>2</sup>) in Canberra.

In Sydney only 4,800m<sup>2</sup> became available in the CBD, while no supply was added in the Perth and Adelaide business districts. Despite the new supply, completions failed to meet demand.

Supply continues to grow across all markets nationally, with several projects due to commence in Perth and Brisbane. However, potential oversupply does not yet appear to be a concern for any market with the possible exception of Adelaide.

## Tenant demand

Tenant demand remains robust and is likely to once again deliver strong net absorption. Nationally this includes a record 50,000m<sup>2</sup> in Brisbane, and 35,000m<sup>2</sup> in Melbourne. In Perth, demand continues to outstrip supply.

## Vacancy rates

The vacancy rates for both Perth and Brisbane moved into uncharted territory, recording rates of below 1.0%, while the Melbourne, Sydney and Adelaide CBD's are likely to contract. Vacancies in Canberra have plateaued and are expected to fall slightly next quarter.

## Rent growth

Rental growth in Perth and Brisbane continued to flourish, with a 10% spike in the Brisbane CBD on the back of a number of leasing deals. The overall outlook remains buoyant for landlords.

## Sales activity

Sales over the quarter were stable. There has been some capitilisation in rental growth in Perth with some larger assets changing hands. Two notable sales were 50% of Bankwest tower for \$137 million and the sale of Allendale Square and Allendale 2 developments for \$230 million. Other significant sales included the Flinders Link development in Adelaide for \$156 million, and 151 Pirie Street for \$61 million.

## Yields

Recent interest rates increases have pushed yields to "fair value" in most markets. However, this may not be the case in 2007. In Sydney the prime yield contracted to between 5.50% – 6.25%, the lowest level since 1990.

\* Source: Jones Lang LaSalle Research's Real Estate Intelligence Service. December 2006.

# Fund review – The Commercial Office Fund

As at the quarter ended 31 December 2006

Unit Price	\$1.1027
Portfolio Size	\$520m
Distribution (quarter) cents per unit	2.1000c
Distribution (rolling 12 months) cents per unit	8.3000c
Distribution Yield (rolling 12 months)	8.30%

## Performance data

	Distribution yield (%)	Capital growth (%)	Total return <sup>1</sup> (%)	Tax effective <sup>2</sup> (%)
1 Year (annualised)	8.30	10.27	18.57	100.00

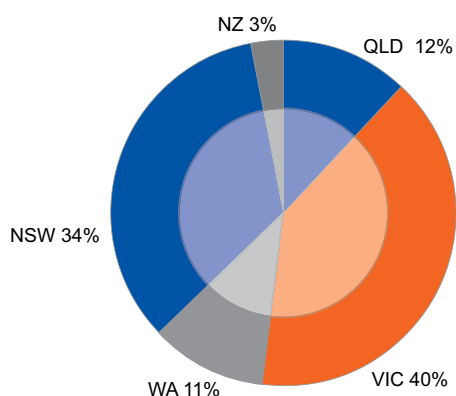
<sup>1</sup> Returns are net of all management fees and Fund expenses.

<sup>2</sup> Tax effective figures are based on estimated numbers for the year ended 30 June 2006.

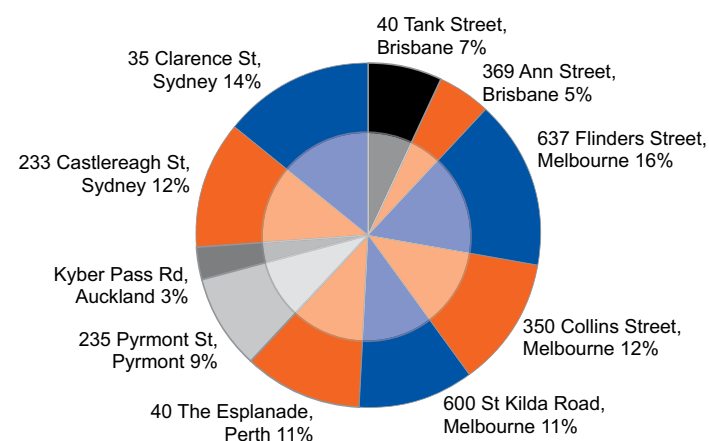
## Tenancy mix

	Location	By net lettable area (%)	By gross income (%)
Victorian Police	637 Flinders St, VIC	20.10	18.01
Sinclair Knight Merz	369 Ann St, QLD	4.78	5.18
John Holland	235 Pyrmont St, NSW	3.76	3.52
Aker Kvaerner	600 St Kilda Rd, VIC	3.72	3.10
Wesfarmers House	40 The Esplanade, WA	3.62	4.48
Queensland Police	40 Tank St, QLD	3.26	2.18
George Patterson	35 Clarence St, NSW	2.51	4.55
Horwath Melbourne Partnership	600 St Kilda Rd, VIC	2.26	2.11
Kings Parking	40 Tank St. QLD	N/A	3.03
Other tenants	Various	58.25	53.84
<b>Total</b>		<b>100</b>	<b>100</b>

## Geographic allocation as at 31 December 2006



## Asset mix as at 31 December 2006



## Average lease duration

The Fund's weighted average lease expiry (WALE) is 3.87 years as at 31 December 2006.

The WALE is still relatively short, in part due to Ann Street, Brisbane, Pyrmont Street, Sydney and Wesfarmers House, Perth. All of which are in markets that we expect to continue to improve, with tightening vacancy rates and increases in rents.

## Fund commentary

Although the Fund made no new acquisitions over the quarter, it continued to actively source quality office properties. The Fund revalued 5 assets at an average increase of 12.17%, which was reflected in a unit price of \$1.1027. This represents a 10.27% increase from the original unit price of \$1.00.

## Property in focus

### Victoria Police Centre

Centrally located at 637 Flinders Street, Melbourne, these two linked office buildings are 5 and 10 levels respectively. The property comprises 23,050m<sup>2</sup> of lettable commercial office space, fully leased to Victoria Police.



Victoria Police Centre, 637 Flinders Street, Melbourne, VIC

### 350 Collins Street, Melbourne VIC

Located in the heart of Melbourne's CBD, this property comprises 15 levels of office space, a ground floor retail space and basement car parking for 65 vehicles. With 70 tenants including Austock Group, CSBC, and Citibank, the building has 17,770m<sup>2</sup> of lettable commercial space.



350 Collins Street, Melbourne, VIC

For further information,  
please contact your PIS financial adviser  
or call SAITeysMcMahon on 1800 008 494

[www.saiteysmcmahon.com](http://www.saiteysmcmahon.com)

**Commercial Office Fund**

**ARSN 115 845 871**

**Discovery Investment Services Corporation Limited**

**ABN 74 100 299 125**

**SAITeysMcMahon Securities Pty Limited**

**ABN 16 091 909 376**

**Holder of Australian Financial Services Licence No. 241053**

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SAITeysMcMahon Property Limited ABN 90 006 387 435 AFSL No. 233191 is the issuer of interests in Commercial Office Fund and is a related body corporate of SAITeysMcMahon Securities Pty Limited.

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