



Investa Funds Management Limited  
ACN 120 839 447  
AFSL 303614

5 March 2009

[Name]  
[Address]  
[Address]  
[City] [State] [Postcode]

Level 6 Deutsche Bank Place  
126 Phillip Street  
Sydney NSW 2000  
GPO Box 4180  
Sydney NSW 2001  
Australia

Dear Unitholder

### **Investa Second Industrial Trust (Trust) - Mid-term review**

As foreshadowed in my letter dated 22 December 2008, Investa Funds Management Limited has now completed its mid-term review of the Trust. We recommend that the Trust continue in its current form until capital markets recover and an exit strategy can be developed which is in the best interests of Unitholders.

We considered three options prior to making our recommendation. They were:

- Option 1:* To continue the Trust in its current form until capital markets recover and an exit strategy can be developed which is in the best interests of Unitholders – this is our recommended option. If the Trust continues, we anticipate that the current distribution rate will be maintainable over the next two years. However, this is subject to a number of risks that are further explained in the attached Explanatory Memorandum (**EM**);
- Option 2:* To sell all the Properties now and wind up the Trust – this is not recommended. Forced vendors are selling properties at significant discounts to the carrying values in the current market which would adversely impact the Trust's returns. If forced to sell all of the Trust's assets within the next 3 to 6 months, we would expect that returns to Unitholders would be less than those available under Option 1; and
- Option 3:* To restructure the Trust and provide a limited liquidity opportunity for those Unitholders who wish to exit in part or in full. The implementation of this option would require new equity and debt to be raised which is unlikely to occur in the current capital constrained environment. If this option becomes viable in the future, we may seek formal approval from Unitholders by way of a special resolution to amend the Constitution of the Trust in order to implement it.

These three options are considered in more detail in the attached EM. After reading the EM, we invite you to provide feedback on our recommendation by **completing the attached feedback form and returning it to us by 3 April 2009**.

Following the closing date for Unitholder feedback, we will advise all Unitholders of the changes (if any) to our recommendation as a result.

If you have any questions about this letter, the EM, the feedback form or about the Trust generally, please call our Client Services team on 02 8226 9342 or email us at [clientservices@investa.com.au](mailto:clientservices@investa.com.au).

Yours sincerely

A handwritten signature in blue ink, appearing to be "Paul Cull".

**Paul Cull**  
**Fund Manager**  
**Investa Funds Management Limited**



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ACN 120 839 447  
AFSL 303614

Level 6 Deutsche Bank Place  
126 Phillip Street  
Sydney NSW 2000  
GPO Box 4180  
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# Investa Second Industrial Trust Unitholder Feedback Form

Unitholder Name: [Name]  
SRN: [SRN]  
Number of Units: [Units]

## Feedback Opportunity

This form provides an opportunity for Unitholders to provide feedback on the recommendation by Investa Funds Management Limited (the **Manager**) as to the future of the Trust following the mid-term review, as discussed in the attached Explanatory Memorandum (**EM**).

Please note that this is not a vote of Unitholders. Instead, this is an opportunity for you to provide your views to the Manager and for the Manager to consult with Unitholders in relation to the future of the Trust.

## Recommendation

The Manager recommends that the Trust continue in its current form until capital markets recover and an exit strategy can be developed which is in the best interests of Unitholders.

## Unitholder Feedback *(Please tick one of the boxes below)*

**I agree** with the Manager's recommendation:

- Option 1:* to continue the Trust in its current form until capital markets recover and an exit strategy can be developed which is in the best interests of Unitholders.

**I do not agree** with the Manager's recommendation and would prefer:

- Option 2:* to sell all the Properties now and wind up the Trust. I understand that if forced to sell now, the sales are likely to occur at a substantial discount to the current book value of the properties in order to effect a sale; or
- Option 3:* to restructure the Trust now and provide a limited liquidity opportunity for those Unitholders who wish to exit in part or in full. I understand that it is highly unlikely that the Manager can implement this option in this capital constrained environment, and if it were to be implemented there may be redundant capital raising costs if it is not successful. Practically, I acknowledge that this option may become available in the future if Option 1 is implemented.

## Comments

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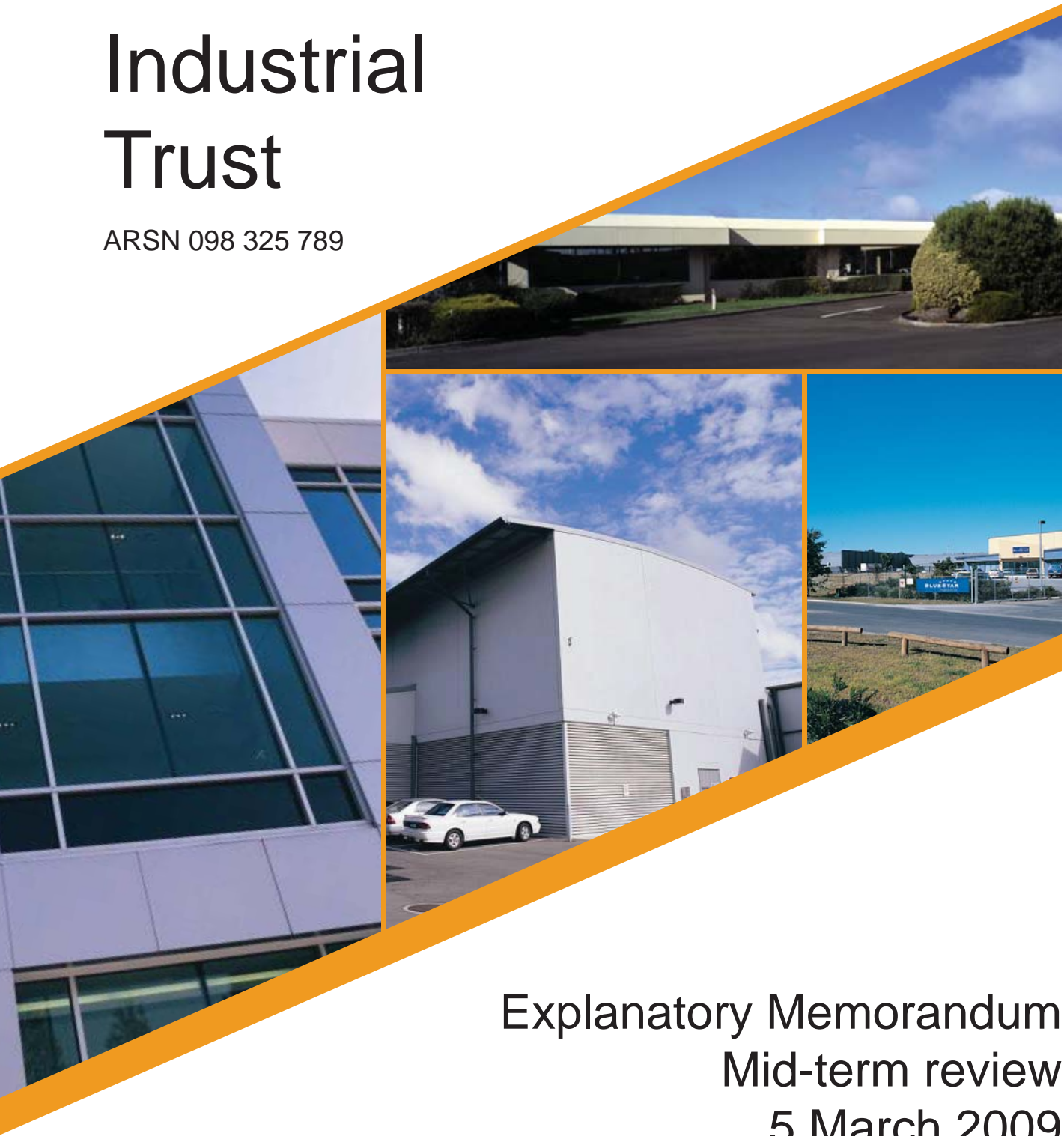
**Please return this form to Investa by 3 April 2009 in one of the following ways:**

- using the enclosed reply paid envelope;
- by emailing it to [clientservices@investa.com.au](mailto:clientservices@investa.com.au); or
- by faxing it to us on 02 9844 9342.



# Investa Second Industrial Trust

ARSN 098 325 789



Explanatory Memorandum  
Mid-term review  
5 March 2009

## **1. Why are you receiving this document?**

### **1.1 Mid-term review**

The Prospectus for the Investa Second Industrial Trust (**Trust**) states that: “In 2008 Unitholders will be consulted on the future strategy for the Properties including possible sale. Given the cyclical nature of property markets, the timing of a possible sale needs to be flexible.” “If market conditions are appropriate and a satisfactory sale price can be achieved then the Properties may be offered for sale. Otherwise, the Responsible Entity will recommend an exit strategy to be implemented at an appropriate future time.”

The timing for this strategic review is 6 years after establishment of the Trust in 2002, which is a mid point of the 12 year term of the Trust.

In May 2008, Investa Funds Management Limited as the Responsible Entity of the Trust (the **Manager**) wrote to Unitholders advising that:

- the Manager’s preferred exit strategy, prior to completing the Manager’s review, was to open up the Trust’s mandate to acquire further properties and provide a limited ‘cash out’ liquidity facility for those Unitholders who wished to exit their investment; and
- the continuing uncertainty in the financial markets had constrained the Manager’s ability to develop the preferred exit strategy and delayed the announcement of the outcome of the Manager’s review.

Since that time there has been considerable deterioration in the financial and property markets worldwide. It is against this background that the Manager has completed its review, and the Manager has set out its findings in this Explanatory Memorandum (**EM**).

### **1.2 Purpose of this document**

The purpose of this document is to:

- provide Unitholders with details of the three options the Manager considered during its review;
- provide Unitholders with the reasons for the Manager’s proposed recommendation; and
- invite Unitholders to provide feedback on the Manager’s recommendation.

### **1.3 Important information and disclaimers**

This EM is dated 5 March 2009 and is issued by Investa Funds Management Limited (ABN 48 120 839 447) as the Manager of the Trust. The Manager has prepared this EM based on information within its knowledge or provided by its advisers.

The information contained within this EM is current as at the date of issue. Any material updates to the information contained within this EM will be notified to Unitholders, and will be made available on the Manager’s website at [www.investa.com.au/FundsManagement/ISIT/](http://www.investa.com.au/FundsManagement/ISIT/). Unitholders should check the website from time to time.

Capitalised terms in this EM have the same meaning given to that expression in the Prospectus for the Trust dated 30 April 2002 (**Prospectus**).

This EM is not a product disclosure document for the purposes of the Corporations Act 2001 (Cth) and accordingly is unlikely to contain all the information that is required to be contained in such document. This EM contains statements regarding Trust targets and certain future matters. There is no assurance that any of those matters will occur, and future events may differ from those assumed or envisaged in this EM. Unitholders should therefore rely on their own enquiries, particularly in deciding whether or not to acquire or dispose of units in the Trust.

**Investa Second Industrial Trust**  
**Explanatory Memorandum – Mid-term review**

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Investments in the Trust are not investments, deposits or other liabilities of the Manager, Investa Property Group, Morgan Stanley Real Estate (**MSRE**) or other members of the MSRE Group. An investment in the Trust is subject to investment and other risks as described in the Prospectus, including possible delays in repayment and loss of income and principal invested. None of the Manager, Investa Property Group, MSRE or any other Investa or MSRE Group entity guarantees any particular rate of return or the performance of the Trust, nor do they guarantee any repayment of capital.

## **2. Option 1: Continue the Trust in its current form**

### **2.1 Description of Option 1**

Under this option, the Trust would continue to operate as it has for the last six years until the capital markets recover and an exit strategy can be developed which is in the best interests of Unitholders. The Manager is of the opinion that the current market volatility may remain for another one to two years and a suitable exit strategy is unlikely to be able to be developed and executed during this period. Individual property sales, including the sale of 8 - 10 Kitchen Road, Dandenong, will continue to be considered on a case-by-case basis.

### **2.2 Trust background and properties**

The Trust is a 12-year closed end fund which commenced on 14 June 2002. It currently has total assets of \$60.2m comprising cash, receivables and investments in four industrial properties, namely:

- 2 Eden Park Drive, North Ryde NSW;
- 23 - 25 Waterloo Road, North Ryde NSW;
- 8 - 10 Kitchen Road, Dandenong VIC; and
- 101 Beenleigh Road, Acacia Ridge QLD.

Further information on these properties is contained in the Prospectus and the latest Quarterly Report sent to Unitholders on 9 February 2009.

In the quarter ending 31 December 2006, the Manager sold the Trust's second largest property located at 131 Beenleigh Road Acacia Ridge, Queensland. The profit on sale, combined with the profit from the sale of excess floor space ratio at 23 - 25 Waterloo Road, North Ryde, delivered a return of capital of \$0.424826 per unit to Unitholders in February 2007.

In October 2008, the Manager sought to sell another property located at 8 - 10 Kitchen Road, Dandenong, following the local Council's consent to a two lot subdivision of the land. The Manager received four offers for the property, all of which were below the then book value of \$10.8m. A call for second round offers to short-listed parties resulted in the highest bidder withdrawing their offer. This level of demand and pricing expectation is consistent with the broader property sector in this current climate (see section 3.2 below which discusses property market conditions in more detail). Based on the offers received, the Manager has not sold the Dandenong property as the Manager considered the offers not to be in the best interests of Unitholders. The property remains for sale.

### **2.3 Trust borrowings**

Much focus has been on the borrowing levels of all property investment vehicles since the start of the global financial crisis. As at 31 December 2008, the Trust has borrowed \$23.85m against total property assets of \$59.25m (resulting in a loan to value ratio (**LVR**) of 40.2%). This compares favourably with the bank's LVR covenant of 55%. Even if property values fall by another 25%, the Trust will still comply with its LVR covenant. These borrowings will mature in July 2010 and will need to be refinanced before this time if Option 1 is implemented.

The Trust has entered into a number of interest rate derivatives in line with its policy to minimise the sensitivity of the Trust's earnings to changes in interest rates. As at 31 December 2008, over 80% of the Trust's borrowings were hedged (fixed) using interest rate swaps. These hedges expire in line with the expiry of the Trust's term debt (i.e. July 2010). A new hedge was put in place in January 2009 which fixes \$10m of the Trust's debt from July 2010 to July 2011 at a much lower rate than the previous hedges. The Manager is considering the benefits of putting even more hedges in place from beyond July 2010. All new hedges will improve the earnings of the Trust beyond July 2010 if they are put in place at a rate below the current hedges (assuming all other things remain equal).

## Investa Second Industrial Trust Explanatory Memorandum – Mid-term review

### 2.4 Historical Trust returns

The Trust has met distribution forecasts for all periods contained in the Prospectus (i.e. from inception through to 30 June 2007). The table below summarises the Trust's distribution history and its net tangible assets (**NTA**) per unit since inception. The total return since inception is 16.3% p.a. as at 31 December 2008.

**Table 1: Historical Trust returns**

	Year ending 30 June						
	2003	2004	2005	2006	2007	2008	2009 (Half Yr)
<b>Distribution (cents per unit)</b>	9.25	9.52	10.00	10.24	49.89 <sup>1</sup>	5.00	2.20
<b>Net capital subscribed (\$/unit)</b>	1.0000	1.0000	1.0000	1.0000	0.5752 <sup>1</sup>	0.5752	0.5752
<b>Distribution yield on net capital (p.a.)</b>	9.3%	9.5%	10.0%	10.2%	12.9% <sup>2</sup>	8.7%	7.6%
<b>NTA (\$/unit)</b>	0.92	0.92	0.91	1.48	1.16	1.33	1.16
<b>Distribution yield on NTA (p.a.)</b>	10.1%	10.3%	11.0%	6.9%	6.4% <sup>2</sup>	3.7%	3.8%
<b>Total return since inception (p.a.)</b>	1.2%	5.7%	6.9%	19.4%	18.6%	18.7%	16.3%

Notes:

1. The December 2006 quarterly distribution (paid in February 2007) included a return of capital of 42.4826 cents per unit following the sale of 131 Beenleigh Road, Acacia Ridge, QLD and the sale of excess floor space ratio at 23 - 25 Waterloo Road, North Ryde, NSW.
2. Distribution yield calculations exclude one off amounts returned as capital.

Following the disposal of 131 Beenleigh Road, Acacia Ridge, distributions immediately reduced in line with the significant loss of income from this property. Since then, property income from the remaining assets has continued to grow in line with rent reviews, although distributions have been reducing because financing costs have increased at a faster rate.

Notwithstanding the reduction in the distribution rate, the current quarterly distribution rate of 1.1 cents per unit represents an annual distribution yield of:

- 7.6% p.a. of net capital subscribed (i.e. the \$1.00 original investment less the capital return of 42.4826 cents per unit in February 2007); and
- 3.8% p.a. on the current NTA (as at 31 December 2008).

### 2.5 Distribution outlook for the next two years

Subject to the risks outlined in section 2.7 below, the Manager anticipates that the quarterly distribution rate for the next two years will remain stable at around 1.1 cents per unit.

More specific distribution guidance cannot be provided due to the significant uncertainty in the current economic environment. In particular, the Manager expects the distribution rate to be most sensitive to the following factors:

- economic conditions impacting on property valuations (and associated Manager fees), market rents, downtime on re-leasing and tenants' ability to meet lease commitments;
- costs of refinancing and interest rate movements; and
- lease expiries, renewals and incentives.

**2.6 Advantages of continuing the Trust in its current form**

By continuing the Trust, the Manager can implement an exit strategy in the future when the global financial crisis abates, and sell the properties at a time when property market conditions are more favourable. Depending on the speed and extent in the recovery of property markets, this is likely to deliver higher total returns to Unitholders than selling all of the Trust's properties now.

In addition, the taxation implications associated with continuing the Trust in its current form are no different to those currently existing.

**2.7 Disadvantages and risks of continuing the Trust**

There are risks associated with continuing the Trust. The main risks considered by the Manager are detailed in the table below.

**Table 2: Risk assessment – Option 1**

<b>Risk</b>	<b>Description</b>																				
Property valuation risk	<p>The current valuation of the Trust's properties has been determined by independent valuations based on a range of factors. These factors continue to change over time as market conditions change. Apart from movement in effective market rents, two of the most important factors that change over time are the rate at which the passing net market rent is capitalised (i.e. the capitalisation rate) and the rate at which future cash flows are discounted (i.e. the discount rate) to derive a property valuation (after certain adjustments). The weighted average capitalisation rate of the Trust's properties is 7.9% p.a. as at 31 December 2008. As a point of comparison, the weighted average capitalisation rate for the same properties at inception of the Trust was 9.1% p.a.</p> <p>If Option 1 is implemented, there is a risk that the value of the Trust's properties may fall below current values; however, values may also increase over time as the property cycle continues to evolve.</p>																				
Refinancing risk	<p>The Trust's borrowings expire in July 2010. As the Trust may need to continue beyond this date if Option 1 is implemented, it is likely that the Trust will need to refinance its debt facility prior to expiry. Given that the Trust is currently well within its financial covenants, the Manager anticipates that the Trust will be able to refinance (although, depending on the state of the credit markets at the time of refinancing, the cost of debt including fees may be higher or lower). A cost of debt which is 1% higher (or lower) than the Trust's current cost of debt may reduce (or increase) quarterly distributions by 0.22 cents per unit.</p> <p>If the sale of a property proceeds prior to refinancing, the repayment of debt from the sales proceeds (and associated reduction in gearing) will significantly reduce the refinancing risk. This is based on the desire of financiers in general to reduce LVR's and to increase the frequency of valuations for properties used as security for the loan.</p> <p>The sensitivity of the Trust's LVR to the risk of future reductions in the value of all four of the Trust's properties is illustrated in the following table.</p> <p><b>Table 3: LVR vs property value reductions</b></p> <table border="1"> <thead> <tr> <th rowspan="2"></th> <th colspan="6">Reduction in property values as at 31 December 2008</th> </tr> <tr> <th>0%</th> <th>5%</th> <th>10%</th> <th>15%</th> <th>20%</th> <th>25%</th> </tr> </thead> <tbody> <tr> <td>LVR</td> <td>40%</td> <td>42%</td> <td>44%</td> <td>47%</td> <td>50%</td> <td>54%</td> </tr> </tbody> </table>		Reduction in property values as at 31 December 2008						0%	5%	10%	15%	20%	25%	LVR	40%	42%	44%	47%	50%	54%
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**Investa Second Industrial Trust**  
**Explanatory Memorandum – Mid-term review**

Risk	Description																								
Covenant breach risk	<p>The Trust is required under the current lending agreements to satisfy the following financial undertakings (or covenants):</p> <ul style="list-style-type: none"> <li>• Minimum interest cover of 1.50 times tested 6 monthly on a rolling 12 month basis; and</li> <li>• Maximum LVR of 55%.</li> </ul> <p>As at 31 December 2008, as noted elsewhere in this EM, the Trust was in compliance with these covenants. There have been no material changes to the Trust's level of compliance since then.</p> <p>Any failure to comply with these financial covenants is as an event of default. If such an event were to occur, the lender may declare at any time by notice (amongst other rights) that the amount owing becomes immediately due and payable.</p> <p>The financial undertakings which are agreed upon refinancing the term debt may differ from those currently in force.</p>																								
Interest rate risk	<p>Over 80% of the Trust's borrowings have been hedged using interest rate derivatives until July 2010 (when the Trust's borrowings mature) which significantly reduces exposure to future interest rate increases up to this time.</p>																								
Derivative valuation risk	<p>The estimated cost (or benefit) to terminate the Trust's interest rate derivatives is classified as a liability (or asset) in the Trust's accounts. The resulting 'value' of these derivatives (and therefore the Trust's total returns) changes as expectations of future interest rates change. However, this risk will reduce over time because the current value of existing hedges will unwind to nil as they reach their expiry (the majority of which currently expire in July 2010).</p>																								
Lease expiry risk	<p>The following table illustrates that leases representing 19.1% of the Trust's passing annual gross property income (as at 31 December 2008) expire over the next two and a half years (i.e. through until 30 June 2011). The earnings of the Trust (and hence distributions) may reduce if these leases are not renewed when they expire.</p> <p><b>Table 4: Lease expiry schedule</b></p> <table border="1" data-bbox="616 1447 1383 1823"> <thead> <tr> <th data-bbox="616 1447 871 1536">Lease expiry in financial year ending:</th> <th data-bbox="871 1447 1126 1536">Value of leases expiring (by income) <sup>1</sup></th> <th data-bbox="1126 1447 1383 1536">Cumulative value of all leases expiring (by income) <sup>1</sup></th> </tr> </thead> <tbody> <tr> <td data-bbox="616 1536 871 1581">Vacant</td> <td data-bbox="871 1536 1126 1581">2.0%</td> <td data-bbox="1126 1536 1383 1581">2.0%</td> </tr> <tr> <td data-bbox="616 1581 871 1626">June 2009</td> <td data-bbox="871 1581 1126 1626">3.2%</td> <td data-bbox="1126 1581 1383 1626">5.2%</td> </tr> <tr> <td data-bbox="616 1626 871 1671">June 2010</td> <td data-bbox="871 1626 1126 1671">4.0%</td> <td data-bbox="1126 1626 1383 1671">9.2%</td> </tr> <tr> <td data-bbox="616 1671 871 1715">June 2011</td> <td data-bbox="871 1671 1126 1715">9.9%</td> <td data-bbox="1126 1671 1383 1715">19.1%</td> </tr> <tr> <td data-bbox="616 1715 871 1760">June 2012</td> <td data-bbox="871 1715 1126 1760">20.3%</td> <td data-bbox="1126 1715 1383 1760">39.4%</td> </tr> <tr> <td data-bbox="616 1760 871 1805">June 2013</td> <td data-bbox="871 1760 1126 1805">11.9%</td> <td data-bbox="1126 1760 1383 1805">51.3%</td> </tr> <tr> <td data-bbox="616 1805 871 1823">June 2014+</td> <td data-bbox="871 1805 1126 1823">48.7%</td> <td data-bbox="1126 1805 1383 1823">100%</td> </tr> </tbody> </table> <p>Note:</p> <p>1. Value of leases expiring is calculated as the annual passing gross income available from the lease as a percentage of passing gross income available from all leases within the portfolio as at 31 December 2008.</p> <p>The level of leasing risk implied by this lease expiry profile is typical for most property funds.</p>	Lease expiry in financial year ending:	Value of leases expiring (by income) <sup>1</sup>	Cumulative value of all leases expiring (by income) <sup>1</sup>	Vacant	2.0%	2.0%	June 2009	3.2%	5.2%	June 2010	4.0%	9.2%	June 2011	9.9%	19.1%	June 2012	20.3%	39.4%	June 2013	11.9%	51.3%	June 2014+	48.7%	100%
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**Investa Second Industrial Trust**  
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Risk	Description																
	<p>The expiry risk over the next two and a half years is represented by 8 leases at 2 Eden Park Drive, North Ryde. Some persisting vacancy at 2 Eden Park Drive is expected during this period. However, leasing demand is expected to be supported in an otherwise difficult market by the asset's strategic location as well as limited competition for this type of property.</p> <p>An additional 20.3% of property income is due to expire in the following year ending 30 June 2012 and is represented by 3 small leases at 2 Eden Park Drive, North Ryde, together with the lease to Startronics at 8 - 10 Kitchen Road, Dandenong. The income from the Startronics lease currently represents 14% of all gross property income as at 31 December 2008. However, even if Startronics vacates and the property remains vacant for 12 months, the interest cover debt covenant can still be maintained (all other things being equal). Any increases in rent within the portfolio secured over the next 3 years, together with the prospects for additional hedging to reduce interest costs, will help to offset the earnings risk in this period.</p>																
Tenant default risk	<p>The current global financial crisis increases the risk that a tenant will default on their lease commitments, including payment of rent on time and in full. The following table illustrates the concentration of the Trust's risk to any one tenant.</p> <p><b>Table 5: Tenant concentration</b></p> <table border="1" data-bbox="616 1012 1383 1368"> <thead> <tr> <th data-bbox="616 1012 1002 1057">Tenant</th> <th data-bbox="1002 1012 1383 1057">% of Trust's property income</th> </tr> </thead> <tbody> <tr> <td data-bbox="616 1057 1002 1102">Fujitsu</td> <td data-bbox="1002 1057 1383 1102">22.9%</td> </tr> <tr> <td data-bbox="616 1102 1002 1146">Startronics</td> <td data-bbox="1002 1102 1383 1146">14.0%</td> </tr> <tr> <td data-bbox="616 1146 1002 1191">Bluestar Logistics</td> <td data-bbox="1002 1146 1383 1191">9.4%</td> </tr> <tr> <td data-bbox="616 1191 1002 1236">NuSkin</td> <td data-bbox="1002 1191 1383 1236">7.3%</td> </tr> <tr> <td data-bbox="616 1236 1002 1281">Carl Zeis</td> <td data-bbox="1002 1236 1383 1281">5.9%</td> </tr> <tr> <td data-bbox="616 1281 1002 1326">Remaining (18) tenants</td> <td data-bbox="1002 1281 1383 1326">40.5%</td> </tr> <tr> <td data-bbox="616 1326 1002 1368"><b>Total</b></td> <td data-bbox="1002 1326 1383 1368"><b>100.0%</b></td> </tr> </tbody> </table> <p>The Manager is not aware of any deterioration in the payment history of any of the tenants in the portfolio to date, and will continue to monitor the efficiency of rent and other payments owing from tenants.</p>	Tenant	% of Trust's property income	Fujitsu	22.9%	Startronics	14.0%	Bluestar Logistics	9.4%	NuSkin	7.3%	Carl Zeis	5.9%	Remaining (18) tenants	40.5%	<b>Total</b>	<b>100.0%</b>
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<b>Total</b>	<b>100.0%</b>																
Net property income risk	<p>Apart from the risks to property income outlined above, over 80% of the rent reviews in FY09 are fixed or CPI related (rather than market driven) which provides significant support for forecast income levels.</p>																

**2.8 The Manager's assessment of this option – recommended**

Overall, the Manager considers that the advantages of continuing the Trust in its current form significantly outweigh the disadvantages and risks, particularly in this difficult capital market. Whilst the timing for the recovery of capital markets is difficult to predict, the Manager considers that the current market volatility may remain for another one to two years. Depending on the speed and extent in the recovery of property markets, Option 1 is likely to deliver higher total returns to Unitholders than selling all of the Trust's properties in the current market.

### **3. Option 2: Sell all properties now and wind up the Trust**

#### **3.1 Description of Option 2**

Under this option, the Trust would put all properties up for sale as soon as practicable and sell each property at the best offer available in the market – even if this means selling the property at a significant discount to current book value. If no offers are received for a property, the property would be put up for sale again after a reasonable period of time. Proceeds from the sale of the properties, net of all Trust liabilities, would be progressively distributed to Unitholders. Once all properties were sold, the Trust would be wound up as soon as practicable.

#### **3.2 Property market conditions – not an appropriate time to sell**

The current property market is characterised by a significant excess of sellers over buyers in all sectors, which is serving to drive both property prices and sales rates in a downward direction.

Anecdotal evidence suggests limited sales are continuing to occur between willing (but not anxious) sellers to cashed up investors at, or slightly below, book value. More motivated (or forced) sellers are exchanging properties at significant discounts to carrying values – with reports of discounts to carrying values of even 25% in some cases. As discussed in section 2.2 above, the limited appetite for property has been experienced directly by the Trust in the call for expressions of interest for 8 - 10 Kitchen Road, Dandenong.

To date, valuers are considering these ‘forced sales’ as being outside the definition of market value (i.e. between a willing, but not anxious, buyer and seller), as sellers are more than anxious and buyers are often less than willing as they consider future values may drop below current values as economic conditions continue to worsen. As property valuations are based on market value, these ‘forced sales’ are not currently impacting on the valuation of the Trust’s assets.

Distressed or forced sales are highly likely to occur at passing yields at or in excess of 10% p.a. as most prospective buyers are seeking a risk premium for entering the market at this point in the cycle. If the Trust’s properties were to be sold in the current market, they would be competing with these distressed sales which are transacting at up to 25% below book value.

The Manager is therefore of the view that realising assets in the current market is likely to result in a lower price for the assets than if the assets were realised at a future time when depth to the market (and hence competitive tension) returns. Selling assets now is therefore likely to dilute Unitholder returns.

#### **3.3 Advantages of selling all properties and winding up the Trust**

An immediate sale and winding up will bring certainty to Unitholders regarding the financial performance of their investment in the face of deteriorating economic conditions. However, given current market conditions, the precise level of total return achievable from such a sale and wind-up is difficult to ascertain. Table 6 in section 3.4 below provides some sensitivities as a guide to Unitholders.

The liquidity provided from the return of capital following the sale and wind-up of the Trust would also be an advantage for those Unitholders who value liquidity above the returns available from continuing their investment in the Trust.

### **3.4 Disadvantages of selling all properties and winding up the Trust**

The key disadvantage for this option is that the total returns to Unitholders are likely to be less under this option compared to Option 1 because:

- the properties are likely to be sold at a significant discount to ‘fair market value’ given the lack of liquidity in the property market and the continuing deterioration in economic conditions; and
- existing interest rate hedges would need to be cancelled at a time when they are ‘out of the money’. As at 31 December 2008, the estimated costs to cancel the Trust’s hedges was \$1.3m. This cost will vary as expectations of future interest rates continue to change. This cost will gradually unwind to nil as the majority of hedges reach their expiry date in July 2010.

The effect of the discount to ‘fair market value’ on the Trust’s total returns since inception (assuming the properties are sold in the current market and the Trust is wound up on 31 December 2009) is illustrated in the following table:

**Table 6: Sensitivity analysis – Total returns since inception vs discount on sale**

	Discount to current book value			
	0%	10%	20%	30%
Passing Yield (p.a.)	8.0%	8.9%	10.0%	11.5%
NTA per unit post sale	\$1.16	\$0.94	\$0.72	\$0.50
Total returns since inception (to 31 December 2009) (p.a.)	16.3%	14.2%	11.7%	8.9%

As market conditions exhibit a real risk of sale discounts in excess of 20%, Unitholder returns are likely to reduce to less than those available under Option 1 if the Manager is forced to sell all of the Trust’s properties in the current market. In addition, redundant selling and marketing costs may be incurred if the properties fail to sell in the initial campaign, and these costs are not factored into the above analysis.

The sale of all properties would also crystallise any capital gains tax liabilities for Unitholders.

### **3.5 The Manager’s assessment of this option – not recommended**

Property markets have not escaped the global financial crisis. If the Manager was forced to sell the Trust’s properties in this current environment, total returns to Unitholders are likely to reduce to below those anticipated under Option 1. The Manager does not therefore recommend selling all of the Trust’s properties at this time.

## **4. Option 3: Restructure the Trust by raising new capital**

### **4.1 Description of Option 3**

Under this option, the Constitution of the Trust would need to be amended (subject to Unitholder approval by way of a special resolution) to:

- allow the Trust to raise more equity and to invest in further properties to enhance the benefits to Unitholders of greater scale and diversification;
- create an “open ended” Trust by removing the fixed expiry date for the Trust; and
- provide for limited liquidity options which would permit existing Unitholders to redeem some or all of their units, subject to availability.

This option will require the Manager to access the capital markets (both debt and equity) to invest in further properties and fund the necessary liquidity required for those Unitholders who wish to exit.

### **4.2 Capital market conditions are bearish**

Since late 2007, the effects of the global financial crisis have adversely impacted property stocks on the Australian Securities Exchange (ASX). During the course of the last 12 months (to 31 December 2008) listed property stocks on the ASX (S&P/ASX A-REIT Index) fell 57.4% and the general equities market on the ASX (S&P/ASX 200) fell 41.3%. Most of the volatility in these prices has been driven by weakening economic conditions and tight credit conditions in global financial markets, which has been reported in the media every day.

### **4.3 Debt is scarce and expensive**

In an effort to stimulate economic growth and restore some calm to financial markets, central banks around the world have slashed interest rates and continue to do so. Whilst interest rates are falling quickly, sourcing debt finance remains difficult. Banks are now only providing debt finance to their key clients, and are not lending as much. When banks are lending, they are charging higher fees to their cost of debt – often 2 or 3 times higher than last year and with much tighter conditions.

### **4.4 Equity raisings are limited and often completed at a discount**

Some of the largest names in the listed property sector have recently raised equity at up to a 50% discount to the then current share price. In the unlisted property sector, the last equity raising completed was over a year ago in February 2008. This was not successful and the underwriters had to acquire a substantial number of units. The lack of equity flowing into property funds has been exacerbated by the Federal Government’s bank deposit guarantee scheme and, up until recently, the generally high level of interest rates.

### **4.5 Advantages of restructuring the Trust by raising new capital**

There are a number of advantages associated with restructuring the Trust. Subject to raising further capital (both debt and equity which is discussed in sections 4.3 and 4.4 above), existing Unitholders will have a greater diversification of properties, lower management costs given improved economies of scale, and may have a limited scope to withdraw from the Trust. However, raising further capital is unlikely in the next 6-12 months (and possibly longer), and these advantages are quickly outweighed by the disadvantages (see section 4.6 below).

### **4.6 Disadvantages of restructuring the Trust by raising new capital**

Capital in this global financial crisis is constrained and expensive. If the Manager was able to raise further capital in this environment, the increased cost of capital will dilute returns to existing Unitholders and is not recommended. Further, in order to provide some form of withdrawal arrangements for Unitholders who do not want to participate in the restructure or who want to exit the Trust at a future point in time, implementing this option will require an underwriter to commit to a minimum level of equity subscriptions. No financial or

property institutions are underwriting unlisted property funds in this current environment and existing Unitholders may incur substantial equity raising costs if a minimum level of equity cannot be raised.

**4.7 The Manager's assessment of this option – not recommended**

As capital (both debt and equity) is scarce and expensive, the Manager considers that raising equity will be dilutive to Unitholder returns. Further, if the Manager is not successful in raising a minimum level of subscriptions, redundant costs may be incurred. This will also adversely impact on Unitholder returns. The Manager does not therefore recommend this option in the current capital environment. Practically, this option may become available in the future if Option 1 is implemented.

## **5. Recommendation: Continue the Trust**

### **5.1 Recommendation**

The Manager recommends that the Trust continue in its current form until capital markets recover and an exit strategy can be developed which is in the best interests of Unitholders. This is discussed in section 2 of this EM above.

### **5.2 Complete the feedback form**

The Manager invites you to provide feedback on its recommendation by:

- completing the feedback form attached to the covering letter of this EM; and
- **returning the feedback form to us by 3 April 2009 in one of the following ways:**
  - by using the enclosed reply paid envelope;
  - by email to [clientservices@investa.com.au](mailto:clientservices@investa.com.au); or
  - by fax to 02 9844 9342.

The Manager does not intend to hold a meeting of Unitholders to discuss the options and its recommendation.

### **5.3 Implementing the Manager's recommendation**

Following the closing date for Unitholder feedback, the Manager will consider the feedback received and implement the option which it considers to be in the best interests of Unitholders. The Manager will advise all Unitholders of the changes (if any) to the Manager's recommendation as a result.

### **5.4 Questions?**

If you have any questions about this EM, the feedback form or about the Trust in general, please call the Manager's Client Services team on 02 8226 9342 or email them at [clientservices@investa.com.au](mailto:clientservices@investa.com.au).

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Graham Dunstan (Chairman)  
Scott MacDonald  
Deborah Page AM  
Robert (Gary) Reid

## Company Secretary

Jonathan Callaghan

## Fund Information

Investa Second Industrial Trust  
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ABN 19 635 318 874

## Auditor

PricewaterhouseCoopers

# QUESTIONS

Any questions about this Explanatory Memorandum or the performance of Investa Second Industrial Trust should be directed to Claire Gannon or the Fund Manager, Paul Cull.

Any questions about your unitholding, distribution and tax statements, or any change of details should be directed to Registries (Victoria) Pty Limited on 1300 131 040.



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