Quarterly Real Estate Market Update

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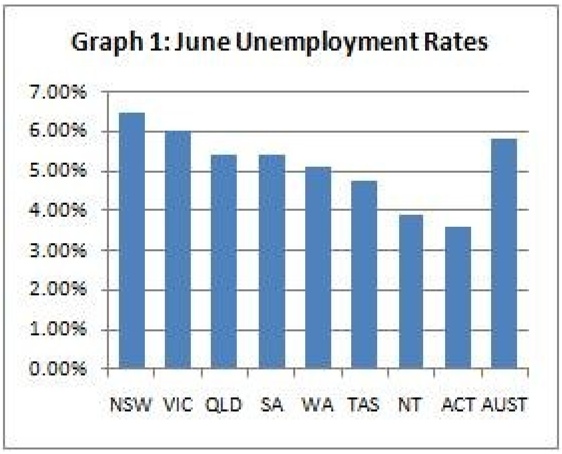
NEW SOUTH WALES

STATE ECONOMIC SITUATION

Due to its reliance on sectors such as finance, insurance and retail, the New South Wales economy has been hit hard by the global downturn. The state currently has a 6.5% unemployment rate, which, as Graph 1 shows, is the highest in the country.



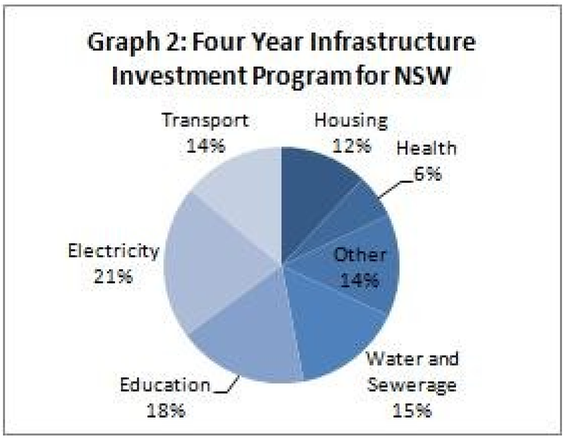
This reliance may in turn provide some confidence that the state may recover more quickly than others such as Western Australia and perhaps even end its decade-long pattern of under-performance.

The New South Wales Treasury agrees with the Federal Government that the state will return to respectable 2.25% growth in 2010-11, after contracting by 0.5% in 2009-10.

STATE BUDGET

Last November's 'Mini-Budget' introduced expenditure cuts, tax increases and a reprioritisation of the capital works program in order to preserve the state's AAA credit rating. With these uncomfortable decisions out of the way, the Rees Government was able to deliver a more attractive budget for 2009-10.

The NSW Government claims that the priority of the 2009-10 Budget is to support and invest in jobs and, accordingly, it will invest $62.9 billion over the next 4 yrs in "job supporting infrastructure".



Graph 2 illustrates how this infrastructure spending will be allocated. In fact, this budget includes record high levels of spending, raising the state's liabilities to the equivalent of $36,000 debt for every household. No new taxes have been introduced to cover the cost, although the abolition of some taxes has been delayed to raise revenue.

Housing features prominently in the New South Wales 2009-10 budget. A crucial budget measure for the housing sector is the new Housing Construction Acceleration Plan, which provides a 50% cut to stamp duty for newly-constructed dwellings up to $600,000 until the end of the year.

This discount is aimed at resuscitating the state's dismal construction rates. It is available to all buyers except first home buyers, as they already pay little or no stamp duty on purchases up to $600,000. The NSW Government has also extended its $3000 first home buyers supplement for newly-constructed homes until the end of June 2010.

SYDNEY HOUSING MARKET

Perhaps the most disappointing result for Sydney from the Infrastructure Australia projects announced by the Federal Government was the virtual canning of the Sydney West Metro project. It demonstrates three problems with such initiatives:

- The "hot and cold" attitude of the State Labor Government to infrastructure.
- The Federal Government's unwillingness to associate closely with a faltering State Government.
- The inherent problems associated with infrastructure development in Sydney, given its geography, population density and distribution.

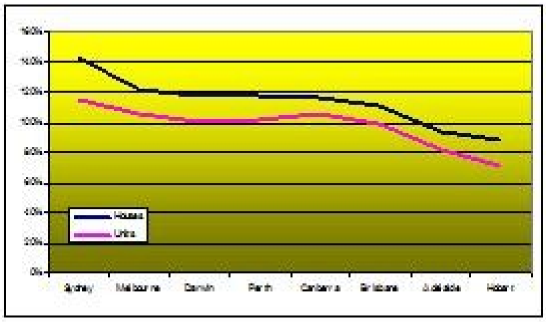
While the first two problems are temporary, the third is getting more acute as Sydney's overburdened population still grows at an annual rate of 1.3%. Developers are increasingly turning toward unit construction as this enables areas of high demand along the harbour, bay and ocean foreshores to be utilised to their maximum population density potential. It also encourages the redevelopment of old inner industrial and warehousing precincts. As a result, more units than houses were sold in Sydney last year and this is a growing trend.

Sydney's unit values increased by over 4% last year compared to virtually no growth in the house market and, while both are now in overall growth, recent increases have been higher for units than houses. For investors, the good news is that units also deliver higher rental yields and it is now possible to find many suburbs in Sydney's older western and south-western suburbs where unit rents can be positively geared. However, there are only a few outer western suburbs in Sydney where house rents provide such opportunities.

In our opinion, it is only the current regime of low interest rates that is providing a growth spurt to Sydney's house buyer market, and this will end as soon as the comparative affordability of renting is greater than that of purchase.

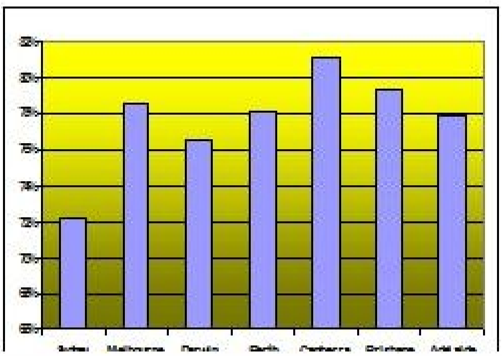
Graph 3 shows that Sydney's house value is 143% that of the national median, while units are just 115%. There is a disconnect between Sydney house and unit values which is greater than in other capital cities.

Graph 3: Capital City House and Unit Values Compared to the Australian Median Value



Graph 4 shows this in another way, with Sydney's median unit value only 72% of the median house value, which is far lower than in any other mainland capital city.

Graph 4: Unit Values Compared to House Values



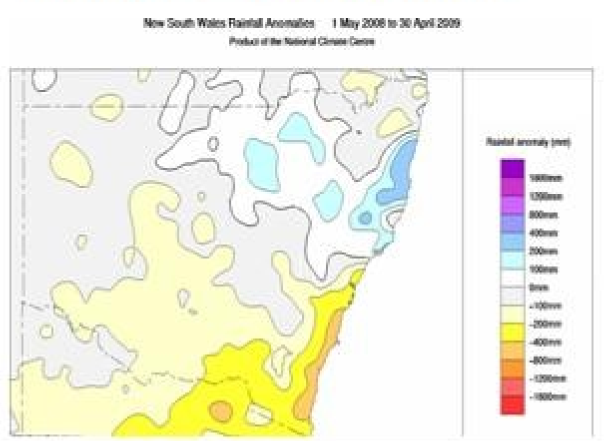
Only Adelaide and Hobart have unit median values which are much lower than Sydney's, with all other capital cities at or near 90% of the Sydney median unit value. The implications are obvious. Sydney units are comparatively underpriced and any increase in interest rates will only serve to drive more home buyers from the house market to the unit market.

RURAL HOUSING MARKET

Apart from the Pacific Highway bypass project, the major Infrastructure Australia project planned for New South Wales is the $1.45 billion Hunter Expressway. While this leaves the wish list largely unticked, the overall economic situation is far more positive for northern rural New South Wales than it has been for many years.

Graph 5 shows that the drought has well and truly retreated from northern parts of the state. In fact, recent heavy falls in the northern localities have already positively affected crop quality.

Graph 5: NSW 12 Month Rainfall Anomaly



The South Coast and central areas of the state remain a concern as wheat and canola sowing continues during the winter months, much of it dry sowing, while water carting continues in the south. Farmers have resorted to handfeeding, destocking and agistment to preserve viable livestock numbers.

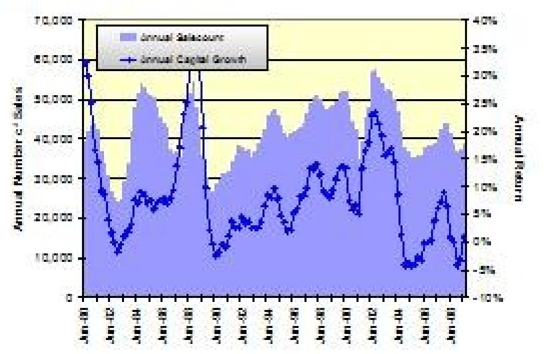
Other good news for the state's northern housing market, although not for the farmers, is the expected development of coal fields in the Gunnadah Basin. This is already having an impact on the residential housing market in the local towns, especially Quirindi, Narrabri and Gunnedah.

Overall, the impact of retiree arrivals, especially in towns and resorts along the north coast, will create higher growth in those markets than in most other areas. Housing markets in the larger population centres of rural NSW have had varied fortunes over the last few years. Wollongong has returned to growth after several years of experiencing small falls in value, while the Central Coast has suffered larger falls and is yet to return to growth. Newcastle has maintained modest growth for the last nine years, although in recent years there has not been any growth in real terms.

SYDNEY HOUSES – SALES & CAPITAL GROWTH

Graph 6 shows that there were 38,910 house sales in Sydney in the year ending June 2009, which is 5.6% less than the previous year. House sales rebounded slightly in the June quarter as first home owners rushed to take advantage of government grants.

Graph 6: Sydney Houses – Sales and Annual Returns



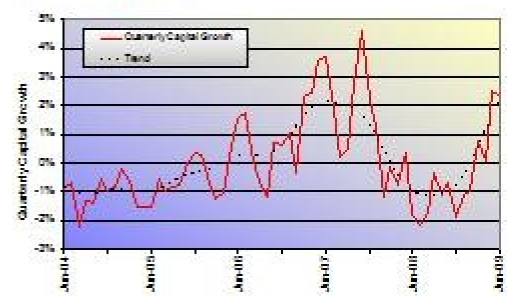
Although Sydney has a larger population, Melbourne had 10,000 more house sales over the past year, reflecting Sydney's move to unit dwelling that we have covered above. This is confirmed by Melbourne's unit sales being only 75% those of Sydney.

The median value of houses in Sydney is currently $577,500, which is still the highest in the country. However, the gap continues to close, due to growth in Darwin and Melbourne in particular. Sydney house prices grew by just 0.8% overall for the past year, compared to the ten-year annual growth average of 6.5%. Over the same period there was 14.8% growth in Darwin and 2.7% growth in Melbourne. Sydney had comparatively good growth of 2.3% in the June quarter, indicating that the market has picked up.

Indeed, Graph 7 illustrates that quarterly growth for Sydney houses is trending strongly upwards. Many suburbs have experienced growth of over 10% in the last year, especially first home buyer suburbs in the outer south-west, and this has spread into higher socio-economic suburbs such as

Canterbury, Putney, Rodd Point and Chifley. In the last quarter, growth in the lower priced suburbs has intensified, with a number of outer western and south-western suburbs experiencing increases of over 5%.

Graph 7: Sydney Houses – Quarterly Growth Trend



At the top end of the market in the eastern, north shore and northern beaches suburbs, falls of up to 8% or more occurred during the last year and there is no sign that the trend is over. It is interesting that those who referred to the Sydney house market as a "two tier" market when the reverse was happening, are now silent on this issue. It is actually a clear reflection of the cyclical nature of the housing market which is being accelerated by the reluctance of lenders to provide loans at what they perceive as the high risk end of the market.

While we believe that the Sydney house median value is at the limit of affordability for most home buyers, the attraction of low interest rates is creating a higher, but temporary, affordability limit. Under these highly sensitive conditions, predicting the future of the market is problematical.

Should interest rates remain where they are, good growth can be expected to continue with the possibility of a return to the boom markets of the early 2000s. If there is a significant rise in rates later this year or early next year, growth will be affected. However, as we have seen, it has historically taken a prolonged series of rate rises to throttle growth effectively.

SYDNEY HOUSES – RENTAL YIELDS

The median rent for houses in Sydney is still $490 a week and has not changed during the past year. Sydney's house rent is the second most expensive in the country after Darwin, where weekly rents have grown by 16.3% over the past year to $500.

Graph 8 shows that rental yield for Sydney houses is still hovering around 4.4%, which is slightly below the national average of 4.5%. Only Darwin, Canberra and Hobart have a higher rental yield.

Graph 8: Sydney Houses – Rental Yield

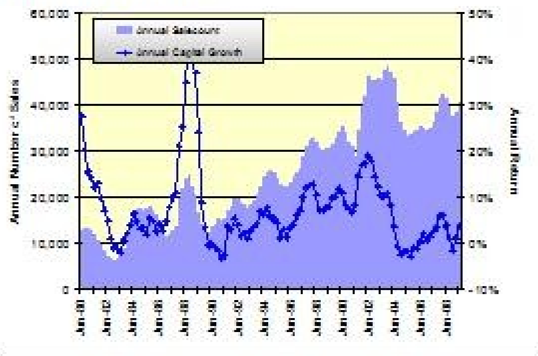
The highest house rental yields are to be found in Sydney's outer western suburbs in the Mount Druitt/St Marys localities and the outer south-west in the Campbelltown area, where yields tend to exceed 5.5% and in a few cases are over 6%. At the other end of the socio-economic scale, falls of 10% and more in median house rents have occurred in the eastern, north shore and northern beaches suburbs in tandem with the falls in house values that have occurred in these areas.

Although there was no overall change to Sydney's median house rent in the last year, there was good growth in the Hills District and some southern suburbs such as Sylvania Waters and Illawong, with increases of over 30%. Some of these suburbs, whose median house values tend to be higher than the Sydney median, now have rental yields approaching 4.5% and in a few areas exceeding 5%.

SYDNEY UNITS – SALES & CAPITAL GROWTH

Graph 9 shows that there were 40,399 unit sales in Sydney in the year ending June 2009, which is slightly higher than the number of house sales. Unit sales fell by 2.5% for the year, compared to a 5.6% drop in house sales. Unit sales also rebounded slightly in the June quarter.

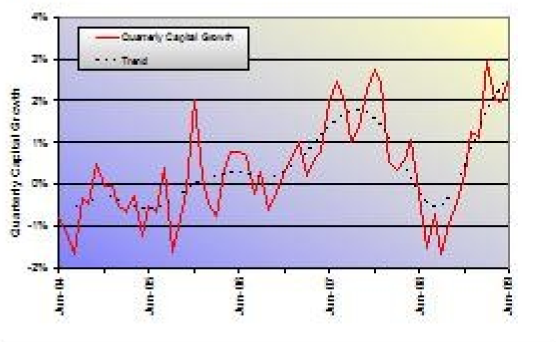
Graph 9: Sydney Units – Sales and Annual Returns



Sydney is easily the largest unit market in the nation, followed by Melbourne and country Queensland. The fall in unit sales in Sydney has not been as significant as those in Brisbane, Darwin, Canberra and Adelaide.

The median value of units in Sydney is currently $417,000, which is only $30,000 higher than the median value for units in Melbourne and illustrates the fact the Sydney unit market is good bargain hunting territory for investors. In fact, Sydney unit prices grew by 4% overall for the past year, compared to the ten-year annual growth average of 6.1% and the unit market has been significantly more resilient than the housing market, in which values rose by only 0.8% last year.

Graph 10 Sydney Units – Quarterly Growth Trend



Graph 10 illustrates that quarterly growth for Sydney units has been trending sharply upwards over the past 9 months, with the highest growth of over 12% last year occurring in many inner south-western suburbs.

It is also encouraging that after many years of price stagnation and falls, the outer western suburb unit market has now taken off with growth of around 5% in St Marys and Kingswood plus good growth in other areas on the western rail line.

While there have not been any significant falls in unit values over the last year, during the last quarter the most sluggish suburbs have been in the higher price brackets, indicating that a similar unaffordability barrier to houses exists. Our growth prediction reservations are similar to those we have for the house market, with good growth expected in the more affordable suburbs.

SYDNEY UNITS – RENTAL YIELDS

The median rent for units in Sydney is still $420 a week and is unchanged overall for the past year. This is $170 greater than the weekly rent for units in the rest of New South Wales. Sydney's unit rent is the most expensive in the country, followed by Darwin and Canberra.

Graph 11 shows that rental yield for Sydney units is currently 5.3%, which is slightly above the national unit average of 5%. The only cities where rental yield for units is higher than Sydney are Darwin and Hobart.

The highest rental yields provided by Sydney units are in the Liverpool, Punchbowl, Rose Hill and Harris Park areas, reflecting the high demand for rentals in those localities by overseas arrivals. For the same reason, suburbs such as Lidcombe, Belfield and Croydon have experienced rent increases of over 28% in the last year. However, the highest increase was in Woolloomooloo, with a rent hike of nearly 40% occurring there due to the desirability of this inner suburban enclave to young urban professionals.

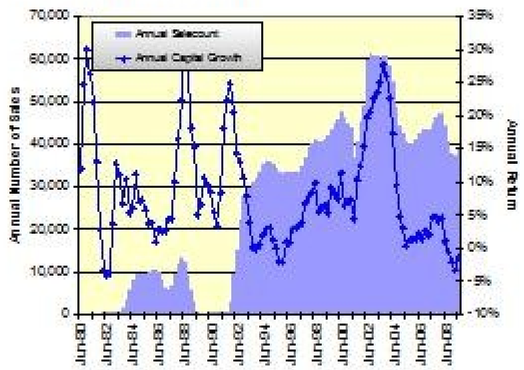
Graph 11: Sydney Units – Rental Yield

There were few suburbs with significant falls in rent during the last year and they were spread throughout the metropolitan area. The largest falls were in Carlingford with -13.8%, Queenscliff -12.9% and Allawah -10.3%.

REST OF NSW - HOUSES

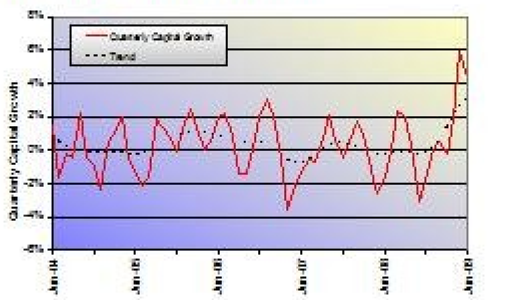
Graph 12 shows that there were 39,029 house sales in country New South Wales in the year ending June 2009, which is slightly higher than the number of house sales in Sydney. This is the second most active rural house market after Victoria, which had 39,694 sales.

Graph 12: Country NSW Houses – Sales and Annual Returns



House sales in country New South Wales fell by 11.5% in the past 12 months. Indeed, drops in sales occurred in all country house markets and in Western Australia, South Australia and Queensland the falls were greater than in New South Wales.

Graph 13: Wollongong Houses – Quarterly Growth Trend



The median value of houses in country New South Wales is currently $315,000 and fell by 1.4% overall for the past year. While the quarterly growth trend is now positive, it is only just out of negative territory, largely because significant falls in value have occurred in widespread areas of New South Wales including the central and far west and along the South and North Coasts. The highest growth during the last year was in Bangalee, with nearly 16% growth, while towns such as Wooli, Shell Cove, Karuah and Casuarina recorded growth of over 13.5%. During the last quarter, growth has centred on the areas around Singleton and Maitland where growth of over 5% has occurred. With no overall growth predicted by our forecast models, investors should look to the coastal resorts and towns we have identified in this report as well as the areas likely to benefit from coal mining in the Gunnedah Basin.

The two largest regional house markets of Newcastle and Wollongong are showing positive quarterly growth trends. Wollongong, as Graph 13 shows, is indicating a good growth outlook after five years of virtually no growth.

The key to Wollongong's house market future in the medium term is whether, given the city's dependence on manufacturing, the economic downturn will lead to a rise in unemployment large enough to cause this growth to falter.

The median rent for houses in country New South Wales is now $300 a week. This is lower than rents for houses in the Northern Territory and Queensland, but is higher than rents in all other country areas. Rent for houses in country New South Wales is significantly cheaper than rents for both houses and units in Sydney.

Graph 14 shows that the rental yield for country New South Wales houses has steadily improved to 5%. This is exceeded only by the rental yield in the Northern Territory. Rent rose by 7.1% in this market over the past 12 months.

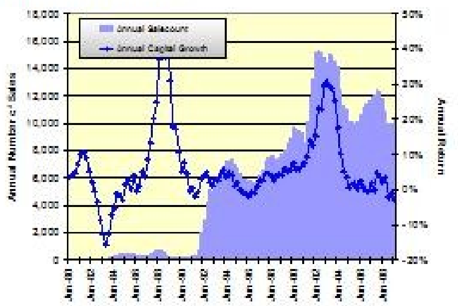
Graph 14 Country NSW Houses – Rental Yield

There are many towns in rural NSW where it is possible to obtain rental yields in excess of 6%, such as Parkes, Junee, Grafton and Albury. This is despite the fact that rents in these towns have fallen in the last year, some by up to 10%. It is interesting that these are all inland towns where the effects of the drought are still in evidence. The highest rent increases during the year occurred along the coast with many Central Coast suburbs achieving rent increases greater than 30% during the year. Some coastal towns in the Illawarra region also had rent increases over 25%.

REST OF NSW - UNITS

Graph 15 shows that there were 10,277 unit sales in country New South Wales in the year ending June 2009, which is roughly one quarter of the number of house sales. This is the second most active country unit market after Queensland, which had 16,143 sales.

Graph 15: Country NSW Units – Sales and Annual Returns

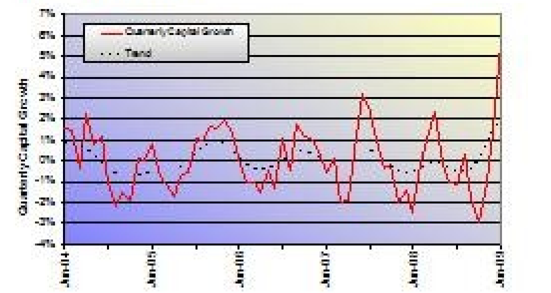


Unit sales in country New South Wales dropped by 12.4% in the past 12 months, although falls in sales occurred in all other country unit markets except for Tasmania and Victoria.

The median value of units in country New South Wales is currently $276,500 and fell by 2.6 % overall during the past year. Falls in value of around 8% were experienced in Nelson Bay, Wollongong and The Entrance. Meanwhile, the highest growth was experienced in Queanbeyan, with around 15% growth for the year, and good growth also occurred in towns such as Armidale, Muswellbrook and Inverell. Although our predictive models show overall negative growth in this market, good opportunities will be found in coastal retirement towns and in the upper Hunter Region when Gunnedah Basin coal mining moves beyond the exploration stage.

Both the Wollongong and Newcastle unit markets are showing positive quarterly growth trends, with Wollongong in particular looking very promising, with its highest growth rate trend for over six years, as Graph 16 shows.

Graph 15 Wollongong Units – Quarterly Growth Trend



Again, we issue a cautionary note, as any large increase in unemployment will impact on this market very quickly, given its proximity to Sydney and the ability of people to move fairly easily from one city to the other.

The median rent for units in country New South Wales is now $250 a week and rose by a total of 6.4% over the past 12 months. The rental yield for country New South Wales units has improved to 4.7% with rental yields of over 6% to be found on the Central Coast, in Tamworth and in Albury. The lowest unit rental yields are in Central Highlands towns such as Mittagong and Bowral as well as some inner Newcastle suburbs.

The highest rent increases occurred in the Queanbeyan area, with rises of around and over 30% during the year. Meanwhile, falls of 15% occurred in Griffith and significant falls also occurred in Armidale, Maitland and Coffs Harbour.

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